

**Memorandum**

DEC 13 1993

Date

From

June Gibbs Brown  
Inspector General

Subject

Audit of Medicare Contractor's Segmented Pension Cost, Blue Cross and Blue Shield of Maryland (A-07-93-00692)

To

Bruce C. Vladeck  
Administrator  
Health Care Financing Administration

This is to alert you to the issuance on December 14, 1993, of our final audit report. A copy is attached. The audit was of Blue Cross and Blue Shield of Maryland's (Maryland) implementation of its Medicare contract clause on pension plan segmentation. Our review showed that Maryland had, as of January 1, 1991, understated Medicare pension assets by \$1.9 million.

Under its Medicare contract, Maryland is required to identify, allocate, and report pension assets and costs separately for Medicare segments. Compliance required Maryland to:

- o compute actuarial liabilities for the Medicare segments as of 1981,
- o determine a ratio of Medicare's total actuarial liability to the plan's total actuarial liability as of 1981 (asset fraction),
- o allocate a portion of the total pension assets as of 1986 to Medicare based on the 1981 ratio,
- o update the 1986 Medicare assets to subsequent years, and
- o assess whether Medicare's pension costs should be determined by a separate segmented calculation.

Maryland calculated an asset fraction as of January 1, 1984 rather than as of January 1, 1981. Using the correct 1981 asset fraction increases the pension assets of the Medicare segment by \$1,394,145 as of 1986.

Maryland's update of the Medicare segment assets from 1986 through 1990 understated the assets of the Medicare segment by

another \$539,352. The understatement occurred because Maryland's update (1) omitted certain cost centers and (2) did not consider participant transfers into and out of the Medicare segment.

We have recommended that Maryland increase the January 1, 1991 assets of the Medicare segment by \$1,933,497 (\$1,394,145 plus \$539,352). We also recommended that Maryland include participant transfers in Medicare segment updates after 1991.

In responding to our draft report, Maryland agreed with our recommendations. The cognizant Health Care Financing Administration regional office did not provide specific comments on our draft report but did inform the central office of the need for specialized monitoring of the final outcome of this review.

Attachment

For further information contact:  
Vincent R. Imbriani  
Regional Inspector General  
for Audit Services, Region VII  
(816) 426-3591

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF  
MEDICARE CONTRACTOR'S SEGMENTED  
PENSION COST,  
BLUE CROSS AND BLUE SHIELD OF MARYLAND**



DECEMBER 1993    A-07-93-00692



Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64106

CIN: A-07-93-00692

Ms. Mary Anne Heckwolf  
Vice-President, Medicare Operations  
Blue Cross and Blue Shield of Maryland  
1946 Greenspring Drive  
Timonium, Maryland 21093

Dear Ms. Heckwolf:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled "REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION, BLUE CROSS AND BLUE SHIELD OF MARYLAND." The purpose of our review was to evaluate Blue Cross and Blue Shield of Maryland's (Maryland) compliance with the pension segmentation requirements of its Medicare contracts.

Maryland's Medicare contracts require the separate identification, calculation, and reporting of pension assets, and when appropriate, costs for the Medicare segment. Compliance requires: (1) establishing a ratio (asset fraction) using the 1981 actuarial liabilities of the segment and the total plan, (2) applying the ratio to total pension assets as of 1986, (3) updating the Medicare segment's 1986 pension assets to later years, and (4) assessing if Medicare's pension costs require separate calculations.

Maryland calculated an asset fraction as of January 1, 1984 rather than as of January 1, 1981. Using the correct 1981 asset fraction increases the pension assets of the Medicare segment by \$1,394,145 as of 1986.

Maryland's update of the Medicare segment assets from 1986 through 1990 understated the assets of the Medicare segment by another \$539,352. The understatement occurred because Maryland's update (1) omitted certain cost centers and (2) did not consider participant transfers into and out of the Medicare segment.

We recommend that Maryland increase the January 1, 1991 assets of the Medicare segment by \$1,933,497 (\$1,394,145 plus \$539,352). We also recommend that Maryland include participant transfers in Medicare segment updates after 1991. Maryland agreed with our recommendations and its response is included in its entirety as Appendix B.

## INTRODUCTION

### BACKGROUND

Title XVIII of the Social Security Act, Health Insurance for the Aged and Disabled (Medicare), provides that organizations may help in administering the Medicare program under contracts with the Secretary, Department of Health and Human Services (HHS). Most Medicare contractors, intermediaries (Part A) and carriers (Part B), performed under cost reimbursement contracts renewed annually. Maryland has administered Medicare Part A and Part B under cost reimbursement contracts since the start of the Medicare program.

Reimbursement principles for cost reimbursement contracts are contained in the contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS). Medicare contracts provide that a contractor "...shall be paid its costs of administration under the principle of neither profit nor loss...."

In 1985, we issued an audit report, "Medicare Intermediaries and Carriers Should Be Required to Use Segment Accounting For Claiming Pension Costs" (07-62013) to the Health Care Financing Administration (HCFA). The report showed that pension contributions charged to Medicare exceeded the amounts needed to meet Medicare's pension liabilities. The report recommended that HCFA amend Medicare contracts to require treatment of Medicare as a separate segment for calculating and charging pension costs.

The HCFA incorporated segmentation requirements into Medicare contracts starting with Fiscal Year (FY) 1988 and distributed a pension cost questionnaire to contractors in 1989. The purpose of the questionnaire was to ensure that contractors developed and maintained the data necessary for segmentation calculations.

Maryland's questionnaire response of March 8, 1989 showed that all direct Medicare employees were in the Medicare Operations Division. The response identified total pension assets of \$41,735,862 and Medicare segment assets of \$3,041,584 as of January 1, 1986. Maryland also concluded that separate valuations for the Medicare segment were required.

### Criteria Governing Segmented Pension Costs

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The contractual language incorporated by HCFA starting with FY 1988 specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment. Maryland's contracts required:

- o computing the Medicare segment's actuarial liability as of 1981,
- o determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability as of 1981,
- o allocating a portion of total pension assets as of 1986 based on the 1981 ratio,
- o updating Medicare pension assets annually, and
- o assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

"The term 'Medicare Segment' shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract;  
or
2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract."

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the

actuarial liabilities of the total plan as of the first day of the first plan year starting after December 31, 1980.

Other CAS requirements apply to the calculation of pension costs. For instance, pension costs for a segment can consider all, or just active, participants (CAS, section 413.50(c)(9)). Also, if they materially affect a segment's ratio of assets to liabilities, transfer adjustments are necessary (CAS, section 413.50(c)(8)). Finally, the CAS addresses allocating or separately calculating pension costs for segments.

#### **SCOPE OF AUDIT**

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Maryland's compliance with pension segmentation requirements of its Medicare contracts. Achieving our objective did not require a review of Maryland's internal control structure. The audit addressed Maryland's initial determination of pension assets for its Medicare segment and later updates. Our review covered January 1, 1981 through December 31, 1990.

In conjunction with this audit of pension segmentation requirements, we addressed in another report entitled "Review of Unfunded Pension Costs of Blue Cross and Blue Shield of Maryland, Timonium, Maryland" (A-07-93-00693) the CAS and FAR requirements relating to the development of pension costs. We obtained and reviewed the same information during both audits.

We reviewed Maryland's identification of the Medicare segment as of January 1, 1988 and traced the segment's organizational lineage back to 1981. We also reviewed Maryland's computation of the 1984 asset fraction and their update of Medicare assets from 1986 through 1990.

In performing our review, we used information provided by Maryland's pension actuary. The information included liabilities, normal costs, contributions, expenses, and earnings. We also used Maryland's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Forms 5500. Using this information, we calculated the 1981 asset fraction, determined the 1986 Medicare segment assets, and updated the Medicare segment assets through 1990. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Maryland's corporate offices in Timonium, Maryland during April of 1993.

**FINDINGS AND RECOMMENDATIONS**

**MEDICARE ASSETS AS OF 1986**

Contrary to the contract, Maryland calculated an asset fraction of 7.2877 as of January 1, 1984. Maryland indicated that it used 1984 data because Maryland changed actuarial firms starting with the 1984 valuation. We obtained valuation data for 1981 from its prior actuarial firm and calculated an asset fraction of 10.6281 percent. We applied the 1981 asset fraction to Maryland's 1986 total company assets. Use of the 10.6281 percent increased the Medicare segment assets by \$1,394,145. Details of Maryland's and our calculations are shown in the following schedule.

**Computation of Medicare Assets as of January 1, 1986**

	1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	Rounded Asset Fraction (C) (B)/(A)	1986 Total Company Assets 1/ (D)	1986 Medicare Segments Assets 1/ (E) (C)x(D)
OIG Calculation	\$36,062,777	\$3,832,786	.106281	\$41,735,862	\$4,435,729
Maryland's Calculation	<u>39,369,219</u>	<u>2,869,097</u>	<u>.072877</u> 2/	<u>41,735,862</u>	<u>3,041,584</u>
Difference	<u>(\$3,306,442)</u>	<u>\$ 963,689</u>	<u>.033404</u>	<u>\$ 0</u>	<u>\$1,394,145</u>

1/ Market Value

2/ 1984 Asset Fraction

**Recommendation**

We recommend that Maryland increase the 1986 Medicare segment assets by \$1,394,145.

**Auditee Response**

Maryland agreed with this recommendation.

**MEDICARE'S ASSET BASE AS OF 1986 UPDATED TO 1991**

Maryland's methodology in updating the Medicare segment assets from 1986 through 1990 understated the 1991 segment assets by an additional \$539,352. Maryland omitted certain cost centers (increase of \$101,441) and did not consider participant transfers into and out of the Medicare segment (increase of \$437,911). When considered with the 1986 adjustment, Medicare's pension assets are understated by a total of \$1,933,497 as of 1991.

**Participant Omissions**

Maryland omitted participants of several cost centers that met the contractual specifications for inclusion in the segment. We included participants from these cost centers (6 for 1989, 10 for

1990, and 7 for 1991) in updating the Medicare segment assets to 1991. The inclusion in the updates increased the Medicare segment assets by \$101,441.

**Participant Transfers**

In its update, Maryland understated the 1991 Medicare segment assets by \$437,911 because it did not consider participant transfers. The CAS requires adjustments if transfers are large enough to cause a distortion of a segment's ratio of fund assets to actuarial liabilities (CAS, section 413.50(c)(8)). We performed a detailed analysis of the effect of participant transfers. Our analysis showed positive transfer adjustments for 1986 (\$497,439), 1989 (\$206,959), and negative transfer adjustments for 1987 (\$82,717), 1988 (\$20,058), and 1990 (\$167,827). See Appendix A for more details. The following table illustrates the effect of considering or disregarding transfer adjustments as of 1991.

Transfer Distortion

<u>Description</u>	<u>Assets</u> (A)	<u>Liabilities</u> (B)	<u>Funding Level</u> (A)/(B)
Considered	\$6,558,297	\$4,100,934	159.9%
Not Considered	<u>6,120,386</u>	<u>4,100,934</u>	<u>149.2%</u>
Difference	<u>\$ 437,911</u>	<u>-0-</u>	<u>10.7%</u>

Percentage Difference for the Funding Level 6.7%

Both the dollar amount difference (\$437,911) and the percentage difference for the funding level (6.7 percent) represent a significant distortion. Maryland should have adjusted for transfers in updating the Medicare segment assets. Considering transfer adjustments in the updates increases 1991 Medicare segment assets by \$437,911.

**Medicare Assets as of January 1, 1991**

We updated pension assets of the Medicare segment from January 1, 1986 to January 1, 1991 (see Appendix A). Our calculation showed that assets of the Medicare segment increased by a total of \$1,933,497 as of January 1, 1991. This increase resulted from the asset fraction revision (\$1,394,145), the omitted cost centers (\$101,441), and the positive transfer adjustment (\$437,911).

**Recommendations**

We recommend that Maryland:

- o Increase pension assets of the Medicare segment as of January 1, 1991 by \$1,394,145 to reflect the 1986 adjustment.

- o Increase the Medicare segment assets by \$539,352 as of January 1, 1991 to reflect the omitted cost centers and positive transfer adjustment.
- o Make periodic transfer adjustments as needed.

**Auditee Response**

Maryland agreed with these recommendations.

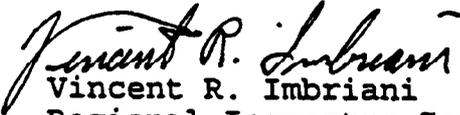
**INSTRUCTIONS FOR AUDITEE RESPONSE**

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on the final determination.

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In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

Sincerely,

  
Vincent R. Imbriani  
Regional Inspector General for  
Audit Services, Region VII

**Enclosures**

**HHS Action Official:**

Mr. Maurice Hartman  
Regional Administrator, Region III  
Health Care Financing Administration  
3535 Market Street  
Room 3100  
Philadelphia, Pennsylvania 19101-3363

BLUE CROSS AND BLUE SHIELD OF MARYLAND  
TIMONIUM, MARYLAND

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1991

<u>Description</u>	<u>Total Company</u>	<u>Other Segment</u>	<u>Medicare Segment</u>
<b>Assets January 1, 1986 <sup>1/</sup></b>	<b>\$41,735,862</b>	<b>\$37,300,133</b>	<b>\$4,435,729</b>
Contributions <sup>2/</sup>	0	0	0
Benefits <sup>3/</sup>	(4,640,380)	(4,595,552)	(44,828)
Expenses <sup>4/</sup>	379,523	339,187	40,336
Earnings <sup>5/</sup>	6,312,875	5,641,936	670,939
Net Transfers <sup>6/</sup>	<u>0</u>	<u>(497,439)</u>	<u>497,439</u>
<b>Assets January 1, 1987</b>	<b>\$43,787,880</b>	<b>\$38,188,265</b>	<b>\$5,599,615</b>
Contributions	1,926,310	1,689,765	236,545
Benefits	(9,894,887)	(9,362,304)	(532,583)
Expenses	(223,476)	(194,898)	(28,578)
Earnings	1,364,501	1,190,008	174,493
Net Transfers	<u>0</u>	<u>82,717</u>	<u>(82,717)</u>
<b>Assets January 1, 1988</b>	<b>\$36,960,328</b>	<b>\$31,593,553</b>	<b>\$5,366,775</b>
Contributions	1,648,661	1,601,833	46,828
Benefits	(1,812,325)	(1,768,819)	(43,506)
Expenses	(207,401)	(177,286)	(30,115)
Earnings	3,516,557	3,005,940	510,617
Net Transfers	<u>0</u>	<u>20,058</u>	<u>(20,058)</u>
<b>Assets January 1, 1989</b>	<b>\$40,105,820</b>	<b>\$34,275,279</b>	<b>\$5,830,541</b>

BLUE CROSS AND BLUE SHIELD OF MARYLAND  
TIMONIUM, MARYLAND

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1991

<u>Description</u>	<u>Total Company</u>	<u>Other Segment</u>	<u>Medicare Segment</u>
<b>Assets January 1, 1989</b>	<b>\$40,105,820</b>	<b>\$34,275,279</b>	<b>\$5,830,541</b>
Contributions	1,779,909	1,695,660	84,249
Benefits	(1,794,267)	(1,760,057)	(34,210)
Expenses	(183,647)	(156,949)	(26,698)
Earnings	4,379,407	3,742,734	636,673
Net Transfers	<u>0</u>	<u>(206,959)</u>	<u>206,959</u>
<b>Assets January 1, 1990</b>	<b>\$44,287,222</b>	<b>\$37,589,708</b>	<b>\$6,697,514</b>
Contributions	2,009,900	1,994,471	15,429
Benefits	(2,645,521)	(2,315,985)	(329,536)
Expenses	(240,954)	(204,515)	(36,439)
Earnings	2,507,166	2,128,010	379,156
Net Transfers	<u>0</u>	<u>167,827</u>	<u>(167,827)</u>
<b>Assets January 1, 1991</b>	<b>\$45,917,813</b>	<b>\$39,359,516</b>	<b>\$6,558,297</b>
<b>Assets Per Maryland</b> <u>7/</u>	<b>\$45,917,813</b>	<b>\$41,293,013</b>	<b>\$4,624,800</b>
<b>Asset Variance</b> <u>8/</u>	<b>\$0</b>	<b>(\$1,933,497)</b>	<b>\$1,933,497</b>

BLUE CROSS AND BLUE SHIELD OF MARYLAND  
TIMONIUM, MARYLAND

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES TO STATEMENT OF MEDICARE PENSION ASSETS

1/ We calculated the Medicare segment assets based on our identification of the Medicare segment and our computed asset fraction (10.6281%). We computed the asset fraction as explained in our finding section of the report narrative. The amounts shown for the other segment represent the difference between the total company and the Medicare segment.

2/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated contributions to the Medicare segment based on participant salaries for years 1986 and 1987. For years 1988 and after, the contributions were assigned to the Medicare segment based on separately computed CAS pension costs. Maryland did not make a contribution to the pension plan in 1986.

3/ Maryland provided benefit payment amounts and we verified them to IRS Form 5500 reports. We based Medicare segment benefit payments on benefits paid to Medicare segment retirees.

4/ Maryland provided administrative expense amounts and we verified them to IRS Form 5500 reports. We allocated expenses to the Medicare segment based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. Maryland used the same methodology.

5/ Maryland provided earnings amounts and we verified them to IRS Form 5500 reports. We allocated earnings to the Medicare segment based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. Maryland used the same methodology.

6/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Maryland. The listings contained the actuarial liability of each participant at year end. We transferred assets equal to the net transfer of the actuarial liability of the participants who moved from the Medicare segment to the other segment and vice versa.

BLUE CROSS AND BLUE SHIELD OF MARYLAND  
TIMONIUM, MARYLAND

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1991

7/ Maryland identified the total asset amounts in its January 1, 1991 Actuarial Valuation Report.

8/ We computed the asset variance by subtracting our calculation of assets as of January 1, 1991 from Maryland's calculation of the assets.



Blue Cross Blue Shield  
of Maryland

Medicare

1946 Greenspring Drive  
Timonium, Maryland 21093-4141

July 15, 1993

Mr. Vincent R. Imbriana  
Regional Inspector General  
Department of Health & Human Services  
Office of Audit Services  
601 East 12th Street, Room 284A  
Kansas City, Missouri 64106

Dear Mr. Imbriana:

Blue Cross and Blue Shield of Maryland (BCBSMD) offers the following comments to the Draft Pension Audit Reports:

- . Review of Medicare Contractor's Pension Segmentation  
(CIN: A-07-93-00692)
- . Review of Unfunded Pension Costs (CIN: A-07-93-00693)

We understand that a third draft audit report will be released shortly to address the financial implications of the above two reports.

Medicare Contractor's Pension Segmentation

- . Recommendations:
  - Increase pension assets of the Medicare segment as of January 1, 1991 by \$1,394,145 to reflect the 1986 adjustment.
  - Increase the Medicare segment assets by \$539,352 as of January 1, 1991 to reflect the omitted cost centers and positive transfer adjustment.
  - Make periodic transfer adjustments as needed.
- . RESPONSE : BCBSMD agrees with these recommendations.

Unfunded Pension Costs

Page 2 - Mr. Vincent R. Imbriani

. Recommendations:

- Identify \$358,998 as an unallowable element of direct pension costs as of 1991.
- Update annually the unallowable pension cost element related to the unfunded CAS costs for 1986 through 1991.
- Identify and track unfunded pension costs for any later years in a similar manner.

. RESPONSE:

- BCBSMD will defer comment on the first recommendation until we receive and review the third audit report. Some issues are still unclear-
  - . Does "unallowable element" relate to allocated costs, or FACP billed costs? If amounts noted in the draft report are adjustments to allocated costs, the net allowable pension costs would still exceed the FACPs.
  - . How can we reconcile fiscal and calendar years?
  - . What impact is there on the unsettled FY85-88 administrative cost audit and associated issues of budget overruns, offsets, etc.
- BCBSMD agrees with the second two recommendations. We will update annually, and track unallowable pension cost elements in future years.

If you have any questions, please contact me at (410) 561-4270, or Steve Simms at (410) 561-7961.

Sincerely,



Brian B. Austin  
Director,  
Medicare Finance