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

February 18, 2004

Report Number: A-07-04-03053

Mr. Charles R. Hartsell
President and Chief Operating Officer
Cahaba Government Benefit Administrators
P.O. Box 830139
Birmingham, Alabama 35283-0130

Dear Mr. Hartsell:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General draft report entitled ***"Review of Cahaba Government Benefit Administrators Unfunded Pension Costs."*** A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. 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), Office of Inspector General reports issued to the Department's grantees and contractors are made available 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.)

If you have any questions or comments about this report, do not hesitate to call me or Gregory Tambke, Audit Manager at (573) 893-8338, ext. 30 or through e-mail at gtambke@oig.hhs.gov. To facilitate identification, please refer to Report Number A-07-04-03053 in all correspondence relating to this report.

Sincerely,

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures – as stated

Directly Reply to HHS Action Official:

Rose Crum-Johnson
Regional Administrator
Centers for Medicare & Medicaid Services
Atlanta Federal Center
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303-8909

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF CAHABA GOVERNMENT BENEFIT ADMINISTRATORS UNFUNDED PENSION COSTS

FEBRUARY 2004
A-07-04-03053

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 awarding agency will make final determination on these matters.

EXECUTIVE SUMMARY

OBJECTIVE

The purpose of our review was to:

- Determine if pension costs allocable to the Medicare contracts for plan years 1994 through 1995 were funded in accordance with the Federal Acquisition Regulations (FAR).

- Determine if the accumulated unfunded pension costs identified in our prior review (Report Number: A-07-94-00817) have been properly accounted for.

- Identify any unallowable components of the accumulated unfunded pension costs.

FINDINGS

We found that Cahaba funded the pension costs allocable to the Medicare contracts for plan years 1994 and 1995 in accordance with FAR. Additionally, Cahaba accounted for the accumulated unfunded pension costs that were identified in our prior review. However, Cahaba had some minor errors in its calculation of unallowable unfunded pension costs.

Effective January 1, 1996, the revised Cost Accounting Standards (CAS) allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. However, the revision to the 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, then those costs and any accrued interest on those costs are unallowable in future periods. The unallowable portion of accumulated unfunded pension costs must be updated, with interest, as per CAS regulations.

We determined that a portion of Cahaba's accumulated unfunded pension costs could have been funded in the year incurred, but Cahaba chose not to fund those costs. Consequently, those unallowable costs must be updated with interest, and removed from future periods' pension cost computations. Cahaba identified unallowable costs of $650,223 for the Medicare segment, and $3,193,808 for the "Other" segment as of January 1, 2002.

We updated the unallowable portion of Cahaba's accumulated unfunded pension costs from January 1, 1994 to January 1, 2002. We found the unallowable costs to be $672,724 for the Medicare segment, and $3,333,817 for the "Other" segment as of January 1, 2002.

RECOMMENDATIONS

We recommend that Cahaba:

- Adjust the unallowable component of Medicare segment pension costs to $672,724 as of January 1, 2002.

- Adjust the unallowable component of the "Other" segment's pension costs to $3,333,817 as of January 1, 2002.

- Update annually the unallowable components of pension costs for the Medicare and "Other" segments.

AUDITEE COMMENTS

Cahaba stated that it did account for the accumulated unfunded pension costs in its actuarial reports. However, Cahaba also acknowledged that its calculation was slightly incorrect. Cahaba is in agreement with the unallowable component of unfunded costs as shown in this report. Cahaba's comments are included in their entirety as Appendix A.

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Glossary of Abbreviations and Acronyms

FAR	Federal Acquisition Regulations
CAS	Cost Accounting Standards
FPR	Federal Procurement Regulations
CFR	Code of Federal Regulations
ERISA	Employees Retirement Income Security Act of 1974
TRA 86	Tax Reform Act of 1986
OBRA 87	Omnibus Budget Reconciliation Act of 1987
OAS	Office of Audit Services
CMS	Centers for Medicare and Medicaid Services

INTRODUCTION

BACKGROUND

Cahaba and Medicare

Cahaba administers Medicare Part A and Part B operations under cost reimbursement contracts. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Procurement Regulations (FPR), which were superseded by the Federal Acquisition Regulations (FAR), the CAS and the Medicare contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

CAS and 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 Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs on March 30, 1995. Unless otherwise noted, the following references to the CAS refers to the standards that were in effect before the revision. For purposes of clarity, we will refer to the post revision standards as the "revised" CAS. Applicable portions of the revised CAS are discussed in the following section.

The CAS within 48 Code of Federal Regulations (CFR) 30.412-50 (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, the 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...."*

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 the 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.

Revised CAS

As previously noted, the 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 and the period assignment provisions of the CAS. The new rule allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. However, the method or methods used to reassign the unfunded pension costs must be approved by the contracting officer.

The revision to the CAS does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA. If a contractor could have funded pension costs and chose not to, then those costs and any accrued interest on those costs are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per FAR and CAS regulations.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

Our objective was to identify any unfunded CAS costs, plus interest adjustments on the unfunded costs, from January 1, 1994 to January 1, 1996. Our objective also included identifying interest adjustments on the accumulated unfunded pension costs previously reported. An additional objective was to identify any unallowable components of the accumulated unfunded pension costs. Achieving our objectives did not require that we review the internal control structure of Cahaba.

Scope

We made our examination in accordance with generally accepted government auditing standards. Our review covered the period January 1, 1994 to January 1, 2002. However, certain information obtained during our prior audit covering 1986 through 1993 was used in the conduct of this review.

We performed this review in conjunction with our audits of Medicare segmentation (Report Number: A-07-03-03038), and pension costs claimed for Medicare reimbursement (Report Number: A-07-04-03048). The information obtained and reviewed during those audits was also used in performing this review.

Methodology

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

In performing the review, we used information provided by Cahaba's actuarial consulting firm. The information included liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Cahaba's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, CMS pension actuarial staff calculated the allowable CAS pension costs for each year 1994 through 2001, and determined the extent to which Cahaba funded those costs with contributions to the pension trust fund. We reviewed the methodology and calculations.

We performed site work at Cahaba's corporate office in Birmingham, Alabama during March of 2003. We also performed audit work in our Office of Inspector General offices in Kansas City and Jefferson City, Missouri.

FINDINGS IN DETAIL

We found that Cahaba funded the pension costs allocable to the Medicare contracts for plan years 1994 and 1995 in accordance with FAR. Additionally, Cahaba accounted for the accumulated unfunded pension costs that were identified in our prior review. However, Cahaba had some minor errors in its calculation unallowable accumulated unfunded pension costs.

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. However, the revision to the 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, then those costs and any accrued interest on those costs are unallowable in future periods. The unallowable portion of accumulated unfunded pension costs must be updated, with interest, per FAR and CAS regulations.

We determined that a portion of Cahaba's accumulated unfunded pension costs could have been funded in the year incurred, but Cahaba chose not to fund those costs. Consequently, those unallowable costs must be updated with interest, and removed from future periods' pension cost computations. We updated the unallowable portion of Cahaba's accumulated unfunded pension costs from January 1, 1994 to January 1, 2002. We found the unallowable costs to be $672,724 for the Medicare segment, and $3,333,817 for the "Other" segment as of January 1, 2002.

Update of Unallowable Unfunded January 1, 2002				
Date	**Description**	**Other Segments**	**Medicare Segment**	**Total Company**
01/01/94	Prior Unallowable[1]	$1,801,156	$363,453	$2,164,609
01/01/95	Interest [2]	144,093	29,076	173,169
01/01/96	Interest	155,620	31,402	187,022
01/01/97	Interest	168,070	33,914	201,984
01/01/98	Interest	181,515	36,628	218,143
01/01/99	Interest	196,036	39,558	235,594
01/01/00	Interest	211,720	42,722	254,442
01/01/01	Interest	228,657	46,140	274,797
01/01/02	Interest	246,950	49,831	296,781
	Total	**3,333,817**	**672,724**	**4,006,541**

CRITERIA

For Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413, and (2) funded as specified by Part 31 of the FAR. The Medicare 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."*

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[1] The prior unallowable unfunded pension costs were determined in our prior audit of Cahaba's accumulated unfunded pension costs (Report Number: A-07-94-00817)

[2] Interest was calculated on accumulated unallowable unfunded pension costs, and calculated based on the rates shown in the valuation reports.

CONDITION AND CAUSE

Unfunded CAS Pension Costs Over The ERISA Tax Maximum

During our previous review of Cahaba (Report Number: A-07-94-00817), we determined that the Medicare segment accumulated $912,730 in unfunded pension costs as of January 1, 1994. We recommended that Cahaba update annually the unallowable pension cost component related to the unfunded CAS costs for Plan Years 1986 through 1993. We also recommended that Cahaba identify and update the unfunded pension costs for any later years in a similar manner.

Cahaba accounted for the accumulated unfunded pension costs that were identified in our prior review. However, Cahaba had some minor errors in its calculation of unallowable accumulated unfunded pension costs.

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. However, the method, or methods, used to reassign the unfunded pension costs must be approved by the contracting officer. Cahaba did not request or receive such approval.

Our current review showed that the Medicare segment accumulated $1,064,608 in unfunded pension costs (with interest) as of January 1, 1996. Of that amount, $640,677 was eligible to be reassigned to subsequent periods. However, the remaining $423,931 was an unallowable component of Medicare segment pension costs, and was not eligible for reassignment to subsequent periods.

Our current review also showed that the “Other” segment accumulated $5,254,243 in unfunded pension costs (with interest) as of January 1, 1996. Of that amount, $3,153,374 was eligible to be reassigned to subsequent periods. However, the remaining $2,100,869 was an unallowable component of “Other” segment pension costs, and was not eligible for reassignment to subsequent periods.

The “Other” segment represents all operations other than those attributable to the Medicare segment. Indirect Medicare operations are attributable to the “Other” segment. Therefore, portions of the “Other” segment’s pension costs are allocable to indirect Medicare operations.

Unallowable Costs For Future Periods

As of January 1, 1996, Cahaba had accumulated $2,524,800 in unallowable pension costs (and interest) for the Medicare and “Other” segments. The pension costs are unallowable because they were not funded within specific time periods set by FAR. The unallowable pension costs are attributable to plan years 1986 through 1993. Cahaba could have funded the pension costs, as they were within ERISA maximum limits, but chose not to. Imputed interest on the unfunded costs is also unallowable per CAS regulations.

As of January 1, 2002 the unallowable costs had increased with interest to $672,724 for the Medicare segment, and $3,333,817 for the "Other" segment.

EFFECT

As of January 1, 2002, Cahaba has accumulated unfunded pension costs of $672,724 for the Medicare segment, and $3,333,817 for the "Other" segment, that is unallowable as a component of future periods' pension costs.

RECOMMENDATIONS

We recommend that Cahaba:

- Adjust the unallowable component of Medicare segment pension costs to $672,724 as of January 1, 2002.
- Adjust the unallowable component of the "Other" segment's pension costs to $3,333,817 as of January 1, 2002.

- Update annually the unallowable components of pension costs for the Medicare and "Other" segments.

AUDITEE RESPONSE

Cahaba stated that it did account for the accumulated unfunded pension costs in its actuarial reports. However, Cahaba also acknowledged that its calculation was slightly incorrect. Cahaba is in agreement with the unallowable component of unfunded costs as shown in this report. Cahaba's comments are included in their entirety as Appendix A.

Appendix

January 29, 2004

Mr. James P. Aasmundstad
Regional Inspector General for Audit Services, Region VII
601 East 12th Street
Room 284A
Kansas City, MO 64106

RE: Report Number(s) A-07-04-03053
A-07-03-03038
A-07-04-03048

Dear Mr. Aasmundstad:

We have received and reviewed the draft reports for the following audits conducted at Cahaba Government Benefit Administrators:

a) Review Of Cahaba Government Benefit Administrators Unfunded Pension Costs
b) Review Of Medicare Contractor's Pension Segment, Cahaba Government Benefit Administrators
c) Review Of Pension Costs Claimed By Cahaba Government Benefit Administrators

We appreciate the opportunity to respond to the draft reports and have provided our written comments in the attached report.

If you should have any questions regarding our responses, please contact Chris Smith, at 205-220-5789.

Sincerely,

Mrs. Lynda Northcutt
Senior Vice President
Cahaba Government Benefit Administrators

cc: **Greg Tambke, HHS, OIG OAS**
Norma Jo Bales, CMS – Atlanta Regional Office
Genise Huey, CMS – Atlanta Regional Office
Cindi Vice, Blue Cross and Blue Shield of Alabama
Ron Whitehead, Cahaba Government Benefit Administrators
David Brown, Cahaba Government Benefit Administrators

Report Number: A-07-04-03053
Review of Cahaba Government Benefit Administrators Unfunded Pension Costs

Recommendation(s):

1. *Identify $672,724 as an unallowable component of Medicare segment pension costs as of January 1, 2002.*
2. *Identify $3,333,817 as an unallowable component of the "Other" segment's pension cost as of January 1, 2002.*
3. *Update annually the unallowable components of pension costs for the Medicare and "Other" segments.*

Cahaba GBA comment:
In the "Findings" section of this report, the OIG comments "…Cahaba did not properly account for the accumulated unfunded pension costs that were identified in our prior review. Cahaba should have brought the accumulated unfunded pension costs forward, with interest, to January 1, 1996." However, we did properly account for the accumulated unfunded pension costs in the 1996 report (please see Exhibit II – Section 412.50(a)(2) Base). This issue was discussed with the CMS actuary, who was in agreement that these costs were properly brought forward. Please note that the CMS actuary did not agree with the dollar amount of the bases established in the 1996 report and did modify our calculations slightly. In our opinion, the final report should reflect the agreed upon modifications.

Cahaba has made the changes suggested by the CMS actuary.

Report Number: A-07-03-03038
Review of Medicare Contractor's Pension Segment, Cahaba Government Benefit Administrators

Recommendations(s):

1. *We recommend that Cahaba decrease the Medicare segment pension assets by $4,745,558 as of January 1, 2002. We also recommend that Cahaba reassign the prepayment credit of $2,872,185 to the other segment.*

Cahaba GBA comment**:**
We agree with all but one issue noted in the report. The calculation methodology used by the OIG has changed since the last audit to apply the prepayment credit before contributions are allocated. This change impacts the allocation of net earnings, expenses and contributions. The OIG auditors restated the net transfer amounts and benefit payments and also made a correction to the Wellmark asset transfer. However, in our opinion, the assets were incorrectly adjusted for the Wellmark transfer amount. Adjustments were made to both the total company asset figure and the Medicare segment asset figure. In our opinion, the adjustment should have only been made to the Medicare segment asset figure.

We recommend the adjustment made to the total company asset calculation be combined with the earnings component, and the January 1, 2002 asset calculation, as identified in Appendix A of the above noted report, should be the same as reported by Cahaba (resulting in no asset variance for the total company).

Report Number: A-07-04-03048
Review Of Pension Costs Claimed By Cahaba Government Benefit Administrators

Recommendations(s):

1. *We recommend that Cahaba revise its FACPs for the FYs 1994 through 2002 to claim additional allowable CAS pension costs of $7,085,493.*

Cahaba GBA comment**:**
We agree with this finding that Cahaba under claimed allowable pension cost by $7,085,493 for fiscal years 1994 through 2002. Cahaba will revise its FACPs to claim these additional costs.