DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

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

APR 2 6 2007

Report Number: A-07-07-00228

Eric Schindler, Vice President and Chief Financial Officer
Blue Cross Blue Shield of Montana
404 Fuller Avenue
Helena, Montana 59604

Dear Mr. Schindler:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Audit of Blue Cross Blue Shield of Montana's Unfunded Pension Costs 1987 to 2004." A copy of this report will be forwarded to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports are made available to the public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to contact me at (816) 426-3591, or Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-07-00228 in all correspondence.

Sincerely,

Patrick J. Cogley

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Mr. George Mills
Regional Administrator (Acting), Region VIII
Centers for Medicare & Medicaid Services
Colorado State Bank Building
1600 Broadway, Suite 700
Denver, Colorado 80202

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF BLUE CROSS BLUE SHIELD OF MONTANA'S UNFUNDED PENSION COSTS 1987 TO 2004

Daniel R. Levinson
Inspector General

April 2007
A-07-07-00228

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Montana (Montana) administers Medicare Part A and B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS). Effective March 1, 1986, Blue Cross of Montana merged with Montana Physicians' Service, and the two companies became Blue Cross and Blue Shield of Montana. The two pension plans merged effective January 1, 1987.

OBJECTIVES

The objectives of our review were to:

- determine whether pension costs for plan years 1987 to 2004 were funded in accordance with the Federal Acquisition Regulation and Cost Accounting Standards, and

- identify and properly account for any unallowable unfunded pension costs.

SUMMARY OF FINDING

Montana did not correctly identify the accumulated unallowable unfunded pension costs. As of January 1, 2004, Montana determined its accumulated unallowable unfunded pension costs to be $0; however, we identified accumulated unallowable unfunded pension costs of $56,099 ($7,324 for the Medicare segment plus $48,775 for the Other segment). As a result, Montana understated the accumulated unallowable unfunded pension costs by $56,099.

RECOMMENDATIONS

We recommend that Montana:

- identify $56,099 of accumulated unallowable unfunded pension costs ($7,324 as an unallowable component of Medicare segment pension costs and $48,775 as an unallowable component of the Other segment pension costs) as of January 1, 2004; and

- properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

AUDITEE'S COMMENTS

In written comments on our draft report, Montana concurred with our recommendation to identify $56,099 of accumulated unallowable unfunded pension costs as of January 1, 2004 and to properly identify, and update with interest, unallowable unfunded pension costs in subsequent years. Montana stated that it plans to establish a schedule of unallowable pension costs as identified by our draft report and to appropriately update the schedule to include accumulated interest. Montana's response is included in its entirety as the Appendix.

INTRODUCTION

BACKGROUND

Montana and Medicare

Blue Cross Blue Shield of Montana (Montana) administers Medicare Part A and B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS). Effective March 1, 1986, Blue Cross of Montana merged with Montana Physicians' Service, and the two companies became Blue Cross and Blue Shield of Montana. The two pension plans merged effective January 1, 1987.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. The payments are allowable pension costs under the Federal Acquisition Regulation (FAR) and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated Cost Accounting Standards (CAS) 412 and 413.

Cost Accounting Standards

The CAS deals with stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, published revisions to those portions of the CAS that dealt with accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the postrevision standards as the revised CAS. Applicable portions of the revised CAS are discussed in a later section.

Also, CAS within 48 CFR § 9904.412-50(a)(2) states: "Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions . . . shall be separately identified and eliminated from any unfunded actuarial liability being amortized. . . ."

The CAS within 48 CFR § 9904.412-40(c) imposes the fundamental requirement for assigning pension costs: "Except costs assigned to future periods by 9904.412-59(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period."

Federal Acquisition Regulation

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. FAR, 48 CFR § 31.205-6(j)(1)(i), states: ". . . the contractor shall fund pension costs by the time set for the filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year."

Conflict between the Federal Acquisition Regulation Funding Requirement and Tax Limits

Pension costs computed in accordance with CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act of 1974 (ERISA), which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code.

Under tax laws in effect prior to 1986, employers could fund the CAS contribution in excess of the tax-deductible limit, and any excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded CAS computed amounts, the excess funding could be carried forward as a prepayment credit to fund allowable contract costs for future years.

The Tax Reform Act of 1986 (TRA 86) changed the effect of making pension plan contributions in excess of the tax-deductible limit. TRA 86 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. This excise tax is cumulative from year to year and is applied on a first-in/first-out basis considering carry-forwards and current year contributions. As such, contractors faced a conflict between plan funding limits and the period assignment provisions of the CAS. The effect of this conflict was contractors did not fund CAS pension costs because the funding (i.e. contributions) lacked tax deductibility.

The Omnibus Budget Reconciliation Act of 1987 added a "current liability" full funding limitation that lowered the tax-deductible limit for many plans, further increasing the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund the CAS pension cost without incurring excise tax penalties, yet the FAR provided that unfunded CAS costs could not be carried forward to future years. However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than the CAS cost was a voluntary financial action.

Revised Cost Accounting Standards

As previously noted, CAS that related to accounting for pension costs was revised on March 30, 1995 and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS removes the regulatory conflict between the funding limits of ERISA of 1974 and the period assignment provisions of CAS. The transition provisions of the new rule (48 CFR § 9904.412-64) allow the reassignment of prior period pension costs, with interest, which had not been funded because they lacked tax deductibility. The contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The CAS revision does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA. If a contractor could in past periods have funded pension costs but chose not to, then those costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to:

- determine whether pension costs for plan years 1987 to 2004 were funded in accordance with the FAR and CAS, and

- identify and properly account for any unallowable unfunded pension costs.

Scope

Our review covered the period of plan years 1987 to 2004. Achieving our objectives did not require that we review Montana's internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with the FAR and CAS.

We performed fieldwork at Montana's office in Helena, Montana, during September 2006.

Methodology

The CMS Office of the Actuary developed the methodology used for computing CAS pension costs based on Montana's historical practices.

In performing our review, we used information provided by Montana's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Montana's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, CMS Office of the Actuary staff calculated the assignable CAS pension costs for each year of the period 1987 to 2004 for both the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment. Additionally, the CMS Office of the Actuary staff determined the extent to which Montana funded those costs with contributions to the pension trust fund. We reviewed the methodology for the calculations and updated Montana's unfunded pension costs for the years 1987 to 2004 for both the Medicare segment and the Other segment.

We performed this review in conjunction with our audits of Medicare segmentation (A-07-07-00226) and pension costs claimed for Medicare reimbursement (A-07-07-00227). The information obtained and reviewed during those audits was also used in performing this review.

We performed our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATIONS

Montana did not correctly identify the accumulated unallowable unfunded pension costs. We found that Montana funded the pension costs allocable to the Medicare contracts for plan years 1987 to 2004 in accordance with the FAR. However, Montana did not properly identify accumulated unallowable unfunded pension costs in accordance with the CAS. Montana identified accumulated unallowable unfunded pension costs of $0 as of January 1, 2004. However, we identified accumulated unallowable unfunded pension costs of $56,099 ($7,324 for the Medicare segment plus $48,775 for the Other segment) as of January 1, 2004.

Effective January 1, 1996, the revised CAS allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility as accumulated reassignable pension costs. However, the revision to CAS does not remove the requirement to fund pension costs when contributions are tax deductible. If in past periods a contractor could have funded pension costs and chose not to, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

We determined that a portion of Montana's accumulated unfunded pension costs could have been funded in the year incurred, but Montana chose not to fund those costs. Consequently, those unallowable costs must be updated with interest, and removed from future periods' pension cost computations. We updated the unallowable portion of Montana's accumulated unfunded pension costs from January 1, 1987 to January 1, 2004. We found the unallowable costs to be $56,099 ($7,324 for the Medicare segment and $48,775 for the Other Segment) as of January 1, 2004.

RECOMMENDATIONS

We recommend that Montana:

- identify $56,099 of accumulated unallowable unfunded pension costs ($7,324 as an unallowable component of Medicare segment pension costs and $48,775 as an unallowable component of the Other segment pension costs) as of January 1, 2004; and

- properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

AUDITEE'S COMMENTS

In written comments on our draft report, Montana concurred with our recommendation to identify $56,099 of accumulated unallowable unfunded pension costs as of January 1, 2004 and to properly identify, and update with interest, unallowable unfunded pension costs in subsequent years. Montana stated that it plans to establish a schedule of unallowable pension costs as identified by our draft report and to appropriately update the schedule to include accumulated interest. Montana's response is included in its entirety as the Appendix.

APPENDIX

BlueCross BlueShield of Montana

560 N. Park Avenue
P.O. Box 4309
Helena, Montana 59604
(406) 444-8200
Customer Information Line:
1-800-447-7828
Website:
www.bluecrossmontana.com

March 16, 2007

Patrick J. Cogley
Regional Inspector General for Audit Services
Office of Inspector General
Offices of Audit Services, Region VII
601 E 12th St, Rm 284A
Kansas City MO 64106

Re: Report Number A-07-07-00228

Dear Mr. Cogley:

Blue Cross Blue Shield of Montana (BCBSMT) is in receipt of the draft copies of the OIG report entitled "Audit of BCBSMT's Unfunded Pension Costs 1987 - 2004."

In this report, the OIG recommends that BCBSMT identify $56,099 of accumulated allowable unfunded pension costs as of January 1, 2004 and properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

BCBSMT concurs with these recommendations and plans to implement the following corrective action:

1. We have discussed these findings with NEBA and Chicago Consulting Actuarial Strategies (CCA), the actuarial firm who completes our annual pension valuation. CCA has agreed to establish a schedule of unallowable pension costs as identified by the OIG and to appropriate update that schedule to include accumulated interest.

We appreciate the opportunity to provide input on the draft report. If you have any questions about our response, please contact Erin Frisbey, 406-444-8983.

Sincerely,

Eric Schindler
BCBSMT Vice President and Chief Financial Officer