



DEPARTMENT OF HEALTH AND HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL



OFFICE OF AUDIT SERVICES, REGION VII
601 EAST 12TH STREET, ROOM 0429
KANSAS CITY, MO 64106

April 4, 2012

Report Number: A-07-12-00376

Mr. Peter S. Moore
Vice President of Government Programs
GHI Medicare
25 Broadway
New York, NY 10004

Dear Mr. Moore:

Enclosed is the U.S. Department of Health and Human Services, Office of Inspector General (OIG), final report entitled *Audit of Group Health Incorporated's Cash Balance Pension Plan Unfunded Pension Costs for Plan Years 2003 Through 2007*. We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this 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.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-12-00376 in all correspondence.

Sincerely,

/Patrick J. Cogley/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor
Director & Chief Financial Officer
Office of Financial Management
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, MD 21244-1850

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF
GROUP HEALTH INCORPORATED'S
CASH BALANCE PENSION PLAN
UNFUNDED PENSION COSTS FOR
PLAN YEARS 2003 THROUGH 2007**



Daniel R. Levinson
Inspector General

April 2012
A-07-12-00376

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Group Health Incorporated (GHI), an EmblemHealth Company, administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). These contracts terminated on July 18, 2008, but GHI continues to administer Medicare operations under a Coordination of Benefits contract with CMS.

During our audit period, GHI had three defined benefit pension plans: the GHI Local 153 Pension Plan; the GHI Cash Balance Pension Plan; and the EmblemHealth Services Company, LCC, Employees' Retirement Plan. This report will address the unfunded pension costs for the GHI Cash Balance Pension Plan only.

Beginning with fiscal year 1988, CMS incorporated segmentation requirements into the Medicare contracts. The Medicare contracts specify segmentation requirements and require separate identification of unfunded pension costs for the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment.

OBJECTIVES

The objectives of our review were to:

- determine whether pension costs for the GHI Cash Balance Pension Plan for plan years 2003 through 2007 were funded in accordance with the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts, and
- identify and properly account for any unallowable unfunded pension costs.

SUMMARY OF FINDINGS

GHI did not properly fund the pension costs allocable to the Medicare contracts in accordance with the FAR and CAS for plan year 2004. In addition, GHI did not identify or properly account for unallowable unfunded pension costs in accordance with the CAS. As a result of these errors, GHI understated the January 1, 2008, accumulated unallowable unfunded pension costs by \$11,149 (\$1,232 for the Medicare segment plus \$9,917 for the "Other" segment).

RECOMMENDATIONS

We recommend that GHI:

- identify \$11,149 of accumulated unallowable unfunded pension costs (\$1,232 as an unallowable component of the Medicare segment pension costs and \$9,917 as an unallowable component of the "Other" segment pension costs) as of January 1, 2008, and

- properly identify, and update with interest, unallowable unfunded pension costs for subsequent plan years

AUDITEE COMMENTS

In written comments on our draft report, GHI agreed with our recommendations.

GHI's comments are included in their entirety as the Appendix.

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INTRODUCTION

BACKGROUND

Group Health Incorporated and Medicare

Group Health Incorporated (GHI), an EmblemHealth Company, administered Medicare Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). These contracts terminated on July 18, 2008, but GHI continues to administer Medicare operations under a Coordination of Benefits contract with CMS. GHI also performs Medicare work as a subcontractor on the Medicare Secondary Payer Recovery and Retiree Drug Subsidy contracts.

During our audit period, GHI had three defined benefit pension plans: the GHI Local 153 Pension Plan; the GHI Cash Balance Pension Plan; and the EmblemHealth Services Company, LCC, Employees' Retirement Plan. This report will address the unfunded pension costs for the GHI Cash Balance Pension Plan only.

In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These payments are allowable pension costs under the FAR and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and FPR incorporated CAS 412 and 413.

Cost Accounting Standards

The CAS works to ensure stability between contract periods and requires that pension costs be consistently measured and 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 the accounting for pension costs applicable with the start of the first accounting period thereafter.

The revised CAS removed the regulatory conflict between the funding limits of the Employee Retirement Income Security Act of 1974 (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 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, in accordance with the FAR and CAS.

Federal Acquisition Regulation

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)(2)(i) and (iii)),¹ states: "... pension costs ... assigned to the current accounting period, but not funded during it, are not allowable in subsequent years.... Increased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable."

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to:

- determine whether pension costs for the GHI Cash Balance Pension Plan for plan years 2003 through 2007 were funded in accordance with the FAR, CAS, and Medicare contracts, and
- identify and properly account for any unallowable unfunded pension costs.

Scope

Our review covered plan years 2003 through 2007. Achieving our objectives did not require that we review GHI's internal control structure. However, we reviewed internal controls relating to the funding of pension costs to ensure that the pension costs had been funded in accordance with the FAR, CAS, and Medicare contracts.

We performed fieldwork at GHI in New York, New York, during September 2008 and July 2010.

Methodology

The CMS Office of the Actuary developed the methodology used for computing pension costs based on the CAS. In performing this review, we used information provided by GHI's actuarial consulting firms, which included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed GHI's accounting records, the pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Forms 5500. Using these documents, the CMS Office of the Actuary calculated the assignable CAS-based pension costs for each year of the period 2003 through 2007 for both the Medicare segment and the business units comprising the rest of the company, which are aggregated and identified as the "Other" segment.

¹ During the period covered by our review, FAR 31.205-6 was amended with sections being renumbered and reworded. Refer to FAR 31.205-6(j)(3)(i) and (iii) for relevant prior FAR citations.

Additionally, the CMS Office of the Actuary determined the extent to which GHI funded those costs with contributions to the pension trust fund. We reviewed the methodology for the calculations and updated GHI's unfunded pension costs for plan years 2003 through 2007 for both the Medicare segment and the "Other" segment.

We performed this review in conjunction with our audits of Medicare segmentation of the GHI Cash Balance Pension Plan (A-07-12-00374) and of GHI's pension costs claimed for Medicare reimbursement (A-07-12-00379, A-07-12-00380, and A-07-12-00381). We used the information obtained during those audits in this review.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

GHI did not properly fund the pension costs allocable to the Medicare contracts in accordance with the FAR and CAS for plan year 2004. In addition, GHI did not identify or properly account for unallowable unfunded pension costs in accordance with the CAS. As a result of these errors, GHI understated the January 1, 2008, accumulated unallowable unfunded pension costs by \$11,149 (\$1,232 for the Medicare segment plus \$9,917 for the "Other" segment).

UNALLOWABLE UNFUNDED PENSION COSTS

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 contracts state: "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."

The revised CAS state that 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, in accordance with the FAR and CAS.

For plan year 2004, we identified \$8,974 of pension costs² that GHI could have funded with contributions as provided by ERISA. However, GHI did not fund these pension costs. As of January 1, 2008, GHI had \$11,149 (\$1,232 for the Medicare segment plus \$9,917 for the "Other" segment) in unfunded pension costs and imputed interest for plan years 2003 through 2007. These pension costs are unallowable because they were not funded within specific time periods set by the FAR. Imputed interest on the unfunded costs is also unallowable pursuant to the CAS.

² Total Company unfunded pension costs as of the end of the plan year.

RECOMMENDATIONS

We recommend that GHI:

- identify \$11,149 of accumulated unallowable unfunded pension costs (\$1,232 as an unallowable component of the Medicare segment pension costs and \$9,917 as an unallowable component of the “Other” segment pension costs) as of January 1, 2008, and
- properly identify, and update with interest, unallowable unfunded pension costs for subsequent plan years.

AUDITEE COMMENTS

In written comments on our draft report, GHI agreed with our recommendations.

GHI’s comments are included in their entirety as the Appendix.

APPENDIX

APPENDIX

APPENDIX: AUDITEE COMMENTS



February 17, 2012

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Office of Inspector General
Office of Audit Services
Region VII
601 East 12th Street, Room 0429
Kansas City, Missouri 64106

Re: OIG Report Number: A-07-12-00376
Audit of Group Health Incorporated's Cash Balance Pension Plan Unfunded Pension
Costs for Plan Years 2003 through 2007.

Dear Mr. Cogley:

This response is in regard to the subject report. GHI and its actuaries have carefully reviewed the report and supporting work papers. As recommended by the OIG, GHI agrees to:

- identify \$11,149 of accumulated unallowable unfunded pension costs (\$1,232 as an unallowable component of the Medicare segment pension costs and \$9,917 as an unallowable component of the "Other" segment pension costs) as of January 1, 2008, and
- properly identify, and update with interest, unallowable unfunded pension costs for subsequent plan years.

Please let me know if you have any questions regarding this letter.

Sincerely,

A handwritten signature in blue ink that reads 'Peter S. Moore'.

Peter S. Moore
Vice President

Group Health, Incorporated
25 Broadway, New York, NY 10004-1010
www.ghimedicare.com