



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

May 24, 2004

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

Report Number: A-07-04-00167

Christopher Woodfin
Vice President of Finance
Blue Cross Blue Shield of North Carolina
P.O. Box 2291
Durham, North Carolina 27702-2291

Dear Mr. Woodfin:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of Inspector General report titled "Audit of the Post Retirement Benefits Costs Claimed by Blue Cross Blue Shield of North Carolina for Fiscal Year's 1993 through 2002." 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 by 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.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the department's grantees and contractors are made available 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.)

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 email at Jenenne.Tambke@oig.hhs.gov. To facilitate identification, please refer to report number A-07-04-00167 in all correspondence.

Sincerely,

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

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

Enclosure

CMS Action Official

Ms. Rose Crum-Johnson
Regional Administrator, Region IV
Centers for Medicare & Medicaid Services
Sam Nunn Atlanta Federal Center
4th Floor 61 Forsythe Street, SW Suite 4T20
Atlanta, Georgia 30303

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF THE POST RETIREMENT
BENEFITS COSTS CLAIMED BY
BLUE CROSS BLUE SHIELD
OF NORTH CAROLINA FOR FISCAL
YEAR'S 1993 THROUGH 2002**



**MAY 2004
A-07-04-00167**

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

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The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs.

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Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

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In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

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

North Carolina administered Medicare Part A under cost reimbursement contracts until the contractual relationship terminated on October 31, 2001. In claiming costs, contractors were to follow cost reimbursement principles contained in Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and the Medicare contracts.

FAR sets forth the allowability requirements and applicable methods of accounting for post retirement benefits (PRB) costs under a Government contract. The PRB costs can include, but are not limited to post-retirement health care, life insurance provided outside a pension plan, and other welfare benefits, such as tuition assistance, day care, legal services, and housing subsidies provided after retirement.

FAR 31 allows contractors to choose one of three accounting methods for measuring and assigning PRB costs to accounting periods. FAR further states that to be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof.

OBJECTIVE

The audit objective was to determine the allowability of PRB costs claimed for Medicare reimbursement by North Carolina for FY's 1993 through 2002.

FINDING

For FY's 1993 through 2002, North Carolina did not claim \$616,846 of PRB costs that were allowable for Medicare reimbursement. North Carolina did not include all of the PRB costs that were allowable per Government regulations.

RECOMMENDATION

North Carolina should revise its FACPs for FY's 1993 through 2002 to claim additional allowable PRB costs of \$616,846.

AUDITEE'S COMMENT

North Carolina agreed with the audit recommendation. North Carolina's comments are included in their entirety as Appendix C.

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Glossary of Abbreviations and Acronyms

FAR	Federal Acquisition Regulations
CAS	Cost Accounting Standards
FPR	Federal Procurement Regulations
OIG	Office of Inspector General
OAS	Office of Audit Services
CMS	Centers for Medicare & Medicaid Services
PRB	Post-Retirement Benefits

INTRODUCTION

BACKGROUND

Medicare

North Carolina administered Medicare Part A under cost reimbursement contracts until the contractual relationship terminated on October 31, 2001. In claiming costs, contractors were to follow cost reimbursement principles contained in FAR, CAS, and the Medicare contracts.

FAR sets forth the allowability requirements and applicable methods of accounting for PRB costs under a Government contract. PRB costs can include, but are not limited to post-retirement health care, life insurance provided outside a pension plan, and other welfare benefits, such as tuition assistance, day care, legal services, and housing subsidies provided after retirement. PRBs do not cover cash benefits and life insurance benefits paid by pension plans during the period following the employees' retirement.

FAR 31 allows contractors to choose one of three accounting methods for measuring and assigning PRB costs to accounting periods. FAR further states that to be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof.

Beginning in 1993, Statement of Financial Accounting Standards (SFAS) 106 required contractors to report the accrued liability and expense for PRBs for current and retired employees in their financial statements. FAR allows contractors the option of electing SFAS 106 accrual accounting for funded PRBs, or recognizing PRB costs on the cash or terminal funding basis for Government contract purposes, if that had been their practice. CAS likewise allows contractors the option of electing accrual accounting in accordance with generally accepted accounting principles for funded retiree insurance programs, or recognizing the cost of retiree insurance programs on the cash or terminal funding basis for Government contract purposes.

Regulations

According to FAR 31.205-6(o)(2), PRB costs can be calculated using one of the following:

Cash Basis (or pay-as-you-go) - recognizes PRB costs when they are paid.

Terminal Funding - recognizes the entire PRB liability as a lump sum payment upon termination of employees. The lump sum payment must be remitted to an insurer or trustee for the purpose of providing PRBs to retirees. The lump sum payment is allowable if amortized over a period of 15 years.

Accrual Basis - measures and assigns costs according to generally accepted accounting principles and pays an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRBs to retirees. The accrual must be

calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

FAR further states that to be allowable, costs must be funded by the time set for filing the Federal income tax return or any extension thereof. PRB costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year. FAR also disallows any increased costs caused by a delay in funding.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

The audit objective was to determine the allowability of PRB costs claimed for Medicare reimbursement by North Carolina for FY's 1993 through 2002.

Scope and Methodology

We performed this review in conjunction with our audits of pension segmentation¹ and pension costs² for a terminated contractor. We used the information obtained from the prior audits in performing this review. We did not review North Carolina's internal control structure.

We identified North Carolina's PRB costs for the total company and for the Medicare segment. We also determined the extent to which North Carolina funded the PRB costs with contributions to the VEBA trust fund. Using this information, we calculated PRB costs that are allowable for Medicare reimbursement for FY's 1993 through 2002. Appendices A and B contains the details for PRB costs and contributions.

The Centers for Medicare & Medicaid Services Office of Actuary and the Office of Inspector General developed the methodology used for computing allowable PRB costs based on North Carolina's historical practices. We performed on site work at North Carolina's corporate offices in Durham, North Carolina.

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

FINDING AND RECOMMENDATION

For FY's 1993 through 2002, North Carolina did not claim \$616,846 of PRB costs that were allowable for Medicare reimbursement. North Carolina did not include all of the PRB costs that were allowable per Government regulations.

¹Report Number A-07-02-03017, Blue Cross Blue Shield of North Carolina Pension Segment Closing Audit, issued final on February 6, 2003.

² Report Number A-07-02-03030, Blue Cross Blue Shield of North Carolina Pension Costs Claimed for Medicare Reimbursement, issue final on April 29, 2003.

Criteria - Government Regulations for Claiming PRB Costs

In 1990, the Financial Accounting Standards Board issued SFAS 106, which established accounting standards for PRBs. SFAS 106 significantly changed the practice of accounting for PRBs from the cash basis to the accrual basis.

With the implementation of SFAS 106, companies are required to report in their financial statements the accrued liability for PRBs for current and retired employees. SFAS 106 requires the annual reporting of net periodic service costs, as well as a transition obligation (i.e., a cumulative effect of an accounting change) which may be recognized either immediately or amortized on a straight line basis over the average remaining service of active plan participants.

FAR allows contractors the option of electing SFAS 106 accrual accounting. Additionally, FAR requires the amortization of the transition obligation amount due to a change in accounting methodology.

Since FAR 31.205-6 (o) relies on SFAS 106 for the accounting measurement, the trust must also be recognized as a plan asset. According to SFAS 106:

“Assets not segregated in a trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes are not plan assets for purposes of this Statement, even though the employer may intend that those assets be used to provide postretirement benefits.”

Condition and Cause - North Carolina Under Claimed PRB Costs

For FY’s 1993 through 2002, North Carolina did not claim PRB costs that were allowable for Medicare reimbursement. North Carolina did not include all of the PRB costs that were allowable to the extent that the accrued costs were funded by deposits to the VEBA trusts, or by the prepayment credit carry-forwards.

The following schedule provides a comparison of allowable PRB costs as calculated by North Carolina and the OIG.

FY	Per NC	Per OIG	Difference
1993	\$84,739	\$124,472	\$ (39,733)
1994	102,052	225,799	(123,747)
1995	102,052	210,993	(108,941)
1996	194,418	84,511	109,907
1997	13,046	83,597	(70,551)
1998	(4,988)	157,914	(162,902)
1999	118	71,581	(71,463)
2000	137	6,591	(6,454)
2001	18,543	145,777	(127,234)
2002	470	16,198	(15,728)
Total	<u>\$ 510,587</u>	<u>\$ 1,127,433</u>	<u>\$ (616,846)</u>

Effect – North Carolina Under Claimed Allowable PRB Costs Totaling \$616,846

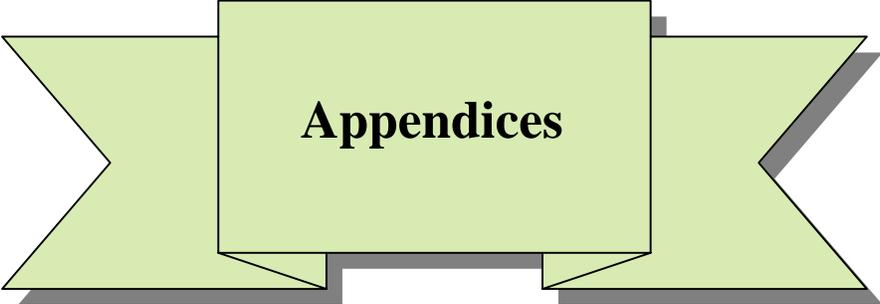
For FY's 1993 through 2002, North Carolina did not claim \$616,846 in PRB costs that were allowable for Medicare reimbursement.

RECOMMENDATION

North Carolina should revise its FACPs for FY's 1993 through 2002 to claim additional allowable PRB costs of \$616,846.

AUDITEE'S COMMENT

North Carolina agreed with the audit recommendation. North Carolina's comments are included in their entirety as Appendix C.



Appendices

BLUE CROSS BLUE SHIELD OF NORTH CAROLINA
STATEMENT OF ALLOWABLE PRB COSTS

Description	01/01/1993	01/01/1994	01/01/1995	01/01/1996	01/01/1997	01/01/1998	01/01/1999	01/01/2000	01/01/2001	
1. Accrual Cost Adjusted for FAR/CAS										
Service Cost (EOY)	\$942,081	\$1,050,754	\$1,178,203	\$1,621,690	\$1,812,956	\$1,825,505	\$590,854	\$522,113	\$744,845	
Interest Cost (<i>eAPBO x Discount Rate</i>)	954,481	1,810,141	1,973,011	2,391,505	2,541,825	2,724,417	2,072,625	1,517,151	1,925,363	
Net Return on Adjusted Assets Value										
Actual Return on VEBA Assets	<u>1/</u> (1,501)	136,549	(1,387,569)	(1,256,323)	(2,016,978)	(2,158,822)	(1,718,997)	448,472	1,078,348	
Interest on AV of Unfunded Accruals	<u>2/</u> 0	0	(42,567)	(45,121)	(242,248)	(365,752)	(387,697)	(416,477)	(526,003)	
Interest on AV of Prepayment Credits	<u>3/</u> 0	136,012	0	36,916	0	0	14,805	0	0	
Amortization of Unrecognized Balances										
Amortization of Initial Transition Obligation	<u>4/</u> 596,550	596,550	596,550	596,550	596,550	596,550	596,550	596,550	596,550	
Amortization of Added Transition Obligation	<u>4/</u> 0	547,283	547,283	547,283	547,283	547,283	547,283	547,283	547,283	
Amortization of 1999 Past Service Cost	0	0	0	0	0	0	(1,806,139)	(1,806,139)	(1,806,139)	
Amortization of 2001 Past Service Cost	0	0	0	0	0	0	0	0	187,767	
Amortization of (Gains) or Losses	<u>0</u>	<u>0</u>	<u>(8,306)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>562,062</u>	<u>0</u>	<u>42,486</u>	
FAR 31.205-6(o) Accrued PRB Cost	<u>2,491,611</u>	<u>4,277,289</u>	<u>2,856,605</u>	<u>3,892,500</u>	<u>3,239,388</u>	<u>3,169,181</u>	<u>471,346</u>	<u>1,408,953</u>	<u>2,790,500</u>	
2. Funding of FAR 31.205-6(o) Accrued PRB Cost										
Current Contributions to VEBA (EOY Value)	(4,758,475)	(1,164,958)	(3,471,865)	0	(1,423,233)	(3,415,937)	(117,814)	0	(4,168,105)	
Prepayment Credit Applied (BOY Value)	0	(2,266,864)	0	(615,260)	0	0	(246,756)	0	0	
Interest on Prepayment Credit Applied	<u>0</u>	<u>(136,012)</u>	<u>0</u>	<u>(36,916)</u>	<u>0</u>	<u>0</u>	<u>(14,805)</u>	<u>0</u>	<u>0</u>	
Total Funding Available	<u>(4,758,475)</u>	<u>(3,567,834)</u>	<u>(3,471,865)</u>	<u>(652,176)</u>	<u>(1,423,233)</u>	<u>(3,415,937)</u>	<u>(379,375)</u>	<u>0</u>	<u>(4,168,105)</u>	
New Unfunded Accrual (Prepayment Credit)	(2,266,864)	709,455	(615,260)	3,240,324	1,816,155	(246,756)	91,971	1,408,953	(1,377,605)	
3. Funded (Allowable) Accrued PRB Cost for PY	<u>\$2,491,611</u>	<u>\$3,567,834</u>	<u>\$2,856,605</u>	<u>\$652,176</u>	<u>\$1,423,233</u>	<u>\$3,169,181</u>	<u>\$379,375</u>	<u>\$0</u>	<u>\$2,790,500</u>	

Footnotes

See Page 2.

**BLUE CROSS BLUE SHIELD OF NORTH CAROLINA
STATEMENT OF ALLOWABLE PRB COSTS**

Footnotes

1/ SFAS 106 reports did not recognize VEBA as Plan Asset until 2001, therefore the SFAS 106 reports show \$0 Actual Return on Assets for 1993-2000.

2/ In accordance with FAR 31.205-6(o)(3), costs accrued for a period but not funded by the tax-filing deadline shall not be recognized in any subsequent period. This is accomplished by treating the accumulated value of unfunded accruals as an asset and thereby reducing the unrecognized amounts to be amortized and accrued in future periods. Furthermore, interest, based on long-term rate of return, on the accumulated value of unfunded accruals is treated as the actual return on plan assets for purposes of calculating the accrued PRB cost. This treatment of the interest eliminates the unallowable interest on the unfunded accruals from the computation of the accrued PR cost as required by FAR 31.205-6(o)(4).

3/ Amounts deposited before needed to funded costs accrued for FAR/CAS purposes are subtracted, with interest, from the assets used to determine the current funded status and unrecognized amounts. Note that this is the equitable opposite of FAR 31.205-6(o)(3) & (4), and looks to CAS 412 for guidance on the treatment of prepayment credits.

4/ The Transition Obligation and Added Transition Obligation are amortized in accordance with FAR 31.205-6(o)(5). The Transition Obligation recognized by North Carolina for 1993 was computed in accordance with Statement of Statutory Accounting Principles #14, and the Added Transition Obligation computed in 1994 was computed based on the accounting change to SFAS 106. This is a technical noncompliance with FAR 31.205-6(o)(2)(iii), but no financial adjustment is being recommended for purposes of this audit.

**BLUE CROSS BLUE SHIELD OF NORTH CAROLINA
STATEMENT OF MEDICARE LINES OF BUSINESS PERCENTAGES**

Description	01/01/1993	01/01/1994	01/01/1995	01/01/1996	01/01/1997	01/01/1998	01/01/1999	01/01/2000	01/01/2001	01/01/2002
1. Allocation of Allowable PRB Cost										
Funded (Allowable) Accrued PRB Cost for PY (Appdx B)	\$2,491,611	\$3,567,834	\$2,856,605	\$652,176	\$1,423,233	\$3,169,181	\$379,375	\$0	\$2,790,500	
Assigned to Jan-Sept (75% of PY Cost)	1,868,708	2,675,876	2,142,454	489,132	1,067,425	2,376,886	284,531	0	2,092,875	
Assigned to Oct-Dec (25% of PY Cost)	622,903	891,958	714,151	163,044	355,808	792,295	94,844	0	697,625	
Allocation Base Denominator (Total VEBA Ppts*)	2,251	2,268	2,463	2,561	2,627	3,040	3,373	3,195	3,208	3,275
Indirect CC Allocation Base Numerator	2,129	2,135	2,318	2,417	2,477	2,887	3,202	3,035	3,030	3,130
Segment Allocation Base Numerator	122	133	145	144	150	153	171	160	178	145
* Eligible & ineligible actives, retirees and spouses										
PRB Cost Allocated to Indirect CCs										
Assigned to Jan-Sept	1,767,428	2,518,957	2,016,325	461,629	1,006,476	2,257,260	270,106	0	1,976,749	0
Assigned to Oct-Dec	589,143	839,652	672,108	153,876	335,492	752,420	90,036	0	658,916	0
PRB Cost Allocated to Medicare Segment										
Assigned to Jan-Sept	101,280	156,919	126,129	27,503	60,949	119,626	14,425	0	116,126	0
Assigned to Oct-Dec	33,760	52,306	42,043	9,168	20,316	39,875	4,808	0	38,709	0
2. PRB by Fiscal Year Ending										
	09/30/1993	09/30/1994	09/30/1995	09/30/1996	09/30/1997	09/30/1998	09/30/1999	09/30/2000	09/30/2001	10/31/2001
Allocated to Indirect CC's (FY Basis)	1,767,428	3,108,100	2,855,977	1,133,737	1,160,352	2,592,752	1,022,526	90,036	1,976,749	219,639
Medicare Indirect Percentage	<u>1/</u> 1.44%	1.26%	1.14%	1.32%	1.23%	0.82%	1.69%	1.98%	1.50%	1.50%
PRB Cost for Indirect CC's (FY Basis)	25,451	39,162	32,558	14,965	14,272	21,261	17,281	1,783	29,651	3,295
Allocated to Medicare Segment (FY Basis)	101,280	190,679	178,435	69,546	70,117	139,942	54,300	4,808	116,126	12,903
Medicare Segment Percentage	<u>1/</u> 97.77%	97.88%	100.00%	100.00%	98.87%	97.65%	100.00%	100.00%	100.00%	100.00%
PRB Cost for Medicare Segment (FY Basis)	99,021	186,637	178,435	69,546	69,325	136,653	54,300	4,808	116,126	12,903
Allowable PRB Cost Allocated to FACP	\$124,472	\$225,799	\$210,993	\$84,511	\$83,597	\$157,914	\$71,581	\$6,591	\$145,777	\$16,198

Footnotes

1/ Medicare Indirect Percentage and Medicare Segment Percentage were taken from Report Number A-07-02-03030, Blue Cross and Blue Shield of North Carolina Pension Costs Claimed for Medicare Reimbursement, issued in final on April 29, 2003



April 22, 2004

Mr. James P. Aasmundstad
Regional Inspector General for Audit Services
Office of Inspector General
Office of Audit Services
Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Re: Draft report entitled *Audit of the Post Retirement Benefits Costs Claimed by Blue Cross Blue Shield of North Carolina for the Fiscal Years 1993 through 2002*;
Report Number A-07-04-00167

Dear Mr. Aasmundstad:

This letter responds to the HHS Office of Inspector General's draft report entitled "Audit of the Post Retirement Benefits Costs Claimed by Blue Cross Blue Shield of North Carolina for the Fiscal Years 1993 through 2002; Report Number A-07-04-00167. Regarding the above-referenced audit report, I accept your findings and conclusion regarding the \$616,846 of allowable but unclaimed PRB costs.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Woodfin".

Christopher C. Woodfin
Vice President of Finance and Chief Accounting Officer