

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
MEDICARE CONTRACTOR'S
PENSION SEGMENTATION
BLUE CROSS AND BLUE SHIELD
OF MISSISSIPPI**



JUNE GIBBS BROWN
Inspector General

SEPTEMBER 1997
CIN: A-07-97-01209



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

CIN: A-07-97-01209
September 8, 1997

Mr. John Proctor, III, JD, CFE
Director, Corporate Audit
Blue Cross and Blue Shield of Mississippi
PO Box 1043
Jackson, MS 39215-1043

Dear Mr. Proctor:

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 Mississippi*. The purpose of our review was to evaluate Blue Cross and Blue Shield of Mississippi's (Mississippi) compliance with the pension segmentation requirements of its Medicare contract.

Our review showed that Mississippi understated Medicare segment pension assets as of 1986 by \$224,711. The understatement occurred because Mississippi omitted certain Medicare segment cost centers in determining Medicare's initial assets. However, Mississippi's update of the Medicare segment assets from Plan Year 1986 to Plan Year 1996 overstated segment assets by \$950,412. The overstatement primarily occurred because Mississippi did not make the correct transfer adjustment.

We recommend that Mississippi decrease the January 1, 1996 assets of the Medicare segment by \$725,701 (\$950,412 less \$224,711). Mississippi accepted our recommendations and its response is included in its entirety as Appendix B. Subsequent to our review, Mississippi provided information on 9 eligible Medicare segment participants that were not factored into the original segmentation report. We have included these additional Medicare segment participants in our calculations and made the appropriate adjustments.

INTRODUCTION

BACKGROUND

Mississippi has administered Medicare Part A under a cost reimbursement contract since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR),

which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

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 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.

Mississippi'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 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 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 that contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. Mississippi's questionnaire response of March 13, 1989 identified total pension assets of \$10,139,147 and Medicare segment assets of \$818,541 as of April 1, 1986. Mississippi also concluded that separate valuations for the Medicare segment were not required.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Mississippi's compliance with pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of Mississippi's internal control structure. The audit addressed Mississippi's initial determination of pension assets for its Medicare segment and later updates. Our review covered April 1, 1981 to January 1, 1996.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-97-01210) and pension costs claimed for Medicare reimbursement (CIN: A-07-97-01211). The information obtained and reviewed during those audits was also used in performing this review.

We reviewed Mississippi's identification of the Medicare segment as of April 1, 1988 and traced the segment's organizational lineage back to 1981. We also reviewed Mississippi's computation of the asset fraction and its update of Medicare assets from April 1, 1986 to January 1, 1996.

In performing the review, we used information provided by Mississippi's prior and current consulting actuarial firms. The information included liabilities, normal costs, contributions, expenses, and earnings. We reviewed Mississippi'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 the asset fraction, determined the 1986 Medicare segment assets, and updated the Medicare segment assets to January 1, 1996. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Mississippi's corporate offices in Jackson, Mississippi during February 1997. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDINGS AND RECOMMENDATIONS

MEDICARE ASSETS AS OF APRIL 1, 1986

We determined that Mississippi's asset fraction was understated by 1.9730 percent. Mississippi omitted three Medicare cost centers (containing five participants) from the Medicare segment. We increased the asset fraction from 8.0731 percent to 10.0461 percent by including the omitted cost centers. Our calculation increased the Medicare segment assets by \$224,711 to \$1,144,174.

We calculated Mississippi's asset fraction using participants' liabilities as of April 1, 1981. The following schedule shows the details of Mississippi's and our calculations.

| | 1981 Total Actuarial Liability (A) | 1981 Medicare Actuarial Liability (B) | 1981 Rounded Asset Fraction (C) (B)/(A) | 1986 Total Company Assets (D) | 1986 Medicare Segment Assets (E) (C)x(D) |
|-------------|--|---|--|---|---|
| OIG | \$5,026,174 | \$504,932 | .100461 | \$11,389,236 | \$1,144,174 |
| Mississippi | <u>4,188,484</u> | <u>338,140</u> | <u>.080731</u> | <u>11,389,236</u> | <u>919,463</u> |
| Difference | <u>\$837,690</u> | <u>\$166,792</u> | <u>(.019730)</u> | <u>\$ 0</u> | <u>\$ (224,711)</u> |

Recommendation:

We recommend that Mississippi:

- Increase the 1986 pension assets of the Medicare segment by \$224,711.

Auditee Response

Mississippi accepted our recommendation.

MEDICARE ASSET BASE AS OF APRIL 1, 1986 UPDATED TO JANUARY 1, 1996

Mississippi's methodology in updating the Medicare segment assets from April 1, 1986 to January 1, 1996 overstated the segment assets by \$950,412. This overstatement resulted primarily from Mississippi not making the correct transfer adjustment. When considered with the 1986 adjustment, Mississippi overstated Medicare's pension assets by \$725,701 as of January 1, 1996.

Participant Transfers

For plan years 1986 through 1994, Mississippi did not adjust for participant transfers into and out of the Medicare segment. An adjustment for participant transfers is required if the transfers were large enough that their nonconsideration would result in a distortion of a segment's ratio of fund assets to actuarial liabilities (CAS, 9904.413-50(C)(8)). We performed a detailed analysis of the annual effect of participant transfer for plan years 1986 through 1994 and concluded that the transfers did not cause a material distortion, and thus transfer adjustments were not necessary.

Mississippi joined the National Retirement Program administered by the Blue Cross Blue Shield National Employee Benefits Administration (NEBA) beginning with plan year 1995. Consequently, NEBA's actuarial firm, Watson Wyatt Worldwide (Wyatt), began providing actuarial support to Mississippi at the same time. With this change in actuarial firms also came a change in methodology. NEBA's methodology, implemented by Wyatt, consists of the following three factors: 1) the Medicare segment consists of active participants only, 2) transfer adjustments are made each year, and 3) the CAS pension costs are always separately calculated. Consistent with NEBA's methodology, a transfer adjustment was made at the end of plan year 1995.

To be consistent with Mississippi's methodology we also made a transfer adjustment for plan year 1995. Using our identification of the Medicare segment active participants our transfer adjustment was a transfer out of \$314,912. For that same period Mississippi's transfer adjustment was a transfer in of \$11,701. This difference results from the exclusion of nonactive participants in the Medicare segment. As a consequence, Mississippi overstated Medicare segment assets by \$326,613 (\$314,912 plus \$11,701).

Earnings and Expenses

Mississippi's update methodology for Plan Years 1986 through 1994 allocated earnings and expenses to the Medicare segment based on the average asset value each year, weighted for contributions and benefit disbursements as if such transactions occurred uniformly throughout the year. With a change in actuarial firms beginning in Plan Year 1995, Mississippi's update methodology also changed with the allocation of investment earnings and expenses to the Medicare segment based on a ratio of segment assets to total company assets. Because Mississippi's asset amounts were incorrect, it understated the segment's earnings and expenses for each year of the update. Except for correcting asset amounts, as previously described, we used Mississippi's allocation methodologies in our update and decreased the Medicare segment assets by \$589,253.

Benefit Payments

Mississippi allocated benefit payments to the Medicare segment in proportion to the period of time the retiree had performed Medicare related functions during employment. We identified the actual benefits paid to the retirees from Medicare segment and assigned these costs to the Medicare segment. A comparison of Mississippi's and our computed benefit amounts are shown on the following schedule.

| <u>Benefit Payments to Medicare Segment Retirees</u> | | | |
|--|------------------|------------------|--------------------|
| Year | Mississippi | OIG | Variance |
| 1986 | \$ 12,518 | \$ 12,518 | \$ 0 |
| 1987 | 0 | 0 | 0 |
| 1988 | 8,744 | 0 | 8,744 |
| 1989 | 1,176 | 0 | 1,176 |
| 1990 | 57,462 | 63,051 | (5,589) |
| 1991 | 5,915 | 7,213 | (1,298) |
| 1992 | 584,625 | 845,155 | (260,530) |
| 1993 | 8,504 | 0 | 8,504 |
| 1994 | 0 | 0 | 0 |
| 1995 | <u>0</u> | <u>0</u> | <u>0</u> |
| Total | <u>\$678,944</u> | <u>\$927,937</u> | <u>\$(248,993)</u> |

We corrected the benefit payment amounts in updating the Medicare segment assets as shown in Appendix A. This resulted in a net reduction of \$248,993 in the Medicare segment assets.

Pension Contributions

Mississippi's update methodology allocated total company contributions to the segment based on the ratio of segment's payroll to total company payroll. For plan year 1986 we also allocated the contribution to the segment based on the ratio of the segment's payroll to total company payroll. For plan years 1992 through 1995 we assigned total company contributions to the segment based on the ratio of the segment's CAS funding target to the total company CAS funding target. The separately computed CAS funding target was smaller than the allocated amount used by Mississippi. Our methodology decreased Medicare segment assets by \$199,986.

Additionally, for years 1993 through 1995, Mississippi's contributions exceeded the required funding of the CAS pension cost. According to CAS 9904.412-50(c)(1), amounts funded in excess of the pension cost shall be applied to fund pension costs of the future periods. We

considered these excess contributions in our computations and made prepayment adjustments (\$7,537 in 1993, \$206,445 in 1994, and \$200,451 in 1995) to fund the CAS pension costs of the Medicare segment.

Using the pension costs as calculated by the HCFA Office of the Actuary (CIN: A-07-97-01211), 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 \$214,447.

We recommend that Mississippi decrease the pension assets of the Medicare segment by \$725,701 as of January 1, 1996. The decrease of \$725,701 resulted from: (1) revising the asset fraction (\$224,711 increase), (2) adjusting for participants that moved in and out of the Medicare segment (\$326,613 decrease), (3) revising earnings and expenses (\$589,253 decrease), (4) adjusting benefit payments (\$248,993 decrease), and (5) assigning pension contributions equitably to the Medicare segment (\$214,447 increase),

Recommendation:

We recommend that Mississippi:

- Decrease the pension assets of the Medicare segment by \$725,701 as of January 1, 1996.

Auditee Response

Mississippi accepted our recommendation.

**MEDICARE PENSION COST ALLOCATED
OR CALCULATED SEPARATELY**

The Medicare contract provides that pension costs, where funded by plan contributions, could be charged to Medicare on an annual basis through allocations. However, consistent with CAS, the contract specified that where a Medicare segment exists, a separate calculation of pension costs for the segment was required if such calculation (versus allocation) materially affected the amount of pension costs charged to the contracts. This assessment of materiality started with Plan Year 1988.

Mississippi did not separately calculate pension costs for Medicare on a segmented basis for plan years 1988 through 1994. Mississippi's methodology of allocating the contribution to the segment was based on the ratio of the segment's actuarial liability to the total company actuarial liability.

We computed pension costs, in accordance with CAS, for Plan Years 1988 through 1994 and determined what the costs would have been to the Medicare segment on an allocation and separate calculation basis. The results are shown on the following schedule.

Annual CAS Pension Costs

| <u>Method</u> | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|----------------------|-----------------|-----------------|-----------------|------------------|------------------|------------------|------------------|
| Allocated | \$23,027 | \$19,992 | \$40,693 | \$131,291 | \$151,343 | \$195,395 | \$270,255 |
| Separate Calculation | <u>\$27,825</u> | <u>\$11,784</u> | <u>\$12,815</u> | <u>\$158,871</u> | <u>\$181,982</u> | <u>\$234,598</u> | <u>\$329,997</u> |
| Difference | \$ 4,798 | \$ 8,208 | \$27,878 | \$ 27,580 | \$ 30,639 | \$ 39,203 | \$ 59,742 |
| Percentage | 20.84% | 41.06% | 68.51% | 21.01% | 20.24% | 20.06% | 22.11% |

As shown, the costs separately calculated were materially different in dollar amounts and as a percentage of cost.

Recommendation

We recommend that Mississippi:

- Separately compute pension costs for the Medicare segment whenever material differences exist between allocated and separately computed CAS pension costs.

Auditee Response

Mississippi accepted our recommendation.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS actions 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 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

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

CIN: A-07-97-01209

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

| Description | | Total Company | Other Segment | Medicare |
|-----------------------------|-----------|---------------------|---------------------|--------------------|
| Assets April 1, 1986 | <u>1/</u> | \$11,389,236 | \$10,245,062 | \$1,144,174 |
| Contributions | <u>2/</u> | 29,390 | 25,452 | 3,938 |
| Earnings | <u>3/</u> | 1,331,640 | 1,194,653 | 136,987 |
| Benefits | <u>4/</u> | (644,627) | (632,109) | (12,518) |
| Expenses | <u>5/</u> | (35,037) | (31,433) | (3,604) |
| Assets April 1, 1987 | | \$12,070,602 | \$10,801,625 | \$1,268,977 |
| Contributions | | 0 | 0 | 0 |
| Earnings | | 1,304,149 | 1,165,213 | 138,936 |
| Benefits | | (318,210) | (318,210) | 0 |
| Expenses | | (34,990) | (31,262) | (3,728) |
| Assets April 1, 1988 | | \$13,021,551 | \$11,617,366 | \$1,404,185 |
| Contributions | | 0 | 0 | 0 |
| Earnings | | 1,269,209 | 1,122,895 | 146,314 |
| Benefits | | (1,681,773) | (1,681,773) | 0 |
| Expenses | | (29,657) | (26,238) | (3,419) |
| Assets April 1, 1989 | | \$12,579,330 | \$11,032,250 | \$1,547,080 |

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

CIN: A-07-97-01209

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

| Description | Total Company | Other Segment | Medicare |
|-----------------------------|---------------------|---------------------|--------------------|
| Assets April 1, 1989 | \$12,579,330 | \$11,032,250 | \$1,547,080 |
| Contributions | 0 | 0 | 0 |
| Earnings | 1,139,779 | 993,711 | 146,068 |
| Benefits | (1,014,759) | (1,014,759) | 0 |
| Expenses | (22,761) | (19,844) | (2,917) |
| Assets April 1, 1990 | \$12,681,589 | \$10,991,358 | \$1,690,231 |
| Contributions | 0 | 0 | 0 |
| Earnings | 1,148,766 | 997,395 | 151,371 |
| Benefits | (187,038) | (123,987) | (63,051) |
| Expenses | (28,147) | (24,438) | (3,709) |
| Assets April 1, 1991 | \$13,615,170 | \$11,840,328 | \$1,774,842 |
| Contributions | 0 | 0 | 0 |
| Earnings | 1,074,548 | 923,785 | 150,763 |
| Benefits | (1,981,663) | (1,974,450) | (7,213) |
| Expenses | (44,650) | (38,385) | (6,265) |
| Assets April 1, 1992 | \$12,663,405 | \$10,751,278 | \$1,912,127 |

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CIN: A-07-97-01209

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

| Description | Total Company | Other Segment | Medicare |
|-------------------------------|---------------------|---------------------|--------------------|
| Assets April 1, 1992 | \$12,663,405 | \$10,751,278 | \$1,912,127 |
| Contributions | 895,779 | 703,166 | 192,613 |
| Earnings | 1,295,553 | 1,129,003 | 166,550 |
| Benefits | (1,845,913) | (1,000,758) | (845,155) |
| Expenses | (46,196) | (40,257) | (5,939) |
| Assets January 1, 1993 | \$12,962,628 | \$11,542,432 | \$1,420,196 |
| Prepayment Transfer <u>6/</u> | 0 | (7,537) | 7,537 |
| Contributions | 1,907,050 | 1,668,255 | 238,795 |
| Earnings | 1,154,717 | 1,027,105 | 127,612 |
| Benefits | (36,980) | (36,980) | 0 |
| Expenses | (39,799) | (35,401) | (4,398) |
| Assets January 1, 1994 | \$15,947,616 | \$14,157,874 | \$1,789,742 |
| Prepayment Transfer | 0 | (206,445) | 206,445 |
| Contributions | 1,524,081 | 1,380,544 | 143,537 |
| Earnings | (118,351) | (103,537) | (14,814) |
| Benefits | (3,930,371) | (3,930,371) | 0 |
| Expenses | (67,280) | (58,858) | (8,422) |
| Assets January 1, 1995 | \$13,355,695 | \$11,239,207 | \$2,116,488 |

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

CIN: A-07-97-01209

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

| Description | Total Company | Other Segment | Medicare |
|-----------------------------------|---------------------|---------------------|--------------------|
| Assets January 1, 1995 | \$13,355,695 | \$11,239,207 | \$2,116,488 |
| Prepayment Transfer | 0 | (200,451) | 200,451 |
| Contributions | 2,552,700 | 2,389,121 | 163,579 |
| Earnings <u>7/</u> | 3,263,283 | 2,697,170 | 566,113 |
| Benefits | (2,825,070) | (2,825,070) | 0 |
| Expenses <u>8/</u> | (79,145) | (65,415) | (13,730) |
| Transfers <u>9/</u> | 0 | 314,912 | (314,912) |
| Assets January 1, 1996 | \$16,267,463 | \$13,549,474 | \$2,717,989 |
| Per Mississippi <u>10/</u> | \$16,267,463 | \$12,823,773 | \$3,443,690 |
| Asset Variance <u>11/</u> | \$0 | \$725,701 | (\$725,701) |

FOOTNOTES

- 1/ We calculated the Medicare segment assets based on our identification of the Medicare segment and our computed asset fraction (10.0461%). 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 the 1986 contribution to the Medicare segment based on the ratio of segment's payroll to total company payroll. Mississippi used this same methodology. Mississippi did not make contributions to the pension trust fund for 1987 through 1991. We assigned the 1992 through 1995 contribution to the Medicare segment based on our computation of the separately calculated pension costs.

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

CIN: A-07-97-01209

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

- 3/ Mississippi provided earning amounts and we verified them to IRS Form 5500 reports. We allocated earnings to the Medicare segment based on the average asset value each year, weighted for contributions and benefit disbursements as if such transactions occurred uniformly throughout the year. Mississippi used this same methodology.
- 4/ Mississippi provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.
- 5/ Mississippi provided administrative expense amounts and we verified them to IRS Form 5500 reports. We allocated administrative expenses to the Medicare segment based on the average asset value each year, weighted for contributions and benefit disbursements as if such transactions occurred uniformly throughout the year. Mississippi used this same methodology.
- 6/ Prepayment credit is created when the contributions made to the pension trust exceed the CAS pension cost. The prepayment remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs. We assigned the prepayment in proportion to the CAS pension costs.
- 7/ Beginning with plan year 1995, Mississippi changed the methodology used to allocate earnings to the Medicare segment. In plan year 1995 Mississippi 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. We used this same methodology.
- 8/ Beginning with plan year 1995, Mississippi changed the methodology used to allocate expenses to the Medicare segment. In plan year 1995 Mississippi 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. We used this same methodology.
- 9/ We identified participant transfers between segments by comparing annual participant valuation listings provided by Mississippi. The listings contained the actuarial liability of each participant at year-end. Our transfer adjustment considered each participant's

BLUE CROSS BLUE SHIELD OF MISSISSIPPI

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STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1986 TO JANUARY 1, 1996

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.

- 10/ We obtained the total assets as of January 1, 1996 from Mississippi's update of assets provided by its actuary.

- 11/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1996 and the assets calculated by Mississippi's actuary.



John H. Proctor, III
Vice President
Legal & Internal Audit

August 13, 1997

Ms. Barbara A. Bennett
Regional Inspector General For Audit Services
Office of Inspector General, Region VII
601 East 12th Street Room 284A
Kansas City, Missouri 64106

Dear Ms. Bennett:

This letter is to serve as our formal response to the three draft reports received on June 13, 1997 that comprised the *Review of Pension Costs Claimed for Medicare Reimbursement by Blue Cross and Blue Shield of Mississippi*. Based on our previous conversations and subsequent request for an extension, our due date to respond to the draft reports is August 13, 1997.

In our efforts to evaluate the findings and recommendations from the three draft reports, we coordinated our review with our actuary through 1994, Mr. David Donald, as well as our current actuary, Mr. Carl Voss. During the subsequent reviews of the draft reports, we noted several issues and concerns that we will address in our formal response. Listed below under the titles of each of the three draft reports are our Plan's formal responses to your findings and recommendations:

Review of Pension Costs Claimed by Blue Cross and Blue Shield of Mississippi CIN: A-07-97-01211

OIG Finding

From plan years 1988 through 1996, Blue Cross and Blue Shield of Mississippi claimed \$377,452 in pension costs that were not allowable for Medicare reimbursement.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should revise its Final Administrative Cost Proposals (FACP) to eliminate the unallowable pension costs.

Plan Response

1. Based on previous inquiries and conversations, we found an additional 9 eligible Medicare employees that were not factored into the original Medicare segment for the 1996 fiscal year. The inclusion of these employees in the Medicare segment calculation resulted in a reduction of the nonallowable amount by \$66,452.

2. Per review of the 1996 CAS Valuation Report provided to us with the draft reports, we noted a significant mathematical discrepancy between the 1995 and 1996 Net Amortization calculations. Based on our review, the signs (positive and negative) for the 1996 calculation were exactly opposite of the same amortization used in the 1995 calculation. Therefore, instead of reducing the 1996 Gross Normal Cost by \$666,858 in amortized costs, the proper CAS Pension cost calculation should have added the \$666,858 in net amortized costs. We understand that the net effect of reflecting the audit findings will result in a reduction of the administrative costs for FY 1988 through FY 1996 of \$134,312.
3. During our initial stages of reviewing the OIG draft reports, we were made aware of prepayment credits for the first time. Based on our understanding of the information provided, these new CAS regulations took effect in 1996. It is our general understanding that a prepayment credit exists when amounts that have been funded (contributed) exceed the CAS pension costs.

Correspondence from Mr. Voss indicated that the transition provision of the new CAS regulation provided for an "equitable" transition. The Health Care Financing Administration (HCFA) apparently chose to apply the new rules retroactively. Based on our review of the CAS pension cost calculations, the prepayment credits were calculated retroactively dating back to 1993, however, the credits were reflected in their entirety in the 1996 calculation of the CAS pension costs.

We would like to formally state that we do not deem the retroactive application of the regulation to be an "equitable" transition, nor do we believe that reflecting the retroactive adjustments in one year is an acceptable application. The retroactive application of the new CAS regulations did not allow the Plan the opportunity to account for the calculation of the prepayment credits when claiming pension costs for the years from 1993 through 1996. Also, we believe the regulations should allow for some type of amortization of the prepayment credits rather than the realization of the entire amount in one fiscal year.

Review of Medicare Contractor's Pension Segmentation **CIN: A-07-97-01209**

OIG Finding

From plan years 1988 through 1996, Blue Cross and Blue Shield of Mississippi overstated Medicare segment assets by \$816,524.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should decrease the January 1, 1996 assets of the Medicare segment by \$816,524. The Plan should also separately compute pension costs for the Medicare segment whenever material differences exist between allocated and separately computed CAS pension costs.

Plan Response

Mr. Voss indicated that the calculations that comprised the overall recommendation were proper. We agree with the findings. Mr. Voss indicated that he would make the appropriate adjustments to ensure the OIG recommendations were properly followed. We also agree to begin transferring assets and liabilities from the segment when a Medicare employee retires and takes an annuity payment or terminates employment and is eligible for deferred vested benefits.

**Review of Unfunded Pension Costs of Blue Cross and Blue Shield of
Mississippi
CIN: A-07-97-01210**

OIG Finding

Since Blue Cross and Blue Shield of Mississippi did not make any contributions to the pension trust fund from 1987 through 1991, the plan did not fund the pension costs identifiable with the Medicare segment. Therefore, the plan accumulated \$482,549 in unfunded pension costs.

OIG Recommendation

Blue Cross and Blue Shield of Mississippi should identify and eliminate \$482,549 in unfunded pension costs from the amortization component of future pension costs.

Plan Response

Based on our inquiry with Mr. Voss, we agree with the calculation. Mr. Voss indicated that he would factor in interest and amortize the balance over the next ten years in order to possibly factor those costs into future CAS cost calculations.

We would like to thank you for your timeliness and efforts to assist us in our questions and concerns while attempting to settle this audit engagement. Should you have any questions or need any further assistance or supporting documentation, please feel free to contact myself at (601) 664-4475, or Bryan Lagg at (601) 664-4673.

Sincerely,



John H. Proctor, III
Vice President, Legal and Internal Audit

cc: Jenenne Tambke, Office of Audit Services (OIG)
Carl Voss, External Actuary (Current)
David Donald, External Actuary (Past)
Dorothy Calhoun, Blue Cross Association