



May 12, 2011

Report Number: A-07-11-00362

Mr. Trace Woodward  
Finance Director  
National Heritage Insurance Company  
402 Otterson Drive  
Chico, CA 95928

Dear Mr. Woodward:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Review of Medicare Contractor's Pension Segmentation Requirements at National Heritage Insurance Company for the Period January 1, 2000, to January 1, 2008*. We will forward a copy of this report to the HHS action official noted below.

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 direct them to the HHS action official. Please refer to report number A-07-11-00362 in all correspondence.

Sincerely,

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

Enclosure

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**HHS Action Official:**

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Acting Director & Chief Financial Officer  
Office of Financial Management  
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Baltimore, MD 21244-1850

Department of Health & Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE CONTRACTOR'S  
PENSION SEGMENTATION  
REQUIREMENTS AT NATIONAL  
HERITAGE INSURANCE COMPANY  
FOR THE PERIOD JANUARY 1, 2000,  
TO JANUARY 1, 2008**



Daniel R. Levinson  
Inspector General

May 2011  
A-07-11-00362

# *Office of Inspector General*

<http://oig.hhs.gov>

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**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
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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.

## **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**

During our audit period, National Heritage Insurance Company (NHIC) administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). These operations were a part of NHIC's Medicare Administrative Services (MAS) segment. In addition, NHIC administered the Durable Medical Equipment and Medicare Administrative Contractors (MAC) contracts with CMS as a part of the MAC segment.

NHIC participates in a defined benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.

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.

### **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. Accordingly, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

### **OBJECTIVE**

Our objective was to determine whether, when following Federal requirements and the Medicare contracts' pension segmentation requirements, NHIC reasonably:

- calculated the Medicare segment's initial asset base and
- updated the Medicare segment's assets from the initial asset base to January 1, 2008.

### **RESULTS OF REVIEW**

NHIC calculated a January 1, 2000, initial asset amount of \$3,527,262 for the MAS segment. This is a reasonable representation of NHIC MAS segment assets as of January 1, 2000. While updating the Medicare segment assets to January 1, 2008, NHIC split the assets into two segments: the MAS and MAC segments. NHIC calculated Medicare segment assets of \$8,209,588 for the MAS segment and \$3,024,783 for the MAC segment as of January 1, 2008. This is a reasonable representation of NHIC MAS and MAC segment assets as of January 1, 2008. Therefore, this report makes no recommendations.

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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 Regulation
NHIC	National Heritage Insurance Company
MAC	Medicare administrative contractor
MAS	Medicare administrative services
WAV	weighted average value

# INTRODUCTION

## BACKGROUND

### National Heritage Insurance Company and Medicare

During our audit period, National Heritage Insurance Company (NHIC) administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). These operations were a part of NHIC's Medicare Administrative Services (MAS) segment. In addition, NHIC administered the Durable Medical Equipment<sup>1</sup> and Medicare Administrative Contractors (MAC)<sup>2</sup> contracts with CMS as part of its MAC segment.

NHIC participates in a defined benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.<sup>3</sup>

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.

### 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.

### 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.

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<sup>1</sup> NHIC assumed full operations of Durable Medical Equipment Jurisdiction A on July 1, 2006.

<sup>2</sup> NHIC was awarded Medicare Part A and Part B Jurisdiction 14 MAC operations on November 19, 2008, and assumed full operations in June 2009.

<sup>3</sup> NHIC participates in employee benefit plans, such as the defined benefit pension plan, of its parent company, Hewlett-Packard Enterprise Services.

## **OBJECTIVE, SCOPE AND METHODOLOGY**

### **Objective**

Our objective was to determine whether, when following Federal requirements and the Medicare contracts' pension segmentation requirements, NHIC reasonably:

- calculated the Medicare segment's initial asset base and
- updated the Medicare segment's assets from the initial asset base to January 1, 2008.

### **Scope**

We reviewed NHIC's initial allocation of the Medicare segment assets and its update of the Medicare segment's assets from January 1, 2000, to January 1, 2008.

For the purpose of this audit, NHIC engaged actuarial consulting firms to analyze and develop its Medicare segments pension asset accounting. We have relied upon information provided to us by NHIC and its actuarial consulting firms regarding plan assets. We have reviewed this information for overall reasonableness, but due to the limited information provided by NHIC we could not independently verify this information. Therefore, the accuracy of our results is dependent upon the accuracy and completeness of the information provided by NHIC and its actuarial consulting firms.

We did not review NHIC's overall internal control structure, as our objective did not require us to do so.

### **Methodology**

To accomplish our objective, we did the following:

- We reviewed NHIC's development of the MAS Medicare segment initial assets as of January 1, 2000.
- We reviewed the information provided by NHIC's actuarial consulting firms. Prior to our review, NHIC engaged actuarial consulting firms to analyze and develop its Medicare segment pension asset accounting. This information included the pension plan's assets, contributions, benefit payments, investment earnings, and administrative expenses. We used this information in our review of each Medicare segment's assets.
- Due to a lack of detailed information provided by NHIC for each Medicare segment's assets, we performed analytical procedures to analyze, and assess the reasonableness of, benefit payments and participant transfer adjustments. We verified that Medicare segment investment earnings and administrative expenses were allocated in accordance with the CAS. We performed additional analytical work to ensure that the qualified

defined benefit plan pension costs claimed by NHIC on its Final Administrative Cost Proposals (FACP) and reimbursed by CMS were actually reflected in the MAS Medicare segment asset rollup.

- We reviewed the applicable portions of the FAR, CAS, and the Medicare contracts.
- We obtained and reviewed the pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Forms 5500 used in our review of the Medicare segments' assets.
- As part of our overall review of reasonableness and consistency, we interviewed NHIC staff regarding the identification of the Medicare segments in accordance with the Medicare contracts.

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.

### **RESULTS OF REVIEW**

NHIC calculated a January 1, 2000, initial asset amount of \$3,527,262 for the MAS segment. This is a reasonable representation of NHIC MAS segment assets as of January 1, 2000. While updating the Medicare segment assets to January 1, 2008, NHIC split the assets into two segments: the MAS and MAC segments. NHIC calculated Medicare segment assets of \$8,209,588 for the MAS segment and \$3,024,783 for the MAC segment as of January 1, 2008. This is a reasonable representation of NHIC MAS and MAC segment assets as of January 1, 2008. Therefore, this report makes no recommendations.

### **OTHER MATTER**

For Medicare Part B operations, NHIC claimed \$4,446,256 of allowable Medicare pension costs for its qualified defined benefit pension plan on its FACPs for fiscal years (FY) 2000 through 2007. This is a reasonable representation of the Medicare Part B operations' allowable Medicare pension costs for FYs 2000 through 2007.