

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**PALMETTO GOVERNMENT BENEFITS
ADMINISTRATOR, LLC,
UNDERSTATED ITS MEDICARE
SEGMENT PENSION ASSETS**

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Office of Inspector General

<https://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.

Report in Brief

Date: July 2017

Report No. A-07-17-00503

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL



Why OIG Did This Review

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413.

The HHS, OIG, Office of Audit Services, Region VII pension audit team reviews the Medicare segment pension assets to ensure compliance with Federal regulations.

Previous OIG reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

Our objectives were to determine whether Palmetto Government Benefits Administrator, LLC (Palmetto), complied with Federal requirements, the Medicare contracts' pension segmentation requirements, and its established cost accounting practice when (1) implementing the prior audit recommendations and (2) updating the Palmetto Medicare segment pension assets from January 1, 2005, to January 1, 2013.

How OIG Did This Review

We reviewed Palmetto's update of the Medicare segment pension assets as of January 1, 2013, to ensure compliance with Federal regulations.

Palmetto Government Benefits Administrator, LLC, Understated Its Medicare Segment Pension Assets

What OIG Found

Palmetto concurred with our prior audit recommendation to increase the Medicare segment pension asset by \$2.2 million as of January 1, 2005. However, Palmetto did not correctly update the Medicare segment pension assets from January 1, 2005, to January 1, 2013, in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Palmetto identified \$63.6 million as the Medicare segment pension assets as of January 1, 2013; however, we determined that the Medicare segment pension assets were \$64.6 million. Therefore, Palmetto understated the Medicare segment pension assets as of January 1, 2013 by \$1.0 million. Palmetto understated its Medicare segment's pension assets because it did not have policies and procedures to ensure that it calculated those assets in accordance with Federal regulations, the pension segmentation language of its Medicare contracts, and its established cost accounting practice when updating the Medicare segments' pension assets from January 1, 2005, to January 1, 2013.

What OIG Recommends and Palmetto Comments

We recommend that Palmetto increase the Medicare segment pension assets by \$1.0 million and recognize \$64.6 million as the Medicare segment pension assets as of January 1, 2013, and establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

Palmetto concurred with our recommendations.

TABLE OF CONTENTS

INTRODUCTION..... 1

Why We Did This Review 1

Objectives..... 1

Background 1

Palmetto Government Benefits Administrator, LLC 1

Prior Pension Segmentation Audit..... 2

How We Conducted This Review 2

FINDING..... 3

Prior Audit Recommendation 3

Update of Medicare Segment Pension Assets..... 4

Contributions and Transferred Prepayment Credits Understated..... 4

Benefit Payments Understated..... 5

Net Transfers Out Understated 6

Earnings, Net of Expenses Understated 6

RECOMMENDATIONS 6

OTHER MATTER..... 7

AUDITEE COMMENTS 7

APPENDIXES

A: Audit Scope and Methodology 8

B: Palmetto Government Benefits Administrator, LLC,
Statement of Medicare Segment Pension Assets
for the Period January 1, 2005, to January 1, 2013 10

C: Federal Requirements Related to Pension Segmentation..... 12

D: Palmetto Government Benefits Administrator, LLC,
Cost Accounting Standards Balance Equation as of January 1, 2013 13

E: Auditee Comments 14

INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

At CMS's request, the Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors, Medicare administrative contractors (MACs) and other CAS-covered and Federal Acquisition Regulation (FAR)-covered contracts through Final Administrative Cost Proposals and/or Incurred Cost Proposals.

For this review, we focused on one entity, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Other segment and Medicare segment pension assets that Palmetto updated from January 1, 2005, to January 1, 2013.

OBJECTIVES

Our objectives were to determine whether Palmetto complied with Federal requirements, the Medicare contracts' pension segmentation requirements, and its established cost accounting practice when (1) implementing the prior audit recommendations to increase the Palmetto Medicare segment pension assets as of January 1, 2005, and (2) updating the Palmetto Medicare segment pension assets from January 1, 2005, to January 1, 2013.

BACKGROUND

Palmetto Government Benefits Administrator, LLC

During our audit period, Palmetto was a subsidiary of Blue Cross Blue Shield of South Carolina (BCBS South Carolina), whose home office is in Columbia, South Carolina. Palmetto administered Medicare Part A fiscal intermediary, Medicare Part B carrier, and Railroad Retirement Board contract operations under cost reimbursement contracts with CMS. The Medicare Part A fiscal intermediary and Medicare Part B carrier contracts ended on January 24, 2011, and June 20, 2011, respectively.

With the implementation of Medicare contracting reform,¹ Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 1² and Jurisdiction 11³ effective October 25, 2007, and May 21, 2010, respectively, as well as other CAS-covered and FAR-covered contracts.

BCBS South Carolina has three Medicare segments that participate in its qualified defined-benefit pension plan: (1) Palmetto; (2) TrailBlazer Health Enterprises, LLC (TrailBlazer); and (3) Companion Data Services, LLC (CDS). This report addresses Palmetto's compliance with the pension segmentation language under the provisions of its Medicare contracts. We are addressing TrailBlazer's and CDS's compliance with Federal regulations and the pension segmentation requirements in separate reviews.

Prior Pension Segmentation Audit

We performed a prior pension segmentation audit at BCBS South Carolina (A-07-16-00476, issued April 15, 2016), which brought the Palmetto Medicare segment pension assets to January 1, 2005. We recommended that BCBS South Carolina increase Palmetto's Medicare segment pension assets by \$2,247,707, and, as a result, recognize \$29,470,518 as the Medicare segment pension assets as of January 1, 2005.

HOW WE CONDUCTED THIS REVIEW

We reviewed Palmetto's implementation of the prior audit recommendations as well as its update of Medicare segment pension assets from January 1, 2005, to January 1, 2013.

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 finding and conclusions based on our audit objectives.

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

² Medicare Parts A and B Jurisdiction 1 consists of the States of California, Hawaii, and Nevada, and the territories of American Samoa, Guam, and the Northern Mariana Islands.

³ Medicare Parts A and B Jurisdiction 11 consists of the States of North Carolina, South Carolina, Virginia, and West Virginia (but excludes Part B for the counties of Arlington and Fairfax in Virginia and the city of Alexandria in Virginia). Jurisdiction 11 also includes home health and hospice services provided in the States of Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Kentucky, Louisiana, Mississippi, New Mexico, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, and Texas.

Appendix A contains details of our audit scope and methodology.

FINDING

Palmetto concurred with our prior audit recommendation to increase the Medicare segment pension asset by \$2,247,707 as of January 1, 2005. We were, however, unable to determine whether Palmetto had actually implemented this recommendation. Regarding our second objective, Palmetto did not correctly update the Medicare segment pension assets from January 1, 2005, to January 1, 2013, in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Palmetto identified \$63,606,294 as the Medicare segment pension assets as of January 1, 2013; however, we determined that the Medicare segment pension assets were \$64,634,915. Therefore, Palmetto understated the Medicare segment pension assets as of January 1, 2013, by \$1,028,621. Palmetto understated its Medicare segment's pension assets because it did not have policies and procedures to ensure that it calculated those assets in accordance with Federal regulations, the pension segmentation language of its Medicare contracts, and its established cost accounting practice when updating the Medicare segments' pension assets from January 1, 2005, to January 1, 2013.

Appendix B identifies the details of Palmetto's Medicare segment pension assets from January 1, 2005, to January 1, 2013, as determined during our audit. Table 1 below summarizes the audit adjustments required to update Palmetto's Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per Audit	Per Palmetto	Difference
Prior Audit Recommendations	\$29,470,518	\$27,222,811	\$2,247,707
Update of Medicare Segment Assets			
Contributions and Prepayment Credits	46,447,799	45,983,569	464,230
Benefit Payments	(15,790,265)	(15,681,775)	(108,490)
Net Transfers	(15,512,599)	(13,333,646)	(2,178,953)
Earnings, Net of Expenses	20,019,462	19,415,335	604,127
Understatement of Medicare Segment Assets	\$64,634,915	\$63,606,294	\$1,028,621

PRIOR AUDIT RECOMMENDATION

We performed a prior pension segmentation audit on Palmetto's Medicare segment pension assets (A-07-16-00476, issued April 15, 2016), which recommended that Palmetto increase its Medicare segment pension assets by \$2,247,707 as of January 1, 2005. Palmetto concurred with our recommendation but did not give us an updated Medicare segment CAS rollup. Without that information, we were unable to determine whether Palmetto had implemented

our prior recommendation. Therefore, we continue to identify the prior audit recommendation as an adjustment to the Medicare segment pension assets, as shown in Table 1.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

The Medicare contracts require Medicare contractors to update the Medicare segment pension assets yearly in accordance with the CAS. The CAS requires that the asset base be adjusted by contributions, income, benefit payments, and expenses. For details on the Federal requirements and the relevant language of the Medicare contracts, see Appendix C.

Palmetto did not correctly update the Medicare segment pension assets from January 1, 2005, to January 1, 2013, in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Palmetto identified \$63,606,294 as the Medicare segment pension assets as of January 1, 2013; however, we determined that the Medicare segment pension assets were \$64,634,915. Therefore, Palmetto understated the Medicare segment pension assets as of January 1, 2013, by \$1,028,621. The following are our findings regarding the update of the Medicare segment pension assets from January 1, 2005, to January 1, 2013. Appendix D identifies Palmetto's CAS balance equation as of January 1, 2013.⁴

Contributions and Transferred Prepayment Credits Understated

The audited contributions and transferred prepayment credits⁵ are based on the assignable pension costs.⁶ In compliance with the CAS, we applied prepayment credits first to current-year assignable pension costs (because the credits were available at the beginning of the year) and then updated any remaining credits with interest to the next measurement (valuation) date. We then allocated contributions to assigned pension costs, as needed, as of the date of deposit. For additional details on these Federal requirements, see Appendix C.

Palmetto understated contributions and transferred prepayment credits by \$464,230 for its Medicare segment. The understatement occurred primarily because of differences in the asset base used to compute the assignable pension costs. Table 2 on the following page shows the differences between the contributions and prepayment credits proposed by Palmetto and the contributions and prepayment credits that we calculated during our review.

⁴ The CAS balance equation identifies the market value of assets, actuarial accrued liability, actuarial value of assets, accumulated value of prepayment credits, and the unfunded actuarial liability in accordance with CAS 412.40(c).

⁵ A prepayment credit is the amount funded in excess of the pension costs assigned to a cost accounting period that is carried forward for future recognition.

⁶ These are assigned to a specific cost accounting period.

Table 2: Contributions and Transferred Prepayment Credits

	Per Audit	Per Palmetto	Difference
2005	\$6,611,978	\$5,620,100	\$991,878
2006	7,161,326	7,140,568	20,758
2007	6,557,001	6,697,581	(140,580)
2008	4,985,138	5,070,546	(85,408)
2009	5,031,604	5,134,859	(103,255)
2010	5,650,955	5,601,487	49,468
2011	5,334,690	5,426,966	(92,276)
2012	5,115,107	5,291,462	(176,355)
Total	\$46,447,799	\$45,983,569	\$464,230

Benefit Payments Understated

Palmetto understated benefit payments by \$108,490 for the Medicare segment. This understatement occurred primarily because Palmetto incorrectly identified benefit payments for two Medicare segment participants. This understatement of benefit payments resulted in an overstatement of the Palmetto Medicare segment pension assets by \$108,490. A comparison of Palmetto's and our calculations of benefit payments for the Medicare segment appears in Table 3 below.

Table 3: Benefit Payments

	Per Audit	Per Palmetto	Difference
2005	(\$2,038,213)	(\$1,934,608)	(\$103,605)
2006	(1,756,316)	(1,756,316)	0
2007	(3,139,402)	(3,134,517)	(4,885)
2008	(1,569,007)	(1,569,007)	0
2009	(2,955,469)	(2,955,469)	0
2010	(451,311)	(451,311)	0
2011	(1,311,443)	(1,311,443)	0
2012	(2,569,104)	(2,569,104)	0
Total	(\$ 15,790,265)	(\$15,681,775)	(\$108,490)

Net Transfers Out Understated

Palmetto understated net transfers out of its Medicare segment by \$2,178,953. The understatement occurred because Palmetto incorrectly identified the participants who transferred in or out of its Medicare segment. This understatement of the net transfer adjustment resulted in an overstatement of the Palmetto Medicare segment pension assets by \$2,178,953. Table 4 below shows the differences between the net transfers proposed by Palmetto and the net transfers that we calculated during our review.

Table 4: Net Transfers Out of the Medicare Segment

	Per Audit	Per Palmetto	Difference
2005	\$841,281	\$3,621,388	(2,780,107)
2006	(3,305,109)	(2,172,291)	(1,132,818)
2007	(5,209,821)	(6,596,018)	1,386,197
2008	(1,377,920)	(1,218,311)	(159,609)
2009	(1,267,574)	(1,911,998)	644,424
2010	(1,266,012)	(1,006,500)	(259,512)
2011	(988,765)	(1,001,584)	12,819
2012	(2,938,679)	(3,048,332)	109,653
Total	(\$15,512,599)	(\$13,333,646)	(\$2,178,953)

Earnings, Net of Expenses Understated

Palmetto understated investment earnings, less administrative expenses, by \$604,127 for its Medicare segment, because it used incorrect contributions and transferred prepayment credits, incorrect benefit payments, and incorrect net transfers (all discussed above) to develop the Medicare segment pension asset base. In our audited update, we allocated earnings, net of expenses based on the applicable CAS requirements. For details on applicable Federal requirements, see Appendix C.

RECOMMENDATIONS

We recommend that Palmetto:

- increase the Medicare segment pension assets by \$1,028,621 and recognize \$64,634,915 as the Medicare segment pension assets as of January 1, 2013, and
- establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

OTHER MATTER

During our review, we noted that the lump sum conversion rate used by BCBS South Carolina's actuaries appeared to be based on current market interest rates. This could be inconsistent with the CAS requirement to use long-term interest assumptions. Accordingly, it is appropriate that BCBS South Carolina discuss with CMS the use of noncompliant interest assumptions when settling contract costs.

AUDITEE COMMENTS

In written comments on our draft report, Palmetto concurred with our recommendations. Palmetto's comments appear in their entirety as Appendix E.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed Palmetto's implementation of the prior audit recommendations, its identification of its Medicare segment, and its update of the Palmetto Medicare segment pension assets from January 1, 2005, to January 1, 2013.

Achieving our objective did not require that we review Palmetto's overall internal control structures. We reviewed controls relating to the identification of the Medicare segment and to the update of the Medicare segment pension assets to ensure adherence to the Medicare contracts, CAS 412, and CAS 413.

We performed fieldwork at BCBS South Carolina and Palmetto in Columbia, South Carolina.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed the annual actuarial valuation reports prepared by BCBS South Carolina's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses, and used this information to calculate the Palmetto Medicare segment assets;
- obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Palmetto Medicare segment assets;
- interviewed BCBS South Carolina and Palmetto staff responsible for identifying the Medicare segments to determine whether the segments were properly identified in accordance with the Medicare contracts;
- reviewed Palmetto's accounting records to verify the segments' identifications as well as the benefit payments made to the Medicare segments;
- reviewed the prior segmentation audit performed at BCBS South Carolina (A-07-16-00476) to determine the beginning market value of assets for the Palmetto Medicare segment;
- provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segments' pension assets from January 1, 2005, to January 1, 2013;

- reviewed the CMS actuaries' methodology and calculations; and
- provided the results of the review to Palmetto officials on April 7, 2017.

We performed this review in conjunction with the following audits and used the information obtained during this audit:

- *TrailBlazer Health Enterprises, LLC, Understated Its Medicare Segment Pension Assets and Understated Medicare's Share of the Medicare Segment Excess Pension Assets (A-07-17-00507)* and
- *Companion Data Services, LLC, Overstated Its Medicare Segment Pension Assets (A-07-17-00512)*.

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 finding and conclusions based on our audit objectives.

**APPENDIX B: PALMETTO GOVERNMENT BENEFITS ADMINISTRATOR, LLC,
STATEMENT OF MEDICARE SEGMENT PENSION ASSETS
FOR THE PERIOD JANUARY 1, 2005, TO JANUARY 1, 2013**

Description		Total Company	Other Segments	Palmetto Medicare Segment	TrailBlazer Medicare Segment	CDS Medicare Segment
Assets January 1, 2005	<u>1/</u>	\$299,645,812	\$248,926,783	\$29,470,518	\$21,248,511	\$0
Prepayment Credits	<u>2/</u>	0	(12,233,031)	6,611,978	5,621,053	0
Contributions	<u>3/</u>	82,491,519	82,491,519	0	0	0
Earnings	<u>4/</u>	23,070,997	18,242,393	2,745,667	2,082,937	0
Benefit Payments	<u>5/</u>	(11,885,572)	(9,308,314)	(2,038,213)	(539,045)	0
Administrative Expenses	<u>6/</u>	(1,199,715)	(948,623)	(142,777)	(108,315)	0
Transfers	<u>7/</u>	0	(317,101)	841,281	(524,180)	0
Assets January 1, 2006		\$392,123,041	\$326,853,626	\$37,488,454	\$27,780,961	\$0
Prepayment Credits		0	(13,070,401)	7,161,326	5,909,075	0
Contributions		80,000,000	80,000,000	0	0	0
Earnings		47,893,044	38,300,446	5,440,572	4,152,026	0
Benefit Payments		(16,503,981)	(14,177,081)	(1,756,316)	(570,584)	0
Administrative Expenses		(1,472,006)	(1,177,175)	(167,217)	(127,614)	0
Transfers		0	4,772,334	(3,305,109)	(1,467,225)	0
Assets January 1, 2007		\$502,040,098	\$421,501,749	\$44,861,710	\$35,676,639	\$0
Prepayment Credits		0	(11,857,281)	6,557,001	5,300,280	0
Contributions		30,000,000	30,000,000	0	0	0
Earnings		36,810,082	30,040,521	3,738,425	3,031,136	0
Benefit Payments		(22,412,122)	(18,154,606)	(3,139,402)	(1,118,114)	0
Administrative Expenses		(2,134,523)	(1,741,973)	(216,782)	(175,768)	0
Transfers		0	6,272,405	(5,209,821)	(4,960,345)	3,897,761
Assets January 1, 2008		\$544,303,535	\$456,060,815	\$46,591,131	\$37,753,828	\$3,897,761
Prepayment Credits		0	(10,177,933)	4,985,138	4,196,561	996,234
Contributions		55,000,000	55,000,000	0	0	0
Earnings		(139,128,389)	(114,147,505)	(13,335,545)	(10,360,405)	(1,284,934)
Benefit Payments		(28,796,394)	(22,247,008)	(1,569,007)	(4,980,379)	0
Administrative Expenses		(1,919,561)	(1,574,899)	(183,991)	(142,943)	(17,728)
Transfers		0	4,869,606	(1,377,920)	(3,191,786)	(299,900)
Assets January 1, 2009		\$429,459,191	\$367,783,076	\$35,109,806	\$23,274,876	\$3,291,433
Prepayment Credits		0	(11,383,635)	5,031,604	5,021,589	1,330,442
Contributions		50,000,000	50,000,000	0	0	0
Earnings		70,849,880	58,827,624	6,543,601	4,696,430	782,225
Benefit Payments		(23,417,842)	(19,368,321)	(2,955,469)	(1,094,052)	0
Administrative Expenses		(1,616,076)	(1,341,850)	(149,259)	(107,125)	(17,842)
Transfers		0	1,954,512	(1,267,574)	(967,245)	280,307
Assets January 1, 2010		\$525,275,153	\$446,471,406	\$42,312,709	\$30,824,473	\$5,666,565
Prepayment Credits		0	(12,590,096)	5,650,955	5,244,885	1,694,256
Contributions		80,000,000	80,000,000	0	0	0
Earnings		77,320,884	63,718,906	7,172,774	5,384,228	1,044,976
Benefit Payments		(23,100,379)	(21,367,151)	(451,311)	(469,841)	(812,076)
Administrative Expenses		(1,668,474)	(1,374,963)	(154,778)	(116,184)	(22,549)
Transfers		0	2,807,363	(1,266,012)	(1,411,540)	(129,811)
Assets January 1, 2011		\$657,827,184	\$557,665,465	\$53,264,337	\$39,456,021	\$7,441,361

Description	Total Company	Other Segments	Palmetto Medicare Segment	TrailBlazer Medicare Segment	CDS Medicare Segment
Assets January 1, 2011	\$657,827,184	\$557,665,465	\$53,264,337	\$39,456,021	\$7,441,361
Prepayment Credits	0	(12,390,821)	5,334,690	5,195,739	1,860,392
Contributions	55,000,000	55,000,000	0	0	0
Earnings	(2,100,856)	(1,736,442)	(190,248)	(144,367)	(29,799)
Benefit Payments	(38,031,699)	(34,903,698)	(1,311,443)	(1,364,593)	(451,965)
Administrative Expenses	(1,491,803)	(1,233,035)	(135,094)	(102,514)	(21,160)
Transfers	0	2,497,237	(988,765)	(1,174,954)	(333,518)
Assets January 1, 2012	\$671,202,826	\$564,898,706	\$55,973,477	\$41,865,332	\$8,465,311
Prepayment Credits	0	(6,932,126)	5,115,107	0	1,817,019
Contributions	45,000,000	45,000,000	0	0	0
Earnings	100,064,563	83,487,724	9,224,707	5,776,947	1,575,185
Benefit Payments	(44,963,025)	(33,426,739)	(2,569,104)	(8,826,455)	(140,727)
Administrative Expenses	(1,850,498)	(1,543,942)	(170,593)	(106,833)	(29,130)
Transfers	0	33,240,969	(2,938,679)	(29,044,880)	(1,257,410)
Discount on Accrued Contributions	8/ (1,380,956)	(1,380,956)	0	0	0
Assets January 1, 2013	\$768,072,910	\$683,343,636	\$64,634,915	\$9,664,111	\$10,430,248
Per BCBS South Carolina	9/ \$767,878,032	\$685,213,127	\$63,606,294	\$8,510,483	\$10,548,128
Asset Variance	10/ \$194,878	(\$1,869,491)	\$1,028,621	\$1,153,628	(\$117,880)

ENDNOTES

- 1/ We determined the Medicare segment pension assets as of January 1, 2005, based on our prior segmentation audit of Palmetto (A-07-16-00476). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segments. All pension assets are shown at market value.
- 2/ Transferred prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to avoid incurring unallowable interest. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 3/ We obtained Total Company contribution amounts from the actuarial valuation reports and Department of Labor/Internal Revenue Service Forms 5500. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the Total Company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the Other segment until needed to fund pension costs in the future.
- 4/ We obtained net investment earnings from the actuarial valuation reports. We allocated net investment earnings based on the ratio of each segment's weighted average value (WAV) of assets to Total Company WAV of assets as required by the CAS.
- 5/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by Palmetto.
- 6/ In accordance with the CAS, we allocated administrative expenses to each Medicare segment in proportion to investment earnings.
- 7/ We identified participant transfers between segments by comparing valuation data files provided by Palmetto. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 8/ In accordance with the CAS Harmonization Rule, effective 2013, actual contributions are discounted, at the effective interest rate, from the date of each contribution to the beginning of the program year.
- 9/ We obtained total asset amounts from documents prepared by Palmetto's actuarial consulting firm. The Total Company asset value includes a discount for accrued contributions. The Other segment amount is the difference between the Total Company and the Medicare segments.
- 10/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Palmetto's calculation of the Medicare segment pension assets.

APPENDIX C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION

FEDERAL REGULATIONS

Federal regulations (CAS 412.50(a)(4)) require that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

Federal regulations (CAS 413.50(c)(7)) require that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's WAV of assets to Total Company WAV of assets.

Federal regulations (CAS 413.50(c)(8)) require an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities.

MEDICARE CONTRACTS

The Medicare contracts identify a Medicare segment as:

... any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
2. Less than a majority of the salary dollars are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the Medicare contracts state that "... the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)."

**APPENDIX D: PALMETTO GOVERNMENT BENEFITS ADMINISTRATOR, LLC,
COST ACCOUNTING STANDARDS BALANCE EQUATION
AS OF JANUARY 1, 2013**

Description		Total Company	All Other Segments	Palmetto Segment	CDS Segment	Trailblazers Segment
Actuarial Accrued Liability	<u>1/</u>	\$ 708,728,963	\$ 611,914,012	\$ 74,270,051	\$ 14,664,091	\$ 7,880,809
Less: Actuarial Value of Assets	<u>2/</u>	(747,369,407)	(664,775,522)	(63,005,954)	(10,167,380)	(9,420,551)
Unfunded Actuarial Liability	<u>3/</u>	\$ (38,640,444)	\$ (52,861,510)	\$ 11,264,097	\$ 4,496,711	\$ (1,539,742)
9904.412-50(a)(2) Unallowable	<u>4/</u>	\$ -	\$ -	\$ -	\$ -	\$ -
Prepayment Credit	<u>5/</u>	(211,205,039)	(211,205,039)	-	-	-
Adjustments to UAL	<u>6/</u>	\$ (211,205,039)	\$ (211,205,039)	\$ -	\$ -	\$ -
Net Unamortized Balance	<u>7/</u>	\$ 172,564,595	\$ 158,343,529	\$ 11,264,097	\$ 4,496,711	\$ (1,539,742)
Market Value of Assets	<u>8/</u>	\$ 768,072,910	\$ 683,343,636	\$ 64,634,915	\$ 10,430,248	\$ 9,664,111

ENDNOTES

- 1/ Actuarial accrued liability (AAL) represents the pension cost attributable, under the actuarial cost method in use, to years prior to January 1, 2013. We obtained the total company AAL from the January 1, 2013, BCBS South Carolina actuarial valuation report. The AAL for the Other and Medicare segments was determined as a result of our audit.
- 2/ The actuarial value of assets (AVA) is the value of cash, investments, and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation. The AVA shown here was computed by the CMS Office of the Actuary, based on audited values as of January 1, 2013.
- 3/ The unfunded actuarial liability (UAL) is the AAL less the AVA as of January 1, 2013. An actuarial surplus, or negative UAL, is created whenever the AVA exceeds the AAL.
- 4/ The 9904.412-50(a)(2) unallowable represents the prior period pension costs determined to be unallowable in accordance with Government contractual provisions in effect at the time or pension costs assigned to a cost accounting period that were not funded in that period. This is an adjustment to the UAL required by CAS 412-50(a)(2).
- 5/ The prepayment credit represents funds available to satisfy future funding requirements. This is an adjustment to the AVA for premature funding of future pension costs required by CAS 412-50(a)(4).
- 6/ The sum of the adjustments to the UAL.
- 7/ The net unamortized balance is the UAL less the adjustments to the UAL. It is the remaining balance yet to be amortized in accordance with CAS 412-50(a)(1) and CAS 413-50(a)(2).
- 8/ The market value of assets represents the current value of assets as of January 1, 2013, plus the current value of any accrued contributions used to fund pension costs assigned to periods prior to January 1, 2013.

APPENDIX E: AUDITEE COMMENTS



PALMETTO GBA®
A CELERIAN GROUP COMPANY

PO BOX 100134 | COLUMBIA, SC 29202-3134 | PALMETTOGBA.COM | ISO 9001
KENNETH LEWIS
Vice President and CFO

May 25, 2017

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

Re: Report Number A-07-17-00503

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report dated April 25, 2017 and entitled *Palmetto Government Benefits Administrator, LLC, Understated Its Medicare Segment Pension Assets*.

The report contains the following recommendations:

- We recommend that Palmetto increase the Medicare segment pension assets by \$1,028,621 and recognize \$64,634,915 as the Medicare segment pension assets as of January 1, 2013, and
- establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

Palmetto concurs with the OIG recommendations and does not have any additional comments or questions.

We appreciate the opportunity to comment on the recommendations. Please let me know if you have questions or need additional information regarding our response.

Sincerely,

/Kenneth Lewis/

Kenneth Lewis
Vice President and CFO

Cc: Louis McElveen, BCBSSC
Bruce Hughes, Celerian Group
Joe Johnson, Palmetto GBA