

**Memorandum**Date **MAY 5 1994**From June Gibbs Brown  
Inspector General

Subject Audit of Medicare Contractor's Segmented Pension Cost, IASD Health Services Corporation (A-07-94-00744)

To

Bruce C. Vladeck  
Administrator  
Health Care Financing Administration

This memorandum is to alert you to the issuance on May 9, 1994 of our final audit report. A copy is attached.

The objective of our audit was to determine whether IASD Health Services Corporation (IASD) complied with the pension segmentation requirements of its Medicare contract. Under its Medicare contract, IASD was required to identify, allocate, and report pension assets and costs separately for its Medicare segment. This required IASD to (1) establish a ratio (asset fraction) using the 1981 actuarial liabilities of the segment and the total plan, (2) apply the ratio to total pension assets as of 1986, (3) update the Medicare segment's 1986 pension assets to later years, and (4) assess whether Medicare's pension costs require separate calculations.

Our review disclosed that IASD omitted 8 cost centers (containing 66 participants) from its Medicare segment in computing the actuarial liability of the segment for 1981. The IASD's omission of Medicare segment participants understated the 1981 asset fraction. In understating the asset fraction, IASD understated Medicare's pension assets as of 1986 by \$1,450,102. We are recommending that pension assets of the Medicare segment be increased by \$1,450,102 as of 1986 and that the increase be carried forward as an increase to the pension assets as of 1992.

Medicare's pension assets were understated by another \$179,280 in the updating of the Medicare segment assets from 1986 through 1992. The additional understatement occurred because: (1) the 1986 assets were initially understated and (2) the participants in the Medicare segment were incorrectly identified. We are recommending that IASD increase the Medicare segment pension assets by an additional \$179,280 as of January 1, 1992.

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The IASD neither agreed nor disagreed with our recommendations, but responded that staff would review the calculations used in the draft report. The Health Care Financing Administration regional office did not comment on our recommendations.

For further information contact:

Vincent R. Imbriani  
Regional Inspector General for  
Audit Services, Region VII  
(816) 426-3591

Attachment

Department of Health and Human Services

OFFICE OF  
INSPECTOR GENERAL

AUDIT OF MEDICARE CONTRACTOR'S  
SEGMENTED PENSION COSTS,  
IASD HEALTH SERVICES CORPORATION



JUNE GIBBS BROWN  
Inspector General

APRIL 1994  
A-07-94-00744



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

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

CIN: A-07-94-00744

Ms. Sally T. Wood  
Vice President, Government Programs  
IASD Health Services Corporation  
636 Grand Avenue  
Station 28  
Des Moines, Iowa 50309

Dear Ms. Wood:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled "AUDIT OF MEDICARE CONTRACTOR'S SEGMENTED PENSION COST, IASD HEALTH SERVICES CORPORATION." The purpose of our review was to evaluate IASD Health Services Corporation's (IASD) compliance with the pension segmentation requirements of its Medicare contracts.

In 1989 Blue Cross of Western Iowa and South Dakota (Western Iowa) merged into Blue Cross and Blue Shield of Iowa and the corporate name was changed to IASD. (For clarity, we used the current name of IASD in this report for referring to the company prior to 1989.) We reviewed Western Iowa's compliance with Medicare segmentation requirements in a separate audit (CIN: A-07-93-00746).

IASD's Medicare contracts required the separate identification, calculation, and reporting of pension assets, and when appropriate, costs for the Medicare segment. Compliance required: (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 annually, and (4) assessing if Medicare's pension costs require separate calculations.

Our review showed that IASD understated Medicare segment pension assets as of 1986 by \$1,450,102. Additionally, IASD's update of the Medicare segment assets from January 1, 1986 to January 1, 1992 understated the segment's assets by another \$179,280. The understatements occurred because IASD omitted Medicare segment cost centers from the asset fraction calculation and the asset update. We recommend that IASD increase the January 1, 1992 assets of the Medicare segment by \$1,629,382 (\$1,450,102 plus \$179,280).

The IASD neither agreed nor disagreed with our recommendations, but indicated that staff would be reviewing the calculations used in our report. The IASD's response is included 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, U.S. Department of Health and Human Services. Most Medicare contractors, intermediaries (Part A) and carriers (Part B), performed under cost reimbursement contracts renewed annually. IASD has administered Medicare Parts A and 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 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.

IASD's questionnaire response of April 21, 1989 showed that direct Medicare employees were primarily in the claims processing and provider audit units. IASD identified total pension assets of \$21,135,791 and Medicare segment assets of \$988,625 as of January 1, 1986. IASD also concluded that separate valuations for the Medicare segment were required.

IASD participates in the National Retirement program administered by the Blue Cross/Blue Shield National Employee Benefits Administration (NEBA). The Wyatt Company, NEBA's actuarial firm,

played a major role in the preparation of IASD's questionnaire response.

**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 Fiscal Year 1988 specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment. IASD's contracts required: (1) computing the Medicare segment's actuarial liability as of 1981, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability as of 1981, (3) allocating a portion of total pension assets as of 1986 based on the 1981 ratio, (4) updating Medicare pension assets annually, and (5) 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 movement of participants into and out of a segment materially affects 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

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine IASD's compliance with pension segmentation requirements of its Medicare contracts. Achieving our objective did not require a review of IASD's internal control structure. The audit addressed IASD's initial determination of pension assets for its Medicare segment and later updates. Our review covered January 1, 1981 to January 1, 1992.

In conjunction with this audit of pension segmentation, we addressed in another report (CIN: A-07-94-00745) the CAS and FAR requirements relating to the development of pension costs. We obtained and reviewed the same information during both audits.

We reviewed IASD's identification of the Medicare segment as of January 1, 1988 and traced the segment's organizational lineage back to 1981. We also reviewed IASD's computation of the 1981 asset fraction and its update of Medicare assets from January 1, 1986 to January 1, 1992.

In performing our review, we used information provided by NEBA and NEBA's pension actuary. The information included liabilities, normal costs, contributions, expenses, and earnings. We reviewed IASD's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Forms 5500. Using these documents, we calculated the 1981 asset fraction, determined the 1986 Medicare segment assets, and updated the Medicare segment assets to January 1, 1992. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at IASD's corporate offices in Des Moines, Iowa during September 1993. Subsequently, we performed audit work in the OIG, OAS, Jefferson City, Missouri Field Office.

**FINDINGS AND RECOMMENDATIONS**

**MEDICARE ASSETS AS OF JANUARY 1, 1986**

We determined that IASD's 1981 asset fraction was understated by 6.8609 percent. IASD omitted eight Medicare cost centers (containing 66 participants) from the Medicare segment. We increased the asset fraction from 4.6775 percent to 11.5384 percent by including the missing participants. Our calculations increased the Medicare segment assets by \$1,450,102 to \$2,438,727.

IASD omitted certain cost centers that were less than 100 percent Medicare from its asset fraction calculation. However, IASD subsequently included the same cost centers in the Medicare segment. We determined that these cost centers, containing 66 participants, met the contractual specifications for a segment and included the cost centers in our asset fraction calculation. The following schedule shows the details of IASD's and our calculations.

	1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	Rounded Asset Fraction (C) (B)/(A)	1986 Total Company Assets <u>1/</u> (D)	1986 Medicare Segment Assets <u>1/</u> (E) (C)x(D)
OIG Calculation	\$14,458,393	\$1,668,273	.115384	\$21,135,751	\$2,438,727
IASD Calculation	\$14,458,393	\$ 676,286	.046775	\$21,135,751	\$ 988,625
Difference	<u>\$ 0</u>	<u>\$ 991,987</u>	<u>.068609</u>	<u>\$ 0</u>	<u>\$1,450,102</u>

1/ Market Value

**Recommendation:**

We recommend that IASD:

- o Increase the 1986 pension assets of the Medicare segment by \$1,450,102.

**Auditee Response**

The IASD neither agreed nor disagreed with our recommendation, but indicated that staff would be reviewing the calculations used in our report.

**MEDICARE'S ASSET BASE AS  
OF JANUARY 1, 1986 UPDATED TO JANUARY 1, 1992**

IASD's methodology in updating the Medicare segment assets from January 1, 1986 to January 1, 1992 understated the segment assets by an additional \$179,280. This understatement primarily occurred because IASD started the update with an understated asset base for 1986. Additionally, IASD omitted certain cost centers from the Medicare segment. When considered with the 1986 adjustment, IASD understated Medicare's pension assets by \$1,629,382 as of January 1, 1992.

**Understated Asset Base**

IASD's update methodology allocated investment earnings and administrative expenses to the Medicare segment based on a ratio of segment assets to total company assets. Because IASD started the update with an understated 1986 asset base, it understated the segment's earnings and expenses for each year of the update. Except for using our adjusted 1986 asset base, we used IASD's allocation methodology in our update and increased the Medicare segment assets by \$888,375.

**Participants and Transfers**

IASD omitted participants in cost centers that met the contractual specifications for a segment. (IASD had the same problem identifying the Medicare segment for the 1981 asset fraction.) Additionally, IASD included participants in cost centers that did not meet the specifications for a segment.

Since the identification of the segment participants was incorrect, transfers (representing the movement into and out of the segment each year) in the updates were also incorrect. The following table compares IASD's and our computations of transfer amounts:

Transfer Adjustments To The Medicare Segment

<u>Year</u>	<u>IASD</u>	<u>OIG</u>
1986	\$(70,578)	\$ (38,778)
1987	(72,214)	6,429
1988	715,187	6,195
1989	36,843	42,269
1990	(38,505)	(46,715)
1991	33,983	(73,779)
	<u>\$604,716</u>	<u>\$(104,379)</u>

We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment assets. See

Appendix A. Our computation resulted in a net reduction of \$709,095 in the Medicare segment assets.

**Medicare Assets as of January 1, 1992**

We updated pension assets of the Medicare segment from January 1, 1986 to January 1, 1992. See Appendix A. Our calculation showed that assets of the Medicare segment increased \$1,629,382 as of January 1, 1992. This increase resulted from revising the asset fraction (\$1,450,102 increase), starting the update with an adjusted 1986 asset base (\$888,375 increase) and correcting the transfer adjustment (\$709,095 decrease).

**Recommendations:**

We recommend that IASD:

- o Increase the pension assets of the Medicare segment as of January 1, 1992 by \$1,450,102 to reflect the 1986 adjustment.
- o Increase the pension assets of the Medicare segment as of January 1, 1992 by \$179,280 to reflect the update adjustments.

**Auditee Response**

The IASD neither agreed nor disagreed with our recommendations, but indicated that staff would be reviewing the calculations used in our report.

**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 on the following page. 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

Page 8 - Ms. Sally T. Wood

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. Gene Hyde  
Regional Administrator, Region VII  
Health Care Financing Administration  
601 East 12th Street, Room 235  
Kansas City, Missouri 64106

IASD HEALTH SERVICES CORPORATION  
DES MOINES, IOWA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

<u>Description</u>	<u>Total Company</u>	<u>Other Segment</u>	<u>Medicare Segment</u>
<b>Assets January 1, 1986</b> <sup>1/</sup>	<b>\$21,135,751</b>	<b>\$18,697,024</b>	<b>\$2,438,727</b>
Contributions <sup>2/</sup>	229,968	179,289	50,679
Benefits <sup>3/</sup>	(963,254)	(879,097)	(84,157)
Expenses <sup>4/</sup>	(131,371)	(116,213)	(15,158)
Earnings <sup>5/</sup>	3,325,842	2,942,093	383,749
Net Transfers <sup>6/</sup>	<u>0</u>	<u>38,778</u>	<u>(38,778)</u>
<b>Assets January 1, 1987</b>	<b>\$23,596,936</b>	<b>\$20,861,874</b>	<b>\$2,735,062</b>
Contributions	0	0	0
Benefits	(3,866,625)	(3,482,659)	(383,966)
Expenses	(146,758)	(129,748)	(17,010)
Earnings	1,242,900	1,098,839	144,061
Net Transfers	<u>0</u>	<u>(6,429)</u>	<u>6,429</u>
<b>Assets January 1, 1988</b>	<b>\$20,826,453</b>	<b>\$18,341,877</b>	<b>\$2,484,576</b>
Contributions	0	0	0
Benefits	(833,963)	(833,963)	0
Expenses	(142,881)	(125,835)	(17,046)
Earnings	2,834,593	2,496,429	338,164
Net Transfers	<u>0</u>	<u>(6,195)</u>	<u>6,195</u>
<b>Assets January 1, 1989</b>	<b>\$22,684,202</b>	<b>\$19,872,313</b>	<b>\$2,811,889</b>
Contributions	0	0	0
Benefits	(983,714)	(979,271)	(4,443)
Expenses	(166,541)	(145,897)	(20,644)
Earnings	5,130,446	4,494,486	635,960
Merged Assets <sup>7/</sup>	5,582,899	5,013,948	568,951
Net Transfers	<u>0</u>	<u>(42,269)</u>	<u>42,269</u>
<b>Assets January 1, 1990</b>	<b>\$32,247,292</b>	<b>\$28,213,310</b>	<b>\$4,033,982</b>

IASD HEALTH SERVICES CORPORATION  
DES MOINES, IOWA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

<u>Description</u>	<u>Total Company</u>	<u>Other Segment</u>	<u>Medicare Segment</u>
<b>Assets January 1, 1990</b>	<b>\$32,247,292</b>	<b>\$28,213,310</b>	<b>\$4,033,982</b>
Contributions	0	0	0
Benefits	(1,398,774)	(1,365,192)	(33,582)
Expenses	(176,422)	(154,352)	(22,070)
Earnings	(809,899)	(708,585)	(101,314)
Net Transfers	<u>0</u>	<u>46,715</u>	<u>(46,715)</u>
<b>Assets January 1, 1991</b>	<b>\$29,862,197</b>	<b>\$26,031,896</b>	<b>\$3,830,301</b>
Contributions	0	0	0
Benefits	(1,666,528)	(1,664,298)	(2,230)
Expenses	(165,992)	(144,701)	(21,291)
Earnings	6,477,474	5,646,635	830,839
Net Transfers	<u>0</u>	<u>73,779</u>	<u>(73,779)</u>
<b>Assets January 1, 1992</b>	<b>\$34,507,151</b>	<b>\$29,943,311</b>	<b>\$4,563,840</b>
<b>Assets Per IASD</b> <u>8/</u>	<b>\$34,507,151</b>	<b>\$31,572,693</b>	<b>\$2,934,458</b>
<b>Asset Variance</b> <u>9/</u>	<b><u>\$0</u></b>	<b><u>(\$1,629,382)</u></b>	<b><u>\$1,629,382</u></b>

IASD HEALTH SERVICES CORPORATION  
DES MOINES, IOWA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

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 (11.5384%). 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 the ratio of segment participants' normal costs and accrued liability to total company normal costs and accrued liability. IASD used this same methodology. IASD did not make contributions to the pension trust fund for years after 1986.

3/ IASD provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.

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

5/ IASD 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. IASD used this same methodology.

6/ We identified participant transfers between segments by comparing annual participant valuation listings provided by IASD. The listings contained the actuarial liability of each participant at year-end. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. We calculated the funding level as the assets divided by the liabilities. If the funding level ratio was greater than one, we transferred assets equal to the participant's liability. IASD used this same methodology.

IASD HEALTH SERVICES CORPORATION  
DES MOINES, IOWA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

7/ We merged the pension assets of Blue Cross of Western Iowa and South Dakota (Western Iowa) into IASD's pension assets at year-end. We based asset amounts on the results of our review of Western Iowa's compliance with segmentation requirements (CIN: A-07-94-00746).

8/ We obtained the total asset amounts as of January 1, 1992 from IASD's update of assets provided by its actuary.

9/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1992 and the assets calculated by IASD's actuary.

# Medicare

January 24, 1994

Vincent R. Imbriani  
Regional Inspector General for Audit Services,  
Region VII  
Room 284A, Federal Office Building  
601 E. 12th Street  
Kansas City, MO 64106

Re: Audit CIN: A-07-94-00745  
Audit CIN: A-07-94-00744

Dear Mr. Imbriani:

Thank you for giving us the opportunity to respond to your findings in the draft report of the audits pertaining to pension segmentation and unfunded pension costs for IASD Health Services Corp. Our responses are detailed as follows:

**Unfunded Pension Costs (CIN: A-07-94-00745)**

The regulations which determine the Medicare segment of pension costs and those which determine Medicare reimbursements appear to be contradictory to each other and result in irreconcilable penalties to Medicare contractors. IASD intends to have NEBA's actuary review the findings and will begin working with NEBA to seek a waiver of relief from those penalties. We have been communicating with the Blue Cross and Blue Shield Association on this issue.

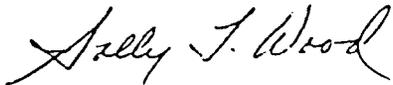
**Pension Segmentation (CIN: A-07-94-00744)**

IASD staff will be reviewing our own records as well as those in NEBA, if necessary, in an attempt to determine if the calculations used in the computation of the 1981 asset fraction are appropriate. We have been communicating with the Blue Cross and Blue Shield Association on this issue.

Vincent R. Imbriani  
January 24, 1994  
Page Two

It was a pleasure working with OIG staff during the course of the work at our Des Moines location. Should you have any questions or comments, please contact Lonny Bartels at (515) 245-4806.

Sincerely,



Sally Wood  
Vice President, Government Programs

/mg

cc: Roger Perryn, HCFA  
Steve Ford, HCFA