Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE CONTRACTOR'S OVERFUNDED PENSION PLAN, BLUE CROSS AND BLUE SHIELD ASSOCIATION

JUNE GIBBS BROWN
Inspector General

MARCH 1999
A-07-98-02528

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-07-98-02528

MAR 10 1999

Mr. Ralph D. Rambach
Vice-President, Finance and Administration
Blue Cross and Blue Shield Association
225 North Michigan Ave, 5th Floor
Chicago, Illinois 60601-7680

Dear Mr Rambach:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Overfunded Pension Plan, Blue Cross and Blue Shield Association*. The purpose of our review was to update the January 1, 1994 accumulated unabsorbed credits, and to determine the effect of the overfunded pension plan on the calculation and funding of Cost Accounting Standards (CAS) pension costs attributable to the Medicare segment for Plan Years 1994 and 1995.

During our previous review of the Blue Cross and Blue Shield Association (the Association) (CIN: A-07-95-01109), we determined that the Medicare segment accumulated $492,293 in unabsorbed credits as of January 1, 1994. The unabsorbed credits were created by negative CAS pension costs, which resulted from the overfunded status of the Association's pension plan. Our current review shows that the accumulated unabsorbed credits increased to $710,699 as of December 31, 1995. The increase resulted from appreciation on the accumulated unabsorbed credits, and from additional negative CAS pension costs for 1994 and 1995.

The CAS relating to the accounting for pension costs was revised effective March 30, 1995, and became applicable to the Association on January 1, 1996. The revised CAS requires that accumulated unabsorbed credits and negative CAS pension costs be assigned to subsequent accounting periods, as an "assignable cost credit". Additionally, the revised CAS requires that assignable cost credits be amortized over ten years.

We recommend that the Association identify $710,699 as an assignable cost credit, attributable to the Medicare segment, as of January 1, 1996. The Association accepted our recommendations and its response is included in Appendix B.

INTRODUCTION

BACKGROUND

The Association 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 CAS.

Since its inception, Medicare has paid a portion of the annual contribution 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 Cost Accounting Standards Board revised the CAS relating to accounting for pension costs effective March 30, 1995. The new rules became applicable to contractors at the start of their next cost accounting period there after. The revised CAS places a zero floor on pension costs and provides for the reassignment of negative pensions costs. The CAS within 48 CFR 9904.412-50(c)(2)(i) states:

> *"Any amount of computed pension cost that is less than zero shall be assigned to future accounting periods as an assignable cost credit. The amount of pension cost assigned to the period shall be zero."*

The transition provisions of the revised CAS also addresses the treatment of unabsorbed credits that have accumulated in accounting periods prior to the CAS revisions. The CAS within 48 CFR 9904-412-64(b)(1) states:

> *"Any portion of pension cost for a defined-benefit pension plan, assigned to a cost accounting period prior to March 30, 1995, which was not allocated as a cost or price credit to contracts subject to this Standard because such cost was less than zero, shall be assigned to subsequent accounting periods, including an adjustment for interest, as an assignable cost credit."*

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to update the accumulated unabsorbed credits from January 1, 1994 to January 1, 1996, and to determine the effect of the overfunded pension plan on the calculation and funding of CAS pension costs attributable to the Medicare segment for Plan Years 1994 and 1995. Achieving our objective did not require that we review the internal control structure of the Association.

We performed this review in conjunction with our audit of pension segmentation (CIN: A-07-98-02527). The information obtained and reviewed during that audit 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 the Association's historical practices.

We performed site work at The Association's corporate offices in Chicago, Illinois during April 1998. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

ASSIGNABLE COST CREDITS

As of January 1, 1994, the Association had accumulated unabsorbed credits of $492,293 related to its Medicare segment. Our calculation of negative CAS pension costs for 1994 and 1995 resulted in additional unabsorbed credits. As of December 31, 1995 the accumulated unabsorbed credits had increased to $710,670. 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 of pension cost for a cost accounting period are (i) the normal cost of the period, (ii) a part 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 1994 and 1995 included negative net amortization amounts for the unfunded actuarial liability. For both years, the negative net amortization amount exceeded the normal cost for the Medicare segment. As a result, the segment's CAS pension costs were negative. Because funds can not be withdrawn from the pension trust fund, the negative CAS pension costs created unabsorbed credits. The following table shows the accumulation of the unabsorbed credits (Appendix A provides additional information).

DATE	DESCRIPTION	AMOUNT
01/01/94	Accumulated Unabsorbed Credit	$482,293
12/31/94	Interest to Year End (8%)	$38,583
12/31/94	Plan Year 1994 Unabsorbed Credit	$54,996
12/31/94	Accumulated Unabsorbed Credit	$575,872
01/01/95	Accumulated Unabsorbed Credit	$575,872
12/31/95	Interest to Year End (8.5%)	$48,949
12/31/95	Plan Year 1995 Unabsorbed Credit	$85,848
12/31/95	Accumulated Unabsorbed Credit	$710,669

The unabsorbed credit accumulated each year with interest at the plan's assumed interest rate. As of December 31, 1995, the Medicare segment's accumulated unabsorbed credit was $710,669.

The CAS relating to the accounting for pension costs was revised effective March 30, 1995, and became applicable to the Association on January 1, 1996. The revised CAS requires that accumulated unabsorbed credits and subsequent negative CAS pension costs be assigned to future accounting periods, as an assignable cost credit. Consequently, the Association should identify $710,699 as an assignable cost credit, attributable to the Medicare segment, as of January 1, 1996.

Recommendation:

We recommend that the Association:

❶ Identify $710,699 as an assignable cost credit, attributable to the Medicare segment, as of January 1, 1996, and begin amortizing the credit over a ten year period.

❷ Identify negative CAS costs for any subsequent years as an assignable cost credit and amortize them over a ten year period.

Auditee Response

The Association accepted our recommendations.

INSTRUCTION FOR AUDITEE RESPONSE

Final determination as to actions to be taken on all matters reported will be made by the HHS actions official identified on the following page. 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 therin 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

Enclosures

BLUE CROSS AND BLUE SHIELD ASSOCIATION
CHICAGO, ILLINOIS

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1994 TO JANUARY 1, 1996

	Description		Total Company	Other Segment	Medicare Segment
01/01/94	Amortization Payment	1/	($3,612,332)	($3,327,146)	($285,186)
	Normal Cost	2/	1,809,493	1,575,229	234,264
01/01/94	CAS Pension Cost	3/	(1,802,839)	(1,751,917)	(50,922)
	Interest to 12/31/94	4/	(144,227)	(140,153)	(4,074)
12/31/94	CAS Funding Target	5/	(1,947,066)	(1,892,070)	(54,996)
	Contribution	6/	0	0	0
12/31/94	Unabsorbed Credit	7/	($1,947,066)	($1,892,070)	($54,996)

01/01/95	Amortization Payment	($3,350,505)	($3,053,062)	($297,443)
	Normal Cost	1,644,845	1,426,525	218,320
01/01/95	CAS Pension Cost	(1,705,660)	(1,626,537)	(79,123)
	Interest to 12/31/95	(144,981)	(138,256)	(6,725)
12/31/95	CAS Funding Target	(1,850,641)	(1,764,793)	(85,848)
	Contribution	0	0	0
12/31/95	Unabsorbed Credit	($1,850,641)	($1,764,793)	($85,848)

FOOTNOTES TO STATEMENT OF CAS PENSION COSTS AND FUNDING

1/ We based the amortization payment on a CAS amortization schedule developed from information obtained from the Association's valuation reports and IRS Form 5500 reports. The amortization payment was negative because pension assets exceeded actuarial liabilities, thereby creating a negative unfunded actuarial liability. The amount shown for the "other segment" represents the difference between the total company and the Medicare segment.

BLUE CROSS AND BLUE SHIELD ASSOCIATION
CHICAGO, ILLINOIS

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1994 TO JANUARY 1, 1996

2/ We obtained the total company normal costs from the Association's actuarial valuation reports. We obtained normal costs for the Medicare segment from data files provided by the Association's actuary.

3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. The pension costs were negative because the negative amortization payment exceeded the normal costs.

4/ We applied one year's interest at the assumed rates of 8 percent for 1994, and 8.5 percent for 1995 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, normally must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 31.205-6(j). However, because the CAS pension costs were negative for both years, no contributions were required.

6/ The Association did not make contributions to its pension plan for years 1994 and 1995.

7/ Because the CAS funding targets were negative, an unabsorbed credit was created for 1994 and 1995. Beginning January 1, 1996 the Association must identify the accumulated unabsorbed credits as an assignable cost credit, and begin amortizing it over ten years at the valuation interest rate.

BlueCross BlueShield Association

An Association of Independent Blue Cross and Blue Shield Plans

Ralph D. Rambach
Vice President
Finance and Administration

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February 12, 1999

Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII
Department of Health & Human Services
Office of Audit Services
610 East 12th Street
Kansas City, MO 64106

Re: CIN A-07-98-02527
CIN A-07-98-02528

Dear Ms. Bennett:

In response to your letters dated September 2, 1998, regarding the draft audit reports of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled "Review of Medicare Contractor's Overfunded Pension Plan, Blue Cross and Blue Shield Association" and "Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield Association", for the period beginning January 1, 1994 to January 1, 1997, please be advised that we accept the audit recommendations and have undertaken the following steps to implement them:

> **RE: A-07-98-02528** – We have identified $710,699 as an assignable cost credit, attributable to the Medicare segment, as of January 1, 1996, and will begin amortizing the credit over a ten year period. In addition, we will identify any negative CAS costs for any subsequent years as an assignable cost credit and amortize them over a ten year period.
>
> **RE: A-07-98-02527** – We have decreased the January 1, 1997 pension assets of the Medicare segment by $407,043.

Sincerely,

Ralph D. Rambach
Vice President, Finance & Administration