DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date JUL 17 1995

From June Gibbs Brown
Inspector General

Subject Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company (A-07-94-00742)

To

Bruce C. Vladeck
Administrator
Health Care Financing Administration

This is to alert you to the issuance on July 18, 1995 of our final audit report. A copy is attached.

The objective of our audit was to determine whether Mutual of Omaha Insurance Company (Mutual) complied with the segmentation requirements of its Medicare contracts. Under its Medicare contracts, Mutual was required to separately identify, allocate, and report pension assets and costs separately for the Medicare segments of their business. This contract required Mutual to (1) establish a ratio using the 1981 actuarial liabilities of the segments and the total plan, (2) apply the ratio to total pension assets as of 1986, (3) update the 1986 Medicare segments' assets to later years, and (4) assess whether Medicare's pension costs require separate calculations.

Our review showed that Mutual understated Medicare segment assets as of 1992 by $3,911,067. The assets were understated by $2,821,482 as of 1986 because Mutual's former actuarial firm used incorrect data in the determination of Medicare's initial assets. Mutual's update of the Medicare segment assets from Plan Years 1986 to 1992 understated segment assets by an additional $1,089,585. Increasing the Medicare segment's assets by these amounts will result in (1) lower Medicare pension costs in future years and (2) Medicare receiving higher reversions/refunds in the event of a pension plan termination or a termination of the Medicare contracts.

We recommend that Mutual increase the January 1, 1992 assets of the Medicare segments by $3,911,067. Mutual accepted our recommendation. Regional Health Care Financing Administration officials declined to comment on our recommendations.

For further information contact:

Barbara A. Bennett
Regional Inspector General
for Audit Services, Region VII
816-426-3591

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION MUTUAL OF OMAHA INSURANCE COMPANY

<u>NOTICE</u>

JUNE GIBBS BROWN
Inspector General

JULY 1995
A-07-94-00742

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-07-94-00742

Ms. Valerie L. Ware
Manager-Financial Operations Planning
5th Floor Corporate Financial Operation and Planning
Mutual of Omaha Insurance Company
Mutual of Omaha Plaza
Omaha, Nebraska 68175

Dear Ms. Ware:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review entitled, *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company*. The purpose of our review was to evaluate Mutual of Omaha Insurance Company's (Mutual) compliance with the pension segmentation requirements of its Medicare contract.

Our review showed that Mutual understated Medicare segment pension assets as of 1992 by $3,911,067. Assets as of 1986 were understated by $2,821,482 because Mutual's former actuarial firm used incorrect data in the determination of Medicare's initial assets. Additionally, Mutual's update of the Medicare segment assets from Plan Years 1986 to 1992 understated segment assets by $1,089,585.

We recommend that Mutual increase the January 1, 1992 assets of the Medicare segment by $3,911,067. Mutual accepted our recommendation and its response is included in its entirety as Appendix B. Also included in Appendix B are Mutual's responses to audit reports entitled, *Review of Medicare Contractor's Overfunded Medicare Segment, Mutual of Omaha Insurance Company (CIN: A-07-94-00741)* and *Review of Pension Costs Claimed for Medicare Reimbursement by Mutual of Omaha Insurance Company (CIN: A-07-94-00743)*. Appendix C contains the Health Care Financing Administration (HCFA), Office of the Actuary's comments to Mutual's responses.

INTRODUCTION

BACKGROUND

Mutual has administered Medicare Part A under cost-reimbursement contracts since the start of the Medicare program. Reimbursement principles for cost-reimbursement contracts are contained in the contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS).

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The HCFA incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and provides for the separate identification of the pension assets for a Medicare segment.

The Medicare contract identifies a Medicare segment as:

> *... any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:*
>
> 1. *The majority of the salary dollars is allocated to the Medicare agreement/contract; or*
>
> 2. *Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.*

Mutual's contract required (1) computing the Medicare segment's actuarial liability determined under an appropriate cost method as of 1981, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability computed under an appropriate cost method as of 1981 (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the 1981 ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated. The contract requires the liabilities to be determined under the immediate-gain actuarial cost method consistent with the cost method which was used to fund the pension plan as of the asset fraction date.

To ensure that contractors developed and maintained the data necessary for segmentation calculations, HCFA distributed a pension cost questionnaire to contractors in 1989. Mutual submitted its questionnaire response on April 28, 1989. The response presented Mutual's initial segment calculations. In subsequent reports, Mutual identified total pension assets of $264,866,603 and Medicare segment assets of $3,514,156 as of January 1, 1992. Mutual also concluded that separate valuations for the Medicare segment were required.

SCOPE

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Mutual's compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require a review of Mutual's internal control structure. The audit addressed Mutual's initial determination of pension assets for its Medicare segment and later updates. We reviewed Mutual's identification of the Medicare segment as of January 1, 1988 and traced the segment's organizational lineage back to 1981. We also reviewed Mutual's computation of the asset fraction and its update of Medicare assets from January 1, 1986 to January 1, 1992.

In performing our review, we used information provided by Mutual's current and former pension actuaries. The information included present value of future benefits, present value of future salaries, covered payroll, liabilities, normal costs, contributions, expenses, and earnings. We also reviewed Mutual's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500. Present value of future benefits, present value of future salaries, liabilities, and normal costs for the Medicare segment were estimated by the HCFA, Office of the Actuary (HCFA Actuary). Using these documents and estimates, we calculated Medicare segment assets as of January 1, 1992. At the request of Mutual and HCFA, we extended the scope of our review to include computing the Medicare segment's assets as of January 1, 1994.

The HCFA Actuary reviewed and agreed with our methodology and calculations.

In conjunction with this audit of pension segmentation, we addressed in other reports (CINs: A-07-94-00741 and A-07-94-00743) the CAS and FAR requirements relating to the development of pension costs. The same information was obtained and reviewed during both audits.

We performed site work at Mutual's corporate offices in Omaha, Nebraska during August and September 1993. Subsequent audit work, including computation of assets for January 1, 1994, was performed in the OIG, OAS, Jefferson City Missouri field office.

FINDINGS AND RECOMMENDATIONS

MEDICARE ASSETS AS OF 1986

We determined that Mutual understated its asset fraction by 1.3905 percent. Mutual's former actuarial firm incorrectly used 1986 participant data and calculated actuarial liabilities under an inappropriate cost method. We increased the asset fraction from 1.0975 percent to 2.4880 percent by using 1981 participant data and appropriate liabilities. Our computations consider Medicare segment and total company participant liabilities computed under the Entry Age Normal (EAN) cost method. In accordance with the contract, the HCFA Actuary determined this cost method is the immediate gain method consistent with the spread gain aggregate cost method used to fund the pension plan in 1981.

The OIG's calculations increased the Medicare segment assets by $2,821,482 to $5,048,434. The following schedule shows the details of Mutual's and OIG's calculations.

Calculation	1981 Total Actuarial Liability (A)	1981 Medicare Actuarial Liability (B)	Rounded Asset Function (C) (B)/(A)	1986 Total Company Assets 1/ (D)	1986 Medicare Segment Assets (E) (C)*(D)
OIG	$126,758,913	$3,153,815	.024880	$202,911,339	$5,048,434
Mutual	2/	2/	.010975	202,911,339	2,226,952
Difference	N/A	N/A	.013905	$ 0	$2,821,482

1/ General Asset Account Balance less Voluntary Employee Contributions.

2/ Mutual did not use 1981 data in their computation of the asset fraction.

Recommendation

We recommend that Mutual:

- Increase the 1986 pension assets of the Medicare segment by $2,821,482.

Auditee's Response

Mutual accepted our recommendation.

MEDICARE'S ASSET BASE AS OF JANUARY 1, 1986 UPDATED TO JANUARY 1, 1992

Mutual's computations understated Medicare's pension assets by a net of $3,911,067 as of January 1, 1992. The major factor was the $2,821,482 increase in the Medicare pension assets as of 1986. Other factors, as discussed below, included revising net earnings and expenses ($1,987,147 increase), adjusting the 1990 contribution ($210,874 decrease), correcting transfer adjustments ($643,384 decrease), and including benefit payments to Medicare segment participants ($43,304 decrease).

Earnings and Expenses

Mutual understated the Medicare segment's earnings and expenses for each year of the asset update. The understatement occurred primarily as a result of the understated 1986 asset base. Our asset adjustments resulted in earnings and expenses increasing by a net amount of $1,987,147.

1990 Contribution

Mutual's former actuary assigned a portion of the 1990 contribution to the Medicare segment based on its computation of the segment's pension cost. Our changes to the asset base changed the computation of the segment's pension cost as well as the assignment of the contribution. Our adjustments decreased the segment assets by $210,874.

Transfers

In its segmentation calculations, Mutual adjusted for the movement of participants to and from the Medicare segment. Using annual participant listings, we analyzed the participant transfers and determined that Mutual's adjustments were incorrect. Our corrections to the transfer amounts reduced the Medicare segment assets by $643,384.

Benefit Payments

In the proposed asset update, Mutual did not identify benefit payments to Medicare segment participants. We matched benefit payments to segment participants and included them in our asset update. This resulted in a reduction of $43,304 in the Medicare segment assets.

Medicare Assets as of January 1, 1992

In summary, our calculations (details are provided on Appendix A) showed that assets of the Medicare segment should be increased by $3,911,067 as of January 1, 1992.

Recommendation

We recommend that Mutual:

❷ Increase pension assets of the Medicare segment by an additional $1,089,585 so that Medicare segment assets as of January 1, 1992 are increased by a total of $3,911,067.

Auditee's Response

Mutual accepted our recommendation. However, Mutual stated that it "... disagrees with the suggestion that its Medicare operations constitute a "segment" within the meaning of the definition set forth in CAS 413. As used in these three responses, the term "segment" refers to the contract definition."

OIG's Comments

We disagree with Mutual contention that its Medicare Segment doesn't constitute a segment within the definition set forth in CAS 413. The CAS is general in nature and states:

> "Segment means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. ***"

Mutual's Medicare Segment conforms to both the specific contract definition, stated in the criteria section of the report, and the general CAS definition above.

OTHER MATTERS

At the request of Mutual and HCFA, we extended the scope of our audit to compute the Medicare segment's assets as of January 1, 1994. As of January 1, 1994, the Medicare segment's assets are $8,738,812. See Appendix A.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to each of the recommendations in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

\- - - - - - - - -

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.)

Sincerely,

Barbara A. Bennett

Barbara A. Bennett
Regional Inspector General
for Audit Services

Enclosures

HHS Action Official:

Mr. Joe L. Tilghman
Regional Administrator, Region VII
Health Care Financing Administration
601 East 12th Street, Room 235
Kansas City, Missouri 64106

MUTUAL OF OMAHA INSURANCE COMPANY
OMAHA, NEBRASKA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1994

Description		Total Plan	Other Segment	Medicare Segment	Companion Life
Assets January 1, 1986	1/	**$202,911,339**	**$194,418,244**	**$5,048,434**	**$3,444,661**
Contributions	2/	9,098,507	8,807,156	159,917	131,434
Benefits	3/	(9,011,034)	(8,865,782)	(9,852)	(135,400)
Expenses	4/	(71,090)	(68,145)	(1,769)	(1,176)
Earnings	5/	23,230,602	22,268,414	577,977	384,211
Net Transfers	6/	0	313,451	(313,451)	0
Assets January 1, 1987		**$226,158,324**	**$216,873,338**	**$5,461,256**	**$3,823,730**
Contributions		0	0	0	0
Benefits		(11,074,846)	(10,891,181)	(33,452)	(150,213)
Expenses		(681,796)	(653,670)	(16,464)	(11,662)
Earnings		24,512,503	23,501,280	591,926	419,297
Net Transfers		0	764,635	(764,635)	0
Assets January 1, 1988		**$238,914,185**	**$229,594,402**	**$5,238,631**	**$4,081,152**
Contributions		0	0	0	0
Benefits		(18,250,105)	(18,098,997)	0	(151,108)
Expenses		(502,690)	(483,065)	(11,022)	(8,603)
Earnings		24,230,334	23,284,383	531,294	414,657
Net Transfers		0	135,359	(135,359)	0
Assets January 1, 1989		**$244,391,724**	**$234,432,082**	**$5,623,544**	**$4,336,098**
Contributions		0	0	0	0
Benefits		(18,959,942)	(18,793,637)	0	(166,305)
Expenses		(529,248)	(508,078)	(12,178)	(8,992)
Earnings		24,592,163	23,608,478	565,875	417,810
Net Transfers		0	8,286	(8,286)	0
Assets January 1, 1990		**$249,494,697**	**$238,747,131**	**$6,168,955**	**$4,578,611**
Contributions		3,564,000	3,564,000	0	0
Benefits		(18,813,508)	(18,606,086)	0	(207,422)
Expenses		(708,119)	(677,813)	(17,509)	(12,797)
Earnings		24,857,108	23,778,287	614,612	464,209
Net Transfers		0	28,588	(28,588)	0
Assets January 1, 1991		**$258,394,178**	**$246,834,107**	**$6,737,470**	**$4,822,601**

MUTUAL OF OMAHA INSURANCE COMPANY
OMAHA, NEBRASKA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1994

Description		Total Plan	Other Segment	Medicare Segment	Companion Life
Assets January 1, 1991		**$258,394,178**	**$246,834,107**	**$6,737,470**	**$4,822,601**
Contributions		0	0	0	0
Benefits		(19,805,347)	(19,584,980)	0	(220,367)
Expenses		(441,707)	(421,925)	(11,517)	(8,265)
Earnings		26,719,479	25,537,239	696,694	485,546
Net Transfers		0	(2,576)	2,576	0
Assets January 1, 1992		**$264,866,603**	**$252,361,865**	**$7,425,223**	**$5,079,515**
Assets Per Mutual	7/	**$264,866,603**	**$256,272,932**	**$3,514,156**	**$5,079,515**
Asset Variance	8/	**$ n/a**	**$ (3,911,067)**	**$3,911,067**	**$ n/a**
Contributions		4,154,109	4,154,109	0	0
Benefits		(19,671,916)	(19,451,475)	0	(220,441)
Expenses		(431,554)	(411,006)	(12,098)	(8,450)
Earnings		26,586,012	25,337,385	745,308	503,319
Net Transfers		0	192,642	(192,642)	0
Assets January 1, 1993		**$275,503,254**	**$262,183,520**	**$7,965,791**	**$5,353,943**
Contributions		8,597,302	8,597,302	0	0
Benefits		(20,242,404)	(20,002,060)	0	(240,344)
Expenses		(430,286)	(409,031)	(12,441)	(8,814)
Earnings		27,486,224	26,182,435	794,726	509,063
Net Transfers		0	9,264	(9,264)	0
Assets January 1, 1994		**$290,914,090**	**$276,561,430**	**$8,738,812**	**$5,613,848**

MUTUAL OF OMAHA INSURANCE COMPANY
OMAHA, NEBRASKA

STATEMENT OF MEDICARE PENSION ASSETS

FOR THE PERIOD
JANUARY 1, 1986 TO JANUARY 1, 1994

FOOTNOTES

1/ We calculated the Medicare segment assets based on our identification of the Medicare segment and our computed asset fraction (2.4880%). We computed the asset fraction as explained in our finding section of the report narrative. The value of assets represents the general account balance less the value of voluntary employee contributions.

For 1986 through 1988, Mutual's valuation reports did not separately account for Companion Life as a segment. Since valuation reports starting in 1989 did account for Companion Life as a separate segment, amounts were estimated by the HCFA Actuary for 1986 through 1988. The amounts shown for the "other segment" represent the difference between the total plan and the Medicare and Companion Life segments.

2/ We obtained total contribution amounts from IRS Form 5500 reports. Mutual made contributions to the pension plan for plan years 1986 and 1990. For 1986, we accepted the contribution Mutual assigned to the Medicare segment. Due to its overfunded status, Mutual requested that no portion of the 1990 contribution be assigned to the Medicare segment.

3/ We obtained total benefit payments from actuarial valuation reports. We based the Medicare segment's benefit payments on actual payments to Medicare segment participants.

4/ We obtained administrative expenses from actuarial valuation reports. We allocated expenses to the Medicare segment based on the ratio of beginning of year value of Medicare assets to the beginning of year value of total assets. This is the methodology described in CAS 413.50(c)(7).

5/ We obtained investment earnings from actuarial valuation reports. We allocated earnings to the Medicare segment based on the ratio of beginning of year value of Medicare assets to the beginning of year value of total assets. This is the methodology described in CAS 413.50(c)(7).

6/ We analyzed the movement of participants between the Medicare and other segments by comparing Mutual's annual participant listings. We made appropriate adjustments as explained in our finding section of the report narrative. Using Mutual's methodology, we transferred assets equal to the net transfer of the actuarial liability of the participants (active and non-active) who moved into and out of the Medicare segment.

7/ We obtained the proposed asset values as of January 1, 1992 from information prepared by Mutual's actuary.

8/ We computed the asset variance by subtracting Mutual's calculation of assets as of January 1, 1992 from our calculation of the assets.

Mutual of Omaha Companies

February 15, 1995

Ms. Barbara Bennett
Regional Inspector General for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services, Region VII
601 E. 12th Street, Room 284A
Kansas City, MO 64106

RE: CIN A-07-94-00741

Dear Ms. Bennett:

This memorandum formally responds to the Office of Inspector General (OIG) Office of Audit Services' draft audit report titled *Review of Medicare Contractor's Overfunded Medicare Segment, Mutual of Omaha Insurance Company.*

We are responding separately to two other draft audit reports that were issued simultaneously by the OIG titled *Review of Pension Costs Claimed for Medicare Reimbursement by Mutual of Omaha Insurance Company* (CIN A-07-94-00743) and *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company* (CIN A-07-94-00742). However, since the scope, background, regulations, and findings and recommendations of the three reports are interrelated, it is important that the three separate responses of Mutual of Omaha Insurance Company (Mutual) be read together.

We have no disagreement with an objective of determining the extent of overfunding of the Mutual of Omaha Retirement Income Plan (the Plan). In our response to the report titled *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company* (CIN A-07-94-00742), we accept, subject to the comments noted, the asset amounts presented, and therefore, when comparing those assets to the accrued liability using the projected unit funding method, we agree that the Medicare "segment" was overfunded as of January 1, 1992.

However, we have concerns that (1) Cost Accounting Standards (CAS) were inappropriately interpreted, (2) new terminology and calculations were created to describe the overfunding of the Plan that are unnecessary and confusing, (3) the stated purpose of the report was not satisfactorily achieved and does not match the actual intent of the review, and (4) other

FEB 21

documentation and reporting objectives should be incorporated. As a result of these concerns, Mutual must object to this report in its entirety. The following is an explanation of each of these concerns.

INTERPRETATION OF THE CAS, NEW TERMINOLOGY, AND CALCULATIONS

The first page of the report states that Mutual has an "*accumulated unabsorbed credit* of $4,541,284." The first page further characterizes the credit as representing "previously reimbursed assets that have been released from the segment's actuarial liability." In the Background section of the report, it was explained that the HCFA Actuary advised that "proper application of the CAS allows for the computation of a *negative* CAS pension cost. A negative CAS pension cost represents a *release* of assets that have been previously applied towards a portion of the actuarial liability." We disagree with these interpretations of the CAS.

"Negative CAS Pension Cost"

In our review of the CAS, there is no mention of "negative CAS pension cost", "release of assets", or "accumulated unabsorbed credits". CAS 412.50(b)(2)(ii) states:

> *The amount of pension cost assigned to a cost accounting period computed under such method is reduced by the excess, if any, of the value of the assets of the pension fund over the actuarial liability of the plan as determined by a projected benefit cost method set forth in subparagraph (b)(1) of this subsection.*

We interpret this section of the CAS to mean that pension costs are reduced to zero if a plan is overfunded, not to a negative amount.

As further support of our interpretation of the CAS, the DCAA (Defense Contractor Audit Administration) Contract Audit Manual, in the "Problem" and "Solution" at section 8-412.3a, describes the DCAA's position that "negative CAS pension costs", "release of assets" and "accumulated unabsorbed credits" are not contemplated or directed by CAS:

> *Problem. A contractor uses the aggregate cost method for computing and funding the $2.3 million pension costs assignable to the period. Since the aggregate method does not provide the cost visibility required by the standard, the contractor, for the fiscal year just ended, made the alternative calculation using the entry age normal method and provided supplementary information on actuarial gains and losses. The contractor's analysis disclosed that at fiscal year end (1) the value of the pension fund assets was $12.6 million, (2) the actuarial liability was $10 million, and (3) the experienced actuarial gain for the period was $1 million.*
>
> *Solution. According to CAS 412.50(b)(2), the pension cost to be allocated to contracts for the cost accounting period is $-0-, because the amount of overfunding ($2.6 million) exceeds the computed cost for the period ($2.3 million). Furthermore, the significance of the experienced actuarial gain would indicate that the actuarial assumptions may not be*

reasonable. The contractor should be required, according to CAS 412.50(b)(7), to identify the actuarial assumptions which were responsible for the gain and to provide rationale for either retaining or revising those assumptions. (Emphasis supplied.)

"Release of Assets"

The first page of the report stated "The released assets remain in the fund and can be used to fund future pension costs of the Medicare segment." On page two, the last two paragraphs state:

> "A negative CAS pension cost represents a release of assets that have previously been applied towards a portion of [the] actuarial liability.... The released assets remain in the trust fund as required by the Employees Retirement Income Securities Act of 1974 (ERISA). This Act does not permit a withdrawal of assets from the pension trust fund."

There is no provision in the CAS that overfunded plans create a "release of assets." A "release of assets" is not directed by CAS.

"Accumulated Unabsorbed Credit"

The report further associates the "release of assets" to an "unabsorbed credit", and then associates the "unabsorbed credit" with credits in general in the Federal Acquisition Regulations (FAR).

> "The released assets within the trust fund form an unabsorbed credit that is available to fund future CAS pension costs. The creation of the credit directly reduces future cash contributions and must be returned to the Government according to the FAR."
>
> "The FAR 31.201-5 states:
>
>> *The applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund."*
>
> "Since the unabsorbed credit remains invested in the trust fund, it accumulates with interest until used to fund future CAS pension costs or otherwise credited to the Government."

There is no CAS reference to or discussion of "unabsorbed credits". "Unabsorbed credits" are not directed by CAS.

In summary, the use of "negative CAS costs", "accumulated unabsorbed credits", and "release of assets" are not in accordance with CAS requirements and should not be unilaterally imposed upon a contractor by the OIG or HCFA.

STATED PURPOSE

The report states the purpose of the review was to "determine the effect of the overfunded Medicare segment on the calculation and funding of the pension costs for Plan Years 1986 through 1991." The scope section stated your objective was to "identify unabsorbed credits, plus appreciation on the credits, ..." We do not agree that the stated objective is in accordance with CAS.

OTHER DOCUMENTATION AND REPORTING OBJECTIVES

Even if the CAS provided support for the report approach, the report does not explain or associate the underlying calculations to the overall assets of the Plan. Specifically, we believe that measurement of overfunding should be associated with the total assets of the Plan. The Plan asset amounts presented in the report *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company* (CIN A-07-94-00742) should be associated with the accrued liability. It is important to show that any calculated amount of overfunding is included in both the total assets of the Plan and the assets allocated to the Medicare segment to eliminate the possible interpretation that these amounts are in addition to the assets identified in the segmentation report. In addition, we believe that the calculation of the "accumulated unabsorbed credit" set forth in the report is not actuarially sound.

Since we have serious concerns with this draft report and believe it would be mutually beneficial to meet and discuss them, we would appreciate the opportunity to meet at your convenience. Please contact me at (402) 351-5638.

Sincerely,

Valerie L. Ware

Valerie L. Ware
Manager-Financial Operations Planning

cc: Dick Bath
Jack Dillon

Mutual of Omaha
Companies

February 15, 1995

Ms. Barbara Bennett
Regional Inspector General for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services, Region VII
601 E. 12th Street, Room 284A
Kansas City, MO 64106

RE: CIN A-07-94-00742

Dear Ms. Bennett:

This memorandum responds to the Office of Inspector General (OIG) Office of Audit Services' draft audit report titled *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company.*

We are responding separately to two other draft audit reports that were issued simultaneously by the OIG titled *Review of Pension Costs Claimed for Medicare Reimbursement by Mutual of Omaha Insurance Company* (CIN A-07-94-00743) and *Review of Medicare Contractor's Overfunded Medicare Segment, Mutual of Omaha Insurance Company,* (CIN A-07-94-00741). However, since the scope, background, regulations, and findings and recommendations of the three reports are interrelated, it is important that the three separate responses of Mutual of Omaha Insurance Company (Mutual) be read together.

RESPONSE TO BACKGROUND

While Mutual agrees that, since October 1, 1987, annual pension costs (and the calculation of the contractor's pension segmentation that is the subject of the draft audit report) are to be computed on the basis of the definition of "Medicare segment" set forth on page 2 of the draft audit report, Mutual disagrees with the suggestion that its Medicare operations constitute a "segment" within the meaning of the definition set forth in CAS 413. As used in these three responses, the term "segment" refers to the contract definition.

FEB 21 1995

RESPONSE TO FINDINGS AND RECOMMENDATIONS:

Medicare Assets as of 1986

We accept the recommendation to increase the initial 1986 pension assets of the Medicare segment by $2,821,482. However, the second sentence on page 4 of the report is partly incorrect. The former actuarial firm incorrectly used 1986 participant data. Mutual selected the actuarial cost method, which it believed was appropriate under regulations regarding actuarial cost methods that provide little guidance. Mutual does not object, however, to the use of the Entry Age Normal (EAN) method for these purposes.

Medicare Assets as of January 1, 1992

We accept, subject to the comments above, the recommendation to increase the pension assets of the Medicare segment by $3,911,067 as of January 1, 1992. This recommendation includes the following:

1. The $2,821,482 adjustment of the initial asset segmentation in the previous recommendation above
2. An increase in earnings and expenses of $1,987,147, generally associated with the change in the initial asset amount
3. A decrease for the 1990 Medicare segment contribution of $210,874 that was not required with the correction of the initial asset segmentation
4. A decrease for participant transfer adjustments of $643,384 and
5. A decrease of $43,304 to adjust benefit payments to actual amounts.

If you have any questions or wish to discuss the response in further detail, please contact me at (402) 351-5638.

Sincerely,

Valerie L. Ware

Valerie L. Ware
Manager-Financial Operations Planning

cc: Dick Bath
Jack Dillon

Mutual of Omaha Companies

February 15, 1995

Ms. Barbara Bennett
Regional Inspector General for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services, Region VII
601 E. 12th Street, Room 284A
Kansas City, MO 64106

RE: CIN A-07-94-00743

Dear Ms. Bennett:

This memorandum formally responds to the Office of Inspector General (OIG) Office of Audit Services' draft audit report titled *Review of Pension Costs Claimed for Medicare Reimbursement by Mutual of Omaha Insurance Company*.

We are responding separately to two other draft audit reports that were issued simultaneously by the OIG titled *Review of Medicare Contractor's Overfunded Medicare Segment, Mutual of Omaha Insurance Company* (CIN A-07-94-00741) and *Review of Medicare Contractor's Pension Segmentation, Mutual of Omaha Insurance Company* (CIN A-07-94-00742). However, since the scope, background, regulations, and findings and recommendations of the three reports are interrelated, it is important that the three separate responses of Mutual of Omaha Insurance Company (Mutual) be read together.

In our response to the *Review of Medicare Contractor's Overfunded Medicare Segment, Mutual of Omaha Insurance Company* (CIN A-07-94-00741) we cited many disagreements including that Cost Accounting Standards (CAS) were inappropriately interpreted and that new terminology and calculations were created to describe overfunding of the Plan. These disagreements carry over to this report and affect the calculation of the cost claimed in excess of allowable pensions costs as well as the various line items presented in Appendix A.

However, we concur that the <u>direct</u> expense portion of pension expenses claimed in fiscal years 1990 and 1991, $144,453 and $48,151 respectively, was in excess of the allowable pension cost. We will be in position to review the <u>indirect</u> expenses claimed in fiscal years 1990 and 1991, $5,297 and $17,348 respectively, when the calculations and Appendix A are corrected to conform to the following contract provision:

FEB 21 1995

For each pension plan year following the initial asset allocation required by this Item XVI, the pension assets allocated to each Medicare Segment [Ed. we note that it has become the practice of the parties not to capitalize the "s" in "Segment"] shall be adjusted in accordance with CAS 413.50 (c)(7).

If you have any questions or wish to discuss the response in further detail, please contact me at (402) 351-5638.

Sincerely,

Valerie L. Ware

Valerie L. Ware
Manager-Financial Operations Planning

cc: Dick Bath
Jack Dillon

DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care Financing Administration

6325 Security Boulevard
Baltimore, MD 21207

HCFA Office of the Actuary
1705 Whitehead Road, Room 100
Baltimore, Maryland 21207-4004
telephone (410)-966-6381

MEMORANDUM

March 14, 1995

To: Jim Aasmunstadt, Audit Manager
Office Of Audit Services
HHS OIG Region VII

From: Eric Shipley, Actuary
Pension Actuarial Staff

Eric Shipley

Mutual of Omaha Pension Audit Reports:
CIN A-07-94-00742 (Pension Segmentation)
CIN A-07-94-00741 (Unfunded Pension Costs)
CIN A-07-94-00743 (Pension Costs Claimed)

As requested, I have reviewed Mutual of Omaha's (Mutual) responses to the three audits reports captioned above. There are facts, findings, and computations common to all three reports and this memo will address the issues in the order in which they logically arise.

<u>CIN A-07-94-00742 *Review of Medicare Contractor's Pension Segmentation*</u>

Mutual concurs with the reports recommendations. However, Mutual takes two exceptions to the findings of the audit report.

Mutual's first contention is that while the identified segment meets the contract definition of a "Medicare Segment", it does not meet the Cost Accounting Standard (CAS) 413 definition of a "segment". This is incorrect. The CAS definition is general in nature so that it may be applied in a variety of contracting environments. As noted in the preamble to the contract clause negotiated between HCFA and the contractors, the Medicare contract clause clarifies the how the definition of a "segment" applies in the case of an insurance company. The Preamble to Section XVI of Appendix B of the contract signed by HCFA and by Mutual states:

> "A. <u>Preamble</u>: 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 and the contractor agree that, for purposes of this agreement/ contract, CAS 413 shall be interpreted and applied as specified herein. Neither the Secretary nor the contractor shall seek to apply a different interpretation of the provisions of the CAS addressed below, consistent with applicable

statutes and regulations, with respect to this or any prior period contract. * * * "

During the period covered by the audit, subparagraph 9904.413-30(a)(11) of the Cost Accounting Standards defines a "segment" as follows:

"Segment means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. * * * "

And, Subsection B of Section XVI of Medicare Contract's Appendix B defines a "segment" as follows:

"B. Definition of Medicare Segment: The term "Medicare Segment" shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/ agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,

2. Less than a majority of the salary dollars are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract. * * *"

The identified segment conforms to both the very specific contract definition and the generalized CAS 413 definitions of a "segment".

Secondly, Mutual asserts that the immediate-gain actuarial cost method they used to compute the "asset fraction"; i.e., the Accrued Benefit cost method was appropriate. The spread-gain actuarial cost method Mutual had used to fund the pension plan was the Aggregate actuarial cost method. Unlike the Aggregate cost method, which is a projected benefit cost method as defined by subparagraph 9904.413-30(a)(10) of the CAS, the Accrued Benefit cost method is not a projected-benefit actuarial cost method since it does not consider future salary and benefit levels. Subdivision 9904.413-50(c)(5)(ii) requires that the assets "be allocated to the segment in a manner consistent with the actuarial cost method or methods used to compute pension cost". The audit report was correct in stating that the actuarial cost method employed by Mutual to determine the "asset fraction" was inappropriate. For plans whose benefits are tied to final salary the Entry Age Normal actuarial cost method, like the Aggregate method, considers projected salary and benefit levels and assigns costs to periods as a percentage of payroll. The auditors used the only immediate-gain actuarial cost method that was consistent with the spread-gain method used to compute costs in 1981.

Actuary's Recommendation: Issue the findings in the audit report as drafted.

CIN A-07-94-00741 *Review of Medicare Contractor's Overfunded Medicare Segment*

Mutual contends that CAS 412 and 413 were inappropriately interpreted and that new unnecessary and confusing terminology and calculations were created. Mutual also asserts that the measurement of overfunding should be associated with the liabilities and assets of the pension plan as a whole.

Terminology

The report does not claim that the phrase "negative CAS pension cost" is a defined term. The phrase "CAS pension cost" is used to describe the pension cost computed for and assigned to the period in accordance with CAS 412 and 413. "Negative" is used as an adjective when computation of the CAS pension cost results in a value less than zero. Consistent with its prohibition on the withdrawal of funds from a tax-qualified trust fund, the provisions of the Employees Retirement Income Security Act (ERISA) explicitly prohibit the development of a negative pension contribution. A plain reading of subdivision 9904.412-50(b)(2)(ii) of the CAS: "reduced by the excess" contains no such explicit prohibition on the computation of pension cost. Furthermore, Generally Accepted Accounting Principles (GAAP), as set forth in Statement 87 of the Financial Accounting Standards Board, do recognize either a positive or a negative pension expense. GAAP is the primary external authority for purposes of cost allocation, as well as cost allowability under the cost principles of Part 31 of Federal Acquisition Regulation (FAR).

Because laws and regulations can only be interpreted by the promulgating body, the CAS can only be interpreted by the Cost Accounting Standards Board (CASB). As representatives of the Department of Health and Human Services, the auditors and I have applied the CAS based on a plain reading of the language of CAS 412. Mutual's exception to the audit finding is based on their "interpretation" of the CAS to read "reduced to zero". Mutual attempts to buttress their interpretation with guidance from the Contract Audit Manual published by the Defense Contract Audit Agency (DCAA). However, manual instructions by an outside agency are not binding upon the HHS OIG. DCAA's Policy and Plans Division and CAS Division are aware that Ron Solomon and I believe their manual instructions to be incorrect. Finally, in response to the silence in the current CAS 412 regarding the development of pension costs less than zero, several other commenters to the recent CAS 412 Notice of Proposed Rule Making (NPRM) have requested that the CASB specify clearly in the new rule whether pension costs are permitted to be less than zero. As Ron Solomon and I noted in our comments on the NPRM, if pension costs cannot be negative, generally accepted actuarial principles and practices require that the CAS explicitly describe how the actuarial balance of the pension plan is to be maintained when excess assets are sufficient to produce negative costs.

The use of the phrase "negative CAS pension cost" to describe the result when a net amortization installment credit exceeds the normal cost is consistent with, not contrary to, the wording of the CAS, and is also consistent with GAAP in an area where CAS 412 is silent.

The phrase "release of assets" is used to describe an event and is not presented as a defined term. When a portion of assets that have previously been accumulated to fund an obligation is no longer needed to fund the obligation because the obligation has been reduced by a new measurement, it is appropriate to refer to such assets as being released from the obligation. This is the accounting event that occurs when a portion of prior asset surplus; that is, assets no longer needed to cover current obligations, is assigned to the current period through the CAS 412 amortization process. This phrase is descriptive and does not impose any requirements upon the contractor.

As with the phrases "negative CAS pension costs" and "released assets", the phrase "accumulated unabsorbed credits" is descriptive and is not presented as a definition of the CAS or FAR. The Medicare segment's assets are the accumulated value of prior period contributions, adjusted for earnings, benefits, and expenses. Medicare participated in the accumulation of such assets by its reimbursements of its share of such prior contributions toward the pension obligation. Normally when a negative cost is assigned to a cost accounting period as a credit, an appropriate portion of the current period credit would be allocated to the Medicare contract in accordance with FAR Section 31.201-5. This is what happens when the contractor receives income in the case of an insurance refund or a gain on the sale of a depreciated asset. Because ERISA generally prohibits the withdrawal of assets from a tax-qualified pension trust, the contractor does not realize a return of funds when a segment is overfunded. Instead, the assets, which have been released from the pension obligations of the segment by the amortization process of CAS 412 and 413, are retained in the trust fund. It would be inequitable for the HHS OIG to recommend that the credit for "negative CAS pension costs" be refunded to HCFA and absorbed by an allocation to the contract when the IRS does not allow the contractor to actually receive a refund of the "released assets". Therefore, these credits remain unabsorbed by the Medicare contract. The audit report identifies and accumulates the amounts that would have otherwise been refunded to HCFA. The accumulated value of these non-refunded amounts is captioned as "accumulated unabsorbed credits". So that HCFA will not be making reimbursements of pension costs for an already overfunded plan, the report recommends that these non-refunded credits retained in the trust fund be used to cover increases in the pension obligation that accrue when positive CAS pension costs are computed and assigned during future cost accounting periods.

Actuary's Recommendation: Maintain the wording of the draft report, but note in the rebuttal to the contractor's response that "negative CAS pension costs", "released assets", and "accumulated unabsorbed credits" are descriptive phrases and not CAS or FAR defined terms. The report's recommendation that the contractor track and account for non-refunded credits, which have arisen from the computation and assignment of pension costs less than zero, is an accounting recommendation properly within the purview of the OIG.

Measurement of Overfunding

In their response, Mutual states "It is important to show that any calculated amount of overfunding is included in both the total assets of the plan and the assets allocated to the Medicare segment to eliminate the possible interpretation that these amounts are in addition to the assets identified in the segmentation report". Mutual is correct that the report is confusing because similar language is used to describe two different situations. The report's title uses the term "overfunded" to describe the situation when the assets allocated to a segment exceed the actuarial accrued liability for that segment; that is, there is an actuarial surplus. The term "overfunded" is proper in the context of an actuarial surplus. The confusion arises in Appendix A of the report where the current period cost is described as overfunded because a credit is developed due to either premature funding or a negative CAS pension cost.

Actuary's Recommendation: The label in Appendix A that currently reads "Under (Over) Funding" should be changed to "Unfunded Cost" when a portion of the assigned cost is not funded, "Premature Funding" when the contribution exceeds the "CAS Funding Target", and "Unallocated Credit" when the assigned CAS pension cost is negative. These labels will be more consistent with current CAS terminology and the phrase "accumulated unabsorbed credit". The footnote should explain that any pension cost credit that has not been allocated to the Medicare contract, and therefore, has not been absorbed by the contract, will be identified and applied against future positive CAS pension costs as an "accumulated unabsorbed credit".

CIN A-07-94-00743 *Review of Pension Costs Claimed for Medicare Reimbursement*

Since there will are no changes required for the computations of the other two audit reports, there need be no changes to the findings of this audit report. The asset roll-up, which is shown in Appendix A of the audit report titled "Review of Medicare Contractor's Pension Segmentation" (CIN A-07-94-00742), follows subparagraph 9904.413-50(c)(7) of the CAS and forms the basis for the findings in this report. Therefore, we do not understand Mutual's concern with the application of the referenced provision.

Actuary's Recommendation: Sustain this audit report as drafted.

cc: Jack Morman, OIG OAS, Kansas City
Jenenne Davis, OIG OAS, Jefferson City
Ron Solomon, HCFA OACT PAS