134135

United States General Accounting Office

GAO

Briefing Report to the Chairman, Special Committee on Aging, U.S. Senate

November 1987

MEDICARE

Change in Contingency Reserve Funding Held Down Increase in Part B Premium

134735

RESTRICTED—Not to be released outside the General Accounting Office except on the basis of the specific approval by the Office of Congressional Relations.

RELEASED

540744

GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-229330

November 30, 1987

The Honorable John Melcher
Chairman, Special Committee
on Aging
United States Senate

Dear Mr. Chairman:

Your September 17, 1987, letter asked for our assistance in the Committee's inquiry into the justification for the 38.5-percent increase in Medicare's part B premium for 1988. We agreed with your office to compare the method used by the Department of Health and Human Services (HHS) to compute the 1988 premium with the methods used in previous years to see if any significant changes had occurred that would have affected the premium amount.

We reviewed HHS's supporting documentation for the premium calculations for 1985-88 and discussed them with officials responsible for them. Our comparison of the computations showed that the only significant change HHS's Health Care Financing Administration (HCFA) made was the way it viewed the part B trust fund for purposes of computing the 1988 contingency margins. The contingency margins are amounts included in the premium calculation to compensate for projection errors and to adjust the projected surplus or deficit in the trust fund so that its balance moves toward the desired level of surplus. In previous years, HCFA had viewed the trust fund as being composed of an aged portion and a disabled portion for purposes of setting contingency margins. In the 1988 premium calculation, HCFA in effect viewed the trust fund as one. This enabled HCFA to include essentially no amount for a contingency margin because the large surplus in the "disabled portion" offset the large deficit in the "aged portion."

Without this change in practice, HCFA figures indicate that the monthly part B premium increase would have been about $1.70 higher than the $6.90 promulgated increase because a substantial amount would have to have been included to help eliminate the deficit in the "aged portion." The large cash surplus for the disabled enabled HCFA to limit the premium increase for 1988.

- - - -

As requested by your office, we did not obtain official agency comments on this report. However, we did discuss its contents with HCFA officials and incorporated their comments where appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this briefing report for 30 days. At that time, we will send copies to the Secretary of HHS and interested congressional committees and make copies available to others on request. If you have any questions, please contact me on 275-6195.

Sincerely yours,

Michael Zimmerman
Senior Associate Director

CHANGE IN CONTINGENCY RESERVE FUNDING HELD DOWN INCREASE IN PART B PREMIUM

BACKGROUND

Medicare is a health insurance program that covers most Americans age 65 and over and certain individuals under 65 who are disabled or have chronic kidney disease. The program, authorized under title XVIII of the Social Security Act, provides coverage under two parts. Part A, Hospital Insurance, which is financed primarily by Social Security payroll taxes, covers inpatient hospital services, posthospital care in skilled nursing facilities, hospice care, and care provided in patients' homes. In fiscal year 1986, Medicare part A covered 30.9 million enrollees, and benefits amounted to about $48.9 billion. This report does not deal with part A.

Part B, Supplementary Medical Insurance, is a voluntary program covering physician services and a variety of other health care services, such as laboratory and outpatient hospital services. In fiscal year 1986, Medicare part B covered about 30.4 million enrollees, and benefits totaled about $25.9 billion. Part B is financed by a combination of beneficiary premiums and general revenues. For the past several years, the premium has been set by law at 25 percent of the actuarial cost for aged enrollees. Although the average costs for the 2.7 million disabled beneficiaries are higher than those for aged enrollees, the law provides that they pay the same premium amount.

Each year HCFA issues a part B premium promulgation notice in the Federal Register, giving the monthly actuarial rate for aged and disabled beneficiaries, which is defined as half of the monthly actuarial cost. The notice also sets the premium to be paid by enrollees, which in recent years has been set at one-half the aged actuarial rate[1] (i.e., one-fourth the aged actuarial cost). On September 30, 1987, HHS announced in the Federal Register that the monthly part B premium for calendar year 1988 would be $24.80, an increase of $6.90, or 38.5 percent, from the $17.90 monthly premium during calendar year 1987.

OBJECTIVES, SCOPE, AND METHODOLOGY

As agreed with the office of the Senate Special Committee on Aging, the objective of our review was to evaluate the computation of the part B premium for 1988 to assess its consistency with prior years' computations. From HCFA's Office of the Actuary, we obtained the documentation related to the premium promulgations for 1985 through 1988. We compared the

[1]The cost experience for the disabled theoretically does not enter into the premium calculation.

methodologies used for these four premium computations and discussed the methodologies with officials in the Office of the Actuary.

As requested by the Committee's office, we did not obtain HCFA's comments on this briefing report. However, we incorporated the views of agency officials where appropriate. Our work was done in September, October, and November 1987. It was performed in accordance with generally accepted government auditing standards.

CHANGE IN CONTINGENCY MARGIN SETTING PRACTICE HELD DOWN PREMIUM INCREASE

Our comparison of the computation of the 1988 part B premium with those from 1985-87 showed that HCFA changed the way it computed the amount necessary to assure an adequate reserve in the part B trust fund to cover contingencies. The effect of this change was to produce a lower increase in the premium for 1988 than would have resulted if the computation had been consistent with prior years' practices.

The amount of general revenues that the part B trust fund receives is basically equal to the difference between the amount collected from beneficiaries as premiums and the program's actuarial cost. Because the average disabled beneficiary receives services that cost the trust fund more than those received by the average aged beneficiary, the trust fund has to receive more general revenues per disabled beneficiary than per aged beneficiary. Because the premium is based on the actuarial cost of aged beneficiaries, HCFA calculates actuarial costs separately for the two groups to enable determination of the required amount of general revenues. Table 1 shows for 1987 the actuarial cost, the premium amount, and the general revenue requirement for both beneficiary groups as shown in the notice promulgating the 1987 premium.

Table 1: Monthly Part B Premium and General Revenues per Beneficiary for 1987

Type of beneficiary	Actuarial cost	Premium amount	Difference = general revenues needed
Aged	$ 71.60	$17.90	$53.70
Disabled	106.00	17.90	88.10

HCFA uses several categories of items when calculating the separate actuarial costs for the aged and disabled. It uses available data to actuarially project what part B costs will be in the year covered by the premium. Table 2 lists the amounts included in the 1987 premium promulgation for each category for both beneficiary types.

Table 2: Breakdown of Actuarial Rate for 1987 Part B Premium by Type of Beneficiary

Category	Aged	Disabled
Covered services	$49.19	$75.59
Beneficiary cost sharing	-11.55	-16.62
Benefits	37.64	58.97
Administrative costs	1.38	2.18
Expenditures	39.02	61.15
Interest earned by trust fund	- .36	-6.70
Contingency margin	-2.86	-1.45
Monthly actuarial rate[a]	$35.80	$53.00

[a]The monthly actuarial rate is equal to half of the monthly actuarial cost, and the premium amount is equal to half of the monthly actuarial rate for the aged.

The last category in table 2--contingency margin--is the one where we noted that the 1988 premium computation had changed significantly from that of earlier years. The contingency margin is an amount included in the computation to provide a margin against projection errors and to adjust the balance in the part B trust fund to bring it in line with the target level.[2] If the part B trust fund has a large surplus projected, a negative contingency margin will be included to decrease the surplus toward the target level. Conversely, if the part B trust fund has a small surplus or a deficit projected, the contingency margin will be positive.

When calculating the 1988 premium, the available data indicated that HCFA had significantly underestimated benefit costs when it had calculated the 1987 premium. As a result, HCFA estimated that, although the part B trust fund would have a positive cash balance at the end of 1987, it would have an

[2]HCFA's current target level for the part B trust fund reserve is 3.5 percent of projected total annual expenditures from the trust fund.

actuarial deficit[3] at that time. This estimated actuarial deficit resulted because although there was a large surplus in the "disabled portion" of the trust fund, there was an even larger deficit in its "aged portion." If HCFA had followed the premium calculation method used in prior years, this situation would have meant that a relatively large positive contingency margin would have been included in the aged actuarial rate computation and a relatively large negative contingency margin in the disabled calculation. This, in turn, would have resulted, according to HCFA figures, in an $8.60 increase in the premium rather than the $6.90 increase actually promulgated.

Rather than follow the practice used for 1985-87, HCFA in effect elected for the 1988 premium calculation to consider the balance in the part B trust fund on an overall basis rather than on a separated "aged portion/disabled portion" basis.[4] This, in turn, enabled HCFA to include a negligible amount ($0.13) for a contingency margin in the aged portion and no contingency margin for the disabled portion. In effect, HCFA was using the large surplus in the disabled portion (which primarily represented prior year allocations of general revenues) to fund the large deficit for the aged.

HCFA projected that, based on the 1988 premium, the part B trust fund would have a cash balance at the end of 1988 and about the same actuarial deficit as was expected at the end of 1987. In future years (1989 and later)--assuming the projections made in calculating the 1988 premium are correct--HCFA will need to include positive contingency margins in calculating monthly actuarial rates in order to build a positive actuarial surplus for the part B trust fund of the desired level.

---

[3]That is, the cost of services beneficiaries had received in 1987 for which claims had not yet been processed and paid would exceed the cash in the trust fund.

[4]Medicare law does not specify the methodology to be used for calculating the contingency margin.

(106322)

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

Address Correction Requested

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100