

**Memorandum**

Date AUG 12 1993

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

Subject Review of Unfunded Pension Costs of Pennsylvania Blue Shield
for Fiscal Years 1988 Through 1991 (A-03-93-00016)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

This memorandum alerts you to the issuance on August 13, 1993, of our final audit report. A copy is attached.

The report summarizes the results of our review of unfunded pension costs of Pennsylvania Blue Shield (PBS) for Fiscal Years (FYs) 1988 through 1991. The purpose of our review was to determine the funding status of pension costs claimed for Medicare reimbursement by PBS for Federal FYs 1988 through 1991. The PBS is the Medicare carrier for Pennsylvania, Delaware, New Jersey, and the District of Columbia.

Under the provision of the Medicare contract, pension costs assigned to an accounting period, but not funded by the tax filing deadlines, are not allowable for Medicare reimbursement. Our review showed that PBS did not make contributions to its pension plans for the FYs 1988 through 1991. Contrary to the provisions of the Medicare contract, however, PBS charged Medicare for pension costs totaling \$1,299,419 during that period that were unallowable for Medicare reimbursement. This situation was previously reported in an Office of Inspector General report (A-03-89-02005) in which PBS claimed Medicare reimbursement of \$653,516 for unfunded pension costs in FYs 1986 and 1987.

We are recommending that PBS: (1) revise its Final Administrative Cost Proposals (FACP) for FYs 1988 through 1991 to refund the \$1,299,419 of unfunded pension costs charged to Medicare and (2) ensure that only funded pension costs be included for reimbursement on future FACPs.

We are also recommending that the Health Care Financing Administration (HCFA) establish an accounts receivable in its accounting records in the amount of \$1,299,419 to account for the refund due.

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In a response to our draft report, dated April 30, 1993, PBS is willing to refund \$1,299,419 to HCFA. However, PBS believes that the costs are reimbursable under the terms of its contract and expressed its intent to seek a waiver which would allow PBS to reassign and claim the costs. The HCFA did not provide comments to the draft report.

For further information, contact:

Thomas J. Robertson
Regional Inspector General
for Audit Services, Region III
215-596-6744

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF
UNFUNDED PENSION COSTS OF
PENNSYLVANIA BLUE SHIELD FOR
FISCAL YEARS 1988 THROUGH 1991**



AUGUST 1993 A-03-93-00016



DEPARTMENT OF HEALTH & HUMAN SERVICES

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Our Reference: Common Identification Number A-03-93-00016

Mr. Everett F. Bryant
Senior Vice President, Government Business Unit
Pennsylvania Blue Shield
Post Office Box 632
Camp Hill, Pennsylvania 17011-0632

Dear Mr. Bryant:

This report provides you with the results of our REVIEW OF UNFUNDED PENSION COSTS OF PENNSYLVANIA BLUE SHIELD FOR FISCAL YEARS 1988 THROUGH 1991. The purpose of our review was to determine the funding status of pension costs claimed for Medicare reimbursement by Pennsylvania Blue Shield (PBS) for Federal Fiscal Years (FY) 1988 through 1991. The PBS is the Medicare carrier for Pennsylvania (PA), Delaware (DE), New Jersey (NJ), and the District of Columbia (DC).

Our review disclosed that, although PBS did not make contributions to any of its pension plans for FYs 1988 through 1991, it charged Medicare for pension costs. As of September 30, 1991, PBS had claimed \$1,299,419 in pension costs that were unallowable for Medicare reimbursement. The unallowable costs involve PBS's regular pension plans. Under the provision of the Medicare contract, pension costs assigned to an accounting period, but not funded by the tax filing deadlines, are not allowable for Medicare reimbursement. This situation was previously reported in an Office of Inspector General (OIG) report,¹ in which PBS claimed Medicare reimbursement of \$653,516 for unfunded pension costs in FYs 1986 and 1987.

We are recommending that PBS: (1) revise its Final Administrative Cost Proposals (FACP) for FYs 1988 through 1991 to refund the \$1,299,419 of unfunded pension costs charged to Medicare and (2) ensure that only funded pension costs be included for reimbursement on future FACPs.

¹ Pennsylvania Blue Shield Review of Administrative Costs
October 1, 1985 to September 30, 1987 (CIN: A-03-89-02005)

On April 30, 1993, PBS responded to a draft of this report. In its comments, PBS agreed to refund \$1,299,419 to the Health Care Financing Administration (HCFA). The PBS comments have been summarized and incorporated in this report and are included in their entirety as an appendix.

BACKGROUND

For Medicare reimbursement, pension costs must be: (1) measured, assigned, and allocated in accordance with Cost Accounting Standards (CAS) 412 and 413; and (2) funded as specified by part 31 of the Federal Acquisition Regulations (FAR). The CAS deals with stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods. The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods are substantiated by funding.

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax exemptions under the Employees Retirement Income Security Act of 1974 (ERISA). The ERISA provides for a minimum and a maximum deposit to pension funds as determined each year. The minimum represents a required deposit while the maximum represented the upper limit that can be deducted for income tax purposes for the year for which the deposit is applicable.

Pension costs computed in accordance with CAS represent an assignment of pension costs to specific accounting periods. Historically, CAS pension costs often fell between ERISA minimum and maximum contributions. In addition, before 1986, if CAS pension costs were greater than maximum ERISA contributions, contractors could deposit the CAS amounts in qualified trust funds, claim them as allowable contract costs, and take ERISA maximums as tax deductions. The excess of the CAS amount over the ERISA maximum could be carried forward to future years for tax deductibility. Similarly, if contractors deposited ERISA maximums that were larger than CAS computed amounts, differences could be carried forward to fund allowable contract costs for future years.

The Tax Reform Act of 1986 (TRA '86) changed the effect of making pension plan contributions in excess of ERISA maximums. The ERISA maximum was still the tax deductible limit and the excess could still be carried forward to future years for deductibility. However, TRA '86 imposed an excise tax of 10 percent on contributions in excess of ERISA maximums. The excise tax is cumulative from year to year and applied on a first-in/first-out basis considering carry forward and current year contributions. The excise tax applies to all Medicare intermediaries and carriers regardless of their tax exempt status.

With the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), the Congress took additional action affecting contractors' pension plan contributions to qualified trust funds. Prior to OBRA '87, ERISA's full funding limitation considered accumulated assets and the actuarial liability. If assets equalled or exceeded actuarial liability, then the tax deductible amount was limited to zero.

The OBRA '87 imposed a second more restrictive test to the full funding limitation. It considers the accumulated assets and 150 percent of the amount designated "current liability." The actuarial liability under the pre-OBRA '87 test was based on projected benefits and conservative valuation assumptions. The current liability test of OBRA '87 considers only currently accrued benefits and values the liability using interest rates based on treasury rates. The effect was that most pension plans that were already in full funding would remain there longer. Also, the same effect would push additional plans into full funding.

SCOPE OF AUDIT

Our examination was made in accordance with generally accepted government auditing standards. Our objective was to determine if pension costs claimed by PBS for Medicare reimbursement for FYs 1988 through 1991 were funded in accordance with the FAR for the qualified defined benefit plan. We did not determine if the pension costs were measured, assigned, and allocated in accordance with CAS 412 and 413. Achieving our objective did not require review of the internal control structure of PBS.

Our review consisted of an examination of PBS's actuarial reports for FYs 1988 through 1991 including an analysis of the recommended cash contributions, actual cash contributions, normal pension costs, market value of plan assets, and the actuarial present value of accumulated plan benefits. In addition, we also reviewed PBS' allocation of pension costs to the Medicare program.

Our review was performed from October 1992 to January 1993 at PBS's corporate offices in Camp Hill, Pennsylvania.

RESULTS OF AUDIT

Unfunded Pension Costs Charged to Medicare

Our review showed that PBS improperly included pension costs of \$1,299,419 on its FYs 1988 through 1991 FACPs. During the period, PBS routinely charged the Medicare program an allocated share of the corporate-wide accrued pension cost. However, the allocation was based on the actuarial assumptions and not the actual contribution as required by the FAR. As a result, pension costs of \$1,299,419 allocated to the Medicare program for FYs 1988 through 1991 were unallowable for reimbursement.

During calendar years² 1987 through 1991, PBS accrued, but did not fund, corporate-wide net pension costs of \$13,474,026, as illustrated below:

<u>Year</u>	<u>Amount</u>
1987	\$ 919,642
1988	968,710
1989	2,154,860
1990	5,408,099
1991	<u>4,022,715</u>
Total	<u>\$13,474,026</u>

The PBS did not fund the accrued pension liability for each of these years based on its actuary's recommendation that the actuarial value of its pension plan assets exceeded the liability and, therefore, met the full funding limitations of ERISA and OBRA '87.

The PBS allocated the \$13.4 million in pension liability to its various lines of business (LOBs), including \$1,299,419 to four Medicare LOBs, as shown below:

² Pension costs are accrued by PBS on a calendar year basis, however, charges to Medicare are based on a fiscal year allocation.

<u>FY</u>	<u>PA Medicare</u>	<u>DE Medicare</u>	<u>NJ Medicare</u>	<u>DC Medicare</u>	<u>Total</u>
1988	\$118,430	\$ 6,216	\$ 214	\$ 21,859	\$ 146,719
1989	123,370	7,011	65,666	23,055	219,102
1990	220,446	13,423	130,496	40,117	404,482
1991	<u>269,188</u>	<u>24,588</u>	<u>179,763</u>	<u>55,577</u>	<u>529,116</u>
Total	<u>\$731,434</u>	<u>\$51,238</u>	<u>\$376,139</u>	<u>\$140,608</u>	<u>\$1,299,419</u>

The FAR 48 CFR 31.205-6(j)(2)(i) and (3)(i) state:

To be allowable in the current year, pension costs must be funded by the time set for filing the Federal income tax return or any extension thereof. Pension costs assigned to the current year, but not funded by the tax return time, shall not be allowable in any subsequent years.

Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.

Furthermore, CAS 412, which is incorporated by reference into FAR states:

... for contractors not required to file Federal income tax returns, the date shall be that established for filing Federal corporation income tax returns.

Therefore, since PBS did not contribute the \$1,299,419 to the pension plan within specified time periods, the pension costs are unallowable.

CONCLUSIONS AND RECOMMENDATIONS

The PBS did not contribute to its pension plans during FYs 1988 through 1991, thus avoiding pension plan deposits that were not tax deductible and the 10 percent excise tax. However, in avoiding the tax consequences, PBS lost allowability of the costs under the FAR by not meeting the time limitations imposed on funding pension plans. As a result, the \$1,299,419 in unfunded pension costs PBS claimed as an administrative cost is unallowable for reimbursement under the Medicare program.

We, therefore, recommend that PBS:

1. Reduce its FYs 1988 through 1991 FACP by \$1,299,419 to refund unfunded pension costs charged to Medicare and
2. Ensure that only funded pension costs be included for reimbursement on future FACP's.

We will also recommend that HCFA establish an accounts receivable in its accounting records in the amount of \$1,299,419 to account for the refund due.

PBS Response and Office of Audit Services' Comments

In its response, PBS agreed to refund the \$1,299,419 to HCFA. The PBS stated, however, that it believes these costs were allowable and reimbursable under the Medicare contract, and has discussed with HCFA a waiver of certain FAR and CAS provisions that govern pension costs. Further the CAS Board has proposed certain amendments to the CAS that, if adopted, could permit unfunded pension costs to be recovered in future periods.

The PBS also stated that it had claimed unfunded pension costs on its FY 1992 FACP and its FY 1993 Interim Expense Reports. The PBS stated that it has not reached an agreement with HCFA on how to report these costs to protect its financial interest through the right to appeal, or a waiver, or the potential change in the appropriate CAS provisions.

Based on the PBS response, we have made certain changes to this report. We are pleased to see that PBS agreed to refund the \$1,299,419 to HCFA. With regard to claiming unfunded pension costs in FYs 1992 and 1993, these costs under regulations now in effect are unallowable and should not be claimed under Medicare.

Final determination as to actions to be taken on all matters will be made by the Department of Health and Human Services (HHS) official named below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may have a bearing on the resolution of this audit may be presented at that time. Should you have any questions, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), HHS/OIG Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act, which the Department chooses to exercise. (See section 5.71 of the Department's Public Information Regulation, dated August 1974, as revised.)

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To facilitate identification, please refer to the referenced common identification number in all correspondence relating to this report.

Sincerely yours,

Thomas J. Robertson
Regional Inspector General
for Audit Services

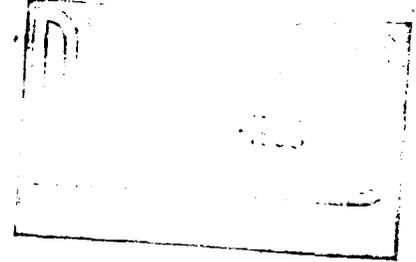
Appendix

HHS Official

Mr. Dennis Carrol
Associate Regional Administrator
Division of Medicare
Health Care Financing Administration
3535 Market Street
Philadelphia, Pennsylvania 19104



April 30, 1993



Mr. Thomas J. Robertson
Regional Inspector General
for Audit Services
Department of Health & Human Services
3535 Market Street, Room 4250
Philadelphia, PA 19104

Dear Mr. Robertson:

Common Identification Number: A-03-93-00016

I am responding to your cover letter of March 3, 1993 which transmitted the draft audit report entitled "Review of Unfunded Pension Costs at Pennsylvania Blue Shield."

We have reviewed the auditors' calculations and agree that \$1,324,487 of pension costs for FY88-91 were charged to Medicare (refer to enclosed schedule). However, the \$1,324,487 included charges to Medicare of \$25,068 for two "Unfunded Pension Plans" (Excess Benefit Plan and Deferred Compensation Supplement Plan).

Both of these plans are unfunded, deferred benefit pension plans for which no funding agency is established for the accumulation of contributions. As such, the Federal Acquisition Regulations (FARs) state in Section 31.205-6 (J)(3)(i)(B) allowable costs for unfunded pension plans, as defined in 31.001, are limited to the amount computed in accordance with 30.412 and 30.413. We do not agree that the \$25,068 charge for the "Unfunded Pension Plans" is an unallowable cost under the Medicare contract. It is our opinion, the FARs do not require "Unfunded Pension Plan" costs assigned to an accounting period to be funded by the tax filing deadline, for those costs to be allowable. Therefore, we are requesting that \$25,068 be deleted from the \$1,324,487 noted in the report. Pennsylvania Blue Shield agrees that \$1,299,419 of pension costs for the Qualified Defined Benefit Plan were charged to the Medicare contract for FY88-91 that were not funded.

Pennsylvania Blue Shield is willing to refund the agreed to amount of pension costs in dispute to HCFA upon receipt of your final audit report. Notwithstanding our agreement to promptly refund these amounts, Pennsylvania Blue Shield believes that such costs are reimbursable under the terms of the Medicare Contract. Therefore, Pennsylvania Blue Shield and staff from the HCFA Central Office have discussed a waiver of certain FAR and CAS provisions that govern pension costs. Also, the CAS Board has proposed certain amendments to the CAS that, if adopted, could permit unfunded pension costs to be recovered in future periods.

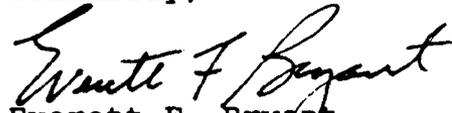
Mr. Thomas J. Robertson
April 30, 1993
Page 2

Appendix
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Recommendation number 2 contained on page 5 of the draft report states: "Ensure that unfunded pension costs will not be included for reimbursement on future FACPs." Pennsylvania Blue Shield has claimed these unfunded pension costs on its fiscal year 1992 FACP and on the year to date IER for fiscal year 1993. We have not reached agreement with HCFA on how to report these costs so that the financial interests of Pennsylvania Blue Shield are protected through the right to appeal, or a waiver, or the potential change in the appropriate CAS provisions.

We appreciate the opportunity to comment on your draft report. Should you have any questions, please contact Ray Eichelberger at (717) 763-3167.

Sincerely,



Everett F. Bryant
Senior Vice President
Government Business

EFB/RRE/mak

Enclosure

PENNSYLVANIA BLUE SHIELD

Medicare Pension Costs
Fiscal Years 1988 - 1991

<u>FY 1988</u>	<u>Qualified Defined Benefit Plan</u>	<u>Excess Benefit Plan</u>	<u>Deferred Comp Supplement Plan</u>	<u>Total</u>
Oct - Dec	\$ 75,005	\$ 0	\$ 0	\$ 75,005
Jan - Mar	24,239	0	0	24,239
Apr - Jun	25,961	0	0	25,961
Jul - Sept	21,514	0	0	21,514
FY 88 Total	\$ 146,719	\$ 0	\$ 0	\$ 146,719
<u>FY 1989</u>				
Oct - Dec	\$ 23,275	\$ 1,669	\$ 0	\$ 24,944
Jan - Mar	49,470	0	0	49,470
Apr - Jun	69,617	0	0	69,617
Jul - Sept	76,740	0	0	76,740
FY 89 Total	\$ 219,102	\$ 1,669	\$ 0	\$ 220,771
<u>FY 1990</u>				
Oct - Dec	\$ 69,798	\$ 4,415	\$ 0	\$ 74,213
Jan - Mar	115,724	0	0	115,724
Apr - Jun	120,941	0	0	120,941
Jul - Sept	98,019	0	0	98,019
FY 90 Total	\$ 404,482	\$ 4,415	\$ 0	\$ 408,897
<u>FY 1991</u>				
Oct - Dec	\$ 208,257	\$ 5,934	\$ 13,050	\$ 227,241
Jan - Mar	117,281	0	0	117,281
Apr - Jun	119,561	0	0	119,561
Jul - Sept	84,017	0	0	84,017
FY 91 Total	\$ 529,116	\$ 5,934	\$ 13,050	\$ 548,100
<u>Total 88 - 91</u>	<u>\$ 1,299,419</u>	<u>\$ 12,018</u>	<u>\$ 13,050</u>	<u>\$ 1,324,487</u>