

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE CONTRACTOR'S  
PENSION SEGMENTATION, BLUE CROSS  
OF WASHINGTON AND ALASKA**



**JUNE GIBBS BROWN**  
**Inspector General**

**MARCH 1997**  
**CIN: A-07-96-01189**



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-07-96-01189

MAR 18 1997

Mr. Kenneth Hamm  
Vice President of Finance  
Blue Cross of Washington and Alaska  
7001 220th Street S.W.  
Mountlake Terrace, WA 98043-2124

Dear Mr. Hamm:

This report provides you with the results of the Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, Blue Cross of Washington and Alaska*. The purpose of our review was to evaluate Blue Cross of Washington and Alaska's (Washington/Alaska) compliance with the pension segmentation requirements of its Medicare contracts.

Our review showed that Washington/Alaska correctly identified Medicare segment pension assets of \$699,059 as of 1986. However, Washington/Alaska's update of the Medicare segment assets from Plan Year 1986 to Plan Year 1995 understated segment assets by \$96,740. This understatement primarily occurred because Washington/Alaska misidentified plan participants as to segment and nonsegment.

We recommend that Washington/Alaska increase the January 1, 1995 assets of the Medicare segment by \$96,740. Washington/Alaska agreed with our recommendation and its response is included in its entirety as Appendix B.

## INTRODUCTION

Washington/Alaska administered Medicare Part A under cost reimbursement contracts since 1966. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Procurement Regulations (FPR), which were superseded by the Federal Acquisition Regulations (FAR), the Cost Accounting Standards (CAS), and the Medicare contracts.

Since its inception, Medicare 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 Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

Washington/Alaska's contract required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above 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:

*...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 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 later of the first day of the first plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first existed.

To ensure contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. Washington/Alaska's questionnaire response of April 21, 1989 identified total pension assets

of \$15,384,562 and Medicare segment assets of \$699,059 as of January 1, 1986. Washington/Alaska also concluded that separate valuations for the Medicare segment were required.

Washington/Alaska participates in the National Retirement Program administered by the Blue Cross/Blue Shield National Employee Benefits Administration (NEBA). The Watson Wyatt Worldwide, NEBA's actuarial firm, played a major role in the preparation of Washington/Alaska's questionnaire response.

## **OBJECTIVE, SCOPE AND METHODOLOGY**

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Washington/Alaska's compliance with pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of Washington/Alaska's internal control structure. The audit addressed Washington/Alaska's initial determination of pension assets for its Medicare segment and later updates. Our review covered January 1, 1981 to January 1, 1995.

This review was performed in conjunction with our audits of unfunded pension costs (CIN: A-07-97-01206) and pension costs claimed for Medicare reimbursement (CIN: A-07-97-01205). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Washington/Alaska's identification of the Medicare segment as of January 1, 1988 and traced the organizational lineage back to 1981. We also reviewed Washington/Alaska's computation of the asset fraction and its update of Medicare assets from January 1, 1986 to January 1, 1995.

In performing the review, we used information provided by NEBA and NEBA's pension actuary. The information included liabilities, normal costs, contributions, earnings, and expenses. We reviewed Washington/Alaska's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we calculated Medicare segment assets as of January 1, 1995. The HCFA pension actuarial staff reviewed our methodology and calculations.

Site work at Washington/Alaska's corporate offices in Mountlake Terrace, Washington, was performed during August 1996. We performed subsequent audit work in our OIG, OAS Jefferson City, Missouri Office.

## **FINDING AND RECOMMENDATION**

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

Washington/Alaska calculated an asset fraction of 4.5439 percent as of January 1, 1981. We determined that Washington/Alaska correctly identified the organizational components and participants of the Medicare segment as of 1981. Accordingly, Washington/Alaska correctly calculated the 1981 asset fraction, which when applied to the total company assets as of January 1, 1986 correctly established the Medicare segment's asset base of \$699,059.

### **MEDICARE ASSET BASE AS OF JANUARY 1, 1986 UPDATED TO JANUARY 1, 1995**

Washington/Alaska's methodology in updating the Medicare segment assets from January 1, 1986 to January 1, 1995 understated the segment assets by \$96,740. This understatement primarily occurred because Washington/Alaska misidentified participants as to segment and nonsegment.

As of January 1, 1995, Washington/Alaska determined Medicare segment assets of \$1,156,503. We identified Medicare segment pension assets of \$1,253,243 as of January 1, 1995. The increase of \$96,740 resulted from: (1) adjusting for participants that moved in and out of the Medicare segment (\$88,895 increase), (2) assigning pension contributions equitably to the Medicare segment (\$9,148 decrease), (3) adjusting benefit payments (\$2,520 increase), and (4) revising earnings and expenses (\$14,473 increase).

### **Participant Transfers**

Washington/Alaska correctly identified the Medicare segment organizational components and cost centers. However, Washington/Alaska's updates incorrectly identified plan participants in the organizational components and cost centers. Some individuals were considered nonsegment participants and should have been considered segment participants. Some individuals were considered segment participants and should have been considered nonsegment participants.

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 Washington/Alaska's and our computations of transfer amounts:

Transfer Adjustments to the Medicare Segment

<u>Year</u>	<u>Washington/Alaska</u>	<u>OIG</u>
1986	\$(131,049)	\$(34,962)
1987	53,046	(113,429)
1988	(44,189)	(60,196)
1989	(11,756)	(7,138)
1990	27,362	(16,785)
1991	(6,925)	16,300
1992	(5,068)	86,190
1993	89,684	(36,328)
1994	<u>(161,362)</u>	<u>64,986</u>
Total	<u>\$(190,257)</u>	<u>\$(101,362)</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 increase of \$88,895 (\$190,257 less \$101,362) in the Medicare segment assets.

**Pension Contributions**

Washington/Alaska's update methodology did not equitably assign pension contributions to the Medicare segment. As a result, Washington/Alaska overstated Medicare segment assets by \$9,148. The overstatement occurred primarily because Washington/Alaska incorrectly identified the Medicare segment plan participants.

Washington/Alaska's consulting actuary allocated a portion of the 1987 contribution 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. Again, since the identification of Medicare segment plan participants was incorrect the contribution allocated in 1987 was also incorrect.

Using our identification of the Medicare segment plan participants we allocated the 1987 contribution to the Medicare segment following Washington/Alaska's methodology. See Appendix A. Our calculations decreased Medicare segment assets by \$10,399.

Washington/Alaska's consulting actuary assigned a portion of the 1994 contributions to the Medicare segment based on its computation of the separately calculated pension costs. Our changes to the asset base changed the computation of the segment's pension cost as well as the assignment of the contribution.

Using the pension costs as calculated by the HCFA Office of the Actuary

(CIN: A-07-97-01205), we assigned an equitable portion of the total company contributions to the Medicare segment, based on the ratio of the Medicare segment CAS funding target to the total company CAS funding target. See Appendix A. Our calculations increased Medicare segment assets by \$1,251.

### **Benefit Payments**

Due to the incorrect identification of the Medicare segment participants, Washington/Alaska's update of segment assets did not properly identify benefit payments to retirees that were segment participants. We matched benefit payments to individual retirees and used these payments in updating the Medicare segment assets shown in Appendix A. This resulted in a net increase of \$2,520 in the Medicare segment assets.

### **Earnings and Expenses**

Washington/Alaska's update methodology allocated investment earnings and expenses to the Medicare segment based on a ratio of segment assets to total company assets. Because Washington/Alaska's asset amounts were incorrect, the segment's earnings and expenses were understated for each year of the update. Except for correcting asset amounts, as previously described, we used Washington/Alaska's allocation methodology in our update and increased the Medicare segment assets by \$14,473.

### **Recommendation:**

We recommend that Washington/Alaska:

- ① Increase the pension assets of the Medicare segment by \$96,740 as of January 1, 1995.

### **Auditee Response**

Washington/Alaskan agreed our recommendation.

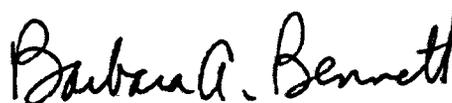
## **INSTRUCTIONS FOR AUDITEE RESPONSE**

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

**Enclosures**

HHS Action Official:

Ms. Nancy Dapper  
Regional Administrator, Region X  
Health Care Financii Administration  
2201 Sixth Ave.  
Mail Stop **RX40**  
Seattle, Washington 08 12 1-2500

BLUE CROSS OF WASHINGTON AND ALASKA

CIN: A-07-96-01189

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1995

Description		Total Company	Other Segment	Medicare
<b>Assets January 1, 1986</b>	<u>1/</u>	<b>\$15,384,562</b>	<b>\$14,685,503</b>	<b>\$699,059</b>
Contributions		0	0	0
Earnings	<u>2/</u>	2,330,560	2,224,662	105,898
Benefits	<u>3/</u>	(951,065)	(951,065)	0
Expenses	<u>4/</u>	(109,663)	(104,680)	(4,983)
Transfers	<u>5/</u>	0	34,962	(34,962)
<b>Assets January 1, 1987</b>		<b>\$16,654,394</b>	<b>\$15,889,382</b>	<b>\$765,012</b>
Contributions	<u>6/</u>	869,116	832,166	36,950
Earnings		737,938	704,041	33,897
Benefits		(363,383)	(363,383)	0
Expenses		(124,139)	(118,437)	(5,702)
Transfers		0	113,429	(113,429)
<b>Assets January 1, 1988</b>		<b>\$17,773,926</b>	<b>\$17,057,198</b>	<b>\$716,728</b>
Contributions		0	0	0
Earnings		2,424,392	2,326,629	97,763
Benefits		(803,516)	(773,957)	(29,559)
Expenses		(132,858)	(127,501)	(5,357)
Transfers		0	60,196	(60,196)
<b>Assets January 1, 1989</b>		<b>\$19,261,944</b>	<b>\$18,542,565</b>	<b>\$719,379</b>

BLUE CROSS OF WASHINGTON AND ALASKA

CIN: A-07-96-01189

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1995

Description	Total Company	Other Segment	Medicare
<b>Assets January 1, 1989</b>	<b>\$19,261,944</b>	<b>\$18,542,565</b>	<b>\$719,379</b>
Contributions	0	0	0
Earnings	4,397,312	4,233,085	164,227
Benefits	(349,314)	(337,675)	(11,639)
Expenses	(175,867)	(169,299)	(6,568)
Transfers	0	7,138	(7,138)
<b>Assets January 1, 1990</b>	<b>\$23,134,075</b>	<b>\$22,275,814</b>	<b>\$858,261</b>
Contributions	0	0	0
Earnings	(589,255)	(567,394)	(21,861)
Benefits	(493,330)	(493,330)	0
Expenses	(165,815)	(159,663)	(6,152)
Transfers	0	16,785	(16,785)
<b>Assets January 1, 1991</b>	<b>\$21,885,675</b>	<b>\$21,072,212</b>	<b>\$813,463</b>
Contributions	0	0	0
Earnings	4,833,372	4,653,722	179,650
Benefits	(536,687)	(536,687)	0
Expenses	(164,462)	(158,349)	(6,113)
Transfers	0	(16,300)	16,300
<b>Assets January 1, 1992</b>	<b>\$26,017,898</b>	<b>\$25,014,598</b>	<b>\$1,003,300</b>

BLUE CROSS OF WASHINGTON AND ALASKA

CIN: A-07-96-01189

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1995

Description	Total Company	Other Segment	Medicare
<b>Assets January 1, 1992</b>	<b>\$26,017,898</b>	<b>\$25,014,598</b>	<b>\$1,003,300</b>
Contributions	0	0	0
Earnings	1,006,426	967,616	38,810
Benefits	(1,970,349)	(1,970,349)	0
Expenses	(166,064)	(159,660)	(6,404)
Transfers	0	(86,190)	86,190
<b>Assets January 1, 1993</b>	<b>\$24,887,911</b>	<b>\$23,766,015</b>	<b>\$1,121,896</b>
Contributions	0	0	0
Earnings	2,492,728	2,380,361	112,367
Benefits	(642,978)	(642,978)	0
Expenses	(208,272)	(198,884)	(9,388)
Transfers	0	36,328	(36,328)
<b>Assets January 1, 1994</b>	<b>\$26,529,389</b>	<b>\$25,340,842</b>	<b>\$1,188,547</b>
Contributions	2,183,071	2,150,880	32,191
Earnings	(554,401)	(529,563)	(24,838)
Benefits	(1,169,908)	(1,169,908)	0
Expenses	(170,598)	(162,955)	(7,643)
Transfers	0	(64,986)	64,986
<b>Assets January 1, 1995</b>	<b>\$26,817,553</b>	<b>\$25,564,310</b>	<b>\$1,253,243</b>
Assets Washington/Alaska <u>7/</u>	<b>\$26,817,553</b>	<b>\$25,661,050</b>	<b>\$1,156,503</b>
Variance <u>8/</u>	<b>\$0</b>	<b>(\$96,740)</b>	<b>\$96,740</b>

BLUE CROSS OF WASHINGTON AND ALASKA

CIN: A-07-96-01189

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1995

**FOOTNOTES**

- 1/ We reviewed Washington/Alaska's asset fraction calculation and determined that Washington/Alaska had correctly computed the 1981 asset fraction (4.5439%).
- 2/ Washington/Alaska provided earning 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 beginning of year market value of total assets. Washington/Alaska used this same methodology.
- 3/ Washington/Alaska provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.
- 4/ Washington/Alaska 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 beginning of year market value of total assets. Washington/Alaska used this same methodology.
- 5/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Washington/Alaska. 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.
- 6/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated the 1987 contribution to the Medicare segment based on the ratio of segment participants' normal costs and accrued liability to total company normal costs and accrued liability. Washington/Alaska used this same methodology. Washington/Alaska did not make contributions to the pension trust fund for years 1986, and 1988 through 1993. We assigned the 1994 contribution to the Medicare segment based on our computation of the separately calculated pension costs.

BLUE CROSS OF WASHINGTON AND ALASKA

CIN: A-07-96-01189

STATEMENT OF MEDICARE PENSION ASSETS  
JANUARY 1, 1986 TO JANUARY 1, 1995

- 7/ We obtained the total assets as of January 1, 1995 from Washington/Alaska's update of assets provided by its actuary.
- 8/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1995 and the assets calculated by Washington/Alaska's actuary.



P. O. Box 327  
Seattle, Washington 98111-0327

March 10, 1997

Ms. Barbara A. Bennett  
Regional Inspector General for Audit Services  
Region VII  
Office of Inspector General  
Department of Health and Human Services  
601 East 12th Street, Room 284A  
Kansas City, MO 64106

Re: CIN: A-07-96-01189  
A-07-97-01205  
A-07-97-01206

Dear Ms. Bennett:

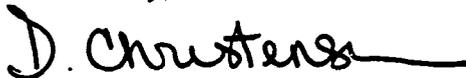
We have reviewed the draft findings of the Office of Inspector (OIG) Medicare Audit.

We agree with the recommendation (CIN: A-07-96-01189) that Blue Cross of Washington and Alaska adjust the Medicare segment assets by \$96,740 as of January 1, 1995.

We agree with the findings (CIN: A-07-97-01205) that for fiscal years 1993, 1994 and 1995 that \$15,688 in excess pension costs over the allowable CAS pension costs were claimed. After the final audits have been issued, we will take the necessary steps to revise the FACP's for these years.

We agree with the recommendation (CIN: A-07-97-01206) that there are accumulated unfunded pension costs of \$106,843 as of January 1, 1995. After the final audits have been issued, we will be seeking a reassignment of these costs under the revised CAS 412 and 413. At that time, we will work with HCFA's Office of the Actuary and Blue Cross and Blue Shield Association to reassign these costs to future periods.

Sincerely,



Donna C. Christensen

cc: HCFA Seattle Regional Office  
Eric Shipley, HCFA, Office of the Actuary (7500 Security Blvd., N3-01-21,  
Baltimore, MD 21244-1850  
Robert Rhodes, BCBSA  
Carol Navin, NEBA