Department of Health and Human Services
OFFICE OF
INSPECTOR GENERAL

PALMETTO GOVERNMENT
BENEFITS ADMINISTRATOR, LLC,
OVERSTATED ITS MEDICARE
SEGMENT PENSION ASSETS AS OF
JANUARY 1, 2017

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

Amy J. Frontz
Deputy Inspector General for Audit Services

April 2020
A-07-20-00586
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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.
Why OIG Did This Audit

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of 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 audits 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 and the Medicare contracts’ pension segmentation requirements when (1) implementing the prior audit recommendation to increase the Medicare segment pension assets by $1.0 million as of January 1, 2013, and (2) updating the Medicare segment pension assets from January 1, 2013, to January 1, 2017.

How OIG Did This Audit

We reviewed Palmetto’s implementation of the prior audit recommendation, its identification of its Medicare segment, and its update of the Medicare segment pension assets from January 1, 2013, to January 1, 2017.

Palmetto Government Benefits Administrator, LLC, Overstated Its Medicare Segment Pension Assets as of January 1, 2017

What OIG Found

Palmetto concurred with our prior audit recommendation to increase the Medicare segment pension assets by $1.0 million as of January 1, 2013. We were unable, however, 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, 2013, to January 1, 2017, in accordance with Federal regulations and the Medicare contracts’ pension segmentation requirements. Palmetto identified $75.8 million as the Medicare segment pension assets as of January 1, 2017; however, we determined that those assets were $73.6 million as of that date. Therefore, Palmetto overstated the Medicare segment pension assets as of January 1, 2017, by $2.1 million. Palmetto 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 Medicare segment’s pension assets from January 1, 2013, to January 1, 2017.

What OIG Recommends and Auditee Comments

We recommend that Palmetto decrease the Medicare segment pension assets by $2.1 million and recognize $73.6 million as the Medicare segment pension assets as of January 1, 2017, and establish policies and procedures to ensure compliance with Federal requirements and the pension segmentation language of the Medicare contracts. Palmetto concurred with our recommendations.

The full report can be found at https://oig.hhs.gov/oas/reports/region7/72000586.asp.
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Palmetto Government Benefits Administrator, LLC, Pension Segmentation (A-07-20-00586)
INTRODUCTION

WHY WE DID THIS AUDIT

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of 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 audits 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 administrative contractors (MACs) and other CAS-covered and Federal Acquisition Regulation (FAR)-covered contracts through Final Administrative Cost Proposals, Incurred Cost Proposals, or both.

For this audit, 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, 2013, to January 1, 2017.

OBJECTIVES

Our objectives were to determine whether Palmetto complied with Federal requirements and the Medicare contracts’ pension segmentation requirements when (1) implementing the prior audit recommendation to increase the Medicare segment pension assets as of January 1, 2013, and (2) updating the Medicare segment pension assets from January 1, 2013, to January 1, 2017.

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 (RRB) 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. The original RRB contract ended on November 26, 2012.
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 1\(^2\) and Jurisdiction 11\(^3\) effective October 25, 2007, and May 21, 2010, respectively, as well as other CAS-covered and FAR-covered contracts. Currently, Palmetto is the Medicare Parts A and B contractor for Jurisdictions J\(^4\) and M (formerly Jurisdiction 11). Palmetto also continues to perform RRB contract operations under a specialty MAC contract awarded on November 27, 2012.

During our audit period, BCBS South Carolina had three Medicare segments that participated in its qualified defined-benefit pension plan: (1) Palmetto, (2) Companion Data Services, LLC (CDS), and (3) TrailBlazer Health Enterprises, LLC (TrailBlazer).\(^5\) This report addresses Palmetto’s compliance with the pension segmentation language under the provisions of Federal requirements and its Medicare contracts. We are addressing CDS’s compliance with Federal requirements in a separate audit.

**Prior Pension Segmentation Audit**

We performed a prior pension segmentation audit of BCBS South Carolina (A-07-17-00503, Jul. 6, 2017), which brought the Palmetto Medicare segment pension assets to January 1, 2013. We recommended that Palmetto increase the Medicare segment pension assets by $1,028,621 and, as a result, recognize $64,634,915 as the Medicare segment pension assets as of January 1, 2013.

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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.


3. Medicare Parts A and B Jurisdiction 11 consisted of the States of North Carolina, South Carolina, Virginia, and West Virginia (but excluded Part B for the counties of Arlington and Fairfax in Virginia and the city of Alexandria in Virginia). Jurisdiction 11 also included 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. Service areas for Jurisdiction M (mentioned in the next sentence of this section) are the same as those for Jurisdiction 11.

4. Medicare Parts A and B Jurisdiction J consists of the states of Alabama, Georgia, and Tennessee.

5. The TrailBlazer Medicare segment closed on April 30, 2013. We issued our audit report on the TrailBlazer Medicare segment closing on August 8, 2017 (A-07-17-00507).
HOW WE CONDUCTED THIS AUDIT

We reviewed Palmetto’s implementation of the prior audit recommendation, its identification of its Medicare segment, and its update of the Medicare segment pension assets from January 1, 2013, to January 1, 2017.

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

Palmetto concurred with our prior audit recommendation to increase the Medicare segment pension assets by $1,028,621 as of January 1, 2013. We were unable, however, 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, 2013, to January 1, 2017, in accordance with Federal regulations and the Medicare contracts’ pension segmentation requirements. Palmetto identified $75,756,924 as the Medicare segment pension assets as of January 1, 2017; however, we determined that those assets were $73,630,103 as of that date. Therefore, Palmetto overstated the Medicare segment pension assets as of January 1, 2017, by $2,126,821. Palmetto 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 Medicare segment’s pension assets from January 1, 2013, to January 1, 2017.

Appendix B identifies the details of Palmetto’s Medicare segment pension assets from January 1, 2013, to January 1, 2017, as determined during our audit. Table 1 on the following page summarizes the audit adjustments required to update Palmetto’s Medicare segment pension assets in accordance with Federal requirements.
Table 1: Summary of Audit Adjustments

<table>
<thead>
<tr>
<th>Audit Adjustment</th>
<th>Per Audit</th>
<th>Per Palmetto</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior Audit Recommendation</td>
<td>$64,634,915</td>
<td>$63,606,294</td>
<td>$1,028,621</td>
</tr>
<tr>
<td>Update of Medicare Segment Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Transfers</td>
<td>(19,390,614)</td>
<td>(17,087,882)</td>
<td>(2,302,732)</td>
</tr>
<tr>
<td>Benefit Payments</td>
<td>(17,014,834)</td>
<td>(15,401,509)</td>
<td>(1,613,325)</td>
</tr>
<tr>
<td>Contributions and Prepayment Credits</td>
<td>20,734,739</td>
<td>19,537,106</td>
<td>1,197,633</td>
</tr>
<tr>
<td>Earnings, Net of Expenses</td>
<td>24,665,897</td>
<td>25,102,915</td>
<td>(437,018)</td>
</tr>
<tr>
<td>Overstatement of Medicare Segment Assets</td>
<td></td>
<td>($2,126,821)</td>
<td></td>
</tr>
</tbody>
</table>

PRIOR AUDIT RECOMMENDATION

We performed a prior pension segmentation audit on Palmetto’s Medicare segment pension assets (A-07-17-00503, Jul. 6, 2017), which recommended that Palmetto increase its Medicare segment pension assets by $1,028,621 as of January 1, 2013. 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 annually in accordance with the CAS. The CAS requires that the Medicare segment asset base be adjusted by contributions, income, benefit payments, and expenses. For details on the Federal requirements, see Appendix C.

Palmetto did not correctly update the Medicare segment pension assets from January 1, 2013, to January 1, 2017, in accordance with Federal requirements. Palmetto identified $75,756,924 as the Medicare segment pension assets as of January 1, 2017; however, we determined that those assets were $73,630,103 as of that date. Therefore, Palmetto overstated the Medicare segment pension assets as of January 1, 2017, by $2,126,821. The following are our findings regarding the update of the Medicare segment pension assets from January 1, 2013, to January 1, 2017. Appendix D identifies Palmetto’s CAS balance equation as of January 1, 2017.6

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6 The CAS balance equation identifies the market value of assets, actuarial accrued liability, actuarial value of assets, accumulated value of prepayment credits, and unfunded actuarial liability in accordance with CAS 412-40(c).
Net Transfers Out Understated

Palmetto understated net transfers out of its Medicare segment by $2,302,732. 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 Medicare segment pension assets by $2,302,732. Table 2 shows the differences between the net transfers proposed by Palmetto and the net transfers that we calculated during our audit.

Table 2: Net Transfers

<table>
<thead>
<tr>
<th>Calendar Year (CY)</th>
<th>Per Audit</th>
<th>Per Palmetto</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>($6,537,605)</td>
<td>($4,910,519)</td>
<td>($1,627,086)</td>
</tr>
<tr>
<td>2014</td>
<td>(3,069,401)</td>
<td>(4,112,888)</td>
<td>1,043,487</td>
</tr>
<tr>
<td>2015</td>
<td>(7,171,779)</td>
<td>(5,528,801)</td>
<td>(1,642,978)</td>
</tr>
<tr>
<td>2016</td>
<td>(2,611,829)</td>
<td>(2,535,674)</td>
<td>(76,155)</td>
</tr>
<tr>
<td>Total</td>
<td>($19,390,614)</td>
<td>($17,087,882)</td>
<td>($2,302,732)</td>
</tr>
</tbody>
</table>

Benefit Payments Understated

Palmetto understated benefit payments by $1,613,325. The understatement occurred because Palmetto incorrectly identified benefit payments for one Medicare participant. This understatement of benefit payments resulted in an overstatement of the Medicare segment pension assets by $1,613,325. A comparison of Palmetto’s and our calculations of benefit payments for the Medicare segment appears in Table 3.

Table 3: Benefit Payments

<table>
<thead>
<tr>
<th>CY</th>
<th>Per Audit</th>
<th>Per Palmetto</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>($7,316,994)</td>
<td>($5,703,669)</td>
<td>($1,613,325)</td>
</tr>
<tr>
<td>2014</td>
<td>(3,769,631)</td>
<td>(3,769,631)</td>
<td>0</td>
</tr>
<tr>
<td>2015</td>
<td>(4,025,876)</td>
<td>(4,025,876)</td>
<td>0</td>
</tr>
<tr>
<td>2016</td>
<td>(1,902,333)</td>
<td>(1,902,333)</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>($17,014,834)</td>
<td>($15,401,509)</td>
<td>($1,613,325)</td>
</tr>
</tbody>
</table>
Contributions and Transferred Prepayment Credits Understated

The audited contributions and transferred prepayment credits\(^7\) are based on the assignable pension costs.\(^8\) 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 $1,197,633 for its Medicare segment. The understatement occurred primarily because of differences in the asset base used to compute the assignable pension costs. Table 4 shows the differences between the contributions and prepayment credits proposed by Palmetto and the contributions and prepayment credits that we calculated during our audit.

<table>
<thead>
<tr>
<th>CY</th>
<th>Per Audit</th>
<th>Per Palmetto</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>$5,321,905</td>
<td>$5,535,136</td>
<td>($213,231)</td>
</tr>
<tr>
<td>2014</td>
<td>5,233,789</td>
<td>4,780,076</td>
<td>453,713</td>
</tr>
<tr>
<td>2015</td>
<td>5,354,797</td>
<td>4,839,315</td>
<td>515,482</td>
</tr>
<tr>
<td>2016</td>
<td>4,824,248</td>
<td>4,382,579</td>
<td>441,669</td>
</tr>
<tr>
<td>Total</td>
<td>$20,734,739</td>
<td>$19,537,106</td>
<td>$1,197,633</td>
</tr>
</tbody>
</table>

Earnings, Net of Expenses, Overstated

Palmetto overstated investment earnings, less administrative expenses, by $437,018 for its Medicare segment, because it used incorrect net transfers, incorrect benefit payments, and incorrect contributions and transferred prepayment credits (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.

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\(^7\) 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.

\(^8\) These are assigned to a specific cost accounting period.
RECOMMENDATIONS

We recommend that Palmetto Government Benefits Administrator, LLC:

- decrease the Medicare segment pension assets by $2,126,821 and recognize $73,630,103 as the Medicare segment pension assets as of January 1, 2017, and
- establish policies and procedures to ensure compliance with Federal requirements and the pension segmentation language of the Medicare contracts.

AUDITEE COMMENTS

In written comments on our draft report, Palmetto concurred with our recommendations to decrease the Medicare segment pension assets by $2,126,821 and recognize $73,630,103 as the Medicare segment pension assets as of January 1, 2017, and establish policies and procedures to ensure compliance with Federal requirements and the pension segmentation language of the Medicare contracts.

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 recommendation, its identification of its Medicare segment, and its update of the Medicare segment pension assets from January 1, 2013, to January 1, 2017.

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 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 and the CAS 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 Medicare segment assets;
- obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Medicare segment assets;
- interviewed BCBS South Carolina and Palmetto staff responsible for identifying the Medicare segment to determine whether the segment was properly identified;
- reviewed Palmetto’s accounting records to verify the Medicare segment’s identification as well as the benefit payments made from the Medicare segment;
- reviewed the prior segmentation audit performed at Palmetto (A-07-17-00503) to determine the beginning market value of assets for the Medicare segment;
- provided the CMS Office of the Actuary, which provides technical actuarial advice, with the actuarial information necessary for it to calculate the Medicare segment pension assets from January 1, 2013, to January 1, 2017;
- reviewed the CMS actuaries’ methodology and calculations; and
• provided the results of our audit to Palmetto officials on February 10, 2020.

We performed this audit in conjunction with the following audit and used the information obtained during it: *Companion Data Services, LLC, Overstated Its Medicare Segment Pension Assets as of January 1, 2017 (A-07-20-00587).*

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, 2013, TO JANUARY 1, 2017

<table>
<thead>
<tr>
<th>Description</th>
<th>Total Company</th>
<th>Other Segments</th>
<th>TrailBlazer Medicare Segment</th>
<th>Palmetto Medicare Segment</th>
<th>CDS Medicare Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets January 1, 2013</strong></td>
<td>$768,072,910</td>
<td>$683,343,636</td>
<td>$9,664,111</td>
<td>$64,634,915</td>
<td>$10,430,248</td>
</tr>
<tr>
<td><strong>Prepayment Credits</strong></td>
<td>0</td>
<td>(7,155,811)</td>
<td>0</td>
<td>5,321,905</td>
<td>1,833,906</td>
</tr>
<tr>
<td><strong>Contributions</strong></td>
<td>70,000,000</td>
<td>70,000,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td>120,158,827</td>
<td>106,814,252</td>
<td>671,100</td>
<td>10,755,807</td>
<td>1,917,668</td>
</tr>
<tr>
<td><strong>Benefit Payments</strong></td>
<td>(54,838,340)</td>
<td>(44,627,004)</td>
<td>(2,006,875)</td>
<td>(7,316,994)</td>
<td>(887,467)</td>
</tr>
<tr>
<td><strong>Administrative Expenses</strong></td>
<td>(1,806,816)</td>
<td>(1,611,106)</td>
<td>(5,140)</td>
<td>(161,734)</td>
<td>(28,836)</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>0</td>
<td>15,122,361</td>
<td>(8,323,196)</td>
<td>(6,537,605)</td>
<td>(261,560)</td>
</tr>
<tr>
<td><strong>Discount on Accrued Contributions</strong></td>
<td>(2,388,743)</td>
<td>(2,388,743)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Assets January 1, 2014</strong></td>
<td>$899,197,838</td>
<td>$819,497,585</td>
<td>0</td>
<td>$66,696,294</td>
<td>$13,003,959</td>
</tr>
<tr>
<td><strong>Prepayment Credits</strong></td>
<td>0</td>
<td>(7,038,587)</td>
<td>0</td>
<td>5,233,789</td>
<td>1,804,798</td>
</tr>
<tr>
<td><strong>Contributions</strong></td>
<td>65,000,000</td>
<td>65,000,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td>59,459,561</td>
<td>53,732,529</td>
<td>0</td>
<td>4,744,838</td>
<td>982,194</td>
</tr>
<tr>
<td><strong>Benefit Payments</strong></td>
<td>(42,862,271)</td>
<td>(38,474,244)</td>
<td>0</td>
<td>(3,769,631)</td>
<td>(618,396)</td>
</tr>
<tr>
<td><strong>Administrative Expenses</strong></td>
<td>(479,915)</td>
<td>(433,690)</td>
<td>0</td>
<td>(38,297)</td>
<td>(7,928)</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>0</td>
<td>4,094,491</td>
<td>0</td>
<td>(3,069,401)</td>
<td>(1,025,090)</td>
</tr>
<tr>
<td><strong>Discount on Accrued Contributions</strong></td>
<td>(1,978,060)</td>
<td>(1,978,060)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Assets January 1, 2015</strong></td>
<td>$978,337,153</td>
<td>$894,400,024</td>
<td>0</td>
<td>$69,797,592</td>
<td>$14,139,537</td>
</tr>
<tr>
<td><strong>Prepayment Credits</strong></td>
<td>0</td>
<td>(7,016,349)</td>
<td>0</td>
<td>5,354,797</td>
<td>1,661,552</td>
</tr>
<tr>
<td><strong>Contributions</strong></td>
<td>45,000,000</td>
<td>45,000,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td>16,039,580</td>
<td>14,527,836</td>
<td>0</td>
<td>1,246,221</td>
<td>265,523</td>
</tr>
<tr>
<td><strong>Benefit Payments</strong></td>
<td>(73,981,415)</td>
<td>(69,519,921)</td>
<td>0</td>
<td>(4,025,876)</td>
<td>(435,618)</td>
</tr>
<tr>
<td><strong>Administrative Expenses</strong></td>
<td>(682,520)</td>
<td>(618,192)</td>
<td>0</td>
<td>(53,029)</td>
<td>(11,299)</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>0</td>
<td>7,031,055</td>
<td>0</td>
<td>(7,171,779)</td>
<td>140,724</td>
</tr>
<tr>
<td><strong>Discount on Accrued Contributions</strong></td>
<td>(1,424,925)</td>
<td>(1,424,925)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Assets January 1, 2016</strong></td>
<td>$963,287,873</td>
<td>$882,379,528</td>
<td>0</td>
<td>$65,147,926</td>
<td>$15,760,419</td>
</tr>
<tr>
<td><strong>Prepayment Credits</strong></td>
<td>0</td>
<td>(6,480,337)</td>
<td>0</td>
<td>4,824,248</td>
<td>1,656,089</td>
</tr>
<tr>
<td><strong>Contributions</strong></td>
<td>50,000,000</td>
<td>50,000,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Earnings</strong></td>
<td>111,953,279</td>
<td>101,728,545</td>
<td>0</td>
<td>8,218,437</td>
<td>2,006,297</td>
</tr>
<tr>
<td><strong>Benefit Payments</strong></td>
<td>(46,138,289)</td>
<td>(43,101,968)</td>
<td>0</td>
<td>(1,902,333)</td>
<td>(1,133,988)</td>
</tr>
<tr>
<td><strong>Administrative Expenses</strong></td>
<td>(631,339)</td>
<td>(573,679)</td>
<td>0</td>
<td>(46,346)</td>
<td>(11,314)</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>0</td>
<td>3,612,878</td>
<td>0</td>
<td>(2,611,829)</td>
<td>(1,001,049)</td>
</tr>
<tr>
<td><strong>Discount on Accrued Contributions</strong></td>
<td>(1,474,515)</td>
<td>(1,474,515)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Assets January 1, 2017</strong></td>
<td>$1,076,997,009</td>
<td>$986,090,452</td>
<td>0</td>
<td>$73,630,103</td>
<td>$17,276,454</td>
</tr>
<tr>
<td><strong>Per Palmetto</strong></td>
<td>$1,091,262,315</td>
<td>$997,451,856</td>
<td>0</td>
<td>$75,756,924</td>
<td>$18,053,135</td>
</tr>
<tr>
<td><strong>Asset Variance</strong></td>
<td>(14,265,306)</td>
<td>(11,361,404)</td>
<td>0</td>
<td>(2,126,821)</td>
<td>(777,081)</td>
</tr>
</tbody>
</table>

ENDNOTES

1/ We determined the Medicare segment pension assets as of January 1, 2013, based on our prior segmentation audit of Palmetto (A-07-17-00503; Jul. 6, 2017). 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.
In accordance with the CAS Harmonization Rule, effective CY 2013, actual contributions are discounted, at the effective interest rate, from the date of each contribution to the beginning of the program year.

The TrailBlazer Medicare segment closed on April 30, 2013. We issued our audit report on the TrailBlazer Medicare segment closing on August 8, 2017 (A-07-17-00507).

We obtained segment asset amounts from documents prepared by Palmetto’s actuarial consulting firm.

The asset variance represents the difference between our calculation of the Palmetto 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 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. During each successive accounting period of the Pension Harmonization Rule Transition Period, the contractor shall recognize on a scheduled basis (1) the amount by which the minimum actuarial liability differs from the actuarial accrued liability and (2) 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 be 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. 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.

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9 Explanatory language in the CAS Harmonization Rule states: “To 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.”
APPENDIX D: PALMETTO GOVERNMENT BENEFITS ADMINISTRATOR, LLC,  
COST ACCOUNTING STANDARDS BALANCE EQUATION  
AS OF JANUARY 1, 2017

<table>
<thead>
<tr>
<th>Description</th>
<th>Total Company</th>
<th>Other Segments</th>
<th>Palmetto Medicare Segment</th>
<th>CDS Medicare Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial Accrued Liability 1/</td>
<td>$ 898,657,329</td>
<td>$ 806,272,416</td>
<td>$ 72,915,174</td>
<td>$ 19,469,739</td>
</tr>
<tr>
<td>Less: Actuarial Value of Assets 2/</td>
<td>(1,075,406,907)</td>
<td>(984,634,567)</td>
<td>(73,521,394)</td>
<td>(17,250,946)</td>
</tr>
<tr>
<td>Unfunded Actuarial Liability 3/</td>
<td>$ (176,749,578)</td>
<td>$ (178,362,151)</td>
<td>$ (606,220)</td>
<td>$ 2,218,793</td>
</tr>
<tr>
<td>9904.412-50(a)(2) Unallowable 4/</td>
<td>$ -</td>
<td>-</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Prepayment Credit 5/</td>
<td>(269,905,513)</td>
<td>(269,905,513)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Adjustments to UAL 6/</td>
<td>$ (269,905,513)</td>
<td>$ (269,905,513)</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Net Unamortized Balance 7/</td>
<td>$ 93,155,935</td>
<td>$ 91,543,362</td>
<td>$ (606,220)</td>
<td>$ 2,218,793</td>
</tr>
<tr>
<td>Market Value of Assets 8/</td>
<td>$ 1,076,997,009</td>
<td>$ 986,090,452</td>
<td>$ 73,630,103</td>
<td>$ 17,276,454</td>
</tr>
</tbody>
</table>

ENDNOTES

1/ Actuarial accrued liability (AAL) represents the pension cost attributable, under the actuarial cost method in use, to years prior to January 1, 2017. We obtained the total company AAL from the January 1, 2017, BCBS South Carolina actuarial valuation report. The AALs for the Other Segment and Medicare segments were 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, 2017.

3/ The unfunded actuarial liability (UAL) is the AAL less the AVA as of January 1, 2017. 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/ Adjustments to the UAL represent the sum of the unallowable and prepayment balances as of January 1, 2017.

7/ The net unamortized balance is the UAL less the adjustments to the UAL. It is the portion of the UAL 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, 2017, plus the current value of any accrued contributions used to fund pension costs assigned to periods prior to January 1, 2017.
March 23, 2020

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  

Report Number: A-07-20-00586  

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report dated February 21, 2020 and entitled *Palmetto Government Benefits Administrator, LLC, Overstated Its Medicare Segment Pension Assets of January 1, 2017*. The report contains the following recommendation:

- We recommend that Palmetto decrease the Medicare segment pension assets by $2.1 million and recognize $73.6 million as the Medicare segment pension assets as of January 1, 2017, and establish policies and procedures to ensure compliance with Federal requirements 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 any questions or need additional information regarding our response.

Sincerely,

/Kenneth Lewis/

Kenneth Lewis  
Vice President and CFO  

Cc: Lori Hair, BCBSSC  
Bruce Hughes, Celerian Group  
Joe Johnson, Palmetto GBA