Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF UNFUNDED PENSION COSTS OF ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT

JUNE GIBBS BROWN
Inspector General

MARCH 1998
A-07-98-02501

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-07-98-0250 1

MAR241998

Mr. Phillip Finger
Director of Cost and Budget
Anthem Blue Cross and Blue Shield of Connecticut
370 Bassett Road
North Haven, Connecticut 06473-420 1

Dear Mr. Finger:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Unfunded Pension Costs of Anthem Blue Cross and Blue Shield of Connecticut.* The purpose of our review was to compute interest on the January 1, 1992 accumulated unfunded pension costs and to determine if pension costs allocable to the Medicare contracts for Plan Years 1992 through 1996 were funded in accordance with the Federal Acquisition Regulations.

During our previous review of Anthem Blue Cross and Blue Shield of Connecticut (Connecticut) (CIN: A-07-93-00710), we determined that the Medicare segment accumulated $184,209 in unfunded pension costs as of January 1, 1992. Additionally, as of January 1, 1992, Connecticut had accumulated unabsorbed credits totaling $53,183 attributable to the Medicare segment. These unabsorbed credits, which were allocable to Medicare contracts in prior periods, must be absorbed by future pension costs, and are unallowable for Medicare reimbursement.

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 3 1 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 computedfor 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 ofpension 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 3 1.205-6(j)(3)(i) and (iii), states:

> *...costs ofpension plans notfunded in the year incurred, and all other components of pension costs...assignable to the current accountingperiod but notfunded 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 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 equaled 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.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to identify any unfunded CAS costs, plus interest adjustments on the unfunded costs, from January 1, 199 1 to January 1, 1997. Our objective also included identifying interest adjustments on the unfunded pension costs previously reported. Achieving our objective did not require that we review the internal control structure of Connecticut.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-97-02500) and pension costs claimed for Medicare reimbursement (CIN: A-07-98-02502). The information obtained and reviewed during those audits was also used in performing this review.

In 1992, Office of Personnel Management requested that Connecticut treat the Federal Employee Program (FEP) cost centers within the Medicare segment as a separate segment and perform separate FEP valuations and CAS cost computations. We previously determined and accepted the cost centers identified as the FEP Segment were included in the organization unit originally identified as the Medicare Segment. Thus we performed a spin-off of the FEP segment from the Medicare segment as of January 1, 1993 as indicated by the FEP segmentation values developed by Connecticut's actuary.

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

We performed site work at Connecticut's corporate offices in North Haven, Connecticut during September 1997. Subsequently, we preformed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

As of January 1, 1997, Connecticut had accumulated $219,501 in unallowable direct pension costs related to its Medicare segment. These costs included only the $184,209 in unfunded pension costs identified in our previous audit with appreciation of $78,420, less unfunded pension cost of $43,128 allocable to the FEP segment as part of the spin-off of FEP from the Medicare segment.

We found that Connecticut did not include the unfunded pension costs of the prior periods, plus interest, in its calculation of subsequent pension costs.

Recommendation:

We recommend that Connecticut:

❶ Identify $219,501 as an unallowable component of direct pension costs as of January 1, 1997.

Auditee Response

Connecticut agreed with our methodology, but deferred agreement on the amount of unallowable direct pension costs as a result of revisions in the segmentation report. Connecticut has filed a request with HCFA to allow recapture of the unallowable direct pension costs.

OIG Response

Subsequent to our review Connecticut provided corrected cost center information on four pension plan participants and concluded that one entire cost center should be excluded from our identification of the Medicare segment. We corrected the cost center information and excluded the cost center in our calculations and made the appropriate adjustments.

UNABSORBED CREDITS

As of January 1, 1992, Connecticut had accumulated unabsorbed credits of $53,183 related to its Medicare segment. Our calculation of negative CAS pension cost for 1992 resulted in additional unabsorbed credits. This condition occurred because the pension assets exceeded the actuarial liabilities, which resulted in negative unfunded actuarial liability amounts.

The CAS 412 within 48 CFR 9904.412-40(a) states:

> *. ..components ofpension cost for a cost accounting period are (i) the normal cost of the period, (ii) apart of any unfunded actuarial liability, (iii) an interest equivalent on the unamortized portion of any unfunded actuarial liability, and (iv) an adjustment for any actuarial gains and losses.*

Our computation of the CAS pension cost for years 1992 and 1993 included a negative net amortization amount for the unfunded actuarial liability. For 1992 and 1993, the negative net amortization amount exceeded the normal cost for the Medicare segment. As a result, the segment's CAS pension cost was a negative amount for 1992 ($33,277) and 1993 ($18,756). The negative CAS pension cost created an unabsorbed credit that must be carried forward, with interest, and offset (absorbed) by future positive pension costs.

We carried forward the unabsorbed credit from our prior report and increased the credit by the negative CAS cost calculated for 1992 and 1993. We applied the unabsorbed credit against positive pension costs for 1994 through 1996. However, the positive pension costs were not sufficient to fully offset the unabsorbed credit. As of January 1, 1997, the accumulated unabsorbed credits totaled $72,65 1.

Connecticut cannot charge any CAS pension costs to Medicare until the accumulated unabsorbed credits, including interest, are fully offset by future pension costs. The following table shows our application and accumulation of the unabsorbed credits (Appendix A provides additional information).

	1992	1993	1994	1995	1996
CAS Pension Costs	($33,277)	($18,756)	$5,354	$13,106	$31,540
Interest to End of Year	($2,995)	($1,688)	$0	$0	$0
Less:					
Unabsorbed Credit	$53,183	$94,242	$101,103	$103,888	$98,499
Interest to End of Year	$4,787	$6,660	$8,139	$7,717	$5,692
Spin-off Adjustment	$0	($20,243)	$0	$0	$0
Accumulated Credits	($94,242)	($101,103)	($103,888)	($98,499)	($72,651)

Recommendations

We recommend that Connecticut:

❷ Identify $72,651 as a nonreimbursable unabsorbed credit as of January 1, 1997.

❸ Update annually the unabsorbed credit until such time as it is fully offset against positive CAS pension costs.

❹ Identify and update negative CAS costs and unabsorbed credits for any later years in a similar manner.

Auditee Response

Connecticut concluded that recalculation of the CAS pension costs due to revised transfer information would impact the unabsorbed credit amount.

OIG Response

As stated above, subsequent to our review Connecticut provided corrected cost center information on four pension plan participants and concluded that one entire cost center should be excluded from our identification of the Medicare segment. We corrected the cost center information and excluded the cost center in our calculations and made the appropriate adjustments.

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. The new rule will allow the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. Additionally, the amended CAS 412 places a $0 floor on pension costs and provides for the reassignment of negative pensions costs. However, the method or methods used to reassign the unfunded pension costs must be approved by the contracting officer.

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 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, Region VII

Enclosure

HHS Action Official:

Ms. Judy Berek
Acting Regional Administrator, Region I
Health Care Financing Administration
John F. Kennedy Federal Building, Room 2325
Boston, Massachusetts 02203-0003

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT
CIN: A-07-98-02501

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1992 TO JANUARY 1, 1997

	Description		Total Company	Other Segment	Medicare Segment	FEP Segment
01/01/92	Normal Cost	1/	$4,730,208	$4,664,218	$65,990	$0
0 l/O 1/92	Amortization Payment	2/	($2,905,168)	($2,805,901)	($99,267)	$0
01/01/92	CAS Pension Cost	3/	$1,825,040	$1,858,317	($33,277)	$0
	Interest to 12/31//92	4/	$164,254	$167,249	($2,995)	$0
12/31/92	CAS Funding Target	5/	$1,989,294	$2,025,566	($36,272)	$0
	Contribution	6/	$0	$0	$0	$0
	Interest to 12/31/92	7/	$0	$0	$0	$0
12/31/92	Under (Over) Funding	8/	$1,989,294	$2,025,566	($36,272)	$0

01/01/93	Normal Cost	9/	$5,061,349	$4,980,845	$56,929	$23,575
0 1 /01/93	Amortization Payment		($2,998,133)	($2,901,740)	($75,685)	($20,708)
01/01/93	CAS Pension Cost		$2,063,216	$2,079,105	($18,756)	$2,867
01/01/93	Absorbed Credit	10/	($2,867)	$0	$0	($2,867)
	Interest to 12/31//93		$185,431	$187,119	($1,688)	$0
12/31/93	CAS Funding Target		$2,245,780	$2,266,224	($20,444)	$0
	Contribution		($6,000,000)	($6,000,000)	$0	$0
	Interest to 12/31/93		($91,368)	($9 1,368)	$0	$0
12/31/93	Under (Over) Funding		($3,845,588)	($3,825,144)	($20,444)	$0

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STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1992 TO JANUARY 1, 1997

	Description		Total Company	Other Segment	Medicare Segment	FEP Segment
01/01/94	Normal Cost		$5,535,748	$5,439,404	$67,509	$28,835
01/01/94	Amortization Payment		($2,630,125)	($2,550,780)	($62,155)	($17,190)
01/01/94	CAS Pension Cost		$2,905,623	$2,888,624	$5,354	$11,645
01/01/94	Absorbed Credit		($16,999)	$0	($5,354)	($11,645)
01/01/94	Prepayment Credit	11/	($2,888,624)	($2,888,624)	$0	$0
	Interest to 12/31//94		$0	$0	$0	$0
12/31/94	CAS Funding Target		$0	$0	$0	$0
	Contribution		($6,800,000)	($6,800,000)	$0	$0
	Interest to 12/31/94		($359,747)	($359,747)	$0	$0
12/31/94	Under (Over) Funding		($7,159,747)	($7,159,747)	$0	$0

01/01/95	Normal Cost	$5,680,566	$5,572,493	$72,461	$35,612
01/01/95	Amortization Payment	($2,420,511)	($2,347,302)	($59,355)	($13,854)
01/01/95	CAS Pension Cost	$3,260,055	$3,225,191	$13,106	$21,758
01/01/95	Absorbed Credit	($21,021)	$0	($13,106)	$35,612
01/01/95	Prepayment Credit	($3,239,034)	($3,225,191)	$0	($13,843)
	Interest to 12/31//95	$0	$0	$0	$0
12/31/95	CAS Funding Target	$0	$0	$0	$0
	Contribution	($6,600,000)	($6,600,000)	$0	$0
	Interest to 12/31/95	($476,289)	($476,289)	$0	$0
12/31/95	Under (Over) Funding	($7,076,289)	($7,076,289)	$0	$0

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT
CIN: A-07-98-02501

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1992 TO JANUARY 1, 1997

	Description	Total Company	Other Segment	Medicare Segment	FEP Segment
01/01/96	Normal Cost	$6,272,674	$6,152,077	$79,504	$41,093
01/01/96	Amortization Payment	($1,589,568)	($1,530,447)	($47,964)	($11,157)
01/01/96	CAS Pension Cost	$4,683,106	$4,621,630	$31,540	$29,936
01/01/96	Absorbed Credit	($3 1,540)	$0	($31,540)	$0
01/01/96	Prepayment Credit	($4,651,566)	($4,621,630)	$0	($29,936)
	Interest to 12/31//96	$0	$0	$0	$0
12/31/96	CAS Funding Target	$0	$0	$0	$0
	Contribution	($8,351,738)	($8,351,738)	$0	$0
	Interest to 12/3 1 /96	($524,188)	($524,188)	$0	$0
12/31/96	Under (Over) Funding	($8,875,926)	($8,875,926)	$0	$0

FOOTNOTES

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

2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Connecticut'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 separately calculated CAS pension costs for years 1992 through 1996.

4/ We applied one year's interest at the assumed rate of 9.0 percent for years 1992 and 1993 and 8.5 percent for years 1994 through 1996. We obtained the interest rates from the actuarial valuation reports.

ANTHEM BLUE CROSS AND BLUE SHIELD OF CONNECTICUT
CIN: A-07-98-02501

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1992 TO JANUARY 1, 1997

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 3 1.205-6(j).

6/ Connecticut did not make contributions to its pension plan for 1992. However, it did make contributions for years 1993 through 1996. We assigned contributions to the Medicare segment and the FEP 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 absorbed credit (a negative value) in those instances where (1) our computed CAS pension costs were negative or (2) a positive pension cost was fully absorbed by the carry forward of prior period absorbed credit. A prepayment credit is created for years in which contributions are made in excess of the CAS funding target. The prepayment credit is carried forward and applied towards the funding of future CAS pension costs.

9/ In 1992, the Office of Personnel Management requested that Connecticut treat the Federal Employee Program (FEP) cost centers within the Medicare segment as a separate segment and perform separate FEP valuations and CAS cost computations. We determined that all government contracts should be treated similarly, thus we performed a spin-off of the FEP segment from the Medicare segment as of January 1, 1993.

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

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

Anthem Blue Cross and Blue Shield of Connecticut
370 Bassett Road
North Haven, Connecticut 06473-4201
203-239-4911

Anthem.

February 6, 1998

Mr. Jack Mot-man
OIG Office of Audit Services, Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64 106

Re: CIN: A-07-97-02500
CIN: A-07-98-02501
CM: A-07-98-02502

Dear Jack:

This letter responds to the audit of the Medicare segment of the Blue Cross Blue Shield of Connecticut, Inc. Employees' Retirement Plan which was conducted by your office last year. We have reviewed your draft reports and our conclusions follow:

CIN: A-07-97-02500 - Pension Segmentation

- **Participant Transfers -** We do not concur with the reports findings on participant transfers. As you are now aware, BCBS erred when providing you with cost center information and has subsequently provided you with the correction information. We believe the transfer calculations as originally prepared by our actuaries are correct.

- **Federal Employee Program Spin-off -** We agree with your methodology for spinning off assets for the FEP segment, but given that your January 1, 1993 Medicare assets are overstated due to the excessive transfers in 1991 and 1992, the FEP asset spin-off is also overstated.

- **Pension Contributions -** Given that we agree with your methodology for the FEP spin-off, FEP is no longer a sub-segment of the Medicare segment. The FEP segment exists independent of the Medicare segment. Therefore, positive contributions to FEP should not have any impact on the Medicare assets.

- **Earnings and Expenses -** The above stated revisions will affect the earnings and expenses year by year.

CIN: A-07-98-02501 - Unfunded Pension Cost

- **Unallowable Direct Pension Costs -** We concur with your methodology, but a revision of the participant transfer data will affect the amount allocated to the FEP segment.

- BCBS has filed a request with HCFA to allow recapture of the Unallowable Direct Pension Costs and use of the Fresh Start approach. Ifneeded, we will also request use of the $0 floor on pension costs and the reassignment of negative pension costs. Karen Claggett at HCFA, Division of Accounting, has informed us that they will not act on our request until this audit is closed.

- **Unabsorbed Credits -** Recalculation of the CAS pension costs due to revised transfer information will impact the unabsorbed credit amount.

CIN: A-07-98-02502 - CAS Pension Cost Claimed for Medicare Reimbursement

- Revisions to the participant transfer data and the FEP asset spin-off will affect the CAS pension costs for each of the years.

I understand that your are considering whether or not to change the results presented in the draft audit report to reflect the corrected data. We believe that the final audit report should use the corrected data. The corrections will more accurately reflect the actual CAS costs we have incurred. In addition, our actuaries have used the correct data, and will have to revise their records based upon the incorrect data if the audit stays as originally drafted.

Please call me if we can be of additional assistance.

Sincerely,

Phil Finger

Phil Finger

cc: Ronald 0. Schlee