Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION UNDERSTATED MEDICARE'S SHARE OF THE MEDICARE SEGMENT EXCESS PENSION ASSETS

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May 2018
A-07-17-00529

Office of Inspector General

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Report in Brief
Date: May 2018
Report No. A-07-17-00529

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL

Wisconsin Physicians Service Insurance Corporation Understated Medicare's Share of the Medicare Segment Excess Pension Assets

Why OIG Did This Review

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413.

The HHS, OIG, Office of Audit Services, Region VII pension audit team reviews the Medicare segment pension assets to ensure compliance with Federal regulations.

Previous OIG reviews found that Medicare contractors did not always correctly calculate Medicare's share of the Medicare segment excess pension assets or liabilities.

Our objectives were to determine whether Wisconsin Physicians Service Insurance Corporation (WPS) complied with Federal requirements when (1) implementing the prior audit recommendations to increase the Medicare segment assets as of December 31, 2013, and (2) determining Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its Managerial Pension Plan (MPP) benefit curtailment.

How OIG Did This Review

We reviewed $3.9 million that WPS proposed as Medicare's share of the Medicare segment excess pension liabilities as of December 31, 2013, as a result of its benefit curtailment.

What OIG Found

WPS did not concur with our recommendation in the prior WPS MPP segmentation audit (A-07-17-00518) to increase the Medicare segment pension assets by $3.2 million as of December 31, 2013. Consequently, WPS did not implement our recommendation.

WPS did not comply with Federal requirements when determining Medicare's share of the Medicare segment excess pension liabilities as of the benefit curtailment date. WPS calculated Medicare's share of the excess pension liabilities as of December 31, 2013, to be $3.9 million. We determined, however, that Medicare's share of the surplus of pension assets was $13.8 million as of that date. Therefore, WPS understated Medicare's share of the surplus of Medicare segment pension assets by $17.7 million. WPS understated these assets because its calculation used an unreasonable long-term interest rate that did not comply with CAS 413.

What OIG Recommends and Auditee Comments

We recommend that WPS increase Medicare's share of the Medicare segment excess pension assets as of December 31, 2013, by $17.7 million and recognize $13.8 million as Medicare's share of the excess pension assets as a result of the benefit curtailment.

WPS disagreed with our findings. Specifically, WPS cited its comments on our prior MPP segmentation report (A-07-17-00518) to support its disagreement with the $3.2 million Medicare pension asset amount that we calculated as of December 31, 2013. WPS also stated that the long-term interest rate that it used to compute its accrued liabilities was required by CAS 413.

We maintain that our findings and recommendations in our prior report, as modified, remain valid and as such are valid to be used to calculate Medicare's share of the excess pension assets for this current report. Also, the long-term interest rate that WPS used did not comply with CAS 413, and we maintain that our use of a higher long-term interest rate, based on an average of historical assumptions, was reasonable for our calculation of WPS's liabilities as a result of the benefit curtailment.

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INTRODUCTION

WHY WE DID THIS REVIEW

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

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

For this review, we focused on one entity, Wisconsin Physicians Service Insurance Corporation (WPS). In particular, we examined Medicare's share of the Medicare segment pension assets that WPS determined as a result of its benefit curtailment.

OBJECTIVES

Our objectives were to determine whether WPS complied with Federal requirements when (1) implementing the prior audit recommendations to increase the Medicare segment assets as of December 31, 2013, and (2) determining Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its benefit curtailment.

BACKGROUND

Wisconsin Physicians Service Insurance Corporation and Medicare

During our audit period, WPS administered Medicare Part A fiscal intermediary and Part B carrier operations under cost reimbursement contracts with CMS until its contractual relationships ended on July 1, 2013, and September 7, 2013, respectively.

With the implementation of Medicare contracting reform,[1] WPS continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 5[2] and Jurisdiction 8[3] effective September 10, 2007, and September 30, 2011, respectively.

WPS employees participated in a defined-benefit pension plan called the Managerial Pension Plan (MPP). Effective December 31, 2013, WPS froze its pension plan, which triggered a curtailment of employee benefits under CAS 413. This report addresses WPS's calculation of Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its benefit curtailment.

Upon the curtailment of its pension plan, WPS identified Medicare's share of the Medicare segment excess pension liabilities to be $3,925,524 as of December 31, 2013.

Prior Pension Segmentation Audit

We performed a prior pension segmentation audit of WPS's MPP (A-07-17-00518, Jan. 4, 2018), which brought the WPS Medicare segment pension assets to December 31, 2013. We recommended that WPS increase the Medicare segment pension assets by $3,214,152 and recognize $68,813,688 as the Medicare segment pension assets as of December 31, 2013.

HOW WE CONDUCTED THIS REVIEW

We reviewed WPS's calculation of Medicare's share of its Medicare segment's excess pension liabilities, as of December 31, 2013, as a result of its benefit curtailment.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

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[1] Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

[2] Medicare Parts A and B Jurisdiction 5 consists of the States of Iowa, Kansas, Missouri, and Nebraska.

[3] Medicare Parts A and B Jurisdiction 8 consists of the States of Indiana and Michigan.

FINDINGS

WPS did not concur with our recommendation in the prior WPS MPP segmentation audit (A-07-17-00518) to increase the Medicare segment pension assets to $3,214,152 as of December 31, 2013. Consequently, WPS did not implement our recommendation.[4] However, we maintain that our findings, as revised, are valid as stated. Therefore, we used the Medicare pension asset amount of $3,214,152 to calculate Medicare's share of the Medicare segment's excess pension assets as of December 31, 2013.

Regarding our second objective, WPS did not comply with Federal requirements when determining Medicare's share of the Medicare segment excess pension liabilities as of the benefit curtailment date. WPS calculated Medicare's share of the excess pension *liabilities* as of December 31, 2013, to be $3,925,524. We determined, however, that Medicare's share of the surplus of pension *assets* was $13,807,170 as of that date. Therefore, WPS understated Medicare's share of the surplus of Medicare segment pension assets by $17,732,694 (that is, $3,925,524 + $13,807,170). WPS understated the Medicare segment excess pension assets because its calculation used an unreasonable long-term interest rate that did not comply with CAS 413.50(c)(12).

PRIOR AUDIT RECOMMENDATION

WPS did not concur with our recommendation in the prior WPS MPP segmentation audit (A-07-17-00518) to increase the Medicare segment pension assets by $3,214,152 as of December 31, 2013.[5] In written comments on our prior audit's draft report, WPS disagreed with some of the determinations we made in developing some of our findings and, consequently, it did not concur with our draft report's recommendation. After reviewing WPS's comments on our prior audit's draft report, we revised some of our findings and the associated dollar amounts for that audit's final report. Although WPS disagreed with our findings and recommendations, we maintain that those recommendations, as revised, are valid as stated.

Those revisions, in turn, were incorporated into the findings and recommendation in this report. In fact, we use $3,214,152 as the Medicare segment asset values throughout this report to identify the excess pension assets as of December 31, 2013.

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[4] The HHS action official, an official CMS designates to resolve Medicare pension matters, will make a final determination as to actions taken on our prior audit recommendation, as well as any recommendations stemming from this audit.

[5] The $3,214,152 recommended increase in WPS's Medicare segment pension assets represents the revised dollar amount conveyed in our prior audit's final report.

MEDICARE SEGMENT CURTAILMENT ADJUSTMENT

Surplus of Medicare Segment Pension Assets as of December 31, 2013

WPS did not comply with Federal requirements when calculating the Medicare segment excess pension liabilities as of its benefit curtailment date. Federal regulations (Appendix B) require WPS to have computed a Medicare segment curtailment adjustment as a result of the benefit curtailment. WPS identified $3,929,336 in Medicare segment excess pension *liabilities* as of December 31, 2013. However, we calculated a surplus of Medicare segment excess pension *assets* totaling $13,815,459 as of that date. (It is necessary to calculate the pension assets and liabilities as well as any adjustments for the Medicare segment before calculating Medicare's share. See Table 1 later in this report for details regarding the calculation of Medicare's share.) Therefore, WPS understated the Medicare segment pension assets by $17,744,795. This amount was a surplus, consisting of the $3,929,336 in Medicare segment excess pension liabilities that WPS identified added to the $13,815,459 of Medicare segment pension assets that we calculated.

WPS understated these assets because its calculation used an unreasonable long-term interest rate that did not comply with CAS 413. Specifically, WPS used a 5.50 percent long-term interest rate to compute its accrued liabilities; however, in consultation with CMS we used the historical rate of 7.50 percent, which complies with CAS 413.50(c)(12)(i) (Appendix B).

At our request, WPS provided its justification for using the 5.50 percent long-term interest rate in its calculation. This justification attributed the decrease in the interest rate that WPS used to the plan's asset allocation and to general market conditions. We forwarded that justification to the CMS Office of the Actuary (OACT) (with which we routinely consult on CAS requirements pertaining to Medicare segment pension audits) for review. After reviewing WPS's justification, CMS OACT determined that the 5.50 percent interest rate did not reflect prior long-term assumptions as required by the CAS. Accordingly, CMS OACT recommended that we ask WPS to provide us with the accrued liabilities as of December 31, 2013, recalculated using the historical long-term interest rate of 7.50 percent. WPS did so and in turn, we used that 7.50 percent interest rate when calculating the accrued liabilities for this audit.

We used the surplus of Medicare segment pension assets that we calculated to identify Medicare's share of the surplus of the Medicare segment's pension assets, as discussed just below.

Medicare's Share of the Surplus of Medicare Segment Pension Assets

WPS calculated the aggregate Medicare percentage (that is, the percentage that reflects Medicare's share of the Medicare segment excess pension liabilities) as of December 31, 2013, to be 99.903 percent. We calculated the aggregate Medicare percentage to be 99.940 percent (Appendix C) using the Medicare segment pension costs developed during the prior pension costs claimed audit (A-07-11-00369, Feb. 1, 2012) and current pension costs claimed audits

(A-07-17-00519 and A-07-17-00530; Appendix A) as required by the CAS. For details on the Federal requirements regarding the aggregate Medicare percentage, see Appendix B.

WPS calculated $3,925,524 as Medicare's share of the Medicare segment excess pension *liabilities* as of December 31, 2013; however, we calculated that Medicare's share of the surplus of Medicare segment pension *assets* was $13,807,170 as of that date. The difference, $17,732,694, constituted allowable Medicare segment pension assets that WPS did not include in its curtailment adjustment. WPS understated Medicare's share of the surplus of Medicare segment pension assets by $17,732,694 primarily because it understated the Medicare segment's pension assets (as discussed above).

Table 1 below shows our calculation of Medicare's share of the surplus of pension assets.

Table 1: Medicare's Share of Excess Pension (Assets)/Liabilities

	Per Audit	Per WPS	Difference
Medicare Segment Assets as of December 31, 2013	$68,813,688	$65,599,536	$3,214,152
Medicare Segment Liabilities as of December 31, 2013[6]	54,998,229	69,528,872	(14,530,643)
Excess Medicare Segment (Assets)/Liabilities	(13,815,459)	3,929,336	(17,744,795)
Aggregate Medicare Percentage	99.940%	99.903%	0.04%
Excess (Assets)/Liabilities Attributable to Medicare	($13,807,170)	$3,925,524	**($17,732,694)**

RECOMMENDATION

We recommend that WPS increase Medicare's share of the Medicare segment excess pension assets as of December 31, 2013, by $17,732,694 and recognize $13,807,170 as Medicare's share of the pension assets as a result of the benefit curtailment.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, WPS disagreed with some of the determinations and methodologies we used in developing our findings and, consequently, it did not concur with our findings.

A summary of WPS's main points and our responses follows. Specifically, WPS cited its comments on our prior, related report (A-07-17-00518, discussed earlier) to support its disagreement with the Medicare pension asset amount of $3,214,152 that we used to calculate Medicare's share of the Medicare segment's excess pension assets as of December 31, 2013. WPS also stated that the 5.50 percent long-term interest rate that it used to compute its

[6] As requested, WPS provided us with the revised accrued liabilities for the Medicare segment using a 7.50 percent rate as of December 31, 2013. However, due to participant differences in the Medicare segment, we adjusted the revised accrued liabilities that WPS provided to reflect those participant differences. Specifically, we adjusted the Medicare segment accrued liabilities as of December 31, 2013, using a ratio of our audited liabilities at 7.50 percent to WPS's proposed liabilities at 7.50 percent.

accrued liabilities was required by CAS 413 and represented WPS's best estimate of the rate of return on pension plan assets.

WPS's comments appear in their entirety as Appendix D.

After reviewing WPS's comments, we maintain that our use of the 7.50 percent discount rate for the calculation of the accrued liabilities as of December 31, 2013, remains valid. Therefore, we maintain that our findings and our recommendation remain valid as well.

MANAGERIAL PENSION PLAN ASSET VALUE AS OF DECEMBER 31, 2013 (PRIOR AUDIT RECOMMENDATION)

Auditee Comments

WPS's comments referred to our prior, related Managerial pension plan segmentation report (A-07-17-00518, Jan. 4, 2018), in which WPS disagreed with our finding. In that prior report, we identified pension segmentation assets of $3,214,152 as of December 31, 2013. We used this asset amount to calculate Medicare's share of the Medicare segment's excess pension assets for that prior report.

Office of Inspector General Response

After reviewing WPS's comments on draft report A-07-17-00518, we revised some of our findings for that final report, based on the issues that WPS had raised. Specifically, in its comments on that prior, related report, WPS posed questions regarding the treatment of some cost centers and the classification of some plan participants. After reviewing WPS's comments, we revised some of our findings—which in turn resulted in revised Medicare segment pension assets as of December 31, 2013, of $3,214,152—for that final, prior report.

We maintain that our findings and recommendations in our final, prior report A-07-17-00518 remain valid, and as such are valid to be used to calculate Medicare's share of the excess pension assets for this current report.

DISCOUNT RATE USED TO CALCULATE CURTAILMENT ACCRUED LIABILITIES

Auditee Comments

WPS disagreed with the $13,807,170 that our findings (discussed earlier) identified as Medicare's share of the surplus of Medicare segment pension assets. WPS based its disagreement on the assumptions with which it justified the 5.50 percent long-term interest rate that it used. These assumptions included changes in the pension plan's asset allocation, an appeal to current and anticipated market conditions, and a reference to CAS 412 valuation as a "reasonable" basis for actuarial assumptions.

WPS cited earlier, separate communications with our staff, including a June 1, 2017, letter, and stated that a 5.50 percent long-term interest rate was required by CAS 413, as that rate represented WPS's best estimate of the rate of return on plan assets, "taking into account past experience and reasonable expectations." Furthermore, WPS said that the 7.50 percent rate that CMS OACT and we used was a historical average and did not meaningfully support the estimation of future returns because it disregarded the change to the pension plan's asset allocation and current anticipated market conditions. Accordingly, WPS maintains that Medicare's share of the Medicare segment excess pension liabilities should be $3,925,524.

WPS also stated that both CMS OACT and we had acknowledged that the 5.50 percent rate was a reasonable assumption for computing liabilities and costs at the time of the benefit curtailment. WPS further stated that neither CMS nor we had identified any provision in CAS 413 suggesting that actuarial liability should be calculated based on "an average of historic[al] assumptions, as opposed to the best assumption as of the date of the curtailment."

WPS cited CAS 413.50(c)(12), which states that if there is a curtailment, the difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs. WPS added that this provision of the CAS states that the actuarial assumptions employed in the development of the liability shall be consistent with the current and prior long-term assumptions used for the measurement of pension costs. WPS said that it did not understand how CMS OACT or we could interpret this language to mean that a Medicare contractor is to take an average of past rates. WPS stated: "The only reasonable interpretation of these requirements is that a curtailment adjustment must be calculated using the forward-looking assumptions at the time of the curtailment."

WPS also quoted from the preamble to CAS 413 and stated that this language shows the intent of CAS 413 to measure the curtailment based on the appropriate long-term assumptions at the time of the curtailment and not based on an average of historic assumptions.

Further, WPS said that U.S. Government presenters at pension industry conferences indicated that "while no formal guidance exists, a reasonable approach would be to tie into the actuarial assumptions in the most recent CAS 412 valuation used for incurred cost proposals *on or before* the agreed to CAS 413 measurement date" (emphasis in original).

Office of Inspector General Response

Nothing in WPS's comments caused us to change our findings or our recommendation. We continue to believe, in conjunction with CMS OACT, that WPS's 5.50 percent long-term interest rate, which it based on CAS 412, did not comply with Federal requirements. The applicable provisions, in fact, appear in CAS 413, which we cite as criteria for our findings and which we discuss again below. For this and the following reasons, we maintain that our use of the 7.50 percent long-term interest rate was reasonable for our calculation of Medicare's share of the Medicare segment excess pension liabilities as a result of the benefit curtailment.

WPS's incorrect reliance on CAS 412 appeared in the June 1, 2017, letter that it mentioned in its written comments, as well as in those comments themselves. In fact, the reference to "past experience and reasonable expectations," which formed part of WPS's justification of its 5.50 percent long-term interest rate, came from CAS 412.40(b)(2), which 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." The requirements in CAS 412 pertain to the fundamentals of computing annual pension costs, not—as is the case for this audit—to the computation of assets and liabilities as a result of benefit curtailments.[7] Both our finding and Appendix B of this report make clear that the relevant Federal requirements appear in CAS 413.

WPS's incorrect reliance on CAS 412 influenced other, related facets of its written comments on our findings. For instance, with respect to WPS's statement that both CMS OACT and we had acknowledged that the 5.50 percent rate was a reasonable assumption, we acknowledge that WPS had in recent years shifted to more of a bond-based investment portfolio (for which interest rates typically are lower than those for a stocks-heavy portfolio). On this basis, we communicated to WPS officials our view that the 5.50 percent rate seemed reasonably acceptable for the purpose of calculating annual pension costs (under CAS 412). We did not and do not suggest that the 5.50 percent rate was a reasonable assumption for the purpose of calculating assets and liabilities as a result of a benefit curtailment (for which CAS 413 applies).

Moreover, we disagree with WPS's assertion that neither CMS nor we had given WPS any information or guidance that the long-term interest rate could be based on an average or historical rates. In fact, we sent a letter to WPS, dated April 3, 2017 (over 9 months before we issued our draft report), which explained our position regarding the appropriateness of the 7.50 percent interest rate that we subsequently cited in our report's findings. This letter included (1) a supporting graph, prepared by CMS OACT, that identified the 15- and 25-year historical averages of long-term interest rates, and (2) references to the applicable CAS.

We also disagree with WPS's interpretation of the relevant provision of CAS 413.50(c)(12)(i). As also quoted in Appendix B, this requirement states: "The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and *prior long term assumptions* used in the measurement of pension costs" (emphasis added). WPS cited this same language in its written comments, but its follow-on statement—that it did not understand how this language could refer to an average of past rates—overlooked the CAS's reference to prior long-term assumptions. The same Federal requirement that WPS cited (CAS 413.50(c)(12)) has as its

[7] Along these lines, we note that WPS's comments about "a reasonable approach" taking the form of "the most recent CAS 412 valuation" may have presented information out of context. This possibility is reinforced by the fact that WPS offered no specific information identifying which U.S. Government presenters and which pension industry conferences it was referring to.

purpose the adjustment of *previously determined* pension costs—the adjustment, that is, of what WPS referred to as “past rates.”

Those past rates, as calculated and averaged (to 7.50 percent) by CMS OACT and as used in our review of WPS’s accrued liabilities, resulted from the fact that for many decades before WPS shifted to more of a bond-based investment portfolio, it used a much higher long-term interest rate to measure and assign its pension costs. Accordingly, our review focused on WPS’s curtailment of benefits that were based on higher-interest earnings from previous periods. In conformance with CAS 413, WPS was required to adjust the unfunded liability attributable to those prior costs. Our audit work, undertaken in coordination with CMS OACT, focused on identifying the correct amount of this adjustment. In other words, we adjusted prior historical costs using prior historical assumptions, in accordance with CAS 413.50(c)(12)(i).

Our audit work did not focus on identifying the increase in unfunded liability created by WPS’s recent asset rebalancing—a focus that WPS appeared to be calling for in its reference to “the forward-looking assumptions at the time of the curtailment.” An audit of that nature would involve the computation and measurement of annual pension costs, for which the applicable Federal requirements appear at CAS 412.40(b)(2) and CAS 412(b)(4)—not, as WPS asserted, at CAS 413.50(c)(12) and 413.50(c)(12)(i).

WPS’s incorrect use of CAS 413 extended to its comments about that document’s preamble, which overlook the fact that a preamble is merely a summary of the regulations that follow and does not, in and of itself, supersede those regulations. In fact, according to *Perry v. Martin Marietta,* 47 F.3d 1134 (1995), the preambles are not regulatory but are intended to explain why the Standards and related Rules and Regulations were written.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Upon the curtailment of its pension plan, WPS identified Medicare's share of the Medicare segment excess pension liabilities to be $3,925,524. We reviewed WPS's calculation of Medicare's share of its Medicare segment's excess pension liabilities, as of December 31, 2013, as a result of its benefit curtailment.

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

We performed fieldwork at WPS in Madison, Wisconsin.

METHODOLOGY

To accomplish our objectives, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;

- reviewed the curtailment calculation prepared by WPS's actuarial consulting firm;

- reviewed the prior segmentation audit performed at WPS (A-07-17-00518, Jan. 4, 2018) to determine the December 31, 2013, market value of assets for the Medicare segment;

- obtained WPS's justification for its use of a 5.50 percent long-term interest rate in its calculation of its accrued liabilities, and consulted with CMS OACT as to whether that interest rate complied with the CAS; and

- reviewed WPS's accrued liabilities using the revised (7.50 percent) interest rate.

We performed this review in conjunction with the following audits and used the information obtained during this audit:

- *Wisconsin Physicians Service Insurance Corporation Understated Its Medicare Segment Pension Assets for Its Managerial Pension Plan* (A-07-17-00518) and

- *Wisconsin Physicians Service Insurance Corporation Understated Medicare Administrative Contract Allowable Pension Costs* (A-07-17-00530).

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO BENEFIT CURTAILMENT ADJUSTMENT

FEDERAL REGULATIONS

Federal regulations (CAS 413.50(c)(12)) state, in part:

> If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.
>
> i. The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs….
>
> ii. … The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).
>
> iii. The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.
>
> iv. Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

The methodology for determining the Federal Government's share of excess pension assets and liabilities is addressed by CAS 413.50(c)(12)(vi), which states:

> The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the **sum of the pension plan costs** allocated to all contracts and subcontracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the **total pension costs** assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique. [Emphasis added.]

MEDICARE CONTRACTS

The Medicare contracts state: "The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413. The Secretary [of Health and Human Services] and the contractor agree that, for purposes of this agreement/contract, CAS 413 shall be interpreted and applied as specified herein."

APPENDIX C: CALCULATION OF AGGREGATE MEDICARE PERCENTAGE

Calendar Year	Allowable Medicare Segment Pension Costs From FACPs	Allowable Medicare Segment Pension Costs From ICPs	Total Allocable Medicare Segment Pension Costs	Medicare Aggregate Percentage
1/	(A) 2/	(B) 3/	(C) 4/	((A+B)/C) 5/
1990	$125,370		$127,707	
1991	0		0	
1992	0		0	
1993	0		0	
1994	0		0	
1995	0		0	
1996	0		0	
1997	0		0	
1998	591,550		591,550	
1999	1,541,754		1,541,754	
2000	1,639,790		1,639,790	
2001	1,867,504		1,868,064	
2002	2,115,213		2,115,213	
2003	2,998,663		2,998,663	
2004	2,934,100		2,934,100	
2005	3,058,815		3,059,427	
2006	3,201,293		3,201,933	
2007	1,978,076	28,697	2,006,773	
2008	2,490,118	705,619	3,195,737	
2009	1,848,706	743,786	2,592,492	
2010	1,195,782	476,406	1,672,188	
2011	1,312,814	527,061	1,857,405	
2012	1,795,609	1,499,087	3,294,696	
2013	325,300	1,077,458	1,402,758	
Total	$31,020,457	$5,058,114	$36,100,250	99.940%

ENDNOTES

1/ We based the aggregate percentage on the audited pension costs developed during the prior pension costs claimed audit (A-07-11-00369, Feb. 1, 2012) and current pension costs claimed audits (A-07-17-00519 and A-07-18-00530) as required by the CAS.

2/ This column identifies the allowable Medicare segment pension costs that relate to the Legacy Medicare contract.

3/ This column identifies the allowable Medicare Parts A and B contract, Jurisdictions 5 and 8, segment pension costs that relate to the MAC contracts. In some instances, we limited the allowable pension costs from the ICP to equal 100 percent of the allocable pension costs. This was necessary because when using the actual allowable pension costs claimed from the ICPs, the line of business percentage exceeded 100 percent.

4/ This column identifies the total allocable Medicare segment pension costs during the contract period.

5/ In accordance with 9904.413-50(c)(12)(vi), we calculated the aggregate Medicare percentage by dividing the total of the Medicare segment's pension costs charged to Medicare (that is, the combined amounts from the two columns to the right of the "Calendar Year" column) by the total allocable Medicare segment pension costs pursuant to CAS 413.

WPS GOVERNMENT HEALTH ADMINISTRATORS

Wisconsin Physicians Service Insurance Corporation
A CMS Medicare Contractor
1717 W. Broadway | P.O. Box 1787 | Madison, WI 53701-1787

March 16, 2018

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

RE: OIG Draft Reports Number A-07-17-00529

Dear Mr. Cogley:

This letter is in response to Report Number A-07-17-00529 entitled *Wisconsin Physicians Service Insurance Corporation Understated Medicare's Share of the Medicare Segment Excess Pension Assets.* You requested that WPS provide you with a written comment including a statement of concurrence or nonconcurrence with the recommendation. WPS does not concur with the findings.

First, for the reasons set forth in WPS's response to Audit Report Number A-07-17-00518, WPS disagrees with the Medicare pension asset amount of $3,214,152 used to calculate Medicare's share of the Medicare segment's excess pension assets as of December 31, 2013.

Second, for the reasons set forth in WPS's June 1, 2017 and October 27, 2015 letters to Seth Sanders of your office, WPS maintains that a 5.50% discount rate is required by Cost Accounting Standards ("CAS") 413, as that rate represents WPS's best estimate of the rate of return on Plan assets taking into account past experience and reasonable expectations. The 7.50% discount rate identified in Report Number A-07-17-00529 is a historical average that does not meaningfully estimate future returns because it disregards changes to the Plan's asset allocation and current and anticipated market conditions.

In fact, both HHS OIG and CMS OACT acknowledged that 5.50% is a reasonable assumption that is appropriate for measuring the liability and cost at the time of the curtailment. Neither your office nor CMS has identified any provision in CAS 413 suggesting that actuarial liability should be calculated based on an average of historic assumptions, as opposed to the best assumption as of the date of the curtailment.

CAS 413.50(c)(12) states that if there is a curtailment, difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs. It states that the actuarial assumptions employed in the development of the liability shall be consistent with the current and prior long-term assumptions used for the measurement of pension costs. WPS does not understand how OIG and CMS OACT can interpret this language to mean to take an average of past rates. CAS 413 also states that actuarial assumption means an estimate of _future_ conditions affecting pension costs; for example, mortality rate, employee turnover, compensation levels, *earnings on pension plan assets, changes in values of pension plan assets*. The only reasonable interpretation of these requirements is that a curtailment adjustment must be calculated using the forward-looking assumptions at the time of the curtailment.

We note that the preamble to CAS 413 states the following:

Consistent with the requirement that actuarial assumptions be individual best-estimate of *future* long-term economic and demographic trends, this final rule requires that the assumptions used to determine the actuarial liability be consistent with the assumptions that have been in use. This is consistent with the fact that the pension plan is continuing even though the segment has closed or the earning of future benefits has been curtailed. *The Board does not intend this rule to prevent contractors from using assumptions that have been revised based on a persuasive actuarial experience study or a change in a plan's investment policy*.

The language in the preamble clearly shows the intent of CAS 413 to measure the curtailment based on the appropriate long-term assumption at the time of the curtailment and not based on an average of historic assumptions as was done by WPS.

Further, WPS notes that in pension industry conferences with representatives of the US Government as presenters indicated that "while no formal guidance exists, a reasonable approach would be to tie into the actuarial assumptions in the most recent CAS 412 valuation used for incurred costs purposes *on or before* the agreed to CAS 413 measurement date."

We believe for the reasons stated above, the appropriate long-term assumption to use for the CAS 413 curtailment calculation is 5.50% and not the 7.50% assumption employed by OIG and CMS OACT. As a result, WPS believes Medicare's share of the Medicare Segment Excess Pension Liability is $3,925,524 and not the Asset of $13,807,170 indicated in this Draft report.

Thank you for the opportunity to comment, please contact me at (402) 995-0361 or e-mail me at Janet.Kyle@wpsic.com if you have any questions.

Sincerely,

Janet L. Kyle
Executive Vice President
GHA Division