Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

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

JUNE GIBBS BROWN
Inspector General

JANUARY 1996
CIN: A-07-95-01166

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-07-95-01 166

January 29, 1996

Mr. Duane Wilson, Controller
Blue Cross and Blue Shield of Nebraska
P.O. Box 3248
Main Post Office Station
Omaha, Nebraska 68180-0001

Dear Mr. Wilson:

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** Nebraska.* 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 Nebraska (Nebraska) did not make contributions to the pension trust fund for Plan Years 1987 through 1992. Accordingly, Nebraska did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Nebraska accumulated unfunded pension costs of $73,509 as of January 1, 1995. Nebraska must separately identify and eliminate this amount from the amortization components of future pension costs. Nebraska accepted our recommendation and its 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 31 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 imposed a second more restrictive test to the full funding limitation. It considered 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 considered only currently accrued benefits and valued 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, 1986 to January 1, 1995. Achieving our objective did not require that we review the internal control structure of Nebraska.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-95-01159) and pension costs claimed for Medicare reimbursement (CIN: A-07-95-01 167). 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 Nebraska's historical practices.

We performed site work at Nebraska's corporate offices in Omaha, Nebraska during June 1995. Subsequently, we performed audit work in our Kansas City, Missouri Office.

FINDING AND RECOMMENDATIONS

As of January 1, 1995, Nebraska had accumulated $73,509 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.

Nebraska did not make contributions to the pension trust fund in Plan Years 1987 through 1992 because the pension plan was fully funded. In the actuarial valuation report for those years, Nebraska's actuary recommended 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 $73,509 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 12/31/94	Total As Of 12/31/94
1986	$ 0	$ 0	$ 0
1987	3,178	2,552	5,730
1988	6,940	4,539	11,479
1989	4,084	2,114	6,198
1990	9,086	3,564	12,650
1991	13,638	3,781	17,419
1992	17,097	2,936	20,033
1993	0	0	0
1994	0	0	0
Total	$54,023	$19,486	$73,509

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

1. Identify $73,509 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

Nebraska accepted our recommendations.

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:

Mr. Joe L. Tilghman
Regional Administrator, Region VII
Health Care Financing Administration
601 East 12th Street, Room 235
Kansas City, Missouri 64106

BLUE CROSS AND BLUE SHIELD OF NEBRASKA
Omaha, Nebraska
CIN: A-07-95-01 166

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/	$ 342,103	$ 324,472	$ 17,631
01/01/86 Amortization Payment	2/	(358,260)	(342,056)	(16,204)
01/01/86 CAS Pension Cost	3/	(16,157)	(17,584)	1,427
Interest to 12/31/86	4/	(1,454)	(1,582)	128
12/31/86 CAS Funding Target	5/	(17,611)	(19,166)	1,555
Contribution	6/	(119,026)	(117,559)	(1,467)
Interest to 12/31/86	7/	(7,137)	(7,049)	(88)
12/31/86 Unfunded Pension Cost	8/	**$(143,774)**	$(143,774)	**$ 0**
01/01/87 Normal Cost		$468,838	$451,395	$17,443
01/01/87 Amortization Payment		(275,969)	(268,888)	(7,081)
01/01/87 CAS Pension Cost		192,869	182,507	10,362
01/01/87 Absorbed Credit	9/	(19,167)	(19,167)	0
01/01/87 Prepayment Credit	10/	(124,607)	(117,174)	(7,433)
Interest to 12/31/87		4,173	3,924	249
12/31/87 CAS Funding Target		53,268	50,090	3,178
Contribution		0	0	0
Interest to 12/31/87		0	0	0
12/31/87 Unfunded Pension Cost		$ 53,268	$ 50,090	$ 3,178
01/01/88 Normal Cost		$ 461,694	$ 440,762	**$ 20,932**
01/01/88 Amortization Payment		(398,021)	(383,456)	(14,565)
01/01/88 CAS Pension Cost		63,673	57,306	6,367
Interest to 12/31/88		5,731	5,158	573
12/31/88 CAS Funding Target		69,404	62,464	6,940
Contribution		0	0	0
Interest to 12/31/88		0	0	0
12/31/88 Unfunded Pension Cost		**$ 69,404**	$ 62,464	$ 6,940

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Description	Total Company	Other Segment	Medicare Segment
01/01/89 Normal Cost	$ 577,078	$ 555,699	$ 21,379
01/01/89 Amortization Payment	(392,572)	(374,940)	(17,632)
01/01/89 CAS Pension Cost	184,506	180,759	3,747
Interest to 12/3 1 /89	16,606	16,269	337
12/31/89 CAS Funding Target	201,112	197,028	4,084
Contribution	0	0	0
Interest to 12/31/89	0	0	0
12/31/89 Unfunded Pension Cost	$ 201,112	$ 197,028	$ 4,084
01/01/90 Normal Cost	$ 663,812	$ 636,159	$ 27,653
0 l/O 1 /90 Amortization Payment	(464,212)	(444,895)	(19,317)
01/01/90 CAS Pension Cost	199,600	191,264	8,336
Interest to 12/31/90	17,964	17,214	750
12/31/90 CAS Funding Target	217,564	208,478	9,086
Contribution	0	0	0
Interest to 12/31/90	0	0	0
12/31/90 Unfunded Pension Cost	$ 217,564	$208,478	$ 9,086
01/01/91 Normal Cost	$ 706,996	$ 673,607	$ 33,389
0 1 /0 1 /9 1 Amortization Payment	(500,520)	(479,643)	(20,877)
01/01/91 CAS Pension Cost	206,476	193,964	12,512
Interest to 12/31/91	18,583	17,457	1,126
12/31/91 CAS Funding Target	225,059	211,421	13,638
Contribution	0	0	0
Interest to 12/31/91	0	0	0
12/31/91 Unfunded Pension Cost	**$ 225,059**	$ 211,421	**$ 13,638**

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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	$ 707,736	$ 671,135	$ 36,601
01/01/92 Amortization Payment	(517,783)	(496,867)	(20,916)
01/01/92 CAS Pension Cost	189,953	174,268	15,685
Interest to 12/31/92	17,096	15,684	1,412
12/31/92 CAS Funding Target	207,049	189,952	17,097
Contribution	0	0	0
Interest to 12/31/92	0	0	0
12/31/92 Unfunded Pension Cost	**$ 207,049**	$ 189,952	**$ 17,097**
01/01/93 Normal Cost	$ 885,642	$ 837,630	$ 48,012
01/01/93 Amortization Payment	(126,208)	(119,043)	(7,165)
01/01/93 CAS Pension Cost	759,434	718,587	40,847
Interest to 12/31/93	64,552	61,080	3,472
12/31/93 CAS Funding Target	823,986	779,667	44,319
Contribution	(1,111,293)	(1,051,521)	(59,772)
Interest to 12/31/93	(19,412)	(18,368)	(1,044)
12/31/93 Unfunded Pension Cost	$ (306,719)	$ (290,222)	**$(16,497)**
01/01/94 Normal Cost	$ 1,048,654	$ 993,294	$ 55,360
01/01/94 Amortization Payment	(34,540)	(29,826)	(4,714)
01/01/94 CAS Pension Cost	1,014,114	963,468	50,646
01/01/94 Prepayment Credit	(306,719)	(290,222)	(16,497)
Interest to 12/31/94	56,592	53,860	2,732
12/31/94 CAS Funding Target	763,987	727,106	36,881
Contribution	(1,433,370)	(1,364,175)	(69,195)
Interest to 12/31/94	(37,921)	(36,090)	(1,831)
12/31/94 Unfunded Pension Cost	$ (707,304)	$ (673,159)	**$(34,145)**

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

FOOTNOTES

1/ We obtained the total company normal cost from Nebraska's actuarial valuation reports. We obtained normal cost for the Medicare segment from data files provided by Nebraska'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 Nebraska'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 8.0 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 31.205-6(j).

6/ Nebraska did not make contributions to its pension plan for years 1987 through 1992. However, it did make contributions to the pension plan for years 1986, 1993, and 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. We calculated an unabsorbed credit (a negative value) where our computed CAS pension cost was negative. Nebraska must carry forward the unabsorbed credit and offset it against future positive CAS pension costs. 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.

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9/ The absorbed credit represents the carry forward of the prior year(s) negative CAS pension costs. The unabsorbed credit is unallowable for Medicare reimbursement and must be offset against future positive CAS pension costs until it is completely absorbed.

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 Nebraska

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December 7. 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 284A
Kansas City, MO 64106

Re: CIN: A-07-95-01167
A-07-95-01159
A-07-95-01166

Dear Ms. Bennett:

We have reviewed the findings included in the above drafts of the Office of Inspector (OIG) Medicare Pension Audit. We will accept the recommendations in each of the drafts and will move forward to carry out the requested actions.

In the course of our review we had questions about the Medicare segment salary component used in the computations and requested some additional information. Additional material was received for FY 1987, 1988, 1993, and 1994 for review.

The review of this additional information determined that the Medicare segment definition used in the computations was different from our understanding of the composition of the segment. The difference was our Medicare "allocation only" cost centers. These "allocation only" cost centers are used solely by Medicare personnel. These represent a situation where a given Medicare staff person may charge time to several different cost centers in the payroll system even though their function is totally Medicare oriented. The purpose of this process relates to the derivation of certain information for proper recording and reporting on Medicare Interim Expenditure Reports (IER). Specifically, these cost centers are 484, 485, 486, 487, 489, 490, and 491. In fiscal year 1987 cost centers 488, 493 (also FY88), 494, and 495 were also of this nature.

This difference in segment definition has subsequently been discussed with your office and there doesn't seem to be a problem with either definition of the segment. The identified cost centers were included in the indirect Medicare allocation for audit purposes. As stated earlier we will accept the draft audit findings and implement the suggested recomendations but we also want to make sure the correct segment is identified and used prospectively.

If I can be of any further assistance in this matter please give me a call. My telephone number is (402) 398-3701.

Sincerely,

Duane Wilson

'Duane Wilson
Controller

cc: Robert Rhodes, BCBSA
Carol Navin, BCBSA
Eric Shipley, HCFA, Office of Actuary, Baltimore