

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF UNFUNDED PENSION
COSTS OF BLUE CROSS AND BLUE
SHIELD OF OKLAHOMA**



**JULY 2001
A-07-01-00120**

Office of Inspector General

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

CIN: A-07-01-00120
July 17, 2001

Ms. Gerri Webb
Vice President of Government Programs
Blue Cross and Blue Shield of Oklahoma
P.O. Box 3404
1215 South Boulder
Tulsa, Oklahoma 74101-3404

Dear Ms. Webb:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Unfunded Pension Costs of Blue Cross and Blue Shield of Oklahoma*. The purpose of our review was to determine if pension costs assignable to the Medicare contracts for plan years 1986 through 1996 were funded in accordance with the Federal Acquisition Regulations (FAR).

Oklahoma did identify and track unfunded pension costs for years 1989 through 1995. However, we determined that Oklahoma understated its accumulated unfunded pension costs by \$195,837 as of January 1, 1996. Also, Oklahoma began amortizing unfunded costs without prior approval from its contracting officer.

We recommend that Oklahoma increase the January 1, 1996 accumulated unfunded pension costs of the Medicare segment by \$195,837. We also recommend that Oklahoma obtain approval of its contracting officer before including any portion of the accumulated unfunded costs as a component of the Medicare segment's pension costs.

We also identified \$6,328 of unallowable pension costs for the Medicare segment as of May 1, 1989. In addition, any interest on this amount is unallowable in future periods. Therefore, Oklahoma has \$11,063 in unallowable pension costs as of January 1, 1996.

We recommend that Oklahoma identify \$11,063 as an unallowable component of Medicare segment pension costs as of January 1, 1996. We also recommend that Oklahoma update annually the unallowable component of pension costs related to the unallowable CAS costs for all future periods.

Oklahoma accepted our recommendations in principle, but noted that the results should change based on adjustments made to our pension segmentation report (CIN: A-07-00-00106). Oklahoma's response is included in its entirety as Appendix D.

INTRODUCTION

BACKGROUND

Cost Accounting Standards (CAS) and FAR

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

The Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs on March 30, 1995. Unless otherwise noted, the following references to the CAS refer to the standards that were in effect before the revision. For purposes of clarity, we will refer to the post revision standards as the "revised" CAS. Applicable portions of the revised CAS are discussed in a following section.

The CAS within 48 Code of Federal Regulations (CFR) 30.412-50(a)(7) stated:

If any portion of the pension costs computed for a cost accounting period is not funded in that period, no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period.

In addition, the CAS within 48 CFR 9904.412-50(a)(2) stated:

Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions...shall be separately identified and eliminated from any unfunded actuarial liability being amortized....

Furthermore, the FAR, 48 CFR 31.205-6(j)(3)(i) and (iii), states:

...costs of pension plans not funded in the year incurred, and all other components of pension costs...assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years....

Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

Employees Retirement Income Security Act of 1974 (ERISA)

Trust fund deposits qualifying for tax-exemptions under ERISA have traditionally satisfied the FAR funding requirement. The ERISA provided for a minimum and a maximum deposit to pension funds as determined each year. The minimum represented a required deposit while the maximum represented the upper limit that could be deducted for income tax purposes for the year that the deposit was applicable.

Pension costs computed in accordance with the CAS represented an assignment of pension costs to specific accounting periods. The CAS pension costs often fell between ERISA minimum and maximum contributions. If contractors deposited the minimum ERISA contribution in their qualified trust funds, and the CAS pension costs exceeded the ERISA minimum, the contractors could only claim the funded portion of the CAS amount as allowable contract costs. Additionally, the excess of the CAS costs over the ERISA minimum contribution could not be carried forward as a component of future CAS pension costs.

Conversely, if CAS pension costs before 1986 were greater than maximum ERISA contributions, contractors could deposit the CAS amounts in qualified trust funds, claim them as allowable contract costs, and take ERISA maximums as tax deductions. The excess of the CAS amount over the ERISA maximum could be carried forward to future years for tax deductibility. Similarly, if contractors deposited ERISA maximums that were larger than CAS computed amounts, differences could be carried forward to fund allowable contract costs for future years.

Tax Reform Act of 1986 (TRA 86)

The TRA 86 changed the effect of making pension plan contributions in excess of ERISA maximums. The ERISA maximum was still the tax-deductible limit and the excess could still be carried forward to future years for deductibility. However, TRA 86 imposed an excise tax of 10 percent on contributions in excess of ERISA maximums. The excise tax is cumulative from year to year and applied on a first-in/first-out basis considering carry-forwards and current year contributions.

Omnibus Budget Reconciliation Act of 1987 (OBRA 87)

Prior to OBRA 87, ERISA's full funding limitation traditionally considered accumulated assets and the actuarial liability. If assets equaled or exceeded the actuarial liability, the tax-deductible amount was limited to zero. With OBRA 87, the Congress took additional action affecting contractors' pension plan contributions to qualified trust funds.

The OBRA 87 imposes a second more restrictive test to the full funding limitation. It considers the accumulated assets and 150 percent of the amount designated "current liability." The actuarial liability under the pre-OBRA 87 test was based on projected benefits and conservative valuation assumptions. The current liability test of OBRA 87 considers only currently accrued

benefits and values the liability using interest rates based on Treasury rates. The effect was that most pension plans that were already in full funding would remain there longer. Also, the same effect would push additional plans into full funding.

Revised CAS

As previously noted, the CAS relating to accounting for pension costs was revised on March 30, 1995, and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS removed the regulatory conflict between the funding limits of ERISA and the period assignment provisions of the CAS. The new rule allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. However, the contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The revision to the CAS does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA. If a contractor could have funded pension costs and chose not to, then those costs and any accrued interest on those costs are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per FAR and CAS regulations.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to identify any unfunded CAS costs, plus interest adjustments on the unfunded costs, from May 1, 1986 to January 1, 1996. Our objective also included identifying interest adjustments on the unfunded pension costs previously reported. Achieving our objective did not require that we review the internal control structure of Oklahoma.

We performed this review in conjunction with our audit of pension segmentation (CIN: A-07-00-00106), and our review of pension costs claimed (CIN: A-07-01-00121). The information obtained and reviewed during that audit was also used in performing this review.

The Health Care Financing Administration (HCFA) Office of the Actuary developed the methodology used for computing the CAS pension costs based on Oklahoma's historical practices.

We performed site work at Oklahoma's corporate offices in Tulsa, Oklahoma during April 2000. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDINGS AND RECOMMENDATIONS

Unfunded CAS Pension Costs Over The ERISA Tax Maximum

As of January 1, 1996, Oklahoma identified accumulated unfunded pension costs of (\$112,806) related to its Medicare segment. We determined that the Medicare segment's accumulated unfunded pension costs were \$83,031 as of January 1, 1996. Therefore, Oklahoma understated the accumulated unfunded pension costs by \$195,837. For plan years 1989 through 1996, Oklahoma identified, tracked and updated Medicare segment unfunded pension costs. As of January 1, 1996 Oklahoma identified the Medicare segment's accumulated unfunded pension costs as (\$112,806).

For plan years 1987, and 1991 through 1996, Oklahoma made contributions to its pension plan in excess of its pension costs. These contributions were sufficient to include an installment towards the accumulated unfunded pension costs. Therefore, Oklahoma began amortizing the Medicare segment's accumulated unfunded costs as a component of the Plan Year 1996 segment pension costs. Oklahoma amortized the unfunded costs using the methodology set forth in the revised CAS.

The revised CAS does provide for the amortization and assignment of accumulated unfunded pension costs. However, the revised CAS requires that the contracting officer must approve the method or methods used to reassign the unfunded pension costs. Oklahoma did not receive such approval.

The HCFA Office of the Actuary computed the Medicare segment accumulated unfunded pension costs to be \$83,031 as of January 1, 1996. Therefore Oklahoma understated the accumulated unfunded pension costs by \$195,837 ($\$83,031 - (\$112,806)$) as of January 1, 1996.

Unallowable Costs For Future Periods

For plan years 1988 and 1989, we identified \$6,328 of segment pension costs that Oklahoma could have funded with contributions per ERISA, but chose not to. As of January 1, 1996, Oklahoma had accumulated \$11,063 in unallowable direct pension costs related to its Medicare segment. The pension costs are unallowable because they were not funded within specific time periods set by FAR regulations. Imputed interest on the unfunded costs is also unallowable per CAS regulations. The \$11,063 represents unfunded pension costs and imputed interest for years 1988 through 1995.

Recommendations

We recommend that Oklahoma:

- Increase the accumulated unfunded pension costs of the Medicare segment by \$195,837 as of January 1, 1996.

- Obtain approval from its contracting officer before including any portion of the accumulated unfunded pension costs as a component of the Medicare segment's CAS pension costs.
- Identify \$11,063 as an unallowable component of direct pension costs as of January 1, 1996.
- Update annually the unallowable component of pension costs related to the unfunded CAS costs for 1988 and 1989.

Auditee Response

Oklahoma accepted our recommendations in principle, but noted that the results should change based on adjustments made to our pension segmentation report (CIN: A-07-00-00106). Oklahoma's response is included in its entirety as Appendix D.

OIG Comments

We did revise our pension segmentation report (CIN: A-07-00-00106) as a result of Oklahoma's response to our pension segmentation draft report. However, those revisions were only applicable to plan years after 1996. Therefore, the revisions did not affect the findings and recommendations set forth 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 actions official identified on the following page. We request that you provide us with written comments 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,



James P. Aasmundstad
Regional Inspector General for
Audit Services, Region VII

Enclosure

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|---------|----------------------|--------------------------------|-----------------|------------------|
| 5/1/86 | Normal Cost | 1/ \$844.113 | | |
| 5/1/86 | Amortization Payment | 2/ <u>122.581</u> | | |
| 5/1/86 | CAS Pension Cost | 3/ 966.694 | 920.338 | 46.356 |
| | Credit Absorbed | 4/ <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 5/ 966.694 | 920.338 | 46.356 |
| 5/1/86 | Pre-Payment Applied | 6/ 0 | 0 | 0 |
| | Interest To Year End | 7/ <u>77.336</u> | <u>73.628</u> | <u>3.708</u> |
| 4/30/87 | Required Funding | 8/ 1,044.030 | 993.966 | 50.064 |
| | Contribution | 9/ (1,023.081) | (974.049) | (49.032) |
| | Interest to 4/30/87 | 10/ <u>(21.526)</u> | <u>(20.494)</u> | <u>(1.032)</u> |
| 4/30/87 | Under (Over) Funding | 11/ <u>(\$577)</u> | <u>(\$577)</u> | <u>\$0</u> |

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|---------|----------------------|----------------|----------------|-----------------|
| 5/1/87 | Normal Cost | \$718.834 | \$678.316 | \$40.518 |
| 5/1/87 | Amortization Payment | <u>32.321</u> | <u>56.785</u> | <u>(24.464)</u> |
| 5/1/87 | CAS Pension Cost | 751.155 | 735.101 | 16.054 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 751.155 | 735.101 | 16.054 |
| 5/1/87 | Pre-Payment Applied | (577) | (565) | (12) |
| | Interest To Year End | <u>60.046</u> | <u>58.763</u> | <u>1.283</u> |
| 4/30/88 | Required Funding | 810.624 | 793.299 | 17.325 |
| | Contribution | (797.586) | (780.540) | (17.046) |
| | Interest to 4/30/88 | <u>(6.553)</u> | <u>(6.413)</u> | <u>(140)</u> |
| 4/30/88 | Under (Over) Funding | <u>\$6.485</u> | <u>\$6.346</u> | <u>\$139</u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|---------|----------------------|------------------|------------------|------------------|
| 5/1/88 | Normal Cost | \$823.281 | \$773.831 | \$49.450 |
| 5/1/88 | Amortization Payment | <u>(41.052)</u> | <u>(12.905)</u> | <u>(28.147)</u> |
| 5/1/88 | CAS Pension Cost | 782.229 | 760.926 | 21.303 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 782.229 | 760.926 | 21.303 |
| 5/1/88 | Pre-Payment Applied | 0 | 0 | 0 |
| | Interest To Year End | <u>62.578</u> | <u>60.874</u> | <u>1.704</u> |
| 4/30/89 | Required Funding | 844.807 | 821.800 | 23.007 |
| | Contribution | (290.583) | (282.670) | (7.913) |
| | Interest to 4/30/89 | <u>(6.676)</u> | <u>(6.494)</u> | <u>(182)</u> |
| 4/30/89 | Under (Over) Funding | <u>\$547.548</u> | <u>\$532.636</u> | <u>\$14.912</u> |

| | | | | |
|----------|----------------------|------------------|------------------|-----------------|
| 5/1/89 | Normal Cost | \$576.192 | \$513.658 | \$62.534 |
| 5/1/89 | Amortization Payment | <u>(98.320)</u> | <u>(74.637)</u> | <u>(23.683)</u> |
| 5/1/89 | CAS Pension Cost | 477.872 | 439.021 | 38.851 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 477.872 | 439.021 | 38.851 |
| 5/1/89 | Pre-Payment Applied | 0 | 0 | 0 |
| | Interest To Year End | <u>28.674</u> | <u>26.343</u> | <u>2.331</u> |
| 12/31/89 | Required Funding | 506.546 | 465.364 | 41.182 |
| | Contribution | 0 | 0 | 0 |
| | Interest to 12/31/89 | <u>0</u> | <u>0</u> | <u>0</u> |
| 12/31/89 | Under (Over) Funding | <u>\$506.546</u> | <u>\$465.364</u> | <u>\$41.182</u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|----------|----------------------|--------------------------|--------------------------|-------------------|
| 1/1/90 | Normal Cost | \$850.386 | \$790.610 | \$59.776 |
| 1/1/90 | Amortization Payment | <u>(228.513)</u> | <u>(184.224)</u> | <u>(44.289)</u> |
| 1/1/90 | CAS Pension Cost | 621.873 | 606.386 | 15.487 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 621.873 | 606.386 | 15.487 |
| 1/1/90 | Pre-Payment Applied | 0 | 0 | 0 |
| | Interest To Year End | <u>55.969</u> | <u>54.575</u> | <u>1.394</u> |
| 12/31/90 | Required Funding | 677.842 | 660.961 | 16.881 |
| | Contribution | (702.959) | (686.078) | (16.881) |
| | Interest to 12/31/90 | <u>0</u> | <u>0</u> | <u>0</u> |
| 12/31/90 | Under (Over) Funding | <u><u>(\$25.117)</u></u> | <u><u>(\$25.117)</u></u> | <u><u>\$0</u></u> |

| | | | | |
|----------|----------------------|---------------------------|---------------------------|-------------------|
| 1/1/91 | Normal Cost | \$959.243 | \$895.648 | \$63.595 |
| 1/1/91 | Amortization Payment | <u>(109.691)</u> | <u>(69.349)</u> | <u>(40.342)</u> |
| 1/1/91 | CAS Pension Cost | 849.552 | 826.299 | 23.253 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 849.552 | 826.299 | 23.253 |
| 1/1/91 | Pre-Payment Applied | (25.117) | (24.430) | (687) |
| | Interest To Year End | <u>74.199</u> | <u>72.168</u> | <u>2.031</u> |
| 12/31/91 | Required Funding | 898.634 | 874.037 | 24.597 |
| | Contribution | (1,218.295) | (1,194.026) | (24.269) |
| | Interest to 12/31/91 | <u>(16.447)</u> | <u>(16.119)</u> | <u>(328)</u> |
| 12/31/91 | Under (Over) Funding | <u><u>(\$336.108)</u></u> | <u><u>(\$336.108)</u></u> | <u><u>\$0</u></u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|----------|----------------------|---------------------------|---------------------------|-------------------|
| 1/1/92 | Normal Cost | \$996.648 | \$925.584 | \$71.064 |
| 1/1/92 | Amortization Payment | <u>(117.825)</u> | <u>(76.162)</u> | <u>(41.663)</u> |
| 1/1/92 | CAS Pension Cost | 878.823 | 849.422 | 29.401 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 878.823 | 849.422 | 29.401 |
| 1/1/92 | Pre-Payment Applied | (336.108) | (324.864) | (11.244) |
| | Interest To Year End | <u>48.844</u> | <u>47.210</u> | <u>1.634</u> |
| 12/31/92 | Required Funding | 591.559 | 571.768 | 19.791 |
| | Contribution | (1,214.651) | (1,195.482) | (19.169) |
| | Interest to 12/31/92 | <u>(39.431)</u> | <u>(38.809)</u> | <u>(622)</u> |
| 12/31/92 | Under (Over) Funding | <u><u>(\$662.523)</u></u> | <u><u>(\$662.523)</u></u> | <u><u>\$0</u></u> |

| | | | | |
|----------|----------------------|-----------------------------|-----------------------------|-------------------|
| 1/1/93 | Normal Cost | \$1,254.251 | \$1,168.929 | \$85.322 |
| 1/1/93 | Amortization Payment | <u>143.226</u> | <u>168.864</u> | <u>(25.638)</u> |
| 1/1/93 | CAS Pension Cost | 1,397.477 | 1,337.793 | 59.684 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 1,397.477 | 1,337.793 | 59.684 |
| 1/1/93 | Pre-Payment Applied | (662.523) | (634.228) | (28.295) |
| | Interest To Year End | <u>62.471</u> | <u>59.803</u> | <u>2.668</u> |
| 12/31/93 | Required Funding | 797.425 | 763.368 | 34.057 |
| | Contribution | (1,824.732) | (1,791.563) | (33.169) |
| | Interest to 12/31/93 | <u>(48.873)</u> | <u>(47.985)</u> | <u>(888)</u> |
| 12/31/93 | Under (Over) Funding | <u><u>(\$1,076.180)</u></u> | <u><u>(\$1,076.180)</u></u> | <u><u>\$0</u></u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|----------|----------------------|----------------------|----------------------|---------------------|
| 1/1/94 | Normal Cost | \$1,486,670 | \$1,387,170 | \$99,500 |
| 1/1/94 | Amortization Payment | <u>306,907</u> | <u>318,150</u> | <u>(11,243)</u> |
| 1/1/94 | CAS Pension Cost | 1,793,577 | 1,705,320 | 88,257 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 1,793,577 | 1,705,320 | 88,257 |
| 1/1/94 | Pre-Payment Applied | (1,076,180) | (1,023,224) | (52,956) |
| | Interest To Year End | <u>57,392</u> | <u>54,568</u> | <u>2,824</u> |
| 12/31/94 | Required Funding | 774,789 | 736,664 | 38,125 |
| | Contribution | (2,331,253) | (2,294,118) | (37,135) |
| | Interest to 12/31/94 | <u>(62,142)</u> | <u>(61,152)</u> | <u>(990)</u> |
| 12/31/94 | Under (Over) Funding | <u>(\$1,618,606)</u> | <u>(\$1,618,606)</u> | <u>\$0</u> |

| | | | | |
|----------|----------------------|----------------------|----------------------|-----------------|
| 1/1/95 | Normal Cost | \$1,361,420 | \$1,263,438 | \$97,982 |
| 1/1/95 | Amortization Payment | <u>(1,351)</u> | <u>20,990</u> | <u>(22,341)</u> |
| 1/1/95 | CAS Pension Cost | 1,360,069 | 1,284,428 | 75,641 |
| | Credit Absorbed | <u>0</u> | <u>0</u> | <u>0</u> |
| | CAS Funding Target | 1,360,069 | 1,284,428 | 75,641 |
| 1/1/95 | Pre-Payment Applied | (1,360,069) | (1,284,428) | (75,641) |
| | Interest To Year End | <u>0</u> | <u>0</u> | <u>0</u> |
| 12/31/95 | Required Funding | 0 | 0 | 0 |
| | Contribution | (1,874,737) | (1,874,737) | 0 |
| | Interest to 12/31/95 | <u>(67,645)</u> | <u>(67,645)</u> | <u>0</u> |
| 12/31/95 | Under (Over) Funding | <u>(\$1,942,382)</u> | <u>(\$1,942,382)</u> | <u>\$0</u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

FOOTNOTES

- 1/ We obtained the total company normal costs from Oklahoma's actuarial valuation reports. We obtained normal costs for the Medicare segment from data files provided by Oklahoma's actuary.
- 2/ We based the amortization payments on a CAS amortization schedule developed from information obtained from Oklahoma's valuation reports and IRS Form 5500 reports.
- 3/ The CAS pension cost represents the sum of the normal cost and the amortization payment. We separately calculated the CAS pension cost for the Medicare segment for the years 1992 through 1995. The amounts shown for the "other segment" represent the difference between the total company and the Medicare segment.
- 4/ The credit absorbed represents the portion of the accumulated unabsorbed credit that is used to fund the current year CAS pension cost. The credit is used first to fund the CAS pension cost before any current or prepaid contributions are considered for funding. Oklahoma had no accumulated unabsorbed credits for any plan year through 1996.
- 5/ The CAS funding target represents the annual CAS pension cost, adjusted with interest to the end of the year, that must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 31.205-6 (j).
- 6/ The prepayment credit represents the negative unfunded CAS pension costs from the previous year(s). We carried forward the prepayment credit, with interest, until needed to fund future CAS pension costs.
- 7/ We applied one years' interest at Oklahoma's assumed rates for each year. The assumed rates were 8% for plan years 1986 through 1988, and 1994, 9% for plan years 1989 through 1992, and 8.5% for 1993, 1995, and 1996. We obtained the interest rates from Oklahoma's actuarial valuation reports.
- 8/ The required funding represents the CAS funding target adjusted for interest earned and prepayment credits applied.
- 9/ Oklahoma did not make a contribution to its pension plan for 1989. However, it did make contributions to the plan for years 1986 through 1988, and 1990 through 1995. We assigned the contribution to the Medicare segment based on the segment's required funding.

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF CAS PENSION COSTS AND FUNDING

May 1, 1986 To January 1, 1996

- 10/ We applied interest on the contributions from the date of deposit to the end of year using Oklahoma's assumed rates of interest (same as number 7 above). We did not include any interest for deposits made to the trust fund after year-end.
- 11/ We computed the unfunded pension cost by subtracting the value of contributions and interest at year-end from the required funding. We calculated a prepayment credit (a negative value) in those instances where our computed CAS pension costs were less than the contributions. Oklahoma may carry forward the prepayment credit to fund future CAS pension costs.

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF UNALLOWABLE PENSION COSTS

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|------------|---------------------------|------------------|------------------|---------------------|
| 04/30/1987 | Current Unfunded Cost | <u>\$0</u> | <u>\$0</u> | <u>\$0</u> |
| 05/01/1987 | 1/ Unfunded Pension Costs | 0 | 0 | 0 |
| | 2/ Interest | 0 | 0 | 0 |
| 04/30/1988 | 3/ Current Unfunded Cost | <u>6,485</u> | <u>6,346</u> | <u>139</u> |
| 05/01/1988 | Unfunded Pension Costs | 6,485 | 6,346 | 139 |
| | Interest | 519 | 508 | 11 |
| 04/30/1989 | Current Unfunded Cost | <u>227,230</u> | <u>221,041</u> | <u>6,189</u> |
| 05/01/1989 | Unfunded Pension Costs | 234,234 | 227,895 | 6,339 |
| | Interest | 14,055 | 13,675 | 380 |
| 12/31/1989 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1990 | Unfunded Pension Costs | 248,289 | 241,570 | 6,719 |
| | Interest | 22,346 | 21,741 | 605 |
| 12/31/1990 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1991 | Unfunded Pension Costs | 270,635 | 263,311 | 7,324 |
| | Interest | 24,357 | 23,698 | 659 |
| 12/31/1991 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1992 | Unfunded Pension Costs | 294,992 | 287,009 | 7,983 |
| | Interest | 26,549 | 25,831 | 718 |
| 12/31/1992 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1993 | Unfunded Pension Costs | 321,541 | 312,840 | 8,701 |
| | Interest | 27,331 | 26,591 | 740 |
| 12/31/1993 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1994 | Unfunded Pension Costs | 348,872 | 339,431 | 9,441 |
| | Interest | 27,910 | 27,155 | 755 |
| 12/31/1994 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1995 | Unfunded Pension Costs | 376,782 | 366,586 | 10,196 |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
STATEMENT OF UNALLOWABLE PENSION COSTS

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|------------|------------------------|------------------|------------------|---------------------|
| 01/01/1995 | Unfunded Pension Costs | 376,782 | 366,586 | 10,196 |
| | Interest | 32,026 | 31,159 | 867 |
| 12/31/1995 | Current Unfunded Cost | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1996 | Unfunded Pension Costs | <u>\$408,808</u> | <u>\$397,745</u> | <u>\$11,063</u> |

FOOTNOTES

- 1/ Unfunded pension costs represent the total pension costs and accrued interest that could have been funded by Oklahoma but were not. These costs are unallowable for future periods per CAS 9904.412-50(a)(2) and (7). They must be separately updated, with interest, and eliminated from any costs claimed in future periods.
- 2/ We applied interest to the unfunded pension costs using Oklahoma's assumed rates for each year. The assumed rates were 8% for plan years 1986 through 1988, and 1994, 9% for plan years 1989 through 1992, and 8.5% for 1993, 1995, and 1996. We obtained the assumed rates from Oklahoma's actuarial valuation reports.
- 3/ Current unfunded costs represent the yearly-unfunded costs. 1988 and 1989 were the only years that Oklahoma chose not to fully fund its pension costs.

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA

PENSION COSTS SUBJECT TO FULL FUNDING LIMITATION

May 1, 1986 To January 1, 1996

| Date | Description | Total Company | Other Segment | Medicare Segment |
|------------|-------------------------|--------------------|--------------------|---------------------|
| 04/30/1987 | Current Nondeductible | <u>\$0</u> | <u>\$0</u> | <u>\$0</u> |
| 05/01/1987 | Assignable Cost Deficit | 0 | 0 | 0 |
| | Interest | 0 | 0 | 0 |
| 04/30/1988 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 05/01/1988 | Assignable Cost Deficit | 0 | 0 | 0 |
| | Interest | 0 | 0 | 0 |
| 04/30/1989 | Current Nondeductible | <u>320,318</u> | <u>311,595</u> | <u>8,723</u> |
| 05/01/1989 | Assignable Cost Deficit | 320,318 | 311,595 | 8,723 |
| | Interest | 19,220 | 18,697 | 523 |
| 12/31/1989 | Current Nondeductible | <u>506,546</u> | <u>465,364</u> | <u>41,182</u> |
| 01/01/1990 | Assignable Cost Deficit | 846,084 | 795,656 | 50,428 |
| | Interest | 76,148 | 71,609 | 4,539 |
| 12/31/1990 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1991 | Assignable Cost Deficit | 922,232 | 867,265 | 54,967 |
| | Interest | 83,001 | 78,054 | 4,947 |
| 12/31/1991 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1992 | Assignable Cost Deficit | 1,005,233 | 945,319 | 59,914 |
| | Interest | 90,471 | 85,079 | 5,392 |
| 12/31/1992 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1993 | Assignable Cost Deficit | 1,095,704 | 1,030,398 | 65,306 |
| | Interest | 93,135 | 87,584 | 5,551 |
| 12/31/1993 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1994 | Assignable Cost Deficit | 1,188,839 | 1,117,982 | 70,857 |
| | Interest | 95,107 | 89,438 | 5,669 |
| 12/31/1994 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1995 | Assignable Cost Deficit | 1,283,946 | 1,207,420 | 76,526 |
| | Interest | 109,135 | 102,630 | 6,505 |
| 12/31/1995 | Current Nondeductible | <u>0</u> | <u>0</u> | <u>0</u> |
| 01/01/1996 | Assignable Cost Deficit | <u>\$1,393,081</u> | <u>\$1,310,050</u> | <u>\$83,031</u> |

BLUE CROSS AND BLUE SHIELD OF OKLAHOMA
PENSION COSTS SUBJECT TO FULL FUNDING LIMITATION

May 1, 1986 To January 1, 1996

FOOTNOTES

- 1/ The assignable cost deficit represents the accumulated costs from prior years, with interest, that were not funded due to the ERISA tax maximum regulations.
- 2/ We applied one years' interest at Oklahoma's assumed rates for each year. The assumed rates were 8% for plan years 1986 through 1988, and 1994, 9% for plan years 1989 through 1992, and 8.5% for 1993, 1995, and 1996.
- 3/ CAS pension cost for the current plan year as of December 31 of that year. These amounts were not funded because the contractor was subject to an excise tax on contributions during these periods.



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June 1, 2001

Mr. Greg Tambke
HHS/OIG/OAS
2425 Hyde Park Road
Jefferson City, Missouri 65109

Dear Greg:

I am writing in regards to the following Office of Inspector General (OIG) Audit Reports:

- Review of Medicare Contractor Pension Segmentation
Blue Cross Blue Shield of Oklahoma # A-07-00-00106
- Review of Unfunded Pension Costs of Blue Cross Blue Shield of Oklahoma
A 07-01-00120
- Review of Pension Costs Claimed for Medicare Reimbursement by
Blue Cross Blue Shield of Oklahoma # A 07-01-00121

Upon reviewing the information in the Office of Inspector General (OIG) audit report entitled "Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield of Oklahoma" with our actuaries, we have the following response to the findings:

1. Regarding the net transfer adjustments during calendar years 1997 and 1998 (reflected in valuations as of 1/1/1998 and 1/1/1999, respectively), we did base the liability amounts on the ABCM. We do not agree with the claim that these amounts "used an incorrect cost method to value transfers" (page 5) for 1997 and 1998. However, in working through the transfers with HCFA's actuary, Eric Shipley, we discovered that the timing of the recognition of some of the transfers was off by one year (some transfers occurred during 1996 that were reflected in our valuations as having transferred during 1997). We have provided Eric with revised transfer amounts to reflect the proper year of transfer for these individuals.
2. Under net transfer adjustments to the Medicare Segment on page 6, the 1998 value for OK should be (338,029). This is reflected in our Medicare Segment asset development in the CAS Pension Cost section of our 1999 actuarial report. The (579,881) amount that is reflected appears to be the sum of the net transfers (338,029) and the benefit payments



BlueCross BlueShield
of Oklahoma

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*A HCFA Contracted
Intermediary*

Mr. Greg Tambke
June 1, 2001
Page 2

(241,852). However, since the (241,852) amount is also reflected on page 7 under Benefit Payments to Retirees, we feel that this amount should not be double counted. Otherwise, we have no objections to any other items within this report.

We have also reviewed the OIG's audit reports entitled "Review of Unfunded Pension Costs of Blue Cross and Blue Shield of Oklahoma" and "Review of Pension Costs Claimed for Medicare Reimbursement by Blue Cross and Blue Shield of Oklahoma". Although we have no comments on the process and methodologies within these reports, we would like to note that the results within these reports should change based on any adjustments that may be made to the results reflected in the report entitled "Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield of Oklahoma".

Please call me at (918) 560-2090 or Jay Pinkerton (Chicago Consulting Actuaries; (312) 454-8167) if you have any questions or need any additional information.

Sincerely,

/s/

Garoldine Y. Webb

cc: Mr. David Manuszak, Blue Cross Blue Shield Association
Ms. Carol Navin, Blue Cross Blue Shield Association
Mr. John Thomas, Group Health Service of Oklahoma, Inc.
Ms. Kathy Durfee, Group Health Service of Oklahoma, Inc.

Appendix E

**AUDIT REPORT CIN: A-07-01-00120
BLUE CROSS AND BLUE SHIELD OF OKLAHOMA**

**INDIVIDUALS HAVING ACCESS TO SOURCE
INFORMATION REGARDING THIS AUDIT REPORT**

Greg Tambke, Audit Manager
Scott Englund, Senior Auditor
Dave Imhoff, Auditor
Ashok Mullick, Auditor

Class of Persons Having Access To This Report

Office Administrative Personnel