DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 0429
Kansas City, Missouri 64106

JUL 13 2009

Report Number: A-07-09-00318

Mr. Carlos González, CPA
Executive Vice-President of Infrastructure and Chief Financial Officer
Cooperativa de Seguros de Vida de Puerto Rico
400 Americo Miranda Avenue
Rio Piedras, Puerto Rico 00927

Dear Mr. González:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Audit of Cooperativa de Seguros de Vida de Puerto Rico's Unfunded Pension Costs for 1986 to 2007." 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.

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at http://oig.hhs.gov.

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 email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-09-00318 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor, Acting Director
Office of Financial Management (OFM)
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, Maryland 21244-1850

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF COOPERATIVA DE SEGUROS DE VIDA DE PUERTO RICO'S UNFUNDED PENSION COSTS FOR 1986 TO 2007

Daniel R. Levinson
Inspector General

July 2009
A-07-09-00318

Office of Inspector General

http://oig.hhs.gov

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Cooperativa de Seguros de Vida de Puerto Rico (COSVI) has administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) since 1970.

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The contracts specify segmentation requirements and require 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 pension costs for plan years 1986 through 2006 were funded in accordance with the Federal Acquisition Regulation (FAR) and Cost Accounting Standards (CAS), and

- identify and properly account for any unallowable unfunded pension costs.

SUMMARY OF FINDINGS

COSVI did not properly fund the pension costs allocable to the Medicare contracts in accordance with the FAR and the CAS for plan years 1986, 1987, and 1988. In addition, COSVI did not identify or properly account for unallowable unfunded pension costs. As a result of these errors, COSVI understated the January 1, 2007, accumulated unallowable unfunded pension costs by $800,063 ($76,088 for the Medicare segment plus $723,975 for the "Other" segment).

RECOMMENDATIONS

We recommend that COSVI:

- identify $800,063 of accumulated unallowable unfunded pension costs ($76,088 as an unallowable component of the Medicare segment pension costs and $723,975 as an unallowable component of the "Other" segment pension costs) as of January 1, 2007; and

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

AUDITEE COMMENTS

In written comments on our draft report, COSVI concurred with our recommendations.

COSVI’s comments are included in their entirety as the Appendix.

INTRODUCTION

BACKGROUND

Cooperativa de Seguros de Vida de Puerto Rico and Medicare

Cooperativa de Seguros de Vida de Puerto Rico (COSVI) has administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) since 1970.[1] In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and Medicare contracts.

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 FAR and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated 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 and allocated to cost objectives, including Federal contracts. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs applicable with the start of the first accounting period thereafter.

The revised CAS removed the regulatory conflict between the funding limits of the Employee Retirement Income Security Act of 1974 (ERISA) 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 were not funded because they lacked tax deductibility.

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 have funded pension costs and chose not to, 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.

Federal Acquisition Regulation

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. FAR (48 CFR § 31.205-6(j)(2)(i) and (iii)),[2] states: ". . . pension costs . . . assigned to the current accounting period, but not funded during it, are not

[1]On February 28, 2009, the contractual relationship was terminated.

[2]During the period covered by our review, FAR 31.205-6 was amended with sections being renumbered and reworded. Refer to FAR 31.205-6(j)(3)(i) and (iii) for relevant prior FAR citations.

allowable in subsequent years. . . . Increased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable."

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to:

- determine whether pension costs for plan years 1986 through 2006 were funded in accordance with the FAR and CAS, and

- identify and properly account for any unallowable unfunded pension costs.

Scope

Our review covered plan years 1986 through 2006. Achieving our objectives did not require that we review COSVI's internal control structure. However, we reviewed internal controls relating 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 COSVI's office in Rio Piedras, Puerto Rico, during March and April 2008.

Methodology

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

In performing this review, we used information provided by COSVI's actuarial consulting firms, which included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed COSVI's accounting records, the pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, the CMS Office of the Actuary calculated the assignable CAS pension costs for each year of the period 1986 through 2006. The assignable CAS pension costs for the period 1986 through 1995 were calculated on a Total Company basis. The assignable CAS pension costs for the period 1996 through 2006 were calculated 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 determined the extent to which COSVI funded those costs with contributions to the pension trust fund. We reviewed the methodology for the calculations and update of COSVI's Total Company unfunded pension costs for the years 1986 through 1995, as well as the Medicare segment and the "Other" segment unfunded pension costs for the years 1996 through 2006. This review included the allocation of the January 1, 1996, accumulated unfunded pension cost to the Medicare and "Other" segments, an allocation that was based on each segment's actuarial liability.[3]

We performed this review in conjunction with our audits of Medicare segmentation (A-07-08-00271) and pension costs claimed for Medicare reimbursement (A-07-08-00272; A-07-09-00317). We used the information obtained during those audits in this review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

COSVI did not properly fund the pension costs allocable to the Medicare contracts in accordance with the FAR and the CAS for plan years 1986, 1987, and 1988. In addition, COSVI did not identify or properly account for unallowable unfunded pension costs. As a result of these errors, COSVI understated the January 1, 2007, accumulated unallowable unfunded pension costs by $800,063 ($76,088 for the Medicare segment plus $723,975 for the "Other" segment).

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 Medicare contracts state: "The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413."

The revised CAS states that if a contractor could have funded pension costs and chose not to, 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.

For plan years 1986, 1987, and 1998, we identified $148,331, $11,632, and $29,109, respectively, of pension costs[4] that COSVI could have funded with contributions as provided for by ERISA. However, COSVI did not fund these costs in this manner. As of January 1, 2007, COSVI had accumulated $800,063 in unallowable pension costs ($76,088 for the Medicare segment plus $723,975 for the "Other" segment). The pension costs are unallowable because they were not funded within specific time periods set by FAR regulations. Imputed interest on the unfunded costs is also unallowable per CAS regulations. The $800,063 represents unfunded pension costs and imputed interest for the years 1986 through 2006.

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[3]The actuarial liability was based on the entry age normal cost method exclusive of pre-1982 employee contribution account balances.

[4]Total Company unfunded pension costs as of the end of each year.

RECOMMENDATIONS

We recommend that COSVI:

- identify $800,063 of accumulated unallowable unfunded pension costs ($76,088 as an unallowable component of the Medicare segment pension costs and $723,975 as an unallowable component of the "Other" segment pension costs) as of January 1, 2007; and

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

AUDITEE COMMENTS

In written comments on our draft report, COSVI concurred with our recommendations.

COSVI's comments are included in their entirety as the Appendix.

APPENDIX

COSVI
COOPERATIVA DE SEGUROS DE VIDA DE PUERTO RICO

June 16, 2009

Mr. Patrick J. Cogley
Regional Inspector General
for Audit Services
OFFICE OF INSPECTOR GENERAL
Office of Audit Services
Region VII
601 East 12th Street Rm 0429
Kansas City, Missouri 64106

Dear Mr. Cogley:

Enclosed are our written comments to the U.S. Department of Health and Human Services, Office of Inspector General (OIG), draft reports dated April 17, 2009.

1. **A-07-09-00317 "Review of Pension Costs Claimed for Medicare Reimbursement by Cooperativa de Seguros de Vida de Puerto Rico, for Fiscal Years 1988 Through 1995"** – Based on the agreement reached by our actuary with the OIG, we agree with the adjustment of $70,282 for the 1988 through 1995 period. Our approach will be to reduce the FY 2009 FACP by this amount or consider it as an offset during the final settlement.

2. **A-07-09-00318 "Audit of Cooperativa de Seguros de Vida de Puerto Rico's Unfunded Pension Costs for 1986 to 2007"** – We concur with the adjustment. The OIG's recommendation will be referred to our actuary for the identification of accumulated unallowable unfunded cost and update of interest as applicable.

3. **A-07-08-00271 "Review of Pension Segmentation Requirements for the Qualified Pension Plan at Cooperativa de Seguros de Vida de Puerto Rico, for the Period January 1, 1996 to January 1, 2007"** – We concur with the OIG finding that the Medicare segment pension assets are understated by $858,062. We will refer the OIG recommendation of increasing the Medicare segment assets as of January 1, 2007 by that amount to our actuary.

Thank you for the opportunity to comment on the report. From the outcome the reports we anticipate that since the Medicare segment assets are understated by $858,000, the final settlement will result in a refund equivalent to that amount.

Sincerely,

Carlos L. González Rodríguez, CPA, CMA
Finance Vice President and CFO

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