

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**BLUE CROSS BLUE SHIELD  
ASSOCIATION OVERSTATED ITS  
MEDICARE SEGMENT PENSION ASSETS  
AND UNDERSTATED MEDICARE'S  
SHARE OF THE MEDICARE SEGMENT  
EXCESS PENSION ASSETS AS OF  
SEPTEMBER 30, 2015**

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# *Office of Inspector General*

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## EXECUTIVE SUMMARY

*Blue Cross Blue Shield Association, a terminated Medicare contractor, overstated the Medicare segment pension assets by \$1,011,000 as of September 30, 2015. In addition, Blue Cross Blue Shield Association understated Medicare's share of the Medicare segment excess pension assets by \$161,000 as of September 30, 2015, as a result of the contract termination.*

### WHY WE DID THIS REVIEW

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. In addition, in situations such as contract terminations or benefit curtailments, CAS 413 requires contractors to identify excess Medicare pension assets and liabilities allocated to the Medicare segment. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

At CMS's request, the Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors through Final Administrative Cost Proposals and/or Incurred Cost Proposals.

The objectives of this review were to determine whether Blue Cross Blue Shield Association (BCBS Association) complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendation to increase the Medicare segment pension assets as of January 1, 2011, (2) updating the Medicare segment's pension assets from January 1, 2011, to September 30, 2015, and (3) determining Medicare's share of the Medicare segment excess pension assets as a result of the Medicare segment closing as of September 30, 2015.

### BACKGROUND

During our audit period, BCBS Association administered Medicare Part A operations under cost reimbursement contracts with CMS until its contractual relationship ended on September 30, 2015.

We performed a prior pension segmentation audit at BCBS Association (A-07-13-00410, issued February 28, 2013), which brought the Medicare segment pension assets to January 1, 2011. We recommended that BCBS Association increase its Medicare segment pension assets by \$334,481 and, as a result, recognize \$5,419,935 as the Medicare segment pension assets as of January 1, 2011.

As a result of BCBS Association ending its participation in the Medicare program, the CAS requires that a segment closing adjustment be performed. The effective date for the segment closing was September 30, 2015. This report addresses the update of assets from January 1, 2011, to September 30, 2015, and the segment closing adjustment as of September 30, 2015. We are addressing the pension costs claimed by BCBS Association in a separate review.

Upon the termination of its Medicare contract, BCBS Association identified Medicare's share of the Medicare segment excess pension assets to be \$272,734.

## **WHAT WE FOUND**

BCBS Association implemented the prior audit recommendation; however, BCBS Association did not correctly update the Medicare segment pension assets in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Specifically, BCBS Association identified Medicare segment pension assets of \$7,577,489 as of September 30, 2015; however, we determined that the Medicare segment pension assets were \$6,566,432. Thus, BCBS Association overstated the Medicare segment pension assets by \$1,011,057 as of that date. This overstatement occurred primarily because BCBS Association did not correctly identify its participant transfers when updating the Medicare segment pension assets from January 1, 2011, to September 30, 2015.

In addition, BCBS Association incorrectly computed its accrued liabilities and normal costs during calendar year (CY) 2015 because it did not comply with CAS 413 and its Medicare contracts when computing those liabilities and normal costs and when computing its Medicare segment closing calculation as of September 30, 2015. BCBS Association is required to calculate its actuarial accrued liabilities and normal costs in accordance with CAS 412 and 413 and the Medicare contracts. The Medicare contracts require that any change in accounting practice for such pension and/or postretirement benefit costs be submitted to CMS in advance for approval. Beginning on January 1, 2015, BCBS Association changed its cost accounting methodology but did not seek approval in advance from CMS to do so. Therefore, the cost accounting methodology that BCBS Association used to value its CY 2015 actuarial accrued liabilities and normal costs did not comply with the CAS and the Medicare contracts.

This change in cost accounting methodology also affected BCBS Association's computation of Medicare's share of the Medicare segment excess pension assets—the focus of our third objective. In this regard, BCBS Association computed Medicare's share of the Medicare segment excess pension assets to be \$272,734 as of September 30, 2015; however, we determined that Medicare's share of these assets was \$433,368 as of that date. BCBS Association understated Medicare's share of the Medicare segment excess pension assets by \$160,634 primarily because it did not calculate its final Medicare segment liabilities in accordance with the CAS and the Medicare contracts.

Because BCBS Association's contractual relationship with CMS has ended, it is not appropriate for this report to make a procedural recommendation involving CMS approval of future changes in cost accounting methodology.

## **WHAT WE RECOMMEND**

We recommend that BCBS Association:

- decrease its Medicare segment pension assets as of September 30, 2015, by \$1,011,057 and recognize \$6,566,432 as the Medicare segment pension assets, and
- increase Medicare's share of the Medicare segment excess pension assets as of September 30, 2015, by \$160,634 and recognize \$433,368 as Medicare's share of the Medicare segment excess pension assets as a result of the Medicare segment closing adjustment.

## **AUDITEE COMMENTS**

In written comments on our draft report, BCBS Association stated that it accepted our recommendations and added that it understood that the Federal Government would present a global settlement, as a result of the Medicare contract termination, summarizing all Medicare pension segment audit recommendations relating to its contract with the U.S. Department of Health and Human Services, including the recommendations in this report.

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## **INTRODUCTION**

### **WHY WE DID THIS REVIEW**

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. In addition, in situations such as contract terminations or benefit curtailments, CAS 413 requires contractors to identify excess Medicare pension assets and liabilities allocated to the Medicare segment. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

At CMS's request, the Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors through Final Administrative Cost Proposals and/or Incurred Cost Proposals.

### **OBJECTIVES**

Our objectives were to determine whether Blue Cross Blue Shield Association (BCBS Association) complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendation to increase the Medicare segment pension assets as of January 1, 2011, (2) updating the Medicare segment's pension assets from January 1, 2011, to September 30, 2015, and (3) determining Medicare's share of the Medicare segment excess pension assets as a result of the Medicare segment closing as of September 30, 2015.

### **BACKGROUND**

#### **Blue Cross Blue Shield Association and Medicare**

During our audit period, BCBS Association administered Medicare Part A operations under cost reimbursement contracts with CMS until its contractual relationship ended on September 30, 2015.

We performed a prior pension segmentation audit at BCBS Association (A-07-13-00410, issued February 28, 2013), which brought the Medicare segment pension assets to January 1, 2011. We recommended that BCBS Association increase its Medicare segment pension assets by \$334,481 and, as a result, recognize \$5,419,935 as the Medicare segment pension assets as of January 1, 2011.

As a result of BCBS Association ending its participation in the Medicare program, the CAS requires that a segment closing adjustment be performed. The effective date for the segment closing was September 30, 2015. This report addresses the update of assets from January 1,

2011, to September 30, 2015, and the segment closing adjustment as of September 30, 2015. We are addressing the pension costs claimed by BCBS Association in a separate review.

Upon the termination of its Medicare contract, BCBS Association identified Medicare's share of the Medicare segment excess pension assets to be \$272,734.

### **Medicare Segment Closing Accounting Methodology**

The Medicare contracts require BCBS Association to calculate qualified defined-benefit costs in accordance with the Federal Acquisition Regulation (FAR) and CAS 412 and 413. BCBS Association's Medicare segment closed effective September 30, 2015. The CAS requires that when computing a segment closing calculation, a Medicare contractor like BCBS Association "...use current and prior long-term assumptions used in the measurement of pension costs." The CAS also states that the segment closing calculation (also referred to as the segment true-up) represents an adjustment of previously-determined pension costs. Finally, any recent plan improvements are phased in to the closing liability.

### **HOW WE CONDUCTED THIS REVIEW**

We reviewed BCBS Association's implementation of the prior audit recommendation; identification of its Medicare segment; update of the Medicare segment's pension assets from January 1, 2011, to September 30, 2015; and the Medicare segment closing adjustment as of September 30, 2015.

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 finding and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

### **FINDINGS**

BCBS Association implemented the prior audit recommendation; however, BCBS Association did not correctly update the Medicare segment pension assets in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Specifically, BCBS Association identified Medicare segment pension assets of \$7,577,489 as of September 30, 2015; however, we determined that the Medicare segment pension assets were \$6,566,432. Thus, BCBS Association overstated the Medicare segment pension assets by \$1,011,057 as of that date. This overstatement occurred primarily because BCBS Association did not correctly identify its participant transfers when updating the Medicare segment pension assets from January 1, 2011, to September 30, 2015.

Appendix B presents details of the Medicare segment's pension assets from January 1, 2011, to September 30, 2015, 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.

<b>Table 1: Summary of Audit Adjustments</b>			
	<b>Per Audit</b>	<b>Per BCBS Association</b>	<b>Difference</b>
<b>Prior Audit Recommendation</b>	\$5,419,935	\$5,419,935	\$0
<b>Update of Medicare Segment Assets</b>			
Contributions and Prepayment Credits	0	0	0
Net Transfers Out	(399,220)	612,763	(1,011,983)
Earnings, Net of Expenses	1,923,245	1,922,319	926
Benefits Payments	(377,528)	(377,528)	0
<b>Overstatement of Medicare Segment Assets</b>	<b>\$6,566,432</b>	<b>\$7,577,489</b>	<b>(\$1,011,057)</b>

In addition, BCBS Association incorrectly computed its accrued liabilities and normal costs during calendar year (CY) 2015 because it did not comply with CAS 413 and its Medicare contracts when computing those liabilities and normal costs and when computing its Medicare segment closing calculation as of September 30, 2015. BCBS Association is required to calculate its actuarial accrued liabilities and normal costs in accordance with CAS 412 and 413 and the Medicare contracts. The Medicare contracts require that any change in accounting practice for such pension and/or postretirement benefit costs be submitted to CMS in advance for approval. Beginning on January 1, 2015, BCBS Association changed its cost accounting methodology but did not seek approval in advance from CMS to do so. Therefore, the cost accounting methodology that BCBS Association used to value its CY 2015 actuarial accrued liabilities and normal costs did not comply with the CAS and the Medicare contracts.

This change in cost accounting methodology also affected BCBS Association's computation of Medicare's share of the Medicare segment excess pension assets—the focus of our third objective. In this regard, BCBS Association computed Medicare's share of the Medicare segment excess pension assets to be \$272,734 as of September 30, 2015; however, we determined that Medicare's share of these assets was \$433,368 as of that date. BCBS Association understated Medicare's share of the Medicare segment excess pension assets by \$160,634 primarily because it did not calculate its final Medicare segment liabilities in accordance with the CAS and the Medicare contracts.

### **PRIOR AUDIT RECOMMENDATION**

BCBS Association implemented the prior audit recommendation (A-07-13-00410, issued February 28, 2013), which recommended that BCBS Association increase its Medicare segment pension assets by \$334,481 and, as a result, recognize \$5,419,935 as the Medicare segment pension assets as of January 1, 2011.

## UPDATE OF MEDICARE SEGMENT PENSION ASSETS

The Medicare contracts require Medicare contractors to update the Medicare segment pension assets yearly in accordance with the CAS. The CAS requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses.

For details on the Federal requirements and the relevant language of the Medicare contracts, see Appendix C.

BCBS Association did not correctly update the Medicare segment pension assets from January 1, 2011, to September 30, 2015, in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. BCBS Association identified Medicare segment pension assets of \$7,577,489 as of September 30, 2015; however, we determined that the Medicare segment pension assets were \$6,566,432. Thus, BCBS Association overstated the Medicare segment pension assets by \$1,011,057. The following are our findings regarding the update of Medicare segment pension assets from January 1, 2011, to September 30, 2015.

### Net Transfers Out Understated

BCBS Association understated net transfers out of the Medicare segment by \$1,011,983. The understatement occurred primarily because BCBS Association did not correctly identify its participant transfers out of the Medicare segment. This understatement of net transfers out resulted in an overstatement of the Medicare segment pension assets by \$1,011,983. Table 2 below shows the differences between the Medicare segment net transfers proposed by BCBS Association and the net transfers that we calculated during our review.

	<b>Per Audit</b>	<b>Per BCBS Association</b>	<b>Difference</b>
2011	\$0	\$0	\$0
2012	353,343	353,343	0
2013	(264,209)	(264,209)	0
2014	487,276	523,629	(36,353)
2015	(975,630)	0	(975,630)
<b>Total</b>	<b>(\$399,220)</b>	<b>\$612,763</b>	<b>(\$1,011,983)</b>

### Earnings, Net of Expenses, Understated

BCBS Association understated investment earnings, less administrative expenses, by \$926 for its Medicare segment, because of incorrect Medicare segment accrued liabilities calculated by BCBS Association as a result of its change in accounting methodology (which we discuss in the next section of this report). In our audited update, we allocated earnings, net of expenses based on the applicable CAS requirements. For details on the applicable Federal requirements, see Appendix C.

## CHANGE IN COST ACCOUNTING METHODOLOGY

BCBS Association is required to calculate its actuarial accrued liabilities and normal costs in accordance with CAS 412 and 413 and the Medicare contracts. The Medicare contracts require that any change in accounting practice for such pension and/or postretirement benefit costs be submitted to CMS in advance for approval.

BCBS Association incorrectly computed its accrued liabilities and normal costs during CY 2015 because it did not comply with CAS 413 and its Medicare contracts when computing those liabilities and normal costs and when computing its Medicare segment closing calculation as of September 30, 2015. Beginning on January 1, 2015, BCBS Association changed its cost accounting methodology but did not seek approval in advance from CMS to do so. Therefore, the cost accounting method that BCBS Association used to value its CY 2015 actuarial accrued liabilities and normal costs did not comply with CAS and the Medicare contracts. See additional details on the relevant Federal requirements in Appendix C.

The details on this change in cost accounting methodology and its implications are as follows. Effective January 1, 2015, BCBS Association changed its cost accounting methodology. Whereas it had previously used an expense load on normal costs, BCBS Association's new methodology now began incorporating expenses into the discount rate on participant liabilities. Before CY 2015, BCBS Association computed an expense load on plan normal costs equal to 0.25 percent of the market value of assets. Effective January 1, 2015, BCBS Association removed the expense load and replaced it by lowering the discount rate on plan liabilities by 25 basis points. Thus, BCBS Association decreased its discount rate from 7.5 percent to 7.25 percent and decreased its lump sum conversion rate from 4.5 percent to 4.25 percent. This alteration of the expense load constituted a change in cost accounting methodology and, as such and as specified in the Medicare contracts, required advance approval from CMS.

CAS 413.50(c)(12) states that when a Medicare contractor is computing a segment closing, the true-up of assets and liabilities must represent an adjustment of previously-determined pension costs. In addition, CAS 413.50(c)(12)(i) requires the use of current and prior long-term assumptions in the measurement of pension costs. Because BCBS Association changed its cost accounting methodology in the final year of its Medicare contract and did not seek approval in advance from CMS to do so, BCBS Association's segment closing calculation did not comply with the CAS.

Because long-term assumption changes do not usually show fluctuation over time, and because gains and losses due to inaccurate assumptions cannot be recovered after a segment closes, we determined that the effects of such assumptions must be corrected. Therefore, we requested that BCBS Association revise its CY 2015 actuarial accrued liabilities and normal costs using the CY 2014 assumptions (that is, the assumptions it had used before the change in cost accounting methodology).

Using the revised actuarial accrued liabilities (which derived from the same assumptions used during CY 2014), we determined that the Total Company actuarial accrued liabilities were \$198,944,321, a decrease of \$15,150,942. The normal costs also decreased from \$4,393,506 to

\$3,977,046. We based the results of our review (the update of the Medicare segment, the calculation of pension costs claimed, and the Medicare segment closing calculation, the latter of which we discuss in the next section of this report) on the revised actuarial accrued liabilities and normal costs.

Because BCBS Association's contractual relationship with CMS has ended, it is not appropriate for this report to make a procedural recommendation involving CMS approval of future changes in cost accounting methodology.

## **MEDICARE SEGMENT CLOSING ADJUSTMENT**

The change in cost accounting methodology discussed just above also affected BCBS Association's computation of Medicare's share of the Medicare segment excess pension assets—the focus of our third objective. We determined BCBS Association understated Medicare's share of the Medicare segment excess pension assets by \$160,634 as of September 30, 2015 (the closing date of the Medicare contract). The discussion that follows explains how we determined that dollar amount.

### **Medicare Segment Excess Pension Assets as of September 30, 2015**

CAS 413 (Appendix C) requires that a terminated Medicare contractor like BCBS Association compute a Medicare segment closing adjustment as a result of the termination of its Medicare contract. Accordingly, BCBS Association identified \$272,734 in Medicare segment excess pension assets as of September 30, 2015. However, we calculated the Medicare excess pension assets to be \$516,345 as of that date. (It is necessary to calculate the pension assets and liabilities as well as any adjustments for the Medicare segment before calculating Medicare's share of those assets and liabilities.) Therefore, BCBS Association understated the Medicare segment excess pension assets by \$243,611.

The understatement occurred because BCBS Association (1) incorrectly identified the Medicare segment participants as of September 30, 2015; (2) overstated the Medicare segment pension assets as of September 30, 2015; and (3) computed the 2015 accrued liabilities using inappropriate assumptions (as discussed above in "Change in Cost Accounting Methodology"). Both BCBS Association and we then used the development of excess assets to identify Medicare's share of the Medicare segment's excess pension assets.

### **Medicare's Share of the Medicare Segment Excess Pension Assets**

BCBS Association calculated the aggregate Medicare percentage (that is, the percentage that reflects Medicare's share of the Medicare segment excess pension assets) as 100 percent. By contrast, we calculated the aggregate Medicare percentage to be 83.93 percent (Appendix D) using the Medicare segment line of business (LOB) percentages developed during the prior pension costs claimed (A-07-95-01109, issued May 10, 1995, and A-07-13-00411, issued February 28, 2013) and current pension costs claimed (A-07-17-00497) audits.

CAS 413.50(c)(12)(vi) specifically prescribes the method to be used to determine the Federal Government’s share (i.e., Medicare’s share) of any excess pension assets or liabilities at the Medicare segment closing date. However, given the facts that BCBS Association’s qualified pension plan was fully funded during CYs 1986 through 2015 and that there were no allowable Medicare segment pension costs, we determined that the use of the method prescribed in the CAS would be inequitable to the Federal Government. We reached this conclusion because the method prescribed in the CAS would not accurately represent the Federal Government’s participation in the qualified pension plan during the period of CYs 1966 through 1985.<sup>1</sup>

In discussions with BCBS Association, we therefore proposed to compute an average of the Medicare LOB percentages (based on salary dollars) from CYs 1986 through 2015 and use the result of that calculation to identify Medicare’s share of the Medicare segment excess pension assets. BCBS Association accepted our proposal to use the average of the Medicare LOB percentages as the Medicare aggregate percentage for the segment closing. See Appendix D for our calculation of the Medicare aggregate percentage. Table 3 below shows our calculations of Medicare’s share of the Medicare segment excess pension assets. For details on the Federal requirements regarding the aggregate Medicare percentage, see Appendix C.

<b>Table 3: Medicare Segment Closing Adjustment</b>			
	<b>Excess Medicare Segment Assets (A)</b>	<b>Aggregate Medicare Percentage (B)</b>	<b>Excess Assets Attributable to Medicare (A x B)</b>
Per Audit	\$516,345	83.93%	\$433,368
Per BCBS Association	272,734	100%	272,734
<b>Difference</b>			<b>\$160,634</b>

Because BCBS Association calculated the aggregate Medicare percentage as 100 percent, it calculated \$272,734 as both the Medicare segment pension assets, and Medicare’s share of the Medicare segment excess pension assets, as of September 30, 2015. However, on the basis of our calculation of 83.93 percent as the aggregate Medicare percentage, we determined that Medicare’s share of the Medicare segment excess pension assets was \$433,368 as of that date. BCBS Association understated Medicare’s share of the Medicare segment excess pension assets by \$160,634 because it (1) computed the CY 2015 accrued liabilities using inappropriate assumptions (as discussed above) and (2) did not calculate the aggregate Medicare percentage in accordance with the CAS.

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<sup>1</sup> BCBS Association began administering Medicare Part A operations in CY 1966. CYs 1966 through 1985 represent the period of time when pension segmentation was not required by the Medicare contracts.

## **RECOMMENDATIONS**

We recommend that BCBS Association:

- decrease its Medicare segment pension assets as of September 30, 2015, by \$1,011,057 and recognize \$6,566,432 as the Medicare segment pension assets, and
- increase Medicare's share of the Medicare segment excess pension assets as of September 30, 2015, by \$160,634 and recognize \$433,368 as Medicare's share of the Medicare segment excess pension assets as a result of the Medicare segment closing adjustment.

## **AUDITEE COMMENTS**

In written comments on our draft report, BCBS Association stated that it accepted our recommendations and added that it understood that the Federal Government would present a global settlement, as a result of the Medicare contract termination, summarizing all Medicare pension segment audit recommendations relating to its contract with the U.S. Department of Health and Human Services, including the recommendations in this report.

BCBS Association's comments are included in their entirety as Appendix E.

## **APPENDIX A: AUDIT SCOPE AND METHODOLOGY**

### **SCOPE**

We reviewed BCBS Association's implementation of the prior audit recommendation; identification of its Medicare segment; update of the Medicare segment's pension assets from January 1, 2011, to September 30, 2015; and the Medicare segment closing adjustment as of September 30, 2015.

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

We performed fieldwork at BCBS Association's office in Chicago, Illinois.

### **METHODOLOGY**

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the Federal Acquisition Regulation, CAS, and the Medicare contracts applicable to this audit.
- We reviewed the annual actuarial valuation reports prepared by BCBS Association's actuarial consulting firm, 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's 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 BCBS Association staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed BCBS Association's accounting records to verify the Medicare segment identification and benefit payments made to Medicare segment participants.
- We reviewed the prior segmentation audit performed at BCBS Association (A-07-13-00410, issued February 28, 2013) to determine the beginning market value of assets for the Medicare segment.
- We reviewed the Medicare segment closing adjustment prepared by BCBS Association's actuarial consulting firm.

- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment's pension assets from January 1, 2011, to September 30, 2015, and the Medicare segment's excess pension assets as of September 30, 2015.
- We reviewed the CMS actuaries' methodology and calculations.
- We provided the results of the review to BCBS Association officials on December 6, 2016.

We performed this review in conjunction with the following audit and used the information obtained during this review: *Blue Cross Blue Shield Association Did Not Claim Some Allowable Medicare Pension Costs for Fiscal Years 2011 Through 2015 (A-07-17-00497)*.

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.

**APPENDIX B: BLUE CROSS BLUE SHIELD ASSOCIATION  
STATEMENT OF MEDICARE SEGMENT PENSION ASSETS  
FOR THE PERIOD JANUARY 1, 2011, TO SEPTEMBER 30, 2015**

Description		Total Company	Other Segments	Medicare Segment
Assets January 1, 2011	1/	\$173,423,247	\$168,003,312	\$5,419,935
Prepayment Credits	2/	0	0	0
Contributions	3/	16,000,000	16,000,000	0
Earnings	4/	3,646,157	3,528,261	117,896
Benefit Payments	5/	(13,181,468)	(13,181,468)	0
Administrative Expenses	6/	(415,242)	(401,815)	(13,427)
Transfers	7/	0	0	0
Assets January 1, 2012		\$179,472,694	\$173,948,290	\$5,524,404
Prepayment Credits		0	0	0
Contributions		6,500,000	6,500,000	0
Earnings		25,809,156	25,018,567	790,589
Benefit Payments		(10,576,358)	(10,198,830)	(377,528)
Administrative Expenses		(518,838)	(502,945)	(15,893)
Discount on Accrued Contributions	8/	(108,261)	(108,261)	0
Transfers		0	(353,343)	353,343
Assets January 1, 2013		\$200,578,393	\$194,303,478	\$6,274,915
Prepayment Credits		0	0	0
Contributions		6,500,000	6,500,000	0
Earnings		23,111,187	22,363,934	747,253
Benefit Payments		(13,012,984)	(13,012,984)	0
Administrative Expenses		(494,256)	(478,275)	(15,981)
Discount on Accrued Contributions		(118,678)	(118,678)	0
Transfers		0	264,209	(264,209)
Assets January 1, 2014		\$216,563,662	\$209,821,684	\$6,741,978
Prepayment Credits		0	0	0
Contributions		4,500,000	4,500,000	0
Earnings		16,981,402	16,440,362	541,040
Benefit Payments		(9,911,851)	(9,911,851)	0
Administrative Expenses		(555,097)	(537,411)	(17,686)
Discount on Accrued Contributions		(80,411)	(80,411)	0
Transfers		0	(487,276)	487,276
Assets January 1, 2015		\$227,497,705	\$219,745,097	\$7,752,608
Prepayment Credits		0	0	0
Contributions		0	0	0
Earnings		(5,658,387)	(5,459,997)	(198,390)
Benefit Payments		(12,761,918)	(12,761,918)	0
Administrative Expenses		(346,698)	(334,542)	(12,156)
Discount on Accrued Contributions		0	0	0
Transfers		0	975,630	(975,630)
Assets September 30, 2015		\$208,730,702	\$202,164,270	\$6,566,432
Per BCBS Association	9/	208,730,702	201,153,213	7,577,489
Asset Variance	10/	0	(1,011,057)	1,011,057

**ENDNOTES**

1/ We determined the Medicare segment pension assets as of January 1, 2011, based on our prior segmentation audit of BCBS Association (A-07-13-00410, issued February 28, 2013). 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/ Transferred 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 net investment earnings from the actuarial valuation reports. We allocated net investment earnings based on the ratio of each segment's weighted average value (WAV) of assets to Total Company WAV of assets as required by the 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 BCBS Association.
- 6/ In accordance with the CAS, we allocated administrative expenses to each Medicare segment in proportion to investment earnings.
- 7/ We identified participant transfers between segments by comparing valuation data files provided by BCBS Association. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 8/ Actual contributions are discounted, at the effective interest rate, from the date of each contribution to the beginning of the program year.
- 9/ We obtained total asset amounts from documents prepared by BCBS Association's actuarial consulting firm.
- 10/ The asset variance represents the difference between our calculation of the Medicare segment pension assets and BCBS Association's calculation of the Medicare segment pension assets.

## **APPENDIX C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION AND MEDICARE SEGMENT CLOSING ADJUSTMENT**

### **PENSION SEGMENTATION**

#### **Federal Regulations**

Federal regulations (CAS 412.50(a)(4)) require 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.

Federal regulations (CAS 413.50(c)(7)) require 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 WAV of assets to Total Company WAV of assets.

Federal regulations (CAS 413.50(c)(8)) require that an adjustment 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.

#### **Medicare Contracts**

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)."

### **MEDICARE SEGMENT CLOSING ADJUSTMENT**

#### **Federal Regulations**

Federal regulations (CAS 413-50(c)(12)) state that 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 accrued 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.

Federal regulations (CAS 413-50(c)(12)(i)) require that the determination of the actuarial accrued liability 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. If there is a pension plan termination, the actuarial accrued liability shall be measured as the amount paid to irrevocably settle all benefit obligations or paid to the Pension Benefit Guarantee Corporation.

The methodology for determining the Federal Government's share of excess pension assets and 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 Contracts**

The Medicare contracts, Appendix B, section II(A), require that costs be estimated (budgeted), accumulated, and reported on a consistent basis. In addition, CMS issued to Medicare contractors the Budget and Performance Requirements, section VI(B), which states that "as regards the allocation of such costs to the Medicare contract/agreement ... [a]ny change in accounting practice for such pension and/or post-retirement benefit costs must be submitted to CMS in advance for approval." (Emphasis in original.)

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 assets and liabilities in accordance with CAS 413.

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

<b>Fiscal Year</b>	<b>Medicare Aggregate Percentage</b>
1/	2/
1986	78.58%
1987	83.24%
1988	78.70%
1989	77.64%
1990	75.21%
1991	78.13%
1992	71.63%
1993	74.39%
1994	74.39%
1995	74.39%
1996	74.39%
1997	74.39%
1998	78.01%
1999	94.75%
2000	98.12%
2001	99.26%
2002	98.11%
2003	91.55%
2004	93.95%
2005	93.13%
2006	92.28%
2007	82.49%
2008	90.43%
2009	90.21%
2010	91.29%
2011	88.70%
2012	70.82%
2013	85.37%
2014	84.02%
2015	80.40%
<b>Total</b>	<b>83.93%</b>

**ENDNOTES**

1/ The aggregate LOB percentage was based on the audited LOB percentages calculated during the prior pension costs claimed (A-07-95-01109, issued May 10, 1995, and A-07-13-00411, issued January 3, 2013) and current pension costs claimed (A-07-17-00497) audits.

2/ We calculated the aggregate Medicare percentage by computing the average of the Medicare LOB percentages for CYs 1986 through 2015.

## APPENDIX E: AUDITEE COMMENTS



February 10, 2017

Patrick J. Cogley  
Regional Inspector General  
DHHS OIG Office of Audit Services, Region VII  
601 East 12th Street, Room 0429  
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RE: Draft Audit Report Number: A-07-17-00496

Blue Cross Blue Shield Association Overstated Its Medicare Segment Pension Assets  
And Understated Medicare's Share of the Medicare Segment Excess Pension Assets  
as of September 30, 2015

Dear Patrick,

Reference is to the draft audit report submitted to Blue Cross Blue Shield Association (BCBSA)  
under cover of your letter dated January 4, 2017.

Following is the comments in the Recommendations section on page 8 of the report (in the order in which  
they appear):

- Decrease its Medicare segment pension assets as of September 30, 2015, by \$1,011,057 and recognize \$6,566,432 as the Medicare segment pension assets, and
- Increase Medicare's share of the Medicare segment excess pension assets as of September 30, 2015, by \$160,634 and recognize \$433,368 as Medicare's share of the Medicare segment excess pension assets as a result of the Medicare segment closing adjustment.

BCBSA accepts the audit recommendations listed above. BCBSA understands the Federal Government will present us a global settlement summarizing all Medicare pension segment audit recommendations relating to our contract with the Department of Health and Human Services, including the recommendations referenced in this letter.

I want to thank you and your staff for the professional manner in which this audit was conducted and for affording us the opportunity to discuss the various issues raised during the audit. This spirit of cooperation clearly facilitated the timely completion of the audit.

Sincerely,

/Steve Mickelson/

Executive Director, Financial Services

Copies: Terrance Cooney, BCBSA  
Mitchell Helfand, BCBSA  
Jeffrey Wilson, DHHS OIG

Mark Rangel, BCBSA  
James Williamson, BCBSA  
Jenene Tambke, DHHS OIG