

**Memorandum**

JUN 3 1992

Date

From

Richard P. Kusserow  
Inspector General

Subject

Audit of Special Early Retirement Program Pension Costs  
Claimed by Blue Cross and Blue Shield of Michigan, Inc.  
(A-07-92-00525)

To

William Toby  
Acting Administrator  
Health Care Financing Administration

This is to alert you to the issuance on June 4, 1992, of our final audit report. A copy is attached. The audit examined Blue Cross and Blue Shield of Michigan, Inc.'s (Michigan) pension costs of a Special Early Retirement Program (SERP) claimed for Medicare reimbursement. The allowability of pension costs for Medicare contractors is governed by the Cost Accounting Standards (CAS) 412 and 413 and the Federal Acquisition Regulations (FAR).

Michigan received \$2,135,884 in unallowable Medicare reimbursement for SERP pension expenses claimed on the 1988 Final Administrative Cost Proposal (FACP). The amount received was not computed or funded in accordance with the CAS and FAR.

Michigan's actuarial firm calculated the estimated cost of implementing the SERP. Michigan allocated the entire estimated cost of the SERP to its various lines of business. About \$3 million was allocated to Medicare and claimed for Medicare reimbursement on Michigan's 1988 FACP. Medicare reimbursed \$2,135,884 of the SERP pension expense.

Under CAS, the unfunded actuarial liability (UAL) of the SERP should have been amortized over 10 to 30 years as a component in determining pension costs for Medicare reimbursement rather than charging estimated costs in their entirety in 1 year. Depending on the amortization schedule chosen, we estimate that the UAL of the SERP assignable to a year could have ranged from about \$491,426 (30-year amortization schedule) to about \$824,486 (10-year amortization schedule). Since the SERP was effective August 1, 1988, only one-sixth, \$81,904 and \$137,414 respectively, of our estimated amounts would have been assignable to Fiscal Year 1988.

Page 2 - William Toby

Assignable costs for 1988, with the amortized UAL of the SERP as a component, would have been significantly less than the \$2,135,884 actually paid by Medicare. However, in order for even the lower assigned costs to be allowable for Medicare reimbursement, they must have been funded (contribution made to the plans) by the date specified by the FAR. Our review found that Michigan's pension plans were not funded within the FAR specified time frame as it applies to 1988. Therefore, pension costs, with the amortized UAL of the SERP as a component, are not allowable for 1988. The entire \$2,135,884 reimbursed by Medicare on Michigan's 1988 FACP is unallowable. We are recommending that Michigan refund \$2,135,884 to Medicare and compute future Medicare pension costs in accordance with applicable regulations.

Michigan generally agreed with our recommendations. The Health Care Financing Administration also agreed with our finding and recommendations.

Attachment

For further information contact:  
Vincent R. Imbriani  
Regional Inspector General for  
Audit Services, Region VII  
816-426-3591

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF SPECIAL EARLY RETIREMENT  
PROGRAM PENSION COSTS CLAIMED  
BY BLUE CROSS AND BLUE SHIELD OF  
MICHIGAN, INC.**



Richard P. Kusserow  
INSPECTOR GENERAL

A-07-92-00525



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-07-92-00525

Ms. Catherine Schmitt  
Director, Budget Reporting and Planning  
Blue Cross and Blue Shield of Michigan, Inc.  
600 Lafayette East  
Detroit, Michigan 48226

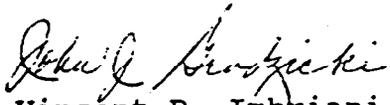
Dear Ms. Schmitt:

Enclosed for your information are two copies of an Office of Inspector General (OIG), Office of Audit Services (OAS) report titled "AUDIT OF SPECIAL EARLY RETIREMENT PROGRAM PENSION COSTS CLAIMED BY BLUE CROSS AND BLUE SHIELD OF MICHIGAN, INC." Your attention is invited to the finding and recommendations contained in the report. The below named official will be communicating with you in the near future regarding implementation of necessary actions.

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.)

To facilitate identification, please refer to the above CIN in all correspondence relating to this report.

Sincerely,

  
for Vincent R. Imbriani  
Regional Inspector General for  
Audit Services, Region VII

Enclosures

Action Official:  
Chester C. Stroyny  
Regional Administrator, Region V  
Health Care Financing Administration  
105 West Adams Street, 15th Floor  
Chicago, Illinois 60606



DEPARTMENT OF HEALTH & HUMAN SERVICES

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601 East 12th Street  
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CIN: A-07-92-00525

Ms. Catherine Schmitt  
Director, Budget Reporting and Planning  
Blue Cross and Blue Shield of Michigan, Inc.  
600 Lafayette East  
Detroit, Michigan 48226

Dear Ms. Schmitt:

This report provides you with the results of our AUDIT OF SPECIAL EARLY RETIREMENT PROGRAM PENSION COSTS CLAIMED BY BLUE CROSS AND BLUE SHIELD OF MICHIGAN, INC. The purpose of our audit was to determine if pension costs of a Special Early Retirement Program (SERP) claimed by Blue Cross and Blue Shield of Michigan, Inc. (Michigan) were allowable for Medicare reimbursement.

Michigan amended its pension plans in 1988 with a SERP. For Fiscal Year (FY) 1988, Michigan allocated SERP pension expense to its various lines of business. The SERP pension expense allocated to Medicare was about \$3 million. Michigan claimed the SERP pension expense allocated to Medicare on its 1988 Final Administrative Cost Proposal (FACP). Medicare reimbursed \$2,135,884 of the claimed SERP pension expense. Our review showed that the \$2,135,884 was not computed or funded in accordance with applicable requirements and was unallowable for Medicare reimbursement. Both Michigan and the Health Care Financing Administration generally agreed with our conclusions and recommendations.

#### BACKGROUND

Title XVIII of the Social Security Act, Health Insurance Program for the Aged and Disabled (Medicare), provides that organizations may assist in administering the Medicare program under contracts with the Secretary, U.S. Department of Health and Human Services (HHS).

Medicare contractors, intermediaries (Part A) and carriers (Part B), are reimbursed for reasonable and allowable costs incurred in administering the Medicare program. Most of the contracts are cost reimbursement and are renewed annually. Michigan has administered Medicare Part A and B operations under cost reimbursement contracts since July 1, 1966.

Medicare reimburses a portion of annual contributions paid into contractors' pension plans. The Medicare reimbursements represent allowable pension costs in accordance with the contracts and the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR). In 1980, Cost Accounting Standards (CAS) 412 and 413 were incorporated into both the FPR and the Medicare contracts.

The CAS 412 and 413 provide guidance for determining, measuring, and charging the pension costs. The FAR provides guidance on the funding of pension costs.

#### SCOPE OF AUDIT

Our examination was made in accordance with generally accepted government auditing standards. The audit only addressed pension costs related to Michigan's SERP. Our objective was to determine the allowability of SERP pension costs reimbursed by Medicare in FY 1988. Achieving our audit objective did not require that we review the internal control structure of Michigan.

Our review covered the period October 1, 1987 through September 30, 1988. We reviewed documents from Michigan's Cost Accounting Department regarding the amount of SERP pension expense claimed on its FY 1988 FACP. We also reviewed actuarial valuation reports, financial accounting statements, and pension plan documents.

We also reviewed documents provided by the Health Care Financing Administration in Region V regarding the SERP pension expense reimbursed by Medicare.

Field work was performed during June through December of 1991. It included work performed at Michigan's corporate offices in Detroit, Michigan.

#### RESULTS OF AUDIT

Michigan received \$2,135,884 in unallowable Medicare reimbursement for SERP pension expenses claimed on its 1988 FACP. The amount received was not computed or funded in accordance with the CAS and FAR.

The CAS specifies how to amortize the unfunded actuarial liability created by a pension plan improvement, such as a SERP. An increase in unfunded actuarial liability created by a pension plan improvement is to be amortized over a period of 10 to 30 years (CAS, Section 412.50(a)(1)(iii)). In addition, pension costs assignable to a current accounting period must be funded by the Federal income tax filing deadline to be allowable for Medicare reimbursement (FAR 31.205-6(j)(2)(i)). Pension costs are funded when a contribution is made to a pension plan.

Michigan's actuarial firm calculated the estimated cost of implementing the SERP. Michigan allocated the entire estimated cost of the SERP to its various lines of business. Costs of the SERP allocated to Medicare were \$3,605,866. Michigan claimed \$3,027,878 of the allocated costs for Medicare reimbursement on its 1988 FACP and was reimbursed \$2,135,884 based on its claim. Details of allocated, claimed, and reimbursed SERP pension costs are provided in Appendix A.

Under CAS, the unfunded actuarial liability (UAL) of the SERP should have been amortized over 10 to 30 years as a component in determining pension costs for Medicare reimbursement rather than charging estimated costs in their entirety in 1 year. Depending on the amortization schedule chosen, we estimate that the UAL of the SERP assignable to a year could have ranged from about \$491,426 (30-year amortization schedule) to about \$824,486 (10-year amortization schedule). Since the SERP was effective August 1, 1988, only one-sixth, \$81,904 and \$137,414 respectively, of our estimated amounts would have been assignable to FY 1988.

Assignable costs for 1988, with the amortized UAL of the SERP as a component, would have been significantly less than the \$2,135,884 actually paid by Medicare. However, in order for even the lower assigned costs to be allowable for Medicare reimbursement, they must have been funded (contribution made to the plans) by the date specified by the FAR. Our review found that Michigan's pension plans were not funded within the FAR specified time frame as it applies to 1988. Therefore, pension costs, with the amortized UAL of the SERP as a component, are not allowable for 1988. The entire \$2,135,884 reimbursed by Medicare on Michigan's 1988 FACP is unallowable.

In discussing the issues we have raised, Michigan acknowledged that the entire estimated cost of the SERP had been claimed on the 1988 FACP contrary to CAS requirements. Michigan also acknowledged that the FAR funding requirement precludes it from receiving Medicare reimbursement for any SERP pension costs assignable to 1988.

**Recommendations**

We recommend that Michigan:

- o Refund \$2,135,884 in SERP pension costs reimbursed by Medicare on the 1988 FACP.
- o Ensure pension costs charged to Medicare in the future are computed in accordance with applicable regulations.

**Auditee Comments**

Michigan generally agreed with our report and specifically stated that "BCBSM would support including an audit adjustment of \$2,135,884 in the final settlement of fiscal year 1988 Medicare expenses." Michigan's response is included, in its entirety, as Appendix B to this report.

**INSTRUCTIONS FOR AUDITEE RESPONSE**

The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may have a bearing on the resolution of this audit may be presented at that time.

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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).

To facilitate identification, please refer to the referenced Common Identification Number (CIN) in any correspondence relating to this report.

Sincerely,

  
for Vincent R. Imbriani  
Regional Inspector General  
for Audit Services, Region VII

Enclosure

APPENDICES

## Appendix A

MICHIGAN SERP PENSION COSTS  
ALLOCATED, CLAIMED, AND REIMBURSED

FACP Line	Amount FACP Exceeded NOBA	SERP Pension Costs			
		Allocated	Claimed	Reimbursed 1/	Unreimbursed
Part A					
1 & 2	\$ 221,320	\$ 275,205#	\$ -0-	\$ -0-	\$ -0-
3	57,354	117,025	117,025	59,671	57,354 *
4	46,624	106,787	106,787	60,163	46,624 *
5 - 7	379,278	446,888	446,888	67,610	379,278 *
8	107,188	118,026	118,026	10,838	107,188 *
9	-0-	101,234	101,234	101,234	-0- **
10	74,856	-0-	-0-	-0-	-0-
11	198,990	14,614	14,614	-0-	14,614
	<u>\$1,085,610</u>	<u>\$1,179,779</u>	<u>\$ 904,574</u>	<u>\$ 299,516</u>	<u>\$ 605,058</u>
Part B					
1 - 3	\$ 707,362	\$1,518,340#	\$1,215,557	\$1,215,557	\$ -0- ***
5	144,219	300,403	300,403	156,184	144,219 *
6	155,359	142,717	142,717	-0-	142,717 *
7	-0-	160,590	160,590	160,590	-0- **
8	-0-	304,037	304,037	304,037	-0- **
10	-0-	-0-	-0-	-0-	-0-
	<u>\$1,006,940</u>	<u>\$2,426,087</u>	<u>\$2,123,304</u>	<u>\$1,836,368</u>	<u>\$ 286,936</u>
Total	<u>\$2,092,550</u>	<u>\$3,605,866</u>	<u>\$3,027,878</u>	<u>\$2,135,884</u>	<u>\$ 891,994</u>

1/ Included as costs reimbursed on Michigan's submitted FACPs.

# Included \$275,205 (Part A) and \$302,783 (Part B) in SERP costs allocated to Medicare but not claimed on the FACP due to the fixed price restriction on Maximum Allowable Unit Cost (MAUC) lines.

\* Unreimbursed SERP pension costs are the amount by which the FACP line item costs exceed Notice of Budget Approval (NOBA) limitations up to the amount of SERP pension costs claimed.

\*\* All claimed SERP pension costs reimbursed as the FACP line items did not exceed NOBA limitations.

\*\*\* Michigan's submitted FACPs show the SERP amount as being reimbursed with the FACP overrun of the NOBA limitation due to "568,203 claims processed over NOBA @ \$1.245 each."

**Blue Cross  
Blue Shield**  
of Michigan



**Medicare**

Rosalee Livingston  
Vice President  
Government Business Group

600 Lafayette East  
Detroit, Michigan 48226

March 6, 1992

Vincent R. Imbriani  
Regional Inspector General  
Office of Audit Services, Region VII  
Room 284A  
601 East 12th Street  
Kansas City, MO 64106

Dear Mr. Imbriani:

RE: CIN A-07-92-00525

We have reviewed the draft audit report regarding our Special Early Retirement Program (SERP) and the charges to Medicare in fiscal year 1988 emanating from the retirement program.

We understand that Cost Accounting Standard (CAS) 412 requires that unfunded actuarial liabilities be amortized over a 10 to 30 year period. We also understand that Federal Acquisition Regulation (FAR) 31.205-6 (j) (2) (i) requires that pension costs assigned to an accounting period must be funded within the time limits for that period. Since the SERP expenses claimed in fiscal year 1988 were not amortized and not funded in accordance with CAS 412 and FAR 31, we agree that they are not allowable Medicare expenses.

We have reviewed the amounts noted in the draft audit report. We concur that about \$3 million in SERP expenses were allocated to Medicare in fiscal year 1988 and that Blue Cross and Blue Shield of Michigan (BCBSM) was reimbursed \$2,135,884 for SERP expenses.

Fiscal year 1988 administrative expenses for the Medicare Part A and Part B programs are in the process of being audited. We believe that the field work of the audit has been completed and we are awaiting a draft audit report. BCBSM would support including an audit adjustment of \$2,135,884 in the final settlement of fiscal year 1988 Medicare expenses.

In general, we agree with the draft audit report. If there are any questions please contact me on (313) 225-0860 or

have your staff contact Catherine D. Schmitt on (313)  
225-0703.

Sincerely,

*Rosalee Livingston* /*RL*

Rosalee Livingston

cc: B. Ball  
C. Schmitt  
M. Stanton, OAS Region V