Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF UNFUNDED PENSION COSTS OF BLUE CROSS AND BLUE SHIELD OF OREGON

JUNE GIBBS BROWN
Inspector General

OCTOBER 1995
CIN: A-07-95-01151

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-07-95-01 151

October 25, 1995

Ms. Lisa Johnson, Controller
Blue Cross and Blue Shield of Oregon
100 SW Market Street
P.O. Box 1271
Portland, Oregon 97207- 127 1

Dear Ms. Johnson:

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 Oregon.* The purpose of our review was to determine if pension costs for Plan Years 1986 through 1994 were funded in accordance with the Federal Acquisition Regulations (FAR).

Blue Cross and Blue Shield of Oregon (Oregon) did not make contributions to the pension trust fund for Plan Years 1988 through 1990. Accordingly, Oregon did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Oregon accumulated unfunded pension costs of $260,335 as of January 1, 1995. Oregon must separately identify and eliminate this amount from the amortization components of future pension costs. Oregon agreed that there are accumulated unfunded pension costs of $260,335 as of January 1, 1995. Oregon'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 EIUSA 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 pushed 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, 1986 to January 1, 1995. Achieving our objective did not require that we review the internal control structure of Oregon.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-95-01150) and pension costs claimed for Medicare reimbursement (CIN: A-07-95-01153). 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 Oregon's historical practices.

We performed site work at Oregon's corporate offices in Portland, Oregon during May 1995. Subsequently, we performed audit work in our Jefferson City, Missouri Office.

FINDING AND RECOMMENDATIONS

As of January 1, 1995, Oregon had accumulated $260,335 in unallowable direct pension costs related to its Medicare segment. These costs represent unfunded pension costs and imputed interest for Plan Years 1986 through 1994.

Oregon did not make contributions to the pension trust fund in Plan Years 1988 through 1990 because the pension plan was fully funded. Oregon's actuary recommended in the actuarial valuation reports for those years that the plan not be funded.

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. In addition, the unfunded costs cannot be claimed in future cost accounting periods.

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 $260,335 for plan years 1986 through 1994. The following table shows the unfunded amounts, and interest, which are unallowable on a cumulative basis.

Unfunded CAS Pension Costs and Interest

Year	Unfunded CAS Costs	Interest To 1/1/95	Total As Of 1/1/95
1986	$ 3,126	$ 2,988	$ 6,114
1987	56,415	45,298	101,713
1988	32,937	21,544	54,481
1989	30,982	16,034	47,016
1990	17,586	6,900	24,486
1991	20,767	5,758	26,525
1992	0	0	0
1993	0	0	0
1994	0		
Total	$161,813	$98,521:	$260.33:

Our computation of the unfunded amounts plus interest considers those costs which should have been funded for the applicable years. In other words, if Oregon funded the costs, the assets of the hledicare segment would have been greater. Appendix A provides additional information on the CAS pension costs.

Recommendations

We recommend that Oregon:

1. Identify $260,335 as an unallowable component of direct pension costs as of January 1, 1995.

2. Update annually the unallowable pension cost component related to the unfunded CAS costs for Plan Years 1986 through 1994.

3. Identify and update unfunded pension costs for any later years in a similar manner.

Auditee Response

Oregon agreed with the recommendation that there are accumulated unfunded pension costs of $260,335 as of January 1, 1995. Oregon plans to seek a reassignment of these unfunded pension costs under the revised CAS 412 and 413.

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. Additionally, the new rule will allow the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. 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 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.

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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 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

Enclosures

HHS Action Official:

Ms. Nancy Dapper
Regional Administrator, Region X
Health Care Financing Administration
2201 Sixth Ave.
Mail Stop RX40
Seattle, Washington 98121-2500

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 15 1

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1995

Description		Total Company	Other Segment	Medicare Segment
01/01/86 Normal Cost	1/	$870,583	$828,764	$41,819
01/01/86 Amortization Payment	2/	(484,982)	(467,859)	(17,123)
01/01/86 CAS Pension Cost	3/	385,601	360,905	24,696
Interest to 12/31/86	4/	34,704	32,481	2,223
12/31/86 CAS Funding Target	5/	420,305	393,386	26,919
Contribution	6/	(354,116)	(331,436)	(22,680)
Interest to 12/31/86	7/	(17,376)	(16,263)	(1,113)
12/31/86 Unfunded Pension Cost	8/	$ 48,813	$45,687	$ 3,126
01/01/87 Normal Cost		$1,294,860	$1,221,184	$73,676
0 1 /01/87 Amortization Payment		(231,991)	(222,548)	(9,443)
01/01/87 CAS Pension Cost		1,062,869	998,636	64,233
Interest to 12/31/87		90,344	84,884	5,460
12/31/87 CAS Funding Target		1,153,213	1,083,520	69,693
Contribution		(216,626)	(203,535)	(13,091)
Interest to 12/31/87		(3,088)	(2,901)	(187:)
12/31/87 Unfunded Pension Cost		**$ 933,499**	$ 877,084	**$56,415**
01/01/88 Normal Cost		$1,191,907	$1,121,617	$70,290
01/01/88 Amortization Payment		(678,053)	(637,980)	(40,073)
01/01/88 CAS Pension Cost		513,854	483,637	30,217
Interest to 12/31/88		46,247	43,527	2,720
12/31/88 CAS Funding Target		560,101	527,164	32,937
Contribution		0	0	0
Interest to 12/31/88		0	0	0
12/31/88 Unfunded Pension Cost		$ 560.101	$ 527.164	$32,937

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 151

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1995

Description	Total Company	Other Segment	Medicare Segment
01/01/89 Normal Cost	$1,440,492	$1,365,865	$74,627
0 1/0 1 /89 Amortization Payment	(640,114)	(593,911)	(46,203)
01/01/89 CAS Pension Cost	800,378	77 1,954	28,424
Interest to 12/3 1 /89	72,034	69,476	2,558
12131189 CAS Funding Target	872,412	84 1,430	30,982
Contribution	0	0	0
Interest to 12/3 1 /89	0	0	0
12/31/89 Unfunded Pension Cost	$ 872,412	$ 841,430	$30,982
01/01/90 Normal Cost	$1,684,956	$1,612,629	$72,327
0 1 /01/90 Amortization Payment	(746,789)	(690,596)	(56,193)
01/01/90 CAS Pension Cost	938,167	922,033	16,134
Interest to 12/3 1 /90	84,435	82,983	1,452
12/3 1 /90 CAS Funding Target	1,022,602	1,005,016	17,586
Contribution	0	0	0
Interest to 12/3 1 /90	0	0	0
12/31/90 Unfunded Pension Cost	$1,022,602	$1,005,016	$17,586
01/01/91 Normal Cost	$1,868,337	$1,777,811	$90,526
0 1 /0 1 /9 1 Amortization Payment	(730,773)	(673,902)	(56,871)
01/01/91 CAS Pension Cost	1,137,564	1,103,909	33,655
Interest to 12/31/91	102,381	99,352	3,029
12/31/91 CAS Funding Target	1,239,945	1,203,261	36,684
Contribution	(530,502)	(514,807)	(15,695)
Interest to 12/3 1 /9 1	(7,520)	(7,298)	(222)
12/31/91 Unfunded Pension Cost	$ 701,923	$ 681.156	$20.767

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01151

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1995

Description		Total Company	Other Segment	Medicare Segment
01/01/92 Normal Cost		$2,044,654	$1,949,125	$95,529
01/01/92 Amortization Payment		(701,643)	(647,716)	(53,927)
01/01/92 CAS Pension Cost		1,343,011	1,301,409	41,602
Interest to 12/31/92		120,871	117,127	3,744
12/31/92 CAS Funding Target		1,463,882	1,418,536	45,346
Contribution		(1,606,488)	(1,556,724)	(49,764)
Interest to 12/31/92		(17,133)	(16,602)	(531)
12/31/92 Unfunded Pension Cost	9/	($ 159,739)	($ 154,790)	**($ 4,949)**
01/01/93 Normal Cost		$2,325,084	$2,214,823	$110,261
01/01/93 Amortization Payment		(372,487)	(335,380)	(37,107)
01/01/93 CAS Pension Cost		1,952,597	1,879,443	73,154
01/01/93 Prepayment Credit	10/	(159,739)	(154,790)	(4,949)
Interest to 12/31/93		152,393	146,596	5,797
12/31/93 CAS Funding Target		1,945,251	1,871,249	74,002
Contribution		(3,187,726)	(3,066,456)	(121,270)
Interest to 12/31/93		(79,065)	(76,057)	(3,008)
12/31/93 Unfunded Pension Cost		($1,321,540)	($1,271,264)	**($ 50,276)**
01/01/94 Normal Cost		$2,722,156	$2,607,167	$114,989
01/01/94 Amortization Payment		11,019	35,733	(24,714)
01/01/94 CAS Pension Cost		2,733,175	2,642,900	90,275
01/01/94 Prepayment Credit		(1,321,540)	(1,271,265)	(50,275)
Interest to 12/31/94		112,931	109,731	3,200
12/31/94 CAS Funding Target		1,524,566	1,481,366	43,200
Contribution		(4,163,440)	(4,045,465)	(117,975)
Interest to 12/31/94		(107,816)	(104,761)	(3,055)
12/31/94 Unfunded Pension Cost		($2,746,690)	($2,668,860)	**($ 77,830)**

BLUE CROSS AND BLUE SHIELD OF OREGON
Portland, Oregon
CIN: A-07-95-01 151

STATEMENT OF CAS PENSION COSTS AND FUNDING
JANUARY 1, 1986 TO JANUARY 1, 1995

FOOTNOTES

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

2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Oregon'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 allocated the CAS pension cost to the Medicare segment based on the ratio of the individual participant's normal cost and accrued liability to the total company normal cost and accrued liability for years 1986 and 1987. We separately calculated CAS pension costs for years 1988 through 1994.

4/ We applied one year's interest at the assumed rate of 9.0 percent for years 1986 and 1988 through 1992, 8.5 percent for 1987 and 1993, and 8 .O percent for 1994 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, must be funded by current and prepaid contributions to satisfy the allowability criteria of FAR, section 3 1.205-6(j).

6/ Oregon did not make contributions to its pension plan for years 1988, 1989, and 1990. However, it did make contributions to the pension plan for years 1986, 1987, and 1991 through 1994. We assigned contributions to the Medicare 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.

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.

BlueCross BlueShield of Oregon

100 SW Market Street
PO Box 1271
Portland, Oregon 97207-1271

503/225-5221
1-800-452-7278

HMO Oregon
(Formerly Capitol Health Care)

October 10, 1995

Ms. Barbara A. Bennett
Regional Inspector General for Audit Services
Region VII
Office of Inspector General
Department of Health and Human Services
601 East 12th Street
Room 284 A
Kansas City, MO 64106

Re: CM: A-07-95-01 150
A-07-95-01151
A-07-95-01 153

Dear Ms. Bennett:

We have reviewed the draft findings of the Office of Inspector (OIG) Medicare Audit.

We agree with the recommendation (CIN: A-07-95-01150) that Blue Cross and Blue Shield of Oregon adjust the Medicare segment allocation by increasing the segment assets by $191,312 as of January 1, 1994.

We agree with the recommendation (CIN: A-07-95-01 15 1) that there are accumulated unfunded pension costs of $260,335 as of January 1, 1995. After the final drafts have been issued, we will be seeking a reassignment of these costs under the revised CAS 412 and 413. At that time, we will work with HCFA's Office of the Actuary and Blue Cross and Blue Shield Association to reassign these costs to future periods.

We also agree with the findings (CM: A-07-95-01153) that for fiscal years 1993 and 1994 an additional $45,664 may be claimed for reimbursement. After the final audits have been issued, we will take the necessary steps to reflect these findings.

Sincerely,

Lisa L. Johnson

Lisa L. Johnson, CPA
Controller

cc: Steve Hooker
Jim Verdick
Ronald L. Solomon, HCFA, Office of Actuary, Baltimore
Richard M. Snow, HCFA
Robert Rhodes, BCBSA
Carol Navin, BCBSA, NEBA