Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF UNFUNDED PENSION COSTS OF ADMINASTAR FEDERAL

JUNE GIBBS BROWN
Inspector General

OCTOBER 1998
A-07-98-01224

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-07-98-01224

OCT 15 1998

Mr. Robert B. Fleming
Vice President and Chief Financial Officer
AdminaStar Federal
9901 Linn Station Road, Suite 400
Louisville, Kentucky 40223-3824

Dear Mr. Fleming:

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 AdminaStar Federal.* 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.

AdminaStar Federal (Kentucky) did not make contributions to the pension trust fund for Plan Years 1988 through 1993 and 1995. Accordingly, Kentucky did not fund the pension costs identifiable with its Medicare segment during this period. As a result, Kentucky accumulated unfunded pension costs of $4,286,294 as of January 1, 1996. Kentucky must separately identify and eliminate this amount from the amortization components of future pension costs. The auditee did not provide a response to our report.

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 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 equaled 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, except that we have not reported the auditee's views concerning our findings, conclusions, and recommendations. We repeatedly solicited, but did not receive, Kentucky's comments on our report. Kentucky's failure to respond to our report does not change the results of the audit.

Our objective was to identify any unfunded CAS costs, plus appreciation on the unfunded costs, from October 1, 1986 to January 1, 1996. Achieving our objective did not require that we review the internal control structure of Kentucky.

We performed this review in conjunction with our audits of pension segmentation (CIN: A-07-97-01223) and pension costs claimed for Medicare reimbursement (CIN: A-07-98-01225). 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 Kentucky's historical practices.

We performed site work at Kentucky's corporate offices in Louisville, Kentucky during August and September 1997. Subsequently, we preformed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

As of January 1, 1996, Kentucky had accumulated $4,286,294 in previously unallowable direct pension costs related to its Medicare segment. These costs represent unfunded pension costs and imputed interest for Plan Years 1986 through 1995.

Kentucky did not make contributions to the pension trust fund in Plan Years 1988 through 1993 and 1995 because the pension plan was fully funded. Kentucky's actuary recommended in the actuarial 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 the 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 $4,286,294 for plan years 1986 through 1995. The following table shows the unfunded amounts, and interest on a cumulative basis.

Unfunded CAS Pension Costs and Interest

Year	Unfunded CAS Costs	Interest To 01/01/96	Total As Of 01/01/96
1986	$7,652	$6,796	$14,448
1987	$15,440	$11,550	$26,990
1988	$607,236	$375,642	$982,878
1989	$496,868	$247,795	$744,663
1990	$416,023	$161,294	$577,317
1991	$531,591	$151,453	$683,044
1992	$493,375	$93,607	$586,982
1993	$561,222	$57,020	$618,242
1994	$45,871	$918	$46,789
1995	$4,941	$0	$4,941
Total	$3,180,219	$1,106,075	$4,286,294

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

Recommendation:

We recommend that Kentucky:

- Identify $4,286,294 as an unallowable component of direct pension costs as of January 1, 1997.

Auditee Response

As previously stated, Kentucky did not provide a response to our report.

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. The new rule will allow the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. Additionally, the amended CAS 412 places a $0 floor on pension costs and provides for the reassignment of negative pensions costs. 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 below. We request that you respond to the recommendation 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.

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, Region VII

HHS Action Official:

Ms. Rose Crum-Johnson
Regional Administrator, Region IV
Health Care Financing Administration
Atlanta Federal Center
61 Forsyth Street SW, Suite 4T20
Atlanta, Georgia 30303-8909

Enclosure

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STATEMENT OF CAS PENSION COSTS AND FUNDING
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	Description		Total Company	Other Segment	Medicare A	Medicare B
10/01/86	Normal Cost	1/	$2,106,745	NA	NA	NA
10/01/86	Amortization Payment	2/	$395,974	NA	NA	NA
10/01/86	CAS Pension Cost	3/	$2,502,719	$2,388,927	$43,624	$70,168
	Interest to 09/30/87	4/	$200,218	$191,115	$3,490	$5,613
09/30/87	CAS Funding Target	5/	$2,702,937	$2,580,042	$47,114	$75,781
	Contribution	6/	($2,503,755)	($2,389,916)	($43,642)	($70,197)
	Interest to 09/30/87	7/	($30,886)	($29,482)	($538)	($866)
09/30/87	Under (Over) Funding	8/	$168,296	$160,644	$2,934	$4,718
10/01/87	Normal Cost		$2,679,374	$2,349,255	$116,785	$213,334
10/01/87	Amortization Payment		$183,568	$60,373	$33,041	$90,154
10/01/87	CAS Pension Cost		$2,862,942	$2,409,628	$149,826	$303,488
	Interest to 09/30/88		$229,035	$192,770	$11,986	$24,279
09/30/88	CAS Funding Target		$3,091,977	$2,602,398	$161,812	$327,767
	Contribution		($2,937,403)	($2,472,299)	($153,723)	($311,381)
	Interest to 09/30/88		($57,056)	($48,021)	($2,986)	($6,049)
09/30/88	Under (Over) Funding		$97,518	$82,078	$5,103	$10,337

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10/01/88	Normal Cost	$3,105,104	$2,718,762	$142,113	$244,229
10/01/88	Amortization Payment	$763,496	$587,582	$65,892	$110,022
10/01/88	CAS Pension Cost	$3,868,600	$3,306,344	$208,005	$354,251
	Interest to 09/30/89	$309,488	$264,508	$16,640	$28,340
09/30/89	CAS Funding Target	$4,178,088	$3,570,852	$224,645	$382,591
	Contribution	$0	$0	$0	$0
	Interest to 09/30/89	$0	$0	$0	$0
09/30/89	Under (Over) Funding	$4,178,088	$3,570,852	$224,645	$382,591
10/01/89	Normal Cost	$2,824,908	$2,462,894	$137,673	$224,341
10/01/89	Amortization Payment	$101,836	$3,787	$5,479	$92,570
10/01/89	CAS Pension Cost	$2,926,744	$2,466,681	$143,152	$316,911
	Interest to 09/30/90	$234,140	$197,335	$11,452	$25,353
09/30/90	CAS Funding Target	$3,160,884	$2,664,016	$154,604	$342,264
	Contribution	$0	$0	$0	$0
	Interest to 09/30/90	$0	$0	$0	$0
09/30/90	Under (Over) Funding	$3,160,884	$2,664,016	$154,604	$342,264

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10/01/90	Normal Cost	$2,607,949	$2,282,001	$120,609	$205,339
10/01/90	Amortization Payment	($197,117)	($256,375)	($5,227)	$64,485
10/01/90	CAS Pension Cost	$2,410,832	$2,025,626	$115,382	$269,824
	Interest to 09/30/91	$192,867	$162,050	$9,231	$21,586
09/30/91	CAS Funding Target	$2,603,699	$2,187,676	$124,613	$291,410
	Contribution	$0	$0	$0	$0
	Interest to 09/30/91	$0	$0	$0	$0
09/30/91	Under (Over) Funding	$2,603,699	$2,187,676	$124,613	$291,410
10/01/91	Normal Cost	$2,993,359	$2,569,191	$152,129	$272,039
10/01/91	Amortization Payment	($375,170)	($443,216)	($15,080)	$83,126
10/01/91	CAS Pension Cost	$2,618,189	$2,125,975	$137,049	$355,165
	Interest to 09/30/92	$209,455	$170,078	$10,964	$28,413
09/30/92	CAS Funding Target	$2,827,644	$2,296,053	$148,013	$383,578
	Contribution	$0	$0	$0	$0
	Interest to 09/30/92	$0	$0	$0	$0
09/30/92	Under (Over) Funding	$2,827,644	$2,296,053	$148,013	$383,578

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	Description	Total Company	Other Segment	Medicare A	Medicare B
10/01/92	Normal Cost	$3,345,340	$2,917,614	$127,650	$300,076
10/01/92	Amortization Payment	($766,517)	($795,619)	($66,867)	$95,969
10/01/92	CAS Pension Cost	$2,578,823	$2,121,995	$60,783	$396,045
	Interest to 09/30/93	$206,306	$169,759	$4,863	$31,684
09/30/93	CAS Funding Target	$2,785,129	$2,291,754	$65,646	$427,729
	Contribution	$0	$0	$0	$0
	Interest to 09/30/92	$0	$0	$0	$0
09/30/93	Under (Over) Funding	$2,785,129	$2,291,754	$65,646	$427,729
10/01/93	Normal Cost	$3,690,507	$3,175,762	$157,065	$357,680
10/01/93	Amortization Payment	($705,363)	($710,268)	($85,303)	$90,208
10/01/93	CAS Pension Cost	$2,985,144	$2,465,494	$71,762	$447,888
	Interest to 09/30/94	$238,812	$197,240	$5,741	$35,831
09/30/94	CAS Funding Target	$3,223,956	$2,662,734	$77,503	$483,719
	Contribution	$0	$0	$0	$0
	Interest to 09/30/94	$0	$0	$0	$0
09/30/94	Under (Over) Funding	$3,223,956	$2,662,734	$77,503	$483,719

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	Description	Total Company	Other Segment	Medicare A	Medicare B
10/01/94	Normal Cost	$3,820,404	$3,178,368	$188,946	$453,090
10/01/94	Amortization Payment	($161,642)	($235,784)	($33,646)	$107,788
10/01/94	CAS Pension Cost	$3,658,762	$2,942,584	$155,300	$560,878
	Interest to 09/30/95	$292,701	$235,407	$12,424	$44,870
09/30/95	CAS Funding Target	$3,951,463	$3,177,991	$167,724	$605,748
	Contribution	($3,704,137)	($2,979,077)	($157,226)	($567,834)
	Interest to 09/30/95	($12,979)	($10,438)	($551)	($1,990)
09/30/95	Under (Over) Funding	$234,347	$188,476	$9,947	$35,924
10/01/95	Normal Cost	$328,539	$244,598	$25,757	$58,184
10/01/95	Amortization Payment	($633,794)	($540,626)	($39,828)	($53,340)
10/01/95	CAS Pension Cost	($305,255)	($296,028)	($14,071)	$4,844
	Interest to 12/31/95	($6,105)	($5,921)	($281)	$97
12/31/95	CAS Funding Target	($311,360)	($301,949)	($14,352)	$4,941
	Contribution	$0	$0	$0	$0
	Interest to 12/31/95	$0	$0	$0	$0
12/31/95	Under (Over) Funding	($311,360)	($301,949)	($14,352)	$4,941

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FOOTNOTES

1/ We obtained the total company normal cost from Kentucky's actuarial valuation reports. We obtained normal cost for the Medicare Part A and Medicare Part B segments from data files provided by Kentucky's actuary. The amount shown for the "other segment" represents the difference between the total company and the Medicare segments. For 1986 Kentucky allocated the CAS pension cost based on Medicare segment's salary dollars to total company salary dollars, thus the normal cost for the Medicare segments and other segment was not applicable.

2/ We based the amortization payment on a CAS amortization schedule developed from information obtained from Kentucky'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. For 1986 Kentucky allocated the CAS pension cost based on Medicare segment's salary dollars to total company salary dollars, thus the normal cost for the Medicare segments and other segment was not applicable.

3/ The CAS pension cost represents the sum of the amortization payment and the normal cost. We separately calculated CAS pension costs for years 1992 through 1996.

4/ We applied one year's interest at the assumed rate of 8 percent for years 1987 through 1994 and 2 percent for year 1995 (plan year only 3 months). 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/ Kentucky did not make contributions to its pension plan for 1988 through 1993 and 1995. However, it did make contributions for years 1986, 1987, and 1994. For 1986 we assigned contributions to the Medicare segment based on a ratio of Medicare segment's salary to total company salary. For 1987 and 1994 we assigned contributions to the Medicare segments based on a ratio of Medicare segment's CAS funding target to the total company CAS funding target.

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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.