

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW
OF
UNFUNDED PENSION COSTS OF
BLUE CROSS AND BLUE SHIELD
OF FLORIDA**



JUNE GIBBS BROWN
Inspector General

DECEMBER 1995
CIN: A-07-95-01126



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

CIN: A-07-95-01 126

December 7, 1995

Mr. Rick Kibler
Director of Internal Audit
Blue Cross and Blue Shield of Florida
P.O. Box 1798 - JMA-3
Jacksonville, Florida 32231-0014

Dear Mr. Kibler:

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 Blue Cross and Blue Shield of Florida*. The purpose of our review was to compute interest on the January 1, 1990 accumulated unfunded pension costs and to determine if pension costs for Plan Years 1990 through 1993 were funded in accordance with the Federal Acquisition Regulations (FAR).

During our previous review of Blue Cross and Blue Shield of Florida (Florida) (CIN: A-07-91-00473), we determined that the Medicare segment accumulated \$2,378,198 in unfunded pension costs as of January 1, 1990. Our current review showed that Florida did not make contributions to the pension trust fund for Plan Years 1990 and 1991. Accordingly, Florida did not fund the pension costs identifiable with its Medicare segment for these years. In addition, the 1993 contribution did not fully fund the entire pension cost. As a result, accumulated unfunded pension costs increased by \$4,049,889 to \$6,428,087 as of January 1, 1994. Florida must separately identify and eliminate \$6,428,087 from the amortization components of future pension costs. Florida agreed with the recommendations. Florida's response is included in its entirety 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 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 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, 1990 to January 1, 1994. Our objective also included identifying appreciation on the unfunded pension costs previously reported. Achieving our objective did not require that we review the internal control structure of Florida.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-94-01 107) and pension costs claimed for Medicare reimbursement (CIN: A-07-95-01125). 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 Florida's historical practices.

We performed site work at Florida's corporate offices in Jacksonville, Florida during September 1994. Subsequently, we performed audit work in our Jefferson City, Missouri Office.

FINDING AND RECOMMENDATIONS

As of January 1, 1994, Florida had accumulated \$6,428,087 in unallowable direct pension costs related to its Medicare segment. These costs included \$4,049,889 in unfunded pension cost and imputed interest over and above the \$2,378,198 identified in our previous audit. At the recommendation of its actuary, Florida did not make contributions in 1990 and 1991 because the pension plan was fully funded. Florida also underfunded the 1993 CAS costs by \$59,808.

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.

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 \$6,428,087 as of January 1, 1994. The following table shows the unfunded amounts, and interest, which are unallowable on a cumulative basis.

Unfunded CAS Pension Costs and Interest

<u>Year</u>	<u>Unfunded CAS Costs</u>	<u>Interest To 1/1/94</u>	<u>Total As Of 1/1/94</u>
Prior			
Accumulated	\$2,378,198	\$ 963,423	\$3,341,621
1990	1,246,813	360,439	1,607,252
1991	1,200,191	219,215	1,419,406
1992 ^{1/}	0	0	0
1993	<u>59,808</u>	<u>0</u>	<u>59,808</u>
Total	<u>\$4,885,010</u>	<u>\$1,543,077</u>	<u>\$6,428,087</u>

^{1/} In Plan Year 1992, Florida's plan contribution fully funded the CAS pension cost

Our computation of the unfunded amounts plus interest considers those costs which should have been funded for the applicable years. In other words, if Florida 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 Florida:

- 0 Identify \$6,428,087 (\$2,378,198 determined in prior audit plus \$4,049,889) as an unallowable component of direct pension costs as of January 1, 1994.
- ② Annually update the unallowable pension cost component related to the accumulated unfunded CAS costs as of January 1, 1994.
- ③ Update unfunded pension costs for any subsequent years unallowable costs are identified.

Auditee Response

Florida agreed with the recommendations. Florida anticipates filing a request to amortize the unfunded pension costs.

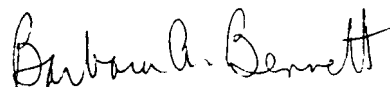
INSTRUCTIONS FOR AUDITEE RESPONSE

Final determination as to actions to be taken on all matters reported will be made by the HHS action official identified below. 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 identified on the following page, presenting any comments or additional information that you believe may have a bearing on final determination.

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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 in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

Sincerely,



Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII

Enclosures

HHS Action Official:

Mr. Clarence J. Boone
Acting Regional Administrator, Region IV
Health Care Financing Administration
101 Marietta Street
Atlanta, Georgia 30023

BLUE CROSS AND BLUE SHIELD OF FLORIDA
JACKSONVILLE, FLORIDA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1990 TO JANUARY 1, 1994

Description		Total Company	Other Segment	Medicare Segment
01/01/90	Amortization Payment	<u>1/</u> \$ 331,801	\$ 247,524	\$ 84,277
	Normal Cost	<u>2/</u> 4,057,505	2,997,917	1,059,588
01/01/90	CAS Pension Cost	<u>3/</u> 4,389,306	3,245,441	1,143,865
	Interest to 12/31/90	<u>4/</u> 395,038	292,090	102,948
12/31/90	CAS Funding Target	<u>5/</u> 4,784,344	3,537,531	1,246,813
	Contribution	<u>6/</u> 0	0	0
	Interest to 12/31/90	<u>7/</u> 0	0	0
12/31/90	Unfunded Pension Cost	<u>8/</u> \$4,784,344	\$3,537,531	\$1,246,813
01/01/91	Amortization Payment	\$ (365,742)	\$ (359,839)	\$ (5,903)
	Normal Cost	4,405,175	3,298,179	1,106,996
01/01/91	CAS Pension Cost	4,039,433	2,938,340	1,101,093
	Interest to 12/31/91	363,549	264,451	99,098
12/31/91	CAS Funding Target	4,402,982	3,202,791	1,200,191
	Contribution	0	0	0
	Interest to 12/31/91	0	0	0
12/31/91	Unfunded Pension Cost	\$4,402,982	\$3,202,791	\$1,200,191
01/01/92	Amortization Payment	\$ (522,294)	\$ (386,567)	\$ (135,727)
	Normal Cost	5,412,332	4,159,400	1,252,932
01/01/92	CAS Pension Cost	4,890,038	3,772,833	1,117,205
	Interest to 12/31/92	440,103	339,555	100,548
12/31/92	CAS Funding Target	5,330,141	4,112,388	1,217,753
	Contribution	(5,571,012)	(4,298,228)	(1,272,784)
	Interest to 12/31/92	0	0	0
12/31/92	Unfunded Pension Cost	<u>9/</u> \$ (240,871)	\$ (185,840)	\$ (55,031)
01/01/93	Amortization Payment	\$ 572,827	\$ 508,947	\$ 63,880
	Normal Cost	6,557,351	5,096,582	1,460,769
01/01/93	CAS Pension Cost	7,130,178	5,605,529	1,524,649
	Prepayment Credit	<u>10/</u> (240,871)	(185,840)	(55,031)
	Interest to 12/31/93	585,591	460,673	124,918
12/31/93	CAS Funding Target	7,474,898	5,880,362	1,594,536
	Contribution	(6,996,899)	(5,504,329)	(1,492,570)
	Interest to 12/31/93	(197,631)	(155,473)	(42,158)
12/31/93	Unfunded Pension Cost	\$ 280,368	\$ 220,560	\$ 59,808

BLUE CROSS AND BLUE SHIELD OF FLORIDA
JACKSONVILLE, FLORIDA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1990 TO JANUARY 1, 1994

FOOTNOTES

- 1/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Florida'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. The amount shown for the "other segment" represents the difference between the total company and the Medicare segment.
- 2/ We obtained the total company normal costs from Florida's actuarial valuation reports. We obtained normal costs for the Medicare segment from data files provided by Florida's actuary.
- 3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. We separately calculated the Medicare segment's CAS pension costs for years 1990 through 1994.
- 4/ We applied one year's interest at the assumed rate reported in the actuarial valuation reports. For 1990 through 1992, the interest rate is 9.0 percent. For 1993, the interest rate is 8.5 percent. 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 3 1.205-6(j).
- 6/ Florida did not make contributions to its pension plan for years 1990 and 1991. However, they did make contributions to the pension plan for years 1992 and 1993. We assigned contributions to the Medicare segment based on a ratio of the 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 rate of interest (see footnote 4/).
- 8/ The unfunded pension cost represents the CAS funding target less the value of contributions.

BLUE CROSS AND BLUE SHIELD OF FLORIDA
JACKSONVILLE, FLORIDA

STATEMENT OF CAS PENSION COSTS AND FUNDING

FOR THE PERIOD
JANUARY 1, 1990 TO JANUARY 1, 1994

- 9/ 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.
- 10/ 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.



P O Box 1798, JMA-3
Jacksonville FL 32231-0014
(904) 791-6111

July 7, 1995

Ms. Barbara A. Bennett
Regional Inspector General for Audit Services, Region VII
Office of Inspector General
Office of Audit Services
601 East 12th Street
Kansas City, Missouri 64106

Re: Review of Pension Costs Claimed For Medicare Reimbursement CIN: A-07-95-01 125
Review of Unfunded Pension Costs CIN: A-07-95-01 126
Review of Medicare Contractor's Pension Segmentation CIN: A-07-94-01 107

Dear Ms. Bennett:

We have reviewed the drafts of the three audit reports referenced above. This letter will serve to document Blue Cross and Blue Shield of Florida's response. Due to the technical nature of the review, we have relied heavily on our consultants from the National Employee Benefits Administration (NEBA) and our actuary from The Wyatt Company. The page numbers below correspond to the page numbers in the draft reports.

- 0 CIN: A-07-95-01 125 Pension Costs Claimed For Medicare Reimbursement (Recommendation - page 4) We recommend that Florida: Revise its FACPs for Fiscal Years 1992 and 1993 to claim \$216,113 in allowable CAS pension costs.

Response: The Plan agrees that it did not fully claim its pension costs for Fiscal Year 1992. It anticipates that it will request reimbursement for those costs for which it is entitled to submit claims. Additionally it is continuing to review whether it agrees with the finding that \$853,847 in pension costs should be disallowed for Fiscal Year 1993.

- 0 CIN: A-07-95-01 126 Unfunded Pension Costs (Recommendation - page 5) We recommend that Florida: Identify \$6,428,087 (\$2,378,198 determined in prior audit plus \$4,049,889) as an unallowable component of direct pension costs as of January 1, 1994.

Annually update the unallowable pension cost component related to the accumulated unfunded CAS costs as of January 1, 1994.

Update unfunded pension costs for any subsequent years unallowable costs are identified.

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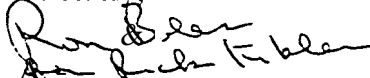
Response: The Plan agrees that it did not make contributions in 1990 and 1991 and that it under-funded the 1993 CAS pension costs by \$59,808. In accord with recent changes to the Cost Accounting Standards, BCBSF anticipates filing a request to amortize the eligible unfunded pension costs. It also agrees that it should identify, as an unallowable component of direct pension costs as of January 1, 1994, those pension costs that will remain unfunded following resolution of its request. Additionally, the Plan agrees with the last two recommendations.

- 0 CIN: A-07-94-01 107 Medicare Contractor's Pension Segmentation
(Recommendation - page 6) We recommend that Florida:
Increase the pension assets of the Medicare segment by \$813,122 (\$432,579 plus \$380,543) as of January 1, 1994.

Response: The Plan agrees with the recommendation.

If you have additional questions, please do not hesitate to call me at (904) 363-4661 or Ken Perkins at (904) 363-4662.

Sincerely,



Rick Kibler

Audit Director

Internal Audit Division

RAb/rab

(RAB05552)