

**Memorandum**

Date DEC 27 1993

From June Gibbs Brown
Inspector General *June G Brown*

Subject Impact of the Employee Retirement Income Security Act Full
Funding Limitation on Medicare Contractors' Funding of
Pension Costs (A-07-93-00684)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of our final report entitled, "Impact of the Employee Retirement Income Security Act Full Funding Limitation on Medicare Contractors' Funding of Pension Costs." Our review consolidates the results of our audits of pension assets of two Medicare contractors that were members of the Blue Cross/Blue Shield Association's (BCBSA) National Employee Benefits Administration (NEBA) and had adopted the National Retirement Program (NRP). We found that the contractors, based on NEBA's advice as the pension plans' administrator, were not accounting for pension assets of the Medicare segment in accordance with the Medicare contracts, the Federal Acquisition Regulations (FAR), and the Cost Accounting Standards (CAS).

The NEBA provides consulting and administrative services to 27 individual BCBSA plans which adopted the NRP as offered to its members by the BCBSA. In this capacity, NEBA provides plan guidance and accounting services to member plans.

Beginning with Fiscal Year 1988, Medicare contracts require the separate identification, calculation, and reporting of pension assets, and when appropriate, costs for the Medicare segment of its business. Compliance with the contracts includes: (1) establishing a ratio using the 1981 actuarial liabilities of the segment and the total plan, (2) applying the ratio to total pension assets as of 1986, and (3) annually updating the Medicare segment's 1986 pension assets. Included in the annual updates are pension costs computed in accordance with CAS 412 and 413 and funded in accordance with the FAR. The FAR requires funding of the CAS computed pension costs for them to be allowable for Medicare

reimbursement. Both the FAR and the CAS prohibit the reassignment and reimbursement of any pension costs, and associated interest thereon, which are not funded.

Based on NEBA's advice, the contractors opted not to fund CAS computed pension costs with deposits to their pension trust funds. The primary reason was to avoid a substantial excise tax penalty since the pension plans were fully funded under the Employee Retirement Income Security Act.

Again, based on NEBA's advice, the two contractors, in an attempt to protect the allowability of CAS pension costs for future Medicare reimbursement, used paper transfers of pension assets from their nonsegments to fund their Medicare segments in annually updating the pension assets of the Medicare segments. Such transfers do not constitute funding and are unacceptable in meeting the funding requirements of the FAR and CAS. Both NEBA and the two contractors concurred with our removal of the paper transfers from the Medicare segment updates.

The NEBA indicated that all other member plans in similar situations had followed similar advice. The annual updates of the Medicare segment assets are the official record for determining Medicare's claim against trust funds in the event of pension plan or contract terminations. It is imperative that this record reflect accurate figures determined in accordance with the contract and regulations. We believe that NEBA should follow through and remove transferred pension assets from the pension plan records of all other member plan Medicare contractors.

We recommend that the Health Care Financing Administration (HCFA) require that NEBA revise the Medicare segment updates for all NEBA contractors that executed paper transfers in an attempt to fund CAS pension costs.

The HCFA concurred with our recommendation and stated that appropriate instructions will be issued.

Please advise us, within 60 days, on actions taken or planned on our recommendation. 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 top Department officials.

Attachments

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**IMPACT OF THE EMPLOYEE
RETIREMENT INCOME SECURITY ACT
FULL FUNDING LIMITATION ON
MEDICARE CONTRACTORS' FUNDING
OF PENSION COSTS**



DECEMBER 1993 A-07-93-00684

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Subject Impact of the Employee Retirement Income Security Act Full
Funding Limitation on Medicare Contractors' Funding of
Pension Costs (A-07-93-00684)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

This report provides you with the results of our review of the "Impact of the Employee Retirement Income Security Act Full Funding Limitation on Medicare Contractors' Funding of Pension Costs." Our review consolidates the results of our audits of Medicare pension assets at two Medicare contractors that were members of the Blue Cross/Blue Shield Association's National Employee Benefits Administration (NEBA) and had adopted the National Retirement Program (NRP). The NRP is offered to individual Blue Cross and Blue Shield plans by the Blue Cross and Blue Shield Association. The NEBA provides consulting and administrative services for member plans. Twenty-seven Medicare contractors are members of the NRP.

Our two audits showed that the contractors, based on advice from NEBA in acting as the pension plans' administrator, were not accounting for Medicare pension assets in accordance with the Medicare contracts, the Cost Accounting Standards (CAS), and the Federal Acquisition Regulations (FAR). Beginning with Fiscal Year 1988, Medicare contracts require the separate identification, calculation, and reporting of pension assets, and when appropriate, costs for Medicare. Compliance includes the annual updating of the pension assets of Medicare. The pension assets used in the updates are to be determined in accordance with CAS 412 and 413 and funded in accordance with the FAR.

Our audits showed that the two member plans followed NEBA's advice and did not fund pension costs computed in accordance with CAS with deposits to pension trust funds. Deposits to the pension trust fund could have resulted in excise tax penalties since the pension plans were fully funded under the Employees Retirement Income Security Act (ERISA). Both

the FAR and the CAS prohibit the reassignment and subsequent reimbursement of pension costs applicable to an accounting period to a later accounting period.

Again, based on NEBA's advice, the two contractors, in an attempt to protect the allowability of CAS pension costs for future Medicare reimbursement, transferred non-Medicare pension assets to Medicare assets in annually updating the pension assets of Medicare. Such paper transfers do not constitute funding and are unacceptable in meeting the funding requirements specified in the FAR and CAS. Both NEBA and the two contractors concurred with our removal of the paper transfers from the Medicare updates.

The NEBA indicated that all other member plans in similar situations had received and followed similar advice. Since the annual updates of Medicare assets are the official record for determining any Medicare claim against trust funds upon pension plan or contract terminations, the updates need to reflect pension assets in accordance with the contract and regulations. We believe that NEBA should follow through and remove transferred pension assets from the pension plan records of all other member plan Medicare contractors.

We recommend that the Health Care Financing Administration (HCFA) require that NEBA revise the Medicare segment updates for all NEBA contractors that executed paper transfers to fund CAS pension costs in updating the pension assets of their Medicare segments. The HCFA concurred with our recommendation. A copy of the text of HCFA's response is included as an Attachment to this report.

BACKGROUND

Title XVIII of the Social Security Act, Health Insurance for the Aged and Disabled (Medicare), provides that organizations may help in administering the Medicare program under contracts with the Secretary, Department of Health and Human Services. Most Medicare contractors, intermediaries (Part A) and carriers (Part B), perform under cost reimbursement contracts renewed annually. Included in reimbursable costs is Medicare's share of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the contracts, the FAR, which superseded the Federal Procurement Regulations (FPR), and the CAS. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

As the result of an Office of Inspector General report, "Medicare Intermediaries and Carriers Should Be Required to Use Segment Accounting For Claiming Pension Costs" (A-07-86-62013), issued on October 8, 1985, HCFA incorporated pension segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and provides for the separate identification of the pension assets for a Medicare segment. The contracts require:

- o computing the Medicare segment's actuarial liability as of 1981,
- o determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability as of 1981,
- o allocating a portion of total pension assets as of 1986 based on the 1981 ratio,
- o updating Medicare pension assets annually, and
- o assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

"The term 'Medicare Segment' shall mean any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or
2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract."

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare

segment to the actuarial liabilities of the total plan as of the first day of the first plan year starting after December 31, 1980.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The FAR funding requirement has traditionally been satisfied by trust fund deposits qualifying for tax-exemptions under ERISA. The ERISA provided for a minimum and a maximum deposit to pension funds as determined each year. The minimum represented a required deposit while the maximum represented the upper limit that could be deducted for income tax purposes for the year for which the deposit was applicable.

Pension costs computed in accordance with CAS represented an assignment of pension costs to specific accounting periods. The CAS pension costs often fell between ERISA minimum and maximum contributions. If contractors deposited the minimum ERISA contribution in their qualified trust fund, 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.

In contrast, before 1986, if CAS pension costs 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.

The Tax Reform Act of 1986 (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.

With the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), the Congress took additional action affecting contractors pension plan contributions to qualified trust funds. Prior to OBRA '87, ERISA's full funding limitation traditionally considered accumulated assets and the actuarial liability. If assets equalled or exceeded actuarial liability, then the tax deductible amount was limited to zero.

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.

We recognize that Government contractors, if impacted by either of the full funding limitation tests, would probably not make tax deductible contributions to the pension trust fund due to the unreimburseable excise tax penalty. Nevertheless, contractors would still be required to comply with the FAR and CAS requirements and fund the Medicare CAS costs in a timely manner, or risk making the CAS costs unallowable in the future.

SCOPE OF AUDIT

Our review was done in accordance with generally accepted government auditing standards. The purpose of this review was to consolidate the results of our audits of two Medicare contractors who were members of NEBA and had adopted the NRP.

The report is based on the segmentation audit results at two Medicare contractors: Blue Cross and Blue Shield of Florida, Inc. (A-07-92-00473 issued on November 23, 1992) (Florida) and Blue Cross and Blue Shield of Arizona, Inc. (A-07-92-00586 issued on September 18, 1992) (Arizona). In those audits, we reported that funding used in the annual

updates of the Medicare segment pension assets did not constitute funding of the pension plans in accordance with the FAR and CAS.

Audits at the two Medicare contractors involved the period from the initial asset allocation, generally 1986, through 1992. We performed our field work during January 1993.

RESULTS OF AUDIT

We found that NEBA is not updating the pension assets of the segments of its members that are Medicare contractors in accordance with the Medicare contracts, the FAR, and the CAS. Since updates of Medicare segment assets determine Medicare's share of any excess assets upon plan or contract terminations, the updates need to be in accordance with the contracts and regulations.

The NEBA provides consulting and administrative services for individual Blue Cross and Blue Shield plans which have adopted the NRP. In this capacity, NEBA provides pension plan guidance and accounting services to member plans. Services provided by NEBA to its member plans that are Medicare contractors includes the initial segmentation as well as the annual updates of the pension assets for their Medicare segments.

We have performed audits of two plans (Florida and Arizona) that are members of NEBA. Our audits of the two member plans showed that, based on NEBA's advice, the contractors opted not to fund, by deposits to the pension trust fund, pension costs that exceeded the Full Funding Limitation of ERISA. The primary reason these contractors followed NEBA's financial advice was to avoid a substantial excise tax penalty imposed by TRA '86. Although fully funded under ERISA, the two plans still had pension costs computed in accordance with CAS that either had to be funded or be excluded from current and future Medicare costs.

Part 31 of the FAR requires funding of the pension cost computed for and assigned to each period in accordance with CAS 412 and 413. Both the FAR and the CAS prohibit the reassignment and reimbursement of any pension costs, and associated interest thereon, which are not funded.

The FAR at 48 CFR 31.205-6(j)(2)(i) states:

"...to be allowable in the current year, pension costs must be funded by the time set for filing the

Federal income tax return or any extension thereof. Pension costs assigned to the current year, but not funded by the tax return time, shall not be allowable in any subsequent year."

In a parallel fashion, the CAS does not permit the reassignment to future periods of pension costs not funded. The portion of the unfunded actuarial liability (UAL) attributable to the cost not funded must be separately identified. Amortization of this separately identified UAL can never be a component of pension cost in the future. The CAS at 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..."

In addition, no amount for interest on the portion of pension costs not funded in a period can be a component of any future cost accounting period cost. The CAS at 48 CFR 9904.412-50(a)(7) states:

"If any portion of the pension cost 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."

As plan administrator for these contractors, NEBA attempted to use a nontraditional accounting approach to comply with the FAR and CAS and the 1988 contract amendment requiring the current funding of pension costs computed in accordance with CAS when preparing asset updates for Medicare segments. Instead of making deposits to the trust fund, NEBA equated the transferring of assets to the funding of the CAS pension cost.

The NEBA attempted to comply with the FAR and the CAS regulations by paper transfers of assets within the trust funds from the indirect cost pools to the Medicare segments. This method allowed NEBA to show the proper amount of contributions for the CAS pension costs in asset updates of the Medicare segments. The NEBA indicated that all member plans that were Medicare contractors (27) and were fully funded under ERISA, but having CAS pension costs, had their Medicare segment updates calculated using the same methodology.

Despite the accounting logic for this paper transaction, the mere paper transfer of assets does not constitute funding.

As noted by an administrative law judge of the Armed Services Board of Contract Appeals in the Chrysler case (71-1 BCA P8779) funding of a pension trust fund should represent "...something more substantial than the gleam in an actuary's eye or the flick of a bookkeeper's pen."

Furthermore, NEBA transferred the assets accumulated by prior deposits (contributions) from indirect cost pools. These prior contributions had previously been considered for Medicare reimbursement. The NEBA focused only on the pension costs of the Medicare segments and overlooked that Medicare also reimburses a share of all other pension costs on an indirect basis.

We reported that this accounting treatment was unacceptable at the two contractors. The NEBA and the contractors concurred with the removal of unfunded contributions from their Medicare segment updates.

The update of the Medicare segment assets is the official record for determining Medicare's claim against the trust fund in the event of plan or contract termination. It is imperative that this record reflect accurate figures determined in accordance with the contract and regulations.

RECOMMENDATION

We recommend that HCFA require NEBA to revise the Medicare segment asset updates for all NEBA contractors where contributions were based upon paper transfers of assets within the trust fund.

THE HCFA RESPONSE

The HCFA concurred with our recommendation. A copy of the text of HCFA's response is included as an Attachment to this report.



DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care
Financing Administration

Memorandum

NOV 3 1993

RECEIVED
11/5/93

Date: Bruce C. Vladeck
From: Administrator

Subject: Office of Inspector General (OIG) Draft Report: "Impact of the Employee Retirement Income Security Act (ERISA) Full Funding Limitation on Medicare Contractors' Funding of Pension Costs" (A-07-93-00684)

To: Bryan B. Mitchell
Principal Deputy Inspector General

We reviewed the above-referenced report in which OIG found that the National Employee Benefits Administration (NEBA) is not updating the pension assets of the Medicare segments of its members who are Medicare contractors in accordance with Medicare contracts, the Federal Acquisitions Regulation, and Cost Accounting Standards.

We concur with OIG's recommendation that the Health Care Financing Administration require NEBA to revise the Medicare segment asset updates for NEBA contractors where contributions were based upon paper transfers of assets within the pension fund. We will issue appropriate instructions to NEBA. In addition, we plan to issue these instructions to the Wyatt Company itself, to ensure compliance.

Thank you for the opportunity to review and comment on this draft report.

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