



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

FEB 18 2005

Report Number A-07-04-00178

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Mr. Joseph D. Wright, CPA
Vice President and Chief Financial Officer
Blue Cross Blue Shield of South Carolina
PO Box 100134 AG-A15
Columbia, South Carolina 29202-3134

Dear Mr. Wright:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) report titled "Audit of Blue Cross Blue Shield of South Carolina's Unfunded Pension Costs for the Period Covering 1994 Through 2001." A copy of this report will be forwarded to the HHS action official noted on the next page for her review and any action deemed necessary.

The action official will make final determination regarding actions taken on all matters in the report. 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.

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If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, ext. 225, or Jenenne Tambke, Audit Manager, at (573) 893-8338, ext. 21, or through email at Jenenne.Tambke@oig.hhs.gov. To facilitate identification, please refer to report number A-07-04-00178 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad", written over a white background.

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosure

Page 2 - Mr. Joseph D. Wright, CPA

Direct Reply to HHS Action Official:

Rose Crum-Johnson
Regional Administrator
Centers for Medicare & Medicaid Services
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Atlanta, Georgia 30303-8909

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF BLUE CROSS BLUE SHIELD
OF SOUTH CAROLINA'S UNFUNDED
PENSION COSTS FOR THE PERIOD
COVERING 1994 THROUGH 2001**



FEBRUARY 2005

A-07-04-00178

Office of Inspector General

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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

BACKGROUND

Blue Cross Blue Shield of South Carolina (South Carolina) administers Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

OBJECTIVES

The objectives of our review were to:

- determine if the accumulated unfunded pension costs identified in our prior review (Report Number: A-07-94-00770) were accounted for properly;
- determine if pension costs for plan years 1994-2001 were funded in accordance with the Federal Acquisition Regulations (FAR) and the Cost Accounting Standards (CAS); and
- identify and properly account for any additional accumulated unfunded pension costs, including allowable and reassignable portions.

SUMMARY OF FINDINGS

South Carolina properly accounted for the accumulated unfunded pension costs identified in our prior review. Additionally, South Carolina funded the pension costs for plan years 1994-2001 in accordance with the FAR and the CAS. However, South Carolina did not correctly identify or properly account for the additional accumulated unfunded pension costs due to a lack of adequate policies and procedures.

The accumulated unfunded pension costs consist of the accumulated unallowable pension costs and the accumulated reassignable pension costs. South Carolina correctly identified and properly accounted for the accumulated unallowable pension costs.

South Carolina overstated the accumulated reassignable pension costs for the Medicare segment by \$467,768. As of January 1, 2002, South Carolina determined its accumulated reassignable pension costs for the Medicare segment were \$467,768; however, audited costs were \$0. Additionally, South Carolina did not identify its accumulated reassignable pension costs for the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment. We identified \$3,471,124 attributable to the Other segment as of January 1, 2002.

RECOMMENDATIONS

South Carolina should:

- decrease the accumulated reassignable pension costs of the Medicare segment by \$467,768 as of January 1, 2002;
- identify the accumulated reassignable pension costs of the Other segment as \$3,471,124 as of January 1, 2002; and
- establish procedures to annually update the reassignable pension costs for the Medicare and Other segments.

AUDITEE COMMENTS

South Carolina agreed with our draft report findings and recommendations, and stated it would implement our recommendations. Its comments are presented in their entirety in the Appendix.

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SOUTH CAROLINA'S COMMENTS ON DRAFT REPORT

Glossary of Abbreviations and Acronyms

| | |
|----------------|--|
| CAS | Cost Accounting Standards |
| CFR | Code of Federal Regulations |
| CMS | Centers for Medicare & Medicaid Services |
| ERISA | Employees Retirement Income Security Act of 1974 |
| FAR | Federal Acquisition Regulations |
| OBRA 87 | Omnibus Budget Reconciliation Act of 1987 |
| OIG | Office of the Inspector General |
| South Carolina | Blue Cross Blue Shield of South Carolina |
| TRA 86 | Tax Reform Act of 1986 |

INTRODUCTION

BACKGROUND

South Carolina and Medicare

South Carolina administers Medicare Part A and Part B operations under cost reimbursement contracts. In claiming costs, contractors must follow cost reimbursement principles contained in the 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. The payments represented allowable pension costs under the FAR and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and the FPR incorporated CAS 412 and 413.

CAS

The CAS deals with stability between contract periods and requires that pension costs be consistently measured, assigned to contract periods, and allocated to cost objectives, including Federal contracts. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the post revision standards as the revised CAS.

The CAS within 48 Code of Federal Regulations (CFR) 9904.412-50(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.”

Also, 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”

The revised CAS within 48 CFR 9904.412-40(c) imposes the fundamental requirement:

“Assignment of pension cost. Except costs assigned to future periods by 9904.412-50(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable only to that period”

FAR

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. 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.

Conflict Between the FAR Funding Requirement and Tax Limits

Pension costs computed in accordance with the CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act of 1974 (ERISA), which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code.

Under tax laws in effect prior to 1986, employers could fund the CAS contribution in excess of the tax-deductible limit and any the excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded the CAS computed amounts, the excess funding could be carried forward as a prepayment credit 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 the tax-deductible limit. TRA 86 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. 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.

The Omnibus Budget Reconciliation Act of 1987 (OBRA 87) added a “current liability” full funding limitation that lowered the tax-deductible limit for many plans, further increasing the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund the CAS pension cost without incurring excise tax penalties, yet the FAR provided that unfunded CAS costs could not be carried forward to future years.

However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than the CAS cost was a voluntary financial action.

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 transition provisions of the new rule (48 CFR 9904.412-64) allow the reassignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. The contracting officer must approve the method or methods used to reassign the unfunded pension costs.

The CAS revision 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, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and the CAS.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to:

- determine if the accumulated unfunded pension costs identified in our prior review had been accounted for properly;
- determine if pension costs for plan years 1994-2001 were funded in accordance with the FAR and the CAS; and
- identify and properly account for any additional accumulated unfunded pension costs, including allowable and reassignable portions.

Scope

Our review covered January 1, 1994, to January 1, 2002. Achieving our objectives did not require that we review South Carolina's overall internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with the CAS and the FAR.

We performed this review in conjunction with our audits of Medicare segmentation (report number: A-07-03-03042) and pension costs claimed for Medicare reimbursement (report number: A-07-04-00176). The information obtained and reviewed during the audits also was used in performing this review.

We performed site work at South Carolina's corporate office in Columbia, SC during February of 2004.

Methodology

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

In performing the review, we used information provided by South Carolina's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed South Carolina's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. Using the documents, the CMS pension actuarial staff calculated the assignable CAS pension costs for each year 1994-2001 for the Medicare segment and the Other segment. Additionally, the CMS pension actuarial staff determined the extent to which South Carolina funded the pension costs with contributions to the pension trust fund. The CMS pension actuarial staff also determined the unallowable and reassignable portions of unfunded pension costs. We reviewed the methodology for the calculations and updated South Carolina's unfunded pension costs for 1994-2001 for both the Medicare segment and the Other segment.

We performed our review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

South Carolina properly accounted for the accumulated unfunded pension costs identified in our prior review. Additionally, South Carolina funded the pension costs allocable to the Medicare contracts for plan years 1994-2001 in accordance with the FAR. However, South Carolina did not correctly identify or properly account for the additional accumulated unfunded pension costs.

The revised CAS requires the identification of the two components of the accumulated unfunded pension costs - the accumulated unallowable pension costs and the accumulated reassignable pension costs. South Carolina overstated the accumulated reassignable pension costs for the Medicare segment by \$467,768. As of January 1, 2002, South Carolina determined its accumulated reassignable pension costs for the Medicare segment were \$467,768; however, audited costs were \$0. Additionally, South Carolina did not identify its accumulated reassignable pension costs for the Other segment; however, we identified of \$3,471,124 attributable to the Other segment as of January 1, 2002.

ADDITIONAL ACCUMULATED UNFUNDED PENSION COSTS

CRITERIA: THE CAS AND THE FAR

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

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 as accumulated reassignable pension costs. 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, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and the CAS.

CONDITION: INCORRECT COMPUTATION OF THE ACCUMULATED REASSIGNABLE PENSION COSTS

Accumulated Reassignable Pension Costs

As of January 1, 2002, South Carolina determined its accumulated reassignable pension costs for the Medicare segment were \$467,768. In 1998, the Medicare segment became fully funded, and all amortization bases should have been fully amortized. Consequently, from that date forward, the audited accumulated reassignable pension costs for the Medicare segment was \$0. Thus, South Carolina overstated the accumulated reassignable pension costs for the Medicare segment by \$467,768.

Additionally, South Carolina did not identify its accumulated reassignable pension costs for the Other segment; however, we identified \$3,471,124 attributable to the Other segment as of January 1, 2002.

CAUSE: LACK OF ADEQUATE CONTROLS

South Carolina did not have adequate controls in place to ensure that reassignable pension costs were identified and properly accounted for in accordance with CAS requirements.

EFFECT

As of January 1, 2002, South Carolina overstated the accumulated reassignable pension costs for the Medicare segment by \$467,768. Additionally, we identified accumulated reassignable pension costs of \$3,471,124 attributable to the Other segment as of January 1, 2002, which South Carolina did not identify.

RECOMMENDATIONS

South Carolina should:

- decrease the accumulated reassignable pension costs of the Medicare segment by \$467,768 as of January 1, 2002;
- identify the accumulated reassignable pension costs of the Other segment as \$3,471,124 as of January 1, 2002; and
- establish procedures to annually update the reassignable pension costs for the Medicare and Other segments.

AUDITEE COMMENTS

South Carolina agreed with our draft report findings and recommendations, and stated it would implement our recommendations.

APPENDIX



Medicare
Palmetto GBA
Post Office Box 100134
Columbia, South Carolina 29202-3134

Joseph D. Wright
Vice President and Chief Financial Officer

December 30, 2004

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

Dear Mr. Aasmundstad:

Re: Draft Report entitled "Audit of Blue Cross Blue Shield of South Carolina's Unfunded Pension Costs for the Period Covering 1994 through 2001"
Report No. A-07-04-00178

We received the above titled draft report and are responding to the findings and recommendations included in the report. We consulted with Chicago Consulting Actuaries in determining our response to this report.

The report found that we properly accounted for the accumulated unfunded pension costs identified in your prior review and that pension costs for plan years 1994-2001 were properly funded in accordance with FAR and CAS. However, the report found that we did not identify and correctly or properly account for the additional unfunded pension cost due to a lack of adequate policies and procedures. Palmetto's Medicare segment's accumulated reassignable pension costs are overstated by \$467,768; they should be reduced to zero. Accumulated reassignable pension costs for the rest of the company (Other Segment) of \$3,471,124 were not identified.

The report lists the following recommendations.

South Carolina should:

- Decrease the accumulated reassignable pension costs of the Medicare segment by \$467,768 as of January 1, 2002.
- Identify the accumulated reassignable pension costs of the Other segment as \$3,471,124 as of January 1, 2002.
- Establish procedures to annually update the reassignable pension costs for the Medicare and Other segments.

Because we did not determine that the plan was fully funded for CAS purposes, we did not discontinue amortization of accumulated reassignable pension costs. We agree with the findings and will implement the recommendations.

Thank you for the additional time to submit our response. We appreciate the professional manner in which this audit was conducted.

Sincerely,

Joseph D. Wright /df

Joseph D. Wright, CPA

Cc: Rose Crum-Johnson, CMS Atlanta RO

