Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF UNFUNDED PENSION COSTS OF ROCKY MOUNTAIN HEALTH CARE CORPORATION

JUNE GIBBS BROWN
Inspector General

FEBRUARY 1997
CIN: A-07-96-01198

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-07-96-01198

FEB 4 1997

Ms. Pat Miller
Manager of Cost Accounting
Rocky Mountain Health Care Corporation
700 Broadway
Denver, Colorado 80273

Dear Ms. Miller:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Unfunded Pension Costs of Rocky Mountain Health Care Corporation*. The purpose of our review was to determine if pension costs for Plan Years 1986 through 1995 were funded in accordance with the Federal Acquisition Regulations (FAR).

Rocky Mountain Health Care Corporation (Rocky Mountain) did not make contributions to the pension trust fund for Plan Years 1987 through 1992. Accordingly, Rocky Mountain did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Rocky Mountain accumulated unfunded pension costs of $543,421 as of January 1, 1996. Rocky Mountain's unfunded pension costs includes unfunded pension costs of $31,372 attributable to Blue Cross and Blue Shield of New Mexico (New Mexico) (CIN: A-07-96-01195) as of the January 1, 1989 merger. Rocky Mountain must separately identify and eliminate this amount from the amortization components of future pension costs. The Auditee was unable to provide a definitive response to our report within the 75 days granted to them for providing a response (30 initial days plus a 45 day extension). The auditee's letter is included as Appendix B.

INTRODUCTION

BACKGROUND

Cost Accounting Standards (CAS) and FAR

For Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413, and (2) funded as specified by part 31 of the 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 CAS within 48 Code of Federal Regulations (CFR) 9904.412-50(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 9904.412-50(a)(2) states:

> *Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions shall be separately identified and eliminated from any unfunded actuarial liability being amortized....*

Furthermore, the FAR, 48 CFR 31.205-6(j)(3)(i) and (iii), states:

> *...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.*

Employees Retirement Income Security Act of 1974 (ERISA)

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax-exemptions under ERISA. The ERISA provided for a minimum and a maximum deposit to pension funds as determined each year. The minimum represented a required deposit while the maximum represented the upper limit that could be deducted for income tax purposes for the year for which the deposit was applicable.

Pension costs computed in accordance with CAS represented an assignment of pension costs to specific accounting periods. The CAS pension costs often fell between ERISA minimum and maximum contributions. If contractors deposited the minimum ERISA contribution in their qualified trust funds, and the CAS pension costs exceeded the ERISA minimum, the contractors could only claim the funded portion of the CAS amount as allowable contract costs. Additionally, the excess of the CAS costs over the ERISA minimum contribution could not be carried forward as a component of future CAS pension costs.

Conversely, if CAS pension costs before 1986 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.

Tax Reform Act of 1986 (TRA 86)

The 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-forwards and current year contributions.

Omnibus Budget Reconciliation Act of 1987 (OBRA 87)

Prior to OBRA 87, ERISA's full funding limitation traditionally considered accumulated assets and the actuarial liability. If assets equalled or exceeded the actuarial liability, the tax deductible amount was limited to zero. With OBRA 87, the Congress took additional action affecting contractors' pension plan contributions to qualified trust funds.

The OBRA 87 imposes 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

We made our examination in accordance with generally accepted government auditing standards. Our objective was to identify any unfunded CAS costs, plus appreciation on the unfunded costs, from January 1, 1986 to January 1, 1996. Achieving our objective did not require that we review the internal control structure of Rocky Mountain.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-96-01185) and pension costs claimed for Medicare reimbursement (CIN: A-07-96-01197) and our audits of New Mexico's pension segmentation (CIN: A-07-96-01195), unfunded pension costs (CIN: A-07-96-01199) and pension costs claimed for Medicare reimbursement (CIN: A-07-96-01196). The information obtained and reviewed during those audits was also used in performing this review.

The Health Care Financing Administration (HCFA) Office of the Actuary developed the methodology used for computing the CAS pension costs based on Rocky Mountain's historical practices.

We performed site work at Rocky Mountain's corporate offices in Denver, Colorado during June 1996. Subsequently, we performed audit work in our Jefferson City, Missouri Office.

FINDING AND RECOMMENDATIONS

As of January 1, 1996, Rocky Mountain had accumulated $543,421 in unallowable direct pension costs related to its Medicare segment. These costs represent unfunded pension costs and imputed interest for Plan Years 1986 through 1995.

Rocky Mountain did not make contributions to the pension trust fund in Plan Years 1987 through 1992 because the pension plan was fully funded. Rocky Mountain's actuary recommended in the actuarial valuation reports for those years that the plan not be funded.

The CAS pension costs not funded are unallowable as a component of pension costs for any future years. Imputed interest on the unfunded costs is also unallowable. In addition, the unfunded costs cannot be claimed in future cost accounting periods.

We compared CAS pension costs for the Medicare segment, computed by HCFA Office of the Actuary, to actual contributions to the Medicare segment. We found that the Medicare segment had accumulated unfunded pension costs, plus interest, of $543,421 for plan years 1986 through 1995. The following table shows the unfunded amounts, and interest, which are unallowable on a cumulative basis.

Unfunded CAS Pension Costs and Interest

Year	Unfunded CAS Costs	Interest To 1/1/96	Total As Of 1/1/96
1986	$ 0	$ 0	$ 0
1987	116,239	111,149	227,388
1988	84,037	66,783	150,820
1989	53,000	34,264	87,264
1990	15,403	7,864	23,267
1991	9,206	3,553	12,759
1992	32,973	8,951	41,923
1993	0	0	0
1994	0	0	0
1995	0	0	0
Total	$310,858	$232,563	$543,421

Our computation of the unfunded amounts plus interest considers those costs which should have been funded for the applicable years. In other words, if Rocky Mountain funded the costs, the assets of the Medicare segment would have been greater. Appendix A provides additional information on the CAS pension costs.

Recommendations

We recommend that Rocky Mountain:

1. Identify $543,421 as an unallowable component of direct pension costs as of January 1, 1996.

2. Identify and update unfunded pension costs for any later years in a similar manner.

Auditee Response

The Auditee stated they were unable to provide a definitive response to our report within the 75 days granted to them for providing a response (30 initial days plus a 45 day extension). They also stated they would continue their evaluation of the draft audit report and will work with us and the Contracting Officer to bring these matters to a prompt and fair resolution.

OTHER MATTERS

The Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs effective March 30, 1995. The revised CAS removes the regulatory conflict between the funding limits of ERISA and the period assignment provisions of the CAS. Additionally, the new rule will allow the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. However, the method or methods used to reassign the unfunded pension costs must be approved by the contracting officer.

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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 on the following page. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS 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, Region VII

HHS Action Official:

Ms. Mary K. Smith
Regional Administrator, Region VIII
Health Care Financing Administration
1961 Stout Street
Denver, Colorado 80294-3538

Enclosures

ROCKY MOUNTAIN HEALTH CARE CORPORATION

CIN: A-07-96-01198

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare Segment
01/01/86 Normal Cost	1/	$825,995	$628,108	$197,887
01/01/86 Amortization Payment	2/	(802,489)	(692,200)	(110,289)
01/01/86 CAS Pension Cost	3/	23,506	(64,092)	87,598
Interest to 12/31/86	4/	2,116	(5,768)	7,884
12/31/86 CAS Funding Target	5/	25,622	(69,860)	95,482
Contribution	6/	(266,000)	(175,957)	(90,043)
Interest to 12/31/86	7/	(16,069)	(10,630)	(5,439)
12/31/86 Unfunded Pension Cost (Overfunded)	8/	$(256,447)	$(256,447)	**$0**
01/01/87 Normal Cost		$1,145,295	$856,950	$288,345
01/01/87 Amortization Payment		(691,476)	(585,067)	(106,409)
01/01/87 CAS Pension Cost		453,819	271,883	181,936
01/01/87 Prepayment Credit	9/	(186,587)	(111,784)	(74,803)
Interest to 12/31/87		22,715	13,609	9,106
12/31/87 CAS Funding Target		289,947	173,308	116,239
Contribution		0	0	0
Interest to 12/31/87		0	0	0
12/31/87 Unfunded Pension Cost		$289,947	$173,708	**$116,239**
01/01/88 Normal Cost		$1,090,053	$853,039	$237,014
01/01/88 Amortization Payment		(1,102,656)	(942,740)	(159,916)
01/01/88 CAS Pension Cost		(12,603)	(89,701)	77,098
Interest to 12/31/88		(1,134)	(8,073)	6,939
12/31/88 CAS Funding Target		(13,737)	(97,774)	84,037
Contribution		0	0	0
Interest to 12/31/88		0	0	0
12/31/88 Unfunded Pension Cost		$(13,737)	$(97,774)	**$84,037**

ROCKY MOUNTAIN HEALTH CARE CORPORATION

CIN: A-07-96-01198

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare Segment
01/01/89 Normal Cost		$1,656,058	$1,352,001	$304,057
01/01/89 Amortization Payment		(1,518,246)	(1,262,813)	(255,433)
01/01/89 CAS Pension Cost		137,812	89,188	48,624
01/01/89 Absorbed Credit	10/	(89,188)	(89,188)	0
Interest to 12/31/89		4,376	0	4,376
12/31/89 CAS Funding Target		53,000	0	53,000
Contribution		0	0	0
Interest to 12/31/89		0	0	0
12/31/89 Unfunded Pension Cost	11/	$53,000	$0	**$53,000**
01/01/90 Normal Cost		$1,823,632	$1,483,935	$339,697
01/01/90 Amortization Payment		(1,856,007)	(1,530,441)	(325,566)
01/01/90 CAS Pension Cost		(32,375)	(46,506)	14,131
Interest to 12/31/90		(2,914)	(4,186)	1,272
12/31/90 CAS Funding Target		(35,289)	(50,692)	15,403
Contribution		0	0	0
Interest to 12/31/90		0	0	0
12/31/90 Unfunded Pension Cost		$(35,289)	$(50,692)	**$15,403**
01/01/91 Normal Cost		$1,962,345	$1,616,287	$346,058
01/01/91 Amortization Payment		(1,773,955)	(1,436,343)	(337,612)
01/01/91 CAS Pension Cost		188,390	179,944	8,446
01/01/91 Absorbed Credit		(159,055)	(159,055)	0
Interest to 12/31/91		2,640	1,880	760
12/31/91 CAS Funding Target		31,975	22,769	9,206
Contribution		0	0	0
Interest to 12/31/91		0	0	0
12/31/91 Unfunded Pension Cost		$31,975	$22,769	**$9,206**

ROCKY MOUNTAIN HEALTH CARE CORPORATION

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STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/92 Normal Cost	$2,176,255	$1,811,273	$364,982
01/01/92 Amortization Payment	(1,714,128)	(1,379,396)	(334,732)
01/01/92 CAS Pension Cost	462,127	431,877	30,250
Interest to 12/31/92	41,591	38,868	2,723
12/31/92 CAS Funding Target	503,718	470,745	32,973
Contribution	0	0	0
Interest to 12/31/92	0	0	0
12/31/92 Unfunded Pension Cost	$503,718	$470,745	**$32,973**
01/01/93 Normal Cost	$2,608,211	$2,173,309	$434,902
01/01/93 Amortization Payment	(496,080)	(333,144)	(162,936)
01/01/93 CAS Pension Cost	2,112,131	1,840,165	271,966
Interest to 12/31/93	179,531	156,414	23,117
12/31/93 CAS Funding Target	2,291,662	1,996,579	295,083
Contribution	(2,937,750)	(2,642,735)	(295,015)
Interest to 12/31/93	(674)	(606)	(68)
12/31/93 Unfunded Pension Cost	$(646,762)	$(646,762)	**$0**
01/01/94 Normal Cost	$2,960,257	$2,468,477	$491,780
01/01/94 Amortization Payment	(575,377)	(387,416)	(187,961)
01/01/94 CAS Pension Cost	2,384,880	2,081,061	303,819
01/01/94 Prepayment Credit	(646,761)	(564,368)	(82,393)
Interest to 12/31/94	139,050	121,336	17,714
12/31/94 CAS Funding Target	1,877,169	1,638,029	239,140
Contribution	(3,410,968)	(3,178,228)	(232,740)
Interest to 12/31/94	(93,788)	(87,388)	(6,400)
12/31/94 Unfunded Pension Cost	$(1,627,587)	$(1,627,587)	**$0**

ROCKY MOUNTAIN HEALTH CARE CORPORATION

CIN: A-07-96-01198

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/95 Normal Cost	$2,760,094	$2,523,648	236,446
01/01/95 Amortization Payment	(834,140)	(386,900)	(447,240)
01/01/95 CAS Pension Cost	1,925,954	2,136,748	(210,794)
01/01/95 Prepayment Credit	(1,627,588)	(1,627,588)	0
Interest to 12/31/95	25,361	43,278	(17,917)
12/31/95 CAS Funding Target	323,727	552,438	(228,711)
Contribution	(1,839,764)	(1,839,764)	0
Interest to 12/3/95	(91,467)	(91,467)	0
12/31/95 Unfunded Pension Cost	$(1,607,504)	$(1,378,793)	**$(228,711)**

ROCKY MOUNTAIN HEALTH CARE CORPORATION

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STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

FOOTNOTES

1/ We obtained the total company normal cost from Rocky Mountain's actuarial valuation reports. We obtained normal cost for the Medicare segment from data files provided by Rocky Mountain's actuary. The amount shown for the "other segment" represents the difference between the total company and the Medicare segment.

2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Rocky Mountain's valuation reports and IRS Form 5500 reports. The amortization payment was negative for years in which pension assets exceeded actuarial liabilities, thereby creating a negative unfunded actuarial liability.

3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. We allocated the CAS pension cost to the Medicare segment based on the ratio of the individual participant's normal cost and accrued liability to the total company normal cost and accrued liability for years 1986 and 1987. We separately calculated CAS pension costs for years 1988 through 1995.

4/ We applied one year's interest at the assumed rate of 9.0 percent for years 1988 through 1992, 8.5 percent for 1987, 1993, and 1995, and 8.0 percent for 1994 to the CAS pension cost. We obtained the interest rates from the actuarial valuation reports.

5/ The annual CAS pension cost, adjusted with interest to the end of the year, must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 31.205-6(j).

6/ Rocky Mountain did not make contributions to its pension plan for years 1987 through 1992. However, it did make contributions to the pension plan for years 1986 and 1993 through 1995. We assigned contributions to the Medicare segment based on a ratio of Medicare segment's CAS funding target to the total company CAS funding target.

7/ We calculated interest on the contributions, from the date of deposit to the end of the year, at the assumed rates of interest (see footnote 4/).

8/ The unfunded pension cost represents the CAS funding target less the value of contributions. We calculated an unabsorbed credit (a negative value) where our computed CAS pension cost was negative. Rocky Mountain must carry forward the unabsorbed credit and offset it against future positive CAS pension costs. A negative unfunded pension cost, resulting from contributions in excess of the CAS funding target, represents a prepayment credit. The prepayment credit is carried forward and applied towards the funding of future CAS pension costs.

ROCKY MOUNTAIN HEALTH CARE CORPORATION

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STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1996

9/ We applied the prepayment credit towards the funding of the CAS pension costs. The prepayment credit is reimbursable for the plan year in which it is absorbed.

10/ The absorbed credit represents the carry forward of the prior year(s) negative CAS pension costs. The unabsorbed credit is unallowable for Medicare reimbursement and must be offset against future positive CAS pension costs until it is completely absorbed.

11/ The unfunded pension cost for the Medicare segment includes unfunded pension costs attributable to Blue Cross and Blue Shield of New Mexico, which were unallowable for Medicare reimbursement (CIN: A-07-96-01195).

700 Broadway
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Rocky Mountain
Health Care
Corporation

January 27, 1997

Barbara A. Bennett
Regional Inspector General
for Audit Services, Region VII
Department of Health and Human Services
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Dear Ms. Bennett:

Thank you for extending until January 27, 1997, the time for our response to the following draft audit reports:

CIN:	A-07-96-01198	CIN:	A-07-96-01199
CIN:	A-07-96-01185	CIN:	A-07-96-01195
CIN:	A-07-96-01196	CIN:	A-07-96-01197

Those draft audit reports relate to the Office of Inspector General's audit of Blue Cross and Blue Shield of Colorado's and Blue Cross and Blue Shield of New Mexico's claimed pension costs, pension segmentation, and unfunded pension costs for Fiscal Years 1988 through 1995.

As you know, the proper treatment of pension costs pursuant to CAS 412 and 413 may be the single most difficult government cost accounting issue, and there are complex interactions among the draft reports. Despite our best efforts, and those of our outside actuarial, legal and accounting consultants, we have not yet been able to complete our review and analysis of the issues raised in the draft reports. Accordingly, we are unable to provide you at this time with the definitive Plan responses that you have requested.

We understand from your letter of December 17, 1996, that you will not grant us a further extension at this time. Nonetheless, please be assured that we will continue our evaluation of the draft audit reports, and will work with your auditors and the Contracting Officer to bring these matters, and the related contract termination pension cost matters, to a prompt and fair resolution.

Thank you for affording us an opportunity to comment on the draft audit reports. We regret that we are unable to do so at this time.

Sincerely,

William P. Crossen

William P. Crossen
Chief Financial Officer