

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**BLUE CROSS BLUE SHIELD
ASSOCIATION UNDERSTATED THE
MEDICARE SEGMENT PENSION ASSETS
FOR THE PERIOD OF JANUARY 1, 1997,
TO JANUARY 1, 2011**

*Inquiries about this report may be addressed to the Office of Public Affairs at
Public.Affairs@oig.hhs.gov.*



Patrick J. Cogley
Regional Inspector General

February 2013
A-07-13-00410

Office of Inspector General

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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 Association (the Association) administers Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

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 language 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 Medicare 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.

Prior Pension Segmentation Audit Report

We performed a prior pension segmentation report at the Association (A-07-98-02527, issued March 10, 1999), which brought the Medicare segment pension assets to January 1, 1997. We recommended that the Association decrease its Medicare segment pension assets by \$407,043 and, as a result, recognize \$7,300,353 as the Medicare segment pension assets as of January 1, 1997.

OBJECTIVES

Our objectives were to determine whether the Association complied with Federal regulations and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation, and
- updating the Medicare segment's pension assets from January 1, 1997, to January 1, 2011.

SUMMARY OF FINDINGS

The Association implemented the prior audit recommendation to recognize \$7,300,353 as the Medicare segment pension assets as of January 1, 1997. When updating the Medicare segment's pension assets, the Association identified Medicare segment pension assets of \$5,085,454; however, we determined that the Medicare segment pension assets were \$5,419,935 as of January 1, 2011. The difference, \$334,481, was an understatement of Medicare segment pension assets. The Association understated the Medicare segment assets because it did not have controls to ensure that it calculated those assets in accordance with Federal requirements and the

Medicare contracts' pension segmentation language when updating the Medicare segment pension assets from January 1, 1997, to January 1, 2011.

RECOMMENDATIONS

We recommend that the Association:

- increase the Medicare segment pension assets as of January 1, 2011, by \$334,481, and
- establish controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when allocating benefit payments, participant transfers, and investment earnings and expenses.

AUDITEE COMMENTS

In written comments on our draft report, the Association accepted our recommendations and described corrective actions that it planned to implement.

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Glossary of Abbreviations and Acronyms

Association	Blue Cross Blue Shield Association
CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulation
WAV	weighted average value

INTRODUCTION

BACKGROUND

Blue Cross Blue Shield Association and Medicare

Blue Cross Blue Shield Association (the Association) administers Medicare Part A under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

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 Medicare segment. 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.

Prior Pension Segmentation Audit Report

We performed a prior pension segmentation report at the Association (A-07-98-02527, issued March 10, 1999), which brought the Medicare segment pension assets to January 1, 1997. We recommended that the Association decrease its Medicare segment pension assets by \$407,043 and, as a result, recognize \$7,300,353 as the Medicare segment pension assets as of January 1, 1997.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine whether the Association complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the prior audit recommendation, and
- updating the Medicare segment's pension assets from January 1, 1997, to January 1, 2011.

Scope

We reviewed the Association's identification of its Medicare segment and its update of Medicare segment assets from January 1, 1997, to January 1, 2011.

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

We performed fieldwork at the Association's office in Chicago, Illinois, during April and May 2012.

Methodology

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the FAR, CAS, and the Medicare contracts applicable to this audit.
- We reviewed the annual actuarial valuation reports prepared by the Association'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 obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Medicare segment assets.
- We interviewed Association staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.

- We reviewed the Association's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We reviewed the prior segmentation audit performed at the Association (A-07-98-02527) 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 the Medicare segment pension assets from January 1, 1997, to January 1, 2011.
- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of the Association's pension costs claimed for Medicare reimbursement (A-07-13-00411) 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 objectives.

FINDINGS AND RECOMMENDATIONS

The Association implemented the prior audit recommendation to recognize \$7,300,353 as the Medicare segment pension assets as of January 1, 1997. When updating the Medicare segment's pension assets, the Association identified Medicare segment pension assets of \$5,085,454; however, we determined that the Medicare segment pension assets were \$5,419,935 as of January 1, 2011. The difference, \$334,481, was an understatement of Medicare segment pension assets. The Association understated the Medicare segment assets because it did not have controls to ensure that it calculated those assets in accordance with Federal requirements and the Medicare contracts' pension segmentation language when updating the Medicare segment pension assets from January 1, 1997, to January 1, 2011.

Appendix A presents details of the Medicare segment's pension assets from January 1, 1997, to January 1, 2011, as determined during our audit. Table 1 on the following page summarizes the audit adjustments required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per Audit	Per Association	Difference
Prior Audit Recommendation	\$7,300,353	\$7,300,353	\$0
Update of Medicare Segment Assets			
Benefit Payments	(3,383,240)	(3,929,224)	545,984
Net Transfers	(4,553,905)	(4,264,004)	(289,901)
Earnings, Net Expenses	6,056,727	5,978,329	78,398
Understatement of Medicare Segment Assets			\$334,481

PRIOR AUDIT RECOMMENDATION

The Association implemented the prior audit recommendation (A-07-98-02527) which recommended that the Association decrease the Medicare segment pension assets by \$407,043 and recognize \$7,300,353 of Medicare segment pension assets as of January 1, 1997.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

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. 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.

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.

Benefit Payments Overstated

The Association overstated benefit payments by \$545,984 because of a difference in the identification of one Medicare segment participant for 2006. Therefore, the Medicare segment pension assets were understated by \$545,984.

Net Transfers Understated

The Association understated net transfers out of the Medicare segment by \$289,901. The understatement occurred primarily because the Association incorrectly identified participants who transferred in and out of the Medicare segment during the audit period. This understatement of the net transfer adjustment resulted in an overstatement of the Medicare segment assets by \$289,901.

Earnings, Net Expenses Understated

The Association understated investment earnings, less administrative expenses, by \$78,398 for the Medicare segment, because it (a) used an incorrect methodology to allocate investment earnings, less administrative expenses to the Medicare segment during 1997 through 2001, and (b) used incorrect benefit payment and net transfers amounts (as discussed above) to develop the Medicare segment pension asset base. In our audited update, we allocated earnings, net expenses based on the applicable CAS requirements.

Table 2 provides information on our calculations of earnings, net expenses, the Association's calculations, and the difference between the two on a year-by-year basis.

	Per Audit	Per Association	Difference
1997	\$1,513,330	\$1,491,346	\$21,984
1998	1,332,610	1,328,733	3,877
1999	1,112,264	1,059,949	52,315
2000	(323,076)	(327,321)	4,245
2001	(365,365)	(347,129)	(18,236)
2002	(549,067)	(530,242)	(18,825)
2003	1,090,741	1,059,840	30,901
2004	665,122	646,523	18,599
2005	539,972	524,686	15,286
2006	931,339	904,976	26,363
2007	617,011	614,303	2,708
2008	(2,157,816)	(2,094,304)	(63,512)
2009	865,839	900,922	(35,083)
2010	783,823	746,047	37,776
Total	\$6,056,727	\$5,978,329	\$78,398

RECOMMENDATIONS:

We recommend that the Association:

- increase the Medicare segment pension assets as of January 1, 2011, by \$334,481, and
- establish controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when allocating benefit payments, participant transfers, and investment earnings and expenses.

AUDITEE COMMENTS

In written comments on our draft report, the Association accepted our recommendations and described corrective actions that it planned to implement.

The Association's comments are included in their entirety as Appendix B.

APPENDIXES

**APPENDIX A: STATEMENT OF MARKET VALUE OF PENSION ASSETS
FOR BLUE CROSS BLUE SHIELD ASSOCIATION
FOR THE PERIOD JANUARY 1, 1997, TO JANUARY 1, 2011**

Description		Total Company	“Other” Segment	Medicare Segment
Assets January 1, 1997	<u>1/</u>	\$88,703,613	\$81,403,260	\$7,300,353
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings	<u>2/</u>	18,550,570	17,001,344	1,549,226
Benefit Payments	<u>3/</u>	(2,577,022)	(2,577,022)	0
Expenses	<u>4/</u>	(429,827)	(393,931)	(35,896)
Transfers	<u>5/</u>	0	63,321	(63,321)
Assets January 1, 1998		\$104,247,334	\$95,496,972	\$8,750,362
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		16,625,515	15,251,083	1,374,432
Benefit Payments		(3,544,532)	(2,987,044)	(557,488)
Expenses		(505,896)	(464,074)	(41,822)
Transfers		0	2,672,690	(2,672,690)
Assets January 1, 1999		\$116,822,421	\$109,969,627	\$6,852,794
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		19,014,418	17,871,461	1,142,957
Benefit Payments		(5,636,361)	(5,636,361)	0
Expenses		(510,609)	(479,916)	(30,693)
Transfers		0	601,728	(601,728)
Assets January 1, 2000		\$129,689,869	\$122,326,539	\$7,363,330
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		(5,272,141)	(4,985,243)	(286,898)
Benefit Payments		(5,461,147)	(4,552,169)	(908,978)
Expenses		(664,826)	(628,648)	(36,178)
Transfers		0	0	0
Assets January 1, 2001		\$118,291,755	\$112,160,479	\$6,131,276

Description		Total Company	“Other” Segment	Medicare Segment
Assets January 1, 2001		\$118,291,755	\$112,160,479	\$6,131,276
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		(6,347,750)	(6,013,714)	(334,036)
Benefit Payments		(3,556,154)	(3,556,154)	0
Expenses		(595,344)	(564,015)	(31,329)
Transfers		0	(35,319)	35,319
Assets January 1, 2002		\$107,792,507	\$101,991,277	\$5,801,230
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		(9,452,205)	(8,928,558)	(523,647)
Benefit Payments		(6,152,320)	(6,152,320)	0
Expenses		(458,841)	(433,421)	(25,420)
Transfers		0	228	(228)
Assets January 1, 2003		\$91,729,141	86,477,206	\$5,251,935
Transferred Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		18,923,758	17,806,729	1,117,029
Benefit Payments		(5,510,566)	(5,510,566)	0
Expenses		(445,345)	(419,057)	(26,288)
Transfers		0	(170,481)	170,481
Assets January 1, 2004		\$104,696,988	\$98,183,831	\$6,513,157
Transferred Prepayment Credits		0	0	0
Contributions	<u>6/</u>	5,000,000	5,000,000	0
Earnings		11,098,489	10,404,652	693,837
Benefit Payments		(3,798,373)	(3,625,136)	(173,237)
Expenses		(459,326)	(430,611)	(28,715)
Transfers		0	0	0
Assets January 1, 2005		\$116,537,778	\$109,532,736	\$7,005,042

Description	Total Company	“Other” Segment	Medicare Segment
Assets January 1, 2005	\$116,537,778	\$109,532,736	\$7,005,042
Transferred Prepayment Credits	0	0	0
Contributions	5,400,000	5,400,000	0
Earnings	9,235,702	8,667,750	567,952
Benefit Payments	(5,251,695)	(5,251,695)	0
Expenses	(454,998)	(427,018)	(27,980)
Transfers	0	0	0
Assets January 1, 2006	\$125,466,787	\$117,921,773	\$7,545,014
Transferred Prepayment Credits	0	0	0
Contributions	3,200,000	3,200,000	0
Earnings	15,590,779	14,629,462	961,317
Benefit Payments	(6,201,425)	(6,201,425)	0
Expenses	(486,180)	(456,202)	(29,978)
Transfers	0	0	0
Assets January 1, 2007	\$137,569,961	129,093,608	\$8,476,353
Transferred Prepayment Credits	0	0	0
Contributions	12,000,000	12,000,000	0
Earnings	10,303,757	9,648,093	655,664
Benefit Payments	(8,728,359)	(8,728,359)	0
Expenses	(607,426)	(568,773)	(38,653)
Transfers	0	432,190	(432,190)
Assets January 1, 2008	\$150,537,933	\$141,876,759	\$8,661,174
Transferred Prepayment Credits	0	0	0
Contributions	20,000,000	20,000,000	0
Earnings	(37,148,297)	(35,019,571)	(2,128,726)
Benefit Payments	(13,336,939)	(12,503,024)	(833,915)
Expenses	(507,648)	(478,558)	(29,090)
Transfers	0	69,601	(69,601)
Assets January 1, 2009	\$119,545,049	\$113,945,207	\$5,599,842

Description	Total Company	“Other” Segment	Medicare Segment
Assets January 1, 2009	\$119,545,049	\$113,945,207	\$5,599,842
Transferred Prepayment Credits	0	0	0
Contributions	20,000,000	20,000,000	0
Earnings	18,206,597	17,323,360	883,237
Benefit Payments	(8,225,572)	(8,225,572)	0
Expenses	(358,624)	(341,226)	(17,398)
Transfers	0	(145,713)	145,713
Assets January 1, 2010	\$149,167,450	\$142,556,056	\$6,611,394
Transferred Prepayment Credits	0	0	0
Contributions	14,000,000	14,000,000	0
Earnings	18,940,509	18,136,649	803,860
Benefit Payments	(8,212,593)	(7,302,971)	(909,622)
Expenses	(472,119)	(452,082)	(20,037)
Transfers	0	1,065,660	(1,065,660)
Assets January 1, 2011	\$173,423,247	\$168,003,312	\$5,419,935
Per the Association	7/ \$173,423,247	168,337,793	\$5,085,454
Asset Variance	8/ \$0	(\$334,481)	\$334,481

ENDNOTES

- 1/ We determined the Medicare segment pension assets as of January 1, 1997, based on our prior segmentation audit of Blue Cross Blue Shield Association (the Association) (A-07-98-02527). 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/ We obtained investment earnings from the actuarial valuation reports. We allocated investment earnings based on the ratio of the segments’ weighted average value (WAV) of assets to Total Company WAV of assets as required by the Cost Accounting Standards (CAS).
- 3/ We based the Medicare segment’s benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by the Association.
- 4/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.
- 5/ We identified participant transfers between segments by comparing valuation data files provided by the Association. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.

6/ 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.

7/ We obtained total asset amounts as of January 1, 2011, from documents prepared by the Association’s actuarial consulting firms.

8/ The asset variance represents the difference between our calculation of Medicare segment pension assets and the Association’s calculation of the Medicare segment pension assets.

APPENDIX B: AUDITEE COMMENTS



**BlueCross BlueShield
Association**

An Association of Independent
Blue Cross and Blue Shield Plans

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January 29, 2013

Mr. Patrick J. Cogley
Regional Inspector General
Office of Audit Services, Region VII
601 East 12th Street, Room 0429
Kansas City, Missouri 64106

RE: Report Number A-07-13-00410

Dear Mr. Cogley:

In response to your letter dated January 3, 2013, regarding the Office of Inspector General (OIG), Office of Audit Services draft audit report entitled "*Blue Cross Blue Shield Association Understated the Medicare Segment Pension Assets for the Period of January 1, 1997 to January 1, 2011*", please be advised that the Blue Cross and Blue Shield Association (Association) has accepted the OIG's audit recommendations and will undertake the following steps to implement corrective action:

- Direct Association actuaries to increase understated Medicare segment pension assets by \$334,481 as of January 1, 2011.
- Enhance internal controls to ensure compliance with Federal regulations and the Medicare contracts' pension segmentation requirements when allocating benefit payments, participant transfers, and investment earnings and expenses. Enhanced controls will include inserting a step in the process to improve the accuracy of Medicare segment data sent to Association actuaries. This enhancement will involve an annual review of Medicare segment data by appropriate Association staff familiar with Medicare contract operations to assure Medicare segment employees are properly identified before data is sent to actuaries.

Sincerely,

A handwritten signature in black ink, appearing to read 'James Williamson', written over a circular stamp or seal.

James Williamson
Director, General Accounting
Corporate Finance

With attachment

Copies without attachment to:

Mitch Helfand, BCBSA
Peter Kelly, BCBSA
Sharon Keyes, BCBSA
Ed Sawica, BCBSA

Kevin Shanklin, BCBSA
Jenene Tambke, DHHS OIG
Jeffrey Wilson, DHHS OIG