DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date OCT 27 1992

From Bryan B. Mitchell *Bryan Mitchell*
Principal Deputy Inspector General

Subject Audit of Unfunded Pension Costs of Blue Cross and Blue Shield of Texas, Inc. (A-07-92-00578)

To William Toby, Jr.
Acting Administrator
Health Care Financing Administration

This is to alert you to the issuance on October 28, 1992, of our final audit report. A copy is attached. Our review showed that as of April 1, 1991, Blue Cross and Blue Shield of Texas, Inc. (Texas) had accumulated $6.2 million in pension costs that are unallowable for Medicare reimbursement.

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 Regulations (FAR). Pension cost assigned to an accounting period, but not funded by tax filing deadlines, may not be reassigned to or claimed in subsequent accounting periods. Also, interest on any unfunded costs is an unallowable component of pension costs of future cost accounting periods.

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax exemptions under the Employees Retirement Income Security Act of 1974 (ERISA). The ERISA provides for a minimum and a maximum deposit to pension funds as determined each year. The minimum represents a required deposit while the maximum represents the upper limit that can be deducted for income tax purposes for the year for which the deposit is applicable.

Pension costs computed in accordance with CAS represent an assignment of pension costs to specific accounting periods. Historically, CAS pension costs often fell between ERISA minimum and maximum contributions. In addition, before 1986, if CAS pension costs were greater than maximum ERISA contributions, contractors could deposit the CAS amounts in qualified trust funds, claim them as allowable contract costs, and take ERISA maximums as tax deductions. The excess of the CAS amount over the ERISA maximum could be carried forward to future years for tax deductibility. Similarly, if contractors deposited ERISA maximums that were larger than CAS computed amounts, differences could be carried forward as 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 ERISA maximums. The ERISA maximum was still the tax deductible limit and the excess could still be carried forward to future years for deductibility. However, TRA '86 imposed an excise tax of 10 percent on contributions in excess of ERISA maximums. The excise tax is cumulative from year to year.

With the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), the Congress took additional action affecting contractors' pension plan contributions. The OBRA '87 imposed a second more restrictive test to the full funding limitation. The more restrictive test caused most pension plans that were already in full funding to retain their full funding status longer and pushed additional plans into a full funding status.

Texas made no contributions to its pension plan for plan years 1988, 1989, and 1990 to avoid the tax implications of TRA '86 and OBRA '87. By not making contributions for the 3 years, Texas avoided making pension plan deposits that were not tax deductible and avoided paying the 10 percent excise tax. However, in avoiding the tax consequences, Texas lost allowability of the costs under Medicare. Considering unallowable interest on the deposits not made, Texas has accumulated $6.2 million as of April 1, 1991, that must be separately identified and excluded as future components of Medicare pension costs.

We are recommending that Texas: (1) separately identify $6.2 million as an unallowable component of pension costs as of 1991, (2) continue a yearly update of unallowable pension cost components related to the unfunded CAS costs for 1988 through 1990, and (3) identify unallowable components of pension costs for any subsequent years for which CAS costs of the pension plan are not funded.

Texas agreed with the calculations and criteria contained in the report, but expressed its intent to seek a waiver which would allow Texas to reassign and claim the costs in future accounting periods. Regional Health Care Financing Administration officials agreed with our findings and recommendations.

Attachment

For further information contact:
Vincent R. Imbriani
Regional Inspector General
for Audit Services, Region VII
816-426-3591

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF TEXAS, INC.

OCTOBER 1992 A-07-92-00578

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

CIN: A-07-92-00578

Mr. Vernon Walker
Vice President, Comptroller
Blue Cross and Blue Shield of Texas, Inc.
P.O. Box 655730
Dallas, Texas 75265-5730

Dear Mr. Walker:

Enclosed for your information are two copies of an Office of Inspector General (OIG), Office of Audit Services (OAS) report titled "AUDIT OF UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF TEXAS, INC." Your attention is invited to the finding and recommendations contained in the report. The below named official will be communicating with you in the near future regarding implementation of necessary actions.

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

To facilitate identification, please refer to the above Common Identification Number (CIN) in all correspondence relating to this report.

Sincerely,

Vincent R. Imbriani
Regional Inspector General for
Audit Services, Region VII

Enclosures

Action Official:

Gale A. Drapala
Regional Administrator, Region VI
Health Care Financing Administration
1200 Main Tower, Room 2000
Dallas, Texas 75202

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

CIN: A-07-92-00578

Mr. Vernon Walker
Vice President, Comptroller
Blue Cross and Blue Shield of Texas, Inc.
P.O. Box 655730
Dallas, Texas 75265-5730

Dear Mr. Walker:

This report provides you with the results of our review of "UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF TEXAS, INC.," as of 1991. The purpose of our review was to determine any unfunded pension costs for pension plan years 1988 through 1990 and any resulting missing assets as of April 1, 1991, the start of the 1991 plan year.

As of April 1, 1991, Blue Cross and Blue Shield of Texas, Inc. (Texas) had accumulated $6.2 million in pension costs that are unallowable for Medicare reimbursement. Pension cost assigned to an accounting period, but not funded by tax filing deadlines, may not be reassigned to or claimed in subsequent accounting periods. Also, no amount for interest on the portion not funded in a period can be a component of pension cost of any future cost accounting period. For plan years 1988 through 1990, Texas did not make contributions to a trust fund for pension costs identifiable with its direct Medicare segment. As a result, as of the beginning of the 1991 plan year, Texas had accumulated $6.2 million of unfunded pension costs. Texas must separately identify and eliminate this amount from the amortization components of future pension costs.

Texas agreed with the calculations and criteria contained in the report, but expressed its intent to seek a waiver which would allow Texas to reassign and claim the costs in future accounting periods.

BACKGROUND

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 Regulations (FAR). The CAS deals with stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods. The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding.

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax exemptions under the Employees Retirement Income Security Act of 1974 (ERISA). The ERISA provides for a minimum and a maximum deposit to pension funds as determined each year. The minimum represents a required deposit while the maximum represents the upper limit that can be deducted for income tax purposes for the year for which the deposit is applicable.

Pension costs computed in accordance with CAS represent an assignment of pension costs to specific accounting periods. Historically, CAS pension costs often fell between ERISA minimum and maximum contributions. In addition, before 1986, if CAS pension costs were greater than maximum ERISA contributions, contractors could deposit the CAS amounts in qualified trust funds, claim them as allowable contract costs, and take ERISA maximums as tax deductions. The excess of the CAS amount over the ERISA maximum could be carried forward to future years for tax deductibility. Similarly, if contractors deposited ERISA maximums that were larger than CAS computed amounts, differences could be carried forward as 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 ERISA maximums. The ERISA maximum was still the tax deductible limit and the excess could still be carried forward to future years for deductibility. However, TRA '86 imposed an excise tax of 10 percent on contributions in excess of ERISA maximums. The excise tax is cumulative from year to year and applied on a first-in/first-out basis considering carry forward and current year contributions. The excise tax affects all Medicare intermediaries and carriers as TRA '86 also eliminated Blue Cross and Blue Shields' special tax exempt status.

With the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), the Congress took additional action affecting contractors' pension plan contributions. Prior to OBRA '87, ERISA's full funding limitation considered accumulated assets and the actuarial liability. If assets equalled or exceeded the actuarial liability, the tax deductible amount was limited to zero.

The OBRA '87 imposed a second more restrictive test to the full funding limitation. It considers the accumulated assets and 150 percent of the amount designated "current liability." The actuarial liability under the pre-OBRA '87 test was based on projected benefits and conservative valuation assumptions. The current liability test of OBRA '87 considers only currently accrued benefits and values the liability using interest rates based on treasury rates. This change caused most pension plans that were already in full funding to retain their full funding status longer and pushed additional plans into a full funding status.

SCOPE OF AUDIT

Our examination was made in accordance with generally accepted government auditing standards. Our objective was to identify unfunded CAS costs, plus appreciation on the unfunded costs, for 1988 through 1990. Achieving our objective did not require that we review the internal control structure of Texas.

This review was done in conjunction with our segmentation audit of Texas (A-07-91-00472). The information obtained and reviewed during the segmentation audit was also used in this review.

The methodology used for computing CAS costs in this review was developed by the Health Care Financing Administration (HCFA), Office of the Actuary (OACT), based on Texas' historical practices.

Field work was performed from January to November 1991. It included work at the contractor's corporate offices in Dallas, Texas.

RESULTS OF AUDIT

We found that, as of April 1, 1991, Texas had accumulated $6,244,637 in unallowable direct pension costs related to its Medicare segment. The pension costs were not funded within specific time periods set by regulation. Imputed interest on the unfunded costs is also unallowable. The $6,244,637 represents unfunded pension costs and imputed interest for plan years 1988 through 1990 as of April 1, 1991. Texas cannot claim any of these unfunded costs in future cost accounting periods.

The FAR 48 CFR 31.205-6(j)(3)(i) and (iii) state:

> "...costs of pension plans not funded in the year incurred, and all other components of pension costs...assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years...."
>
> "Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable."

Furthermore, the CAS within 48 CFR 30.412-50(a)(7) states:

> "If any portion of the pension costs computed for a cost accounting period is not funded in that period, no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period."

In addition, the CAS within 48 CFR 30.412-50(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...."

We compared CAS pension costs for the Medicare segment, computed by HCFA's OACT, to Texas' actual contributions to the Medicare segment for plan years 1988 through 1990. We found the following differences:

Plan Year	CAS Computed Costs	Actual Funding	Difference
1988	$1,588,676	$ -0-	$1,588,676
1989	1,741,003	-0-	1,741,003
1990	2,048,758	-0-	2,048,758
	$5,378,437	$ -0-	$5,378,437

Since the difference of $5,378,437 was not funded within specified time periods, the pension costs are unallowable as components of pension costs for any future years. Interest related to these unfunded costs is also unallowable as a component of future years' pension costs. Appendix A provides additional information.

The following table shows both the unfunded amounts and interest which are unallowable on a cumulative basis. Our computation of the unfunded amounts considered those costs which should have been funded for the applicable years. In other words, if the costs had been funded, the assets of the Medicare segment would have been greater at the specified times. Appendix B provides additional information.

	Unfunded Pension Costs and Interest			
Date	1989	1990	1991	Total
4/1/89	$1,715,770	$ -0-	$ -0-	$1,715,770
4/1/90	1,853,031	1,880,283	-0-	3,733,314
4/1/91	2,001,273	2,030,706	2,212,658	6,244,637

Texas made no contributions to its pension plan for plan years 1988, 1989, and 1990 to avoid the tax implications of TRA '86 and OBRA '87. By not making contributions for the 3 years, Texas avoided making pension plan deposits that were not tax deductible and avoided paying the 10 percent excise tax. However, in avoiding the tax consequences, Texas lost allowability of the costs under Medicare. Considering unallowable interest on the deposits not made, Texas has accumulated $6,244,637 as of April 1, 1991, that must be separately identified and excluded as future components of Medicare pension costs.

Recommendations

We recommend that Texas:

- Separately identify $6,244,637 as an unallowable component of direct pension costs as of the beginning of plan year 1991.

- Continue a yearly update of unallowable pension cost components related to the unfunded CAS costs for plan years 1988 through 1990.

- Identify and track unallowable components of pension costs for any subsequent years for which CAS costs of the pension plan are not funded.

Auditee Comments

"...We did not choose to not make or to defer the subject pension plan contributions...and we did not avoid making deposits simply to avoid tax consequences or paying excise tax.... We were subjected to the Internal Revenue Service Full Funding Limitation and despite recommended ERISA contributions and recommended CAS contributions were effectively prevented from making pension contributions, acting on advice from qualified actuarial consultants."

"Therefore, due to the fact that...[we] did not make current period pension cost contributions...because of Federally-imposed limits that conflict with other Federally-regulated methodology and not because of any discretionary cash flow reasoning, we do not agree that the subject identified assets (costs) will be unallowable. We herein formally contest such definition and seek relief from such definition in the form of a specific waiver. We have been waiting for this draft report...as a vehicle for waiver request. ...the CAS Board has notified Federal agencies that they may waive CAS pension cost assignment requirements for contractors whose overfunded qualified plans are in a situation subject to tax penalty. Further, we have been made aware that waiver has been granted to other contractors as a temporary relief measure, pending the reconciliation of conflicting Federal requirements."

"While we are responding to the calculations of your draft positively as a matter of methodology verification, we are responding to the...issues underlying the draft as follows...[we request] a specific waiver, covering the...years in question retrospectively and prospectively, be granted that will allow us to accrue pension costs in a given fiscal year, not make payments to the pension fund because of IRS mandated tax penalty..., and preserve our right to seek reimbursement from the Government for such costs during a future fiscal year when the costs are actually funded."

Office of Inspector General's (OIG) Response

The OIG does not have the authority to grant a waiver. Since a waiver had not been requested, the issue of whether or not a waiver should be granted was not included in the scope of this audit. With regard to a waiver, the CAS Board, in an April 8, 1991 memorandum, delegated to Federal agencies:

> "on a temporary basis, the authority to waive the cost assignment provisions of CAS 412.40(c), Federal Acquisition Regulation (FAR) 30.412-40(c), in instances in which the overfunded status of qualified plans precluded Federal tax deductibility of contributions, or would have caused the incurrence of a 10 percent excise tax on such overfunding. This will permit agencies to accept the reassignment of contractor accruals of pension costs under CAS 412.40(c) to later cost accounting periods."

The same memorandum stated that "waiver authority may be exercised by the Senior Procurement Executive on a non-delegable basis" and that it should involve a "case-by-case assessment of the respective interests of both the Government and the contractor in the achievement of equitable contract costing."

The section of CAS for which the CAS Board delegated waiver authority specifically states:

> "Assignment of pension cost. The amount of pension cost computed for a cost accounting period is assignable only to that period."

In our opinion, waiver authority delegated by the CAS Board applies only to cost computed for the period and does not apply to CAS 30.412-50(a)(7) which states that "...no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period." Our interpretation is consistent with the Department of Defense's interpretation as provided by a May 27, 1992, memorandum from the

Office of the Under Secretary of Defense titled "Waiver of Cost Accounting Standard (CAS) 412.40(c)." Guidelines attached to the memorandum stated that in determining reassignable amounts of pension costs "Additional interest incurred on the unfunded liability, as a result of delayed funding, is unallowable." As such, we believe that the additional interest of $866,200 related to the unfunded costs of $5,378,437 is not eligible for a waiver.

Since the CAS Board delegated waiver authority only to agencies' Senior Procurement Executives on a nondelegable basis, Texas needs to contact HCFA about the procedures to be followed if it wishes to pursue the granting of a waiver.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determination as to actions to be taken on all matters reported will be made by the Department of Health and Human Services (HHS) official named below. We request that you respond to the recommendations in this report within 30 days from the date of this letter to the HHS official named below, presenting any comments or additional information that you believe may have a bearing on his final decision.

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

To facilitate identification, please refer to the above common identification number in all correspondence relating to this report.

Sincerely,

Vincent R. Imbriani

Vincent R. Imbriani
Regional Inspector General for
Audit Services, Region VII

Enclosures

Action Official:

Gale A. Drapala
Regional Administrator, Region VI
Health Care Financing Administration
1200 Main Tower, Room 2000
Dallas, Texas 75202

BLUE CROSS BLUE SHIELD OF TEXAS, INC.
DALLAS, TEXAS

STATEMENT OF UNFUNDED PENSION COSTS
SEPARATELY CALCULATED BY SEGMENT

FOR PLAN YEARS
1988 THROUGH 1990

		MEDICARE SEGMENT 1	MEDICARE SEGMENT 2	MEDICARE SEGMENT 3	MEDICARE SEGMENT 4	TOTAL MEDICARE SEGMENTS	OTHER SEGMENTS	TOTAL COMPANY
UAL As Of 4-1-88	1/	**$205,212**	**$1,070,524**	**$2,821,980**	**$769,689**	**$4,867,405**	**$7,235,543**	**$12,102,948**
Amortization Of UAL	2/	$22,199	$115,804	$305,269	$ 83,261	$ 526,533	$ 782,710	$1,309,243
1988 Normal Costs	3/	21,648	340,823	592,395	107,277	1,062,143	2,066,634	3,128,777
1988 CAS Costs	4/	43,847	456,627	897,664	190,538	1,588,676	2,849,344	4,438,020
Interest To Yearend	5/	3,508	36,530	71,813	15,243	127,094	227,948	355,042
Expected Additional Assets As Of 4-1-89	6/	47,355	493,157	969,477	205,781	1,715,770	3,077,292	4,793,062
Less: Costs Funded	7/	0	0	0	0	0	0	0
Unfunded Pension Costs For 1988	8/	**$47,355**	**$493,157**	**$969,477**	**$205,781**	**$1,715,770**	**$3,077,292**	**$4,793,062**
Amortization of UAL		$22,199	$115,804	$305,269	$ 83,261	$ 526,533	$ 782,710	$1,309,243
Amortization of 1988 Experience Loss	9/	(3,041)	4,802	25,719	4,132	31,612	4,070	35,682
1989 Normal Costs		23,629	402,275	638,324	118,630	1,182,858	2,145,852	3,328,710
1989 CAS Costs		42,787	522,881	969,312	206,023	1,741,003	2,932,632	4,673,635
Interest To Yearend		3,423	41,830	77,545	16,482	139,280	234,611	373,891
Expected Additional Assets As Of 4-1-90		46,210	564,711	1,046,857	222,505	1,880,283	3,167,243	5,047,526
Less: Costs Funded		0	0	0	0	0	0	0
Unfunded Pension Costs For 1989		**$46,432**	**$547,711**	**$1,046,857**	**$222,505**	**$1,880,283**	**$3,167,243**	**$5,047,526**
Amortization of UAL		$22,199	$115,804	$305,269	$ 83,261	$ 526,533	$ 782,710	$1,309,243
Amortization of 1988 Experience Loss		(3,041)	4,802	25,719	4,132	31,612	4,070	35,682
Amortization of 1989 Experience Loss		9,528	30,817	95,536	(3,051)	132,830	403,323	536,153
Plan Amendment	10/	1,137	6,139	18,836	3,146	29,258	68,704	97,962
1990 Normal Costs		27,057	466,598	700,381	134,489	1,328,525	2,346,001	3,674,526
1990 CAS Costs		56,880	624,160	1,145,741	221,977	2,048,758	3,604,808	5,653,566
Interest To Yearend		4,550	49,933	91,659	17,758	163,900	288,385	452,285
Expected Additional Assets As Of 4-1-91		61,430	674,093	1,237,400	239,735	2,212,658	3,893,193	6,105,851
Less: Costs Funded		0	0	0	0	0	0	0
Unfunded Pension Costs For 1990		**$61,430**	**$674,093**	**$1,237,400**	**$239,735**	**$2,212,658**	**$3,893,193**	**$6,105,851**

FOOTNOTES TO STATEMENT OF UNFUNDED PENSION COSTS

1/ The unfunded actuarial liability (UAL) is the difference between the actuarial liability and the actuarial value of assets. According to the CAS, amortization of existing UAL is a component of pension costs.

2/ Amortization of the 4-1-88 UAL over 15 years.

3/ Texas' consulting actuary calculated the normal cost for each participant. We directly assigned normal costs to the Medicare segments.

4/ The sum of the amortization of the UAL and the normal cost.

5/ According to the CAS, interest is a component of pension cost. We used Texas' interest assumption for all calculations.

6/ The sum of the CAS costs adjusted with interest to the end of the year.

7/ Texas made no contributions to the trust fund for plan years 1988, 1989, and 1990 due to the full funding limitation.

8/ The value of CAS pension costs less the value of contributions, if any, at yearend.

9/ The experience loss represents the difference between anticipated changes in liabilities and assets and actual results. According to the CAS, amortization of experience gains and losses are a component of pension costs. The CAS requires that gains and losses be amortized over 15 years. Gains are indicated as negative losses.

10/ Texas' actuary, Wyatt Company, provided these amounts.

BLUE CROSS BLUE SHIELD OF TEXAS, INC.
DALLAS, TEXAS

STATEMENT OF ACCUMULATED UNFUNDED PENSION ASSETS

FOR THE PERIOD
APRIL 1, 1988 THROUGH APRIL 1, 1991

	MEDICARE SEGMENT 1	MEDICARE SEGMENT 2	MEDICARE SEGMENT 3	MEDICARE SEGMENT 4	TOTAL MEDICARE SEGMENTS	OTHER SEGMENTS	TOTAL COMPANY
Unfunded Pension Costs for 1988	**$43,847**	**$456,627**	**$897,664**	**$190,538**	**$1,588,676**	**$2,849,344**	**$4,438,020**
Add: Interest To 3-31-89	3,508	36,530	71,813	15,243	127,094	227,948	355,042
Missing Assets As Of 4-1-89	**$47,355**	**$493,157**	**$969,477**	**$205,781**	**$1,715,770**	**$3,077,292**	**$4,793,062**
Unfunded Pension Costs For 1989	42,787	522,881	969,312	206,023	1,741,003	2,932,632	4,673,635
Add Interest to 3-31-90 on:							
Missing Assets (4-1-89)	3,788	39,453	77,558	16,462	137,261	246,184	383,445
Unfunded Costs (1989)	3,423	41,830	77,545	16,482	139,280	234,611	373,891
Missing Assets As Of 4-1-90	**$97,353**	**$1,097,321**	**$2,093,892**	**$444,748**	**$3,733,314**	**$6,490,719**	**$10,224,033**
Unfunded Pension Costs For 1990	56,880	624,160	1,145,741	221,977	2,048,758	3,604,808	5,653,566
Add Interest to 3-31-91 on:							
Missing Assets (4-1-90)	7,788	87,786	167,511	35,580	298,665	519,258	817,923
Unfunded Costs (1990)	4,550	49,933	91,659	17,758	163,900	288,385	452,285
Missing Assets As Of 4-1-91	**$166,571**	**$1,859,200**	**$3,498,803**	**$720,063**	**$6,244,637**	**$10,903,170**	**$17,147,807**

Blue Cross
and
Blue Shield
of Texas, Inc.

Vernon W. Walker
Vice President, Comptroller

P.O. Box 655730
Dallas, Texas 75265-5730
(214) 669-6190

June 29, 1992

Mr. Vincent R. Imbriani
Regional Inspector General
for Audit Services, Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64106

Re: Draft Audit - Unfunded Pension Costs of
Blue Cross and Blue Shield of Texas, Inc.
CIN A-07-92-00578

Dear Mr. Imbriani:

Your letter dated May 28, 1992 requested our review of and our response on the subject draft by June 30, 1992.

We have reviewed the draft report and have attempted to research available subject matter related to the anomaly involved. We have conferred with our Consulting Actuary, BCA, and other organizations. We have completed a preliminary view of our Plan's annual actuarial valuation process, including a "CAS" valuation supplement.

With regard to the recommendations found on Page 5 of the draft, your Auditors, your Actuary, and our Actuary compared methodology during the Segment Audit process and reached understanding of the CAS 412/413 amortization bases and separate combination of pension costs by segment. The CAS Supplement to our Plan's annual valuation contains a schedule that substantially mirrors the results in your draft Appendices A and B.

It is our intention (and as stated, we have commenced) to separately identify, annually update, and continually track the subject pension cost components from 4-1-88 forward, as needed. In doing so we will employ our own actuarial computations and schedules, as described, and not those in this draft report (note that our accumulated "missing asset" number at 4-1-90 is $17,147,807 in total and $6,244,637 for the Medicare segments). However, we do not agree that the "missing assets" identified are forever unallowable components of Medicare pension costs and therefore not chargeable to future contract periods.

Pages 1 and 2 of the draft provide background on aspects of CAS, FAR, TRA 86, OBRA 87, ERISA, and Blue Cross and Blue Shield of Texas, Inc. pension costs. Pages 3 and 4 of the draft describe the "scope" and "results" of the audit. The fact that Blue Cross and Blue Shield of Texas, Inc. had not been able to fund its pension plan due to Full Funding Limitations surfaced to OIG during the course of a Segmented Pension Cost audit performed by them. In fact, Blue Cross and Blue Shield of Texas, Inc. raised the issue to the OIG team seeking exposure and assistance on what was mutually considered to be a potential "Catch 22" situation. We did not choose to not make or to defer the subject pension plan contributions for the three years covered by this draft and we did not avoid making deposits simply to avoid tax consequences or paying excise tax (which applies not only at 10% for one year but compounds and applies thereafter, per The Wyatt Company). We were subjected to the Internal Revenue Service Full Funding Limitation and despite recommended ERISA contributions and recommended CAS contributions were effectively prevented from making pension contributions, acting on advice from qualified actuarial consultants.

Therefore, due to the fact that Blue Cross and Blue Shield of Texas, Inc. did not make current period pension cost contributions from 4-1-88 through 3-31-91 (and will be restricted at 4-1-91, 4-1-92, and possibly into the future) because of Federally-imposed limits that conflict with other Federally-regulated methodology and not because of any discretionary cash flow reasoning, we do not agree that the subject identified assets (costs) will be unallowable. We herein formally contest such definition and seek relief from such definition in the form of a specific waiver. We have been waiting for this draft report in order to clarify the so-described "Catch 22" in OIG terms and to use as a vehicle for waiver request. We have been made aware that the CAS Board has notified Federal agencies that they may waive CAS pension cost assignment requirements for contractors whose overfunded qualified plans are in a situation subject to tax penalty. Further, we have been made aware that waiver has been granted to other contractors as a temporary relief measure, pending the reconciliation of conflicting Federal requirements.

While we are responding to the calculations of your draft positively as a matter of methodology verification, we are responding to the logical, regulatory, and substantial issues underlying the draft as follows: Blue Cross and Blue Shield of Texas, Inc., Administrator of the Texas Blue Cross Employees Retirement Plan covering certain Medicare employees working on the Part A and Part B contracts, requests a specific waiver, covering the above years in question retrospectively and prospectively, be granted that will allow us to accrue pension costs in a given fiscal year, not make payments to the pension fund because of IRS mandated tax penalty (FFL), and preserve our right to seek reimbursement from the government for such costs during a future fiscal year when the costs are actually funded.

Please incorporate this response in the final audit and supply it to the appropriate Federal agencies. We will pass a copy of this response and the final audit to our Regional HCFA Office.

Sincerely,

VW:mw

cc: Gene George
Blue Cross and Blue Shield of Texas, Inc.

cc: Gale A. Drapala
Regional Administrator HCFA
1200 Main Tower Building
Dallas, TX 75202

cc: Larry W. Seals
Chief, Payments and Systems Branch
Division of Medicare