

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
PENSION COSTS CLAIMED FOR
MEDICARE PART A REIMBURSEMENT
BY BLUE CROSS AND BLUE SHIELD
OF LOUISIANA**



JUNE GIBBS BROWN
Inspector General

FEBRUARY 1996
CIN: A-07-95-01 140



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

CIN: A-07-95-01 140

February 7, 1996

Mr. Carl J. Mautner
Vice President & Controller
Blue Cross and Blue Shield of Louisiana
5525 Reitz Avenue
P.O. Box 98029
Baton Rouge, LA 70809-9029

Dear Mr. Mautner:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Pension Costs Claimed for Medicare Part A Reimbursement by Blue Cross and Blue Shield of Louisiana*. The purpose of our review was to determine the allowability of Fiscal Years 1988 through 1991 pension costs claimed for Medicare Part A reimbursement.

For 1988 through 1991, we determined that Blue Cross and Blue Shield of Louisiana (Louisiana) under claimed allowable Medicare Part A pension costs. During this period, the allowable Medicare Part A pension costs were \$90,572. However, Louisiana claimed pension costs of \$32,714 for Medicare reimbursement. As a result, Louisiana did not claim \$57,858 of allowable Part A pension costs. The under claim occurred primarily because Louisiana did not base their claim on separately computed pension costs for the Medicare segment, calculated in accordance with the Cost Accounting Standards (CAS).

We are recommending Louisiana revise its Final Administrative Cost Proposals (FACPs) to reflect the remaining allowable pension costs. Louisiana stated that they did not have any comments relating to the finding in this report. Their response is included in its entirety in Appendix C.

INTRODUCTION

BACKGROUND

Louisiana administered Medicare Part A operations under cost reimbursement contracts from Medicare's inception until February 4, 1991. Louisiana's Medicare Part A contract was terminated effective October 1, 1990. However, Louisiana continued to administer Part A

operations, under a subcontract with Blue Cross and Blue Shield of Mississippi, until February 4, 1991.

Medicare contractors must follow cost reimbursement principles contained in the CAS, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations, and their Medicare contracts.

Since its inception, Medicare has reimbursed a portion of annual contributions paid into contractors' pension plans. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413, and (2) funded as specified by part 31 of the FAR.

The CAS deals with stability between contract periods and requires consistent measurement and assignment of pension costs to contract periods. The CAS costs that are allowable as charges to Medicare include (1) the normal cost and (2) the amortization of the unfunded actuarial liability.

The FAR addresses allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding.

In addition to CAS and FAR requirements, the Health Care Financing Administration (HCFA) incorporated specific segmentation language into Medicare contracts starting with Fiscal Year 1988. To implement segmentation requirements, contracts stipulated procedures for identifying the Medicare segment and assigning pension assets to the segment.

Furthermore, the contracts required a separate calculation of pension costs for a segment if such a calculation (versus an allocation) materially affected pension costs charged to Medicare. Under a separate calculation method, the normal costs and amortization for the Medicare segment are separately identified by the contractor. Under an allocation method, total plan CAS costs are determined and a share is allocated to Medicare. This allocation includes direct and indirect costs.

SCOPE OF AUDIT

We made our examination in accordance with generally accepted government auditing standards. This audit only addresses pension costs. Our objective was to identify allowable CAS pension costs for Fiscal Years 1988 through 1991. Achieving our objective did not require that we review Louisiana's internal control structure.

This review was done in conjunction with our audit of pension segmentation and contract termination (CIN: A-07-95-01121). The information obtained and reviewed during that audit was also used in performing this review.

During our review, we calculated Louisiana's CAS pension costs for the total company and for the Medicare segments. We also determined the extent to which Louisiana funded CAS pension costs with contributions to the pension trust fund. Using this information, we calculated CAS pension costs that are allowable for Medicare reimbursement for Fiscal Years 1988 through 1991. To determine allowable CAS pension costs, we converted the plan year allocable CAS pension costs to a fiscal year basis (October 1 through September 30). We calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs.

The HCFA Office of the Actuary developed the methodology used for computing allowable CAS pension costs based on Louisiana's historical practices.

We performed site work during January and February 1995 at Louisiana's corporate offices in Baton Rouge, Louisiana. Subsequently, we performed audit work in the OIG, OAS, Jefferson City, Missouri Field Office.

FINDING AND RECOMMENDATION

For Fiscal Years 1988 through 1991, Louisiana did not claim \$57,858 for Part A pension costs which were allowable for Medicare reimbursement. The pension costs were allowable because the funded portion of CAS computed costs exceeded the costs claimed. The under claim occurred primarily because Louisiana did not base their claim on separately computed CAS pension costs for the Medicare segment. Therefore, Louisiana did not consider a prepayment credit that resulted from excess contributions for plan year 1987. Louisiana should revise its FACP's to reflect the additional CAS pension costs which were allowable for reimbursement.

For Fiscal Year 1988, Louisiana originally claimed pension costs of \$203,650 for Medicare Part A reimbursement on its FACP. Louisiana based its claim on an allocation of total company accrued pension costs. Louisiana's consulting actuary provided the total company pension costs and the allocation of costs, by participant. Louisiana assigned a portion of the accrued costs to Medicare direct and indirect operations using cost center and line of business information.

The pension costs reimbursed for 1988 were subsequently reduced to \$32,714 by an OIG, OAS administrative cost audit. The auditors questioned pension costs of \$170,936 because the costs were not funded by contributions to the pension trust fund. Louisiana concurred with the finding and adjusted the 1988 FACP accordingly.

For Fiscal Years 1989 through 1991, Louisiana did not claim Medicare reimbursement for pension costs on its FACP's, because no contributions were made to the pension trust fund.

Generally, pension costs allowable for Medicare reimbursement are limited to the lesser of CAS computed pension costs or actual contributions. When contributions are not made to

the pension trust fund, costs generally are not allowable for Medicare reimbursement. However, contributions in excess of the CAS computed pension costs create a prepayment credit that carries forward to fund future period(s) pension costs. The subsequent pension costs that are funded by the prepayment credit are allowable for Medicare reimbursement. This is the situation that occurred at Louisiana.

We calculated the allowable CAS pension costs for the Medicare segments and for indirect Medicare operations, for Fiscal Years 1988 through 1991. The calculations were based on separately computed CAS pension costs for the Medicare segments and total company CAS pension costs. Additionally, the calculations included a prepayment credit that was created in plan year 1987. See Appendix A for additional details.

We compared the allowable CAS pension costs for Medicare Part A to the pension costs claimed on Louisiana's FACPs and found:

<u>Fiscal</u> <u>Year</u>	costs <u>Claimed</u> (A)	Allowable <u>CAS Costs</u> (B)	<u>Variance</u> (A)-(B)
1988	\$32,714	\$59,575	\$(26,861)
1989	-0-	27,307	(27,307)
1990	-0-	3,690	(3,690)
1991	-0-	- 0 -	- 0 -
TOTAL	<u>\$32,714</u>	<u>\$90,572</u>	<u>\$(57,858)</u>

For 1988 through 1991, Louisiana claimed pension costs of \$32,714 for Medicare Part A reimbursement. However, the allowable CAS pension costs were \$90,572. As a result, Louisiana could have claimed \$57,858 in additional CAS pension costs.

Recommendation

We recommend that Louisiana:

- ① Revise its FACPs for Fiscal Years 1988 through 1990 to claim additional allowable CAS pension costs of \$57,858.

Auditee Response

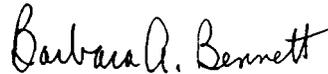
Louisiana did not have any comments relating to the finding in this report.

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 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 final determination.

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,



Barbara A. Bennett
Regional Inspector General
for Audit Services, Region VII

Enclosures

HHS Action Official:

Ms. Rose Crum-Johnson
Regional Administrator, Region VI
Health Care Finance Administration
1200 Main Street, Suite 2000
Dallas, Texas 75202-4348

BLUE CROSS AND BLUE SHIELD OF LOUISIANA

STATEMENT OF CAS PENSION COSTS
JANUARY 1, 1986 TO JANUARY 1, 1991

Description		Total Company	Other Segment	Medicare Part B	Medicare Part A
01/01/86 Normal Cost	<u>1/</u>	\$496,971	\$418,147	\$22,442	\$56,382
01/01/86 Amortization Payment	<u>2/</u>	(313,208)	(264,496)	(3,448)	(45,264)
01/01/86 CAS Pension Costs	<u>3/</u>	\$183,763	\$153,651	\$18,994	\$11,118
01/01/87 Normal Cost		\$648,182	\$519,188	\$48,057	\$80,937
01/01/87 Amortization Payment		(207,605)	(181,050)	(3,741)	(22,814)
01/01/87 CAS Pension Costs		\$440,577	\$338,138	\$44,316	\$58,123
01/01/88 Normal Cost		\$549,627	\$429,192	\$48,673	\$71,762
01/01/88 Amortization Payment		(410,822)	(405,238)	774	(6,358)
01/01/88 CAS Pension Costs		\$138,805	\$23,954	\$49,447	\$65,404
01/01/89 Normal Cost		\$645,163	\$484,913	\$84,801	\$75,449
01 /01/89 Amortization Payment		(441,594)	(442,888)	7,553	(6,259)
01/01/89 CAS Pension Costs		\$203,569	\$42,025	\$92,354	\$ 69,190
01/01/90 Normal Cost		\$573,069	\$502,607	\$0	\$70,462
0 l/O 1/90 Amortization Payment		(697,844)	(674,006)	0	(23,838)
01/01/90 CAS Pension Costs		(\$124,775)	(\$171,399)	\$0	\$46,624
01/01/91 Normal Cost		\$487,907	\$462,522	\$0	\$25,385
01/01/91 Amortization Payment		(823,091)	(706,852)	0	(116,239)
01/01/91 CAS Pension Costs		(\$335,184)	(\$244,330)	\$0	(\$90,854)

BLUE CROSS AND BLUE SHIELD OF LOUISIANA

STATEMENT OF CAS PENSION COSTS
JANUARY 1, 1986 TO JANUARY 1, 1991

FOOTNOTES

- 1/ We obtained normal costs for the total company from Louisiana's actuarial valuation reports and normal costs for the Medicare segments from data files provided by Louisiana's actuary. The amount shown for the "other segment" represents the difference between the total company and the Medicare segments. We have included the CAS cost computation beginning in 1986 for illustrative purposes, because the allocation of Plan assets to the Medicare segment was on January 1, 1986.
- 2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Louisiana's valuation reports and IRS Form 5500 reports. The amortization payment was negative for years in which pension assets exceeded actuarial liabilities, thereby creating a negative unfunded actuarial liability.
- 3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. We allocated the CAS pension cost to the Medicare segment based on the ratio of the individual participant's normal cost and accrued liability to the total company normal cost and accrued liability for years 1986 and 1987. We separately calculated CAS pension costs for years 1988 through 1991.

BLUE CROSS AND BLUE SHIELD OF LOUISIANA
STATEMENT OF ALLOWABLE CAS PENSION COSTS
FOR FISCAL YEARS 1988 THROUGH 1991

		Plan Total	Plan Indirect	Medicare Part B	Medicare Part A
1987	Plan Year Contribution	<u>1/</u> \$628,852	\$482,637	\$63,254	\$82,961
	Discount for Interest	<u>2/</u> (\$19,179)	(\$14,719)	(\$1,930)	(\$2,530)
	Prepayment Credit	\$0	\$0	\$0	\$0
	Present Value of Funding	<u>3/</u> \$609,673	\$467,918	\$61,324	\$80,431
	CAS Pension Costs	<u>4/</u> \$440,577	\$338,138	\$44,316	\$58,123
	Percentage of Cost Funded	<u>5/</u> 100.00%	100.00%	100.00%	100.00%
	Funded CAS Pension Costs	<u>6/</u>	\$338,138	\$44,316	\$58,123
	Allowable Interest	<u>7/</u>	\$10,637	\$1,395	\$1,828
	Allocable Pension Costs	<u>8/</u>	\$348,775	\$45,711	\$59,951
1988	Plan Year Contribution	\$0	\$0	\$0	\$0
	Discount for Interest	\$0	\$0	\$0	\$0
	Prepayment Credit	<u>9/</u> \$138,805	\$23,954	\$49,447	\$65,404
	Present Value of Funding	\$138,805	\$23,954	\$49,447	\$65,404
	CAS Pension Costs	\$138,805	\$23,954	\$49,447	\$65,404
	Percentage of Costs Funded	100.00 %	100.00%	100.00%	100.00%
	Funded CAS Pension Costs		\$23,954	\$49,447	\$65,404
	Allowable Interest		\$0	\$0	\$0
	Allocable Pension Costs		\$23,954	\$49,447	\$65,404
	Fiscal Year Pension Costs	<u>10/</u>	\$105,159	\$48,513	\$64,041
	Part A LOB Percentage	<u>11/</u>	3.22%	0.00%	87.74%
	Medicare Part A Pension Costs	<u>12/</u> <u>\$59,575</u>	\$3,386	\$0	\$56,189

BLUE CROSS AND BLUE SHIELD OF LOUISIANA
STATEMENT OF ALLOWABLE CAS PENSION COSTS
FOR FISCAL YEARS 1988 THROUGH 1991

	Plan Total	Plan Indirect	Medicare Part B	Medicare Part A
1989				
Plan Year Contribution	\$0	\$0	\$0	\$0
Discount for Interest	\$0	\$0	\$0	\$0
Prepayment Credit	\$48,684	\$10,050	\$22,087	\$16,547
Present Value of Funding	\$48,684	\$10,050	\$22,087	\$16,547
CAS Pension Costs	\$203,569	\$42,025	\$92,354	\$69,190
Percentage of Cost Funded	23.92%	23.92%	23.92%	23.92%
Funded CAS Pension Costs		\$10,050	\$22,087	\$16,547
Allowable Interest		\$0	\$0	\$0
Allocable Pension Costs		\$10,050	\$22,087	\$16,547
Fiscal Year Pension Costs		\$13,526	\$28,927	\$28,761
Part A LOB Percentage		3.29%	1.27%	92.12%
Medicare Part A Pension Costs	<u>\$27,307</u>	\$445	\$367	\$26,495
1990				
Plan Year Contribution	\$0	\$0	\$0	\$0
Discount for Interest	\$0	\$0	\$0	\$0
Prepayment Credit	\$0		\$0	\$0
Present Value of Funding	\$0	\$0	\$0	\$0
CAS Pension Costs	(\$124,775)	(\$171,399)	\$0	\$46,624
Percentage of Costs Funded	0.00%	0.00%	0.00%	0.00%
Funded CAS Pension Costs		(\$171,399)	\$0	\$46,624
Allowable Interest		\$0	\$0	\$0
Allocable Pension Costs		\$0	\$0	\$0
Fiscal Year Pension Costs		\$2,513	\$5,522	\$4,137
Part A LOB Percentage		2.68%	0.00%	87.58%
Medicare Part A Pension Costs	<u>\$3,690</u>	\$67	\$0	\$3,623

BLUE CROSS AND BLUE SHIELD OF LOUISIANA
 STATEMENT OF ALLOWABLE CAS PENSION COSTS
 FOR FISCAL YEARS 1988 THROUGH 1991

	Plan Total	Plan Indirect	Medicare Part B	Medicare Part A
1991 Plan Year Contribution	\$0	\$0	\$0	\$0
Discount for Interest	\$0	\$0	\$0	\$0
Prepayment Credit	\$0	\$0	\$0	\$0
Present Value of Funding	\$0	\$0	\$0	\$0
CAS Pension Costs	(\$335,184)	(\$244,330)	\$0	(\$90,854)
Percentage of Cost Funded	0.00%	0.00%	0.00%	0.00%
Funded CAS Pension Costs		\$0	\$0	\$0
Allowable Interest		\$0	\$0	\$0
Allocable Pension Costs		\$0	\$0	\$0

BLUE CROSS AND BLUE SHIELD OF LOUISIANA

STATEMENT OF ALLOWABLE CAS PENSION COSTS
FOR FISCAL YEARS 1988 THROUGH 1991

FOOTNOTES

- 1/ Louisiana did not make contributions to its pension plan for years 1986, and 1988 through 1991. However, they did make contributions to the pension plan for 1987. We assigned contributions to the Medicare segments based on a ratio of the Medicare segments' CAS funding target to the total company CAS funding target. We have included fiscal year 1987 because a prepayment credit was created in plan year 1987.
- 2/ We subtracted interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning of year value. For purposes of this appendix, we computed the interest as the difference between the present value of contributions, at the valuation interest rates, and the actual contribution amounts.
- 3/ The present value of funding represents the present value of contributions plus the prepayment credit. This is the amount of funding that is available to cover the CAS pension cost measured at January 1 of each year.
- 4/ See APPENDIX A for details on the calculation of the annual CAS pension costs. The CAS pension costs, computed at January 1 of each year, must be funded by current or prepaid contributions to satisfy the funding requirement of FAR 31.205-6(j)(3)(i).
- 5/ The percentage of costs funded is a measure of the portion of the CAS pension cost that was funded during the plan year. Since any funding in excess of the CAS pension cost is considered premature funding in accordance with CAS 412.50(a)(7), we determined that the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS pension cost.
- 6/ We computed the funded CAS pension cost as the CAS pension costs multiplied by the percent funded.
- 7/ We assumed interest on the funded CAS pension costs is to accrue in the same proportion as the interest on contributions bears to the present value of funding. However, we limited interest by FAR 31.205-6(j)(3)(iii) which does not permit the allowable interest to exceed the interest that would accrue if the CAS pension costs were funded in four equal installments deposited within 30 days of the end of each quarter.

BLUE CROSS AND BLUE SHIELD OF LOUISIANA

STATEMENT OF ALLOWABLE CAS PENSION COSTS
FOR FISCAL YEARS 1988 THROUGH 1991

- 8/ The allocable pension costs are the amounts of pension costs which may be allocated for contract cost purposes, on a plan year basis.
- 9/ We applied the prepayment credit towards the funding of the CAS pension costs. The prepayment credit represents the premature funding from the previous year. Prepayment credits may be carried forward, with interest, to fund future pension costs. The prepayment credits are reimbursable for the plan year in which they are absorbed.
- 10/ We converted the plan year allocable CAS pension costs to a fiscal year basis (October 1 through September 30). We calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Our calculations began with fiscal year 1988, because Medicare Part A contract years prior to 1988 are closed.
- 11/ We calculated allowable pension costs of the Medicare and other segments based on the Medicare Part A line of business (LOB) percentage of each segment. We obtained the percentages from salary information provided by Louisiana.
- 12/ The Medicare pension costs are the amounts of CAS pension costs which may be claimed for Medicare Part A reimbursement for the segment and indirect Medicare Part A operations.

BlueCross BlueShield of Louisiana

An independent licensee of the Blue Cross and Blue Shield Association

P.O. Box 95029 - Baton Rouge, Louisiana 70898-9029 - 504/295-2214 - FAX 504/295-2557

Carl J. Mautner, CPA
Vice President **and**
Controller

November 6, 1995

Ms. Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII
Department of Health and Human Services
Room 284A
601 East 12th Street
Kansas City, Missouri 64 106

Re: Comments by Blue Cross & Blue Shield of Louisiana on Draft Audit
Report Nos. CIN A-07-95-01 121, -01140, -01141 & -01142

Dear Ms. Bennett:

Thank you for affording Blue Cross & Blue Shield of Louisiana ("BCBSLA") this opportunity to comment on draft Audit Report Nos. CIN A-07-95-01 121, -01140, -01141 & -01142. We have carefully reviewed those reports with our outside actuary and with outside counsel knowledgeable about Medicare pension cost matters, and our comments are set forth below. We would be pleased to discuss our comments with you or your staff at your convenience.

Draft Report Nos. CIN A-07-01 121 & -01141

In draft Report No. CIN A-07-95-01 121, you recommended that BCBSLA refund to the Government \$647,127 of excess pension assets as a result of the termination of BCBSLA's Medicare Part A contract, which became effective October 1, 1990. Similarly, in draft Report No. CIN A-07-95-01 141, you recommended that BCBSLA refund to the Government \$194,177 of excess pension assets as a result of the termination of BCBSLA's Medicare Part B subcontract on October 1, 1989. These recommendations are purportedly based upon Cost Accounting Standard ("CAS") 413.50(c)(12), which provides for an adjustment of previously determined pension costs upon the closing of a segment.

Your auditors calculated the recommended refund for each purported Medicare segment by (1) determining the amount of pension assets attributable to the segment; (2) subtracting from that amount the accrued actuarial liability of employees associated with the segment to determine the amount of the segment's excess pension assets; and (3)

multiplying the segment's amount of excess pension assets by a "Medicare percentage" to determine the amount of the recommended refund.

We believe that two elements of the calculations performed by your auditors should be reconsidered and revised. Because each of those elements caused an overstatement of the refunds that you recommended, we urge you to recalculate the refunds in light of the comments set forth below. We would be pleased to discuss the suggested recalculations with you or your staff in more detail.

The Auditors' Use of the Pension Plan Interest Rate. The first element of your auditors' calculations that should be reconsidered concerns the interest rate that was used to value the Medicare segments' actuarial liabilities for purposes of the CAS 413.50(c)(12) adjustment. The auditors used the pension plan's 9.00% long-term interest rate assumption, rather than the more appropriate interest rate promulgated by the Pension Benefit Guaranty Corporation ("PBGC") for valuing a pension plan's actuarial liability at the time that BCBSLA's Medicare contract and subcontract were terminated. The PBGC rate was 7.25% for each relevant months--January 1, 1990 for Medicare Part B and January 1, 1991 for Medicare Part A. The PBGC rate must be used for two reasons.

First, CAS 413.50(c)(12) requires a comparison between the value of a closed segment's pension assets and the value of its actuarial liabilities. For this calculation, CAS 413.50(c)(12) specifically requires that the closed segment's pension assets be valued at market value as of the date of segment closure. Consistency requires that the closed segment's actuarial liabilities also be valued using an interest rate, such as the PBGC rate, that is consistent with market conditions at the time of segment closure. For example, the auditors' valuation of BCBSLA's Medicare Part A pension assets in a manner that reflects the interest rate environment prevailing on January 1, 1991, while valuing its Medicare Part A actuarial liabilities using the pension plan's higher interest rate assumption, resulted in a meaningless comparison of "apples and oranges." That comparison understated the actuarial liabilities of BCBSLA's purported Medicare Part A segment relative to the value of its pension assets and overstated the Government's share of any required CAS 413.50(c)(12) pension cost adjustment.

For pension funding purposes, BCBSLA values both the assets and actuarial liabilities of its ongoing pension plan using actuarial methods that smooth the effects of short-term fluctuations in market value and market interest rates. For example, in accordance with CAS 412.50(b)(5) and CAS 413.40(b), BCBSLA determines the value of the assets in its ongoing pension plans using an actuarial method that smooths fluctuations in market value and yields actuarial values that may differ significantly from market values. The market values of many BCBSLA pension assets, such as corporate bonds, are sensitive to interest rate fluctuations. The market values of such assets will generally be higher than their actuarial values when the market interest rate is lower than the actuarially smoothed interest rate assumption. On January 1, 1990 and January 1, 1991, the prevailing interest rates were lower than the actuarially smoothed interest rate used by BCBSLA's pension plan.

Similarly, in accordance with CXS 412.50(b)(5), BCBSLX utilizes an interest rate for valuing its pension plan's actuarial liability that smooths the effect that short-term fluctuations in interest rates have on that actuarial liability. A reduction in the discount rate used to calculate the present value of an actuarial liability will increase that present value, while an increase in the discount rate will reduce it. Thus, the present value of the actuarial liability of BCBSLA's pension plan calculated using the actuarially smoothed interest rate would have been significantly less than the present value calculated using the lower market interest rate that was then prevailing.

The CAS 413.50(c)(12) pension cost adjustment did not, however, permit the use of an actuarially smoothed asset value. Instead, it specifically required that "the market value of assets allocated to the segment" be determined "as of the date of the event . . . that caused the closing of the segment." The difference between actuarial asset value and market asset value in part reflects the interest rate environment prevailing on the date of the market valuation. For example, a corporate bond held by the BCBSLA pension plan that was issued with a yield of 9% will increase in market value if the market interest rate decreases to 7.25%, but that increase in market value will not be fully reflected by a valuation method that "smooths" short-term fluctuations in asset value. In contrast, the fair market value of BCBSLA's pension assets on a particular day reflects the interest rate and yield expectations of the marketplace on that date.

In order for a CAS 413.50(c)(12) calculation to be meaningful, the measure of a closed segment's actuarial liability should also reflect the interest rate and yield expectations of the marketplace on the date of the event that caused the segment closing. If not, the actuarial liability will be valued in a manner that is inconsistent with the required fair-market valuation of the closed segment's pension assets.

That inconsistency significantly distorted your auditors' calculation of the recommended refund amounts. Valuing the segments' actuarial liabilities using the pension plan's interest rate assumption, while valuing the pension assets in a manner that reflects the lower interest rates prevailing upon closure of the segments resulted in an understatement of the segments' actuarial liabilities relative to the value of their pension assets. Valuing the Medicare segments' pension assets at market increased the value of those assets, relative to their actuarial value, because that market value reflects the increase in value caused by a reduced interest rate environment. In contrast, valuing the Medicare segments' actuarial liabilities using the plan's ongoing interest rate did not fully recognize the increase in the present value of BCBSLA's actuarial liabilities that resulted from a reduced interest rate environment. Thus, the use of the plan's ongoing interest rate to value the Medicare segments' actuarial liabilities for purposes of the CAS 413.50(c)(12) adjustment resulted in an overstatement of the recommended amount of any refund that may be due the Government as a result of the termination of BCBSLA's Medicare contract and subcontract.

Second, CAS 413.50(c)(12) in effect on the date of the contract and subcontract terminations specifically contemplated that the interest rate promulgated by the PBGC would be used for purposes of the adjustment of previously determined pension costs by providing that "[t]he determination of the actuarial liability shall give consideration to any requirements imposed by agencies of the United States Government." Preamble A to CXS 413, issued in 1977 upon the initial promulgation of CAS 413, explains this provision:

The Board recognizes that, in some cases, the closing of a segment could be associated with a termination of a plan. Several commentators noted that, in such a case, the actuarial liability for that segment could be greatly influenced by regulations developed pursuant to the provisions of ERISA. The standard specifically permits the effect of such regulations to be considered in determining the actuarial liability for the segment.

It should be noted that the provisions of this section are appropriate whenever a segment performing a material amount of Government business is closed, irrespective of whether the closing is caused by the completion of a contract or an organizational change, or whether the closing results in a complete or partial termination of the plan.

The PBGC promulgates an interest rate required to be utilized in determining the actuarial liability of a terminating pension plan at plan termination. This determination is closely analogous to that under CAS 413.50(c)(12), which required a determination of the actuarial liability of a closing segment as of segment closure. Thus, the CAS provision providing that "[t]he determination of the actuarial liability shall give consideration to any requirements imposed by agencies of the United States Government," contemplated the use of the PBGC rate because the use of that rate is required by an agency of the United States Government.

The Auditor's Use of an Accrued Benefit Cost Method for Retained Employees. The second element of your auditors' calculations that should be reconsidered is their use of an accrued benefit cost method for valuing the actuarial liabilities of individual Medicare segment employees who remained with BCBSLA after the termination of the Medicare contract and subcontract. Consistent with the requirements of CAS 412.50(b)(1) & (2), BCBSLA utilizes a projected benefit cost method to determine its annual pension costs. Under that method, the pension cost attributable to the current year properly reflects the actuarial assumption that certain of the contractor's employees will receive salary increases in future years. In contrast, the accrued benefit cost method used by your auditors is based solely on the pension benefits accrued to date by a pension plan participant, and does not consider the assumed escalation in salaries that is integral to BCBSLA's CAS 412-compliant pension cost method.

For those Medicare segment employees who remained BCBSLA employees following the termination of the Medicare contract and subcontract, the projected benefit cost method is the most appropriate method for valuing actuarial liability. Those employees remain with BCBSLA and will receive salary increases. Under BCBSLA's CAS 412-compliant pension cost method, the pension cost associated with those salary increases was properly reflected in the pension costs incurred prior to the termination of the Medicare contract and subcontract. However, because they used an accrued benefit cost method, the auditors understated the actuarial liabilities associated with employees who remain with BCBSLA; a portion of the actuarial liability generated in prior years by BCBSLA's actuarial cost method for such employees was omitted from the auditors' calculation. Thus, to the extent that the accrued benefit cost method fails to consider the salary increases assumed by the projected benefit cost method, the amounts of the recommended refunds were overstated.

Draft Report Nos. CIN A-07-01 140 & -01142

In draft Report No. CIN-07-95-01140, you determined that BCBSLA had undercharged its Medicare Part A contract by \$57,858 of allowable pension costs. Similarly, in draft Report No. CIN-07-95-01142, you determined that BCBSLA had undercharged its Medicare Part B subcontract by \$85,546 of allowable pension costs. BCBSLA has no comments on those reports at this time.

* * *

Thank you again for affording us the opportunity to comment on the draft audit reports. We hope that you will recalculate the recommended refunds as suggested above. We would be pleased to discuss these matters with you or your staff at your convenience.

Sincerely yours,



Carl J. Mautner

cc: James Aasmundstad, DHHS/OIG/OAS
Kevin Dwyer, Miller & Chevalier
Jack Morman, DHHS/OIG/OAS
Robert Rhodes, BCBSA
Carl Voss, Watson Wyatt