Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

GROUP HEALTH INCORPORATED OVERSTATED ITS LOCAL 153 PENSION PLAN MEDICARE SEGMENT PENSION ASSETS AS OF JANUARY 1, 2015

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Office of Inspector General

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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, Group Health Incorporated (GHI). In particular, we examined the Other segment and Local 153 Pension Plan (Local 153 Plan) Medicare segment pension assets that GHI updated from January 1, 2009, to January 1, 2015.

OBJECTIVES

Our objectives were to determine whether GHI complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendation to decrease the GHI Local 153 Plan Medicare segment pension assets as of January 1, 2009, and (2) updating the GHI Local 153 Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015.

BACKGROUND

Group Health Incorporated and Medicare

GHI, a subsidiary of EmblemHealth, LLC, administered Medicare operations under a Coordination of Benefits contract with CMS. During our audit period, GHI also performed Medicare work on the Medicare Secondary Payer Recovery and Benefit Coordination and Recovery contracts.[1] Early in our audit period, GHI also performed work as a subcontractor on the Retiree Drug Subsidy contract.

[1] Before September 2011, GHI performed Medicare work as a subcontractor on the Medicare Secondary Payer Recovery contract and the Retiree Drug Subsidy contract. From September 2011 through February 2014, GHI performed Medicare work as the prime contractor on the Medicare Secondary Payer Recovery and Benefit Coordination and Recovery contracts.

During our audit period, GHI had three defined benefit pension plans: the GHI Local 153 Pension Plan; the GHI Cash Balance Pension Plan; and the EmblemHealth Services Company, LLC, Employees' Retirement Plan. Effective August 31, 2003, benefits accrued under the Local 153 Pension Plan for management employees were frozen at their August 31, 2003, levels.

On September 1, 2003, GHI established the GHI Cash Balance Pension Plan for management employees. Employees from the GHI Local 153 plan were given the option to participate in the GHI Cash Balance Plan. All active employees elected to participate in the GHI Cash Balance Pension Plan and continued to earn a benefit similar to the benefit earned under the GHI Local 153 Pension Plan.

This report addresses the Medicare segment pension assets for the GHI Local 153 Pension Plan for the period of January 1, 2009, through January 1, 2015. We are addressing the Medicare segment pension assets for the GHI Cash Balance Pension Plan and the EmblemHealth Cash Balance Pension Plan in separate reviews.

Prior Pension Segmentation Audit

We performed a prior pension segmentation audit for GHI (A-07-11-00358, Jul. 14, 2011), which brought the GHI Medicare segment pension assets to January 1, 2009. We subsequently revised that report's recommendations and communicated those revisions in a memorandum to CMS on April 3, 2013. Our revised recommendations were that GHI decrease the Medicare segment pension assets by $11,252,357 and, as a result, recognize $17,110,362 as the Medicare segment pension assets as of January 1, 2009.

HOW WE CONDUCTED THIS REVIEW

We reviewed GHI's implementation of the prior audit recommendation, its identification of its Local 153 Medicare segment, and its update of the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015.

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 A contains details of our audit scope and methodology.

FINDINGS

GHI implemented our prior audit recommendation to decrease the Medicare segment pension assets by $11,252,357 as of January 1, 2009. Regarding our second objective, GHI did not correctly update the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015, in accordance with Federal requirements and the Medicare contracts' pension segmentation requirements. GHI identified $34,243,223 as the Local 153 Medicare segment pension assets as of January 1, 2015; however, we determined that those assets were $31,821,914 as of that date. Therefore, GHI overstated the Local 153 Medicare segment pension assets as of January 1, 2015, by $2,421,309. GHI overstated those pension assets because it did not have policies and procedures to ensure that it calculated those assets in accordance with Federal requirements when updating the Local 153 Medicare segment's pension assets from January 1, 2009, to January 1, 2015.

Appendix B identifies the details of GHI's Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015, as determined during our audit. Table 1 below summarizes the audit adjustments required to update GHI's Local 153 Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per Audit	Per GHI	Difference
Prior Audit Recommendation	$17,110,362	$17,110,362	$0
Update of Local 153 Medicare Segment Assets			
Contributions and Prepayment Credits	10,120,554	14,168,275	(4,047,721)
Benefit Payments	(5,828,197)	(2,549,247)	(3,278,950)
Net Transfers	(2,246,092)	(5,554,713)	3,308,621
Earnings, Net of Expenses	12,665,287	11,068,546	1,596,741
Overstatement of Local 153 Medicare Segment Assets			**($2,421,309)**

PRIOR AUDIT RECOMMENDATION

GHI implemented our prior audit recommendation (as revised in our April 3, 2013, memorandum to CMS) that GHI decrease its Medicare segment pension assets by $11,252,357 and recognize $17,110,362 as the Medicare segment pension assets as of January 1, 2009.

UPDATE OF LOCAL 153 PLAN 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.

GHI did not correctly update the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015, in accordance with Federal requirements and the Medicare contracts' pension segmentation requirements. GHI identified $34,243,223 as the Local 153 Medicare segment pension assets as of January 1, 2015; however, we determined that those assets were $31,821,914 as of that date. Therefore, GHI overstated the Local 153 Medicare segment pension assets as of January 1, 2015, by $2,421,309. The following are our findings regarding the update of the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015. Appendix D identifies GHI's CAS balance equation for the Local 153 Pension plan as of January 1, 2015.[2]

Contributions and Transferred Prepayment Credits Overstated

The audited contributions and transferred prepayment credits[3] are based on the assignable pension costs.[4] 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.

GHI overstated contributions and transferred prepayment credits by $4,047,721 for its Local 153 Medicare segment. The overstatement occurred primarily because of differences in the long-term interest rates used by GHI to compute its accrued liabilities. Specifically, GHI used unreasonable long-term interest rates during calendar years (CYs) 2012 through 2015 to compute its accrued liabilities. Table 2 below identifies the long-term interest rates used by GHI from CY 2012 through CY 2015.

Table 2: Long-Term Interest Rates Used by GHI

CY	2012	2013	2014	2015
Long-Term Interest Rate (%)	5.25	4.00	5.00	4.00

[2] 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).

[3] 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.

[4] These are assigned to a specific cost accounting period.

At our request, GHI provided its justification for the long-term interest rates used in the calculations of its accrued liabilities. This justification attributed the decrease in the interest rates to (1) GHI's pension plans asset allocations and (2) general market conditions. We forwarded that justification to the CMS Office of the Actuary (CMS OACT) (with which we routinely consult on CAS requirements pertaining to Medicare segment pension audits) for review. After reviewing GHI's justification, CMS OACT determined that the long-term interest rates did not comply with the CAS.

Accordingly, CMS OACT recommended that we request that GHI recalculate the accrued liabilities for CYs 2012 through 2015, using the historical long-term interest rate of 7.00 percent. We used these recalculated accrued liabilities when computing our audited CAS pension costs.

Table 3 below shows the differences between the transferred prepayment credits and contributions proposed by GHI and the transferred prepayment credits and contributions that we calculated during our review.

Table 3: Contributions and Transferred Prepayment Credits

CY	Per Audit	Per GHI	Difference
2009	$1,671,844	$1,671,844	$0
2010	2,122,571	2,079,030	43,541
2011	1,691,392	1,729,289	(37,897)
2012	1,547,181	2,656,451	(1,109,270)
2013	1,442,117	0	1,442,117
2014	1,645,449	6,031,661	(4,386,212)
Total	**$10,120,554**	**$14,168,275**	**($4,047,721)**

Benefit Payments Understated

GHI understated benefit payments by $3,278,950 for the Local 153 Medicare segment. This understatement occurred because GHI incorrectly identified the Local 153 benefit payments for the Medicare segment participants. This understatement of benefit payments resulted in an overstatement of the GHI Local 153 Medicare segment pension assets by $3,278,950. A comparison of GHI's and our audit calculations of the Local 153 benefit payments for the Medicare segment appears in Table 4 on the following page.

Table 4: Benefit Payments

CY	Per Audit	Per GHI	Difference
2009	($687,189)	($312,387)	($374,802)
2010	(831,450)	(571,781)	(259,669)
2011	(930,982)	(697,458)	(233,524)
2012	(1,065,211)	0	(1,065,211)
2013	(1,111,618)	0	(1,111,618)
2014	(1,201,747)	(967,621)	(234,126)
Total	**($5,828,197)**	**($2,549,247)**	**($3,278,950)**

Net Transfers Out Overstated

GHI overstated net transfers out of its Local 153 Plan Medicare segment by $3,308,621. The overstatement occurred because GHI incorrectly identified the participants who transferred in or out of its Local 153 Medicare segment. This overstatement of the net transfer adjustment resulted in an understatement of the GHI Local 153 Medicare segment pension assets by $3,308,621. Table 5 below shows the differences between the net transfers proposed by GHI and the net transfers that we calculated during our review.

Table 5: Net Transfers Out

CY	Per Audit	Per GHI	Difference
2009	($933,338)	($5,115,249)	$4,181,911
2010	(12,199)	250,393	(262,592)
2011	(253,988)	4,218	(258,206)
2012	(455,074)	(870,638)	415,564
2013	(565,713)	(267,489)	(298,224)
2014	(25,780)	444,052	(469,832)
Total	**($2,246,092)**	**($5,554,713)**	**$3,308,621**

Earnings, Net of Expenses, Understated

GHI understated investment earnings, less administrative expenses, by $1,596,741 for its Local 153 Medicare segment, because it used incorrect contributions and transferred prepayment credits and incorrect net transfers and benefits payments (all discussed above) to develop the Local 153 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. Table 6 on the following page shows the difference in the earnings, net of expenses, proposed by GHI and the earnings, net of expenses, that we calculated during our review.

Table 6: Earnings, Net of Expenses

CY	Per Audit	Per GHI	Difference
2009	($1,707,803)	($1,725,200)	$17,397
2010	2,737,618	2,141,300	596,318
2011	4,016,358	3,271,513	744,845
2012	3,079,870	2,770,206	309,664
2013	(1,011,371)	(881,505)	(129,866)
2014	5,550,615	5,492,232	58,383
Total	**$12,665,287**	**$11,068,546**	**$1,596,741**

RECOMMENDATIONS

We recommend that GHI:

- decrease the Local 153 Medicare segment pension assets by $2,421,309 and recognize $31,821,914 as the Local 153 Medicare segment pension assets as of January 1, 2015, and

- develop quality assurance procedures to ensure that going forward, it calculates Medicare segment pension assets in accordance with Federal requirements.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, GHI did not directly address our recommendations. However, GHI's comments suggest that it disagreed with our recommendation to decrease the Local 153 Medicare segment pension assets by $2,421,309 and recognize $31,821,914 as the Local 153 Medicare segment pension assets as of January 1, 2015. GHI's comments (which also apply to our two related reports cited in Appendix A) address our four findings associated with the update of GHI's Local 153 Plan Medicare segment pension assets.[5]

A summary of GHI's main points and our responses follows. GHI referred to our disagreement with the long-term interest rate assumption that it used to compute accrued liabilities and normal cost, and cited this disagreement as a reason for the differences between GHI's and our calculations of both the contributions and transferred prepayment credits and the net transfers out. With respect to our finding on participants who transferred in or out of the Local 153 Medicare segment and our finding on benefit payments for Medicare segment participants, GHI asked us to provide more detailed information.

GHI's comments appear in their entirety as Appendix E.

[5] The last portion of GHI's comments (involving assets transferred into the EmblemHealth Services Company, LLC, Employees' Retirement Plan after the merger of plans)—that is, the fifth of the "five broad categories" that GHI refers to in its comments—relates only to companion report A-07-19-00561.

After reviewing GHI's comments, we maintain that all of our calculations of the Medicare segment pension assets remain valid. Therefore, we maintain that our findings and recommendations remain valid as well. (GHI chose to submit a single set of written comments in response to all three of our reports.)

We provided our preliminary audit findings to GHI over a month before the issuance of our draft report. With that communication, we gave GHI opportunities to request any detailed data related to the differences between GHI's and our calculations of the Medicare segment pension assets. We did explain in the report how we determined our calculations and identified the causes of the differences. We will separately provide GHI with a list of participant transfers and a list of benefit payments.

CONTRIBUTIONS AND TRANSFERRED PREPAYMENT CREDITS

Auditee Comments

GHI referred to our disagreement with the long-term interest rate assumption that GHI employed to compute accrued liabilities, which affect GHI's calculation of contributions and prepayment credits. In this respect, GHI said that its position regarding the appropriate long-term interest assumption has not changed since its October 13, 2016, letter to us. This letter stated in part:

> Since 2009, GHI has shifted the asset allocation of both plans from 40-60% bonds to 80% bonds. The assumed 4% interest rate is based on an analysis performed by [an actuarial consultant] applying its forward looking capital market assumptions to the asset allocation of the two pension plans, and was used for the 2015 actuarial valuations for each of the plans. As such, this rate reflects GHI's 'best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations.'"

Office of Inspector General Response

GHI is correct in saying that we disagree with the long-term interest rates that it used during CYs 2012 through 2015. Our evaluation of GHI's position, though, remains unchanged from the judgment offered earlier in this report in the discussion centered on Table 2. We developed this judgment in consultation with OACT.

In response to GHI's October 13, 2016, letter, we asked GHI to recalculate the accrued liabilities and normal costs for CYs 2012 through 2015, using the historical long-term interest rate of 7.00 percent. In our request, we explained that the fluctuations in the long-term interest rates that GHI used from CY 2012 and CY 2015 appeared to be extreme insofar as long-term interest rates were concerned. In our judgment, therefore, the assumptions that GHI used were unreasonable. CAS 412-50(b)(4) states: "Actuarial assumptions shall reflect long-term trends so as to avoid distortions caused by short-term fluctuations." GHI's recalculated accrued liabilities, using the historical long-term interest rate of 7.00 percent as we requested, created a particularly noticeable difference in the asset base, as GHI's continued decrease in the interest rates it used—from 6.50 percent in CYs 2012 and 2013 to 4.00 percent by CY 2015 (Table 2)—brought its accrued liabilities and normal costs farther and farther from what they would have been had GHI used the 7.00 percent rate.

Finally, we agree with GHI that our use of a different long-term interest rate assumption affected the contributions and transferred prepayment credits that we calculated as part of our review.

NET TRANSFERS OUT

Auditee Comments

GHI said that it was unclear from the draft report whether our finding was based entirely on the impact of our disagreement with GHI's long-term interest rate assumption or whether it was also based on disagreement between GHI and us regarding the identity of participants transferred in or out of the Medicare segment. GHI asked that, if the identity of the participants was a factor in this finding, we identify the participants and the segment that we believed those individuals transferred in or out of for each year.

Office of Inspector General Response

The overstatement occurred because GHI incorrectly identified the participants who transferred in or out of its Local 153 Plan Medicare segment. To be more specific, GHI's established practice was to maintain inactive employees in the Medicare segment, but GHI did not follow that practice during our audit period.

We will separately provide GHI with a list of the participants who transferred into or out of the Medicare segment as determined during our review.

BENEFIT PAYMENTS

Auditee Comments

GHI made no comment on this finding other than to request that we give it an electronic listing of the benefit payments, by participant, that we believe are the correct benefit payments for each year.

Office of Inspector General Response

We will separately provide GHI with a list of the Medicare segment benefit payments as determined during our review.

EARNINGS, NET OF EXPENSES

Auditee Comments

GHI said that it regards our finding on investment earnings, net of expenses, to have derived from other findings. GHI further requested that we identify additional concerns, if any, on which we based this finding.

Office of Inspector General Response

Our report identifies differences between GHI's and our calculations of contributions and prepayment credits, participant transfers, and benefit payments, as the cause for the difference between GHI's and our calculations of earnings, net of expenses.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed GHI's implementation of the prior audit recommendation, its identification of its Local 153 Medicare segment, and its update of the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015.

Achieving our objective did not require that we review GHI'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 GHI located in New York, New York.

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 GHI's and EmblemHealth'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 Local 153 Medicare segment assets;

- obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Local 153 Medicare segment assets;

- interviewed EmblemHealth and GHI staff responsible for identifying the Local 153 Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts;

- reviewed GHI's accounting records to verify the Local 153 Medicare segment identification as well as the benefit payments made from the Local 153 Medicare segment;

- reviewed the prior segmentation audit performed at GHI (A-07-11-00358), as well as the revised recommendations conveyed in our April 2013 memorandum to CMS, to determine the beginning market value of assets;

- provided the CMS OACT, which provides technical actuarial advice, with the actuarial information necessary for it to calculate the Local 153 Medicare segment pension assets from January 1, 2009, to January 1, 2015;

- reviewed the CMS actuaries' methodology and calculations; and

- provided the results of our review to GHI officials on March 19, 2019.

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

- *Group Health Incorporated Understated Its Cash Balance Pension Plan Medicare Segment Pension Assets as of January 1, 2011* (A-07-19-00557) and

- *Group Health Incorporated Understated Its EmblemHealth Services Company, LLC, Employees' Retirement Plan Medicare Segment Pension Assets as of January 1, 2015* (A-07-19-00561).

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 C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION

FEDERAL REGULATIONS

Federal regulations (CAS 412.40(b)(2)) require that each actuarial assumption used to measure pension cost be separately identified and shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations.

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 412.50(b)(4)) require that actuarial assumptions reflect long-term trends so as to avoid distortions caused by short-term fluctuations.

Federal regulations (CAS 412.64-1(b)) require contractors or subcontractors that become subject to the CAS, as amended, during the Pension Harmonization Rule Transition Period to phase in the minimum actuarial liability and minimum normal cost.[6] During each successive accounting period of the Pension Harmonization Rule Transition Period, the contractor shall recognize on a scheduled basis the amount by which the minimum actuarial liability differs from the actuarial accrued liability and the amount by which the sum of the minimum normal cost plus any expense load differs from the sum of the normal cost plus any expense load.

Federal regulations (CAS 412.64-1(b)(3)) require that the scheduled applicable percentages for each successive accounting period of the Pension Harmonization Rule Transition Period are as follows: 0 percent for the first cost accounting period, 25 percent for the second cost accounting period, 50 percent for the third cost accounting period, 75 percent for the fourth cost accounting period, and 100 percent for the fifth cost accounting period.

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.

[6] Explanatory language in the CAS Harmonization Rule states: "[t]o promote equity and fairness in achieving an orderly change in the contract cost accounting for pension costs, this final rule retains the transition period consisting of five cost accounting periods, the Pension Harmonization Rule Transition Period, that will phase in recognition of any adjustment of the actuarial accrued liability and normal cost. This transition method will apply to all contractors with contracts subject to CAS 412 and 413."

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)."