Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

PALMETTO GOVERNMENT BENEFITS ADMINISTRATOR, LLC, CLAIMED SOME UNALLOWABLE MEDICARE POSTRETIREMENT BENEFIT COSTS FOR FISCAL YEARS 2005 THROUGH 2011

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

Brian P. Ritchie
Assistant Inspector General
for Audit Services

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Office of Inspector General

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EXECUTIVE SUMMARY

Palmetto Government Benefits Administrator, LLC, claimed unallowable postretirement benefit costs of $665,000 for Medicare reimbursement for fiscal years 2005 through 2011.

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their postretirement benefit (PRB) costs, which are funded by direct payments to beneficiaries or contributions to a dedicated trust fund. The amount of PRB costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) as required by the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors have not always complied with Federal requirements when claiming PRB costs for Medicare reimbursement.

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, PRB, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors (MACs) through Final Administrative Cost Proposals (FACPs) and/or Incurred Cost Proposals.

For this review, we focused on one Medicare contractor, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Medicare segment allowable PRB costs (referred to in this report as "PRB costs") that Palmetto claimed for Medicare reimbursement on its FACPs.

The objective of this review was to determine whether the fiscal years (FYs) 2005 through 2011 PRB costs that Palmetto claimed for Medicare reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

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 and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform, Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 1 and Jurisdiction 11 (including home health and hospice services) effective October 25, 2007, and May 21, 2010, respectively.

BCBS South Carolina sponsors a PRB plan called the BCBS South Carolina Postretirement Health and Life Insurance Programs, which is offered to Palmetto employees. The purpose of this PRB plan is to provide retiree health and life insurance benefits to eligible retirees and their dependents. Palmetto claimed PRB costs using the accrual basis of accounting and funded those accrual costs through a Voluntary Employee Benefit Association trust.

During our audit period, Palmetto administered both fiscal intermediary and carrier contracts and MAC-related contracts. This report addresses the PRB costs that Palmetto claimed under the provisions of its fiscal intermediary and carrier contracts. We are addressing the PRB costs that Palmetto claimed under the provisions of its MAC-related contracts in a separate review.

We reviewed $1,740,793 of Medicare Part A and Part B PRB costs that Palmetto claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2005 through 2011.

WHAT WE FOUND

Palmetto claimed PRB costs of $1,740,793 for Medicare reimbursement for FYs 2005 through 2011; however, we determined that the allowable PRB costs during this period were $1,075,563. The difference, $665,230, represented unallowable fiscal intermediary and carrier contract PRB costs that Palmetto claimed on its FACPs for FYs 2005 through 2011. This overstatement occurred because Palmetto did not calculate its PRB costs in accordance with Federal regulations.

WHAT WE RECOMMEND

We recommend that Palmetto revise its FACPs for FYs 2005 through 2011 to reduce its claimed Medicare PRB costs by $665,230.

AUDITEE COMMENTS AND OUR RESPONSE

Auditee Comments

In written comments on our draft report, Palmetto disagreed that it had overstated its PRB costs. Palmetto said that it is allocated costs from its parent company, which is required to use Statement of Statutory Accounting Principles (SSAP) 14 as its accounting method and which, Palmetto said, it followed. Palmetto stated that the use of SSAP 14 is more conservative than the accounting method we used, and added that we did not challenge the accuracy of the SSAP computations.

Palmetto also stated that the differences in cost between our FAR-based method and the SSAP method are differences of timing, and are not permanent as both methods would produce the same cost over time. Palmetto said that, by contrast, our approach of converting the statutory method to the FAR-based method would result in a permanent difference in reimbursable costs, which would permanently disallow a portion of Palmetto’s fundings in the plan without offering an ability to resolve the differences between the two methods in the future.

In addition, Palmetto said that we were “well aware” of its use of the SSAP and referred to a previous audit we had conducted of PRB costs for FYs 2000 through 2004. According to

Palmetto, that audit's conclusion was that Palmetto's parent company would "work with CMS 'to determine a mutually agreeable date for change from SSAP 14 to [S]FAS 106 for determination of PRB costs.'" Palmetto further stated that the U.S. Office of Personnel Management (OPM) audited the PRB costs for 2006 through 2010 and agreed that the use of SSAP conforming to the FAR over a phase-in period was reasonable.

Finally, Palmetto stated that our audit report reflects allowable costs for 2011 based on the assumption that Palmetto had no funding for that year. Palmetto said that, in fact, it funded $3,343,621 to the 401(h) plan for the 2011 year.

Our Response

We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations. Palmetto's appeal to the SSAP 14 accounting method overlooked the fact that the Medicare contracts *require* that MACs, including Palmetto, comply with the FAR when computing PRB costs. Moreover, we have consistently held that the FAR requires MACs to follow SFAS 106 when determining PRB accrual costs.

In addition, Palmetto's assertion that we did not challenge the accuracy of its SSAP computations is largely irrelevant to our finding and recommendation. In fact, we did not review the accuracy of the SSAP calculations, as they do not comply with the requirements of the Medicare contracts. The conclusions we reached for the current audit, as well as the conclusions we reached in our previous audit, were based solely on the requirements of the FAR.

Specifically, our previous audit of the PRB costs for Palmetto's parent company (BCBS South Carolina) used the FAR, which requires compliance with SFAS 106 as specified in the Medicare contracts. BCBS South Carolina did not compute SFAS 106 costs during either FYs 2000 through 2004 (the period covered by our previous audit) or our current audit period (with the exception of CY 2005). Our previous audit addressed this same issue; we recommended that BCBS South Carolina claim future PRB costs in accordance with the Medicare contract. In this light, Palmetto's reference to the previous audit's conclusion—that BCBS South Carolina would "work with CMS 'to determine a mutually agreeable date for change from SSAP 14 to [S]FAS 106 for determination of PRB costs'"—is taken partly out of context. In its written comments on our previous report, BCBS South Carolina prefaced its statement about working with CMS by saying that it "recognizes the applicability of [S]FAS 106 to the determination of PRB costs."

Palmetto's comments also referred to an audit performed by OPM. Neither the Office of Inspector General nor CMS is bound by the position taken by another Federal agency. Moreover, OPM's audit involved its oversight of the costs of a private insurance program. Our audit involved costs associated with Medicare reimbursement, which are largely governed by different Federal requirements.

Finally, with respect to Palmetto's comment regarding the CY 2011 contribution to the 401(h) plan, we fully accounted for the contribution made to the 401(h) plan during that year. Throughout our audits of the BCBS South Carolina PRB, we have consistently shifted deposits from the current CY to a previous CY (if necessary) to satisfy each CY's funding requirements.

Therefore, we assigned the CY 2011 contribution to CY 2010 to avoid identifying unallowable unfunded costs for that period, thereby lessening the financial impact of the lower funding amount.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their postretirement benefit (PRB) costs, which are funded by direct payments to beneficiaries or contributions to a dedicated trust fund. The amount of PRB costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) as required by the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors have not always complied with Federal requirements when claiming PRB costs for Medicare reimbursement.

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, PRB, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors (MACs) through Final Administrative Cost Proposals (FACPs) and/or Incurred Cost Proposals.

For this review, we focused on one Medicare contractor, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Medicare segment allowable PRB costs (referred to in this report as "PRB costs") that Palmetto claimed for Medicare reimbursement on its FACPs.

OBJECTIVE

Our objective was to determine whether the fiscal years (FYs) 2005 through 2011 PRB costs that Palmetto claimed for Medicare reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

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 and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform,[1] Palmetto continued to perform Medicare work after being awarded the

[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.

MAC contracts for Medicare Parts A and B Jurisdiction 1[2] and Jurisdiction 11[3] effective October 25, 2007, and May 21, 2010, respectively.

BCBS South Carolina sponsors a PRB plan called the BCBS South Carolina Postretirement Health and Life Insurance Programs, which is offered to Palmetto employees. The purpose of this PRB plan is to provide retiree health and life insurance benefits to eligible retirees and their dependents. Palmetto claimed PRB costs using the accrual basis of accounting and funded those accrual costs through a Voluntary Employee Benefit Association (VEBA) trust.

During our audit period, Palmetto administered both fiscal intermediary and carrier contracts and MAC-related contracts. This report addresses the PRB costs that Palmetto claimed under the provisions of its fiscal intermediary and carrier contracts. We are addressing the PRB costs that Palmetto claimed under the provisions of its MAC-related contracts in a separate review.

Medicare Reimbursement of Postretirement Benefit Costs

CMS reimburses a portion of the funded accruals that contractors charge for their PRB plans. FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be (1) determined in accordance with Statement of Financial Accounting Standards (SFAS) 106 and (2) funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust.

HOW WE CONDUCTED THIS REVIEW

We reviewed $1,740,793 of Medicare Part A and Part B PRB costs that Palmetto claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2005 through 2011.

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.

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

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

FINDING

Palmetto claimed PRB costs of $1,740,793 for Medicare reimbursement for FYs 2005 through 2011; however, we determined that the allowable PRB costs during this period were $1,075,563. The difference, $665,230, represented unallowable fiscal intermediary and carrier contract PRB costs that Palmetto claimed on its FACPs for FYs 2005 through 2011. This overstatement occurred because Palmetto did not calculate its PRB costs in accordance with Federal regulations.

CLAIMED POSTRETIREMENT BENEFIT COSTS

Palmetto claimed PRB costs of $1,740,793 for Medicare reimbursement, under the provisions of its fiscal intermediary and carrier contracts, on its FACPs for FYs 2005 through 2011. We calculated the allowable Medicare PRB costs in accordance with the FAR. For details on the Federal requirements, see Appendix B.

UNALLOWABLE POSTRETIREMENT BENEFIT COSTS CLAIMED

We determined that the allowable PRB costs for FYs 2005 through 2011 were $1,075,563. Thus, Palmetto claimed $665,230 of unallowable fiscal intermediary and carrier contract PRB costs on its FACPs for FYs 2005 through 2011. This overclaim occurred primarily because Palmetto based its claims for Medicare reimbursement on incorrectly calculated PRB costs. More specifically, Palmetto did not always base its claims on SFAS 106 costs as required by the FAR.

The table below shows the difference between the allowable PRB costs and the PRB costs that Palmetto claimed on its FACPs and that were reflected in its accounting documents for FYs 2005 through 2011. Appendix C contains additional details on allowable PRB costs.

Table: Comparison of Allowable PRB Costs and Claimed PRB Costs

PRB Costs			
Fiscal Year	**Allowable Per Audit**	**Claimed by Palmetto**	**Difference**
2005	$504,277	$502,240	$2,037
2006	51,945	281,085	(229,140)
2007	73,458	230,427	(156,969)
2008	110,068	177,626	(67,558)
2009	138,051	196,850	(58,799)
2010	179,620	240,165	(60,545)
2011	18,144	112,400	(94,256)
Total	**$1,075,563**	**$1,740,793**	**($665,230)**

RECOMMENDATION

We recommend that Palmetto revise its FACPs for FYs 2005 through 2011 to reduce its claimed Medicare PRB costs by $665,230.

AUDITEE COMMENTS

In written comments on our draft report, Palmetto disagreed that it had overstated its PRB costs. Palmetto said that it is allocated costs from its parent company, which is required to use "Statutory accounting methods, including SSAP [Statement of Statutory Accounting Principles] 14, which we followed." Palmetto stated that the use of SSAP 14 is more conservative than the accounting method we used, such that Palmetto's method "effectively understated the Palmetto PRB costs borne by the Government as compared to the costs the Government would have incurred under FAR 31-205-6(o)." Palmetto added that we did not challenge the accuracy of the SSAP computations.

Palmetto also stated that the differences in cost between our FAR-based method and the SSAP method are differences of timing, and are not permanent as both methods would produce the same cost over time. Palmetto said that, by contrast, our approach of converting the statutory method to the FAR-based method would result in a permanent difference in reimbursable costs, a difference which, when multiplied by the interest rate for the return on assets, would have the effect of "permanently disallowing a portion of our fundings in the plan without any ability to resolve the timing differences between the two methods in the future."

In addition, Palmetto said that we were "well aware" of its use of the SSAP and referred to a previous audit we had conducted of PRB costs for FYs 2000 through 2004. According to Palmetto, that audit's conclusion was that Palmetto's parent company would "work with CMS 'to determine a mutually agreeable date for change from SSAP 14 to [S]FAS 106 for determination of PRB costs.'" Palmetto further stated that the U.S. Office of Personnel Management (OPM) audited the PRB costs for 2006 through 2010 and agreed that the use of SSAP conforming to the FAR over a phase-in period was reasonable.

Finally, Palmetto stated that our audit report reflects allowable costs for 2011 based on the assumption that Palmetto had no funding for that year. Palmetto said that, in fact, it funded $3,343,621 to the 401(h) plan for the 2011 year.

Palmetto's comments are included in their entirety as Appendix D.

OFFICE OF INSPECTOR GENERAL RESPONSE

We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations. Palmetto's appeal to the SSAP 14 accounting method overlooked the fact that the Medicare contracts *require* that MACs, including Palmetto, comply with the FAR when computing PRB costs. Moreover, we have consistently held that the FAR requires MACs to follow SFAS 106 (now referred to as Accounting Standards Codification 715.60) when determining PRB accrual costs. Specifically, FAR 31.205-6(o) requires that, to be allowable for

Medicare reimbursement, PRB accrual costs be (1) determined in accordance with SFAS 106 and (2) funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust.

In addition, Palmetto's assertion that we did not challenge the accuracy of its SSAP computations is largely irrelevant to our finding and recommendation. In fact, we did not review the accuracy of the SSAP calculations, as they do not comply with the requirements of the Medicare contracts, and at no point did we agree to use SSAP to calculate PRB costs. Rather, the conclusions we reached for the current audit, as well as the conclusions we reached in our previous audit, were based solely on the requirements of the FAR.

Specifically, our previous audit of the PRB costs for Palmetto's parent company (BCBS South Carolina) for FYs 2000 through 2004 (A-07-07-00230, issued February 25, 2008) used the FAR, which requires compliance with SFAS 106, as specified in the Medicare contracts. BCBS South Carolina did not compute SFAS 106 costs during either FYs 2000 through 2004 (the period covered by our previous audit) or our current audit period (with the exception of CY 2005). Our previous audit addressed this same issue; we recommended that BCBS South Carolina claim future PRB costs in accordance with the Medicare contract. In this light, Palmetto's reference to the previous audit's conclusion—that BCBS South Carolina would "work with CMS 'to determine a mutually agreeable date for change from SSAP 14 to [S]FAS 106 for determination of PRB costs'"—is taken partly out of context. In its written comments on our previous report, BCBS South Carolina prefaced its statement about working with CMS by saying that it "recognizes the applicability of [S]FAS 106 to the determination of PRB costs."

Palmetto's comments also referred to an audit performed by OPM. Neither the Office of Inspector General (which by statute is independent[4]) nor CMS is bound by the position taken by another Federal agency. Moreover, OPM's audit involved its oversight of the costs of a private insurance program. In that we are here involved in oversight of costs associated with Medicare reimbursement—costs that are largely governed by different Federal requirements—the results of OPM's audit are of even less applicability.

Finally, with respect to Palmetto's comment regarding the FY 2011 contribution to the 401(h) plan, we fully accounted for the contribution made to the 401(h) plan during that year. Throughout our audits of the BCBS South Carolina PRB, we have consistently shifted deposits from the current CY to a previous CY (if necessary) to satisfy each CY's funding requirements. Therefore, we assigned the CY 2011 contribution to CY 2010 to avoid identifying unallowable unfunded costs for that period, thereby lessening the financial impact of the lower funding amount.

[4] The Inspector General Act of 1978, 5 U.S.C. App. § 4(a)(1).

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed $1,740,793 of Medicare Part A and Part B PRB costs that Palmetto claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2005 through 2011.

Achieving our objective did not require that we review BCBS South Carolina's or Palmetto's overall internal control structures. We reviewed the internal controls related to the PRB costs claimed for Medicare reimbursement to ensure that these costs were allocable in accordance with the FAR.

We performed our fieldwork at BCBS South Carolina in Columbia, South Carolina.

METHODOLOGY

To accomplish our objective, we:

- reviewed the provisions of the FAR and the Medicare contracts applicable to this audit;

- reviewed accounting records and FACP information provided by Palmetto to identify the amount of PRB costs claimed for Medicare reimbursement for FYs 2005 through 2011;

- used information that BCBS South Carolina's actuarial consulting firms provided, including information on VEBA assets, PRB obligations, service costs, contributions, claims paid, claims reimbursed, investment earnings, and administrative expenses;

- examined BCBS South Carolina's and Palmetto's accounting records, PRB plan documents, and annual actuarial valuation reports;

- determined the extent to which BCBS South Carolina funded PRB costs with contributions to the VEBA trust fund, accumulated prepayment credits, and direct benefit payments;

- engaged the CMS Office of the Actuary to calculate the PRB costs on the basis of the SFAS 106 methodology applied in accordance with FAR 31.205-6(o);

- reviewed and verified the CMS actuaries' methodology and calculations and used this information to calculate the PRB costs for the Palmetto Medicare segment during FYs 2005 through 2011; and

- provided the results of our review to Palmetto officials on June 13, 2016.

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

- *CGS Administrators, LLC's Postretirement Benefit Costs for Fiscal Year 2011 Were Reasonable and Allowable* (A-07-16-00484) and

- *Blue Cross Blue Shield of South Carolina Overstated Its Allocable Medicare Postretirement Benefit Costs for Calendar Years 2006 Through 2011* (A-07-16-00485).

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: FEDERAL REGULATIONS RELATED TO MEDICARE REIMBURSEMENT OF POSTRETIREMENT BENEFIT COSTS

Federal regulations (FAR 31.205-6(o)) require that PRB accrual costs be determined in accordance with SFAS 106 and funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust. The FAR states that accrual accounting may be used to determine the allowable PRB costs if the cost is measured and assigned (actuarially determined) according to generally accepted accounting principles based on amortization of any transition obligation. Costs attributable to past service (transition obligation) must be assigned under the delayed recognition methodology described in paragraphs 112 and 113 of SFAS 106. The FAR also states that allowable costs must be funded by the time set for filing the Federal income tax return or any extension thereof and must comply with the applicable standards promulgated by the Cost Accounting Standards Board.

APPENDIX C: ALLOWABLE POSTRETIREMENT BENEFIT PLAN COSTS FOR PALMETTO GOVERNMENT BENEFITS ADMINISTRATOR, LLC, FOR FISCAL YEARS 2005 THROUGH 2011

Date	Description		Total Company	Health	Life
2004	Allocable PRB cost	1/	$5,035,710	$4,029,393	$1,006,317
2005	Contributions	2/	0	0	0
	Discount for interest	3/	0	0	0
January 1, 2005	Present value contributions	4/	-	-	-
	Prepayment credit applied	5/	1,280,125	988,791	291,334
	Present value of funding	6/	1,280,125	988,791	291,334
January 1, 2005	Funding Target	7/	5,250,559	4,055,623	1,194,936
	Percentage funded	8/		24.38%	24.38%
	Funded PRB cost	9/		988,791	291,334
	Unallowable interest	10/		(75,575)	(15,873)
	Allowable interest	11/		-	-
2005	Total allocable PRB cost			913,216	275,461
	FY PRB costs	12/		1,692,260	458,175
	Medicare LOB* percentage	13/		23.45%	23.45%
2005	Allowable FY PRB cost	14/	$504,277	$396,835	$107,442

Date	Description	Total Company	Health	Life
2006	Contributions	$0	$0	$0
	Discount for interest	-	-	-
January 1, 2006	Present value contributions	-	-	-
	Prepayment credit applied	0	0	0
	Present value of funding	-	-	-
January 1, 2006	Funding Target	3,978,085	2,779,393	1,198,692
	Percentage funded		0%	0%
	Funded PRB cost		$0.00	$0.00
	Unallowable interest		$0.00	$0.00
	Allowable interest		$0.00	$0.00
2006	Total allocable PRB cost		$0.00	$0.00
	FY PRB costs		228,304	68,865
	Medicare LOB* percentage		17.48%	17.48%
2006	Allowable FY PRB cost	$51,945	$39,908	$12,038

Date	Description	Total Company	Health	Life
2007	Contributions	$816,274	$565,933	$250,341
	Discount for interest	(67,980)	(47,131)	(20,849)
January 1, 2007	Present value contributions	748,294	518,802	229,492
	Prepayment credit applied	0	0	0
	Present value of funding	748,294	518,802	229,492
January 1, 2007	Funding Target	3,167,088	2,195,783	971,305
	Percentage funded		23.63%	23.63%
	Funded PRB cost		518,802	229,492
	Unallowable interest		(142,684)	(40,822)
	Allowable interest		13,987	7,016
2007	Total allocable PRB cost		390,105	195,686
	FY PRB costs		292,579	146,765
	Medicare LOB* percentage		16.72%	16.72%
2007	Allowable FY PRB cost	$73,458	$48,919	$24,539

Date	Description	Total Company	Health	Life
2008	Contributions	$1,677,163	$1,183,197	$493,966
	Discount for interest	(139,187)	(98,193)	(40,994)
January 1, 2008	Present value contributions	1,537,976	1,085,004	452,972
	Prepayment credit applied	0	0	0
	Present value of funding	1,537,976	1,085,004	452,972
January 1, 2008	Funding Target	3,039,705	2,144,436	895,269
	Percentage funded		50.60%	50.60%
	Funded PRB cost		1,085,004	452,972
	Unallowable interest		(350,096)	(107,123)
	Allowable interest		27,329	12,861
2008	Total allocable PRB cost		762,237	358,710
	FY PRB costs		669,204	317,954
	Medicare LOB* percentage		11.15%	11.15%
2008	Allowable FY PRB cost	$110,068	$74,616	$35,452

Date	Description	Total Company	Health	Life
2009	Contributions	$2,218,175	$1,633,773	$584,402
	Discount for interest	(164,406)	(121,092)	(43,314)
January 1, 2009	Present value contributions	2,053,769	1,512,681	541,088
	Prepayment credit applied	0	0	0
	Present value of funding	2,053,769	1,512,681	541,088
January 1, 2009	Funding Target	3,764,246	2,772,516	991,730
	Percentage funded		54.56%	54.56%
	Funded PRB cost		1,512,681	541,088
	Unallowable interest		(407,868)	(128,185)
	Allowable interest		41,085	15,355
2009	Total allocable PRB cost		1,145,898	428,258
	FY PRB costs		1,049,983	410,871
	Medicare LOB* percentage		9.45%	9.45%
2009	Allowable FY PRB cost	$138,051	$99,223	$38,827

Date	Description	Total Company	Health	Life
2010	Contributions	$3,000,000	$2,177,155	$822,845
	Discount for interest	(247,824)	(179,850)	(67,974)
January 1, 2010	Present value contributions	2,752,176	1,997,305	754,871
	Prepayment credit applied	0	0	0
	Present value of funding	2,752,176	1,997,305	754,871
January 1, 2010	Funding Target	3,833,372	2,781,949	1,051,423
	Percentage funded		71.80%	71.80%
	Funded PRB cost		1,997,305	754,871
	Unallowable interest		(584,198)	(185,663)
	Allowable interest		52,550	21,167
2010	Total allocable PRB cost		1,465,657	590,375
	FY PRB costs		1,385,717	549,846
	Medicare LOB* percentage		9.28%	9.28%
2010	Allowable FY PRB cost	$179,620	$128,594	$51,026

Date	Description	Total Company	Health	Life
2011	Contributions	$0	$0	$0
	Discount for interest	0	0	0
January 1, 2011	Present value contributions	0	0	0
	Prepayment credit applied	0	0	0
	Present value of funding	0	0	0
January 1, 2011	Funding Target	4,718,600	3,423,200	1,295,400
	Percentage funded		0%	0%
	Funded PRB cost		0	0
	Unallowable interest		0	0
	Allowable interest		0	0
2011	Total allocable PRB cost		0	0
	FY PRB costs		366,414	147,594
	Medicare LOB* percentage		3.53%	3.53%
2011	Allowable FY PRB cost	$18,144	$12,934	$5,210

* Line of Business.

ENDNOTES

1/ The calendar year (CY) allocable PRB cost is the amount of PRB cost that may be allocated for contract cost purposes. We obtained the CY 2004 Total Company allocable PRB cost from our prior BCBS South Carolina PRB review (A-07-07-00230), issued February 25, 2008.

2/ We obtained the contributions from BCBS South Carolina's trust statements. The contributions included deposits made during the plan year (PY) and the discounted value of accrued contributions, if any, deposited after the end of the PY but within the time allowed for filing tax returns.

3/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions and actual contribution amounts. Interest is determined using the expected long-term rate of return assumption as reported in the PRB actuarial valuation report.

4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the CY.

5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year funding target. A prepayment credit is carried forward, with interest, to fund future PRB costs.

6/ The present value of funding represents the present value of contributions plus prepayment credits plus direct benefit payments. This is the amount of funding that is available to cover the funding target measured at the first day of the CY.

7/ The funding target is based on the assignable PRB cost computed during our review. The funding target must be funded by accumulated prepayment credits, current year contributions, or direct benefit payments to satisfy the funding requirement contained in the FAR.

8/ The percentage of costs funded is a measure of the portion of the funding target that was funded during the CY. Because any funding in excess of the funding target is accounted for as a prepayment, the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the funding target. For purposes of illustration, the percentage of costs funded has been rounded to four decimal places.

9/ We computed the funded PRB cost as the funding target multiplied by the percent funded. If the percentage funded was less than 100 percent, we set the funded PRB costs to equal the present value of funding.

10/ Unallowable interest represents the interest cost attributable to the unallowable unfunded costs that are included in the current-period PRB cost (as determined in accordance with SFAS 106), discounted to the beginning of the year at the long-term interest rate.

11/ We assumed that interest on the funded PRB cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(o)(4), which provides that interest costs are unallowable if caused by a delay in funding beyond 30 days after the end of each quarter to which they are assignable.

12/ We converted the allowable PRB cost to an FY basis (October 1 through September 30). We calculated the FY PRB costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs.

13/ We calculated the Medicare line of business (LOB) percentages based on information provided by Palmetto.

14/ We computed the allowable PRB cost as the FY PRB cost multiplied by the Medicare LOB percentage.

PALMETTO GBA.
A CELERIAN GROUP COMPANY

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

August 4, 2016

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

Re: Report Number A-07-16-00483

Dear Mr. Cogley:

We have received your draft audit report regarding the Post Retirement Benefit (PRB) Costs of Palmetto GBA (Palmetto) for calendar years 2005 through 2011 and are responding in accordance with your request. The audit concludes that Palmetto overstated its PRB costs for the audit period by $665,230.

We disagree with the audit conclusion that Palmetto has overstated its PRB costs. To the contrary, the method we applied effectively understated the Palmetto PRB costs borne by the Government as compared to the costs the Government would have incurred under FAR 31.205-6(o). Palmetto is allocated PRB costs from its parent, an insurance company. As such, its parent is required to use Statutory accounting methods, including SSAP 14, which we followed. This Statutory method is more conservative than the method presented by the OIG with the most significant difference being that the FAR method includes a liability for employees who have not vested in the plan whereas the Statutory method does not include a cost for such employees. The result is a lower accrual of costs as compared to SFAS 106 pursuant to the FAR. Specifically, as a result of these conservative calculations – the accuracy of which the OIG does not challenge – our parent funded the PRB plan in accordance with these lower resulting costs and correspondingly charged the Government less.

Any differences in cost between the FAR method and the Statutory method are timing in nature and not permanent as both methods will produce the same cost over time. However, the OIG approach of converting the Statutory method to the FAR results in a permanent difference in reimbursable costs. In the report, the cumulative shortfall in fundings between the two methods is multiplied by the interest rate for return on assets (see "Unallowable interest" Appendix C) and has the effect of reducing the allowable PRB costs for each year. Ironically, this reduction is so great that it reduces allowable costs below our Statutory costs which are already well below the FAR method. The OIG reduction in allowable PRB costs from cumulative shortfalls has the effect of permanently disallowing a portion of our fundings in the plan without any ability to resolve the timing differences between the two methods in the future. This result is inequitable and against the best interests of both parties. Our method, on the other hand, resolves the differences between the two methods and will result in no permanent differences in costs.

The OIG was well aware of the Statutory method we were applying. It audited the PRB costs for the years 2000 through 2004 with the conclusion that our parent company would work with CMS "to determine a mutually agreeable date for change from SSAP 14 to FAS 106 for determination of PRB costs". At the time this audit report was being issued, we notified CMS that the NAIC was in the process of changing the Statutory accounting method to conform to the FAR method and that over time this issue would take care of itself. Beginning in 2013, in accordance with NAIC requirements, the Statutory method has moved to the method provided by the FAR with a 10 year phase-in period. Therefore, the issue of using different methods is being resolved in our existing approach. In addition, the U.S. Office of Personnel Management has audited our PRB costs for the years 2006-2010 and agreed that this approach of the Statutory cost conforming to FAR over a phase-in period is reasonable and no adjustments were necessary.

Finally, the audit report (page 3) reflects allowable costs for the year 2011 based on the assumption that we had no funding for that year. However, we funded $3,343,621 to the 401(h) plan for the 2011 year. Therefore, we request that you update your records to reflect this. We will be glad to provide evidence of that funding to you.

In conclusion, Palmetto maintains its position that the costs at issue were allocable and appropriate. We look forward to working with CMS to reach an equitable resolution of this matter.

Sincerely,

Kenneth Cevo