



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

OCT 04 2004

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

Report Number: A-07-04-00164

Mr. Steven E. Kerr, CPA
Director of Financial Management Reporting
Blue Cross Blue Shield of Tennessee
801 Pine Street
Chattanooga, Tennessee 37402-2555

Dear Mr. Kerr:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) report entitled "Review of Supplemental Executive Retirement Program (SERP) Costs Claimed by Blue Cross Blue Shield of Tennessee (Tennessee)". A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made to the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, ext. 225 or Jenenne Tambke, Audit Manager at (573) 893-8338, ext. 21 or through e-mail at jenenne.tambke@oig.hhs.gov. To facilitate identification, please refer to Report Number A-07-04-00164 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad".

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures – as stated

Page 2 – Mr. Steven E. Kerr, CPA

Directly Reply to HHS Action Official:

Rose Crum-Johnson
Regional Administrator
Centers for Medicare & Medicaid Services
Atlanta Federal Center
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303-8909

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF SUPPLEMENTAL
EXECUTIVE RETIREMENT PROGRAM
(SERP) COSTS CLAIMED BY BLUE
CROSS BLUE SHIELD OF TENNESSEE
(TENNESSEE)**



**AUGUST 2004
A-07-04-00164**

Office of Inspector General

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the awarding agency will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Tennessee (Tennessee) administers Medicare Part A operations under a cost reimbursement contract with Centers for Medicare & Medicaid Services (CMS).

Tennessee had a Supplemental Executive Retirement Program (SERP) to provide deferred compensation for a select group of management and highly compensated employees through a nonqualified pension plan.

In claiming costs for Medicare reimbursement, Tennessee must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and the Medicare contract.

OBJECTIVE

To determine the allowability of SERP costs claimed by Tennessee for Medicare reimbursement for Fiscal Years (FYs) 1994 through 2002.

SUMMARY OF FINDING

For FYs 1994 through 2002, Tennessee claimed unallowable Medicare SERP costs of \$548,944. Tennessee claimed \$765,691 based on accrued costs allocated to Medicare. However, Tennessee did not fund the costs accrued for the SERP; thus, according to CAS, the allowable costs are limited to the plan's benefit payments. The allowable costs based on benefit payments were \$216,747. As a result, Tennessee claimed unallowable SERP costs of \$548,944 (\$765,691 less \$216,747) for Medicare reimbursement.

RECOMMENDATION

Tennessee should revise its Final Administrative Cost Proposals (FACPs) for FYs 1994 through 2002 to reduce its claimed SERP costs by \$548,944.

AUDITEE COMMENTS

Tennessee agreed with our report, and stated they would revise their FACPs for FYs 1994 through 2002. Tennessee's comments are shown in their entirety as Appendix B.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FACP	Final Administrative Cost Proposal
FAR	Federal Acquisition Regulations
FY	Fiscal Year
SERP	Supplemental Executive Retirement Program
Tennessee	Blue Cross and Blue Shield of Tennessee

INTRODUCTION

BACKGROUND

Medicare

Tennessee administers Medicare Part A operations under a cost reimbursement contract. In claiming costs, contractors were to follow cost reimbursement principles contained in FAR, CAS, and the Medicare contract.

Medicare reimburses its portion of Tennessee's annual pension costs. 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.

Tennessee SERP

Tennessee established its SERP on June 1, 1992 to provide deferred compensation for a select group of management and highly compensated employees. The employees can elect to have the deferred compensation as either a lump sum or a life annuity. The SERP is a nonqualified pension plan designed to restore benefits lost under the regular qualified plan due to the Internal Revenue Code 401 (a)(17) and 415 limits. The SERP is a supplemental pension plan, which in combination with the regular pension plan provides a single pension benefit promise to participants.

Tennessee amended their SERP on December 31, 1995 to provide benefits for employees that separated under a Voluntary Separation Agreement Offering. Additionally, Tennessee amended their SERP as of January 1, 1999 and December 1, 2000 to provide for the establishment of a trust that could be used for the funding of the SERP. However, through FY 2002 Tennessee did not make any contributions to the trust for the funding of their SERP costs.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

The objective of our review was to determine the allowability of SERP costs claimed for Medicare reimbursement for FYs 1994 through 2002.

Scope

We reviewed Tennessee's SERP costs claimed on its FACPs for FYs 1994 through 2002. Achieving the objective did not require a review of Tennessee's internal control structure.

We performed site work at Tennessee's corporate office in Chattanooga, Tennessee.

Methodology

Tennessee provided us with a schedule of Medicare SERP costs claimed on its FACPs for FYs 1994 through 2002. We obtained SERP benefit payments from Tennessee. We also obtained Tennessee's Medicare salary ratio for each FY. We applied the Medicare salary ratio to allocable benefit payments to calculate allowable SERP costs. Our calculations are shown in APPENDIX A.

We performed this review in conjunction with our audits of Tennessee's pension segmentation (Report Number: A-07-03-03043), unfunded pension costs (Report Number: A-07-04-03054), and pension costs claimed (Report Number: A-07-04-00165). The information obtained and reviewed during those audits was also used in performing this review.

Our review was performed in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATION

Tennessee claimed Medicare SERP costs of \$765,691. Tennessee based its claims on Medicare's allocation of accrued pension costs. However, Tennessee did not fund the costs accrued for the SERP; thus, according to CAS, the allowable costs are limited to the plan's benefit payments. During this period, the allowable Medicare SERP costs based on benefit payments were \$216,747. As a result, Tennessee claimed unallowable SERP costs of \$548,944 (\$765,691 less \$216,747) for Medicare reimbursement.

CRITERIA: MEDICARE CONTRACT & CAS

Medicare Contract

The determination and allocation of pension costs are addressed by the Medicare contract, which states:

“The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413.

CAS

CAS 412 governs the costs of pension plans. CAS 412.30(a)(20), as amended, defines a pension plan as:

“a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees may be an integral part of a pension plan.”

According to CAS 412.50 (c)(3), the cost of nonqualified defined-benefit pension plans shall be assigned to cost accounting periods in the same manner as qualified plans under the following conditions:

- (i) The contractor, in disclosing or establishing cost accounting practices, elects to have a plan so accounted for;
- (ii) The plan is funded through the use of a funding agency; and,
- (iii) The right to a pension benefit is nonforfeitable and is communicated to the participants.

If a plan does not meet all of the above requirements, the CAS 412.50 (c)(4) states the costs must be assigned using the pay-as-you-go method.

The allocable costs for pay-as-you-go plans are stipulated in CAS 412.50 (b)(3). According to CAS 412.50 (b)(3), the allocable costs are:

- (i) The net amount for any periodic benefits paid for that period, and
- (ii) The level annual installment required to amortize over 15 years any lump-sum benefit payments.

CONDITION: UNFUNDED SERP

Tennessee claimed Medicare SERP costs of \$765,691. Tennessee based its claims on Medicare’s allocation of accrued pension costs.

Tennessee’s SERP plan was not funded. If not funded, the costs of nonqualified defined-benefit plans, such as a SERP, must be based on the pay-as-you-go method. The allowable costs for plans under the pay-as-you-go method are based on allocable benefits paid to participants. Allocable benefits paid are the sum of amortized lump-sum benefit payments, plus annuity benefit payments. The allowable costs for Tennessee’s SERP are developed in Appendix A.

CAUSE: INADEQUATE CONTROLS

Tennessee did not have adequate controls to ensure that its Medicare SERP costs were funded in accordance with CAS.

EFFECT: OVERSTATED SERP COSTS

For FYs 1994 through 2002, Tennessee claimed SERP costs of \$765,691 for Medicare reimbursement. However, the allowable CAS SERP costs were \$216,747 (Appendix A). As a result, Tennessee overstated its Medicare SERP costs by \$548,944. The costs claimed, allowable costs, and overstated SERP costs, by year were:

MEDICARE OVERSTATED SERP COSTS

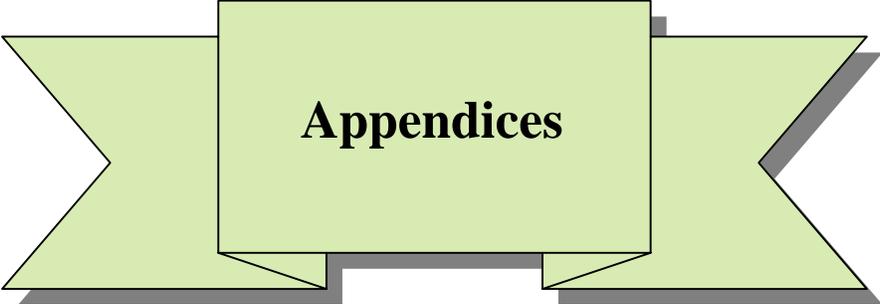
FISCAL YEAR	MEDICARE CLAIMED SERP COSTS	MEDICARE ALLOWABLE SERP COSTS	MEDICARE OVERSTATED SERP COSTS
1994	\$ 1,706	\$ 0	\$ 1,706
1995	14,834	9,778	5,056
1996	430	19,901	(19,471)
1997	53,431	21,396	32,035
1998	41,466	22,741	18,725
1999	45,684	19,726	25,958
2000	126,055	32,994	93,061
2001	202,797	43,964	158,833
2002	<u>279,288</u>	<u>46,247</u>	<u>233,041</u>
TOTAL	<u>\$765,691</u>	<u>\$216,747</u>	<u>\$548,944</u>

RECOMMENDATION

Tennessee should revise its FACPs for FYs 1994 through 2002 to reduce its claimed SERP costs by \$548,944.

AUDITEE COMMENTS

Tennessee agreed with our report, and stated they would revise their FACPs for FYs 1994 through 2002. Tennessee's comments are shown in their entirety as Appendix B.



Appendices

BLUE CROSS BLUE SHIELD OF TENNESSEE
STATEMENT OF ALLOWABLE SERP COSTS
FOR FISCAL YEARS 1994 THROUGH 2002

Fiscal Year	Amortized Lump-Sum Benefit Payments Note 1/	Annuity Benefit Payments Note 2/	Allocable Total Benefit Payments Note 3/	Medicare Salary Ratio Note 4/	Medicare Allowable SERP Costs Note 5/
1994	\$ 0	\$ 0	\$ 0	.0564	\$ 0
1995	133,285	72,997	206,282	.0474	9,778
1996	177,714	253,968	431,682	.0461	19,901
1997	177,714	255,404	433,118	.0494	21,396
1998	180,512	255,143	435,655	.0522	22,741
1999	189,253	161,124	350,377	.0563	19,726
2000	191,857	322,866	514,723	.0641	32,994
2001	233,637	241,138	474,775	.0926	43,964
2002	<u>245,676</u>	<u>241,138</u>	<u>486,814</u>	.0950	<u>46,247</u>
TOTAL	<u>\$1,529,648</u>	<u>\$1,803,778</u>	<u>\$3,333,426</u>		<u>\$216,747</u>

FOOTNOTES

- 1/ Tennessee provided a schedule of lump-sum benefit payments. In accordance with CAS 412.50 (b)(3), we amortized the lump-sum benefit payments, including an interest equivalent, ratably over a 15-year period.
- 2/ Tennessee provided us with total benefit payments for each fiscal year. We subtracted lump-sum benefit payments from total benefit payments to determine annuity benefit payments.
- 3/ Allocable total benefit payments are the sum of (i) amortized lump-sum benefit payments, and (ii) annuity benefit payments. Allocable total benefit payments differ from the total benefit payments provided us by Tennessee due to the amortization of lump-sum benefit payments.
- 4/ Tennessee provided us with Medicare's percentage of corporate salaries for each fiscal year.
- 5/ Medicare allowable SERP costs are total benefit payments multiplied by the Medicare salary ratio.



**BlueCross BlueShield
of Tennessee**

801 Pine Street
Chattanooga, Tennessee 37402-2555

www.bcbst.com

August 16, 2004

Mr. James P. Aasmundstad
Regional Inspector General for Audit Services
DHHS/OIG/OAS
601 East 12th Street, Room 284A
Kansas City, Missouri 64106

Subject: Contractor (BlueCross BlueShield of Tennessee) Responses to Draft Audit Reports

Dear Mr. Aasmundstad:

We have reviewed and are responding to the following draft audit reports:

Pension Segmentation (Report No. A-07-04-0343) - Our pension actuaries, Chicago Consulting Actuaries (CCA) and our Human Resources personnel have reviewed this report. We agree with the report. CCA has supplied their response to this report with the following commitment: "...CCA intends to apply the recommendation that Medicare segment assets be reduced by this amount in the future cost reimbursement calculations". BlueCross BlueShield of Tennessee (BCBST) has already outlined procedural enhancements that will provide several levels of review for Medicare personnel listings being sent to CCA for use in the segmentation calculation process.

Unfunded Pension Costs (Report No. A-07-04-00165) - The CCA actuaries have reviewed this report and have responded as follows: "We agree with the findings described in report 00165...CCA intends to apply the recommendation that these amounts be reflected in future cost reimbursement calculations." BCBST will be following up with reviews and discussions with CCA to assure that all changes are completed.

Pension Costs Claimed (Report No. A-07-04-03054) - Taking into consideration the issues and conclusions drawn from the Segmentation Report, BCBST agrees with this report. We are ready to make appropriate FACP adjustments to clear all outstanding pension cost variances upon receipt of final directions. With the corrective actions associated with the Segmentation Report, differences of this nature will be self-correcting. We await further feedback from the actuaries associated with this audit, who indicated during their onsite visit that the unclaimed undercharges from the previous audit (CIN: A-07-94-00815) would be taken into account and addressed in this audit.

Supplemental Executive Retirement Program (SERP) Costs Claimed (Report No. A-07-04-00164) - We have reviewed the report and the quoted Cost Accounting Standards and we concur with the audit finding. We will be adjusting the appropriate FACPs for the fiscal years 1994 through 2002. We are modifying our financial procedures to include an on-going tracking report that will provide amortization data for our Medicare cost reporting.

We appreciate the professionalism exhibited by the OIG team association with this audit. Please keep us informed as to any revisions to these draft reports.

Sincerely,

Harold H. Cantrell, Jr.
Vice President, Finance

cc: Steve Kerr, Dir., Financial Mgmt. Rptg.
David Deal, Sr. VP and CFO