

**Memorandum**

AUG 4 1994

Date

From

*Michael P. Morgan*  
for June Gibbs Brown  
Inspector General

Subject

Review of Medicare Contractor's Pension Segmentation, Health Care Service Corporation (A-07-94-00763)

To

Bruce C. Vladeck  
Administrator  
Health Care Financing Administration

This memorandum is to alert you to the issuance on August 8, 1994 of our final audit report. A copy is attached.

The objective of our audit was to determine whether Health Care Service Corporation (HCSC) complied with the segmentation requirements of its Medicare contracts. Under its Medicare contracts, HCSC was required to identify and report pension assets and costs separately (called segmentation) for its Medicare line of business. This required HCSC to determine Medicare's pension assets as of 1986 and then annually determine Medicare's pension costs and assets for subsequent years.

This is one of a series of pension audits requested by the Health Care Financing Administration (HCFA) of Medicare contractors. The audits are conducted as joint efforts using Office of Inspector General auditors and HCFA pension actuarial staff. We are alerting you to the issuance of this particular report because of the dollar amount involved.

The HCSC's update of the Medicare segments' assets from January 1, 1986 to January 1, 1992 understated the Medicare segments' assets by \$1,055,458. The understatement primarily occurred because HCSC did not (1) properly calculate Medicare's pension costs and (2) consider participant transfers into and out of their Medicare lines of business.

We recommend that HCSC increase the January 1, 1992 Medicare pension assets by \$1,055,458. The HCSC disagreed with our calculated amount of Medicare assets as of January 1, 1992. They stated they wish to discuss the potential waiver of the established Federal pension rules with HCFA officials.

Page 2 - Bruce C. Vladeck

Regional Health Care Financing Administration officials declined to comment on our recommendations.

For further information contact:

Barbara A. Bennett  
Regional Inspector General for  
Audit Services, Region VII  
(816) 426-3591

Attachment

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE CONTRACTOR'S  
PENSION SEGMENTATION**

**HEALTH CARE SERVICE CORPORATION**



**JUNE GIBBS BROWN**  
Inspector General

**AUGUST 1994**  
A-07-94-00763



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

CIN: A-07-94-00763

Mr. Richard J. Giba  
Internal Audit/Controls Consultant  
Health Care Service Corporation  
233 North Michigan Avenue, 17th Floor  
Chicago, Illinois 60601

Dear Mr. Giba:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled "REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION, HEALTH CARE SERVICE CORPORATION." The purpose of our review was to evaluate Health Care Service Corporation's (HCSC) compliance with the pension segmentation requirements of its Medicare contracts.

The HCSC's Medicare contracts require separate identification, calculation, and reporting of pension assets, and when appropriate, costs for the Medicare segments. Compliance requires: (1) establishing a ratio (asset fraction) using the 1986 actuarial liabilities of the segment and the total plan, (2) applying the ratio to total pension assets as of 1986, (3) updating the Medicare segments' 1986 pension assets annually, and (4) assessing if Medicare's pension costs require separate calculations.

The HCSC established its current pension plan as of January 1, 1986. As a result, there were no total plan assets or Medicare segment assets as of this date.

The HCSC's update of the Medicare segments' assets from January 1, 1986 to January 1, 1992 understated the Medicare segments' assets by \$1,055,458 (Medicare A segment by \$129,177 and Medicare B segment by \$926,281). The Medicare A segment understatement occurred primarily because HCSC did not properly compute the segment's pension cost. The Medicare B segment understatement occurred primarily because HCSC did not consider participant transfers into and out of the Medicare B segment.

We recommend that HCSC increase the January 1, 1992 assets of the Medicare segments by \$1,055,458. The HCSC disagreed with our calculated amount for the updated segments' assets as of January 1, 1992. This difference resulted from HCSC's use of another

funding methodology for the segments' CAS pension costs. The response to our draft report is included as Appendix B.

## INTRODUCTION

### BACKGROUND

Title XVIII of the Social Security Act, Health Insurance for the Aged and Disabled (Medicare), provides that organizations may help in administering the Medicare program under contracts with the Secretary, U.S. Department of Health and Human Services. Most Medicare contractors, intermediaries (Part A) and carriers (Part B), performed under cost reimbursement contracts renewed annually. The HCSC currently administers Medicare Part A and Part B under cost reimbursement contracts.

Reimbursement principles for cost reimbursement contracts are contained in the contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS). Medicare contracts provide that a contractor "\*\*\*shall be paid its costs of administration under the principle of neither profit nor loss\*\*\*."

In 1985, we issued an audit report, "Medicare Intermediaries and Carriers Should Be Required to Use Segment Accounting For Claiming Pension Costs," (07-62013) to the Health Care Financing Administration (HCFA). The report showed that pension contributions charged to Medicare exceeded the amounts needed to meet Medicare's pension liabilities. The report recommended that HCFA amend Medicare contracts to require treatment of Medicare as a separate segment for calculating and charging pension costs.

The HCFA incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988 and distributed a pension cost questionnaire to contractors in 1989. The purpose of the questionnaire was to ensure that contractors developed and maintained the data necessary for segmentation calculations.

The HCSC submitted its questionnaire response on March 15, 1989. In subsequent asset updates, HCSC identified total pension assets of \$46,549,962, Medicare A segment assets of \$2,541,140, and Medicare B segment assets of \$2,379,401 as of January 1, 1992. The HCSC also decided to perform separate valuations for the Medicare segments.

### Criteria Governing Segmented Pension Costs

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or

the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates 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.

The contractual language incorporated by HCFA starting with Fiscal Year 1988 specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment. The HCSC's contracts required: (1) computing the Medicare segments' actuarial liability as of 1986, (2) determining the ratio of the Medicare segments' actuarial liability to the total plan actuarial liability as of 1986, (3) allocating a portion of total pension assets as of 1986 based on the 1986 ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

"The term 'Medicare Segment' shall mean 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 is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract."

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan as of the first day of the first plan year starting after December 31, 1980, or as of the first day of the first plan year following the creation of the segment, whichever date is later.

Other CAS requirements apply to the calculation of pension costs. For instance, pension costs for a segment can consider all, or just active, participants (CAS, section 413.50(c)(9)). Also, if movement of participants into and out of a segment materially affects a segment's ratio of assets to liabilities, transfer adjustments are necessary (CAS, section 413.50(c)(8)). Finally, the CAS addresses allocating or separately calculating pension costs for a segment.

#### SCOPE

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine HCSC's compliance with pension segmentation requirements of its Medicare contracts. Achieving our objective did not require a review of HCSC's internal control structure. The audit addressed HCSC's initial determination of pension assets for its Medicare segments and later updates. Our review covered January 1, 1986 to January 1, 1992.

This review was done in conjunction with our audit of HCSC's unfunded pension costs (CIN: A-07-94-00762). The same information was obtained and reviewed during both audits.

We reviewed HCSC's identification of the Medicare segments as of January 1, 1988 and traced the segments' organizational lineages back to 1986. We also reviewed HCSC's update of Medicare assets from January 1, 1986 to January 1, 1992.

In performing our review, we used information provided by HCSC's pension actuary. The information included liabilities, normal costs, contributions, expenses, and earnings. We also reviewed HCSC's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Forms 5500. Using these documents, we determined the 1986 Medicare segments' assets and updated the Medicare segments' assets through 1991. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at HCSC's corporate offices in Chicago, Illinois during September 1993. Subsequently, we performed audit work in the OIG, OAS, Jefferson City, Missouri Office.

#### FINDINGS AND RECOMMENDATIONS

##### MEDICARE ASSETS AS OF 1986

The HCSC established its current pension plan as of January 1, 1986. As a result, there were no total plan assets or Medicare segment assets as of this date.

**MEDICARE'S ASSET BASE AS  
OF 1986 UPDATED TO 1992**

The HCSC's update of the Medicare segments' assets from January 1, 1986 to January 1, 1992 understated the Medicare segments' assets by \$1,055,458 (Medicare A segment by \$129,177 and Medicare B segment by \$926,281).

The HCSC misidentified participants in the Medicare segments and did not properly assign contributions to the segments. In addition, HCSC's update did not consider participant transfers to and from the segments, omitted benefit payments to Medicare segment non-actives, and used an improper methodology to assign earnings and expenses to the segments.

**Participant Errors**

We agreed with HCSC's identification of the Medicare segments' cost centers. However, HCSC misidentified active and non-active participants in its proposed Medicare segments. We corrected the participant errors in our update of the segments' assets.

**Contributions**

The HCSC's consulting actuary computed pension costs for the Medicare segments and assigned contributions to the segments based on these costs. However, the pension costs computed by the consulting actuary were not calculated in accordance with the CAS. We calculated the segments' year-end CAS funding targets, based on the segments' CAS pension costs, and allocated total company contributions to the segments based on the ratio of the segments' CAS funding targets to the total company CAS funding target.

**Earnings and Expenses**

The HCSC allocated earnings and expenses to the segments based on the ratio of the segments' actual assets to expected assets. We allocated earnings and expenses to the segments in accordance with CAS 413.50(c)(7). The CAS requires that earnings and expenses be allocated based on the ratio of the segment's beginning of year assets to total company beginning of year assets.

Our corrections to the segments' participants, contributions, and the earnings and expenses allocation increased the Medicare A assets by \$565,514 and increased the Medicare B assets by \$390,947.

**Participant Transfers**

In its asset update, HCSC overstated the January 1, 1992 Medicare A segment assets by \$351,399 and understated the January 1, 1992 Medicare B segment assets by \$691,454 because it did not consider participant transfers. The CAS requires asset adjustments if transfers are large enough to cause a distortion of a segment's ratio of fund assets to actuarial liabilities (CAS, section 413.50(c)(8)). The HCSC performed a cursory analysis of transfers, but made no adjustments.

We performed a detailed analysis of the effect of participant transfers. With regards to the Medicare A segment, our analysis showed positive transfer adjustments for 1988 (\$117,182), 1989 (22,907), and negative transfer adjustments for 1987 (\$44,560), 1990 (\$136,547), 1991 (\$257,689), and 1992 (\$25,814). For Medicare B, we made positive adjustments for 1988 (\$78,492), 1989 (\$47,012), 1990 (\$172,617), 1991 (\$249,350), 1992 (\$38,135), and a negative adjustment for 1987 (\$4,936). These amounts include adjustments for transfers between the Medicare A and Medicare B segments. See Appendix A for details.

The following tables illustrate the effect of considering or disregarding transfer adjustments as of January 1, 1992.

Transfer Distortion - Medicare A Segment

<u>Description</u>	<u>Assets</u> (A)	<u>Liabilities</u> (B)	<u>Funding Level</u> (A) / (B)
Considered	\$2,670,317	\$3,890,715	68.63%
Not Considered	<u>3,021,716</u>	<u>3,890,715</u>	<u>77.66%</u>
Difference	<u>\$ (351,399)</u>	<u>\$ -0-</u>	<u>(9.03)%</u>
Percentage Difference in the Funding Level			(13.16)%

Transfer Distortion - Medicare B Segment

<u>Description</u>	<u>Assets</u> (A)	<u>Liabilities</u> (B)	<u>Funding Level</u> (A) / (B)
Considered	\$3,305,682	\$4,000,759	82.63%
Not Considered	<u>2,614,228</u>	<u>4,000,759</u>	<u>65.34%</u>
Difference	<u>\$ 691,454</u>	<u>\$ -0-</u>	<u>17.29%</u>
Percentage Difference in the Funding Level			20.92%

For both segments, the dollar amount differences and the percentage differences in the funding level represent a significant distortion. Considering transfer adjustments in the asset update reduced the Medicare A assets by \$351,399 and

increased the Medicare B assets by \$691,454. The HCSC should have adjusted for transfers in updating the Medicare segments' assets.

#### **Benefit Payments**

The HCSC's computations omitted several benefit payments to Medicare segment non-actives. We identified the benefits paid to Medicare A and B non-actives and included these payments in our update of the segments' assets. Our corrections to the benefit payments reduced the Medicare A assets by \$84,938 and reduced the Medicare B assets by \$156,120.

#### **Medicare Assets as of January 1, 1992**

The HCSC's update of the Medicare segments' assets from January 1, 1986 to January 1, 1992 understated the Medicare segments' assets by \$1,055,458 (Medicare A segment by \$129,177 and Medicare B segment by \$926,281).

Appendix A contains the details on our update of pension assets from January 1, 1986 to January 1, 1992. The increase in assets of the Medicare A segment resulted from including the proper participants in our calculations, and our correction of the contribution and the earnings and expenses allocations (\$565,514 increase), considering participant transfers (\$351,399 decrease), and including all benefit payments to Medicare A non-actives (\$84,938 decrease). The increase in assets of the Medicare B segment resulted from including the proper participants in our calculations, and our correction of the contribution and the earnings and expenses allocations (\$390,947 increase), considering participant transfers (\$691,454 increase), and including all benefit payments to Medicare B non-actives (\$156,120 decrease).

#### **Recommendations**

We recommend that HCSC:

- o Increase the Medicare segments' pension assets by \$1,055,458 as of January 1, 1992.
- o Make periodic transfer adjustments as needed.
- o Allocate the Medicare segments' earnings and expenses in accordance with the CAS in subsequent asset updates.

#### **Auditee Comments**

The HCSC disagreed with the amounts we reported as understated for both Medicare segments: "Your report states that HCSC has

understated Medicare Segment A assets by \$129,177 and Medicare Segment B assets by \$926,281. We do not agree.

"As a result of funding the total CAS pension costs for fiscal 1987 through fiscal 1991 for Medicare Segments A and B, the assets are understated even more. Medicare A should have \$3,399,187 in assets, understated as of January 1, 1992 by \$858,047. Medicare B should have \$3,936,890 in assets, understated as of January 1, 1992 by \$1,557,489."

The HCSC's disagreement focused on their funding of the CAS costs. In their response, HCSC stated it fully funds all CAS costs for the Medicare segments: "Contributions to the plan are allocated first to Medicare Segments A and B in order to fully cover the CAS pension cost."

#### OIG Response

The HCSC's stated funding methodology allocates plan contributions first to the Medicare segments to fully cover the CAS pension costs. However, HCSC did not fund the total company CAS pension costs for Plan Years 1988 through 1990. Since HCSC only partially funded the CAS costs, we allocated the contributions among the Medicare segments and other segment using each segment's CAS computed pension cost in relation to total CAS computed pension costs.

Both the Medicare contracts and CAS provide for the consistent treatment of costs among different cost objectives. For example, Paragraph B, Section II, Appendix B of the Medicare contracts state "\*\*\*the criteria for determining the allocation of costs\*\*\*should be the same for all similar objectives." The CAS 413.50(c)(1) and (10) state "\*\*\*the base to be used for allocating such costs shall be representative of the factors [on] which the pension benefits are based." and "where pension cost is separately calculated for one or more segments, the actuarial cost method shall be the same for all segments\*\*\*."

The HCSC made several deposits into the pension trust fund during the period 1988 through 1990. We found no evidence that the deposits were specifically dedicated to a particular cost objective or group of employees. As such, our proration of the funded costs is appropriate as it provides consistent and equitable treatment of the funded costs among the segments. Therefore, we did not change our computation of the funded pension costs directly attributable to the Medicare segments in determining pension assets of the Medicare segments.

**INSTRUCTIONS FOR AUDITEE RESPONSE**

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on the final determination.

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In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR part 5.)

Sincerely,



Barbara A. Bennett  
Regional Inspector General for  
Audit Services, Region VII

Enclosures

HHS Action Official:

Mr. Chester Stroyny  
Regional Administrator, Region V  
Health Care Financing Administration  
105 West Adams Street, 15th Floor  
Chicago, Illinois 60603

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

Description	Total Company	Other Segment	Medicare A Segment	Medicare B Segment
Assets January 1, 1986 <u>1/</u>	\$ 0	\$ 0	\$ 0	\$ 0
Contributions <u>2/</u>	6,386,878	5,667,628	397,141	322,109
Benefits <u>3/</u>	0	0	0	0
Expenses <u>4/</u>	0	0	0	0
Earnings <u>5/</u>	0	0	0	0
Net Transfers <u>6/</u>	0	49,496	(44,560)	(4,936)
Assets January 1, 1987	\$6,386,878	\$5,717,124	\$ 352,581	\$ 317,173
Contributions	7,137,167	6,408,827	438,720	289,620
Benefits	(438,757)	(391,512)	(31,421)	(15,824)
Expenses	(40,799)	(36,521)	(2,252)	(2,026)
Earnings	(254,639)	(227,937)	(14,057)	(12,645)
Net Transfers	0	(195,674)	117,182	78,492
Assets January 1, 1988	\$12,789,850	\$11,274,307	\$ 860,753	\$ 654,790
Contributions	6,781,427	6,045,872	396,654	338,901
Benefits	(1,940,168)	(1,872,263)	(60,160)	(7,745)
Expenses	(66,447)	(58,573)	(4,472)	(3,402)
Earnings	627,213	552,891	42,211	32,111
Net Transfers	0	(69,919)	22,907	47,012
Assets January 1, 1989	\$18,191,875	\$15,872,315	\$1,257,893	\$1,061,667
Contributions	2,956,245	2,594,828	197,465	163,952
Benefits	(619,045)	(611,854)	0	(7,191)
Expenses	(149,817)	(130,715)	(10,359)	(8,743)
Earnings	5,162,938	4,504,636	356,996	301,306
Asset Transfer <u>7/</u>	77,633	77,633	0	0
Net Transfers	0	(36,070)	(136,547)	172,617
Assets January 1, 1990	\$25,619,829	\$22,270,773	\$1,665,448	\$1,683,608
Contributions	3,771,737	3,300,994	242,840	227,903
Benefits	(975,728)	(840,012)	(10,596)	(125,120)
Expenses	(171,090)	(148,725)	(11,122)	(11,243)
Earnings	1,058,406	920,050	68,803	69,553
Net Transfers	0	8,339	(257,689)	249,350
Assets January 1, 1991	\$29,303,154	\$25,511,419	\$1,697,684	\$2,094,051
Contributions	9,372,073	8,221,293	573,710	577,070
Benefits	(899,404)	(784,591)	(84,225)	(30,588)
Expenses	(214,141)	(186,432)	(12,406)	(15,303)
Earnings	8,988,280	7,825,225	520,738	642,317
Net Transfers	0	(12,951)	(25,184)	38,135
Assets January 1, 1992	\$46,549,962	\$40,573,963	\$2,670,317	\$3,305,682
Assets Per HCSC <u>8/</u>	\$46,549,962	\$41,629,421	\$2,541,140	\$2,379,401
Asset Variance <u>9/</u>	\$0	(\$1,055,458)	\$129,177	\$926,281

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

FOOTNOTES

- 1/ The HCSC's current plan was established as of January 1, 1986. Therefore, there were no total plan assets or Medicare segment assets as of this date. The amounts shown for the other segment represent the difference between the total company and the Medicare segments.
- 2/ We obtained total contribution amounts from IRS Form 5500 reports. We allocated contributions to the Medicare segments based on the ratio of the segments' year-end CAS funding targets to the total company's year-end CAS funding target. The calculation of the CAS funding target is shown in our report of HCSC's unfunded pension costs (CIN: A-07-94-00762).
- 3/ We obtained total benefit payments from IRS Form 5500 reports. We based the Medicare segments' benefit payments on actual payments to Medicare segment participants.
- 4/ We obtained administrative expenses from IRS Form 5500 reports. We allocated expenses to the Medicare segments based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. This is the methodology described in CAS 413.50(c)(7).
- 5/ We obtained investment earnings from IRS Form 5500 reports. Where necessary, we adjusted the total company earnings to agree with the end of year total company asset values. We allocated earnings to the Medicare segments based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets. This is the methodology described in CAS 413.50(c)(7).
- 6/ We analyzed the movement of participants between segments by comparing HCSC's annual participant listings. We made appropriate adjustments as explained in our finding section of the report narrative. We transferred assets equal to the net transfer of the actuarial liability of the participants who moved into and out of the Medicare segments.
- 7/ The asset transfer represents a total company transaction that does not affect the Medicare segments.

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

- 8/ The HCSC identified total company assets in the January 1, 1992 actuarial valuation report. The Medicare segments' assets were identified in a schedule of assets prepared by HCSC's actuary.
- 9/ We computed the asset variance by subtracting HCSC's calculation of assets as of January 1, 1992 from our calculation of the assets.



233 North Michigan Avenue  
Chicago, Illinois 60601-5655  
312/938-6000

March 14, 1994

Mr. James Aasmundstad  
Department of Health and Human Services  
Office of the Inspector General  
Office of Audit Services  
Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64106

Re: *A-07-94-00761*  
*A-07-94-00762*  
*A-07-94-00763*

Dear Mr. Aasmundstad:

I am writing in response to the three reports prepared by the Office of the Inspector General, Office of Audit Services reviewing:

- Pension costs claimed for Medicare reimbursement by Health Care Service Corporation, CIN: A-07-94-00761,
- Unfunded pension costs of Health Care Service Corporation, CIN: A-07-94-00762, and
- Medicare Contractor's pension segmentation, Health Care Service Corporation, CIN: A-07-94-00763.

*Pension Costs Claimed*

Your report states that HCSC has received reimbursement for \$2,811,890 in Medicare pension costs from the Health Care Financing Administration (HCFA) for fiscal years 1987 through 1991. We agree. The funded portion of CAS computed pension costs was reported as \$3,137,403. On this amount, we disagree. HCSC fully funds all CAS

Mr. James Aasmundstad  
March 14, 1994  
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pension costs for the Medicare Part A and Part B segments and, thus, the amount funded was actually \$4,286,117.

Our amounts differ for two reasons:

1. For fiscal years 1987 through 1991, HCSC actually funded the total CAS pension cost for Medicare Segments A and B, and
2. The calculation of the indirect allowable pension cost should multiply the Medicare indirect percentage by the CAS pension cost rather than the allocable pension cost.

Attached is Exhibit I, which shows revised calculations of Appendix A to report CIN: A-07-94-00761.

As a result, HCSC claims an additional \$1,474,227 in allowable CAS pension costs for fiscal years 1987 through 1991, rather than the additional \$325,513 as stated in your report.

#### *Unfunded Pension Costs*

Your report states that HCSC has accumulated unfunded Medicare pension costs for Segment A and Segment B of \$1,233,337. We do not agree.

Contributions to the plan are allocated first to Medicare Segments A and B in order to fully cover the CAS pension cost. As a result of funding the total CAS pension costs for fiscal 1987 through fiscal 1991 for Medicare Segments A and B, there will be no unfunded Medicare pension costs.

Attached is Exhibit II which shows revised calculations of Appendix A to report CIN: A-07-94-00762.

#### *Pension Segmentation*

Your report states that HCSC has understated Medicare Segment A assets by \$129,177 and Medicare Segment B assets by \$926,231. We do not agree.

Mr. James Aasmundstad  
March 14, 1994  
Page 3.

As a result of funding the total CAS pension costs for fiscal 1987 through fiscal 1991 for Medicare Segments A and B, the assets are understated even more. Medicare A should have \$3,399,187 in assets, understated as of January 1, 1992 by \$858,047. Medicare B should have \$3,936,890 in assets, understated as of January 1, 1992 by \$1,557,489.

Attached is Exhibit III, which shows revised calculations of Appendix A to report CIN: A-07-94-00763.

We agree with all other findings and recommendations outlined in the three reports.

Please contact me with your comments to my revisions.

Sincerely,



Richard Giba  
Internal Audit/Controls Consultant

cc: Mr. Vincent Imbriani -- DHHS/OIG/OAS  
Ms. Denise Bujak -- Health Care Service Corporation  
Mr. Mark Ellis -- Health Care Service Corporation  
Mr. John Nutting -- Health Care Service Corporation  
Ms. Virginia Vlcek -- Towers Perrin  
Mr. John Whitney -- Towers Perrin

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

EXHIBIT I

Revised Appendix A

CIN: A-07-94-00761

STATEMENT OF ALLOWABLE CAS PENSION COSTS  
FOR FISCAL YEARS 1987 THROUGH 1991

	<u>Total Plan</u>	<u>Other Segment</u>	<u>Medicare A Segment</u>	<u>Medicare B Segment</u>
1986 Plan Year Contributions	\$6,386,878	\$5,667,628	\$397,141	\$322,109
Discount for Interest	<u>(513,837)</u>	<u>(456,016)</u>	<u>(31,954)</u>	<u>(25,917)</u>
Present Value of Funding	5,872,991	5,211,612	365,187	296,192
CAS Pension Costs	<u>5,872,991</u>	<u>5,211,612</u>	<u>365,187</u>	<u>296,192</u>
Percentage of Costs Funded	100%	100%	100%	100%
Funded CAS Pension Cost	5,872,991	5,211,612	365,187	296,192
Allowable Interest	<u>364,003</u>	<u>323,011</u>	<u>22,634</u>	<u>18,358</u>
		0		
Allocable Pension Cost	6,236,994	5,534,623	387,821	314,550
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			387,821	n/a
Medicare Indirect Percentage			1.6112%	n/a
Allowable Indirect Pension Cost			63,969	n/a
Calendar Year Pension Cost			471,790	n/a
1987 Plan Year Contributions	\$7,137,167	\$6,408,827	\$438,720	\$289,620
Discount for Interest	<u>(574,255)</u>	<u>(515,653)</u>	<u>(35,299)</u>	<u>(23,303)</u>
Present Value of Funding	6,562,912	5,893,174	403,421	266,317
CAS Pension Costs	<u>6,562,912</u>	<u>5,893,174</u>	<u>403,421</u>	<u>266,317</u>
Percentage of Costs Funded	100%	100%	100%	100%
Funded CAS Pension Cost	6,562,912	5,893,174	403,421	266,317
Allowable Interest	<u>406,764</u>	<u>365,254</u>	<u>25,004</u>	<u>16,506</u>
		0		
Allocable Pension Cost	6,969,676	6,258,428	428,425	282,823
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			428,425	n/a
Medicare Indirect Percentage			1.3374%	n/a
Allowable Indirect Pension Cost			78,815	n/a
Calendar Year Pension Cost			507,240	n/a
Fiscal Year Pension Cost			493,373	n/a

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

STATEMENT OF ALLOWABLE CAS PENSION COSTS

FOR FISCAL YEARS 1987 THROUGH 1991

	<u>Total Plan</u>	<u>Other Segment</u>	<u>Medicare A Segment</u>	<u>Medicare B Segment</u>
1988 Plan Year Contributions	\$6,781,427	\$5,900,609	\$474,988	\$405,830
Discount for Interest	<u>(480,039)</u>	<u>(417,688)</u>	<u>(33,623)</u>	<u>(28,728)</u>
Present Value of Funding	6,301,388	5,482,921	441,365	377,102
CAS Pension Costs	<u>7,545,840</u>	<u>6,727,373</u>	<u>441,365</u>	<u>377,102</u>
Percentage of Costs Funded	83.51%	81.50%	100%	100%
Funded CAS Pension Cost	6,301,388	5,482,921	441,365	377,102
Allowable Interest	<u>368,237</u>	<u>320,408</u>	<u>25,792</u>	<u>22,037</u>
		0		
Allocable Pension Cost	6,669,625	5,803,329	467,157	399,139
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			467,157	n/a
Medicare Indirect Percentage			1.8858%	n/a
Allowable Indirect Pension Cost			126,865	n/a
Calendar Year Pension Cost			594,022	n/a
Fiscal Year Pension Cost			572,327	n/a
1989 Plan Year Contributions	\$2,956,245	\$2,128,737	\$452,120	\$375,388
Discount for Interest	<u>(174,547)</u>	<u>(125,688)</u>	<u>(26,695)</u>	<u>(22,164)</u>
Present Value of Funding	2,781,698	2,003,049	425,425	353,224
CAS Pension Costs	<u>6,369,026</u>	<u>5,590,377</u>	<u>425,425</u>	<u>353,224</u>
Percentage of Costs Funded	43.68%	35.83%	100%	100%
Funded CAS Pension Cost	2,781,698	2,003,049	425,425	353,224
Allowable Interest	<u>162,555</u>	<u>117,053</u>	<u>24,861</u>	<u>20,641</u>
		0		
Allocable Pension Cost	2,944,253	2,120,102	450,286	373,865
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			450,286	373,865
Medicare Indirect Percentage			1.6246%	2.0260%
Allowable Indirect Pension Cost			90,521	113,373
Calendar Year Pension Cost			541,107	467,238
Fiscal Year Pension Cost			554,335	243,619

Note: Indirect pension costs include the Medicare Indirect Pension Cost of \$113,373 for 1989.

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

STATEMENT OF ALLOWABLE CAS PENSION COSTS  
FOR FISCAL YEARS 1987 THROUGH 1991

	<u>Total Plan</u>	<u>Other Segment</u>	<u>Medicare A Segment</u>	<u>Medicare B Segment</u>
1990 Plan Year Contributions	\$3,771,737	\$2,852,511	\$474,197	\$445,029
Discount for Interest	<u>(243,039)</u>	<u>(183,807)</u>	<u>(30,556)</u>	<u>(28,676)</u>
Present Value of Funding	3,528,698	2,668,704	443,641	416,353
CAS Pension Costs	<u>6,890,539</u>	<u>6,030,545</u>	<u>443,641</u>	<u>416,353</u>
Percentage of Costs Funded	51.21%	44.25%	100%	100%
Funded CAS Pension Cost	3,528,698	2,668,704	443,641	416,353
Allowable Interest	<u>206,208</u>	<u>155,952</u>	<u>25,925</u>	<u>24,331</u>
		0		
Allocable Pension Cost	3,734,906	2,824,656	469,566	440,684
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			469,566	440,684
Medicare Indirect Percentage			2.0200%	2.5105%
Allowable Indirect Pension Cost			121,817	151,397
Calendar Year Pension Cost			591,383	592,080
Fiscal Year Pension Cost			578,814	565,870
1991 Plan Year Contributions	\$9,372,073	\$8,335,241	\$516,903	\$519,929
Discount for Interest	<u>(628,129)</u>	<u>(558,639)</u>	<u>(34,644)</u>	<u>(34,846)</u>
Present Value of Funding	8,743,944	7,776,602	482,259	485,083
CAS Pension Costs	<u>7,878,131</u>	<u>6,910,789</u>	<u>482,259</u>	<u>485,083</u>
Percentage of Costs Funded	100%	100%	100%	100%
Funded CAS Pension Cost	7,878,131	6,910,789	482,259	485,083
Allowable Interest	<u>460,378</u>	<u>403,849</u>	<u>28,182</u>	<u>28,347</u>
		0		
Allocable Pension Cost	8,338,509	7,314,638	510,441	513,430
Medicare Segment Percentage	<u>n/a</u>	<u>n/a</u>	<u>100%</u>	<u>100%</u>
Allowable Segment Pension Cost			510,441	513,430
Medicare Indirect Percentage			1.8237%	2.2037%
Allowable Indirect Pension Cost			126,032	152,639
Calendar Year Pension Cost			636,473	636,069
Fiscal Year Pension Cost			625,201	647,572

Note: The above information is based on the financial statements of Health Care Service Corporation for the fiscal years ended 12/31/90 and 12/31/91.

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

Exhibit II  
Revised Appendix A  
CIN: A-07-94-00762

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

	<u>Total Plan</u>	<u>Other Segment</u>	<u>Medicare A Segment</u>	<u>Medicare B Segment</u>
01/01/86 Normal Cost	\$3,022,569	n/a	n/a	\$239,044
Amortization Payment	<u>2,850,422</u>	<u>n/a</u>	<u>n/a</u>	<u>57,143</u>
01/01/86 CAS Pension Cost	5,872,991	5,211,612	365,187	296,192
Interest to 12/31/86	<u>513,887</u>	<u>456,016</u>	<u>31,954</u>	<u>25,917</u>
12/31/86 CAS Funding Target	6,386,878	5,667,628	397,141	322,109
Contribution	(6,386,878)	(5,667,628)	(397,141)	(322,109)
Interest on Contribution	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
12/31/86 Unfunded Pension Cost	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
01/01/87 Normal Cost	\$3,475,698	n/a	n/a	\$209,371
Amortization Payment	<u>3,087,214</u>	<u>n/a</u>	<u>n/a</u>	<u>56,946</u>
01/01/87 CAS Pension Cost	6,562,912	5,893,174	403,421	266,317
Interest to 12/31/87	<u>574,255</u>	<u>515,653</u>	<u>35,299</u>	<u>23,303</u>
12/31/87 CAS Funding Target	7,137,167	6,408,827	438,720	289,620
Contribution	(7,137,167)	(6,408,827)	(438,720)	(289,620)
Interest on Contribution	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
12/31/87 Unfunded Pension Cost	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
01/01/88 Normal Cost	\$4,275,446	\$3,716,411	\$263,604	\$295,431
Amortization Payment	<u>3,270,394</u>	<u>\$3,010,962</u>	<u>\$177,761</u>	<u>81,671</u>
01/01/88 CAS Pension Cost	7,545,840	6,727,373	441,365	377,102
Interest to 12/31/88	<u>622,532</u>	<u>555,008</u>	<u>36,413</u>	<u>31,111</u>
12/31/88 CAS Funding Target	8,168,372	7,282,381	477,778	408,213
Contribution	(6,781,427)	(5,900,609)	(474,988)	(405,830)
Interest on Contribution	<u>(39,825)</u>	<u>(34,652)</u>	<u>(2,790)</u>	<u>(2,383)</u>
12/31/88 Unfunded Pension Cost	<u>1,347,120</u>	<u>1,347,120</u>	<u>0</u>	<u>0</u>
01/01/89 Normal Cost	\$3,768,919	\$3,239,945	\$262,930	\$265,044
Amortization Payment	<u>2,580,107</u>	<u>\$2,350,432</u>	<u>\$162,495</u>	<u>67,180</u>
01/01/89 CAS Pension Cost	6,369,026	5,590,377	425,425	353,224
Interest to 12/31/89	<u>525,445</u>	<u>461,205</u>	<u>35,098</u>	<u>29,141</u>
12/31/89 CAS Funding Target	6,894,471	6,051,593	450,523	382,365
Contribution	(2,955,245)	(2,129,737)	(452,120)	(375,388)
Interest on Contribution	<u>(54,943)</u>	<u>(39,553)</u>	<u>(3,403)</u>	<u>(3,977)</u>
12/31/89 Unfunded Pension Cost	<u>3,884,283</u>	<u>3,889,743</u>	<u>0</u>	<u>0</u>

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

Exhibit II  
Revised Appendix A  
CIN: A-07-94-00762

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

		<u>Total Plan</u>	<u>Other Segment</u>	<u>Medicare A Segment</u>	<u>Medicare B Segment</u>
01/01/90	Normal Cost	\$4,382,417	\$3,743,560	\$283,556	\$355,281
	Amortization Payment	<u>2,508,122</u>	<u>\$2,235,965</u>	<u>\$160,085</u>	<u>61,072</u>
01/01/90	CAS Pension Cost	6,890,539	6,030,545	443,641	416,353
	Interest to 12/31/90	<u>568,469</u>	<u>497,520</u>	<u>36,600</u>	<u>34,349</u>
12/31/90	CAS Funding Target	7,459,008	6,528,065	480,241	450,702
	Contribution	(3,771,737)	(2,852,511)	(474,197)	(445,029)
	Interest on Contribution	<u>(48,079)</u>	<u>(36,361)</u>	<u>(6,044)</u>	<u>(5,673)</u>
12/31/90	Unfunded Pension Cost	<u>3,639,192</u>	<u>3,639,192</u>	<u>0</u>	<u>0</u>
01/01/91	Normal Cost	\$4,982,377	\$4,283,479	\$297,545	\$401,353
	Amortization Payment	<u>2,895,754</u>	<u>\$2,627,310</u>	<u>\$184,714</u>	<u>83,730</u>
01/01/91	CAS Pension Cost	7,878,131	6,910,789	482,259	485,083
	Interest to 12/31/91	<u>649,946</u>	<u>570,140</u>	<u>39,786</u>	<u>40,019</u>
12/31/91	CAS Funding Target	8,528,077	7,480,929	522,045	525,102
	Contribution	(9,372,073)	(8,335,241)	(516,903)	(519,929)
	Interest on Contribution	<u>(93,246)</u>	<u>(82,930)</u>	<u>(5,142)</u>	<u>(5,173)</u>
12/31/91	Unfunded Pension Cost	<u>(937,242)</u>	<u>(937,242)</u>	<u>0</u>	<u>0</u>

HEALTH CARE SERVICE CORPORATION  
CHICAGO, ILLINOIS

Exhibit III  
Revised Appendix A  
CIN: A-07-94-00763

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD  
JANUARY 1, 1986 TO JANUARY 1, 1992

Description	Total Plan	Other Segment	Medicare A Segment	Medicare B Segment
Assets January 1, 1986	\$0	\$0	\$0	\$0
Contributions	6,386,678	5,667,628	397,141	322,109
Benefits	0	0	0	0
Expenses	0	0	0	0
Earnings	0	0	0	0
Net Transfers	0	<u>49,496</u>	<u>(44,560)</u>	<u>(4,936)</u>
Assets January 1, 1987	\$6,386,678	\$5,717,124	\$352,561	\$317,173
Contributions	7,137,167	6,408,827	438,720	289,620
Benefits	(438,757)	(391,512)	(31,421)	(15,824)
Expenses	(40,799)	(36,521)	(2,252)	(2,026)
Earnings	(254,639)	(227,937)	(14,057)	(12,645)
Net Transfers	0	<u>(195,674)</u>	<u>117,182</u>	<u>78,492</u>
Assets January 1, 1988	\$12,789,650	\$11,274,307	\$860,753	\$654,790
Contributions	6,761,427	5,900,609	474,988	405,830
Benefits	(1,940,168)	(1,872,263)	(60,160)	(7,745)
Expenses	(66,447)	(58,573)	(4,472)	(3,402)
Earnings	627,213	552,891	42,211	32,111
Net Transfers	0	<u>(69,919)</u>	<u>22,907</u>	<u>47,012</u>
Assets January 1, 1989	\$18,191,875	\$15,727,052	\$1,336,227	\$1,128,596
Contributions	2,956,245	2,128,737	452,120	375,388
Benefits	(619,045)	(611,854)	0	(7,191)
Expenses	(149,817)	(130,715)	(10,359)	(8,743)
Earnings	5,162,938	4,463,410	379,227	320,301
Asset Transfer	77,633	77,633	0	0
Net Transfers	0	<u>(36,070)</u>	<u>(136,547)</u>	<u>172,617</u>
Assets January 1, 1990	\$25,619,829	\$21,618,193	\$2,020,669	\$1,980,968
Contributions	3,771,737	2,852,511	474,197	445,029
Benefits	(975,726)	(840,012)	(10,596)	(125,120)
Expenses	(171,090)	(148,725)	(11,122)	(11,243)
Earnings	1,058,406	893,090	83,478	81,838
Net Transfers	0	<u>8,339</u>	<u>(257,689)</u>	<u>249,350</u>
Assets January 1, 1991	\$29,303,154	\$24,383,396	\$2,298,937	\$2,620,821
Contributions	9,372,073	8,335,241	516,903	519,929
Benefits	(899,404)	(784,591)	(84,225)	(30,586)
Expenses	(214,141)	(186,432)	(12,406)	(15,303)
Earnings	8,988,260	7,479,222	705,162	603,896
Net Transfers	0	<u>(12,951)</u>	<u>(25,184)</u>	<u>38,135</u>
Assets January 1, 1992	\$46,549,962	\$39,213,885	\$3,399,167	\$3,936,890
Assets Per HCSC	\$46,549,962	\$41,629,421	\$2,541,140	\$2,379,401
Asset Variance	\$0	<u>(\$2,415,585)</u>	<u>\$858,027</u>	<u>\$1,557,489</u>

Note: Earnings are adjusted for methodology described in GAS 413 50(c)(7). Earnings are allocated to the Medicare segments based on the ratio of beginning of year market value of Medicare assets to the beginning of year market value of total assets.