DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

FEB - 4 2005

TO: Tim Hill
Director, Office of Financial Management
Centers for Medicare & Medicaid Services

FROM: Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Audit of Blue Cross Blue Shield of Florida's Unfunded Pension Costs for 1994 Through 2003 (A-07-04-00179)

Attached is an advance copy of our final report on Blue Cross Blue Shield of Florida's (Florida) unfunded pension costs. We will issue this report to Florida within 5 business days. We suggest that you share this report with the Centers for Medicare & Medicaid Services components involved with monitoring the Medicare contractors' financial operations, particularly the Center for Medicare Management and the Office of the Actuary.

Florida is a Medicare contractor and, as such, is allowed to claim reimbursement for its Medicare employees' pension costs. Regulations and the Medicare contracts provide for the funding requirements and assignment of pension costs claimed for Medicare reimbursement. We are recommending that Florida increase its accumulated unallowable pension costs by about $2.3 million. Florida agreed with our report finding.

If you have any questions or comments about this report, please do not hesitate to call me, or George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or James P. Aasumndstad, Regional Inspector General, Region VII, at (816) 426-3591, extension 225. Please refer to report number A-07-04-00179 in all correspondence.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

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

Report Number: A-07-04-00179 FEB - 8 2005

Ms. Sandy L. Coston
President & Chief Operating Officer
First Coast Service Options, Inc.
532 Riverside Avenue 20T
Jacksonville, Florida 32202

Dear Ms. Coston:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) report entitled "Audit of Blue Cross Blue Shield of Florida's Unfunded Pension Costs for 1994 Through 2003." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

The HHS action official named below will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action 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.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-07-04-00179 in all correspondence.

Sincerely yours,

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosure - as stated

Direct Reply to HHS Action Official:
Ms. Rose Crum-Johnson
Regional Administrator
Centers for Medicare & Medicaid Services
Department of Health and Human Services
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303-8909

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF BLUE CROSS BLUE SHIELD OF FLORIDA'S UNFUNDED PENSION COSTS FOR 1994 THROUGH 2003

FEBRUARY 2005
A-07-04-00179

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of Florida (Florida) administers Medicare Parts A and B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS). Since its inception, Medicare has paid part of its contractors' pension plan costs. Costs must be funded to be allowable, unless the funding would lack tax deductibility.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The contract specifies segmentation requirements, and requires 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 if the accumulated unfunded pension costs identified in our prior review (A-07-95-01126) were accounted for properly;

- determine if pension costs for plan years 1994 through 2003 were funded in accordance with the Federal Acquisition Regulations (FAR) and the Cost Accounting Standards (CAS); and

- identify and properly account for any additional accumulated unfunded pension costs, including unallowable and reassignable portions.

SUMMARY OF FINDING

Florida did not properly account for the accumulated unfunded pension costs identified in our prior review. For the current audit period, Florida funded pension costs for plan years 1994 through 2003 in accordance with FAR and CAS. As such, there were no additional unfunded pension costs to identify and update.

The accumulated unfunded pension costs consist of two components, the accumulated reassignable pension costs and the accumulated unallowable pension costs. The reassignable component resulted from pension costs that were not funded because they were not tax deductible. The unallowable component resulted from pension costs that were not funded because the contractor chose not to fund the costs. Florida correctly handled the accumulated reassignable pension costs but incorrectly tracked the unallowable pension costs.

Florida understated the accumulated unallowable pension costs by $2,346,492. As of January 1, 2004, Florida determined its accumulated unallowable pension costs were $0; however, audited costs were $2,346,492 ($1,689,429 for the Other segment plus $657,063 for the Medicare segment).

The understatement occurred because Florida did not ensure that unallowable pension costs from our prior report were identified and accounted for properly in accordance with CAS requirements.

RECOMMENDATIONS

We recommend that Florida:

- increase the accumulated unallowable pension costs by $2,346,492 ($1,689,429 for the Other segment plus $657,063 for the Medicare segment) as of January 1, 2004 and

- implement controls to identify and properly account for unfunded unallowable pension costs in subsequent years.

AUDITEE'S COMMENTS

Florida agreed with our report finding. Florida's comments are presented in the appendix to this report.

TABLE OF CONTENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CFR	Code of Federal Regulations
CMS	Centers for Medicare & Medicaid Services
ERISA	Employees Retirement Income Security Act of 1974
FAR	Federal Acquisition Regulations
OIG	Office of Inspector General
TRA	Tax Reform Act of 1986

INTRODUCTION

BACKGROUND

Florida and Medicare

Florida administers Medicare Parts A and B operations under a cost reimbursement contract with CMS. In claiming costs, contractors must follow cost reimbursement principles contained in FAR, CAS, and the 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 FAR and its predecessor, Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated CAS 412 and 413.

CAS

The CAS deals with stability between contract periods and requires that pension costs be consistently measured, 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 CAS relating to accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the postrevision standards as the revised CAS. Applicable portions of the revised CAS are discussed in a later section.

The CAS within 48 CFR § 9904.412-50(a)(7) stated "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, CAS within 48 CFR § 9904.412-50(a)(2) stated "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 . . . ."

CAS within 48 CFR § 9904.412-40(c) imposes the following fundamental requirement "Assignment of pension cost. Except costs assigned to future periods by 9904.412-50(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period . . . ."

FAR

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. 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.”

Conflict Between FAR Funding Requirement and Tax Limits

Pension costs computed in accordance with CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act (ERISA) of 1974, which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code.

Under tax laws in effect before 1986, employers could fund the CAS contribution in excess of the tax-deductible limit and any excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded the CAS computed amounts, the excess funding could be carried forward as a prepayment credit to fund allowable contract costs for future years.

The Tax Reform Act (TRA) of 1986 changed the effect of making pension plan contributions in excess of the tax-deductible limit. The TRA of 1986 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. The excise tax is cumulative from year-to-year and applied on a first-in/first-out basis considering carryforwards and current year contributions.

The Omnibus Budget Reconciliation Act of 1987 added a “current liability” full funding limitation that lowered the tax-deductible limit for many plans, further increasing the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund CAS pension cost without incurring excise tax penalties, yet FAR provided that unfunded CAS costs could not be carried forward to future years. However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than CAS cost was a voluntary financial action.

Revised CAS

As previously noted, CAS relating to accounting for pension costs was revised on March 30, 1995, and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS removed the regulatory conflict between the funding limits of ERISA of 1974 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 contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The CAS revision does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA of 1974. 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 FAR and CAS.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to:

- determine if the accumulated unfunded pension costs identified in our prior review were accounted for properly;

- determine if pension costs for plan years 1994 through 2003 were funded in accordance with FAR and CAS; and

- identify and properly account for any additional accumulated unfunded pension costs, including unallowable and reassignable portions.

Scope

Our review covered January 1, 1994, to January 1, 2004. Achieving our objectives did not require that we review Florida's overall internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with CAS and FAR.
We performed onsite audit work at Florida's office in Jacksonville, FL during June of 2004.

Methodology

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

In performing this review, we used information provided by Florida's actuarial consulting firms. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Florida's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. Using the documents, CMS pension actuarial staff calculated the assignable CAS pension costs for each year 1994 through 2003 for both the Medicare segment and the Other segment. Additionally, CMS pension actuarial staff determined the extent to which Florida funded the pension costs with contributions to the pension trust fund and prepayment credits. The CMS pension actuarial staff also determined the unallowable and reassignable portions of unfunded pension costs. We reviewed the methodology for the calculations and updated Florida's unfunded pension costs for 1994 through 2003 for both the Medicare segment and the Other segment.

We performed this review in conjunction with our audits of Medicare segmentation of pension assets (A-07-04-00172) and pension costs claimed for Medicare reimbursement (A-07-04-00180). We used the information obtained and reviewed during those audits in performing this review.

We performed our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATIONS

Florida did not properly account for the accumulated unfunded pension costs identified in our prior review. For the current audit period, Florida funded pension costs for plan years 1994 through 2003 in accordance with FAR and CAS. As such, there were no additional unfunded pension costs to identify and update.

The revised CAS requires the identification of the two components of the accumulated unfunded pension costs - the accumulated reassignable pension costs and the accumulated unallowable pension costs. Florida correctly handled the accumulated reassignable pension costs but incorrectly updated the unallowable pension cost portion. As of January 1, 2004, Florida determined its accumulated unallowable pension costs were $0; however, audited costs were $2,346,492 ($1,689,429 for the Other segment plus $657,063 for the Medicare 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 FAR. The Medicare contract states "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."

Effective January 1, 1996, the revised CAS allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility as accumulated reassignable pension costs. However, the revision to CAS does not remove the requirement to fund pension costs when contributions are tax deductible. 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 FAR and CAS.

Florida did not ensure that unallowable pension costs from our prior audit were identified and accounted for properly in accordance with CAS requirements. As a result, Florida understated the January 1, 2004, accumulated unallowable pension costs by $2,346,492 ($1,689,429 for the Other segment plus $657,063 for the Medicare segment).

RECOMMENDATIONS

We recommend that Florida:

- increase the accumulated unallowable pension costs by $2,346,492 ($1,689,429 for the Other segment plus $657,063 for the Medicare segment) as of January 1, 2004 and

- implement controls to identify and properly account for unfunded unallowable pension costs in subsequent years.

AUDITEE'S COMMENTS

Florida agreed with our report finding. Florida's comments are presented in the appendix to this report.

APPENDIX

APPENDIX

FIRST COAST
SERVICE OPTIONS, INC.

CMS
CENTERS for MEDICARE & MEDICAID SERVICES

A CMS CONTRACTED INTERMEDIARY & CARRIER

MEDICARE

Sandy Coston
President/COO
First Coast Service Options
Sandy.Coston@fcso.com

January 7, 2005

Mr. James P. Aasmundstad
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Office of Audit Services
601 East 12th Street, Room 284A
Kansas City, Missouri 64106

Dear Mr. Aasmundstad:

Reference: A-07-04-00179

The purpose of this letter is to submit our response to the Department of Health and Human Services Office of Inspector General's draft report for the review of Blue Cross Blue Shield of Florida's (BCBSF) unfunded pension costs for fiscal years 1994 – 2003.

We agree with the report finding regarding accounting for accumulated unfunded pension costs and will take the following action to ensure the report recommendation is implemented.

1) Make account adjustments to increase accumulated unallowable pension costs by $2,346,492 as of January 1, 2004.

Additionally, we are working with BCBSF's actuaries to ensure that these costs are properly accounted for in subsequent periods. These amounts will be tracked separately and carried forward into future valuations in accordance with appropriate cost accounting guidelines.

We appreciate the opportunity to review and provide our comments prior to release of the final report. If you have any questions regarding our response, please contact Mr. Gregory England at 904-791-8364.

Sincerely,

Sandy Coston

Sandy Coston

cc: Mike Davis, VP & CFO, FCSO
Gregory England, Director of Internal Audit, FCSO
Brenda Francisco, Director of Medicare Reporting, FCSO
Curtis Lord, CEO, FCSO
Cheryl Mose, Enterprise Controller, BCBSF
Jay Pinkerton, Chicago Consulting Actuaries, LLP