

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**GROUP HEALTH INCORPORATED  
UNDERSTATED ITS  
EMBLEMHEALTH SERVICES  
COMPANY, LLC, EMPLOYEES'  
RETIREMENT PLAN MEDICARE  
SEGMENT PENSION ASSETS AS  
OF JANUARY 1, 2015**

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July 2019  
A-07-19-00561

# *Office of Inspector General*

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the findings and opinions of OAS. Authorized officials of the HHS  
operating divisions will make final determination on these matters.

## Report in Brief

Date: July 2019

Report No. A-07-19-00561

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



### Why OIG Did This Review

Certain 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 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 reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

Our objectives were to determine whether Group Health Incorporated (GHI) complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendation to increase the EmblemHealth Retirement Plan (EHS Retirement Plan) Medicare segment pension assets as of January 1, 2009, and (2) updating the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015.

### How OIG Did This Review

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

## Group Health Incorporated Understated Its EmblemHealth Services Company, LLC, Employees' Retirement Plan Medicare Segment Pension Assets as of January 1, 2015

### What OIG Found

GHI implemented our prior audit recommendation to recognize \$489,218 as the EmblemHealth Retirement Plan Medicare segment pension assets as of January 1, 2009. Regarding our second objective, GHI did not correctly update the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015, in accordance with Federal requirements and the Medicare contracts' pension segmentation requirements. GHI identified \$5.2 million as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015; however, we determined that those assets were \$5.633 million as of that date. Therefore, GHI understated the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015, by \$432,584. GHI understated those pension assets because it did not have quality assurance procedures to ensure that it calculated those assets in accordance with Federal requirements when updating the EHS Retirement Plan Medicare segment's pension assets from January 1, 2009, to January 1, 2015.

### What OIG Recommends and Auditee Comments

We recommend that GHI increase the EHS Retirement Plan Medicare segment pension assets by \$432,584 and recognize \$5.633 million as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015; and develop quality assurance procedures to ensure that going forward, it calculates Medicare segment pension assets in accordance with Federal requirements.

GHI did not directly address our recommendations. However, GHI's comments suggest that it disagreed with our recommendations. GHI referred to our disagreement with the long-term interest rate assumption that it used to compute accrued liabilities and normal cost, and cited this disagreement as a reason for the differences conveyed in some of our findings.

We maintain that all of our calculations of the Medicare segment pension assets remain valid. Therefore, we maintain that our findings and recommendations remain valid as well.

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## **INTRODUCTION**

### **WHY WE DID THIS REVIEW**

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

At CMS's request, the Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors, Medicare administrative contractors (MACs), and other CAS-covered and Federal Acquisition Regulation (FAR)-covered contracts through Final Administrative Cost Proposals and/or Incurred Cost Proposals.

For this review, we focused on one entity, Group Health Incorporated (GHI). In particular, we examined the Other segment and Medicare segment pension assets for the EmblemHealth Services Company, LLC, Employees' Retirement Plan (EHS Retirement Plan), which GHI updated from January 1, 2009, to January 1, 2015.

### **OBJECTIVES**

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

### **BACKGROUND**

#### **Group Health Incorporated and Medicare**

GHI, a subsidiary of EmblemHealth, LLC, administered Medicare operations under a Coordination of Benefits contract with CMS. During our audit period, GHI also performed Medicare work on the Medicare Secondary Payer Recovery and Benefit Coordination and

Recovery contracts.<sup>1</sup> Early in our audit period, GHI also performed work as a subcontractor on the Retiree Drug Subsidy contract.

During our audit period, GHI had three defined benefit pension plans: the GHI Local 153 Pension Plan; the GHI Cash Balance Pension Plan; and the EHS Retirement Plan.

Effective January 1, 2008, GHI froze the GHI Cash Balance Pension Plan to new entrants and future benefit accruals. GHI employees were given an opportunity to participate in the EHS Retirement Plan effective January 1, 2008. All active employees elected to participate in the EHS Retirement Plan and continued to earn a benefit similar to the benefit earned under the GHI Cash Balance Pension Plan. Effective January 1, 2011, the GHI Cash Balance Pension Plan merged into the EHS Retirement Plan.

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

### **Prior Pension Segmentation Audit**

We performed a prior pension segmentation audit for GHI (A-07-12-00378, Apr. 3, 2012), which brought the EHS Retirement Plan Medicare segment pension assets to January 1, 2009. We recommended that GHI recognize \$489,218 as the Medicare segment pension assets as of January 1, 2009.

### **HOW WE CONDUCTED THIS REVIEW**

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

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

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



## FINDINGS

GHI implemented our prior audit recommendation to recognize \$489,218 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2009. Regarding our second objective, GHI did not correctly update the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015, in accordance with Federal requirements and the Medicare contracts' pension segmentation requirements. GHI identified \$5,200,761 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015; however, we determined that those assets were \$5,633,345 as of that date. Therefore, GHI understated the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015, by \$432,584. GHI understated those pension assets because it did not have quality assurance procedures to ensure that it calculated those assets in accordance with Federal requirements when updating the EHS Retirement Plan Medicare segment's pension assets from January 1, 2009, to January 1, 2015.

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

**Table 1: Summary of Audit Adjustments**

	Per Audit	Per GHI	Difference
<b>Prior Audit Recommendation</b>	\$489,218	\$489,218	\$0
<b>Update of EHS Retirement Plan Medicare Segment Assets</b>			
Contributions and Prepayment Credits	3,370,135	3,666,546	(296,411)
Net Transfers	(372,026)	(797,469)	425,443
Benefit Payments	(379,484)	(37,248)	(342,236)
Earnings, Net of Expenses	1,585,873	1,306,849	279,024
Assets Transferred in After Merger of Plans	939,629	572,865	366,764
<b>Understatement of EHS Retirement Plan Medicare Segment Assets</b>			<b>\$432,584</b>

### PRIOR AUDIT RECOMMENDATION

GHI implemented the prior audit recommendation (A-07-12-00378, Apr. 3, 2012), which recommended that GHI recognize \$489,218 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2009.

## **UPDATE OF EMBLEMHEALTH SERVICES COMPANY, LLC, EMPLOYEES' RETIREMENT PLAN MEDICARE SEGMENT PENSION ASSETS**

The Medicare contracts require Medicare contractors to update the Medicare segment pension assets yearly in accordance with the CAS. The CAS requires that the asset base be adjusted by contributions, income, benefit payments, and expenses. For details on the Federal requirements and the relevant language of the Medicare contracts, see Appendix C.

GHI did not correctly update the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015, in accordance with Federal requirements and the Medicare contracts' pension segmentation requirements. GHI identified \$5,200,761 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015; however, we determined that those assets were \$5,633,345 as of that date. Therefore, GHI understated the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015, by \$432,584. The following are our findings regarding the update of the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015. Appendix D identifies the CAS balance equation for the EHS Retirement Plan as of January 1, 2015.<sup>2</sup>

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

The audited contributions and transferred prepayment credits<sup>3</sup> are based on the assignable pension costs.<sup>4</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.

GHI understated contributions and transferred prepayment credits by \$296,411 for its EHS Retirement Plan Medicare segment. The understatement occurred primarily because of differences in the long-term interest rates used by GHI to compute its accrued liabilities. Specifically, GHI used unreasonable long-term interest rates during calendar years (CYs) 2012 through 2015 to compute its accrued liabilities. Table 2 on the following page identifies the long-term interest rates used by GHI from CY 2012 through CY 2015.

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<sup>2</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>3</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>4</sup> These are assigned to a specific cost accounting period.

**Table 2: Long-Term Interest Rates Used by GHI**

<b>CY</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
<b>Long-Term Interest Rate (%)</b>	6.50	6.50	5.00	4.00

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

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

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

**Table 3: Contributions and Prepayment Transfers<sup>5</sup>**

<b>CY</b>	<b>Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	\$456,448	\$377,071	\$79,377
2010	616,900	573,077	43,823
2011	571,818	587,766	(15,948)
2012	584,152	629,454	(45,302)
2013	572,061	678,625	(106,564)
2014	568,756	820,553	(251,797)
<b>Total</b>	<b>\$3,370,135</b>	<b>\$3,666,546</b>	<b>(\$296,411)</b>

### **Net Transfers Out Overstated**

GHI overstated net transfers out of its EHS Retirement Plan Medicare segment by \$425,443. The overstatement occurred because GHI incorrectly identified the participants who transferred in or out of its EHS Retirement Plan Medicare segment. This overstatement of the net transfer adjustment resulted in an understatement of the EHS Retirement Plan Medicare segment pension assets by \$425,443. Table 4 on the following page shows the differences

<sup>5</sup> The contributions for CYs 2013 and 2014 are discounted values of contributions made at the end of the plan year.

between the EHS Retirement Plan net transfers proposed by GHI and the net transfers that we determined during our review.

**Table 4: Net Transfers Out**

<b>CY</b>	<b>Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	\$(60,435)	\$6,301	\$(66,736)
2010	(77,408)	(488,424)	411,016
2011	2,619	(97,366)	99,985
2012	(72,825)	54,115	(126,940)
2013	(157,953)	1,853	(159,806)
2014	(6,024)	(273,948)	267,924
<b>Total</b>	<b>(\$372,026)</b>	<b>(\$797,469)</b>	<b>\$425,443</b>

### **Benefit Payments Understated**

GHI understated the EHS Retirement Plan benefit payments by \$342,236 for the Medicare segment. This understatement occurred primarily because GHI incorrectly identified EHS Retirement Plan benefit payments for Medicare segment participants during CYs 2010 and 2014. This understatement of benefit payments resulted in an overstatement of the Medicare segment pension assets by \$342,236. Table 5 below shows the differences between GHI's and our calculations of EHS Retirement Plan Medicare segment benefit payments.

**Table 5: Benefit Payments**

<b>CY</b>	<b>Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	(\$59,387)	\$0	(\$59,387)
2010	(32,006)	0	(32,006)
2011	(27,927)	0	(27,927)
2012	0	0	0
2013	(63,577)	0	(63,577)
2014	(196,587)	(37,248)	(159,339)
<b>Total</b>	<b>(\$379,484)</b>	<b>(\$37,248)</b>	<b>(\$342,236)</b>

### **Earnings, Net of Expenses, Understated**

GHI understated investment earnings, less administrative expenses, by \$279,024 for its EHS Retirement Plan Medicare segment, because it used incorrect contributions and transferred prepayment credits and incorrect net transfers and benefit payments (all discussed above) to develop the EHS Retirement Plan Medicare segment pension asset base. In our audited update,

we allocated earnings, net of expenses, based on the applicable CAS requirements. For details on applicable Federal requirements, see Appendix C.

Table 6 below shows the differences between GHI's and our calculations of EHS Retirement Plan Medicare segment earnings, net of expenses.

**Table 6: Earnings, Net of Expenses**

<b>CY</b>	<b>Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	\$149,994	\$142,050	\$7,944
2010	168,687	169,862	(1,175)
2011	59,489	55,065	4,424
2012	350,463	279,356	71,107
2013	69,703	50,774	18,929
2014	787,537	609,742	177,795
<b>Total</b>	<b>\$1,585,873</b>	<b>\$1,306,849</b>	<b>\$279,024</b>

**Assets Transferred Into the EmblemHealth Services, LLC, Employees' Retirement Plan After Merger of Plans**

GHI incorrectly computed the assets transferred into the EHS Retirement Plan Medicare segment as of January 1, 2011. Effective that date, the GHI Cash Balance Plan and HIP Administrators of Florida, Inc., Staff Employees' Retirement Plan merged into the EHS Retirement Plan. GHI identified a transfer of assets totaling \$572,865; however we determined that the correct transfer amount was \$939,629. Therefore, GHI understated the assets transferred into the EHS Retirement Plan by \$366,764. This understatement related directly to the understatement of the GHI Cash Balance Plan pension assets as of January 1, 2011. See our review of the GHI Cash Balance Plan Medicare segment pension assets (A-07-19-00557; Appendix A) for additional details.

**RECOMMENDATIONS**

We recommend that GHI:

- increase the EHS Retirement Plan Medicare segment pension assets by \$432,584 and recognize \$5,633,345 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015, and
- develop quality assurance procedures to ensure that going forward, it calculates Medicare segment pension assets in accordance with Federal requirements.

## **AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

In written comments on our draft report, GHI did not directly address our recommendations. However, GHI's comments suggest that it disagreed with our recommendation to increase the EHS Retirement Plan Medicare segment pension assets by \$432,584 and recognize \$5,633,345 as the EHS Retirement Plan Medicare segment pension assets as of January 1, 2015. GHI's comments (which also apply to our two related reports cited in Appendix A) address only our findings associated with the update of the EHS Retirement Plan Medicare segment pension assets.

A summary of GHI's main points and our responses follows. GHI referred to our disagreement with the long-term interest rate assumption that it used to compute accrued liabilities and normal costs, and cited this disagreement as a reason for the differences between GHI's and our calculations of both the contributions and transferred prepayment credits and the net transfers out. With respect to our finding on participants who transferred in or out of the EHS Retirement Plan Medicare segment and our finding on benefit payments for Medicare segment participants, GHI asked us to provide more detailed information. Finally, GHI said that we provided no explanation or support for our finding regarding the assets transferred into the EHS Retirement Plan after the merger of plans.

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

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

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

### **CONTRIBUTIONS AND TRANSFERRED PREPAYMENT CREDITS**

#### **Auditee Comments**

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

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

### **Office of Inspector General Response**

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

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

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

### **NET TRANSFERS OUT**

#### **Auditee Comments**

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

## **Office of Inspector General Response**

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

## **BENEFIT PAYMENTS**

### **Auditee Comments**

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

## **Office of Inspector General Response**

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

## **EARNINGS, NET OF EXPENSES**

### **Auditee Comments**

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

## **Office of Inspector General Response**

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

## **ASSETS TRANSFERRED INTO THE EMBLEMHEALTH SERVICES, LLC, EMPLOYEES' RETIREMENT PLAN**

### **Auditee Comments**

GHI said that we provided no explanation or support for our calculation of \$939,629 as the correct asset transfer amount after the merger of plans. Therefore, GHI said, it was unable to comment meaningfully on this finding.



## **Office of Inspector General Response**

We disagree with GHI's assertion that we provided no explanation or support for our calculation of the \$939,629 of assets transferred from the GHI Cash Balance Plan into the EHS Retirement Plan. Our related report (A-07-19-00557), which we issued in draft to GHI before we issued the draft report for this review, details our calculations of the \$939,629 Medicare segment pension costs that were subsequently transferred into the EHS Retirement Plan.

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

## **APPENDIX A: AUDIT SCOPE AND METHODOLOGY**

### **SCOPE**

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

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

We performed our fieldwork at GHI located in New York, New York.

### **METHODOLOGY**

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed the annual actuarial valuation reports prepared by GHI's and EmblemHealth's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses, and used this information to calculate the EHS Retirement Plan Medicare segment assets;
- obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the EHS Retirement Plan Medicare segment assets;
- interviewed EmblemHealth and GHI staff responsible for identifying the EHS Retirement Plan Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts;
- reviewed GHI's accounting records to verify the EHS Retirement Plan Medicare segment identification as well as the benefit payments made from the EHS Retirement Plan Medicare segment;
- reviewed the prior segmentation audit performed at GHI (A-07-12-00378) to determine the beginning market value of assets;

- provided the CMS OACT, which provides technical actuarial advice, with the actuarial information necessary for it to calculate the EHS Retirement Plan Medicare segment pension assets from January 1, 2009, to January 1, 2015;
- reviewed the CMS actuaries' methodology and calculations; and
- provided the results of our review to GHI officials on March 19, 2019.

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

- *Group Health Incorporated Understated Its Cash Balance Pension Plan Medicare Segment Pension Assets as of January 1, 2011 (A-07-19-00557)* and
- *Group Health Incorporated Overstated Its Local 153 Pension Plan Medicare Segment Pension Assets as of January 1, 2015 (A-07-19-00562)*.

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 EMBLEMHEALTH SERVICES COMPANY, LLC, EMPLOYEES' RETIREMENT PLAN  
FOR THE PERIOD JANUARY 1, 2009, TO JANUARY 1, 2015**

Description		Total Company	Other Segments	Medicare Segment
Assets January 1, 2009	<u>1/</u>	\$111,862,655	\$111,373,437	\$489,218
Prepayment credits	<u>2/</u>	0	(456,448)	456,448
Contributions	<u>3/</u>	7,888,095	7,888,095	0
Accrued Contributions	<u>4/</u>	21,910,793	21,910,793	0
Other Transactions		0	0	0
Earnings	<u>5/</u>	19,525,480	19,368,765	156,715
Benefit payments	<u>6/</u>	(3,442,840)	(3,383,453)	(59,387)
Administrative expenses	<u>7/</u>	(837,337)	(830,616)	(6,721)
Transfers	<u>8/</u>	0	60,435	(60,435)
Assets January 1, 2010		\$156,906,846	\$155,931,008	\$975,838
Prepayment credits		0	(616,900)	616,900
Contributions		0	0	0
Accrued contributions		15,602,957	15,602,957	0
Other transactions	<u>9/</u>	23,495,606	22,555,977	939,629
Earnings		17,303,023	17,126,790	176,233
Benefit payments		(4,198,331)	(4,166,325)	(32,006)
Administrative expenses		(740,909)	(733,363)	(7,546)
Transfers		0	77,408	(77,408)
Assets January 1, 2011		\$208,369,192	\$205,777,552	\$2,591,640
Prepayment credits		0	(571,818)	571,818
Contributions		11,057,778	11,057,778	0
Accrued contributions		37,009,185	37,009,185	0
Other transactions	<u>10/</u>	7,330,775	7,330,775	0
Earnings		4,510,064	4,443,387	66,677
Benefit payments		(6,424,860)	(6,396,933)	(27,927)
Administrative expenses		(486,208)	(479,020)	(7,188)
Transfers		0	(2,619)	2,619
Assets January 1, 2012		\$261,365,926	\$258,168,287	\$3,197,639
Prepayment credits		0	(584,152)	584,152
Contributions		12,921,137	12,921,137	0
Accrued contributions		25,103,651	25,103,651	0
Other transactions		0	0	0
Earnings		24,960,547	24,602,053	358,494
Benefit payments		(8,263,088)	(8,263,088)	0
Administrative expenses		(559,174)	(551,143)	(8,031)
Transfers		0	72,825	(72,825)
Assets January 1, 2013		\$315,528,999	\$311,469,570	\$4,059,429

Description		Total Company	Other Segments	Medicare Segment
Assets January 1, 2013		\$315,528,999	\$311,469,570	\$4,059,429
Prepayment credits		0	(572,061)	572,061
Contributions		8,135,950	8,135,950	0
Accrued contributions		25,140,000	25,140,000	0
Other transactions		0	0	0
Earnings		5,370,047	5,291,783	78,264
Benefit payments		(9,591,823)	(9,528,246)	(63,577)
Administrative expenses		(587,408)	(578,847)	(8,561)
Discount on Contributions	11/	(1,026,271)	(1,026,271)	0
Transfers		0	157,953	(157,953)
Assets January 1, 2014		\$342,969,494	\$338,489,831	\$4,479,663
Prepayment credits		0	(568,756)	568,756
Contributions		0	0	0
Accrued contributions		10,445,000	10,445,000	0
Other transactions	12/	1,026,271	1,026,271	0
Earnings		51,523,945	50,719,370	804,575
Benefit payments		(53,992,572)	(53,795,985)	(196,587)
Administrative expenses		(1,091,071)	(1,074,033)	(17,038)
Discount on Contributions		(411,530)		0
Transfers		0	6,024	(6,024)
Assets January 1, 2015		\$350,469,537	\$344,836,192	\$5,633,345
Per GHI	13/	350,469,537	\$345,268,776	5,200,761
Asset variance	14/	0	(432,584)	432,584

## ENDNOTES

- 1/ We determined the EmblemHealth Services Company, LLC, Employees' Retirement Plan Medicare segment pension assets as of January 1, 2009, based on our prior segmentation audit of GHI (A-07-12-00378). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segment. All pension assets are shown at market value.
- 2/ 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 Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions include accrued contributions deposited after the end of the CY but within the time allowed for filing tax returns.

- 5/ 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.
- 6/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by GHI.
- 7/ In accordance with the CAS, we allocated administrative expenses to each Medicare segment in proportion to investment earnings.
- 8/ We identified participant transfers between segments by comparing valuation data files provided by GHI. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 9/ Effective December 31, 2010, the GHI Cash Balance Plan and the HIP Administrators of Florida, Inc., Staff Employees' Retirement Plan merged into the EmblemHealth Services Company, LLC, Employees' Retirement Plan. A portion of the merged assets were allocated to the Medicare segment.
- 10/ The Vytra Staff Employee's Pension Plan was merged into the EmblemHealth Services Company, LLC, Employees' Retirement Plan on December 20, 2011. This merger had no effect on the Medicare segment pension assets.
- 11/ In accordance with the CAS Harmonization Rule, effective 2013, contributions made after the end of the plan year are discounted, at the effective interest rate, from the date of each contribution to the last day of the plan year.
- 12/ The Other transactions represent the Accrued Contributions from the prior year.
- 13/ We obtained total asset amounts from documents prepared by GHI's actuarial consulting firm.
- 14/ The asset variance represents the difference between our calculation of the EmblemHealth Retirement Plan Medicare segment pension assets and GHI's calculation of the EmblemHealth Retirement Plan Medicare segment pension assets.

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

### **FEDERAL REGULATIONS**

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

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

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

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

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

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

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

Federal regulations (CAS 413.50(c)(8)) require an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities.

## **MEDICARE CONTRACTS**

The Medicare contracts identify a Medicare segment as:

. . . any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
2. Less than a majority of the salary dollars are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the Medicare contracts state that “. . . the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7).”



**APPENDIX D: EMBLEMHEALTH SERVICES COMPANY, LLC, EMPLOYEES' RETIREMENT PLAN  
COST ACCOUNTING STANDARDS BALANCE EQUATION  
AS OF JANUARY 1, 2015**

Description		Total Company	Other Segments	Medicare Segment
Actuarial Accrued Liability	<u>1/</u>	\$ 285,882,085	\$ 280,652,491	\$ 5,229,594
Less: Actuarial Value of Assets	<u>2/</u>	(350,469,537)	(344,836,192)	(5,633,345)
Unfunded Actuarial Liability	<u>3/</u>	\$ (64,587,452)	\$ (64,183,701)	\$ (403,751)
9904.412-50(a)(2) Unallowable	<u>4/</u>	\$ 18,239	\$ 16,224	\$ 2,015
Prepayment Credit	<u>5/</u>	(118,937,228)	(118,937,228)	-
Adjustments to UAL	<u>6/</u>	\$ (118,918,989)	\$ (118,921,004)	\$ 2,015
Net Unamortized Balance	<u>7/</u>	\$ 54,331,537	\$ 54,737,303	\$ (405,766)
Market Value of Assets	<u>8/</u>	\$ 350,469,537	\$ 344,836,192	\$ 5,633,345

**ENDNOTES**

- 1/ Actuarial accrued liability (AAL) represents the pension cost attributable, under the actuarial cost method in use, to years prior to January 1, 2015. The AAL for January 1, 2015, recognizes 50 percent of the difference between the Minimum Accrued Liability and the Going Concern Accrued Liability in accordance with CAS 412-64.1. We obtained the Total Company AAL from the January 1, 2015, EHS Retirement Plan actuarial valuation report. The AALs for the Other Segment and the Medicare 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 OACT based on audited values as of January 1, 2015.
- 3/ The unfunded actuarial liability (UAL) is the AAL less the AVA as of January 1, 2015. 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/ The sum of the Unallowable and Prepayment balances as of January 1, 2015.
- 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, 2015, plus the current value of any accrued contributions used to fund pension costs assigned to periods prior to January 1, 2015.



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May 30, 2019

**By Email**

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

Re: GHI Response to Draft Report Nos. A-07-19-00557, 00561, & -00562 regarding Medicare Segment Pension Assets

Mr. Cogley:

Group Health Inc. (“GHI”) respectfully provides the following responses to the above-referenced Office of the Inspector General (“OIG”) draft reports regarding GHI’s Medicare Segment Pension Assets for its Cash Balance Plan as of January 1, 2011 (Report No. -00557), the Employees’ Retirement Plan as of January 1, 2015 (Report No. -00561), and the Local 153 Pension Plan as of January 1, 2015 (Report No. -00562). GHI welcomes OIG’s completion of these segmentation audits, and looks forward to the prompt completion of OIG’s audits of GHI’s pension costs for the periods covered in these reports.

The above-referenced draft reports make findings in five broad categories. GHI’s responses to each category of findings is set forth below:

**Contributions and Transferred Prepayment Credits (All Reports).** OIG disagrees with the long-term interest rate assumptions that GHI employed to compute accrued liabilities, which affect GHI’s calculation of contributions and prepayment credits. GHI’s position regarding the appropriate long-term interest rate assumption has not changed since its October 13, 2016 letter to you.

**Net Transfers Out (All Reports).** It is unclear from the draft reports whether OIG’s concerns regarding net transfers out is based entirely on the impact of OIG’s disagreement with GHI’s long-term interest rate assumption, or if OIG also disputes which participants transferred to/from the Medicare segment. If OIG’s position is based, in part, on a dispute regarding the identity of the transferred plan participants, please identify the participants in dispute and which segment OIG believes those individuals transferred to/from for each year.

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**Benefit Payments (All Reports).** Please provide an electronic listing of the benefit payments, by participant, that OIG believes are the correct benefit payments for each year.

**Earnings, Net of Expenses (All Reports).** GHI understands OIG's position regarding investment earnings, net of expenses, to be derivative of OIG's other findings. Accordingly, GHI incorporates its responses to OIG's other findings here. If OIG's position regarding earnings, net of expenses, is based on additional concerns not captured within OIG's other findings, please identify those concerns.

**Asset Transferred Into the EmblemHealth Services, LLC Employee's Retirement Plan After Merger of Plans (Report No. -00561).** OIG states that the correct transfer amount is \$939,629, but provides no explanation or support for that calculation. GHI therefore is unable to comment meaningfully on this finding.

Please let me know if you have any questions regarding GHI's response to your draft reports.

Sincerely,



Daniel P. Graham

cc: Daniel Byrne  
Tony Angi