DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

November 16, 2007

Report Number: A-07-07-00237

Ms. Pamela Bell
Vice President, Government Services
Blue Cross Blue Shield of Georgia
3350 Peachtree Road, NE
Atlanta, Georgia 30326

Dear Ms. Bell:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Audit of Blue Cross Blue Shield of Georgia's Unfunded Pension Costs for 1994 to 2001." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-07-00237 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Tom Lenz, Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, MO 64106

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF BLUE CROSS BLUE SHIELD OF GEORGIA'S UNFUNDED PENSION COSTS FOR 1994 TO 2001

Daniel R. Levinson
Inspector General

November 2007
A-07-07-00237

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Georgia (Georgia) administers Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS).

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The contract specifies segmentation requirements, and requires the separate identification of unfunded costs for the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment.

OBJECTIVES

The objectives of our review were to:

- determine whether the accumulated unfunded pension costs identified in our prior review (A-07-94-00778) were accounted for properly;

- determine whether pension costs for plan years 1994 through 2000 were funded in accordance with the Federal Acquisition Regulation (FAR) and Cost Accounting Standards (CAS); and

- identify and properly account for any additional accumulated unfunded pension costs, including the identification of the unallowable and reassignable portions of the accumulated unfunded pension costs.

SUMMARY OF FINDINGS

Georgia did not properly account for all of the accumulated unfunded pension costs identified in our prior review. For the current audit period, Georgia funded pension costs for plan years 1994 through 1998 and 2000 in accordance with the FAR and CAS. However, in plan year 1999, while Georgia funded pension costs for the Medicare segment, it did not fully fund the pension cost for the Other segment. As such, there were additional unfunded pension costs to identify and update.

The accumulated unfunded pension costs consist of two components: the accumulated reassignable pension costs and the accumulated unallowable pension costs. The reassignable component resulted from pension costs that were not funded because they were not tax deductible. The unallowable component resulted from pension costs that were not funded because the contractor chose not to fund the costs. Georgia correctly handled the accumulated reassignable pension costs but incorrectly updated the unallowable pension cost portion.

As a result of these errors, Georgia understated the accumulated unallowable unfunded pension costs by $1,201,461. As of January 1, 2001, Georgia determined that its accumulated unallowable unfunded pension costs were $0; however, audited costs were $1,201,461 ($88,452 for the Medicare segment plus $1,113,009 for the Other segment).

RECOMMENDATIONS

We recommend that Georgia:

- identify $1,201,461 of accumulated unallowable unfunded pension costs ($88,452 as an unallowable component of Medicare segment pension costs and $1,113,009 as an unallowable component of the Other segment pension costs) as of January 1, 2001; and

- properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

AUDITEE'S COMMENTS

In written comments on our draft report, Georgia concurred with our recommendations. Georgia's response is included in its entirety as the Appendix.

INTRODUCTION

BACKGROUND

Georgia and Medicare

Blue Cross Blue Shield of Georgia (Georgia) administers Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS).

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. The payments are allowable pension costs under the Federal Acquisition Regulation (FAR) and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated Cost Accounting Standards (CAS) 412 and 413.

Cost Accounting Standards

The CAS works to ensure stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, published revisions to those portions of the CAS that dealt with accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the postrevision standards as the revised CAS. Applicable portions of the revised CAS are discussed in a later section.

CAS within 48 CFR § 9904.412-50(a)(2) states that ". . . 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. . . ."

Also, the CAS within 48 CFR § 9904.412-40(c) imposes the fundamental requirement for assigning pension costs: "Except costs assigned to future periods by 9904.412-59(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period."

Federal Acquisition Regulation

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. The FAR within 48 CFR § 31.205-6(j)(1)(i), states that ". . . the contractor shall fund pension costs by the time set for the filing of the Federal income tax return or any extension. Pension costs assigned to the current year, but not funded by the tax return time, are not allowable in any subsequent year."

Conflict between the Federal Acquisition Regulation Funding Requirement and Tax Limits

Pension costs computed in accordance with CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act of 1974 (ERISA), which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code. Under tax laws in effect prior to 1986, employers could fund the CAS contribution in excess of the tax-deductible limit, and any excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded CAS computed amounts, the excess funding could be carried forward as a prepayment credit 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 the tax-deductible limit. TRA 86 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. This excise tax is cumulative from year to year and is applied on a first-in/first-out basis considering carry-forwards and current year contributions. With its implementation, contractors faced a conflict between plan funding limits and the period assignment provisions of the CAS. The effect of this conflict was that contractors did not fund CAS pension costs because the funding (i.e. contributions) lacked tax deductibility.

The Omnibus Budget Reconciliation Act of 1987 added a "current liability" full funding limitation that lowered the tax-deductible limit for many plans, exacerbating the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund the CAS pension cost without incurring excise tax penalties, yet the FAR provided that unfunded CAS costs could not be carried forward to future years. However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than the CAS cost was a voluntary financial action.

Revised Cost Accounting Standards

As previously noted, CAS that related to accounting for pension costs was revised on March 30, 1995 and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS remedies the regulatory conflict between the funding limits of ERISA of 1974 and the period assignment provisions of CAS. The transition provisions of the new rule (48 CFR § 9904.412-64) allow the reassignment of prior period pension costs, with interest, which had not been funded because they lacked tax deductibility. The contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The CAS revision does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA. If a contractor could in past periods have funded pension costs but chose not to, then those costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to:

- determine whether the accumulated unfunded pension costs identified in our prior review (A-07-94-00778) were accounted for properly;

- determine whether pension costs for plan years 1994 through 2000 were funded in accordance with the FAR and CAS; and

- identify and properly account for any additional accumulated unfunded pension costs, including the identification of the unallowable and reassignable portions of the accumulated unfunded pension costs.

Scope

Our review covered the period of plan years 1994 through 2000. Achieving our objectives did not require that we review Georgia's internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with the FAR and CAS.

We performed fieldwork at Georgia's office in Atlanta, Georgia, during March 2007.

Methodology

The CMS Office of the Actuary developed the methodology used for computing CAS pension costs based on Georgia's historical practices.

In performing our review, we used information provided by Georgia's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Georgia's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, CMS Office of the Actuary staff calculated the assignable CAS pension costs for each year of the period 1994 through 2000 for both the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment. Additionally, the CMS Office of the Actuary staff determined the extent to which Georgia funded those costs with contributions to the pension trust fund. We reviewed the methodology for the calculations and updated Georgia's unfunded pension costs for the years 1994 through 2000 for both the Medicare segment and the Other segment.

We performed this review in conjunction with our audits of Medicare segmentation (A-07-07-00236) and pension costs claimed for Medicare reimbursement (A-07-07-00238). The information obtained and reviewed during those audits was also used in performing this review.

We performed our review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Georgia did not properly account for all of the accumulated unfunded pension costs identified in our prior review. For the current audit period, Georgia funded pension costs for plan years 1994 through 1998 and 2000 in accordance with the FAR and CAS. However, in plan year 1999, while Georgia funded pension costs for the Medicare segment, it did not fully fund the pension cost for the Other segment. As such, there were additional unfunded pension costs to identify and update.

The revised CAS requires the identification of the two components of the accumulated unfunded pension costs – the accumulated reassignable pension costs and the accumulated unallowable pension costs. Georgia correctly handled the accumulated reassignable pension costs but incorrectly updated the unallowable pension cost portion. As of January 1, 2001, Georgia determined that its accumulated unallowable pension costs were $0; however, audited costs were $1,201,461 ($88,452 for the Medicare segment plus $1,113,009 for the Other segment).

Effective January 1, 1996, the revised CAS allows the assignment of prior period pension costs, with interest, which previously were not funded because they lacked tax deductibility as accumulated reassignable pension costs. However, the revision to the CAS does not remove the requirement to fund pension costs when contributions are tax deductible. As stated earlier, if a contractor could have funded pension costs and chose not to, then the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and CAS.

Georgia did not ensure that unallowable pension costs from either our prior audit period or the current audit period were identified and accounted for properly in accordance with CAS requirements. As a result, Georgia understated the January 1, 2001, accumulated unallowable pension costs by $1,201,461 ($88,452 for the Medicare segment plus $1,113,009 for the Other segment).

RECOMMENDATIONS

We recommend that Georgia:

- identify $1,201,461 of accumulated unallowable unfunded pension costs ($88,452 as an unallowable component of Medicare segment pension costs and $1,113,009 as an unallowable component of the Other segment pension costs) as of January 1, 2001; and

- properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

AUDITEE’S COMMENTS

In written comments on our draft report, Georgia concurred with our recommendations. Georgia’s response is included in its entirety as the Appendix.

APPENDIX

BlueCross BlueShield of Georgia

Blue Cross and Blue Shield of Georgia
3350 Peachtree Road, NE; P.O. Box 4445
Atlanta, Georgia 30326
An Independent Licensee of The Blue Cross and Blue Shield Association

A CMS Contracted Intermediary

MEDICARE

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November 9, 2007

Mr. Patrick J. Cogley
Regional Inspector General
Office of Inspector General
Office of Audit Services/Regional VII
601 East 12th Street, Room 284A
Kansas City, MO 64106

RE: Report Number: A-07-07-00237

Dear Mr. Cogley:

I am writing to provide comments related to the U.S. Department of Health and Human Services, Office of Inspector General (OIG) draft report. The report is entitled "Audit of Blue Cross Blue Shield of Georgia's Unfunded Pension Costs for 1994 to 2001".

Blue Cross Blue Shield of Georgia (BCBSGA) concurs with the one finding identified in the report. Therefore, BCBSGA will identify \$1,201,461 of accumulated unallowable unfunded pension costs (\$88,452 as an unallowable component of Medicare segment pension costs and \$1,113,009 as an unallowable component of the Other segment pension costs) as of January 1, 2001. Further, BCBSGA will properly identify, and update with interest, unallowable unfunded pension costs in subsequent years.

If you have questions, please contact Art Ellis at (404) 842-8742 or via e-mail at aellis@bcbsga.com.

Sincerely,

Pamela F. Bell

Pamela F. Bell, Vice President
Government Services

PFB/ae

CMS
CENTERS for MEDICARE & MEDICAID SERVICES