DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date OCT 28 1992

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

Subject Review of Unfunded Pension Costs of Blue Cross and Blue Shield of Michigan (A-07-92-00579)

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

This is to alert you to the issuance on October 29, 1992, of our final audit report. A copy is attached. Our review showed that, as of January 1, 1990, Blue Cross and Blue Shield of Michigan (Michigan) had accumulated $2.5 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 cost 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.

Michigan made no contributions to its regular pension plan for 1986 and 1987 and to its union and regular pension plans for 1988 and 1989 to avoid the tax implications of TRA '86 and OBRA '87. By not making the contributions, Michigan avoided making pension plan deposits that were not tax deductible and avoided paying the 10 percent excise tax. However, in avoiding the tax consequences, Michigan lost allowability of the costs under Medicare. Considering interest on the deposits not made, Michigan has accumulated $2.5 million as of January 1, 1990 that must be separately identified and excluded from future components of Medicare pension costs.

We are recommending that Michigan: (1) separately identify $2.5 million as an unallowable component of pension costs as of January 1, 1990, (2) continue a yearly update of unallowable pension cost components related to the unfunded CAS costs for 1986 through 1989, and (3) identify unallowable components of pension costs for any subsequent years for which CAS costs of the pension plan are not funded.

In response Michigan expressed its intent to seek a waiver which would allow Michigan to reassign and claim the costs in future accounting periods. Regional Health Care Financing Administration officials did not provide comments on the draft report.

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

REVIEW OF UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF MICHIGAN

DEPARTMENT OF HEALTH & HUMAN SERVICES · USA

OCTOBER 1992 A-07-92-00579

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-07-92-00579

Ms. Catherine D. Schmitt, Director
Government Budget and Planning
Blue Cross and Blue Shield of Michigan
600 Lafayette East
Detroit, Michigan 48226

Dear Ms. Schmitt:

This report provides you with the results of our "REVIEW OF UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF MICHIGAN." The purpose of our review was to determine any unfunded pension costs for Calendar Years 1986 through 1989 and any resulting accumulated unfunded pension costs as of January 1, 1990, the start of the 1990 plan year.

As of January 1, 1990, Blue Cross and Blue Shield of Michigan (Michigan) had accumulated $2.5 million in pension costs that are unallowable for Medicare reimbursement. The unallowable pension costs involve both its union and regular pension plans. Pension cost assigned to an accounting period, but not funded by the 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.

Michigan made a contribution to its union pension plan for 1986 and 1987. However, Michigan did not make contributions to its regular pension plan for 1986 and 1987. For 1988 and 1989, Michigan did not make contributions to either of the trust funds for pension costs identifiable with its direct Medicare segments. As a result, as of January 1, 1990, Michigan accumulated $2.5 million of unfunded pension costs. Michigan must separately identify and eliminate this amount from the amortization components of future pension costs.

Michigan stated that it understood that the $2.5 million is not reimbursable under current standards. However, Michigan expressed its intent to seek a waiver which would allow Michigan 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 are 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 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 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 applies to all Medicare intermediaries and carriers regardless of their tax exempt status.

With the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), the Congress took additional action affecting contractors' pension plan contributions to qualified trust funds. Prior to OBRA '87, ERISA's full funding limitation considered accumulated assets and the actuarial liability. If assets equalled or exceeded actuarial liability, then 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. The effect was that most pension plans that were already in full funding would remain there longer. Also, the same effect would push additional plans into full funding.

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 July 1, 1986 through January 1, 1990. Achieving our objective did not require that we review the internal control structure of Michigan.

This review was done in conjunction with our segmentation audit of Michigan (A-07-91-00471). The information obtained and reviewed during the segmentation audit was also used in performing 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 Michigan's historical practices.

Field work was performed from July 1991 to June 1992. It included field work at Michigan's corporate offices in Detroit, Michigan.

RESULTS OF AUDIT

We found that, as of January 1, 1990, Michigan had accumulated $2,535,698 in unallowable direct pension costs related to its Medicare segments. The pension costs are unallowable because they were not funded within specific time periods set by regulation. Imputed interest on the unfunded costs is also unallowable. The $2,535,698 represents unfunded pension costs and imputed interest involving 1986 to 1990. Michigan 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 segments, computed by HCFA's OACT, to Michigan's actual contributions to the Medicare segments. We found the following:

Union Plan

	7/1/87	1/1/88	1/1/89	1/1/90	Total
CAS Pension Costs	$947,749	$423,306	$914,570	$680,972	$2,966,597
Interest to End of Year	71,081	15,874	68,593	54,477	210,025
Prepayment Credit	0	(1,332)	0	0	(1,332)
Interest to End of Year	0	(50)	0	0	(50)
Less:					
Actual Contribution	983,289	428,870	0	0	1,412,159
Interest to End of Year	36,873	0	0	0	36,873
Excess Cost Over Contributions	($ 1,332)	$ 8,928	$983,163	$735,449	$1,726,208

Regular Plan

	7/1/87	1/1/88	1/1/89	1/1/90	Total
CAS Pension Costs	$319,268	$ 66,514	$125,442	$ 82,312	$ 593,536
Interest to End of Year	23,945	2,495	9,409	6,584	42,433
Prepayment Credit	0	0	0	0	0
Interest to End of Year	0	0	0	0	0
Less:					
Actual Contribution	0	0	0	0	0
Interest to End of Year	0	0	0	0	0
Excess Cost Over Contributions	$343,213	$ 69,009	$134,851	$ 88,896	$ 635,969

Total Costs Claimed Exceeding Contributions $2,362,177

Since the total excess costs over contributions of $2,362,177 was not funded within specified time periods, the pension costs are unallowable as a component of Medicare 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 the unfunded amounts plus 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 time periods. The horizontal date represents the first contribution that should have been funded for that period. The vertical date represents the contribution plus, for the remaining years, the cumulative interest. Appendix B provides additional information.

Union Plan

	Unfunded Pension Costs and Interest				
Date	7/1/87	1/1/88	1/1/89	1/1/90	Total
7/1/87	$ -0-	$ -0-	$ -0-	$ -0-	$ -0-
1/1/88	-0-	8,928	-0-	-0-	8,928
1/1/89	-0-	9,598	983,163	-0-	992,761
1/1/90	-0-	10,366	1,061,816	735,449	1,807,631

Regular Plan

	Unfunded Pension Costs and Interest				
Date	7/1/87	1/1/88	1/1/89	1/1/90	Total
7/1/87	$ 343,213	$ -0-	$ -0-	$ -0-	$ 343,213
1/1/88	356,083	69,009	-0-	-0-	425,092
1/1/89	382,790	74,184	134,851	-0-	591,825
1/1/90	413,413	80,119	145,639	88,896	728,067

Total Union and Regular Plans as of 1/1/90	$2,535,698

Michigan made no contributions to its regular pension plan for 1986 and 1987 and to its union and regular pension plans for 1988 and 1989 to avoid the tax implications of TRA '86 and OBRA '87. By not making the contributions, Michigan avoided making pension plan deposits that were not tax deductible and avoided paying the 10 percent excise tax. However, in avoiding the tax consequences, Michigan lost allowability of the costs under Medicare. Considering interest on the deposits not made, Michigan has accumulated $2,535,698 as of January 1, 1990 that must be separately identified and excluded from future components of Medicare pension costs.

Recommendations

We recommend that Michigan:

- o Separately identify $2,535,698 as unallowable components of direct pension costs as of January 1, 1990, due to unfunded CAS costs for 1986 through 1989.
- o Continue a yearly update of unallowable pension cost components related to the unfunded CAS costs for 1986 through 1989.
- o Identify and track unallowable components of pension costs for any subsequent years for which CAS costs of the pension plans are not funded.

Auditee Comments

"...We understand that the $2.5 million in pension costs claimed have not been funded and the time limit for doing so has elapsed and under current Cost Accounting Standards...they are not reimbursable."

"...on April 8, 1991, the Cost Accounting Standards Board Chairman issued temporary authority to federal procuring agencies to waive CAS pension cost assignment requirements due to the conflict in CAS and IRS requirements. It is our intention to seek a waiver...on this issue. Consequently, we are not taking action or agreeing with the audit findings until the waiver request is considered or the conflict in regulations is resolved."

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 $173,521 related to the unfunded costs of $2,362,177 is not eligible for a waiver.

Since the CAS Board delegated waiver authority only to the agencies' Senior Procurement Executives on a nondelegable basis, Michigan 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.

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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 referenced Common Identification Number (CIN) in any correspondence relating to this report.

Sincerely,

Vincent R. Imbriani

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

Enclosures

Direct Reply To:

Chester C. Stroyny
Regional Administrator, Region V
Health Care Financing Administration
105 West Adams Street, 15th Floor
Chicago, Illinois 60606

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

STATEMENT OF UNFUNDED PENSION COSTS 1/

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

		UNION PLAN			REGULAR PLAN		
		MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL UNION	MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL REGULAR
UAL as of 7/1/86	2/	**$2,996,595**	**$11,012,805**	**$14,009,400**	**($2,096,971)**	**($9,303,129)**	**($11,400,100)**
Amortization of '86 UAL	3/	$ 406,104	$ 1,492,496	$ 1,898,600	($ 206,771)	($ 917,329)	($ 1,124,100)
1986 Normal Costs	4/	541,645	3,346,655	3,888,300	526,039	6,760,761	7,286,800
1986 CAS Costs	5/	947,749	4,839,151	5,786,900	319,268	5,843,432	6,162,700
Interest to Yearend	6/	71,081	362,937	434,018	23,945	438,257	462,202
Required CAS Funding as of 7/1/87	7/	1,018,830	5,202,088	6,220,918	343,213	6,281,689	6,624,902
Less: Costs Funded	8/	1,020,162	5,208,884	6,229,046	0	0	0
Unfunded Pension Costs as of 7/1/87	9/	**($ 1,332)**	**($ 6,796)**	**($ 8,128)**	**$ 343,213**	**$6,281,689**	**$ 6,624,902**
Amortization of '86 UAL		$ 406,104	$ 1,492,472	$ 1,898,576	($ 206,771)	($ 917,333)	($ 1,124,104)
Amortization of 7/1/87 Experience Loss	10/	(35,831)	9,845	(25,986)	(152,381)	(773,434)	(925,815)
IRC 415 Reduction	11/	(39,452)	(273,983)	(313,435)	(72,262)	(738,578)	(810,840)
1987 Normal Costs		515,791	4,006,609	4,522,400	564,441	7,500,859	8,065,300
7/1/87 CAS Costs		846,612	5,234,943	6,081,555	133,027	5,071,514	5,204,541
7/1/87 1/2 Year CAS Cost	12/	423,306	2,617,472	3,040,778	66,514	2,535,757	2,602,271
Interest to Yearend		15,874	98,156	114,030	2,495	95,090	97,585
Required CAS Funding as of 1/1/88		439,180	2,715,628	3,154,808	69,009	2,630,847	2,699,856
Less:							
Costs Funded		428,870	2,651,880	3,080,750	0	0	0
Prior Prepayment	13/	1,382	7,051	8,433	0	0	0
Unfunded Pension Costs as of 1/1/88		**$ 8,928**	**$ 56,697**	**$ 65,625**	**$ 69,009**	**$2,630,847**	**$ 2,699,856**

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

STATEMENT OF UNFUNDED PENSION COSTS

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

	UNION PLAN			REGULAR PLAN		
	MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL UNION	MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL REGULAR
Unfunded Pension Costs as of 1/1/88	$ 8,928	$ 56,697	$ 65,625	$ 69,009	$2,630,847	$ 2,699,856
Amortization of '86 UAL	$406,104	$1,492,472	$1,898,576	($206,771)	($ 917,333)	($1,124,104)
Amortization of 7/1/87 Experience Loss	(35,831)	9,845	(25,986)	(152,381)	(773,434)	(925,815)
IRC 415 Reduction	(39,452)	(273,983)	(313,435)	(72,262)	(738,578)	(810,840)
Amortization of 1/1/88 Experience Loss	13,732	62,434	76,166	(65,323)	(110,690)	(176,013)
1988 Plan Amendment 14/	7,818	55,118	62,936	13,977	150,964	164,941
1988 Normal Costs	562,199	4,423,337	4,985,536	608,202	8,344,284	8,952,486
1988 CAS Costs	914,570	5,769,223	6,683,793	125,442	5,955,213	6,080,655
Interest to Yearend	68,593	432,691	501,284	9,409	446,640	456,049
Required CAS Funding as of 1/1/89	983,163	6,201,914	7,185,077	134,851	6,401,853	6,536,704
Less: Costs Funded	0	0	0	0	0	0
Unfunded Pension Costs as of 1/1/89	$983,163	$6,201,914	$7,185,077	$134,851	$6,401,853	$6,536,704
Amortization of '86 UAL	$412,630	$1,516,457	$1,929,087	($212,474)	($ 942,635)	($1,155,109)
Amortization of 7/1/87 Experience Loss	(36,764)	10,102	(26,662)	(156,351)	(793,582)	(949,933)
IRC 415 Reduction	(40,155)	(278,861)	(319,016)	(73,549)	(751,729)	(825,278)
Amortization of 1/1/88 Experience Loss	14,074	63,991	78,065	(66,953)	(113,449)	(180,402)
1988 Plan Amendment	8,157	57,506	65,663	14,583	157,507	172,090
Amortization of 1/1/89 Experience Loss	(4,344)	(30,166)	(34,510)	17,640	(1,034,542)	(1,016,902)
1989 Assumption Change 15/	1,158	5,263	6,421	(146,983)	(1,472,271)	(1,619,254)
1989 Plan Amendment 16/	671	4,730	5,401	298,805	2,654,986	2,953,791
1989 Normal Costs	325,545	2,942,344	3,267,889	407,594	5,554,539	5,962,133
1989 CAS Costs	680,972	4,291,366	4,972,338	82,312	3,258,824	3,341,136
Interest to Yearend 17/	54,477	343,310	397,787	6,584	260,708	267,292
Required CAS Funding as of 1/1/90	735,449	4,634,676	5,370,125	88,896	3,519,532	3,608,428
Less: Cost Funded	0	0	0	0	0	0
Unfunded Pension Costs as of 1/1/90	$735,449	$4,634,676	$5,370,125	$ 88,896	$3,519,532	$3,608,428

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

STATEMENT OF UNFUNDED PENSION COSTS

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

FOOTNOTES TO STATEMENT OF UNFUNDED PENSION COSTS

1/ Michigan covered its employees with one defined benefit pension plan until July 1, 1985. Subsequently, two pension plans existed - a spin-off plan (union) covering union employees and the original plan (regular).

2/ The unfunded actuarial liability (UAL) is the difference between the actuarial liability and the actuarial value of assets. We computed the UAL as of July 1, 1986 based on our identification of the Medicare segments. According to CAS, amortization of existing UAL is a component of pension costs.

3/ According to CAS, a change in UAL must be amortized over 10 to 30 years. For simplicity, we began our calculations as of July 1, 1986 and amortized the UAL over a 10-year period for the union plan and a 17-year period for the regular plan. We used 7.5 percent interest.

4/ Michigan's consulting actuary calculated the normal cost for each participant. We allocated normal costs of the Medicare segments.

5/ Sum of the amortization of UAL and the normal cost.

6/ According to CAS, interest is a component of pension cost. We used Michigan's interest assumption of 7.5 percent for calculations from July 1, 1986 to January 1, 1989.

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

8/ Michigan made two contributions, one during December 1986 and one during December 1987. Both contributions were made to the union plan. The December 1986 contribution was adjusted for interest from December 1, 1986 to July 1, 1987. Michigan made no other contributions to the union plan for 1988 and 1989, and during our audit period, made no contributions to the regular plan.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
DETROIT, MICHIGAN

STATEMENT OF UNFUNDED PENSION COSTS

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

FOOTNOTES TO STATEMENT OF UNFUNDED PENSION COSTS

9/ The value of CAS pension costs less the value of contributions, if any, at yearend. A negative value represents a prepayment which may be carried forward until needed to fund CAS cost.

10/ The experience loss represents the difference between anticipated earnings on assets and actual results. According to CAS, amortization of 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.**

11/ Amortization of Internal Revenue Code section 415 benefit change is prorated based on July 1, 1987 actuarial liability computation using the Entry Age Normal funding method (AL-EAN) for active participants only.

12/ The CAS cost for one half year due to the yearend changing from July 1, 1988 to January 1, 1988.

13/ Prepayment carried forward from July 1, 1987 and adjusted for interest to January 1, 1988.

14/ Amortization of the 1988 plan amendment prorated based on January 1, 1988 AL-EAN for active participants only.

15/ Amortization of the assumption change prorated based on AL-EAN for all participants.

16/ Amortization of the 1989 plan amendment prorated based on the increase in AL-EAN for retirees during 1988. Most of the increase was due to the Supplemental Early Retirement Program.

17/ We used Michigan's revised interest assumption of 8 percent for the calculation.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN, INC.
DETROIT, MICHIGAN

STATEMENT OF ACCUMULATED UNFUNDED PENSION COSTS

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

		UNION PLAN			REGULAR PLAN		
		MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL UNION	MEDICARE SEGMENT	OTHER SEGMENTS	TOTAL REGULAR
Unfunded Pension Costs as of 7/1/87	1/	$ 0	$ 0	$ 0	$343,213	$ 6,281,689	$ 6,624,902
Add: Interest to Yearend	2/	0	0	0	12,870	235,563	248,433
Unfunded Pension Costs as of 1/1/88	3/	8,928	56,697	65,625	69,009	2,630,847	2,699,856
Accumulated Unfunded Pension Costs as of 1/1/88	4/	$ 8,928	$ 56,697	$ 65,625	$425,092	$ 9,148,099	$ 9,573,191
Add: Interest to Yearend		670	4,252	4,922	31,882	686,107	717,989
Unfunded Pension Costs as of 1/1/89	5/	983,163	6,201,914	7,185,077	134,851	6,401,853	6,536,704
Accumulated Unfunded Pension Costs as of 1/1/89	6/	$ 992,761	$ 6,262,863	$ 7,255,624	$591,825	$16,236,059	$16,827,884
Add: Interest to Yearend	7/	79,421	501,029	580,450	47,346	1,298,885	1,346,231
Unfunded Pension Costs as of 1/1/90	8/	735,449	4,634,676	5,370,125	88,896	3,519,532	3,608,428
Accumulated Unfunded Pension Costs as of 1/1/90	9/	$1,807,631	$11,398,568	$13,206,199	$728,067	$21,054,476	$21,782,543
Medicare Accumulated Unfunded Pension Costs as of 1/1/90	10/			$2,535,698			

BLUE CROSS AND BLUE SHIELD OF MICHIGAN, INC.
DETROIT, MICHIGAN

STATEMENT OF ACCUMULATED UNFUNDED PENSION COSTS

FOR THE PERIOD
JULY 1, 1986 TO JANUARY 1, 1990

FOOTNOTES TO STATEMENT OF ACCUMULATED UNFUNDED PENSION ASSETS

1/ The unfunded CAS pension cost as of July 1, 1987. The union plan prepayment may be carried forward until needed to fund CAS cost. (See Appendix A.)

2/ Interest is calculated at an annual rate of 7.5 percent. This same rate of interest was used by Michigan.

3/ The unfunded CAS pension cost as of January 1, 1988. (See Appendix A.)

4/ The sum of the unfunded CAS cost as of July 1, 1987, interest on July 1, 1987 CAS cost, and the unfunded CAS cost as of January 1, 1988.

5/ The unfunded CAS pension cost as of January 1, 1989. (See Appendix A.)

6/ The sum of the accumulated unfunded pension cost as of January 1, 1988, interest to the end of the plan year, and the unfunded CAS cost as of January 1, 1989.

7/ Interest is calculated at an annual rate of 8 percent. This same rate of interest was used by Michigan.

8/ The unfunded CAS pension cost as of January 1, 1990. (See Appendix A.)

9/ The sum of the accumulated unfunded pension cost as of January 1, 1989, interest to the end of the plan year, and the unfunded CAS cost as of January 1, 1990.

10/ The sum of Medicare union and regular plans' accumulated unfunded pension costs as of January 1, 1990.

Blue Cross
Blue Shield
of Michigan

Medicare

600 Lafayette East
Detroit, Michigan 48226
313/225-8200

July 21, 1992

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

Dear Mr. Imbriani:

Re: Audit of Unfunded Medicare Pension Costs
CIN: A-07-92-00579

We have reviewed the above noted draft audit report. We understand that the $2.5 million in pension costs claimed have not been funded and the time limit for doing so has elapsed and under current Cost Accounting Standards (CAS) 412 and 413 they are not reimbursable.

As your report clearly indicates, you understand that Blue Cross and Blue Shield of Michigan (BCBSM) made no contributions to its regular pension plan for 1986 and 1987, nor did it contribute to the union or regular pension plans for 1988 and 1989 to avoid the tax implications of the Tax Reform Act of 1986. In avoiding the tax consequences, BCBSM lost allowability of the costs under Medicare.

We further understand the recommendation that these unfunded pension cost be separated and eliminated from the amortization components of future pension costs.

We have become aware that on April 8, 1991, the Cost Accounting Standards Board Chairman issued temporary authority to federal procuring agencies to waive CAS pension cost assignment requirements due to the conflict in CAS and IRS requirements. It is our intention to seek a waiver from the HCFA Procurement Officer on this issue. Consequently, we are not taking action or agreeing with the audit findings until the waiver request is considered or the conflict in regulations is resolved.

If there are any questions please call me on (313) 225-0703.

Sincerely,

Catherine D. Schmitt
Director
Government Budget & Planning

cc: B. Ball
R. Livingston
D. Palka
M. Stanton, Region V, OAS