



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Office of Audit Services, Region VII
601 East 12th Street, Room 0429
Kansas City, MO 64106

September 10, 2010

Report Number: A-07-10-00337

Ms. Nancy Donaldson
Vice President Medicare Contract Administration
Health Care Service Corporation
R13A-5.413
1001 E. Lookout Drive
Richardson, TX 75082

Dear Ms. Donaldson:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Review of the Qualified Pension Plan at Blue Cross Blue Shield of Oklahoma, a Terminated Medicare Contractor, for the Period January 1, 1999, to February 29, 2008*. We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this 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.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-10-00337 in all correspondence.

Sincerely,

/Patrick J. Cogley/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

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Department of Health & Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE QUALIFIED
PENSION PLAN AT BLUE CROSS
BLUE SHIELD OF OKLAHOMA,
A TERMINATED MEDICARE
CONTRACTOR, FOR THE PERIOD
JANUARY 1, 1999, TO
FEBRUARY 29, 2008**



Daniel R. Levinson
Inspector General

September 2010
A-07-10-00337

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Oklahoma (Oklahoma), a division of Group Health Service of Oklahoma (GHSO), administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until GHSO merged with Health Care Service Corporation (HCSC) on November 1, 2005. On December 29, 2006, HCSC merged the Non-Contributory Retirement Program for Certain Employees of Group Health Service of Oklahoma, Inc., into the HCSC Employee Pension Plan.

Pursuant to a novation agreement, HCSC assumed GHSO's Medicare contract and administered the contract under HCSC's Oklahoma division until the contractual relationship terminated effective February 29, 2008. The closing date for the Medicare segment was February 29, 2008. Thus, although we are addressing this report to HCSC, we will associate the term Oklahoma with our findings and recommendations regarding the segmentation termination as of February 29, 2008.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and Medicare contracts. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare segment pension assets/liabilities in accordance with CAS 413.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

Upon the termination of its Medicare contracts, Oklahoma identified Medicare's share of the Medicare segment excess pension liabilities to be \$1,871,051.

Prior Pension Segmentation Audit Report

We performed a prior pension segmentation audit at Oklahoma (A-07-00-00106, issued July 17, 2001), which brought the Medicare segment pension assets to January 1, 1999. The prior audit found that Oklahoma understated the Medicare segment pension assets by \$45,508 as of January 1, 1999. We recommended that Oklahoma increase its Medicare segment pension assets by \$45,508 and, as a result, recognize \$1,823,883 as the Medicare segment pension assets as of January 1, 1999.

OBJECTIVE

Our objective was to determine whether Oklahoma complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,
- updating the Medicare segment's pension assets from January 1, 1999, to February 29, 2008, and
- determining Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts.

SUMMARY OF FINDINGS

Oklahoma properly implemented the prior audit recommendation; however, Oklahoma did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets from January 1, 1999, to February 29, 2008. Oklahoma identified Medicare segment pension assets of \$1,460,435; however, we determined that the Medicare segment pension assets were \$3,034,384 as of February 29, 2008. As a result, Oklahoma understated the Medicare segment pension assets by \$1,573,949 as of February 29, 2008.

In addition, Oklahoma did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension liabilities associated with the termination of the Medicare contracts. Oklahoma computed Medicare's share of the Medicare segment excess pension liabilities to be \$1,871,051; however, we determined that Medicare's share of the Medicare segment excess pension liabilities was \$899,828 as of February 29, 2008. Accordingly, we determined that Oklahoma overstated Medicare's share of excess pension liabilities, due to the termination of the Medicare contracts, by \$971,223.

RECOMMENDATIONS

We recommend that Oklahoma:

- increase the Medicare segment pension assets as of February 29, 2008, by \$1,573,949 and recognize \$3,034,384 as the Medicare segment's pension assets; and
- decrease Medicare's share of the Medicare segment excess pension liabilities by \$971,223 and submit for reimbursement \$899,828 as Medicare's share of the excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS

In written comments on our draft report, Oklahoma did not directly address our first recommendation. Oklahoma concurred with the substance of our second recommendation but disagreed with the final Medicare segment accrued liabilities that we used in our calculations.

Specifically, Oklahoma stated that the final accrued Medicare segment liability (\$3,698,163) used in our draft report to compute the segment closing adjustment was based on our estimation. Oklahoma added that subsequent to the issuance of our draft report, Oklahoma and its actuarial consulting firm provided us with the actual Medicare segment final accrued liabilities of \$3,997,528 as of February 29, 2008. Oklahoma requested that the draft report be finalized, and Medicare's share of the excess Medicare segment pension liabilities be adjusted, on the basis of these revised amounts.

Oklahoma's comments are included in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing Oklahoma's comments, we revised the calculation of Medicare's share of the excess Medicare segment pension liabilities to reflect the actual Medicare segment final accrued liabilities of \$3,997,528. However, we disagree with Oklahoma's statement that the final Medicare segment accrued liabilities used in our draft report were based on our (that is, the Office of Inspector General in consultation with the CMS Office of the Actuary, as mentioned in the Methodology section of our report) estimates. In fact, during our fieldwork we used the final Medicare segment accrued liabilities that Oklahoma provided to us. After the issuance of the draft report, Oklahoma provided us with the actual Medicare segment final accrued liabilities of \$3,997,528 as of February 29, 2008. We incorporated this adjustment into this final report and revised the relevant finding and recommendation accordingly.

Furthermore, although Oklahoma did not specifically address our first recommendation, it effectively agreed to the recommended adjustment to assets as of February 29, 2008, by concurring with our second recommendation.

We maintain that our findings and recommendations, as modified, are valid.

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**A: STATEMENT OF MARKET VALUE OF PENSION ASSETS FOR BLUE CROSS
BLUE SHIELD OF OKLAHOMA FOR THE PERIOD JANUARY 1, 1999, TO
FEBRUARY 29, 2008**

B: CALCULATION OF AGGREGATE MEDICARE PERCENTAGE

C: AUDITEE COMMENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulation
GHSO	Group Health Service of Oklahoma
HCSC	Health Care Service Corporation
Oklahoma	Blue Cross Blue Shield of Oklahoma
WAV	weighted average value

INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of Oklahoma

Blue Cross Blue Shield of Oklahoma (Oklahoma), a division of Group Health Service of Oklahoma (GHSO), administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until GHSO merged with Health Care Service Corporation (HCSC) on November 1, 2005. On December 29, 2006, HCSC merged the Non-Contributory Retirement Program for Certain Employees of Group Health Service of Oklahoma, Inc., into the HCSC Employee Pension Plan.

Pursuant to a novation agreement, HCSC assumed GHSO's Medicare contracts and administered the contracts under HCSC's Oklahoma division until the contractual relationship terminated effective February 29, 2008. The closing date for the Medicare segment was February 29, 2008. Thus, although we are addressing this report to HCSC, we will associate the term Oklahoma with our findings and recommendations regarding the segmentation termination as of February 29, 2008.

Medicare

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare segment pension assets/liabilities in accordance with CAS 413.

Federal Requirements

CAS 412 addresses the determination and measurement of pension cost components. It also addresses the assignment of pension costs to appropriate accounting periods.

CAS 413 addresses 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. CAS 413 also addresses the determination of segment assets and liabilities in the event of contract terminations, segment closings, or pension plan terminations.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contracts require Medicare segment assets to be updated for each year after the initial allocation

in accordance with CAS 412 and 413. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, CAS, and the Medicare contracts.

Upon the termination of its Medicare contracts, Oklahoma identified Medicare's share of the Medicare segment excess pension liabilities to be \$1,871,051.

Prior Pension Segmentation Audit Report

We performed a prior pension segmentation audit at Oklahoma (A-07-00-00106, issued July 17, 2001), which brought the Medicare segment pension assets to January 1, 1999. The prior audit found that Oklahoma understated the Medicare segment pension assets by \$45,508 as of January 1, 1999. We recommended that Oklahoma increase its Medicare segment pension assets by \$45,508 and, as a result, recognize \$1,823,883 as the Medicare segment pension assets as of January 1, 1999.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

Our objective was to determine whether Oklahoma complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation,
- updating the Medicare segment's pension assets from January 1, 1999, to February 29, 2008, and
- determining Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts.

Scope

We reviewed Oklahoma's identification of its Medicare segment; update of Medicare segment assets from January 1, 1999, to February 29, 2008; and the segment closing calculation as of February 29, 2008.

Achieving our objective did not require us to review Oklahoma's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment, the update of the segment's assets, and the segment closing calculation to ensure adherence to the Medicare contracts, CAS 412, and CAS 413.

We performed fieldwork at Oklahoma's office in Tulsa, Oklahoma, during December 2008.

Methodology

To accomplish our objective, we did the following:

- We reviewed the applicable portions of the FAR, CAS, and the Medicare contracts.
- We reviewed the annual actuarial valuation reports prepared by Oklahoma's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment assets.
- We reviewed the Medicare segment closing calculation prepared by Oklahoma's actuarial consulting firms.
- We obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service (IRS) Forms 5500 used in calculating the Medicare segment assets.
- We interviewed Oklahoma staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed Oklahoma's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We reviewed the prior segmentation audit performed at Oklahoma (A-07-00-00106) to determine the beginning market value of assets.
- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate both the Medicare segment pension assets from January 1, 1999, to February 29, 2008, and the Medicare segment's excess pension liabilities as of February 29, 2008.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of Oklahoma's pension costs claimed for Medicare reimbursement (A-07-10-00338) and used the information obtained during that audit in this review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATIONS

Oklahoma properly implemented the prior audit recommendation; however, Oklahoma did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets from January 1, 1999, to February 29, 2008. Oklahoma identified Medicare segment pension assets of \$1,460,435; however, we determined that the Medicare segment pension assets were \$3,034,384 as of February 29, 2008. As a result, Oklahoma understated the Medicare segment pension assets by \$1,573,949 as of February 29, 2008.

Appendix A presents details on the Medicare segment's pension assets from January 1, 1999, to February 29, 2008, as determined during our audit. Table 1 summarizes the audit adjustment required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per Audit	Per Oklahoma	Difference
Prior Audit Recommendation	\$1,823,883	\$1,823,883	\$0
Update of Medicare Segment Assets			
Contributions and Prepayment Credits	\$3,045,732	\$2,666,884	\$378,848
Benefit Payments	2,087,502	2,698,775	611,273
Net Transfers	(1,256,055)	(1,842,303)	586,248
Earnings Net Expenses	1,508,326	1,510,746	(2,420)
Under/(Over)statement of Medicare Pension Segment Assets			\$1,573,949

In addition, CAS 413 requires a segment closing adjustment to be made in order to recognize Medicare's share of the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts. Oklahoma did not fully comply with Federal requirements in its calculation of Medicare's share of the Medicare segment excess pension liabilities associated with the termination of the Medicare contracts. Oklahoma computed Medicare's share of the Medicare segment excess pension liabilities to be \$1,871,051; however, we determined that Medicare's share of the Medicare segment excess pension liabilities was \$899,828 as of February 29, 2008. Accordingly, we determined that Oklahoma overstated Medicare's share of excess pension liabilities, due to the termination of the Medicare contracts, by \$971,223.

PRIOR AUDIT RECOMMENDATION

Oklahoma properly implemented the prior audit recommendation (A-07-00-00106) which recommended that Oklahoma increase Medicare segment pension assets by \$45,508, and recognize \$1,823,883 as the Medicare segment pension assets, as of January 1, 1999.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

Oklahoma did not always comply with Federal requirements and the Medicare contracts' pension segmentation requirements when updating Medicare segment assets from January 1, 1999, to February 29, 2008.

Federal Requirements

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 are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the Medicare contracts state that "... the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)." CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. The CAS requires expenses to be allocated among the segments in proportion to the investment earnings. In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities.

For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets.

Furthermore, CAS 412.50(a)(4) requires that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

Contributions and Prepayment Credits Understated

Oklahoma understated contributions and prepayment credits by \$378,848 for the Medicare segment. This understatement occurred primarily because Oklahoma did not allocate contributions to the Medicare segment from January 1, 2007, through February 29, 2008. As a result, Oklahoma understated the Medicare segment pension assets by \$378,848.

The audited contributions and prepayment credits are based on the assignable pension costs. In compliance with the CAS, we applied prepayment credits first to current-year assignable pension costs because the credits were available at the beginning of the year, and then updated any remaining credits with interest to the next measurement (valuation) date. We then allocated contributions as needed to assigned pension costs as of the date of deposit.

Benefit Payments Overstated

Oklahoma overstated benefit payments by \$611,273, primarily because it incorrectly included non-Medicare segment participants' benefit payments in 2006, 2007, and 2008. Therefore, the Medicare segment pension assets were understated by \$611,273.

Net Transfers Overstated

Oklahoma overstated transfers out of the Medicare segment by \$586,248. The overstatement occurred primarily because Oklahoma incorrectly identified the participants who transferred in and out of the Medicare segment. This overstatement of the net transfer adjustment resulted in an understatement of the Medicare segment assets by \$586,248.

A comparison of Oklahoma's and our calculations of net asset transfers from the Medicare segment appears in Table 2.

	Per Audit	Per Oklahoma	Difference
1999	(\$10,513)	(\$2,070)	(\$8,443)
2000	77,561	79,036	(1,475)
2001	(54,106)	(49,216)	(4,890)
2002	(49,813)	(53,290)	3,477
2003	(48,011)	(40,393)	(7,618)
2004	(22,506)	(22,506)	0
2005	(231,609)	27,251	(258,860)
2006	(858,213)	(1,723,827)	865,614
2007	(58,845)	(57,288)	(1,557)
Total	(\$1,256,055)	(\$1,842,303)	\$586,248

Earnings, Net Expenses Overstated

Oklahoma overstated investment earnings, less administrative expenses, by \$2,420 for the Medicare segment because it used incorrect contributions and prepayment credits, benefit payments, and net transfer amounts (all discussed above) to develop the Medicare segment pension asset base. In our audited update, we allocated earnings and expenses based on the applicable CAS requirements.

MEDICARE SEGMENT EXCESS PENSION LIABILITIES

Federal Requirements

Medicare Contracts

In the event of a contract termination, the Medicare contracts require contractors to follow the segment closing provision of the CAS. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare pension liabilities in accordance with CAS 413.

Cost Accounting Standards

Contract terminations and segment closings are addressed by CAS 413.50(c)(12), which states:

If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.

- (i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs....
- (ii) ... The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).
- (iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

Excess Medicare Segment Pension Liabilities as of February 29, 2008

Oklahoma identified \$2,123,156 in excess Medicare segment pension liabilities as of February 29, 2008. However, we calculated the excess Medicare segment pension liabilities to be \$933,044 as of that date. Therefore, Oklahoma overstated the excess pension liabilities by \$1,190,112. The overstatement occurred primarily because Oklahoma understated the Medicare segment's final market value of assets (as previously discussed) and incorrectly identified the Medicare segment participants as of February 29, 2008.

Medicare's Share of Excess Pension Liabilities as of February 29, 2008

Federal Requirements

The methodology for determining the Federal Government's share of excess pension liabilities is addressed by CAS 413.50(c)(12)(vi), which states:

The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the **sum of the pension plan costs** allocated to all contracts and subcontracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the **total pension costs** assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique. [Emphasis added.]

Medicare's Share of the Excess Pension Liabilities Overstated

Oklahoma did not comply with the Medicare contracts in determining Medicare's share of the excess pension liabilities associated with the termination of the Medicare contracts as of February 29, 2008. Oklahoma calculated \$1,871,051 as Medicare's share of the excess pension liabilities as of February 29, 2008; however, we determined that Medicare's share of the excess pension liabilities was \$899,828 as of February 29, 2008. The overstatement occurred primarily because Oklahoma (1) understated the Medicare segment's pension assets as of February 29, 2008 (as discussed above), and (2) incorrectly included a portion of the "Other" segment excess pension liabilities in its calculation of Medicare's share of the excess pension liabilities. As a result, Oklahoma overstated Medicare's share of the Medicare segment excess pension liabilities by \$971,223.

In accordance with CAS 413.50(c)(12)(vi), we calculated the aggregate Medicare percentage using the Medicare segment pension costs developed during the prior pension costs claimed

(A-07-01-00121) and current pension costs claimed (A-07-10-00338) audits. Appendix B shows our calculation of the Medicare segment's aggregate Medicare percentage; Table 3 shows our calculation of Medicare's share of the excess liabilities.

Table 3: Medicare's Share of the Excess Pension Liabilities	
Per Audit	
Medicare Segment Excess Liability	\$933,044
Aggregate Medicare Percentage	96.44%
Medicare's Share of Excess Pension Liabilities	899,828
Per Oklahoma	
Medicare Segment Excess Liabilities	1,759,997
Other Segment Excess Liabilities	111,054
Medicare's Share of the Excess Pension Liabilities	1,871,051
Difference	(\$971,223)

RECOMMENDATIONS

We recommend that Oklahoma:

- increase the Medicare segment pension assets as of February 29, 2008, by \$1,573,949 and recognize \$3,034,384 as the Medicare segment's pension assets; and
- decrease Medicare's share of the excess pension liabilities by \$971,223 and submit for reimbursement \$899,828 as Medicare's share of the excess pension liabilities due to the segment closing calculation.

AUDITEE COMMENTS

In written comments on our draft report, Oklahoma did not directly address our first recommendation. Oklahoma concurred with the substance of our second recommendation but disagreed with the final Medicare segment accrued liabilities that we used in our calculations.

Specifically, Oklahoma stated that the final accrued Medicare segment liability (\$3,698,163) used in our draft report to compute the segment closing adjustment was based on our estimation. Oklahoma added that subsequent to the issuance of our draft report, Oklahoma and its actuarial consulting firm provided us with the actual Medicare segment final accrued liabilities of \$3,997,528 as of February 29, 2008. Oklahoma requested that the draft report be finalized, and Medicare's share of the excess Medicare segment pension liabilities be adjusted, on the basis of these revised amounts.

Oklahoma's comments are included in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing Oklahoma's comments, we revised the calculation of Medicare's share of the excess Medicare segment pension liabilities to reflect the actual Medicare segment final accrued liabilities of \$3,997,528. However, we disagree with Oklahoma's statement that the final Medicare segment accrued liabilities used in our draft report were based on our (that is, the Office of Inspector General in consultation with the CMS Office of the Actuary, as mentioned in our Methodology section) estimates. In fact, during our fieldwork we used the final Medicare segment accrued liabilities that Oklahoma provided to us. After the issuance of the draft report, Oklahoma provided us with the actual Medicare segment final accrued liabilities of \$3,997,528 as of February 29, 2008. We incorporated this adjustment into this final report and revised the relevant finding and recommendation accordingly.

Furthermore, although Oklahoma did not specifically address our first recommendation, it effectively agreed to the recommended adjustment to assets as of February 29, 2008, by concurring with our second recommendation. We used the Medicare segment pension assets specified in our first recommendation (\$3,034,384 as of February 29, 2008) to compute Medicare's share of the excess pension liabilities (the focus of our second recommendation, with which Oklahoma concurred).

We maintain that our findings and recommendations, as modified, are valid.

APPENDIXES

**APPENDIX A: STATEMENT OF MARKET VALUE OF PENSION ASSETS
FOR BLUE CROSS BLUE SHIELD OF OKLAHOMA
FOR THE PERIOD JANUARY 1, 1999, TO FEBRUARY 29, 2008**

Description	Total Company	"Other" Segment	Medicare Segment
Assets January 1, 1999	1/ \$45,902,185	\$44,078,302	\$1,823,883
Prepayment Credits	2/ 0	(99,474)	99,474
Contributions	3/ 437,900	437,900	0
Other Transactions	0	0	0
Earnings	4/ 7,322,613	7,003,281	319,332
Benefit Payments	5/ (3,762,250)	(3,762,250)	0
Expenses	6/ (229,598)	(219,585)	(10,013)
Transfers	7/ 0	10,513	(10,513)
Assets January 1, 2000	\$49,670,850	\$47,448,687	\$2,222,163
Prepayment Credits	0	(24,241)	24,241
Contributions	1,984,950	1,964,357	20,593
Other Transactions	0	0	0
Earnings	(2,009,247)	(1,915,430)	(93,817)
Benefit Payments	(3,284,143)	(3,284,143)	0
Expenses	(306,899)	(292,569)	(14,330)
Transfers	0	(77,561)	77,561
Assets January 1, 2001	\$46,055,511	\$43,819,100	\$2,236,411
Prepayment Credits	0	(77,456)	77,456
Contributions	7,527,637	7,455,088	72,549
Other Transactions	0	0	0
Earnings	(2,342,961)	(2,222,461)	(120,500)
Benefit Payments	(2,543,186)	(2,538,711)	(4,475)
Expenses	(264,385)	(250,788)	(13,597)
Transfers	0	54,106	(54,106)
Assets January 1, 2002	\$48,432,616	\$46,238,878	\$2,193,738
Prepayment Credits	0	(268,269)	268,269
Contributions	14,100,000	14,100,000	0
Other Transactions	0	0	0
Earnings	(3,954,334)	(3,766,093)	(188,241)
Benefit Payments	(3,118,093)	(2,656,782)	(461,311)
Expenses	(253,454)	(241,389)	(12,065)
Transfers	0	49,813	(49,813)
Assets January 1, 2003	\$55,206,735	\$53,456,158	\$1,750,577
Prepayment Credits	0	(467,199)	467,199
Contributions	22,000,000	22,000,000	0
Other Transactions	0	0	0
Earnings	10,250,697	9,823,521	427,176
Benefit Payments	(3,976,005)	(3,976,005)	0
Expenses	(387,856)	(371,693)	(16,163)
Transfers	0	48,011	(48,011)
Assets January 1, 2004	\$83,093,571	\$80,512,793	\$2,580,778

Description	Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2004	\$83,093,571	\$80,512,793	\$2,580,778
Prepayment Credits	0	(468,678)	468,678
Contributions	13,500,000	13,500,000	0
Other Transactions	0	0	0
Earnings	8,425,145	8,105,556	319,589
Benefit Payments	(5,404,839)	(5,404,839)	0
Expenses	(343,736)	(330,697)	(13,039)
Transfers	0	22,506	(22,506)
Assets January 1, 2005	\$99,270,141	\$95,936,641	\$3,333,500
Prepayment Credits	0	(559,030)	559,030
Contributions	13,000,000	13,000,000	0
Other Transactions	0	0	0
Earnings	7,506,858	7,208,714	298,144
Benefit Payments	(6,756,692)	(6,588,544)	(168,148)
Expenses	0	0	0
Transfers	0	231,609	(231,609)
Assets January 1, 2006	\$113,020,307	\$109,229,390	\$3,790,917
Prepayment Credits	0	(570,758)	570,758
Contributions	6,000,000	6,000,000	0
Other Transactions	8/ 609,448,581	609,448,581	0
Earnings	13,921,390	13,405,642	515,748
Benefit Payments	(13,690,225)	(13,155,937)	(534,288)
Expenses	(474,067)	(456,504)	(17,563)
Transfers	0	858,213	(858,213)
Assets January 1, 2007	\$728,225,986	\$724,758,627	\$3,467,359
Prepayment Credits	0	(354,829)	354,829
Contributions	77,950,000	77,950,000	0
Other Transactions	608,435	608,435	0
Earnings	70,729,172	70,403,733	325,439
Benefit Payments	(73,929,564)	(73,010,284)	(919,280)
Expenses	(3,994,199)	(3,975,821)	(18,378)
Transfers	0	58,845	(58,845)
Assets January 1, 2008	\$799,589,830	\$796,438,706	\$3,151,124

Description	Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2008	\$799,589,830	\$796,438,706	\$3,151,124
Prepayment Credits	0	(62,656)	62,656
Contributions	12,900,000	12,900,000	0
Other Transactions	0	0	0
Earnings	(43,306,625)	(43,132,761)	(173,864)
Benefit Payments	(9,410,768)	(9,410,768)	0
Expenses	(1,377,896)	(1,372,364)	(5,532)
Transfers	0	0	0
Assets February 29, 2008	\$758,394,541	\$755,360,157	\$3,034,384
Per Oklahoma	<u>9/</u> \$758,394,541	\$756,934,106	\$1,460,435
Asset Variance	<u>10/</u> \$0	(\$1,573,949)	\$1,573,949

FOOTNOTES

- 1/ We determined the Medicare segment pension assets as of January 1, 1999, based upon our prior segmentation audit of Blue Cross Blue Shield of Oklahoma (Oklahoma) (A-07-00-00106). The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segment. All pension assets are shown at market value.
- 2/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to avoid incurring unallowable interest. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 3/ We obtained Total Company contribution amounts from the actuarial valuation reports and Department of Labor/Internal Revenue Service Forms 5500. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the Total Company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the "Other" segment until needed to fund pension costs in the future.
- 4/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets as required by the Cost Accounting Standards (CAS).
- 5/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by Oklahoma.
- 6/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.
- 7/ We identified participant transfers between segments by comparing valuation data files provided by Oklahoma. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 8/ We obtained other transactions from the actuarial valuation reports. Other transactions represent the merger of the Non-Contributory Retirement Program for Certain Employees of Group Health Service of Oklahoma, Inc., into the Health Care Service Corporation Employee Pension Plan.
- 9/ We obtained total asset amounts as of February 29, 2008, from documents prepared by Oklahoma's actuarial consulting firms.
- 10/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Oklahoma's calculation of the Medicare segment pension assets.

**APPENDIX B: CALCULATION OF
AGGREGATE MEDICARE PERCENTAGE**

Fiscal Year 1/	Medicare Segment Pension Costs Charged to Medicare (A)	Total Medicare Segment Pension Costs (B)	Medicare's Aggregate % (A/B) 2/
1987	\$35,577	\$35,584	
1988	13,102	13,113	
1989	4,614	4,616	
1990	12,356	12,356	
1991	22,296	22,638	
1992	28,195	28,983	
1993	52,192	53,701	
1994	81,947	82,934	
1995	78,493	79,254	
1996	17,746	18,910	
1997	39,174	39,621	
1998	110,520	116,276	
1999	104,004	108,962	
2000	56,122	58,194	
2001	115,830	122,429	
2002	228,610	238,309	
2003	402,146	417,467	
2004	439,367	468,308	
2005	499,535	536,442	
2006	561,239	567,826	
2007	405,704	408,811	
2008	149,683	151,363	
Total	\$3,458,452	\$3,586,097	96.44%

1/ The aggregate percentage was based on the audited pension costs as determined during the pension audits related to the Oklahoma Medicare segment. The information for fiscal years (FY) 1987 - 1999 was obtained during our prior audit (A-07-01-00121). The information for FYs 2000 - 2008 was obtained during the current review (A-07-10-00338).

2/ We calculated the aggregate Medicare percentage by dividing the Medicare segment pension costs charged to Medicare (numerator) by the total Medicare segment pension costs (denominator) pursuant to Cost Accounting Standard 413.

APPENDIX C: AUDITEE COMMENTS

Via UPS and Email via pdf attachment



BlueCross BlueShield

August 20, 2010

Of Illinois, New Mexico, Oklahoma and Texas

Patrick J. Cogley, Regional Inspector General for Audit Services
 U.S. Department of Health & Human Services
 Office of Inspector General Office of Audit Services
 Region VII
 601 East 12th street
 Room 0429
 Kansas City, Missouri 64106

Email: PCogley@OIG.HHS.GOV

Subject: Draft Report Response and Comments
 Reports Number A-07-10-00337 and Number A-07-10-00338 respectively entitled
 Review of Qualified Pension Plan at Blue Cross Blue Shield of Oklahoma, a Terminated
 Medicare Contractor, for the Period January 1, 1999 to February 29, 2008
 And
 Review of Pension costs Claimed for Medicare Reimbursement by Blue Cross Blue Shield
 of Oklahoma for Fiscal Years 2000 Through 2008

Dear Mr. Cogley:

Your June 29, 2010 letter(s) conveying the draft reports requested that (in order to properly consider our views on the validity of the facts and reasonableness of the recommendations) we provide written comments within 30 days. Based on further interchange with your audit team your office granted an extension for reply until August 20, 2010.

Your letter requests explicit concurrence, including actions taken or non-concurrence, including reasons and alternatives for the recommendation(s) of each audit.

Due to the nature of these type contract termination pension segment closing and settlement audits, our interactive work with the audit team assigned and the structured approach taken in the audit recommendations, our response is summarized at a higher level joining the substance and overarching recommendations across both audits since the outcomes are interrelated. We do also include clarifying and supporting descriptions.

Based on the interlocking approach of the audits as represented in reviews with both the Office of Audit Services staff and the Office of Actuary representatives (OIG), we concur that HCSC (Health Care Service Corporation, a Mutual Legal Reserve Company)(aka Oklahoma per the audit drafts) both: a) Claims the additional allowable pension costs of \$551, 039 for the periods from FY 2000 through 2008 (\$551,039 is taken directly from the recommendation contained within the A-07-10-0338 draft report--see attachment); and b)Submits the request for reimbursement of \$899,827 for Medicare's share of the excess pension liabilities resulting from the segment closing calculations (\$899,827 is based directly on the estimated \$611,120 stated in the recommendation within the A-07-10-00337 draft report, adjusted in agreement with OIG to reflect the effects of the final Medicare segment liabilities which OIG initially estimated in the draft--see attachment).

The recommendation amount related to A-07-10-0337 is adjusted because the final accrued Medicare Segment liability (\$3,698,163) used in the draft report (work papers) to compute the segment closing adjustment was based on OIG estimation. Subsequent to the issuance of the draft report, HCSC (aka Oklahoma per the audit drafts) and Towers Watson & Company Co. (actuarial consultants) provided (and reached agreement with OIG) OIG the actual Medicare segment final accrued liabilities of \$3,997,528 as of 2-29-2008, calculated based on the approach OIG employed in the audit (see attachment). The difference in the liability measurement flows into the difference in the settlement amount due in the recommendation of draft A-07-10-0337. Except for revision in the final segment closing amounts as a result of the revision to the final accrued liabilities, the balance of the reports did not change.

Divisions of Health Care Service Corporation, a Mutual Legal Reserve Company, an Independent Licensee of the Blue Cross and Blue Shield Association

Page 2 letter dated August 20, 2010
 Patrick J. Cogley, Regional Inspector
 General for Audit Services



BlueCross BlueShield
 Of Illinois, New Mexico, Oklahoma and Texas

Beyond the primary summary recommendations of the draft reports (coupled in approach) as concurred above, the majority of the balance of the information or "sub-recommendations" in the reports are technically correct realignments related to OIG strict approach and technique differences versus the initial HCSC/Oklahoma draft settlement, building up to the end results.

Other than the adjustments for a few participant segment assignment and transfer method differences that were corrected by the OIG audit team (which HCSC/Oklahoma had captured differently), the end-of-segment-settlement technique HCSC/Oklahoma initially drafted for OIG review would have lead to a similar net-net overall settlement dollar amount result across the draft audits (plus or minus the less material amounts the OIG team recalculated related to annual CAS cost allocation differences for 2000-2006 in A-07-10-0338).

So that the Draft response will clarify/document the point of interpretive difference between how HCSC/Oklahoma approached the segment ending and why OIG methodically recast the results leading to the final draft recommendations, the primary approach difference was that HCSC/Oklahoma initially created an interim close out/settlement of related pension matters as of 12-31-06.

HCSC/Oklahoma initially selected a 12-31-2006 settlement date because we had forecasted (and ultimately our forecast turned out to be correct) that we would not be actively pursuing Medicare Part A&B business after 2006. Because HCSC did not actively pursue Medicare Part A&B business after 2006, we concluded under the prevailing circumstances that HCSC would not seek reimbursement from CMS for pension related costs incurred by the Medicare segment after 2006 and therefore the pension liabilities should be settled at 12-31-2006 rather than the actual contract termination date. The OIG Audit and Actuarial team instead determined that the regulations require the settlement to be as of the contract end date, 2-29-2008, and that based on advancing the previous Medicare pension segment components to 2-28-2008 methodically, HCSC was therefore entitled to reimbursement of pension costs incurred during the period from 12-31-2006 through 2-29-2008. It is our understanding that OIG accepted HCSC's rationale for selecting the 12-31-2006 date as reasonable and logical but ultimately concluded that the regulations and precedent did not, and do not, provide for any discretion on the selection of the settlement date. HCSC accepted the OIG determination, agreed to the revised basis presented in the audit drafts as reflected in the draft recommendations, and agreed that the audits and closing of the pension related matters should be final.

We appreciate the professionalism and cooperation of the OIG while working on these matters. We request that the two draft audits (A-07-10-00337 and A-07-10-00338) be finalized now as updated with the derived reimbursement amounts (as adjusted per the above) due from CMS to HCSC (approximately \$1,450,866 sum of the above) being either wired directly to HCSC or credited to the overall BCBSOK Medicare Contract global closing agreement settlement.

Thank you.

Gene George, Executive Director Treasury, HCSC
 and

Nancy Donaldson, Vice President Medicare Contract Administration, HCSC

A02-012 or B13A-5.413
 1001 E. Lookout Drive
 Richardson, Texas 75082
 972-766-6192 or 972-766-1664

attachment: (page 3) one page reference support to paragraphs four and five above

Divisions of Health Care Service Corporation, a Mutual Legal Reserve Company, an Independent Licensee of the Blue Cross and Blue Shield Association

Attachment to August 20, 2010 Draft Report Response and Comments Letter
Reports Number A-07-10-00337 and Number A-07-10-00338

Comparison of Allowable Pension Costs and Claimed Pension Costs

Fiscal Year	Medicare Pension Costs		
	Allowable Per Audit	Claimed by Oklahoma	Difference
2000	\$73,071	\$137,873	(\$64,802)
2001	148,810	146,468	2,342
2002	270,937	229,826	41,111
2003	497,935	512,273	(14,338)
2004	516,437	523,324	(6,887)
2005	569,853	604,736	(34,883)
2006	586,204	574,901	11,303
2007	564,853	167,178	397,675
2008	219,518	0	219,518
Total	\$3,447,618	\$ 2,896,579	\$551,039

This underclaim occurred primarily because Oklahoma did not claim pension costs for Medicare reimbursement from January 2007 through February 2008. As a result, Oklahoma did not claim \$551,039 of allowable pension costs.

BCBS of Oklahoma Pension Plan Settlement of Medicare Segment Pension Liability

	OIG Calculation	HCSC Calculation
1 Medicare Segment Benefit Liabilities at 2/28/2008	3,698,163	3,997,528
2 Unallowed	30,100	30,100
3 Net liability: 1 - 2	3,668,063	3,967,428
4 Medicare Segment Assets at 2/28/2008	3,034,384	3,034,384
5 Unfunded Benefit Liabilities: 3 - 4	633,679	933,044
6 Medicare Segment Audited Costs as Percent of Submitted	96.44%	96.44%
7 Net Reimbursement Amount: 5 x 6	611,120	899,827
		288,707

((for reference only--excerpt of 8-13-2010 OIG Confirmation—"...We have reviewed the support for the revised final Medicare segment accrued liabilities of \$3,997,528 as of 2/29/2008. We have determined the revised final liabilities for the Medicare segment appear to be reasonable. We will adjust our final audit report to identify the final Medicare segment accrued liabilities of \$3,997,528 as of 2/29/2008..."))