Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

GROUP HEALTH INCORPORATED OVERSTATED ALLOCABLE PENSION COSTS FOR PLAN YEARS 2007 AND 2008

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

March 2013
A-07-12-00381

Office of Inspector General

https://oig.hhs.gov/

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at https://oig.hhs.gov

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Group Health Incorporated (GHI), an EmblemHealth Company, administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS), which terminated July 18, 2008. GHI also administers Medicare operations under a Coordination of Benefits contract with CMS. In addition, GHI performs Medicare work as a subcontractor on the Retiree Drug Subsidy and on the Medicare Secondary Payer Recovery contracts.

During our audit period, GHI had three defined benefit pension plans. This report will address the allocable pension costs computed for all three of these pension plans.

Before January 1, 2007, GHI based its request for Medicare reimbursement on actual costs. Effective January 1, 2007, GHI amended its disclosure statement with CMS to receive Medicare reimbursement based on indirect cost rates submitted on incurred cost proposals (ICP).

CMS reimburses a portion of the annual contributions that contractors make to their pension plans. The pension costs are included in the computation of the indirect cost rates reported on the ICPs. In turn, CMS uses indirect cost rates in reimbursing costs under cost-reimbursement contracts. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and Medicare contracts.

The Medicare contracts require contractors to allocate or separately calculate pension costs. Contractors must use the separate calculation method if there is a material difference between the results of the two methods.

OBJECTIVE

Our objective was to determine the Medicare allocable pension costs for plan years (PY) 2007 and 2008 for the:

- fringe cost pool and the general and administrative (G&A) cost pool, and

- indirect fringe cost rate and the indirect G&A cost rate.

SUMMARY OF FINDINGS

GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051, and its G&A cost pool by $10,382,279, for PYs 2007 and 2008. These overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413. Specifically:

- GHI reported allocable pension costs of $4,669,583 in its fringe cost pool for PYs 2007 and 2008. We determined that the allocable pension costs in GHI's fringe cost pool for that period were $3,258,532. Thus, GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051.

- Additionally, GHI reported allocable pension costs of $24,524,923 in its G&A cost pool. We determined that the allocable pension costs in GHI's G&A cost pool for that period were $14,142,644. Thus, GHI overstated the allocable pension costs in its G&A cost pool by $10,382,279.

The overstatements in allocable pension costs in both of GHI's cost pools also caused GHI to overstate the pension costs used to calculate the corresponding indirect cost rates. Accordingly, for PYs 2007 and 2008 GHI overstated the pension costs used to calculate its indirect fringe cost rate by $1,411,051 and the pension costs used to calculate its indirect G&A cost rate by $376,093. As with the overstatements in the cost pools, these overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413. Specifically:

- GHI reported pension costs of $4,669,583 used to calculate its indirect fringe cost rate for PYs 2007 and 2008. (This amount is the same as the amount GHI reported in its fringe cost pool for this period because GHI's Medicare segment performed work only on Medicare contracts. Thus, 100 percent of the costs in the fringe cost pool were included in the calculation of the indirect fringe cost rate.) Replicating GHI's allocation methodology in allocating pension costs from the cost pools to the indirect cost rates, we determined that the pension costs were $3,258,532 for the indirect fringe cost rate. Thus, GHI overstated the pension costs used to calculate its indirect fringe cost rate by $1,411,051.

- GHI reported pension costs of $916,946 used to calculate its indirect G&A cost rate for PYs 2007 and 2008. Replicating GHI's allocation methodology in allocating pension costs from the cost pools to the indirect cost rates, we determined that the pension costs were $540,853 for the indirect G&A cost rate. Thus, GHI overstated the pension costs used to calculate its indirect G&A cost rate by $376,093.

RECOMMENDATIONS

We recommend that GHI:

- decrease the allocable pension costs in its fringe cost pool (and used to calculate its indirect fringe cost rate) by $1,411,051, and recognize $3,258,532 as the allocable pension costs for the fringe cost pool and its indirect fringe rate calculation in its ICPs for PYs 2007 and 2008; and

- decrease the allocable pension costs in its G&A cost pool by $10,382,279 and recognize $540,853 as the pension costs included in the indirect G&A cost rate calculation in its ICPs for PYs 2007 and 2008.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, GHI disagreed with the calculations that we used to develop our findings and recommendations. GHI stated that the methodology that MERCER, one of its actuarial consulting firms, used to calculate pension costs resulted in more accurate figures than the methodology that was used by CMS's Office of the Actuary and that we followed for our calculations.

After reviewing GHI's comments and supporting calculations, we maintain that our findings and recommendations remain valid as stated. We based our CAS calculations on information and assumptions used by GHI and its Local 153 plan (one of the defined benefit pension plans that GHI administered) actuary to calculate Employee Retirement Income Security Act of 1974 funding requirements. After we had performed our fieldwork for this audit, GHI hired MERCER to prepare CAS calculations for another audit; however, MERCER's calculations did not use the same assumptions as those initially selected by GHI and its Local 153 plan actuary. Additionally, MERCER's calculations did not comply with the pension segmentation language contained in the Medicare contract and did not provide any justification for its change in plan assumptions.

TABLE OF CONTENTS

Page

INTRODUCTION

BACKGROUND

Group Health Incorporated and Medicare

Group Health Incorporated (GHI), an EmblemHealth Company, administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS), which terminated July 18, 2008. As of November 1, 1999, GHI also administers Medicare operations under a Coordination of Benefits (COB) contract with CMS.[1] In addition, GHI performs Medicare work as a subcontractor on the Retiree Drug Subsidy and Medicare Secondary Payer Recovery contracts as of February 17, 2005, and August 15, 2006, respectively.

During our audit period, GHI had three defined benefit pension plans: the GHI Local 153 Pension Plan, the GHI Cash Balance Pension Plan, and the EmblemHealth Services Company, LLC, Employees' Retirement Plan. Medicare segment employees participated in all three defined benefit pension plans. This report will address the allocable pension costs computed for all three defined benefit pension plans for plan years (PY) 2007 through 2008.[2]

Before January 1, 2007, GHI based its request for Medicare reimbursement on actual costs. Effective January 1, 2007, GHI amended its disclosure statement with CMS to receive reimbursement based on indirect cost rates submitted on incurred cost proposals (ICP).[3]

Medicare Reimbursement

CMS reimburses a portion of the annual contributions that contractors make to their pension plans. The pension costs are included in the computation of the indirect cost rates reported on the ICPs. In turn, CMS uses indirect cost rates in reimbursing costs under cost-reimbursement contracts. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with Cost Accounting Standards (CAS) 412 and 413 and (2) funded as specified by part 31 of the Federal Acquisition Regulation (FAR). In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, the CAS, and the Medicare contracts.

---

[1] The COB contract was issued in accordance with Section 1893 of the Social Security Act, (added by Section 202(a) of Public Law 104-191, Health Insurance Portability and Accountability Act of 1996) to carry out the Medicare Integrity Program activities established by the Act. The primary function of the COB contract is to consolidate activities that support the collection, management, and reporting of all health insurance coverage of Medicare beneficiaries.

[2] We reviewed the allowability of the Part B pension costs that GHI claimed for Medicare reimbursements in a separate audit (A-07-12-00379).

[3] ICPs are submitted annually by Medicare contractors and generally consist of direct and indirect costs sustained by the contractor while performing the duties of the contract. Following the close of each Medicare contractor's calendar year (CY), each contractor submits to CMS an ICP reporting Medicare direct and indirect costs incurred during that CY. The ICP and supporting data provide the basis for the CMS Contracting Officer and the Medicare contractor to determine the final billing rates for allowable Medicare costs.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the Medicare allocable pension costs for PYs 2007 and 2008 for the:

- fringe cost pool and the general and administrative (G&A) cost pool, and
- indirect fringe cost rate and the indirect G&A cost rate.

Scope

We reviewed $29,194,505 of allocable pension costs in the fringe and G&A cost pools for PYs 2007 and 2008. GHI included these costs in its ICPs, which were then used in its calculation of its indirect cost rates.

Achieving our objective did not require that we review GHI's overall internal control structure. We limited our review to the internal controls related to the pension costs that were included in GHI's ICPs and ultimately used as the basis for Medicare reimbursement, to ensure that the pension costs were allocable in accordance with the FAR and the CAS.

We performed fieldwork at GHI in New York, New York, during September 2008 and July 2010.

Methodology

We reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit. We identified the amount of allocable pension costs computed for Medicare reimbursement for PYs 2007 through 2008 by reviewing GHI's ICPs. We also determined the extent to which GHI funded CAS-based pension costs with contributions to the pension trust fund and accumulated prepayment credits.

We based our calculations of allocable pension costs on CMS Office of the Actuary's (OACT) computation of CAS-based pension costs for the Medicare segment and the "Other" segment. OACT separately computed each segment's CAS-based pension costs. OACT based its computations on GHI's historical practices and on the results of our reviews of GHI's pension segmentation requirements for each of the three pension plans[4] as well as our reviews of GHI's unfunded pension costs for the Local 153 Pension Plan for PYs 1987 through 2007 (A-07-12-00375) and the GHI Cash Balance Pension Plan for PYs 2003 through 2007 (A-07-12-00376).

[4] The three pension plans we reviewed on the basis of pension segmentation requirements were the Local 153 Pension Plan for the period April 1, 1987, to January 1, 2009 (A-07-11-00358), the GHI Cash Balance Pension Plan for the period September 1, 2003, to January 1, 2009 (A-07-12-00374), and the EmblemHealth Services Company, LLC, Employees' Retirement Plan for the period January 1, 2008, to January 1, 2009 (A-07-12-00378).

In performing our review, we used information that GHI's actuarial consulting firms provided. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined GHI's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service (IRS) Forms 5500. We also reviewed the Defense Contract Audit Agency audit report, *GHI Medicare Audit of Incurred Cost Proposals for the Years Ended December 31, 2007, 2008 and 2009*. We used the results of this review in our calculation of the pension costs included in the indirect G&A cost rate.

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 objective.

FINDINGS AND RECOMMENDATIONS

GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051, and its G&A cost pool by $10,382,279, for PYs 2007 and 2008. These overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413. Specifically:

- GHI reported allocable pension costs of $4,669,583 in its fringe cost pool for PYs 2007 and 2008. We determined that the allocable pension costs in GHI's fringe cost pool for that period were $3,258,532. Thus, GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051.

- Additionally, GHI reported allocable pension costs of $24,524,923 in its G&A cost pool. We determined that the allocable pension costs in GHI's G&A cost pool for that period were $14,142,644. Thus, GHI overstated the allocable pension costs in its G&A cost pool by $10,382,279.

The overstatements in allocable pension costs in both of GHI's cost pools also caused GHI to overstate the pension costs used to calculate the corresponding indirect cost rates. Accordingly, for PYs 2007 and 2008 GHI overstated the pension costs used to calculate its indirect fringe cost rate by $1,411,051 and the pension costs used to calculate its indirect G&A cost rate by $376,093. As with the overstatements in the cost pools, these overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413. Specifically:

- GHI reported pension costs of $4,669,583 used to calculate its indirect fringe cost rate for PYs 2007 and 2008.[5] Replicating GHI's allocation methodology in allocating pension costs from the cost pools to the indirect cost rates, we determined that the pension costs

[5] This amount is the same as the amount GHI reported in its fringe cost pool for this period because GHI's Medicare segment performed work only on Medicare contracts. Thus, 100 percent of the costs in the fringe cost pool were included in the calculation of the indirect fringe cost rate.

were $3,258,532 for the indirect fringe cost rate. Thus, GHI overstated the pension costs used to calculate its indirect fringe cost rate by $1,411,051.

- GHI reported pension costs of $916,946 used to calculate its indirect G&A cost rate for PYs 2007 and 2008. Replicating GHI's allocation methodology in allocating pension costs from the cost pools to the indirect cost rates, we determined that the pension costs were $540,853 for the indirect G&A cost rate. Thus, GHI overstated the pension costs used to calculate its indirect G&A cost rate by $376,093.

FEDERAL REQUIREMENTS

The Medicare contracts require GHI to submit invoices in accordance with FAR 52.216-7, "Allowable Cost & Payment." Furthermore, FAR 52.216-7(a)(1) addresses the invoicing requirements and the allowability of payments as determined by the Contracting Officer in accordance with FAR subpart 31.2.

FAR 31.205-6(j) requires contractors to measure, assign, and allocate the costs of all defined benefit pension plans in accordance with CAS 412 and 413. FAR 31.205-6(j) also addresses allowability of pension costs by requiring that plan contributions substantiate pension costs assigned to contract periods.

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.

ALLOCABLE PENSION COSTS IN THE FRINGE COST POOL AND INDIRECT FRINGE COST RATE

GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051 for PYs 2007 and 2008. Furthermore, GHI overstated the pension costs used to calculate its indirect fringe cost rate by $1,411,051 for the same period. These overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413.

Overstated Allocable Pension Costs in the Fringe Cost Pool

GHI reported allocable pension costs of $4,669,583 in its fringe cost pool for PYs 2007 and 2008. We determined that the allocable pension costs in GHI's fringe cost pool for that period were $3,258,532. Thus, GHI overstated the allocable pension costs in its fringe cost pool by $1,411,051.

The table below compares allocable Medicare segment CAS-based pension costs included in the fringe cost pool with the allocable pension costs reported on GHI's ICPs. Appendix D contains additional details on allocable pension costs.

Comparison of Allocable Pension Costs Included in the Fringe Cost Pool

	Allocable Pension Costs		
	Allocable	Reported	
Plan Year	**Per Audit**	**By GHI**	**Difference**
2007	$1,411,656	$2,521,135	($1,109,479)
2008	1,846,876	2,148,448	(301,572)
Total	**$3,258,532**	**$4,669,583**	**($1,411,051)**

Overstated Pension Costs in the Indirect Fringe Cost Rate

GHI reported pension costs of $4,669,583 used to calculate its indirect fringe cost rate for PYs 2007 and 2008. As stated above, GHI reported allocable pension costs of $4,669,583 in its fringe cost pool for this period and ultimately allocated the same amount to be used in its calculation of its indirect fringe cost rate for the same period. We calculated the allocable pension costs based on a separately computed CAS-based allocable pension costs for the Medicare segment in accordance with CAS 412 and 413. We allocated 100 percent of the CAS-based allocable pension costs to the Medicare segment because it performed work only on Medicare contracts. We determined that, based on the requirements of CAS 412 and 413, the pension costs for PYs 2007 and 2008 were $3,258,532.

The FAR, the CAS, and the Medicare contracts require GHI to calculate pension costs for Medicare reimbursement pursuant to CAS 412 and 413. However, GHI based its allocable pension costs used for Medicare reimbursement on an amount that did not comply with the provisions of CAS 412 and 413. As a result, GHI overstated the pension costs in its fringe cost pool, and used to calculate its indirect fringe cost rate, by $1,411,051.

ALLOCABLE PENSION COSTS IN THE GENERAL AND ADMINISTRATIVE COST POOL AND INDIRECT COST RATE

GHI overstated the allocable pension costs in its G&A cost pool by $10,382,279 for PYs 2007 and 2008. Furthermore, GHI overstated the allocable pension costs used to calculate its indirect G&A cost rate by $376,093 for the same period. These overstatements occurred because GHI based its allocable pension costs on an amount that did not comply with the provisions of CAS 412 and 413.

Overstated Allocable Pension Costs in the General and Administrative Cost Pool

GHI reported allocable pension costs of $24,524,923 in its G&A cost pool for PYs 2007 and 2008. We determined that the allocable pension costs in its G&A cost pool for that period were

$14,142,644. Thus, GHI overstated the allocable pension costs in its G&A cost pool by $10,382,279.

The table below compares allocable "Other" segment CAS-based pension costs included in the G&A cost pool with the allocable pension costs reported on GHI's ICPs. Appendix D contains additional details on allocable pension costs.

Comparison of Allocable Pension Costs Included in the G&A Cost Pool

	Allocable Pension Costs		
Plan Year	**Allocable Per Audit**	**Reported by GHI**	**Difference**
2007	$7,948,757	$12,503,843	($4,555,086)
2008	6,193,887	12,021,080	(5,827,193)
Total	**$14,142,644**	**$24,524,923**	**($10,382,279)**

Overstated Pension Costs in the Indirect General and Administrative Cost Rate

GHI reported pension costs of $916,946 used to calculate its indirect G&A cost rate for PYs 2007 and 2008. GHI reported allocable pension costs of $24,524,923 in its G&A cost pool for this period and allocated $916,946 to be used in its calculation of its indirect G&A cost rate for the same period. We calculated the allocable pension costs based on a separately computed CAS-based allocable pension costs for the "Other" segment in accordance with CAS 412 and 413. As stated above, based on the requirements of CAS 412 and 413, the allocable pension costs for PYs 2007 and 2008 were $14,142,644. We replicated GHI's allocation methodology in allocating pension costs from the G&A cost pool to the indirect G&A cost rate. We determined that the pension costs to be included in the indirect G&A cost rate were $540,853.

The table on the following page is a further allocation of the pension costs in the G&A cost pool. It compares allocable CAS-based G&A pension costs with the pension costs included in the indirect G&A cost rate reported on GHI's ICPs. Appendix D contains additional details on allocable pension costs.

Comparison of Pension Costs Included in the Indirect G&A Cost Rate

	Pension Costs		
Plan Year	**Per Audit**	**Reported By GHI**	**Difference**
2007			
Home Office Allocation	$178,252	$280,332	($102,080)
Native G&A Adjustment	114,994	126,017	(11,023)
Total 2007	293,246	406,349	(113,103)
2008			
Home Office Allocation	107,030	207,795	(100,765)
Native G&A Adjustment	140,577	302,802	(162,225)
Total 2008	247,607	510,597	(262,990)
Total	**$540,853**	**$916,946**	**($376,093)**

The FAR, the CAS, and the Medicare contracts require GHI to calculate pension costs for Medicare reimbursement pursuant to CAS 412 and 413. However, GHI based its allocable pension costs used for Medicare reimbursement on an amount that did not comply with the provisions of CAS 412 and 413. As a result, GHI overstated the allocable pension costs in its G&A cost pool by $10,382,279, and overstated the pension costs used to calculate its indirect G&A cost rate by $376,093, for PYs 2007 and 2008.

RECOMMENDATIONS

We recommend that GHI:

- decrease the allocable pension costs in its fringe cost pool (and used to calculate its indirect fringe cost rate) by $1,411,051, and recognize $3,258,532 as the allocable pension costs for the fringe cost pool and its indirect fringe rate calculation in its ICPs for PYs 2007 and 2008; and

- decrease the allocable pension costs in its G&A cost pool by $10,382,279 and recognize $540,853 as the pension costs included in the indirect G&A cost rate calculation in its ICPs for PYs 2007 and 2008.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, GHI disagreed with the calculations we used to develop our findings and recommendations. Specifically, GHI disagreed with our recommendations based on the fact that OACT used annual Employee Retirement Income Security Act of 1974 (ERISA) valuations as the basis for our CAS calculations.[6] A summary of GHI's comments and our responses follows.

GHI's comments appear in their entirety as Appendix E.

After reviewing GHI's comments and supporting calculations, we maintain that our findings and recommendations remain valid as stated. We based our CAS calculations on information and assumptions used by GHI and its Local 153 plan actuary to calculate ERISA funding requirements.

GHI made no mention of any CAS calculations until it responded to this draft report. Those written comments made us aware for the first time that GHI had hired MERCER (one of its actuarial consulting firms) to prepare CAS calculations for another audit. However, MERCER's calculations did not use the same assumptions as those initially selected by GHI and its Local 153 plan actuary. Additionally, MERCER's calculations did not comply with the pension segmentation language contained in the Medicare contract and did not provide any justification for its change in plan assumptions.

Because we based our report on OACT's computation of CAS-based pension costs for the Medicare segment and the "Other" segment, we requested and received from OACT a technical memorandum with regard to the assertions made by GHI in its response. The OACT technical memorandum is included in its entirety as Appendix F.

Historical Cost Submissions

Auditee Comments

GHI said that throughout the history of its Medicare contracts, it claimed reimbursement based on an internal allocation of pension costs, initially by using the statutory accounting valuations as a basis, but in later years, including the years in question, by using generally accepted accounting principles (GAAP) pension expense. GHI stated that it based its Medicare allocation on pro rata share of GAAP expense, using Medicare salary dollars as the basis for proration.

Office of Inspector General Response

The use of GAAP does not comply with the Medicare contracts or the requirements of CAS 412 and 413, and for that reason we used the information that was available from GHI's Local 153 plan actuary. For PY 2007, we used the liabilities as determined for ERISA purposes. For the PY 2008 liabilities, we could not use ERISA liabilities because of new regulations enacted by the

[6] P.L. No. 93-406, 29 U.S.C. § 1002.

Pension Protection Act of 2006 (PPA).[7] Both GAAP and PPA are inconsistent with CAS because they use a settlement-based discount rate assumption instead of a long-term best estimate of plan experience. Therefore, we asked GHI's Local 153 plan actuary to provide us with the liabilities using a CAS-compliant methodology. On June 23, 2010, the plan actuary provided the PY 2008 liabilities using a CAS-compliant methodology, which utilized the ERISA long-term interest rate of 8.25 percent. This long-term interest rate was the assumption that GHI and its Local 153 plan actuary selected. Accordingly, we used the 8.25 percent rate (as did OACT) as the basis for our CAS calculations, having no knowledge of any changes in plan assumptions.

Federal Employees Health Benefits Plan
Cost Accounting Standards Calculations

Auditee Comments

GHI said that after another audit, which found that the non-CAS basis for cost allocations for the Federal Employees Health Benefit (FEHB) plan was not acceptable, GHI hired MERCER to perform CAS 412 expense calculations for GHI's pension plans. GHI added that it believes that those calculations, which used a long-term interest rate of 7.00 percent, are a better indicator of the CAS 412 expense for these years.

Office of Inspector General Response

We acknowledge receipt of GHI's CAS calculations, prepared by MERCER for its FEHB audit, on October 26, 2012 (after issuance of our draft report). However, we disagree that these calculations are a better indicator of GHI's CAS 412 expense for these years. GHI disagreed with OACT's use of 8.25 percent as the long-term interest rate to calculate CAS pension costs for PYs 2007 and 2008. We note, though, that GHI and its Local 153 pension plan actuary used this same long-term interest rate to prepare its ERISA actuarial valuation reports. Furthermore, CAS 412-50(b)(6) requires Medicare contractors to justify any material difference between the interest rate used for CAS calculations and the rate used for ERISA funding valuations, but GHI has provided no such justification or explanation to us.

Furthermore, GHI's CAS calculations, prepared June 29, 2011 (but not given to us until October 26, 2012), did not comply with the Medicare contracts' segmentation requirements. Specifically, the Medicare contracts require that the pension assets be separately computed in accordance with CAS 413. However, GHI's CAS calculations were on a Total Company basis and were allocated to the Medicare segment based on a ratio rather than as the product of a separate calculation. GHI incorrectly allocated the assets and liabilities to the Medicare segment based on a ratio of the audited Medicare segment assets and liabilities to the Total Company assets and liabilities. While these calculations may satisfy the requirements of the FEHB contract, they do not satisfy the requirements of the Medicare contracts.

[7] P.L. No. 109-280, August 17, 2006.

Differences in the Cost Accounting Standards Methodology

Auditee Comments

GHI stated that the differences between MERCER's calculations and the OACT CAS calculations dealt with the actuarial cost method and the actuarial assumptions and actuarial methods used. GHI referred to CAS 412.40(b)(1), which requires that "… the amount of pension cost of a cost accounting period shall be determined by use of an immediate-gain actuarial cost method." GHI added that this method did not have to be the same as the actuarial cost method used for ERISA funding calculations. GHI also referred to CAS 412.40(b)(2), which requires that "… each actuarial assumption … shall represent the contractor's best estimates of anticipated experience under the plan," which, GHI said, are not necessarily the same as the assumptions chosen by the actuary for purposes of ERISA funding calculations.

Office of Inspector General Response

GHI contended that the calculations prepared by OACT were not CAS compliant, primarily because of the use of 8.25 percent as the long-term interest rate. However, GHI and its Local 153 plan actuary selected this same rate and used it for its actuarial valuation calculations. This 8.25 percent rate was different from the 7.00 percent rate used by GHI and MERCER in its calculations for the separate FEHB audit, and GHI did not give us any justification for the change in assumptions. The plan actuary acts as a representative of the plan sponsor and is obligated to comply with professional standards and accepted practices. Furthermore, the plan actuary is also required to certify the plan's ERISA assumptions to the IRS. The preambles of the CAS pension rules clearly state that CAS pension costs should reflect the same general cost principles as the ERISA funding rules. Absent any justification for a change in plan assumption, as required by CAS 412-50(b)(6), we had no reason to regard the plan actuary's assumptions as non-compliant. Therefore, we used 8.25 percent as the long-term interest rate in our computations. Ultimately, the information we used to calculate the 2008 CAS pension cost was CAS compliant.

Assumptions, Actuarial Methods, and Calculations

Auditee Comments

GHI stated that our findings would have been very different if we had used GHI's CAS calculations. GHI further stated that had it been asked to supply the calculations, our findings would have been much different due to the use of GHI's selected CAS assumptions and actuarial methods, rather than ERISA funding assumptions.

Office of Inspector General Response

We requested that GHI provide us with any CAS calculations for all of its qualified defined benefit plans during our site work at GHI's office in July 2010. Additionally, we had a conference call with GHI and MERCER officials on July 19, 2010, to determine whether any CAS information was available. During this discussion, we determined that neither GHI nor its actuarial consulting firms had prepared any CAS calculations for the GHI Cash Balance or EmblemHealth pension plans. Furthermore, GHI officials gave us no indication that GHI was preparing the calculations or having its actuarial consulting firms calculate the required information. Accordingly, we requested that GHI provide the information necessary for OACT to calculate the Medicare segment pension assets and pension costs for both the GHI Cash Balance and EmblemHealth pension plans for the periods under review.

GHI gave us the participant files, actuarial valuation reports, and IRS Form 5500 reports for both the GHI Cash Balance and EmblemHealth pension plans on August 4, 2010. After reviewing and verifying the submitted documents, we gave this information to OACT, which calculated the Medicare segment pension assets and subsequent pension costs for the GHI Cash Balance and EmblemHealth pension plans.

GHI's first mention of formal CAS calculations came in its written comments on this draft report. In fact, during the timeframe in which we were performing the current audit and preparing this draft report, we issued a total of seven audit reports to GHI. GHI made no mention of any formal CAS calculations either during, or in its comments on, any of these seven audits, and in fact concurred with the findings and recommendations contained in each of the reports:

1) *Review of the Pension Segmentation Requirements for the Local 153 Pension Plan at Group Health Incorporated for the Period of April 1, 1987, to January 1, 2009* (A-07-011-00358), issued July 14, 2011.

2) *Review of the Pension Segmentation Requirements for the Cash Balance Pension Plan at Group Health Incorporated for the period of September 1, 2003, to January 1, 2009* (A-07-12-00374), issued April 3, 2012.

3) *Review of the Pension Segmentation Requirements for the EmblemHealth Services Company, LLC, Employees' Retirement Plan at Group Health Incorporated for the Period of January 1, 2008, to January 1, 2009* (A-07-12-00378), issued April 3, 2012.

4) *Audit of Group Health Incorporated's Local 153 Pension Plan Unfunded Pension Costs for Plan Years 1987 Through 2007* (A-07-12-00375), issued April 3, 2012.

5) *Review of Medicare Part B Pension Costs Claimed by Group Health Incorporated for Plan Years 1987 through 2008* (A-07-12-00379), issued April 4, 2012.

6) *Review of the Pension Costs Claimed by Group Health Incorporated for Plan Years 1999 Through 2006* (A-07-12-00380), issued April 4, 2012.

7) *Audit of Group Health Incorporated's Cash Balance Pension Plan Unfunded Pension Costs for Plan Years 2003 Through 2007* (A-07-12-00376), issued April 4, 2012.

APPENDIXES

APPENDIX A: ALLOCABLE MEDICARE PENSION COSTS FOR THE LOCAL 153 PENSION PLAN FOR GROUP HEALTH INCORPORATED FOR PLAN YEARS 2007 AND 2008

Date	Description		Total Company	"Other" Segment	Medicare Segment
2007	Contributions	1/	$13,488,137	$13,488,137	$0
8.25%	Discount for Interest	2/	($717,211)	($717,211)	$0
January 1, 2007	Present Value Contributions	3/	$12,770,926	$12,770,926	$0
	Prepayment Credit Applied	4/	$6,029,009	$5,024,910	$1,004,099
	Present Value of Funding	5/	$18,799,935	$17,795,836	$1,004,099
January 1, 2007	CAS Funding Target	6/	$6,029,009	$5,024,910	$1,004,099
	Percentage Funded	7/		100.00%	100.00%
	Funded Pension Cost	8/		$5,024,910	$1,004,099
	Allowable Interest	9/		$0	$0
2007	Allocable Pension Cost	10/		$5,024,910	$1,004,099
2008	Contributions		$11,000,000	$11,000,000	$0
8.25%	Discount for Interest		($556,572)	($556,572)	$0
January 1, 2008	Present Value Contributions		$10,443,428	$10,443,428	$0
	Prepayment Credit Applied		$7,370,223	$5,998,959	$1,371,264
	Present Value of Funding		$17,813,651	$16,442,387	$1,371,264
January 1, 2008	CAS Funding Target		$7,370,223	$5,998,959	$1,371,264
	Percentage Funded			100.00%	100.00%
	Funded Pension Cost			$5,998,959	$1,371,264
	Allowable Interest			$0	$0
2008	Allocable Pension Cost			$5,998,959	$1,371,264

ENDNOTES

1/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. We determined the contributions allocated to the Medicare segment during the pension segmentation reviews of Group Health Incorporated (A-07-11-00358, A-07-12-00374, and A-07-12-00378). The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segment.

2/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the valuation interest rate) and actual contribution amounts.

3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year. For purposes of this Appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year, consistent with the method mandated by the Employee Retirement Income Security Act.

4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standard (CAS) funding target. A prepayment credit is carried forward, with interest, to fund future CAS pension costs.

5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the plan year.

6/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulation (FAR) 31.205-6(j)(2)(i).

7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.

8/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

9/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.

10/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

APPENDIX B: ALLOCABLE MEDICARE PENSION COSTS FOR THE CASH BALANCE PENSION PLAN FOR GROUP HEALTH INCORPORATED FOR PLAN YEARS 2007 AND 2008

Date	Description		Total Company	"Other" Segment	Medicare Segment
2007	Contributions	1/	$5,568,673	$5,178,969	$389,704
7.50%	Discount for Interest	2/	($320,445)	($298,020)	($22,425)
January 1, 2007	Present Value Contributions	3/	$5,248,228	$4,880,949	$367,279
	Prepayment Credit Applied	4/	$169,744	$148,978	$20,766
	Present Value of Funding	5/	$5,417,972	$5,029,927	$388,045
January 1, 2007	CAS Funding Target	6/	$3,171,913	$2,783,868	$388,045
	Percentage Funded	7/		100.00%	100.00%
	Funded Pension Cost	8/		$2,783,868	$388,045
	Allowable Interest	9/		$139,979	$19,512
2007	Allocable Pension Cost	10/		$2,923,847	$407,557
2008	Contributions		$900,000	$900,000	$0
7.50%	Discount for Interest		($62,791)	($62,791)	$0
January 1, 2008	Present Value Contributions		$837,209	$837,209	$0
	Prepayment Credit Applied		$223,107	$194,928	$28,179
	Present Value of Funding		$1,060,316	$1,032,137	$28,179
January 1, 2008	CAS Funding Target		$223,107	$194,928	$28,179
	Percentage Funded			100.00%	100.00%
	Funded Pension Cost			$194,928	$28,179
	Allowable Interest			$0	$0
2008	Allocable Pension Cost			$194,928	$28,179

ENDNOTES

1/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. We determined the contributions allocated to the Medicare segment during the pension segmentation reviews of Group Health Incorporated (A-07-11-00358, A-07-12-00374, and A-07-12-00378). The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segment.

2/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the valuation interest rate) and actual contribution amounts.

3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year. For purposes of this Appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year, consistent with the method mandated by the Employee Retirement Income Security Act.

4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit is carried forward, with interest, to fund future CAS pension costs.

5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the plan year.

6/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulation (FAR) 31.205-6(j)(2)(i).

7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.

8/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

9/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.

10/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

APPENDIX C: ALLOCABLE MEDICARE PENSION COSTS FOR THE EMBLEMHEALTH SERVICES COMPANY, LLC, EMPLOYEES' RETIREMENT PLAN FOR GROUP HEALTH INCORPORATED FOR PLAN YEAR 2008

Date	Description		Total Company	"Other" Segment	Medicare Segment
2008	Contributions	1/	$15,712,164	$15,264,731	$447,433
7.50%	Discount for Interest	2/	($769,092)	($747,191)	($21,901)
January 1, 2008	Present Value Contributions	3/	$14,943,072	$14,517,540	$425,532
	Prepayment Credit Applied		$0	$0	$0
	Present Value of Funding	4/	$14,943,072	$14,517,540	$425,532
January 1, 2008	CAS Funding Target	5/	$425,532	$0	$425,532
	Percentage Funded	6/		0.00%	100.00%
	Funded Pension Cost	7/		$0	$425,532
	Allowable Interest	8/		$0	$21,901
2008	Allocable Pension Cost	9/		$0	$447,433

ENDNOTES

1/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns. We determined the contributions allocated to the Medicare segment during the pension segmentation reviews of Group Health Incorporated (A-07-11-00358, A-07-12-00374, and A-07-12-00378). The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segment.

2/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the valuation interest rate) and actual contribution amounts.

3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year. For purposes of this Appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year, consistent with the method mandated by the Employee Retirement Income Security Act.

4/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the Cost Accounting Standards (CAS) funding target measured at the first day of the plan year.

5/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the Federal Acquisition Regulation (FAR) 31.205-6(j)(2)(i).

6/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1) (as amended), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals.

7/ We computed the funded CAS pension cost as the CAS funding target multiplied by the percent funded.

8/ We assumed that interest on the funded CAS pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.

9/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

APPENDIX D: TOTAL ALLOCABLE PENSION COSTS
FOR GROUP HEALTH INCORPORATED
FOR PLAN YEARS 2007 AND 2008

Date	Description		"Other" Segment	Medicare Segment
January 1, 2007	Local 153 Pension Plan Allocable Pension Cost	1/	$5,024,910	$1,004,099
	Cash Balance Pension Plan Allocable Pension Cost	2/	$2,923,847	$407,557
	Total PY* Allocable Pension Cost in the cost pool	3/	$7,948,757	$1,411,656
	Allocable Pension Percentage	4/	2.24251%	100%
2007	Allocable Pension Cost	5/	$178,252	$1,411,656
	Fringe Benefit Adjustment	6/	$114,994	$0
2007	Total Allocable Pension Cost in indirect cost rate	7/	$293,246	$1,411,656

January 1, 2008	Local 153 Pension Plan Allocable Pension Cost		$5,998,959	$1,371,264
	Cash Balance Pension Plan Allocable Pension Cost		$194,928	$28,179
	EmblemHealth Services Company, LLC, Employees Retirement Plan Allocable Pension Cost	8/	$0	$447,433
	Total PY* Allocable Pension Cost in the cost pool		$6,193,887	$1,846,876
	Allocable Pension Percentage		1.72799%	100%
2008	Allocable Pension Cost		$107,030	$1,846,876
	Fringe Benefit Adjustment		$140,577	$0
2008	Total Allocable Pension Cost in indirect cost rate		$247,607	$1,846,876

*Plan Year

ENDNOTES

1/ The allocable Cost Accounting Standards (CAS) pension costs is the amount of pension cost that may be allocated for contract cost purposes. The calculation of the Group Health Incorporated (GHI) Local 153 Pension Plan allocable pension cost appears in Appendix A.

2/ The allocable CAS pension costs is the amount of pension cost that may be allocated for contract cost purposes. The calculation of the GHI Cash Balance Pension Plan allocable pension cost appears in Appendix B.

3/ The total plan year (PY) allocable pension cost in the cost pool is the total of the segments' CAS-based pension cost from each qualified defined benefit pension plan.

4/ The allocable pension percentage is the percent of pension that was allocated in GHI's accounting system for the "Other" segment and the Medicare segment. This percentage is computed by dividing the allocable pension cost by the total PY allocable pension cost in the cost pool.

5/ The allocable pension cost is calculated using GHI's allocations from its accounting system. We replicated GHI's allocation methodology when allocating pension cost from the cost pools to the cost rates, which were deemed reasonable and appropriate by the incurred cost audit report.

6/ GHI made the Fringe Benefit adjustment to account for fringe benefits for its Native general and administrative (G&A) employees. This adjustment is based on the indirect fringe cost rate. We incorporated our audited adjustments to the indirect fringe cost rate and used results from the incurred cost audit to calculate an audited indirect fringe cost rate. This adjustment is calculated only for the G&A pool.

7/ The total allocable pension cost in the indirect cost rate identifies the audited allocable pension costs. These allocable pension costs are used to compute the indirect G&A and fringe cost rates.

8/ The allocable CAS pension costs is the amount of pension cost that may be allocated for contract cost purposes. The calculation of the EmblemHealth Services Company, LCC, Employees' Retirement Plan allocable pension cost appears in Appendix C.

APPENDIX E: AUDITEE COMMENTS

GHI

October 15, 2012

Daniel R. Levinson
Inspector General
Department of Health & Human Services
HHS/OIG/Office of Audit Services, Region VII
601 East 12th Street, Room 0429,
Kansas City, MO 64106

Dear Mr. Levinson:

Thank you for affording Group Health Incorporated ("GHI") this opportunity to comment on draft Audit Report No. A-07-12-00381 ("the draft audit report") covering the plan years 2007 and 2008, and for extending the due date for the submission of our comments. We appreciate the cooperation rendered to us by your auditors. The draft report is a revision of a previous draft report having the same identification number.

The draft report notes that effective January 1, 2007, GHI amended its disclosure statement with CMS to receive reimbursement based on indirect cost rates submitted on Incurred Cost Proposals ("ICP's").

The draft audit report recommends that:

1. GHI "decrease the allocable pension cost in its fringe pool (and used to calculate its indirect fringe cost rate) by $1,411,051 and recognize $3,258,532 as the allocable pension costs for the fringe cost pool and its indirect fringe rate calculation in its ICP's for PY's 2007 and 2008; and

2. GHI "decrease the allocable pension costs in its G & A cost pool by $10,382,279 and recognize $540,853 as the pension costs included in the indirect G & A cost rate calculation in its ICP's for PY's 2007 and 2008".

The draft report bases its recommendations on calculation of allocable pension costs made by CMS Office of the Actuary (OACT). For purposes of these calculations, the

Group Health Incorporated
441 9th Ave, New York, NY 10001
www.ghimedicare.com

auditors requested and received data pertaining to the annual ERISA valuations for the pension plans maintained by GHI. OACT indicates in the draft report that the computations are based on GHI's "historical practices" as well as on the segmentation requirements for each plan.

We have carefully reviewed the draft audit report, and as described in more detail below, we respectfully disagree with the use of the annual ERISA valuations as the basis for the OACT's CAS calculations, and thus the report's findings and recommendations outlined therein.
The basis for our disagreement is outlined below:

1. Historical cost submissions by GHI for these two years were based on GAAP accounting. Throughout the history of GHI's Medicare contracts, GHI claimed reimbursement based on an internal allocation of pension costs, initially using the statutory accounting valuations as a basis, but in later years, including the years in question (2007 and 2008), using GAAP pension expense as GHI adopted GAAP in 2007. The Medicare allocation was based on pro-rata share of GAAP expense, using Medicare salary dollars as the basis for proration.

2. GHI also provides services to the Federal Employees Health Benefit Plan (FEHBP). In connection with a similar audit where GHI was notified that the non-CAS basis for cost allocations for the FEHBP was not acceptable, GHI hired Mercer to perform CAS 412 expense calculations for our pension plans. We believe that those calculations are a better indicator of the CAS 412 expense for these years.

3. The differences between the Mercer CAS calculations and the OACT calculations relate to the actuarial cost method and the actuarial assumptions and actuarial methods used. In particular, CAS §412.40(b)(1) requires that "the amount of pension cost of a cost accounting period shall be determined by use of an immediate-gain actuarial cost method", but that method does not have to be the same as the actuarial cost method used for ERISA funding calculations. Also, CAS §412.40(b)(2) requires that "each actuarial assumption...shall represent *the Contractor's* best estimates of anticipated experience under the plan...", which are not necessarily the same as the assumptions chosen by actuary for purposes of ERISA funding calculations. In the absence of knowing GHI's selected methods/assumptions for CAS, during the course of the audit, the OACT used the ERISA funding assumptions and actuarial cost methods, which are

different than the actual CAS assumptions and actuarial methods selected by GHI and used in Mercer's CAS calculations.

4. <u>We believe that the audit findings would have been very different had OIG utilized our CAS expense calculations.</u> In examining the draft report, we understand that OIG was operating without having formal CAS calculations submitted by GHI. However, had GHI been asked to supply the calculations, the results would have been much different due to the use of our selected CAS assumptions and actuarial methods, rather than ERISA funding assumptions and methods. As noted above, Mercer actually prepared calculations on the GHI Plans for another Federal agency that requested the CAS calculations, not knowing that OIG was concurrently auditing that same plan. Mercer's calculation of CAS expense for that plan was substantially higher than OIG's and would have resulted in a substantially smaller difference compared to the allocated GAAP expense figures that were originally used by GHI.

The chart below shows the differences between the GAAP figures reported by GHI, the Mercer developed CAS expense figures and the amounts developed by OIG:

	2007	2008	Total
Reported by GHI	$15,024,978	$14,169,528	$29,194,506
Mercer CAS	15,316,776	12,555,712	27,872,488
OIG Allowable	9,360,413	8,040,763	17,401,176

We believe that calculations using the Mercer CAS expense calculations for 2007 and 2008 represent a more appropriate basis than the ERISA assumption/cost method derived figures developed by OACT, and would respectfully request that OIG consider using the Mercer developed CAS calculations as the basis for applying the provisions of CAS 412 to our plans for these years.

Based on the Mercer developed CAS figures and GHI's allocation methodology, we believe that the reported pension costs related to indirect fringe cost pool should have been $4,725,397 for PYs 2007 and 2008, resulting in an understatement of our pension costs by ($ 55,814). Similarly, we believe that our reported pension costs related to indirect G&A should have been $722,004 for PYs 2007 and 2008, resulting in an overstatement of our pension costs of $194,942. On a combined basis, we believe that overstatement amount should be $139,127 instead of the $1,411,051 shown in the draft audit report.

We have also updated our Fringe and G&A pool & bases to reflect the net effect on the actual billed expense. Based on the ICP and subsequent audit by an external CPA firm, the effect is $61,468 to the Fringe expense and credit of ($151,261) to the G&A expense. On a combined basis, we believe the undercharged amount should be ($89,793) resulting in a credit due to GHI.

Thank you again for affording GHI the opportunity to comment on the draft audit report. We believe that the resolution of the issues raised by that report can best be achieved through an open dialogue between the government and GHI. To that end, and because the issues raised are technical and complex, we would be pleased to discuss the report, our comments and our suggested recalculations with you or your staff prior to the issuance of your final report.

Should you have any questions please contact me at (646) 458-6601.

Sincerely Yours,

Peter S. Moore

Peter S. Moore
Vice President

APPENDIX F: CENTERS FOR MEDICARE & MEDICAID SERVICES OFFICE OF THE ACTUARY MEMORANDUM

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Office of the Actuary
7500 Security Blvd, N3-01-21
Baltimore, MD 21244-1850
Phone: 410-786-6396
FAX: 410-786-1295
E-Mail: Russell.Weatherholtz@cms.hhs.gov

M E M O R A N D U M

To: Jenenne Tambke

From: Russ Weatherholtz, Pension Actuary

Date: November 20, 2012

Subject: Response to GHI response to draft Audit Report A-07-12-00381

In its response to the OIG draft Audit Report No. A-07-12-00381 dated October 15, 2012, Group Health Incorporated ("GHI") disagrees with the findings for plan years 2007 and 2008.

GHI lays out their disagreement in four points:

1. GHI's historical claims were based on GAAP accounting.
2. The ERISA calculations used by OACT for this audit are not CAS-compliant.
3. Mercer prepared CAS-compliant calculations for purposes of the FEHBP audit.
4. Had Mercer's CAS-compliant calculations been utilized for this audit, the findings would have been very different.

GAAP accounting, which was used for GHI's historical claims, is inconsistent with CAS requirements because it uses a settlement based discount rate assumption, rather than a long-term best estimate of anticipated plan experience. CAS 412-40(b)(2) states: "Each actuarial assumption used to measure pension cost shall be separately identified and shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations." CAS 412-50(b)(4) states: "Actuarial assumptions shall reflect long term trends so as to avoid distortions caused by short term fluctuations."

Since the GAAP basis was non-compliant, we utilized the 2007 liabilities determined for ERISA purposes. Although the Cost Accounting Standards do not require contractors to use the same assumptions for ERISA and CAS purposes, contractors have generally used the same assumptions for computing accrued liability and normal cost under CAS that they also used for computing accrued liability and normal cost under ERISA prior to the effective date of the

Pension Protection Act (PPA). The same considerations apply (long-term market expectations and plan investment policy) when establishing the interest rate assumption for CAS and ERISA.

For 2008, we could not use the ERISA liabilities because the Pension Protection Act amendments to ERISA require a settlement basis discount rate starting in 2008. Therefore, we requested the plan actuary to prepare 2008 liabilities using a CAS compliant interest rate assumption. The actuary provided these values based on an 8.25% long-term interest rate, the same rate used for the 2007 ERISA valuation. The liability information we used was CAS compliant. We did not use the costs determined for ERISA purposes; we prepared cost calculations in accordance with the methodology set forth in CAS 412 and 413, using the CAS compliant liabilities prepared by GHI's plan actuary.

GHI claims that our calculations were not CAS compliant because the 8.25% estimated long-term rate selected by the GHI Local 153 pension plan actuary and used for our calculations was not the same as the 7.00% rate determined by GHI and utilized by Mercer to prepare CAS calculations for purposes of the Federal Employees Health Benefit Plan (FEHBP) contract audit. The plan actuary, however, acts as a representative of the plan sponsor in these matters, is obligated to follow professional standards and accepted practices, and must certify his ERISA assumptions to the IRS. We have no reason to view the plan actuary's assumptions as non-compliant. Furthermore, we note the significant discrepancy between the rate determined by the ERISA plan actuary and the rate selected by GHI for the Mercer calculations. However, GHI has provided no basis to explain such a wide discrepancy in the rates or to show that Mercer's 7.00% rate meets the CAS criteria and the ERISA actuary's 8.25% rate does not meet the CAS criteria.

General audit standards require that data be verified and this is often accomplished by comparing the audit information with similar data prepared for other purposes. For example, the rate selected for CAS purposes can be compared to the rate GHI selected for SSAP purposes. For 12/31/2006, GHI used a long-term rate of 8.25% for its year-end disclosure. This rate should be consistent with the CAS rate in that it reflects the long-term estimate of the rate of return on plan assets taking into consideration the plan's current investment mix. We note that the 12/31/2006 SSAP 89 rate used by GHI is the same rate we used for our 1/1/2007 CAS calculations. As of 12/31/2007, GHI lowered its interest rate assumption for SSAP89 reporting purposes from 8.25% to 7.50%. The actuaries report as of 12/31/2007 states "the actuarial assumptions were changed to the current assumptions as displayed in this report in order to align with the financial reporting of other members of the Emblem Health group." This suggests that the change in the interest rate assumption was not due to a change in the plan's investment mix or a change in long-term capital market trends, either of which could justify a change under the CAS criteria. Furthermore, the change in the rate of return assumption cannot be attributed to actual experience under the plan in question. In the January 1, 2008 ERISA valuation report, the GHI actuary presents data that shows that "the moving average return on GHI pension assets has consistently remained above the actuarial assumption." (See Exhibit I attached.)

Page 3 of 5

GHI has provided no data to show that their assumptions meet the criteria of CAS 412. There is no support concerning why the 7.50% SSAP interest rate or the 7.00% rate used by Mercer for the GHI Local 153 plan was more appropriate for CAS purposes than the long-term rate used under ERISA (prior to the PPA changes). CAS 412-50(b)(6) requires: *"If the evaluation of the validity of actuarial assumptions shows that any assumptions were not reasonable, the contractor shall*

(i) Identify the major causes for the resultant actuarial gains or losses, and
(ii) Provide information as to the basis and rationale used for retaining or revising such assumptions for use in the ensuing cost accounting period(s)."

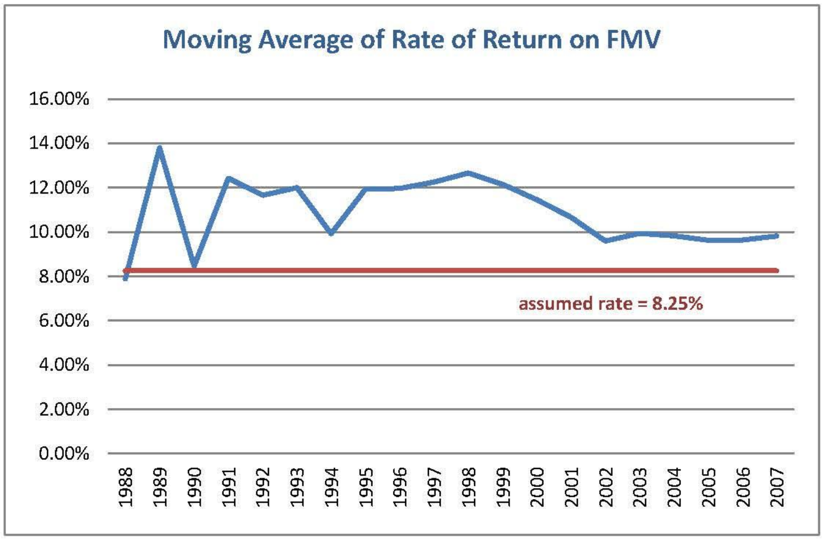
We acknowledge that the Mercer calculations (based on the 7% interest rate), were accepted by the auditors who prepared the FEHBP audit. However, the fact that the FEHBP auditors accepted Mercer's calculations without question does not prevent us from making an independent evaluation of those results. A key purpose of the FEHBP audit review is to determine the reasonableness of the experience-rated insurance rates charged under the FEHBP plan. To make their determination, the FEHBP auditors will look at all of the expenses reflected in the insurance rates, not just pension costs, in order to ascertain if those expense charges are reasonable relative to the expenses charged to other commercial accounts. Accordingly, a key metric for FEHBP purposes will be the level of CAS based pension costs relative to the pension costs determined for insurance reporting (SSAP) purposes. The CMS contracts are cost reimbursement contracts, not experience-rated insurance contracts. The preamble of the CAS pension rules makes it clear that CAS pension costs should reflect the same general cost principles as the ERISA minimum and tax deductible maximum funding rules. Accordingly, the OIG has always looked to the ERISA costs to evaluate the reasonableness of CAS based pension costs. To the extent that the CAS interest rate is materially different from the ERISA long-term rate, it is incumbent upon the contractor to justify the difference.

We also note that the Mercer computations have come into play very late in the game. The OIG performed their fieldwork in September, 2008 and in July, 2010. GHI had made their past claims; the OIG came in and reviewed these claims and all of the available data; they relayed this information to the actuaries at CMS; calculations were performed and reports were issued. Specifically, *the Review of the Pension Segmentation Requirements for the Local 153 Pension Plan at Group Health Incorporated for the Period April 1, 1987 to January 1, 2009* was issued in draft in Spring, 2011. GHI concurred with those findings in its response letter dated June 24, 2011. The Mercer calculations were not issued until June 29, 2011. While neither the timing of the Mercer report nor the fact that GHI has previously concurred with the our calculations prevents us from revising our calculations, we would only do so if we had persuasive evidence to suggest that the original data was materially deficient and the new data was more appropriate. GHI has provided no data to show that the 8.25% rate for the GHI Local 153 plan is not CAS compliant and/or the 7.00% rate used by Mercer is more appropriate.

For the reasons outlined above, we recommend that the OIG issue the final report based on the results reflected in the draft report.

CC: Jeff Wilson
Eric Shipley
Veda Wild

Exhibit I


Moving Average of Rate of Return on FMV
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
assumed rate = 8.25%
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007