



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

FEB 18 2005

Report Number: A-07-03-03042

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  
P.O. Box 100134 AG-A15  
Columbia, South Carolina 29202-3134

Dear Mr. Wright:

Enclosed are two copies of the Department of Health and Human Services, Office of Inspector General (OIG) report entitled "Audit of Blue Cross Blue Shield of South Carolina's Medicare Contract Pension Segmentation for 1993 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.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. §552, as amended by Public Law 104-231), OIG reports are made available publicly to the extent information contained therein is not subject to exemptions of the Act that the Department chooses to exercise. (See 45 CFR part 5)

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 e-mail at [Jenenne.Tambke@oig.hhs.gov](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-03-03042 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad".

James P. Aasmundstad  
Regional Inspector General  
for Audit Services

Enclosures

Page 2 - Mr. Joseph D. Wright, CPA

**Direct Reply to HHS Action Official:**

Rose Crum-Johnson  
Regional Administrator  
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**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF BLUE CROSS BLUE SHIELD  
OF SOUTH CAROLINA'S MEDICARE  
CONTRACT PENSION SEGMENTATION  
FOR 1993 THROUGH 2001**



**FEBRUARY 2005  
A-07-03-03042**

# *Office of Inspector General*

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

## *Office of Audit Services*

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

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The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

# Notices

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**THIS REPORT IS AVAILABLE TO THE PUBLIC  
at <http://oig.hhs.gov/>**

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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 in its Palmetto Government Benefit Administrators (Palmetto) and TrailBlazer Health Enterprises (TrailBlazer) subsidiaries under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

Starting with fiscal year (FY) 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413.

We previously conducted a segmentation review (A-07-94-00768) that addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1993.

### **OBJECTIVES**

Our objectives were to determine if South Carolina:

- implemented our prior audit recommendation, and
- complied with the Medicare contracts' pension segmentation requirements while updating the Palmetto and TrailBlazer Medicare segment assets from January 1, 1993, to January 1, 2002.

### **SUMMARY OF FINDINGS**

South Carolina implemented our prior audit recommendation to increase Medicare segment assets by \$394,005. However, South Carolina did not comply with the Medicare contracts' pension segmentation requirements while updating the Palmetto and TrailBlazer Medicare segment pension assets. As a result, South Carolina understated Palmetto's Medicare segment assets by \$1,106,482 and overstated TrailBlazer's Medicare segment assets by \$345,006. South Carolina did not have adequate controls to ensure that its Medicare segments were identified in accordance with the Medicare contracts and that segment assets were updated in accordance with CAS 412 and 413.

### **RECOMMENDATIONS**

We recommend that South Carolina:

- increase Palmetto’s Medicare segment pension assets by \$1,106,482 as of January 1, 2002,
- decrease TrailBlazer’s Medicare segment pension assets by \$345,006 as of January 1, 2002, and
- implement controls to ensure that Medicare segments are identified in accordance with the Medicare contracts and updated in accordance with CAS 412 and 413.

## **AUDITEE COMMENTS**

South Carolina agreed with the findings and will implement the recommendations. However, they requested an explanation of the allocation of interest on accumulated prepayment credits and additional input on the determination of those areas that should be included in the Medicare segment. South Carolina’s comments are presented in its entirety on Appendix B.

## **OIG RESPONSE**

In response to South Carolina’s request the following paragraphs provide an explanation of the allocation of interest on the accumulated prepayment credits and additional input on the determination of those areas that should be included in the Medicare segment.

Prepayment credits are created when the contributions made for a period exceed the CAS pension cost assignable to that same period. In accordance with CAS 412-50(d)(4), pension costs are funded within the cost accounting period if the contributions are made by the corporate tax filing date, including extensions. Therefore, prepayment credits are available at the beginning of the subsequent accounting period although the actual deposit is made after the first day of the accounting period. The allocation of a full year of interest to prepayment credits for CAS purposes is consistent with the treatment of receivable contributions for employee retirement income security act (ERISA) purposes when determining the pension plan’s actuarial asset value.

South Carolina followed a general rule that an area allocating 50% of its costs to Medicare should be included in the Medicare segment of the appropriate entity. However, the Medicare contract identifies a Medicare segment as “...any organizational component ...having a significant degree of responsibility and accountability for the Medicare contract of which...the majority of the salary dollars is allocated to the Medicare contract.” South Carolina’s identification of the Medicare segment occurred at the cost center level rather than at an organizational level as required by the contract. The identification of the Medicare segment at the organizational or subsidiary level precludes the annual movement of cost centers that fluctuate slightly over or under the 50% general rule as applied by South Carolina.

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## **Glossary of Abbreviations and Acronyms**

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
ERISA	Employee Retirement Income Security Act
FY	fiscal year
OIG	Office of Inspector General
WAV	weighted average value

## **INTRODUCTION**

### **BACKGROUND**

#### **South Carolina's Medicare Contracts**

South Carolina administers Medicare Part A and Part B operations in its Palmetto and TrailBlazer subsidiaries under cost reimbursement contracts. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations, CAS, and the Medicare contracts.

South Carolina acquired TrailBlazer from Blue Cross Blue Shield of Texas in October 1999. No pension plan assets were transferred with TrailBlazer as of October 1, 1999, and no pension contributions were allocated to TrailBlazer prior to January 1, 2000.

The CMS incorporated segmentation requirements into Medicare contracts starting in FY 1988. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

Our previous segmentation review (A-07-94-00768) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1993.

#### **Regulations**

The CAS 412 regulates the determination and measurement of pension cost components. It also regulates the assignment of pension costs to appropriate accounting periods.

The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

### **OBJECTIVES, SCOPE, AND METHODOLOGY**

#### **Objectives**

Our objectives were to determine if South Carolina implemented our prior audit recommendation and complied with the Medicare contracts' pension segmentation requirements while updating the Palmetto and TrailBlazer Medicare segment assets from January 1, 1993, to January 1, 2002.

#### **Scope**

We reviewed South Carolina's identification of its Palmetto Medicare segment and its update of Medicare assets from January 1, 1993, to January 1, 2002. Similarly, we reviewed South

Carolina's identification of its TrailBlazer Medicare segment and its update of Medicare assets from January 1, 2000, to January 1, 2002.

Achieving our objectives did not require that we review South Carolina's overall internal control structure. However, we did review controls relating to the identification of the Medicare segments and the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

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

### **Methodology**

In performing this 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. The CMS pension actuarial staff used the documents to calculate Medicare segment assets as of January 1, 2002. We reviewed the methodology and calculations.

We performed this review in conjunction with our audits of unfunded pension costs (A-07-04-00178) and pension costs claimed for Medicare reimbursement (A-07-04-00176). We used the information obtained and reviewed during those audits in performing this review.

The appendix to this report presents details on the updated pension assets of Palmetto's Medicare segment from January 1, 1993, to January 1, 2002, and of TrailBlazer's Medicare segment from January 1, 2000, through January 1, 2002.

We conducted our audit in accordance with generally accepted government auditing standards.

### **FINDINGS AND RECOMMENDATIONS**

South Carolina implemented the recommendation from the prior audit. However, South Carolina did not have adequate controls to ensure that its Medicare segments were identified in accordance with the Medicare contracts and that the Medicare segments were updated in accordance with CAS 412 and 413. As a result, as of January 1, 2002, South Carolina understated Palmetto's Medicare segment pension assets by \$1,106,482 and overstated TrailBlazer's Medicare segment assets by \$345,006.

#### **Summary of Asset Adjustments**

	<b>Palmetto</b>	<b>Trailblazer</b>
Contributions	(278,287)	49,887
Benefit Payments	27,561	0
Transfers	(71,826)	164,523
Earnings and Expenses	(783,930)	130,596
Over/(Under)Statement	<u>(1,106,482)</u>	<u>345,006</u>

## **MEDICARE CONTRACT AND CAS REQUIREMENTS**

### **Medicare Contract**

The Medicare contract identifies 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 is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.

Furthermore, the Medicare contract states: “The pension assets allocated to each Medicare segment shall be adjusted in accordance with the CAS 413.50(c)(7).”

### **Cost Accounting Standards**

The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfer materially affects the segment’s ratio of pension plan assets to actuarial accrued liabilities.

According to CAS 412.50(a)(4), prepayment credits are funds available to the contractors at the beginning of plan years. These funds should be applied first to satisfy funding requirements in order to reduce interest costs to the Government.

## **COMPONENTS OF ASSET UPDATE**

### **Contributions Understated (Palmetto)**

South Carolina’s update methodology did not equitably assign pension contributions to the Palmetto Medicare segment. As a result, South Carolina understated segment assets by \$278,287.

For plan years 1993-96, South Carolina did not include the prepayment credit transfer in the segment assets. Consequently, contributions to the segment were materially understated. A comparison of the OIG’s and South Carolina’s calculations of pension contributions for the segment follows.

## Palmetto Medicare Segment Contributions and Prepayment Transfers

<u>Year</u>	<u>OIG</u>	<u>South Carolina</u>	<u>Difference</u>
1993	\$471,290	\$279,297	\$191,993
1994	202,461	194,321	8,140
1995	416,994	213,925	203,069
1996	681,852	530,680	151,172
1997	764,446	665,251	99,195
1998	759,679	933,992	(174,313)
1999	1,292,726	1,373,092	(80,366)
2000	1,688,694	1,725,187	(36,493)
2001	<u>1,858,109</u>	<u>1,942,219</u>	<u>(84,110)</u>
<b>Total</b>	<b><u>\$8,136,251</u></b>	<b><u>\$7,857,964</u></b>	<b><u>\$278,287</u></b>

### Contributions Overstated (TrailBlazer)

South Carolina assigned the prepayment credit allocated to the TrailBlazer Medicare segment as a beginning-of-the-year contribution. Consequently, allocable contributions to the segment were overstated by \$49,887. A comparison of OIG's and South Carolina's calculations of pension contributions for the segment follows.

#### TrailBlazer Medicare Segment Contributions

<u>Year</u>	<u>OIG</u>	<u>South Carolina</u>	<u>Difference</u>
2000	\$3,030,787	\$3,031,836	(\$1,049)
2001	<u>2,580,152</u>	<u>2,628,990</u>	<u>(48,838)</u>
<b>Total</b>	<b><u>\$5,610,939</u></b>	<b><u>\$5,660,826</u></b>	<b><u>(\$49,887)</u></b>

### Benefit Payments Understated (Palmetto)

South Carolina understated Palmetto's Medicare segment benefit payments by \$27,561. South Carolina incorrectly identified segment participants who received benefit payments. Since benefit payments reduce segment assets, the assets were overstated.

### Transfers Understated (Palmetto)

South Carolina made adjustments for transfers (the movement of participants in and out of the segment each year) in its update of Palmetto's Medicare segment assets from January 1, 1993, to January 1, 2002. However, South Carolina incorrectly identified the participants who transferred in and out of the segment, which resulted in an understatement of assets of \$71,826. Transfers for the audited update were adjusted based on our revisions to the Medicare segment.

A comparison of OIG's and South Carolina's calculations of net asset transfers into the segment is shown below.

### Net Transfers Into Palmetto Medicare Segment

<u>Year</u>	<u>OIG</u>	<u>South Carolina</u>	<u>Difference</u>
1993	(\$160,885)	\$3,551	(\$164,436)
1994	(169,748)	(79,883)	(89,865)
1995	(266,077)	(84,869)	(181,208)
1996	(169,829)	(426,026)	256,197
1997	(462,590)	(396,495)	(66,095)
1998	472,572	239,894	232,678
1999	(166,513)	(178,127)	11,614
2000	(230,056)	(333,181)	103,125
2001	(404,170)	(373,986)	(30,184)
<b>Total</b>	<b><u>(\$1,557,296)</u></b>	<b><u>(\$1,629,122)</u></b>	<b><u>\$71,826</u></b>

#### Transfers Overstated (TrailBlazer)

South Carolina made adjustments for transfers in its update of TrailBlazer's segment assets from January 1, 2000, to January 1, 2002. However, South Carolina incorrectly identified the participants who transferred in and out of the segment, resulting in an overstatement of assets of \$164,523. Transfers for the audited asset update were adjusted based on our revisions to the Medicare segment. A comparison of OIG's and South Carolina's calculations of net asset transfers into the TrailBlazer Medicare segment is shown below.

### Net Transfers Into TrailBlazer Medicare Segment

<u>Year</u>	<u>OIG</u>	<u>South Carolina</u>	<u>Difference</u>
2000	(13,336)	(5,077)	(8,259)
2001	(35,920)	120,344	(156,264)
<b>Total</b>	<b><u>(\$49,256)</u></b>	<b><u>\$115,267</u></b>	<b><u>(\$164,523)</u></b>

#### Earnings and Expenses Understated (Palmetto)

South Carolina understated allocable investment earnings, less administrative expenses, by \$783,930 for the Palmetto Medicare segment. For plan years 1993-96, South Carolina did not include the prepayment transfer in segment assets. Consequently, assets were materially understated.

#### Earnings and Expenses Overstated (TrailBlazer)

South Carolina overstated its investment earnings, less administrative expenses, by \$130,596 for the TrailBlazer Medicare segment. In 2000-01, South Carolina allocated investment income and expenses based on beginning-of-the-year asset values. However, for plan years beginning after March 30, 1995, CAS required investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company

WAV of assets. The audited update of Medicare segment assets reflects the required change in methodology.

### **LACK OF ADEQUATE CONTROLS**

South Carolina did not have adequate controls to ensure that its Medicare segments were identified in accordance with the Medicare contracts and that Medicare segment pension assets were updated in accordance with CAS 412 and 413.

### **MISSTATEMENTS OF MEDICARE SEGMENT ASSETS**

As of January 1, 2002, South Carolina understated the Palmetto Medicare segment pension assets by \$1,106,482 and overstated the TrailBlazer Medicare segment pension assets by \$345,006.

### **RECOMMENDATIONS**

We recommend that South Carolina:

- increase Palmetto's Medicare segment pension assets by \$1,106,482 as of January 1, 2002,
- decrease TrailBlazer's Medicare segment pension assets by \$345,006 as of January 1, 2002, and
- implement controls to ensure that Medicare segments are identified in accordance with the Medicare contracts and updated in accordance with CAS 412 and 413.

### **AUDITEE COMMENTS**

South Carolina agreed with the findings and will implement the recommendations. However, they requested an explanation of the allocation of interest on accumulated prepayment credits and additional input on the determination of those areas that should be included in the Medicare segment. Additionally, their comments are presented in its entirety on Appendix B.

### **OIG RESPONSE**

In response to South Carolina's request the following paragraphs provide an explanation of the allocation of interest on the accumulated prepayment credits and additional input on the determination of those areas that should be included in the Medicare segment.

Prepayment credits are created when the contributions made for a period exceed the CAS pension cost assignable to that same period. In accordance with CAS 412-50(d)(4), pension costs are funded within the cost accounting period if the contributions are made by the corporate tax filing date, including extensions. Therefore, prepayment credits are available at the beginning of the subsequent accounting period although the actual deposit is made after the first

day of the accounting period. The allocation of a full year of interest to prepayment credits for CAS purposes is consistent with the treatment of receivable contributions for employee retirement income security act (ERISA) purposes when determining the pension plan's actuarial asset value.

South Carolina followed a general rule that an area allocating 50% of its costs to Medicare should be included in the Medicare segment of the appropriate entity. However, the Medicare contract identifies a Medicare segment as "...any organizational component ...having a significant degree of responsibility and accountability for the Medicare contract of which...the majority of the salary dollars is allocated to the Medicare contract." South Carolina's identification of the Medicare segment occurred at the cost center level rather than at an organizational level as required by the contract. The identification of the Medicare segment at the organizational or subsidiary level precludes the annual movement of cost centers that fluctuate slightly over or under the 50% general rule as applied by South Carolina.

# **APPENDIXES**

BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA  
STATEMENT OF MEDICARE PENSION ASSETS  
January 1, 1993, to January 1, 2002

Description		Total Company	Other Segment	Palmetto	Trailblazer
Assets January 1, 1993	<u>1/</u>	\$25,626,243	\$21,829,404	\$3,796,839	\$0
Prepayment Transfer		0	0	0	0
Contributions	<u>2/</u>	3,245,459	2,774,169	471,290	0
Earnings	<u>3/</u>	2,576,369	2,194,649	381,720	0
Benefit Payments	<u>4/</u>	(1,533,588)	(1,450,602)	(82,986)	0
Expenses	<u>5/</u>	(181,534)	(154,638)	(26,896)	0
Transfers	<u>6/</u>	0	160,885	(160,885)	0
Assets January 1, 1994		29,732,949	25,353,867	4,379,082	0
Prepayment Transfer	<u>7/</u>	0	(14,141)	14,141	0
Contribution		4,130,610	3,942,290	188,320	0
Earnings		191,556	163,252	28,304	0
Benefit Payments		(1,395,936)	(1,283,428)	(112,508)	0
Expenses		(162,337)	(138,350)	(23,987)	0
Transfers		0	169,748	(169,748)	0
Assets January 1, 1995		32,496,842	28,193,238	4,303,604	0
Prepayment Transfer		0	(416,994)	416,994	0
Contribution		4,058,278	4,058,278	0	0
Earnings		8,760,661	7,488,059	1,272,602	0
Benefit Payments		(1,246,344)	(1,212,527)	(33,817)	0
Expenses		(175,956)	(150,396)	(25,560)	0
Transfers		0	266,077	(266,077)	0
Assets January 1, 1996		43,893,481	38,225,735	5,667,746	0

BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA  
STATEMENT OF MEDICARE PENSION ASSETS  
January 1, 1993, to January 1, 2002

Description	Total Company	Other Segment	Palmetto	Trailblazer
Assets January 1, 1996	43,893,481	38,225,735	5,667,746	0
Prepayment Transfer	0	(636,065)	636,065	0
Contribution	4,632,141	4,586,354	45,787	0
Earnings	7,117,402	6,093,469	1,023,933	0
Benefit Payments	(2,893,815)	(2,837,305)	(56,510)	0
Expenses	(232,293)	(198,875)	(33,418)	0
Transfers	0	169,829	(169,829)	0
Assets January 1, 1997	52,516,916	45,403,142	7,113,774	0
Prepayment Transfer	0	(687,854)	687,854	0
Contribution	5,488,930	5,412,338	76,592	0
Earnings	11,132,139	9,500,679	1,631,460	0
Benefit Payments	(2,335,216)	(2,233,385)	(101,831)	0
Expenses	(298,189)	(254,488)	(43,701)	0
Transfers	0	462,590	(462,590)	0
Assets January 1, 1998	\$66,504,580	\$57,603,022	\$8,901,558	\$0
Prepayment Transfer	0	(643,310)	643,310	0
Contribution	3,989,700	3,873,331	116,369	0
Earnings	10,830,550	9,288,178	1,542,372	0
Benefit Payments	(1,786,185)	(1,612,087)	(174,098)	0
Expenses	(425,525)	(364,926)	(60,599)	0
Transfers	0	(472,572)	472,572	0
Assets January 1, 1999	79,113,120	67,671,636	11,441,484	0

BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA  
STATEMENT OF MEDICARE PENSION ASSETS  
January 1, 1993, to January 1, 2002

Description	Total Company	Other Segment	Palmetto	Trailblazer
Assets January 1, 1999	79,113,120	67,671,636	11,441,484	0
Prepayment Transfer	0	(535,933)	535,933	0
Contribution	7,102,786	6,345,993	756,793	0
Earnings	13,540,861	11,474,443	2,066,418	0
Benefit Payments	(3,306,975)	(3,166,170)	(140,805)	0
Expenses	(431,129)	(365,336)	(65,793)	0
Transfers	0	166,513	(166,513)	0
Assets January 1, 2000	96,018,663	81,591,146	14,427,517	0
Prepayment Transfer	0	(1,006,531)	360,150	646,381
Contribution	18,933,402	15,220,452	1,328,544	2,384,406
Earnings	(4,535,870)	(3,804,628)	(688,443)	(42,799)
Benefit Payments	(1,978,477)	(1,520,715)	(191,602)	(266,160)
Expenses	(659,802)	(553,433)	(100,143)	(6,226)
Transfers	0	243,392	(230,056)	(13,336)
Assets January 1, 2001	107,777,916	90,169,683	14,905,967	2,702,266
Prepayment Transfer	0	(2,914,539)	1,220,192	1,694,347
Contribution	14,669,236	13,145,514	637,917	885,805
Earnings	(5,221,708)	(4,229,048)	(776,853)	(215,807)
Benefit Payments	(3,081,402)	(2,549,226)	(493,424)	(38,752)
Expenses	(631,643)	(511,566)	(93,972)	(26,105)
Transfers	0	440,090	(404,170)	(35,920)
Assets January 1, 2002	\$113,512,399	\$93,550,908	\$14,995,657	\$4,965,834
Per South Carolina	<u>8/</u> \$113,512,399	\$94,312,384	\$13,889,175	\$5,310,840
Asset Variance	<u>9/</u> \$0	(\$761,476)	\$1,106,482	(\$345,006)

**FOOTNOTES**

- 1/ We determined the Medicare segment assets as of January 1, 1993, in our prior review of South Carolina's pension segmentation (report number: A-07-94-00768). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.
- 2/ We obtained total company contribution amounts from the actuarial valuation reports. 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 cost in future.
- 3/ We obtained investment earnings from actuarial valuation reports. South Carolina allocated its investment earnings based on a ratio of beginning of year segment assets to total company assets. We allocated investment earning for years prior to 1996 using South Carolina's methodology. For years starting with 1996, we allocated investment earnings based on the ratio of the segment's WAV of assets to total company WAV of assets as required by CAS.
- 4/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. South Carolina provided us with supporting documentation for benefit payment amounts to plan retirees. We used actual benefit payments for Medicare segment retirees.
- 5/ We allocated administrative expenses to the Medicare segment in proportion to investment income. South Carolina used the same methodology.
- 6/ We identified participant transfers between segments by comparing valuation data files provided by South Carolina. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. For transfers occurring prior to the 1996 plan year, asset transfers reflected the funding level of the segment from which the participant transferred, based on the actuarial liability and the asset value used for cost purposes. We calculated the funding leveling as the assets divided by the liabilities. If the funding level was greater than one, we transferred assets equal to the participant's liability. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with CAS.
- 7/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to reduce interest costs to the Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.

BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA  
STATEMENT OF MEDICARE PENSION ASSETS  
January 1, 1993, to January 1, 2002

- 8/ We obtained total asset amounts as of January 1, 2002, from South Carolina's actuarial valuation report.
- 9/ The asset variance represents the difference between the OIG calculation of Medicare segment assets and South Carolina's market value of assets shown in its valuation report.



**Medicare**  
**Palmetto GBA**

Post Office Box 100134  
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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 12<sup>th</sup> Street, Room 284A  
Kansas City, MO 64106

Dear Mr. Aasmundstad:

Re: Draft Report entitled "Audit of Blue Cross Blue Shield of South Carolina's Medicare Contract Pension Segmentation for 1993 Through 2001"  
Report No. A-07-03-03042

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.

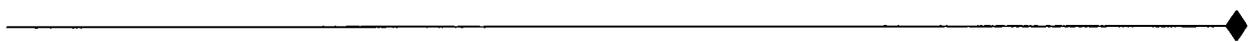
The report found that Palmetto and TrailBlazer's Medicare segment pension costs are overstated (understated) by \$1,106,482 and (\$345,006) respectively. In addition, the report states that we should implement controls to ensure that Medicare segments are identified in accordance with the Medicare contracts and updated in accordance with CAS 412 and 413.

The report lists the following recommendations.

South Carolina should:

- Increase Palmetto's Medicare segment pension assets by \$1,106,482 as of January 1, 2002.
- Decrease TrailBlazer's Medicare segment pension assets by \$345,006 as of January 1, 2002.
- Implement controls to ensure that Medicare segments are identified in accordance with the Medicare contracts and updated in accordance with CAS 412 and 413.

As of January 1, 1993, the pension assets for Palmetto's Medicare segment were in agreement with the OIG audited amounts. Of the differences that have arisen since January 1, 1993, the most substantial difference is due to the fact that the OIG includes a full year of investment



earnings on the accumulated prepayment credits allocated to the segments. This results in the allocation of more of the investment earnings to the segment than our current methodology. To compensate, the investment earnings on the non-Medicare segment are reduced for the investment earnings on the accumulated prepayment credits allocated to the Medicare segments. We are uncertain of the basis for this treatment.

The asset differences after 1997 are attributable primarily to the miscellaneous employee reclassifications that result in different cash flows in the asset development. We have followed a general rule that an area allocating 50% of its costs to Medicare should be included in the Medicare segment of the appropriate entity. Fluctuations slightly over or under 50% by some departments have resulted in the tedious movement of employees in and out of the segment. We would like clarification concerning which areas should be included in the Medicare segment; i.e., should it only be those divisions housed within the Medicare subsidiary?

Some difference also arises from the way that the OIG allocates investment earnings to the segments. We allocated the total investment earnings in proportion to each segment's market value of assets. The OIG method is to calculate the investment return for total plan based on the time-weighted cash flow and then calculate the segment's investment return using this rate with the segment's cash flow.

We agree with the findings and will implement the recommendations. However, we would like an explanation of the allocation of interest on accumulated prepayment credits and additional input on the determination of those areas that should be included in the Medicare segment.

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

