



Memorandum

Date . MAR 30 1993

From Bryan B. Mitchell *Bryan Mitchell*
Principal Deputy Inspector GeneralSubject Implementation of Financial Accounting Standards Board
Statement Number 106, Entitled: "Employers' Accounting for
Postretirement Benefits Other Than Pensions"
To (A-01-92-00520)William Toby, Jr.
Acting Administrator
Health Care Financing Administration

The attached final management advisory report summarizes the results of our review of the implementation of Financial Accounting Standards Board Statement Number 106 (FASB 106) relating to postretirement costs. The objective of our review was to evaluate the potential impact of the implementation of FASB 106 on hospital costs claimed for reimbursement under Medicare.

The FASB 106 requires an accounting change from the cash basis of accounting to the accrual basis for costs associated with retirees' health benefits. This change in accounting for retirees' health benefits under FASB 106 could materially increase hospital claims for Medicare reimbursement of retiree health care costs. For example, we found one hospital's historical cash basis costs for retirees' health benefits was \$3 million annually. However, by implementing accrual basis accounting under FASB 106, this hospital reported a \$15 million accrual for postretirement health benefits on its Fiscal Year 1991 financial statements and Medicare cost report.

The Health Care Financing Administration (HCFA) issued a proposed rule entitled, "Medicare Program: Clarification of Medicare's Accrual Basis of Accounting Policy" (Proposed Rule) on October 9, 1991 which was intended to strengthen and clarify the Medicare policies for accrued costs. The Proposed Rule provides the requirements to be met for the recognition for Medicare payment with respect to the liquidation of liabilities for the accrual of postretirement health benefits. This Proposed Rule specifies that retiree health care costs must actually be funded in order to qualify for Medicare reimbursement. We recognize that HCFA, in publishing this Proposed Rule, has taken the initiative to further strengthen its existing Medicare reimbursement procedures relative to the accrual basis of accounting. However, until the Proposed Rule

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is issued in final, we believe that HCFA should alert fiscal intermediaries (FI) regarding the implementation of FASB 106 and its potential impact on Medicare reimbursement.

We are recommending that HCFA: (1) incorporate its Proposed Rule into Medicare regulations in a timely manner and (2) alert FIs' provider audit staffs to give special attention to accrued retiree health costs on the Medicare cost reports.

In response to our draft report, HCFA concurred with our first recommendation and concurred in part to our second recommendation. We acknowledge HCFA's comments and have adjusted part (i) of our second recommendation accordingly. We continue to believe, however, that HCFA should alert the FIs' provider audit staffs to give special attention to accrued retiree health costs on the Medicare cost reports.

Please advise us within 60 days, on actions taken or planned on our recommendations. If you have any questions, please call me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits at (410) 966-7104. Copies of this report are being sent to other interested top Department officials.

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**IMPLEMENTATION OF FINANCIAL
ACCOUNTING STANDARDS BOARD
STATEMENT NUMBER 106, ENTITLED:
"EMPLOYERS' ACCOUNTING FOR
POSTRETIREMENT BENEFITS OTHER
THAN PENSIONS"**



MARCH 1993 CIN: A-01-92-00520



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Principal Deputy Inspector General

Subject

Implementation of Financial Accounting Standards Board
Statement Number 106, Entitled: "Employers' Accounting for
Postretirement Benefits Other Than Pensions"
(A-01-92-00520)

To

William Toby, Jr.
Acting Administrator
Health Care Financing Administration

This final management advisory report summarizes the results of our review of the implementation of Financial Accounting Standards Board Statement Number 106 (FASB 106), "Employers' Accounting for Postretirement Benefits Other Than Pensions." The objective of our review was to evaluate the potential impact of the implementation of FASB 106 on hospital costs claimed for reimbursement under Medicare.

The change in accounting for retirees' health benefits under FASB 106 could materially increase hospital claims for Medicare reimbursement of retiree health care costs. Prior to the issuance of FASB 106, financial reporting under generally accepted accounting principles (GAAP) and Medicare reimbursement policies were consistent in that both recognized, for accounting and reimbursement purposes, retirees' health benefits costs when paid. However, the FASB 106 requires hospitals to record present employees anticipated retirement health care costs during the period the employee is still working. This GAAP financial reporting requirement of establishing an accrual for postretirement health care costs is now in conflict with long-standing Medicare reimbursement policy.

The change from the cash basis of accounting to the accrual basis for retirees' health benefits costs could result in a significant increase in retirees' health benefits costs claimed for Medicare reimbursement. For example, during our review of general and administrative (G&A) costs at various hospitals, we found that one hospital in Region I included a \$15 million accrual for retirees' health benefits in its Medicare cost report for the year ended September 30, 1991 although its historical cost basis request for health care cost reimbursement was only \$3 million. Since the \$15 million was unfunded (i.e., funds had not actually been set aside by the hospital for these anticipated costs), we recommended that

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the fiscal intermediary (FI) adjust the hospital's Medicare cost report to disallow Medicare reimbursement of this amount.

The Health Care Financing Administration (HCFA) issued a proposed rule entitled, "Medicare Program: Clarification of Medicare's Accrual Basis of Accounting Policy" (Proposed Rule) on October 9, 1991, to incorporate into the Medicare regulations, its long-standing policy of reimbursing only for costs actually incurred. This Proposed Rule was intended to strengthen and clarify the Medicare policies for accrued costs. The Proposed Rule specifies that retiree health care costs must actually be funded in order to qualify for Medicare reimbursement.

We recognize that HCFA, in publishing the Proposed Rule relating to the treatment of accrued costs, has taken the initiative to further strengthen its existing Medicare reimbursement procedures relative to the accrual basis of accounting. However, until the Proposed Rule is issued in final, we believe that HCFA should alert FIs regarding the implementation of FASB 106 and its potential impact on Medicare reimbursement.

We are recommending that HCFA: (1) incorporate its Proposed Rule into Medicare regulations in a timely manner and (2) alert FIs' provider audit staffs to give special attention to accrued retiree health costs on the Medicare cost reports.

In response to our draft report, HCFA concurred with our first recommendation and concurred in part to our second recommendation. We acknowledge HCFA's comments and have adjusted part (i) of our second recommendation accordingly. We continue to believe, however, that HCFA should alert the FIs' provider audit staffs to give special attention to accrued retiree health costs on the Medicare cost reports.

BACKGROUND

The Medicare program under title XVIII of the Social Security Act, as amended, is a broad program of health insurance for the aged and disabled that is administered by HCFA. The Social Security Amendments of 1983 (Public Law 98-21) established the prospective payment system (PPS) of reimbursement to hospitals under Medicare. Under PPS, hospitals are reimbursed prospectively on a per discharge basis. However, certain types of hospitals are excluded from hospital PPS reimbursements and are reimbursed on a reasonable cost basis with limits where applicable.

Historically, Medicare's long-standing reimbursement policy for retiree health care costs was consistent with the stipulated accounting treatment under GAAP. In this regard, the Medicare program reimbursed providers for retirees' health benefits at the time the provider paid for the expense (i.e., on a cash basis). For example, section 2162.9 of the Provider Reimbursement Manual (PRM) provides that Medicare reimbursement for retiree health care costs (for self-insured institutions) is limited to actual funded payments made by a provider. Further, section 2305 of the PRM provides that accrued costs (such as retiree health costs) cannot be recognized unless the related liability for payment of a commercial health insurance premium is liquidated timely in accordance with specified guidelines.

The HCFA issued a Proposed Rule on October 9, 1991 to incorporate its reimbursement policy into the Medicare regulations. This Proposed Rule was intended to strengthen and clarify the Medicare policies for reimbursement of costs related to the liquidation of liabilities for the accrual of postretirement health benefits. The Proposed Rule specifies that retiree health care costs must actually be funded in order to qualify for Medicare reimbursement.

The FASB 106 established accounting standards for employers' accounting of postretirement benefits other than pensions. Although it applies to all forms of postretirement benefits, it focuses principally on postretirement health care benefits since these are likely to be most significant in terms of cost and prevalence. The FASB 106, which encourages early

adoption, is effective for fiscal years (FY) beginning after December 15, 1992.

The FASB 106 significantly changed the practice of accounting for postretirement benefits from the cash basis to the accrual basis. The FASB 106 requires accrual, during the years that the employee renders the necessary service, of the expected cost of providing postretirement benefits to the employee, and the employee's beneficiaries and covered dependents. As such, institutions are required to report in their financial statements the accrued liability for retirees' health benefits costs for current and retired employees. The FASB 106 requires the reporting of net periodic service costs annually, as well as, a transition obligation (i.e., a cumulative effect of an accounting change) which may be recognized either immediately or amortized over a period up to 20 years.

The FASB 106 states that it applies to any arrangement that is in substance a postretirement benefit plan, regardless of its form, or the means or timing of its funding. This would include an institution's provision of retirees' health benefits through self-insurance. Self-insurance is the means whereby a provider, whether proprietary or nonproprietary, undertakes the risk to protect itself against anticipated liabilities by providing funds in an amount equivalent to liquidate those liabilities.

METHODOLOGY

The objective of our review was to evaluate the potential impact of the implementation of FASB 106 on hospital costs claimed for reimbursement under Medicare. To accomplish our objective, we:

1. reviewed current Medicare regulations, reimbursement principles, and HCFA's October 1991 Proposed Rule relating to reimbursement of postretirement costs and the treatment of accrued costs.
2. reviewed FASB 106 and the guidelines for implementation.

3. discussed the implementation of FASB 106 with the American Institute of Certified Public Accountants (AICPA) and obtained from the AICPA recent articles addressing the implementation of FASB 106.
4. met with FI and HCFA personnel to discuss the implementation of FASB 106 and its potential impact on hospital costs claimed under the Medicare program.
5. examined one hospital's recent implementation of FASB 106 to determine the impact on its Medicare cost report.
6. identified those Boston area hospitals which currently provide retirees' health benefits and will be required to accrue these costs under FASB 106.

Our review was conducted during July and August 1992 at the General Hospital Corporation (Hospital) in Boston, Massachusetts; HCFA central office; and HCFA and Office of Inspector General regional offices in Boston.

The draft report was issued to HCFA on September 29, 1992. The HCFA's written comments, dated February 5, 1993, are appended to this report (see APPENDIX II) and addressed on page 8.

RESULTS OF REVIEW

We found that the change in accounting for retirees' health benefits under FASB 106 could materially increase hospital claims for Medicare reimbursement of retiree health care costs. Prior to the issuance of FASB 106, financial reporting under GAAP and Medicare reimbursement policies were consistent in that both recognized retirees' health benefits costs when paid. However, the FASB 106 requires hospitals to accrue for retirees' health benefits costs, during the years the employees render the necessary service, placing GAAP financial reporting requirements in conflict with long-standing Medicare reimbursement policy.

The HCFA's long-standing Medicare policy has been to reimburse providers for the actual costs incurred for retirees' health benefits. However, implementation of FASB 106 could result in hospitals claiming retiree health care costs for reimbursement without having funded such expenditures. This condition could result in the unwarranted payment of Federal trust funds before they are needed to pay the costs of providers' actual expenditures for the furnishing of health care.

During our review of G&A expenses at the Hospital under CIN: A-01-92-00510, it was noted that the Hospital's historical actual costs for retiree's health benefits were \$3 million annually. However, the Hospital included in its FY 1991 financial statements and Medicare cost report an accrual of \$15 million for postretirement health benefits (the estimated effect on Medicare reimbursement after cost settlement would be \$375,000). Further, the Hospital's total actuarially-determined liability for retirees' health benefits related to employees' past service (i.e., the transition obligation) exceeded \$125 million (approximately \$3.1 million would be reimbursed under the Medicare program after cost settlement). The Hospital, however, has not funded any portion of this liability and has stated that it does not plan on doing so (i.e., the Hospital will continue its present policy of only funding actual present day costs for retiree health costs).

In its response to our report on G&A costs, the Hospital stated that it believes that the accrual for health care benefits is comparable to its vacation accrual costs and, therefore, allowable. It also cited what it believed to be a lack of guidelines relative to the accrual basis of accounting and the treatment of accruals under the Medicare program. Since the \$15 million was unfunded, we recommended that the FI adjust the hospital's Medicare cost report. The FI agreed and has withdrawn the \$15 million accrual for retirees' health benefits costs from the Hospital's FY 1991 Medicare cost report during its cost settlement process.

In addition to its response to our report on G&A costs, the Hospital sent us a letter restating and further clarifying its position on the accounting treatment for retirees' health benefits. This letter (see APPENDIX I) states that the Hospital interpreted HCFA's October 9, 1991 Proposed Rule as support for claiming the unfunded liability. The Hospital believes that in the Proposed Rule "...HCFA itself has acknowledged [that] its accrual accounting policies have been unclear for some time." We disagree with the Hospital and

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feel that HCFA's Proposed Rule will further strengthen its existing policy. But, HCFA should implement the Proposed Rule into Medicare regulations in a timely manner. However, until the Proposed Rule is issued in final, we believe that HCFA should alert FIs regarding the implementation of FASB 106 and its potential impact on Medicare reimbursement. Provider audit staffs should be advised to give special attention to accrued retiree health costs on Medicare cost reports.

The change from the cash basis of accounting to the accrual basis for retirees' health benefits costs could result in a significant increase in retirees' health benefits costs claimed for Medicare reimbursement. We expect many major Medicare providers to implement FASB 106 within the next year or so. The Hospital's two affiliated corporations have or are in the process of implementing FASB 106. Further, other major Boston area hospitals provide retiree health insurance benefits and will be required to implement FASB 106 for FYs beginning after December 15, 1992. Additionally, the implementation of FASB 106 not only impacts on the Medicare program, but also on any institution or entity that does business with the Government. For example, we anticipate that Medicare contractors will implement FASB 106 and include an accrual for retiree health benefits costs in their administrative cost budgets submitted to HCFA. However, for it to be allowable and reimbursable under Medicare policy, the transition obligation would have to be funded. Therefore, we suggest that HCFA take the necessary action to ensure that its provider audits encompass this issue.

RECOMMENDATION

We are recommending that HCFA:

1. incorporate its Proposed Rule into Medicare regulations in a timely manner. This will facilitate the proper treatment of these costs under the Medicare program during provider implementation of FASB 106.
2. alert the FIs' provider audit staffs to give special attention to accrued retiree health costs on Medicare cost reports. This will enable early implementation of FASB 106 to be monitored to prevent and detect the inclusion of unfunded retiree health care costs.

**HCFA COMMENTS &
OIG RESPONSE**

HCFA COMMENTS - RECOMMENDATION NUMBER 1

The HCFA concurred with the Office of Inspector General (OIG) recommendation. The HCFA stated that a final rule, incorporating its October 9, 1991 proposed rule into the Medicare regulations, will be published in the Federal Register in 1993.

HCFA COMMENTS - RECOMMENDATION NUMBER 2

The HCFA did not concur with part (i) of this recommendation (i.e., to send a letter to FIs to clarify how accruals qualify for reimbursement - see page 3 of APPENDIX II), and its position on part (ii) is unclear. The HCFA stated that it believes that current guidelines contained in the PRM address Medicare's long-standing policy (which has been in effect since April 1, 1978) relative to Medicare's payment for a provider's cost of employee benefits only when actually paid (or accrued and liquidated timely). Further, the HCFA stated that it did not see FASB 106 as a departure from its long-standing reimbursement policy. As such, the HCFA did not

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believe that it is necessary to reaffirm its policy to FIs or their provider audit staffs at this time.

OIG RESPONSE

We acknowledge HCFA's comments and have adjusted part (i) of our second recommendation accordingly. We do, however, continue to believe that the HCFA should alert FIs' provider audit staffs of the potential inclusion of significant accruals for retiree health care costs in light of the fact that FASB 106 results in a change in hospitals' accounting treatment for retiree health care costs. It is in the best interests of the Medicare program that provider audit staffs be made aware of this potential problem area so that they may design audit steps aimed at identifying such accrued costs during its settlement process.

In addition to the issues discussed above, HCFA may need to address the specifics of FASB 106, such as the treatment of the transition obligation (which represents the measurement of the failure to accrue the retiree health obligation in earlier periods as it arose). For example, the FASB 106 permits the transition obligation to be recognized either immediately in net income of the period of the change, or on a delayed basis as a component of net periodic postretirement health benefits cost. While provider funding of the full transition obligation may be remote, there exists the possibility that a provider may choose to recognize and fund the entire transition obligation. As such, the HCFA may want to include in its Medicare PRM similar language as the Federal Acquisition Regulation to preclude Federal reimbursement with respect to the liquidation of the transition obligation for hospitals which may elect to take a one-time charge.

APPENDICES

The Massachusetts General Hospital
Boston 02114

ST M HADBAD
 SECRETARY
 GENERAL COUNSEL

TELEPHONE: (617) 728-8620
 TELECOPIER: (617) 728-8628

July 9, 1992

Richard P. Kusserow
 Inspector General
 Department of Health and Human Services
 330 Independence Avenue, S.W.
 Washington, D.C. 20201

Re: CIN A-01-92-00510

Dear Mr. Kusserow:

I am writing on behalf of The General Hospital Corporation (the Hospital) to comment on certain findings in the final report of the Hospital's fiscal year 1991 general and administrative and fringe benefit costs (the Report) prepared by the Regional Inspector General for Audit Services and his staff. For the reasons set forth below, the Hospital maintains that its accrual of liability for post-retirement medical benefits for its employees was properly included on its 1991 Medicare cost report, and that the item should be excluded from the OIG's findings.

I. Post-Retirement Medical Benefits Are Allowable Costs under the Medicare Program.

It is important to note at the outset that there is no dispute that the Medicare program has and will continue to reimburse providers for the allocable portion of the reasonable costs of providing post-retirement medical benefits to providers' employees. Such costs are "fringe benefits" as defined in the Provider Reimbursement Manual (PRM) ("amounts paid to, or on behalf of, an employee in addition to direct salary or wages, and from which the employee, his dependant . . . or his beneficiary derives a personal benefit before or after the employee's retirement or death.") PRM, Part I, §2144.1 The Medicare program consistently has reimbursed the Hospital for such costs in the past at the time the Hospital paid them. Thus, the Report did not identify a category which is not reimbursable by the Medicare program. Rather, the only question raised by the Report is the proper accounting method used to determine such costs and to report them to the Medicare program. As demonstrated below, the Hospital acted properly in its accounting and reporting of such costs.

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II. A New Standard of the Financial Accounting Standards Board Prompted the Hospital to Change Its Method of Accounting For and Reporting the Costs of Post-Retirement Employee Benefits.

The Financial Accounting Standards Board (FASB) adopted the Statement of Financial Accounting Standards No. 106 (FAS 106) in December 1990. FAS 106 must be adopted for fiscal years beginning after December 15, 1992; however, the Statement explicitly encourages earlier adoption. FAS 106, §108. The Statement requires employers to estimate their anticipated liabilities for employees' post-retirement medical benefits and accrue the liabilities during the period the employees render services. Obviously, the transition to the accrual basis for such costs will require employers to recognize liabilities related to prior cost reporting periods. FAS 106 provides that an employer may recognize such liabilities either immediately or prospectively. FAS 106, §110. The Hospital chose to recognize a portion of its liability for prior periods in fiscal year 1991 rather than incur the total, significantly larger, liability in a single year.

III. The Hospital Acted Properly In Applying the Accrual Basis of Accounting in Light of the Absence of Regulations Needed to Implement FAS 106.

The Social Security Act itself requires that cost determinations be in accordance with "principles generally applied by national organizations." 42 U.S.C. §1395x(v)(1)(A). Moreover, Medicare regulations state that the cost data provided to the program must be based on the accrual basis of accounting, under which, the regulations expressly provide, "expenses are reported in the period in which they are incurred, regardless of when they are paid." 42 CFR 5413.24(b)(3).

FAS 106 requires a significant change in the Hospital's accounting procedures, and will affect other providers in the same way. To date, there are no regulations or manual provisions to guide providers in preparing their cost reports in light of FAS 106. The Medicare program in all likelihood will need to address how providers should prepare their cost reports in light of this broad-reaching change in generally accepted accounting principles. In the absence of specific regulations governing the accounting method to be used for a given transaction, however, it is now well-established that a provider must apply generally accepted accounting principles. A number of federal courts, including the District of Massachusetts, have so held. Bartlett Hospital East v. Sullivan, Medicare and Medicaid Guide, (CCH) ¶40,227 (D. W. Ky. 1991) (loss on advance refunding of bonds allowed in year incurred); Medical Society of South Carolina

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d/b/a Roper Hospital v. Heckler, Medicare and Medicaid Guide,
(CCH) ¶33,651 (D.S.C. 1984) (accrual basis of accounting requires
sick pay costs to be reimbursed when earned, not when cash
payment is made). Medicare regulations support this principle,
stating that cost data should generally be derived from a
provider's books as usually maintained.¹ The Hospital, in
preparing its 1991 financial statements and cost report, applied
the newly-established accounting principles in recording a
portion of the accrued liability for post-retirement medical
benefits. This action was entirely consistent with, and required
by, Medicare reporting principles in the absence of any direction
to the contrary.

IV. The Hospital Was Required to Include the Accrued Liability
on its Cost Report to Preserve its Appeal Rights.

In the absence of specific guidance from the Medicare
program, the Hospital believes that it should treat the cost of
post-retirement medical benefits in a manner similar to the way
it has reported the cost of accrued vacation benefits.²
Accordingly, the Hospital, in the same manner that it had treated
vacation accrual, included the accrued liability on its cost
report and notified the fiscal intermediary that it had done so.
Even if the Hospital expected that the fiscal intermediary would
disagree with the Hospital's position and disallow the accrued
liability, "[t]he provider must include the nonallowable item in
the cost report in order to establish an appeal issue." PRM,
Part II, §115. The fiscal intermediary then has the
responsibility of providing guidance to the provider, and
settlement discussions between the provider and the fiscal
intermediary are encouraged. PRM, Part II, §52905.2, 2907. In
this case, the fiscal intermediary did declare the accrued
liability unallowable, and the Hospital did not receive any
payment from the Medicare program in relation to these costs.
The Hospital has, however, preserved its right to appeal the
disallowance before the PRRB. Such procedures are necessary

¹ "Standardized definitions, accounting, statistics, and
reporting practices that are widely accepted in the
hospital and related fields are followed. Changes in
these practices and systems will not be required in
order to determine the costs payable under the
principles of reimbursement." 42 CFR §413.20.

² Significantly, the Provider Reimbursement Manual does
contain detailed procedures for the transition from
cash-based accounting to the accrual method of
accounting for vacation benefits. PRM, Part I,
§2146.4.

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because, as HCFA itself has acknowledged, its accrual accounting policies have been unclear for some time.¹

V. The Hospital Could Not Reasonably Be Expected to Pursue "Written Clarification" from HCFA or the Fiscal Intermediary.

The Report states that, rather than including the accrued liability in its cost report, the Hospital should have requested HCFA or the fiscal intermediary to provide written clarification as to how to treat the accrued liability on the fiscal year 1991 cost report. This statement indicates a fundamental misunderstanding of the Hospital's position on this matter, and ignores the practical difficulties inherent in such an endeavor.

First, the Hospital at all relevant times has believed that the accrued liability is properly included in the cost report under current reporting rules, for the reasons set forth in Sections I-III, above. Accordingly, the Hospital had no reason to seek such advice, particularly since it knew that it would have an opportunity to discuss the issue with the fiscal intermediary, as described above. Moreover, the Report fails to acknowledge that, even if the Hospital obtained clarification from HCFA or the fiscal intermediary, the Hospital would be required to include the accrued liability in the cost report to preserve its right to appeal if it disagreed with HCFA's or the fiscal intermediary's interpretation.

In addition, despite the Report's reference to "normal and proper channels," even if the Hospital believed it needed clarification, it is not aware of any formal procedure to obtain written clarification from HCFA. As HCFA is well aware, the Hospital does not have unlimited time in which to prepare its cost report. If the Hospital had requested such clarification informally, it would have had no guarantee (and no basis to believe) that any clarification provided would have been timely. With respect to clarification from the fiscal intermediary, it is the Hospital's understanding that the settlement process described in Section IV, above, is the "normal and proper channel" for such clarification.

¹ HCFA published a Proposed Rule on October 9, 1991, the stated purpose of which was to "clarify the concept of 'accrual basis of accounting.'" 56 Fed. Reg. 50,234 (1991).

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VI. The Accrued Liability for Post-Retirement Medical Benefits is Not a "Self-Insurance Reserve" as Defined By Medicare.

The Report states that by accruing the liability for post-retirement medical benefits, the Hospital established a "self-insurance reserve," but failed to meet the Medicare requirements for such a reserve. As a result, the OIG declared the costs unallowable. This reasoning is flawed, however, in that the accrued liability is not, and the Hospital never intended it to be, a self-insurance reserve as that term is defined for the Medicare program. The costs reported, as directed by FAS 106, are a recognition of the future costs of providing post-retirement medical benefits to the Hospital's employees, or the expected cost of insurance premiums that the Hospital will pay for employees following their retirement. Had the Hospital itself established a reserve for the expected health care costs of these employees (i.e., a "self-insurance reserve," as suggested by the OIG) the liability would be a significantly higher amount than that reported by the Hospital, and would have resulted in the Hospital reporting much higher costs than it did in fact report for 1991.

The Hospital recognizes that, in some instances, Medicare will reimburse providers for their future liabilities when the provider establishes a fund with a fiduciary and the fund is managed in accordance with the requirements set forth in the Provider Reimbursement Manual. PRM, Part I, §2162.7. Those requirements, however, do not address the applicability of FAS 106 or the costs at issue. Moreover, the HCFA manual provision, which relates only tangentially to the costs at issue, cannot overrule the clear mandate of the Social Security Act that providers use the accrual basis of accounting.

Finally, the Report's reference to the notes to the Hospital's financial statements is misleading. While the Report focuses on Note A, which addressed other self-insurance reserves, it ignores the fact that the Hospital's 1991 Balance Sheet shows the \$15 million accrual as "Accrued Employee Benefits and Other" liability, and references a full discussion of this item in Note G. These entries are quite different from the implication in the Report that the Hospital attempted to establish a self-insurance reserve but failed to meet the Medicare requirements.

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The Hospital remains eager to work with the Medicare program as it seeks to clarify reporting requirements. We would be grateful for your careful consideration of these comments.

Sincerely,



Ernest M. Haddad
General Counsel

cc: Richard J. Ogden
Regional Inspector General for Audit Services
Norma E. Burke
Associate Regional Administrator, Medicare Division
Health Care Financing Administration



Memorandum

Date *William Toby, Jr.* FEB 5 1993
 From William Toby, Jr.
 Acting Administrator

Subject Office of Inspector General (OIG) Draft Management Advisory Report:
 Implementation of Financial Accounting Standards Board Statement No. 106,
 Entitled "Employers' Accounting for Postretirement Benefits Other Than Pensions,"
 To (A-01-92-00520)

Bryan B. Mitchell
 Principal Deputy Inspector General

We have reviewed the draft management advisory report which describes how the change in accounting for retirees' health benefits under the Financial Accounting Standards Board Statement No. 106 (FASB 106) could significantly increase hospital claims for Medicare reimbursement of retirees' health care costs. The FASB 106 requires hospitals to change from the cash basis of accounting to the accrual basis for costs associated with retirees' health benefits, thus placing the generally accepted accounting principles (GAAP) financial reporting requirements in conflict with longstanding Medicare reimbursement policy. According to OIG, this change in accounting could result in hospitals claiming retiree health care costs for reimbursement before costs have actually been incurred.

OIG recommends that the Health Care Financing Administration (HCFA): (1) incorporate its proposed rule (which clarifies Medicare policy for accrued costs) into Medicare regulations in a timely manner, and (2) send a letter to fiscal intermediaries (FIs) to (i) clarify existing policy on how accruals for retirees' health benefits costs qualify for reimbursement, providing specific examples of instances where HCFA will reimburse for accruals, and (ii) request that their provider audit staff give special attention to accrued retiree health care costs on the Medicare cost reports.

We are pleased that OIG recognized our initiative to clarify existing Medicare reimbursement policy through issuance of a proposed rule entitled "Medicare Program: Clarification of Medicare's Accrual Basis of Accounting Policy,"

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which specifies that retiree health care costs must actually be funded in order to qualify for Medicare reimbursement. This proposed rule will be incorporated into Medicare regulations. However, we do not see FASB 106 as a departure from HCFA's longstanding reimbursement policy which is addressed in the Provider Reimbursement Manual and is effective for costs incurred during cost reporting periods beginning on or after April 1, 1978. Therefore, we do not believe it is necessary to issue a letter to FIs at this time. Our specific comments are attached for your consideration.

Thank you for the opportunity to review and comment on this report. Please advise us if you agree with our position on the report's recommendations at your earliest convenience.

Attachment

Comments of the Health Care Financing Administration (HCFA)
on Office of Inspector General (OIG) Draft Management Advisory Report -
Implementation of Financial Accounting Standards Board Statement No. 106,
Entitled "Employers' Accounting for Postretirement Benefits Other Than Pensions"

Recommendation 1

HCFA should incorporate its proposed rule into Medicare regulations in a timely manner.

HCFA Response

HCFA concurs with the recommendation. The proposed rule, entitled "Medicare Program: Clarification of Medicare's Accrual Basis of Accounting Policy," states in the preamble and in the regulatory language that "accrual of postretirement health benefits cannot be recognized unless the related liability for payment to a self-insurance fund or for a commercial health insurance premium is liquidated timely." A final rule will be published later this year in the Federal Register incorporating the October 9, 1991, proposed rule into Medicare regulations.

Recommendation 2

HCFA should send a letter to fiscal intermediaries to (i) clarify how accruals qualify for reimbursement, and (ii) request that their provider audit staff give special attention to accrued retiree health benefits costs on the Medicare cost reports.

HCFA Response

HCFA does not concur with the recommendation. We believe that the Provider Reimbursement Manual adequately addresses Medicare's longstanding policy. We also believe it is not necessary to reaffirm the policy to intermediaries or their provider audit staff at this time. HCFA's policy, which has been in effect since April 1, 1978, permits payment for a provider's cost of employee benefits only when actually paid (or accrued and timely liquidated) or, in the case of pensions, deferred compensation, self-insurance, etc., when payment is made into a qualifying fund (or accrued and timely liquidated).