Plan Sponsor Subsidies Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003

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AICPA Employee Benefit Plan Audit Quality Center

Introduction

On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act), which mainly benefits retirees and plan sponsors. This law significantly changes the Medicare Program established in 1965. One notable change is the establishment of a prescription drug plan (Part D plan). Congress recognized that many employers currently offer prescription drug plans to their retirees and wanted to encourage the continuation of those plans by offering retiree drug subsidies to plans that meet certain requirements.

The AICPA Employee Benefit Plan Audit Quality Center has developed this overview of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 to help Center members better understand the Act and how it might be relevant to the plans they audit. This document provides information about the nature of the drug subsidies provided for in the Act, what plans may be eligible for the subsidy, and the benefits provided.

Center members may wish to share the information in this primer with their clients to help educate them about the Act. In addition, because the retiree drug subsidy received by a multiemployer plan may affect the plan's financial statements, employee benefit plan auditors should be aware of this Act and certain of its provisions. Although the plan sponsor or plan will not be eligible to receive this subsidy until 2006, the subsidy may impact the calculation of the postretirement benefit obligation for plan years ending in 2005. For information about accounting for the subsidies, please see the references to the relevant accounting literature noted at the end of this Primer.

Options for Plan Sponsors

Plan sponsors that currently offer their retirees a prescription drug benefit have some decisions to make.

Plan sponsors that currently offer their retirees a prescription drug benefit will need to evaluate their retiree drug benefit plans to determine what option provided under the Act may best serve the company and its retirees. The plan sponsor may:

- Continue the current plan as an option to their retirees in place of the Medicare Part D plan benefit.
- Enroll in a Medicare Part D plan to replace its current prescription drug benefit and subsidize retirees' premiums.
- Offer a plan that is at least actuarially equivalent to Medicare's Part D defined standard prescription drug benefit as an option to their retirees, which may make the sponsor eligible to receive a tax-free drug subsidy from the Medicare Plan.
- Offer a supplemental drug plan which would offer their retirees coverage in addition to the Medicare Plan.
- Terminate drug plan coverage to its retirees.

If the plan sponsor elects to enroll in a Part D plan, they may enroll their retirees directly into a Part D plan or convert their existing plan to a Part D plan pursuant to Centers for Medicare & Medicaid Services (CMS) waivers. If one of these options is selected, the plan sponsor may elect to provide additional coverage over the standard Part D coverage in one of the following ways:

- Paying for enhanced coverage offered under a Part D plan that subsidizes more of their retirees' cost-sharing and provides additional benefits.
- Setting up their own separate supplemental plans and coordinating benefits with the coverage provided by the Part D plans in which their retirees enroll, in much the same way they currently supplement the standard Medicare Part A and B benefits.
- Making special arrangements with Part D plans to provide an employer-only plan with customized drug benefits for their retirees pursuant to CMS waivers.

If the plan's benefits are not equivalent to the Part D plans, the plan sponsor still may elect to continue to offer its own plan to the retirees. Those retirees will then have to make a decision as to whether they want to participate in the employer's plan or in a Medicare Part D plan.

Actuarially Equivalent Plans

The Act defines what qualifies as an actuarially equivalent plan.

To qualify for the drug subsidy under the Act, a plan sponsor must show that its prescription drug benefit is "actuarially equivalent" to (in other words, at least as generous as) defined standard coverage under the new Medicare prescription drug benefit.

The final regulation includes a two-part test for plan sponsors to determine whether this standard—referred to as "actuarial equivalence"—has been met. The first part is the total or gross value test. To meet this requirement, the expected amount of claims paid for Medicare beneficiaries in the retiree drug plan offered by the sponsor must be at least equal to the expected amount of claims that would be paid for those same beneficiaries under the defined standard coverage. The second part is the net value test. This part takes into account the sponsor's contribution toward the financing of the retiree drug coverage. The net value of the sponsor's retiree plan, which is calculated by subtracting the expected retiree premium from the expected amount of claims paid under the sponsor's drug program, must be at least equal to the net value of the Part D standard drug benefit. If the requirements of both parts of the test are met, the plan qualifies as an actuarially equivalent plan.

Standard Benefit and Creditable Coverage Status

Other important concepts defined in the Act are the standard benefit and the creditable coverage status.

The Act establishes a standard benefit that both serves as a minimum benefit and allows for comparisons across plans offered by various plan sponsors. Although drug plan sponsors may offer alternatives to the standard benefit design, any variant offered must at least be actuarially equivalent to the standard benefit structure which means, on average, it provides the same value. The standard benefit structure for 2006 includes:

- Monthly premium of approximately $32
- $250 deductible
- From $251 to $2,250, Medicare pays 75% of drug costs and plan enrollee pays 25%
- From $2,251, plan enrollee pays 100% until true out-of-pocket spending reaches $3,600
- After plan enrollee reaches $3,600 in true out-of-pocket spending, Medicare pays about 95% of drug costs

Coverage is considered creditable if its actuarial value equals or exceeds the actuarial value of standard prescription drug coverage under the Medicare prescription drug benefit. In general, this actuarial equivalence test measures whether the expected amount of paid claims under the plan sponsor's prescription drug coverage is at least equal to the expected amount of paid claims under standard prescription drug coverage under Medicare.

Prescription Plans Must be Registered to Qualify

Plan sponsors are not automatically enrolled in the subsidy program.

As previously noted, not all drug prescription plans offered by plan sponsors for their retirees qualify for the retiree drug subsidy. Even if a plan meets the actuarial equivalence standard, the plan sponsor may not receive a subsidy. Only those plans that are deemed actuarially equivalent (as described above) and have registered their prescription plan are eligible. There are five steps a plan sponsor must follow in order to register a drug prescription plan to qualify for the subsidy:

- Submit an application 90 days prior to the beginning of each plan year.
- Attach to the application an actuary's attestation that the plan meets the Act's actuarial equivalence standard.
- Certify that the creditable coverage status of the plan has or will be disclosed to plan participants and CMS.
- Electronically submit and periodically update enrollment information about retirees and dependents.
- Electronically submit aggregate data about drug costs incurred and reconciled costs at year-end.

About the Federal Retiree Drug Subsidy

Part D coverage begins on January 1, 2006, and the retiree drug subsidies to qualified plans begin on February 28, 2006.

If the above criteria are met, the plan sponsor may be eligible to receive a tax-free federal subsidy of up to 28% of the employer's portion of the individual retiree's drug costs between $250 and $5,000.

However, if the plan sponsor has elected to enroll its retirees directly in a Part D plan, the plan sponsor is not eligible for the federal subsidy payment. Likewise, if the election is made to supplement the retiree's premium for a Part D plan or to offer benefits in addition to the Part D plan to its retirees, the plan sponsor is not eligible for the subsidy.

Plan sponsors may choose whether to submit data and receive payments monthly, quarterly, or annually. For a single-employer drug benefit plan, the plan sponsor would receive the federal subsidy directly from the Federal Government. For a multiemployer drug benefit plan, the subsidy amount is paid directly to the multiemployer plan trust rather than to the individual employers.

References to Accounting Literature

Please refer to the accounting literature noted in this section for more detailed information on proper recording of federal drug subsidies under the Act.

In September 2005, the AICPA issued two Technical Practice Aids to assist plan sponsors and auditors in determining how federal subsidies received pursuant to the Act should be recorded in the plan sponsor's financial records.

TPA 6930.09 – Accounting and Disclosure Requirements for Single-Employer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, states that in a single employer drug benefit plan, the plan's benefit obligation is not reduced by the subsidy, as the money is received directly by the Plan Sponsor. The Plan Sponsor is not obligated to use this money to fund the plan's benefit obligations.

T*PA 6930.10 – Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, states that in a multiemployer benefit plan, the plan's benefit obligations should be reduced by the amount of the subsidy, as the money is received directly by the trust.

For Additional Information on the Medicare Prescription Drug, Improvement and Modernization Act of 2003:

Visit the *Centers for Medicare & Medicaid Services (CMS)* web site, http://www.cms.hhs.gov/ which offers information for both plan sponsors and retirees. Useful links within this sight include:

- Employer & Union Plan Sponsor Information – includes specific publications for Plan Sponsors.
- Employer & Union Plan Sponsor Retiree Drug Subsidy – includes specific information for Plan Sponsors on the Retiree Drug Subsidy.
- Employer Group Waiver Plans – includes specific information for Plan Sponsors on offering a Part D plan to their retirees or enrolling in a Part D plan.
- CMS Legislative Summary – Summary of HR 1 Medicare Prescription Drug, Improvement, and Modernization Act of 2003.

For Additional Information on the Retiree Drug Subsidy Program:

- Call the Retiree Drug Subsidy Hotline: 1-877-RDS-HELP
- Visit the Retiree Drug Subsidy web site at www.rds.cms.hhs.gov http://www.rds.cms.hhs.gov

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This primer is a non-authoritative practice tool developed by the AICPA Employee Benefit Plan Audit Quality Center to assist member firms in preparing staff for the employee benefit plan audits they perform. We have assembled general and background information on the Medicare Prescription Drug, Improvement and Modernization Act of 2003, along with information about the relevant accounting standards, in an easy-to-understand format. This primer also provides information about additional sources that may be consulted when researching the Act and the Retiree Drug Subsidy.

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