

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**BLUE CROSS BLUE SHIELD OF SOUTH  
CAROLINA OVERSTATED ITS  
SUPPLEMENTAL EXECUTIVE  
RETIREMENT PLAN III MEDICARE  
ALLOWABLE SEGMENT PENSION ASSETS  
AS OF JANUARY 1, 2017**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
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**Amy J. Frontz**  
Deputy Inspector General  
for Audit Services

April 2021  
A-07-20-00600

# *Office of Inspector General*

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## **OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

## Report in Brief

Date: April 2021

Report No. A-07-20-00600

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



### 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 update the segmented pension assets.

Our objective was to determine whether Blue Cross Blue Shield of South Carolina (BCBS South Carolina) complied with Federal requirements when updating its Supplemental Executive Retirement Plan III (SERP III) Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

### How OIG Did This Audit

We reviewed BCBS South Carolina's update of its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

## Blue Cross Blue Shield of South Carolina Overstated Its Supplemental Executive Retirement Plan III Medicare Allowable Segment Pension Assets as of January 1, 2017

### What OIG Found

BCBS South Carolina did not correctly update its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017, in accordance with Federal requirements. BCBS South Carolina identified \$396,891 as its SERP III Medicare Allowable segment pension assets as of January 1, 2017; however, we determined that those assets were \$391,943 as of that date. Therefore, BCBS South Carolina overstated its SERP III Medicare Allowable segment pension assets as of January 1, 2017, by \$4,948. BCBS South Carolina overstated those pension assets because its policies and procedures did not always ensure that it calculated those assets in accordance with Federal requirements when updating its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

### What OIG Recommends and Auditee Comments

We recommend that BCBS South Carolina decrease its SERP III Medicare Allowable segment pension assets by \$4,948 and recognize \$391,943 as the SERP III Medicare Allowable segment pension assets as of January 1, 2017, and improve policies and procedures to ensure that going forward, it calculates Medicare Allowable segment pension assets in accordance with Federal requirements.

BCBS South Carolina stated that it did not object to our findings and recommendations and added that it did not believe our findings had a material impact on its submitted Incurred Cost Proposals.

## TABLE OF CONTENTS

INTRODUCTION.....	1
Why We Did This Audit.....	1
Objective .....	1
Background .....	1
Blue Cross Blue Shield of South Carolina and Medicare. ....	1
Supplemental Executive Retirement Plan III.....	2
How We Conducted This Audit.....	3
FINDINGS .....	3
Update of Supplemental Executive Retirement Plan III Medicare	
Allowable Segment Pension Assets .....	4
Contributions and Transferred Prepayment Credits Understated.....	4
Earnings, Net of Expenses, Overstated.....	5
RECOMMENDATIONS.....	5
AUDITEE COMMENTS.....	6
APPENDICES	
A: Audit Scope and Methodology .....	7
B: Statement of Market Value of Pension Assets for the Supplemental Executive Retirement Plan III for the Period January 1, 2015, to January 1, 2017 .....	8
C: Federal Requirements Related to Pension Segmentation .....	10
D: Blue Cross Blue Shield of South Carolina Supplemental Executive Retirement Plan III Cost Accounting Standards Balance Equation as of January 1, 2017 .....	11
E: Auditee Comments .....	13

## 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 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 audits found that Medicare contractors did not always correctly update the segmented pension assets.

At CMS's request, the Department of Health and Human Services, 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, Incurred Cost Proposals (ICPs), or both.

For this audit, we focused on one entity, Blue Cross Blue Shield of South Carolina (BCBS South Carolina). In particular, we examined the Supplemental Executive Retirement Plan III (SERP III) Medicare Allowable segment pension assets that BCBS South Carolina updated from January 1, 2015, to January 1, 2017.

### OBJECTIVE

Our objective was to determine whether BCBS South Carolina complied with Federal requirements when updating its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

### BACKGROUND

#### **Blue Cross Blue Shield of South Carolina and Medicare**

During our audit period, Palmetto Government Benefits Administrator, LLC (Palmetto), CGS Administrators, LLC (CGS), and Companion Data Services, LLC (CDS), were subsidiaries of BCBS South Carolina, whose home office is in Columbia, South Carolina; these subsidiaries administered Medicare functions for CMS. Specifically, Palmetto administers Medicare

operations under the MAC contracts for Medicare Parts A and B Jurisdiction 1<sup>1</sup> and Jurisdiction 11<sup>2</sup> 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<sup>3</sup> and M (formerly Jurisdiction 11). Palmetto also continues to perform Railroad Retirement Board contract operations under a specialty MAC contract awarded on November 27, 2012. CDS was created after being awarded the Enterprise Data Center (EDC) contract effective March 10, 2006. The EDC contract was replaced by a Virtual Data Center contract on November 15, 2012, which is still in effect. CGS administered Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform, CGS continued to perform Medicare work after being awarded the MAC contract for Medicare Parts A and B Jurisdiction 15, effective July 8, 2010.

During our audit period, CMS and BCBS South Carolina entered into an agreement called the “Advance Agreement Regarding the Computation of Nonqualified Defined Benefit Pension Plan Costs for the Periods Beginning January 1, 2015” (agreement). This agreement allowed BCBS South Carolina to change its accounting methodology from a pay-as-you to an accrual method. This agreement also closed costs prior to January 1, 2015. Starting with January 1, 2015, the SERP III plan would, under the terms of the agreement, identify its segments by individual participant. These segments allocate to each of the BCBS South Carolina Medicare subsidiaries: Palmetto, CDS, and CGS. This report addresses BCBS South Carolina’s compliance with the pension segmentation language under the provisions of Federal requirements and its Medicare contracts.

### **Supplemental Executive Retirement Plan III**

BCBS South Carolina sponsors a SERP III plan. The purpose of this deferred compensation plan is to supplement participants’ benefits payable under BCBS South Carolina’s retirement plans. This plan is provided to a limited group of management employees who are responsible for earnings and long-term growth of the company.

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<sup>1</sup> Medicare Parts A and B Jurisdiction 1 consisted of the States of California, Hawaii, and Nevada, and the U.S. Territories of American Samoa, Guam, and the Northern Mariana Islands.

<sup>2</sup> 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.

<sup>3</sup> Medicare Parts A and B Jurisdiction J consists of the states of Alabama, Georgia, and Tennessee.

## HOW WE CONDUCTED THIS AUDIT

We reviewed BCBS South Carolina's update of its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.<sup>4</sup>

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

BCBS South Carolina did not correctly update its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017, in accordance with Federal requirements. BCBS South Carolina identified \$396,891 as its SERP III Medicare Allowable segment pension assets as of January 1, 2017; however, we determined that those assets were \$391,943 as of that date. Therefore, BCBS South Carolina overstated its SERP III Medicare Allowable segment pension assets as of January 1, 2017, by \$4,948. BCBS South Carolina overstated those pension assets because its policies and procedures did not always ensure that it calculated those assets in accordance with Federal requirements when updating its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

Appendix B identifies the details of BCBS South Carolina's SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017, as determined during our audit. Table 1 below summarizes the audit adjustments required to update BCBS South Carolina's SERP III Medicare Allowable segment pension assets in accordance with Federal requirements.

**Table 1: Summary of Audit Adjustments**

	<b>Per Audit</b>	<b>Per BCBS South Carolina</b>	<b>Difference</b>
<b>Update of SERP III Medicare Allowable Segment Assets</b>			
Contributions and Prepayment Credits	1,068,400	1,067,312	1,088
Benefit Payments	(687,056)	(687,056)	0
Earnings, Net of Expenses	10,599	16,635	(6,036)
<b>Overstatement of SERP III Medicare Allowable Segment Assets</b>			<b>(\$4,948)</b>

<sup>4</sup> Medicare Allowable segment pension assets are combined from the individual executives' pension assets. A portion of these executives' pension assets are allowable Medicare costs. The individual executive information is proprietary information and therefore does not appear in this report.

## **UPDATE OF SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN III MEDICARE ALLOWABLE SEGMENT PENSION ASSETS**

Federal requirements require Medicare contractors to update the Medicare Allowable 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, see Appendix C.

BCBS South Carolina did not correctly update its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017, in accordance with Federal requirements. BCBS South Carolina identified \$396,891 as its SERP III Medicare Allowable segment pension assets as of January 1, 2017; however, we determined that those assets were \$391,943 as of that date. Therefore, BCBS South Carolina overstated its SERP III Medicare Allowable segment pension assets as of January 1, 2017, by \$4,948. The following are our findings regarding the update of the SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017. Appendix D identifies BCBS South Carolina's CAS balance equation for the SERP III as of January 1, 2017.<sup>5</sup>

### **Contributions and Transferred Prepayment Credits Understated**

The audited contributions and transferred prepayment credits<sup>6</sup> are based on the assignable pension costs.<sup>7</sup> 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.

BCBS South Carolina understated contributions and transferred prepayment credits by \$1,088. The understatement occurred primarily because of differences in the asset base used to compute the assignable pension costs.

Table 2 on the following page shows the differences between the transferred prepayment credits and contributions proposed by BCBS South Carolina and the transferred prepayment credits and contributions that we calculated during our review.

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<sup>5</sup> 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).

<sup>6</sup> 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.

<sup>7</sup> These are assigned to a specific cost accounting period.

**Table 2: Contributions and Transferred Prepayment Credits**

<b>Calendar Year</b>	<b>Per Audit</b>	<b>Per BCBS South Carolina</b>	<b>Difference</b>
2015	\$286,687	\$286,687	\$0
2016	781,713	780,625	1,088
<b>Total</b>	<b>\$1,068,400</b>	<b>\$1,067,312</b>	<b>\$1,088</b>

**Earnings, Net of Expenses, Overstated**

BCBS South Carolina overstated investment earnings, less administrative expenses, by \$6,036, because it used incorrect contributions and transferred prepayment credits (discussed above) to develop the SERP III Medicare Allowable 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 3 below shows the difference in the earnings, net of expenses, proposed by BCBS South Carolina and the earnings, net of expenses, that we calculated during our review.

**Table 3: Earnings, Net of Expenses**

<b>Calendar Year</b>	<b>Per Audit</b>	<b>Per BCBS South Carolina</b>	<b>Difference</b>
2015	\$491	\$491	\$0
2016	10,108	16,144	(6,036)
<b>Total</b>	<b>\$10,599</b>	<b>\$16,635</b>	<b>(\$6,036)</b>

**RECOMMENDATIONS**

We recommend that Blue Cross Blue Shield of South Carolina:

- decrease its SERP III Medicare Allowable segment pension assets by \$4,948 and recognize \$391,943 as the SERP III Medicare Allowable segment pension assets as of January 1, 2017, and
- improve policies and procedures to ensure that going forward, it calculates Medicare Allowable segment pension assets in accordance with Federal requirements.

## AUDITEE COMMENTS

In written comments on our draft report, BCBS South Carolina stated that it did not object to our findings and recommendations and added that it did not believe our findings had a material impact on its submitted ICPs.

BCBS South Carolina's comments appear in their entirety as Appendix E.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

We reviewed BCBS South Carolina's update of its SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017.

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

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

### METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed the annual actuarial valuation reports prepared by BCBS South Carolina's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses, and used this information to calculate the SERP III Medicare segment assets;
- obtained and reviewed the SERP III pension plan documents;
- reviewed BCBS South Carolina's accounting records to verify the SERP III benefit payments;
- provided the CMS Office of the Actuary, which provides technical actuarial advice, with the actuarial information necessary for it to calculate the SERP III Medicare Allowable segment pension assets from January 1, 2015, to January 1, 2017;
- reviewed the CMS actuaries' methodology and calculations; and
- provided the results of our audit to BCBS South Carolina officials on December 17, 2020.

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: STATEMENT OF MARKET VALUE OF PENSION ASSETS  
FOR THE SUPPLEMENT EXECUTIVE RETIREMENT PLAN III FOR  
THE PERIOD JANUARY 1, 2015, TO JANUARY 1, 2017**

Description		Total Company	Other Segment	Medicare Allowable Segment
Assets January 1, 2015	<u>1/</u>	\$1,952,953	\$1,952,953	\$0
Prepayment credits	<u>2/</u>	0	(286,687)	286,687
Contributions	<u>3/</u>	7,264,000	7,264,000	0
Earnings	<u>4/</u>	6,989	6,498	491
Assets January 1, 2016		\$9,223,942	\$8,936,764	\$287,178
Prepayment credits		0	(272,139)	272,139
Contributions		6,336,017	5,826,443	509,574
Earnings		388,547	378,439	10,108
Benefit payments	<u>5/</u>	(882,613)	(195,557)	(687,056)
Assets January 1, 2017		\$15,065,893	\$14,673,950	\$391,943
Per BCBS South	<u>6/</u>	15,065,893	\$14,669,002	396,891
Asset variance	<u>7/</u>	0	4,948	(4,948)

**ENDNOTES**

1/ We determined the Total Company and Medicare Allowable segments' pension assets as of January 1, 2015, based on BCBS South Carolina's actuarial valuation report. The amounts shown for the Other segment represent the difference between the Total Company and the Medicare Allowable segment. 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 Allowable segment as needed to cover funding requirements.

- 3/ We obtained Total Company contribution amounts from the actuarial valuation reports. We allocated Total Company contributions to the Medicare Allowable segment based on the ratio of the Medicare Allowable segment's 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 Allowable segments benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by BCBS South Carolina.
- 6/ We obtained total asset amounts from documents prepared by BCBS South Carolina's actuarial consulting firm.
- 7/ The asset variance represents the difference between our calculation of the SERP III Medicare Allowable segment pension assets and BCBS South Carolina's calculation of the SERP III Medicare Allowable segment's pension assets.

## **APPENDIX C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION**

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

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

**APPENDIX D: BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA SUPPLEMENTAL  
EXECUTIVE RETIREMENT PLAN III COST ACCOUNTING STANDARDS  
BALANCE EQUATION AS OF JANUARY 1, 2017**

Description		Total Company	Other Segment	SERP III Medicare Allowable
Actuarial Accrued Liability	<u>1/</u>	\$ 3,408,623	\$ 2,378,911	\$ 1,029,712
Less: Actuarial Value of Assets	<u>2/</u>	(15,457,882)	\$ (15,055,741)	(402,141)
Unfunded Actuarial Liability	<u>3/</u>	\$ (12,049,259)	\$ (12,676,830)	\$ 627,571
9904.412-50(a)(2) Unallowable	<u>4/</u>	\$ -	\$ -	\$ -
Prepayment Credit	<u>5/</u>	(14,093,116)	\$ (13,547,872)	(545,244)
Adjustments to UAL	<u>6/</u>	\$ (14,093,116)	\$ (13,547,872)	\$ (545,244)
Net Unamortized Balance	<u>7/</u>	\$ 2,043,857	\$ 871,042	\$ 1,172,815
Market Value of Assets	<u>8/</u>	\$ 15,065,893	\$ 14,673,950	\$ 391,943

**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 SERP III actuarial valuation report. The AALs for the Other Segment and Medicare Allowable segment 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.

## APPENDIX E: AUDITEE COMMENTS

March 8, 2021

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

Report Number: A-07-20-00600

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report dated February 9, 2021, entitled *Blue Cross Blue Shield of South Carolina Overstated Its Supplemental Executive Retirement Plan III Medicare Allowable Segment Pension Assets of January 1, 2017*. The report finds that “Therefore, BCBS South Carolina overstated its SERP III Medicare Allowable segment pension assets as of January 1, 2017, by \$4,948.”

BCBS South Carolina does not object to the findings and recommendations in the above referenced report and does not believe any findings contained therein had a material impact on its Incurred Cost Submissions.

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,

/Lori Hair/

Lori Hair  
Vice President, Controller and Assistant Treasurer

Cc: Michael J. Mizeur, BCBSSC