

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF UNFUNDED PENSION  
COSTS OF COMMUNITY MUTUAL  
INSURANCE COMPANY**



**JUNE GIBBS BROWN**  
**Inspector General**

**JULY 1997**  
**CIN: A-07-97-01207**



Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64106  
CIN: A-07-97-01207

JUL | 1997

Mr. Bob Flemming  
Vice President and Chief Financial Officer  
AdminaStar Federal, Inc.  
9901 Linn Station Road  
Louisville, Kentucky 46223

Dear Mr. Flemming:

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 Community Mutual Insurance Company*. The purpose of our review was to determine if pension costs for Plan Years 1986 through 1995 were funded in accordance with the Federal Acquisition Regulations (FAR).

Community Mutual Insurance Company (Community Mutual) did not make contributions to the pension trust fund for Plan Year 1988. Accordingly, Community Mutual did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Community Mutual accumulated unfunded pension costs of \$571,413 as of January 1, 1996. Community Mutual must separately identify and eliminate this amount from the amortization components of future pension costs.

The Auditee could not either concur or dispute the factual information and proposed adjustments and reserve the right to respond or discuss with HCFA any issues or disagreements they may have with the audit findings. The Auditee's letter is included 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 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.

### **OBJECTIVE, SCOPE AND METHODOLOGY**

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, 1996. Achieving our objective did not require that we review the internal control structure of Community Mutual.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-96-01194) and pension costs claimed for Medicare reimbursement (CIN: A-07-97-01208). 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 Community Mutual's historical practices.

We performed site work at Community Mutual's corporate offices in Cincinnati, Ohio during September 1996. Subsequently, we performed audit work in our OIG, OAS, Jefferson City, Missouri field office.

## FINDING AND RECOMMENDATIONS

As of January 1, 1996, Community Mutual had accumulated \$571,413 in unallowable direct pension costs related to its Medicare segment. These costs represent unfunded pension costs and imputed interest for Plan Years 1986 through 1995.

Community Mutual did not make contributions to the pension trust fund in Plan Year 1988 because the pension plan was fully funded. Community Mutual'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 \$571,413 for plan years 1986 through 1995. 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 1/1/96</u>	<u>Total As Of 1/1/96</u>
1986	\$ 25,688	\$ 28,831	\$ 54,519
1987	0	0	0
1988	180,291	143,276	323,567
1989	64,910	41,965	106,875
1990	57,232	29,220	86,452
1991	0	0	0
1992	0	0	0
1993	0	0	0
1994	0	0	0
1995	0	0	0
Total	<u>\$328,121</u>	<u>\$243,292</u>	<u>\$571,413</u>

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

- ❶ Identify \$571,413 as an unallowable component of direct pension costs as of January 1, 1996.
- ❷ Update annually the unallowable pension cost component related to the unfunded CAS costs for Plan Years 1986 through 1995.
- ❸ Identify and update unfunded pension costs for any later years in a similar manner.

### **Auditee Response**

The Auditee could not either concur or dispute the factual information and proposed adjustments and reserve the right to respond or discuss with HCFA any issues or disagreements they may have with the audit findings.

### **INSTRUCTION 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 the recommendation in this report within 30 days from the date of this to the HHS official, presenting any comments or additional information that you believe may have a bearing on final determination.

### **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.

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 the 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  
Regional Inspector General  
for Audit Services, Region VII

HHS Action Official:

Ms. Dorothy Collins  
Regional Administrator, Region V  
Health Care Financing Administration  
105 W. Adams Street, 14th-16th Floors  
Chicago, Illinois 60603-6201

Enclosures

## COMMUNITY MUTUAL INSURANCE COMPANY

CIN: A-07-97-01207

STATEMENT OF CAS PENSION COSTS AND FUNDING  
JANUARY 1, 1986 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare Segment
01/01/86 Normal Cost	<u>1/</u>	\$2,167,368	\$2,026,204	\$141,164
01/01/86 Amortization Payment	<u>2/</u>	(799,414)	(769,078)	(30,336)
01/01/86 CAS Pension Cost	<u>3/</u>	1,367,954	1,257,126	110,828
01/01/86 Prepayment Credit	<u>4/</u>	(639,894)	(588,051)	(51,843)
Interest to 12/31/86	<u>5/</u>	65,525	60,216	5,309
12/31/86 CAS Funding Target	<u>6/</u>	793,585	729,291	64,294
Contribution	<u>7/</u>	(450,000)	(413,542)	(36,458)
Interest to 12/31/86	<u>8/</u>	(26,519)	(24,371)	(2,148)
<b>12/31/86 Unfunded Pension Cost</b>	<u>9/</u>	<b>\$317,066</b>	<b>\$291,378</b>	<b>\$25,688</b>
01/01/87 Normal Cost		\$3,024,906	\$2,827,178	\$197,728
01/01/87 Amortization Payment		(675,725)	(648,709)	(27,016)
01/01/87 CAS Pension Cost		2,349,181	2,178,469	170,712
Interest to 12/31/87		199,680	185,169	14,511
12/31/87 CAS Funding Target		2,548,861	2,363,638	185,223
Contribution		(3,013,710)	(2,829,943)	(183,767)
Interest to 12/31/87		(23,875)	(22,419)	(1,456)
<b>12/31/87 Unfunded Pension Cost</b>		<b>\$(488,724)</b>	<b>\$(488,724)</b>	<b>\$0</b>
01/01/88 Normal Cost		\$3,141,531	\$2,919,958	\$221,573
01/01/88 Amortization Payment		(688,419)	(673,402)	(15,017)
01/01/88 CAS Pension Cost		2,453,112	2,246,556	206,556
01/01/88 Prepayment Credit		(488,723)	(447,572)	(41,151)
Interest to 12/31/88		176,795	161,909	14,886
12/31/88 CAS Funding Target		2,141,184	1,960,893	180,291
Contribution		0	0	0
Interest to 12/31/88		0	0	0
<b>12/31/88 Unfunded Pension Cost</b>		<b>\$2,141,184</b>	<b>\$1,960,893</b>	<b>\$180,291</b>



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**STATEMENT OF CAS PENSION COSTS AND FUNDING**  
JANUARY 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/89 Normal Cost	\$2,862,359	\$2,649,154	\$213,205
01/01/89 Amortization Payment	(1,468,297)	(1,411,705)	(56,592)
01/01/89 CAS Pension Cost	1,394,062	1,237,449	156,613
Interest to 12/31/89	125,466	111,371	14,095
12/31/89 CAS Funding Target	1,519,528	1,348,820	170,708
Contribution	(937,871)	(832,508)	(105,363)
Interest to 12/31/89	(3,874)	(3,439)	(435)
<b>12/31/89 Unfunded Pension Cost</b>	<b>\$577,783</b>	<b>\$512,873</b>	<b>\$64,910</b>
01/01/90 Normal Cost	\$2,924,017	\$2,696,685	\$227,332
01/01/90 Amortization Payment	(1,519,176)	(1,436,608)	(82,568)
01/01/90 CAS Pension Cost	1,404,841	1,260,077	144,764
Interest to 12/31/90	126,436	113,407	13,029
12/31/90 CAS Funding Target	1,531,277	1,373,484	157,793
Contribution	(960,508)	(861,531)	(98,977)
Interest to 12/31/90	(15,370)	(13,786)	(1,584)
<b>12/31/90 Unfunded Pension Cost</b>	<b>\$555,399</b>	<b>\$498,167</b>	<b>\$57,232</b>
01/01/91 Normal Cost	\$3,079,615	\$2,820,682	\$258,933
01/01/91 Amortization Payment	(1,294,698)	(1,243,058)	(51,640)
01/01/91 CAS Pension Cost	1,784,917	1,577,624	207,293
Interest to 12/31/91	160,643	141,987	18,656
12/31/91 CAS Funding Target	1,945,560	1,719,611	225,949
Contribution	(3,482,891)	(3,258,855)	(224,036)
Interest to 12/31/91	(29,747)	(27,834)	(1,913)
<b>12/31/91 Unfunded Pension Cost</b>	<b>\$(1,567,078)</b>	<b>\$(1,567,078)</b>	<b>\$0</b>

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STATEMENT OF CAS PENSION COSTS AND FUNDING  
JANUARY 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/92 Normal Cost	\$3,190,297	\$2,923,847	\$266,450
01/01/92 Amortization Payment	(1,467,202)	(1,396,416)	(70,786)
01/01/92 CAS Pension Cost	1,723,095	1,527,431	195,664
01/01/92 Prepayment Credit	(1,567,079)	(1,389,131)	(177,948)
Interest to 12/31/92	14,041	12,446	1,595
12/31/92 CAS Funding Target	170,057	150,746	19,311
Contribution	(2,598,221)	(2,579,691)	(18,530)
Interest to 12/31/92	(109,507)	(108,726)	(781)
<b>12/31/92 Unfunded Pension Cost</b>	<b>\$(2,537,671)</b>	<b>\$(2,537,671)</b>	<b>\$0</b>
01/01/93 Normal Cost	\$4,281,089	\$3,921,270	\$359,819
01/01/93 Amortization Payment	870,792	769,776	101,016
01/01/93 CAS Pension Cost	5,151,881	4,691,046	460,835
01/01/93 Prepayment Credit	(2,537,670)	(2,310,676)	(226,994)
Interest to 12/31/93	222,208	202,332	19,876
12/31/93 CAS Funding Target	2,836,419	2,582,702	253,717
Contribution	(6,498,354)	(6,250,147)	(248,207)
Interest to 12/31/93	(144,276)	(138,766)	(5,510)
<b>12/31/93 Unfunded Pension Cost</b>	<b>\$(3,806,211)</b>	<b>\$(3,806,211)</b>	<b>\$0</b>
01/01/94 Normal Cost	\$4,365,764	\$3,999,039	\$366,725
01/01/94 Amortization Payment	855,542	766,334	89,208
01/01/94 CAS Pension Cost	5,221,306	4,765,373	455,933
01/01/94 Prepayment Credit	(3,806,211)	(3,473,846)	(332,365)
Interest to 12/31/94	113,208	103,322	9,886
12/31/94 CAS Funding Target	1,528,303	1,394,849	133,454
Contribution	(6,629,968)	(6,500,212)	(129,756)
Interest to 12/31/94	(188,928)	(185,230)	(3,698)
<b>12/31/94 Unfunded Pension Cost</b>	<b>\$(5,290,593)</b>	<b>\$(5,290,593)</b>	<b>\$0</b>

## COMMUNITY MUTUAL INSURANCE COMPANY

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STATEMENT OF CAS PENSION COSTS AND FUNDING  
JANUARY 1, 1986 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare Segment
01/01/95 Normal Cost	\$3,802,140	\$3,457,585	344,555
01/01/95 Amortization Payment	(484,958)	(483,513)	(1,445)
01/01/95 CAS Pension Cost	3,317,182	2,974,072	343,110
01/01/95 Prepayment Credit	(3,317,182)	(2,974,072)	(343,110)
Interest to 12/31/95	0	0	0
12/31/95 CAS Funding Target	0	0	0
Contribution	(4,617,391)	(4,617,391)	0
Interest to 12/3/95	(193,217)	(193,217)	0
<b>12/31/95 Unfunded Pension Cost</b>	<b>\$(4,810,608)</b>	<b>\$(4,810,608)</b>	<b>\$0</b>

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STATEMENT OF CAS PENSION COSTS AND FUNDING  
JANUARY 1, 1986 TO JANUARY 1, 1996

FOOTNOTES

- 1/ We obtained the total company normal cost from Community Mutual's actuarial valuation reports. We obtained normal cost for the Medicare segment from data files provided by Community Mutual'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 Community Mutual'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 1995.
- 4/ A prepayment credit is created when contributions are made in excess of the CAS pension costs. The prepayment credit remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs. We assigned the prepayment credit in proportion to the CAS pension costs.

During the final resolution process of the Fiscal Year 1986 and 1987 pension costs, the HCFA Office of the Actuary calculated the pension costs according to the CAS and reviewed Community Mutual's funding. It was determined that Community Mutual had made contributions in the excess of the CAS pension costs creating a prepayment credit of \$639,894. This prepayment credit was assigned in proportion to the CAS pension costs.
- 5/ We applied one year's interest at the assumed rate of 9.0 percent for years 1988 through 1992, 8.5 percent for 1987, 1993, and 1995, and 8.0 percent for 1994 to the CAS pension cost. We obtained the interest rates from the actuarial valuation reports.

COMMUNITY MUTUAL INSURANCE COMPANY

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STATEMENT OF CAS PENSION COSTS AND FUNDING  
JANUARY 1, 1986 TO JANUARY 1, 1996

- 6/ 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).
- 7/ Community Mutual did not make contributions to its pension plan for 1988. However, it did make contributions to the pension plan for years 1986, 1987, and 1989 through 1995. For 1986 and 1987, we assigned contributions 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 1989 through 1995, 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.
- 8/ 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 5/).
- 9/ The unfunded pension cost represents the CAS funding target less the value of contributions. We calculated a prepayment credit when the contribution to the pension trust fund exceeded the CAS pension costs. The prepayment remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs.

June 16, 1997

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

RE: Review of Medicare Contractor's Pension Segmentation.  
Review of Unfunded Costs.  
Review of Pension Costs Claimed for Medicare Reimbursement

Dear Ms. Bennett:

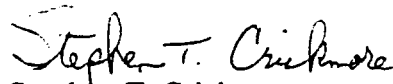
With regard to the referenced draft audit reports, we have engaged a consultant who is an expert in applicable laws and actuarial issues related to pension costs. As of this date, we have not received the workpapers and documentation from the Health Care Financing Administration (HCFA) Staff who provided the actuarial calculations which are the basis of most of the adjustments proposed in your audit reports.

Accordingly, at this time we cannot either concur or dispute the factual information and proposed adjustments and reserve the right to respond or discuss with HCFA any issues or disagreements we may have with the audit findings.

Pension plans and the regulations and Cost Accounting Standard related thereto are complex and technical matters. I understand your desire to issue the final pension audit reports. We do not object to the final reports being issued as long as we retain the right to discuss, challenge and/or appeal any issues resulting from our analysis of the draft reports and detailed documentation supporting the adjustments made in the pension reports.

I appreciate the assistance and cooperation extended by Mr. Jack Morman of your staff during our review on this matter.

Sincerely,



Stephen T. Crickmore  
President and CEO

STC/jp  
Ref. #97-06-052  
cc: J. Hannah  
R. Toller