

Lighting the Way



Palmetto GBA 2003 Annual Report

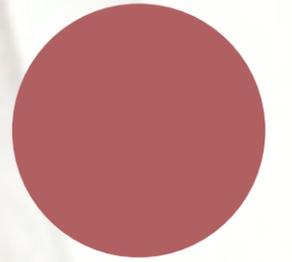
Palmetto GBA 2003 Annual Report



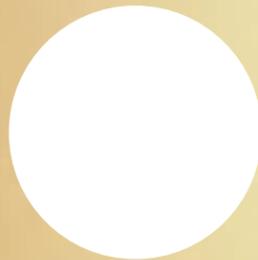


Lighting the Way

With almost **38 years** of Medicare Program experience, **Palmetto GBA** is one of the nation's largest and most **diverse Medicare contractors**. Headquartered in Columbia, South Carolina, Palmetto GBA is a wholly-owned subsidiary of BlueCross BlueShield of South Carolina. Our **expertise** in Medicare claims processing combined with our **dedication** to operational ethics has allowed us to **expand** nationally and employ approximately 2,500 **associates** in our offices in Florida, Georgia, Illinois, North Carolina, Ohio, West Virginia and throughout our home state.



We provide an array of services to **healthcare facilities, doctors** and **patients** in all 50 states, two U.S. Territories and the District of Columbia. In addition to Medicare claims processing, we provide **customer service** and **provider education**, process **appeals**, and conduct pre-payment **medical review**, Medicare Secondary Payor and Electronic Data Interchange functions under our **Medicare contracts**.



We are the only Medicare contractor with **experience** in **all Medicare** business segments—Medicare Part A, Medicare Part B, Durable Medical Equipment and Regional Home Health and Hospice. As **one of four** Durable Medical Equipment Regional Carriers in the country, we **process claims** so that suppliers of wheelchairs, crutches, prosthetics, orthotics, surgical dresses and other medical supplies can be reimbursed. We also **conduct statistical analysis** for all four Durable Medical Equipment Regional Carriers, **safeguarding** the national Medicare program by **protecting** it from fraudulent activities.

As a major Medicare contractor, we have been **entrusted** with **administering** health insurance claims for many of our nation's elderly and disabled citizens. Offering these

customers our **dedication, honesty and integrity**, in addition to outstanding **service and quality**, is central to our **value system** and the key to our **continued success**. Our solid corporate **infrastructure** and investment in the **skill sets** of our **associates** have given us the capacity and flexibility to **respond** to environmental changes quickly. At Palmetto GBA, we foster an atmosphere of **innovation, expertise and recognition** that motivates our entire organization. Our associates' collective energy is the **shining force** that has allowed us to become **the industry leader** we are—consistently **outperforming** expectations, breaking new ground, **venturing** into unexplored territory and **beckoning** others to follow.

Together, we are truly *lighting the way*.

Lighting the Way



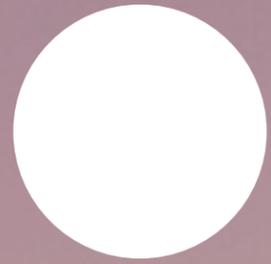
building a culture of **trust** and **reliability**

Lighting the Way

maintaining our competitive edge through a **quality management system**



Lighting the Way



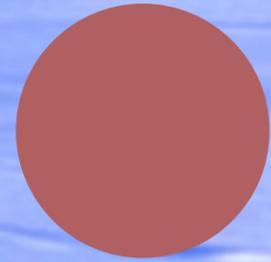
celebrating the integrity and dedication of
our people



Lighting the Way

James Williams, George Stiles, Donna Miller, Harriett Shepherd, Melissa White,

Nick Rinius, Jimmy Ray, Dana Fleming, Kenny Cross, Nadi Shuler, Lynn Messer, Mercedes Courtenay, Jill Armbruster

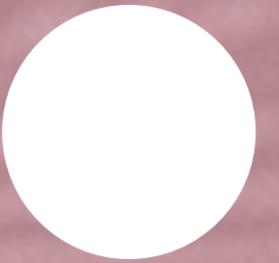


offering **technical
expertise** to our customers

Lighting the Way



Lighting the Way



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letter from the **president**
William R. Horton



The theme of this report—lighting the way—reflects Palmetto GBA's past, present and future. Our past reveals a company that has been the leader, continually outperforming even the highest of expectations. Our present reveals a company that is looking within to shed new light on even better ways to distinguish ourselves. Our future reveals an organization that is going where we have not ventured before.

In 2003, we continued to realize our vision by maintaining our position as the largest Medicare contractor in the nation. We achieved this success because every associate at Palmetto GBA embraces our commitment to excellence. Our performance allowed us to exceed our customers' expectations in 2003 and has positioned us to evolve our strategic direction.

In 2003, we defined our organizational goals for the next three years. Our primary goal is to achieve revenue growth that will provide the capital reserves needed to support growth with our current customers and future partners. While we are increasing our efforts to create growth in new markets, we will continue to perform in a manner that has gained the confidence of the Centers for Medicare and Medicaid Services (CMS).

Palmetto GBA stands ready to partner with CMS to implement the Medicare Prescription Drug and Improvement and Modernization Act (MMA). We are excited about what the future holds for our organization as a result of this new legislation that will significantly improve healthcare for senior citizens. The strength of our values and skills of our associates will allow our organization to embrace change and opportunity in the face of contractor reform.

Palmetto GBA has become an industry leader through the hard work and devotion of each one of our associates. Our commitment to customer satisfaction and flexibility as an organization is seen in the recognition and awards our associates and our company have received this year. We wouldn't be at the top without our associates' commitment to company values and our customers.

Our direction is clear, our resolve is sound and our future is bright.

William R. Horton

William R. Horton
President
Palmetto GBA

Lighting the Way



letter from the
chief operating officer

Bruce W. Hughes



In 2003, we raised the bar on the level of excellence we provide to our customers—the Centers for Medicare and Medicaid Services (CMS), beneficiaries and providers. We stepped up our efforts to evaluate our processes, approaches and strengths and sought out areas for improvement. We have been relentless in our pursuit to improve the performance of not only our organization, but also each department, team and individual player in accordance with our customers' needs.

Our efforts have been rewarded.

Our revenue exceeded 2002 earnings by \$35 million. We have maintained our position as one of the best Medicare contractors in the nation. We processed 104,015,538 claims, served 10,212,775 beneficiaries and paid more than \$22 billion in benefits. Our business development efforts resulted in more than \$3 million in additional revenue.

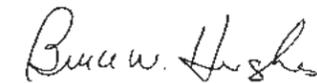
We are continuing to pursue expansion and diversification. Our associate morale survey reflects that the people of Palmetto GBA are proud to be a part of our family. And most important, all of our successes in 2003 were realized because they were built on a foundation of honesty and integrity.

This past year, we sharpened our company's focus and implemented a Strategic Planning Model designed to bring about growth in current and future markets. This model is the guidebook for the future direction of Palmetto GBA. Through detailed analysis of our history, our successes and our strengths, we formulated a plan that is enabling us to become a self-funded organization by increasing the scale and market share of our CMS business and diversifying our customer base. The plan outlines our three key strategic goals and the 11 key company activities that will ensure that we meet those goals. It also includes a set of clearly defined measures that will allow us to see exactly how closely we are sticking to the plan at any given time. This also will let us change processes to quickly correct any deviation from the path.

Our 2003-2005 Strategic Planning Model provides a blueprint for growth while allowing us to maintain the level of service our current customers are accustomed to receiving. Anticipating the needs and expectations of our current customers while reaching out to new markets is the key to continued success. Through the implementation of the new Strategic Planning Model this year, every one of our associates understands that their actions and the momentum they create drive the accomplishment of our goals and ultimately, the mission of our organization. We've backed their efforts by providing the best in technical training and professional development opportunities, allowing Palmetto GBA to jump when opportunity arises.

Palmetto GBA was built on a foundation of trust and values—values that incorporate everything from honoring the privacy of each beneficiary to instilling a company-wide system of total quality management. Without our value system in place, 2003 wouldn't have been the great success it proved to be. We hope that our story inspires you and that our excitement is contagious.

After all, we're going where no one has gone before, lighting the way.



Bruce W. Hughes
Executive Vice President and Chief Operating Officer
Palmetto GBA



Lighting the Way



trust

is the basis of our corporate culture. Our fundamental business rule is that we must approach and handle all of our activities with the highest ethical standards and rate of reliability possible. To do this, we understand that we must control, evaluate and routinely assess operations.

More important, at Palmetto GBA, compliance with Medicare law and regulations is part of our culture, not just a program we've implemented.

We train all associates to ensure that they understand our culture of compliance. Our associates take personal responsibility for their jobs and the outcome of their work.

In 2003, Palmetto GBA received Healthcare Best Compliance Practices Forum recognition for our Management Control Review (MCR) process from the Health Ethics Trust (HET). The HET, a division of the Council of Ethical Organizations, started the best practices initiative to build awareness, offer a structured forum for information exchange and recognize outstanding organizational compliance programs. The key criterion for which we received the best practice recognition includes achievement of a fully integrated internal review process, or audit, of our compliance with applicable laws and regulations as well as a review of our internal controls. This recognition also means that we review and act on the results of the MCR process.

The trust that other organizations place in our hands is also indicative of our corporate value system at work. In November 2000, Palmetto GBA began serving as a pilot contractor for the CMS Healthcare Integrated General Ledger and Accounting System (HIGLAS) Project. Once complete, this project will provide an integrated financial system for CMS, providing accurate and consistent financial data. Our role as a pilot contractor is to help develop and test the HIGLAS solution. On-site testing began in October 2003. The Palmetto GBA HIGLAS team, comprised of experts from our CFO Reporting, Accounts Receivable/Accounts Payable and Banking and Claims Processing areas, was integral to the success of the pilot. During the pilot test, the team was responsible for the execution of 2,087 test scripts and for processing 94,915 claims with a dollar value of



\$114,341,711. CMS, with the continued assistance of Palmetto GBA, is now prepared to move into the next phase of the pilot, User Acceptance Testing, in the summer of 2004.

As a Medicare contractor, we are responsible for engaging in activities that protect the Medicare trust fund. Our Program Safeguard activities (Fraud and Abuse, Medicare Secondary Payor, Medical Review and Provider Audit) result in significant savings for Medicare. In 2003, Palmetto GBA's efforts resulted in the Medicare savings detailed below.

Medicare Summary of Savings 2003

	Part A	Part B	DMERC	RRB	Total
Fraud and Abuse	\$1,139,566	\$52,562	\$116,356,925	\$586,223	\$118,135,276
Medicare Secondary Payor	\$245,646,685	\$75,856,959	\$29,318,377	\$6,583,407	\$357,405,428
Medical Review	\$17,112,980	\$25,787,715	\$291,110,289	\$17,249,743	\$351,260,727
Provider Audit	\$28,710,955				\$28,710,955
TOTAL SAVINGS	\$292,610,186	\$101,697,236	\$436,785,591	\$24,419,373	\$855,512,386

In 2003, we negotiated an agreement with CMS in which we are assuming additional cost report audit and reimbursement workload. Under the terms of this agreement, Palmetto GBA is reviewing and settling Medicare cost reports submitted by End Stage Renal Disease (ESRD) facilities. The Springfield, Illinois office took the lead on integrating the new workload by developing the necessary work instructions, procedures and training tools to meet CMS audit expectations and internal control objectives. This agreement represents a significant addition to the Palmetto GBA Provider Audit workload. Its estimated value is \$3,364,000. The audit office will perform 1,475 desk reviews, 69 audits and 1,475 settlements in 2004. The Palm Harbor, Florida and Columbia, South Carolina offices are assisting with the field reviews.

Lighting the Way



We are dedicated to offering our customers the highest level of service possible. Although we achieve high levels of satisfaction by incorporating customer feedback into our processes, we rely heavily on a

quality management system.

This system of internal evaluation ensures that continuous analysis and improvement of our processes translate into better results for our company and our customers.

Achieving ISO (International Standards Organization) 9000 registration, keeping pace with the latest technological advances, forming creative alliances and encouraging innovation are just a few ways we're lighting the way.

In 1993, we formed the Palmetto Quality Council and selected a director of total quality management. The director provides oversight of our quality management program. The director also coordinates implementation of the ISO 9000 quality management system across all divisions at Palmetto GBA. ISO 9000 is a prestigious certification that assures customers that a company has implemented this internationally recognized quality management system and has successfully passed detailed audits by a third party registrar. Currently, 70% of our associates are working under the ISO 9000 quality management system. We will employ the remaining 30% of the associates in certified areas by summer 2005. ISO 9000 registration ensures that we maintain our competitive edge by improving the quality and consistency of the services we provide.

We celebrate innovation and quality improvement at Palmetto GBA through our Partners in Excellence (PIE) program. Established in 1993, this program rewards employees for creative problem solving that results in process improvement, greater efficiency or monetary savings. In September 2003, our PIE program reached its 10-year anniversary and it is still going strong. The PIE program is based on five key principles: customer focus, teamwork, empowerment, data-based decision making and continuous quality improvement. These principles establish the framework of quality improvement and innovation at Palmetto GBA. The principles also ensure that success is defined through customer feedback, that our corporate culture projects an atmosphere of teamwork and continuous quality improvement, and that we use objective data to evaluate our processes.

In October 2002, Palmetto GBA entered into an innovative arrangement with CMS for its Durable Medical Equipment Regional Carrier (DMERC) contract, the Fiscal-Year 2003 Medicare Performance Contracting Pilot, in which we tested a new performance-based monetary incentive program. In 2003, we met the required 90% of acceptable quality levels, earning an incentive award. We will continue to participate in the performance-contracting pilot in 2004.

In 2003, we completed two processing system conversions. First, we completed the conversion from the Health Care Finance Administration (HCFA) Part B Standard System (HPBSS) to the Multi-Carrier System (MCS) for our Railroad Medicare operation on June 1, 2003. This 15-month system conversion project required process re-engineering throughout the Railroad Part B Operation in Augusta, Georgia. The Railroad Operation met all timeliness and quality standards upon completion of this conversion.

We also converted from the Arkansas Part A Standard-System (APASS) to the Fiscal Intermediary Standard System (FISS) for our North Carolina Part A Operation. This project has been deemed by CMS as "setting the bar by which other conversions will be measured." The conversion was accomplished over a nine-month period with a December 1 cut over. The North Carolina Operation met all performance standards for the month of December.



Lighting the Way



Our people

are our greatest resource. Our associates' depth of knowledge, experience and desire for success is unparalleled. They display uncompromising integrity and personify our value system of trust and compliance.

Their community spirit, commitment and willingness to take on challenges are made evident through the special recognition they have received as well as feedback that our customers have given us. Their dedication to and vision for Palmetto GBA is lighting the way into our future.

Exemplary Customer Service Awards

In 2003, CMS began citing companies for exemplary customer service. CMS honored Palmetto GBA and two of our Ohio employees with this award. We won for customer service provided under our Part B contract, which serves beneficiaries in South Carolina, Ohio and West Virginia, and our Regional Home Health and Hospice contract in 16 states. Patricia Schwenk and Julie Leonard, who both work in Palmetto GBA's office in Grove City, Ohio, received certificates of merit for customer service and were honored for their dedication to Medicare Part B beneficiaries in Ohio and West Virginia. In a letter to Palmetto GBA, Thomas Kickham, director of Beneficiary Services and Partnership Group for CMS, said, "This award signifies that you and your organization understand the value of supporting people with Medicare and have shown this by superior customer service."

Process Improvement of the Year

At Palmetto GBA, we are always looking for ways to conduct our core business functions in a more efficient manner while maintaining exceptional quality. The Palmetto GBA process improvement of the year, received by the Railroad Medicare Office in Augusta, Georgia, focused on a key element of claims processing – the manner in which work is assigned. The goal of the process improvement was to create a claims dispatcher system that would automate the sign-out of work according to the date it was received. The information was then posted online internally using an intranet-based reporting system.

Achievement of this goal facilitated accountability while providing a real-time snapshot of the number of claims pending and the date claims were received. True to the intent of successful process improvement, the Railroad Medicare Operation shared this best practice with the Ohio Part B Operation and TrailBlazer Health Enterprises, Palmetto GBA's sister company. This innovation can substantially improve the workflow of any Medicare Operation that uses the Multi-Carrier System to process claims.

Team of the Year

The South Carolina Part B Provider Enrollment Team works to process applications for physicians and suppliers seeking to enroll in the Medicare program. Once providers or suppliers are enrolled in Medicare, Provider Enrollment keeps the files updated and ensures only properly licensed individuals receive reimbursement. Through innovation, team building, extensive training and process improvements, the team was very successful in 2003. Within one year of their extensive rebuilding, this new team developed a workload database to assist with monitoring workflow and developed an online tutorial to guide and educate the provider community on the initial enrollment process. They also met CMS timeliness and quality standards required for the project. And within the same time frame, they achieved ISO 9000 registration.

Associate of the Year

Angela Horne has been a Palmetto GBA associate for 10 years, working almost three years in the Durable Medical Equipment Regional Carrier (DMERC) Operation. Her excellent job performance, proven leadership and commitment to her associates exemplifies everything the Associate of the Year award stands for. The zero percent error rate she achieved in 2003, beating the CMS expectation of 3% or less, is a feat worthy of celebration. As the process improvement team leader in 2003, Angela also led her team to implement a process improvement that reduced process cycle time, resulting in \$37,918 in annual savings. Angela has consistently shown a commitment to DMERC's customers, the supplier community and Medicare beneficiaries, through her efforts to improve team and divisional performance. Angela personifies what it takes to be a true associate leader at Palmetto GBA. She is a shining example of someone who has an exemplary work ethic and is readily available to offer assistance and share her knowledge and expertise with others.

Provider Survey

We are committed to serving our provider community. Our annual Provider Satisfaction Survey results show sustained overall satisfaction with our performance each year. Over the past five years, we have increased our excellent/good rating by approximately 11%. Since one of our goals is to remain responsive and available to our provider community, this feedback confirms that we are improving the service we offer providers every year. We are committed to preserving and further developing our partnership with providers in the mutual interest of the beneficiaries that we serve.

Provider Survey Results: Five-Year History of Excellent/Good Ratings

	1999	2000	2001	2002	2003
Part A	79	82	81	87	88
Part B	65	71	72	76	77
DMERC	69	78	77	75	75
SADMERC	80	80	79	78	79
NSC	56	60	59	67	69
RRB	N/A	N/A	62	67	72

Example: An 88 rating on Part A operations should be interpreted as "88% of providers who were surveyed rated satisfaction on our Part A operations as excellent or good."

Beneficiary Survey

Every year we survey our beneficiaries to see how our performance is measuring up to their expectations. The results demonstrate that our customers value the services we provide. For 2003, an average of 97% of our beneficiaries rated our service on Medicare Part A, Medicare Part B and Durable Medical Equipment Regional Carrier operations as either excellent or good. We use survey feedback to continuously improve the quality of the service we offer our beneficiaries.

Beneficiary Survey Results: Five-Year History of Excellent/Good Ratings

	1999	2000	2001	2002	2003
Part A	89	97	97	96	97
DMERC	96	94	96	95	95
Part B	95	95	96	98	98
RRB	N/A	N/A	N/A	N/A	97

Example: A 97 rating on Part A operations should be interpreted as "97% of beneficiaries who were surveyed rated satisfaction on our Part A operations as excellent or good."



Our high level of **technical expertise** and business development efforts led to the award of several new contracts in 2003. We are lighting the way for our industry, our company and our employees by providing technical training to our associates so they can not only handle the tasks at hand, but also adapt quickly in a changing environment.

Our associates' understanding of data, software and the inflow and outflow of information in a safe, efficient manner is a big reason that we are one of the top Medicare contractors in the nation, and the primary reason our expertise is sought out.

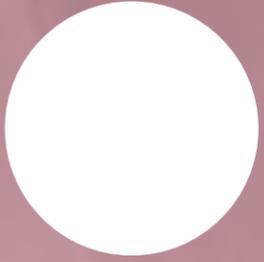
In 2003, we were awarded the CMS Customer Support and Service Center Task Order under the Telephone Customer Service Strategy contract. Through this contract, we support customer service and transaction processing for Medicare + Choice Managed Care Organizations in their submission of risk adjustment data.

CMS also recently awarded us the Next Generation Desktop (NGD) Business Process Standardization and Training Materials Development contract. The NGD is a desktop application that all customer service representatives (CSRs) will use to respond to telephone and written inquiries. We will develop these training materials in stages and refine them as we deploy nationwide over the next several years. The NGD Business Process Standardization will not only condense the training period for CSRs, but it also will allow contractors to view other contractors' claims or service information in reference to a specific beneficiary or provider.

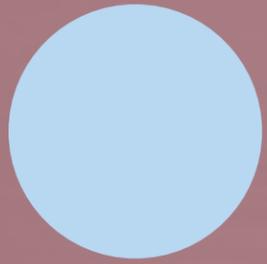
At Palmetto GBA, we're capitalizing on our experience and technical expertise in securing other CMS initiatives. In 2003, we assumed the national Single Drug Pricer (SDP) activities. The SDP was developed to ensure a uniform payment allowance by

establishing prices centrally, resulting in greater consistency in drug pricing nationally. As national Single Drug Pricer (SDP), our Pricing Division reviews all drug claims paid by other carriers, creates Average Wholesale Price (AWP) files for CMS, and provides pricing updates for Part A, Part B and DMERC. CMS has suggested that standardizing drug pricing and revising drug reimbursement rates will result in significant savings.

The Railroad Medicare Operation in Augusta, Georgia successfully converted the Ohio paper claim workload from manual data entry to optical character recognition technology. This technology provides immediate online retrieval of claims and significantly reduces processing time, which translates into savings. This conversion saved \$200,000 in 2003. We're anticipating a savings of \$400,000 in 2004.



Lighting the Way



Palmetto GBA didn't become the largest Medicare contractor in the nation without extraordinary **effort**. We realize that to stay competitive, we must **challenge** the **status quo**, raise **expectations** and constantly measure our **progress**. We set new **goals** to ensure the future **success** of our organization. At Palmetto GBA, we have **committed** to linking these **strategic** goals to our **daily** activities.

The **principles** that Palmetto GBA was founded upon guide us toward **becoming** a better organization, a better work place and a **better community partner**. The **trust** that our customers place in our hands can never be taken for granted. We must treasure our

rich history and honor the **dedication** of so many **associates** by sticking to our **values** and striving to be an **industry role model** worthy of emulation.

In the **future**, we will achieve **growth** by taking appropriate actions to remain one of CMS's "**preferred**" **partners** while seeking to form new **relationships** in different areas of business. Our associates will remain the **drivers** of our **success**, always **exceeding** standards and meeting **customers'** needs. We will continue to reward **innovation** and capitalize on our **skills**. We will remain **dedicated** to our approach.

Our priorities are clear—and we are *lighting the way*.

Lighting the Way

financials and statistics

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Ernst & Young LLP
Suite 2800
600 Peachtree Street
Atlanta, Georgia 30308-2215

Phone: (404) 874-8300
www.ey.com

Report of Independent Auditors

Board of Directors
Palmetto GBA, LLC

We have audited the accompanying balance sheets of Palmetto GBA, LLC (the "Company") as of December 31, 2003 and 2002, and the related statements of operations, changes in member's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Palmetto GBA, LLC at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

February 13, 2004

Palmetto GBA, LLC

a single-owned limited liability company owned by BlueCross BlueShield of South Carolina

Balance Sheets

	in thousands	
	2003	2002
Assets		
Current Assets:		
Cash and cash equivalents	\$ 4,332	\$ 3,168
Short-term investments	4,014	-
Accounts receivable, net	26,353	3,745
Accounts receivable from affiliates	813	-
Prepaid expenses	3	-
Deferred income taxes	1,718	-
Total current assets	<u>\$ 37,233</u>	<u>\$ 6,913</u>
Long-term Assets:		
Fixed assets, net of accumulated depreciation of \$1,447 in 2003	\$ 5,061	\$ -
Long-term investments	2,972	2,564
Investment in affiliate	1,484	656
Deferred income taxes	269	189
Total long-term assets	<u>9,786</u>	<u>3,409</u>
Total assets	<u>\$ 47,019</u>	<u>\$ 10,322</u>
Liabilities and Member's Equity		
Current Liabilities:		
Accrued payroll, taxes and benefits	\$ 17,257	\$ -
Payable to parent	8,309	2,147
Payable to other affiliates	-	113
Other liabilities	7,351	587
Total current liabilities	<u>\$ 32,917</u>	<u>\$ 2,847</u>
Long-term Liabilities:		
Deferred income taxes	66	3
Total long-term liabilities	<u>\$ 66</u>	<u>\$ 3</u>
Member's Equity:		
Contributed capital	\$ 10,187	\$ 4,389
Retained earnings	3,676	3,274
Accumulated other comprehensive income (loss)	173	(191)
Total member's equity	<u>14,036</u>	<u>7,472</u>
Total liabilities and member's equity	<u>\$ 47,019</u>	<u>\$ 10,322</u>

Statement of Operations

	in thousands	
	2003	2002
Revenues:		
Medicare Part A	\$ 52,480	\$ 50,708
Medicare Part B	50,065	29,905
Durable Medical Equipment Regional Carrier	66,235	57,156
Railroad Retirement Board	21,321	19,088
DDI System Access	2,608	3,239
Other Contracts	5,832	3,444
Total Revenues	<u>\$ 198,541</u>	<u>\$ 163,540</u>
Expenses:		
Medicare Part A	\$ 53,447	\$ 51,262
Medicare Part B	50,657	30,204
Durable Medical Equipment Regional Carrier	65,862	57,801
Railroad Retirement Board	21,534	19,308
DDI System Access	1,595	1,622
Other Contracts	5,109	2,817
Other Administrative Expenses	534	254
Total Expenses	<u>\$ 198,738</u>	<u>\$ 163,268</u>
(Loss) Gain from Operations	\$ (197)	\$ 272
Investment Income, Net	770	270
Income Before Income Taxes	573	542
Provision for Income Taxes	\$ 171	\$ 150
Net Income	<u>402</u>	<u>392</u>

Statements of Changes in Member's Equity

in thousands

	Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2002	\$ 3,959	\$ 2,882	\$ 10	\$ 6,851
Net income	-	392	-	392
Change in unrealized losses on securities classified as available-for-sale	-	-	(201)	(201)
Total comprehensive income	\$ -	\$ -	\$ (201)	\$ (191)
Contribution of capital	430	-	-	430
Balance December 31, 2002	\$ 4,389	\$ 3,274	\$ (191)	\$ 7,472
Net income	\$ -	\$ 402	\$ -	\$ 402
Change in unrealized gains on securities classified as available-for-sale	-	-	364	364
Total comprehensive income	\$ -	\$ -	\$ 364	\$ 766
Contribution of capital	5,798	-	-	5,798
Balance December 31, 2003	\$ 10,187	\$ 3,676	\$ 173	\$ 14,036

Statement of Cash Flows

in thousands

	2003	2002
Cash Flows from Operating Activities:		
Net Income	\$ 402	\$ 392
Adjustments to Reconcile Net Income to Net Cash Provided from Operating Activities:		
Depreciation and amortization	1,496	3
Loss on fixed asset disposals	5	-
Realized loss on investments	48	52
Equity in (income) of affiliate	(384)	(174)
Deferred income tax provision	(1,735)	(60)
Changes in Operating Assets and Liabilities:		
(Increase) decrease in accounts receivable	(22,608)	392
(Increase) in receivables from affiliates	(813)	-
(Increase) in prepaid expense	(3)	-
Increase in accrued payroll, taxes and benefits	17,257	-
Increase in payable to parent	6,162	452
(Decrease) in payable to other affiliates	(113)	(69)
Increase in other liabilities	6,764	250
Net Cash Provided from Operating Activities	6,478	1,238
Cash Flows from Investing Activities:		
Fixed assets purchased	(6,551)	-
Investments redeemed - held-to-maturity	357	951
Investments sold - available-for-sale	6,339	264
Investments purchased - held-to-maturity	(109)	(1,352)
Investments purchased - available-for-sale	(10,704)	(1,861)
Capital contribution to affiliate	(444)	(188)
Net Cash Used in Investing Activities	(11,112)	(2,186)
Cash Flows from Financing Activities:		
Capital contribution from parent	5,798	430
Net Increase (Decrease) in Cash and Cash Equivalents	1,164	(518)
Cash and Cash Equivalents, Beginning of Year	3,168	3,686
Cash and Cash Equivalents, End of Year	\$ 4,332	\$ 3,168
Supplemental Disclosures of Cash Paid During the Year for:		
Interest	\$ 34	\$ -
Income Taxes	\$ 38	\$ 156

Notes To Financial Statements

Note 1—Basis of Presentation And Summary of Significant Accounting Policies

Palmetto GBA, LLC (the “Company”) is a single-member limited liability company organized on January 1, 1998. The Company’s sole member is Blue Cross and Blue Shield of South Carolina (“BCBSSC”). The Company is engaged in the business of providing Medicare Part A fiscal intermediary services, Medicare Part B carrier services and Medicare Durable Medical Equipment Regional Carrier services in various states. These services include health insurance claims processing and payment, customer service for Medicare beneficiaries and health care providers, and payment safeguard functions designed to detect and prevent fraud and abuse in the Medicare program. The Company provides services to Medicare beneficiaries residing in several states, Puerto Rico and the U.S. Virgin Islands. The Company’s major customer is the Centers for Medicare and Medicaid Services (“CMS”), the federal agency with fiduciary responsibility for the Medicare program.

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Significant accounting policies and the methods of applying those policies are summarized below.

Cash Equivalents

Cash equivalents represent certificates of deposit that have maturities of less than three months at date of purchase and money market fund investments.

Short-term Investments

Short-term investments are classified as available-for-sale and are carried at fair market value. Such investments have maturities of less than one year at the balance sheet date. Realized gains and losses are computed using the specific identification method.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of short-term investments in overnight repurchase agreements.

Financial Instruments

The Company holds certain financial instruments as defined by Financial Accounting Standards Board Statement No. 107, including cash and accounts receivable. Management believes that the carrying values of financial instruments approximate fair value. The Company also holds investments for which the fair values are disclosed in Note 3.

Asset Valuation Allowances

The Company recorded an allowance for uncollectible receivables in the amount of \$21,000 and \$1,000 at December 31, 2003 and 2002, respectively.

Fixed Assets

Fixed assets for the Company were recorded on the books of BCBSSC until January 1, 2003 at which time they were transferred to the Company in exchange for a promissory note. The note was subsequently liquidated through a capital contribution from BCBSSC. The net book value of fixed assets transferred from BCBSSC to the Company was \$5,193,000.

Fixed assets are stated at cost. Depreciation on new assets purchased is computed using the straight-line method over the estimated useful lives of the respective assets: four to eight years for furniture and fixtures, three years for data processing equipment, and four years for automobiles. Leasehold improvements are depreciated over the lesser of the remaining lease term or estimated useful life of the asset. Depreciation on used assets purchased is computed by using the straight-line method over the estimated remaining useful lives at the time of purchase of the respective assets.

Investments

Investments are comprised of common stocks, bonds, United States Government mortgage-backed securities and money market mutual funds. These assets are accounted for in accordance with Financial Accounting Standards Board Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (“Statement No. 115”). Statement No. 115 requires that fixed maturities are to be classified as either “held-to-maturity”, “available-for-sale”, or “trading”.

Management determines the appropriate classification of its fixed maturity securities at the time of purchase and reevaluates such designation as of each balance sheet date. Fixed maturity securities are classified as held-to-maturity when the Company has the positive intent and ability to hold them to maturity. Held-to-maturity securities are stated at amortized cost, adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization as well as interest earned is included in investment income. Fixed maturity and equity securities not classified as held-to-maturity are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized

gains and losses reported in member's equity. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and interest earned is included in investment income. The cost of securities sold is based on the specific identification method. At December 31, 2003 and 2002, the Company classified all of its debt securities as held-to-maturity and all of its equity securities as available-for-sale. The Company's equity investments are substantially concentrated in industrial stocks. Fair values for fixed maturities and short-term investments are based on quoted market prices, where available. For fixed maturities not actively traded, fair values are estimated using values obtained from independent pricing services. The fair values for common stocks are based on quoted market prices.

Investment in Affiliate

The Company has a 25% interest in TriCenturion, LLC that is accounted for using the equity method. The Company's proportionate share of earnings or losses of this affiliate are reflected in income as earned and dividends or distributions are credited against investment in affiliate when received.

During 2003 and 2002, the Company contributed capital of \$444,000 and \$188,000, respectively, to TriCenturion, LLC.

Assets, liabilities and results of operations for TriCenturion, LLC were as follows:

dollars in thousands	2003	2002
Assets	\$ 9,002	\$ 3,645
Liabilities	\$ 3,074	\$ 1,031
Net Income	\$ 1,538	\$ 697

Revenue Recognition Policies

The Company recognizes revenues based upon allowable costs incurred which are reimbursable under the terms of the following contracts:

- Medicare Part A Fiscal Intermediary subcontract between BCBSSC and the Blue Cross and Blue Shield Association (BCBSA) (this includes the Regional Home Health Intermediary subcontract)**
- Medicare Part B Carrier Services contract between BCBSSC and CMS**
- Durable Medical Equipment Regional Carrier (DMERC) contract between BCBSSC and CMS (this includes the National Supplier Clearinghouse contract and the Statistical Analysis DMERC contract)**
- National 1-800 Beneficiary Telephone Inquiries (IDIQ) contract between BCBSSC and CMS (this includes the Managed Care Disenrollment task order)**
- Railroad Retirement Board Part B Carrier contract between the Company and the Railroad Retirement Board

**These contracts are executed to the Company under a special power of attorney given by BCBSSC.

The Company recognizes revenue on the DDI System Access contracts with various third parties when services are performed and billable.

Note 2—Fixed Assets

Fixed assets consist of the following:

dollars in thousands	2003
Leasehold Improvements	\$ 357
Equipment, furniture and fixtures	\$ 5,440
Software	\$ 690
Automobiles	\$ 21
	\$ 6,508
Accumulated Depreciation	(1,447)
	\$ 5,061

Note 3—Investments

Short-term investments consist of an investment in an Adjustable Rate Mortgage Fund at December 31, 2003. There were realized losses of \$39,000 during the year. A holding loss of \$42,000 is reported in accumulated other comprehensive income on the accompanying balance sheet.

Long-term investments consist of the following :

dollars in thousands	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2003				
Bonds & mortgage-backed securities—held-to-maturity				
	\$ 964	\$ 55	\$ 26	\$ 993
Common stocks—available for sale				
	1,780	274	46	2,008
	\$ 2,744	\$ 329	\$ 72	\$ 3,001
December 31, 2002				
Bonds & mortgage-backed securities—held-to-maturity				
	\$ 1,223	\$ 41	\$ 9	\$ 1,255
Common stocks—available for sale				
	1,532	31	222	1,341
	\$ 2,755	\$ 72	\$ 231	\$ 2,596

Expected Maturities Of Debt Securities

The amortized cost and estimated market values of held-to-maturity debt securities, by contractual maturity, at December 31, 2003 are as follows:

dollars in thousands	Book Value	Market Value
Held-to-maturity Securities:		
Due in 1 or less years	\$ -	\$ -
Due in 1 through 5 years	408	441
Due in 5 through 10 years	197	219
Due after 10 years	-	-
	605	660
Mortgage-backed Securities	359	333
Total Held-to-maturity	\$ 964	\$ 993

There were gross realized gains of \$53,000 and gross realized losses of \$62,000 during the year ended December 31, 2003. There were gross realized gains of \$12,000 and gross realized losses of \$64,000 during the year ended December 31, 2002. Gross unrealized holding gains and (losses) on securities classified as available-for-sale in the amounts of \$274,000 and (\$46,000), respectively, at December 31, 2003 and gross unrealized holding gains and (losses) of \$31,000 and (\$222,000), respectively, at December 31, 2002, are reported in accumulated other comprehensive income in the accompanying balance sheets. No cash or assets are pledged or restricted for any purpose.

The Company experienced an unrealized loss on certain stock investments during 2003. The aggregate amount of unrealized loss on investments that had been in an unrealized loss position for less than twelve months was \$24,000 and the aggregate estimated fair value was \$371,000. For investments that had been in an unrealized position for more than twelve months, the aggregate amount of unrealized loss was \$22,000 and the aggregate estimated fair value was \$183,000. Unrealized losses in available-for-sale securities are considered temporary in light of the extent and duration of the decline in value. The Company recorded no other-than-temporary losses on investments in 2003 and 2002. Market value declines in available-for-sale securities that have been in an unrealized position for less than 12 months are considered temporary in light of the extent and duration of the decline in value absent any evidence of bankruptcy or other significant negative information. Market value declines in available-for-sale securities that have been in an unrealized loss position for more than 12 months include four securities and are not significant both individually and in aggregate.

Note 4—Income Taxes

As a single-member limited liability company, “disregarded entity” status has been elected for federal income tax purposes. Therefore, the Company’s taxable income is included as a division of its owner, BCBSSC. Under a written tax-sharing agreement, BCBSSC allocates the tax provision to each company within the consolidated group based upon the company’s proportionate share of the consolidated federal income tax liability computed on a stand-alone basis multiplied by the total consolidated federal income tax return liability.

The Company has an income tax payable to BCBSSC of \$1,882,000 and \$14,000 at December 31, 2003, and 2002, respectively, which are included in the net payables to the parent.

The Company recognized a provision for income taxes as follows (in thousands):

dollars in thousands	2003	2002
Current	\$ 1,906	\$ 210
Deffered	(1,735)	(60)
	\$ 171	\$ 150

The provision for income taxes differs from the amount computed by applying the federal statutory tax rate of 35% to income before income taxes primarily due to the dividends received deduction allowed for tax and benefits derived from filing on a consolidated basis versus separate company basis. The temporary differences that give rise to deferred tax assets and liabilities are primarily related to accrued expenses, fixed assets, and

investments. There was no valuation allowance at December 31, 2003 and 2002. Deferred tax assets and liabilities are classified as current and long-term based on the classification of the related asset or liability, as follows (in thousands):

	2003	2002
Deferred Tax Assets:		
Current	\$ 1,718	\$ -
Long-term	269	189
	\$ 1,987	\$ 189
Deferred Tax Liabilities		
Current	\$ -	\$ -
Long-term	66	3
	\$ 66	\$ 3
Net Deferred Tax Asset	\$ 1,921	\$ 186

Note 5—Related Parties

The Company is a single-member limited liability company owned by BCBSSC. Certain offices, other facilities and services are provided by BCBSSC pursuant to an administrative services agreement. Prior to January 1, 2003 employees and depreciable assets were provided by BCBSSC as part of that agreement. Expenses associated with the administrative services agreement allocated from BCBSSC to the Company totaled \$97,655,000 and \$164,349,000 for the years ended December 31, 2003 and 2002, respectively. The Company paid \$89,629,000 and \$163,924,000 during the years ended December 31, 2003 and 2002, respectively, to BCBSSC for expenses paid on behalf of the Company.

BCBSSC made capital contributions related to the job tax credit to the Company of \$598,000 and \$430,000 during the years ended December 31, 2003 and 2002, respectively.

The Company made payments in the amount of \$759,000 and \$1,121,000 to TrailBlazer Health Enterprises, LLC, a subsidiary of BCBSSC, during the years ended December 31, 2003 and 2002 for services subcontracted to TrailBlazer Health Enterprises under the Company's Disenrollment contract with CMS.

With the novation (see Note 7) of contracts to Palmetto GBA there are certain administrative services provided by the Company to other subsidiaries of BCBSSC. The Company received \$5,340,000 from various subsidiaries for these services. The Company paid TrailBlazer Health Enterprises, LLC \$5,000 related to certain administrative services provided.

Note 6—Commitments and Contingencies

A financial guarantee has been issued by BCBSSC, which equals the Company's estimated annual net operating expenses multiplied by 8.33%, less current capitalization. This guarantee is estimated to be approximately \$2.4 million at December 31, 2003.

BCBSSC has also executed an indemnification agreement, pursuant to minimum reserve and other requirements established by the Blue Cross and Blue Shield Association ("BCBSA"). BCBSSC is therefore liable to the Company to the extent of its financial guarantee, and to the BCBSA to the full extent of its assets for any claims asserted against the BCBSA resulting from the contractual and financial obligations of the Company arising out of its Medicare Part A subcontract with the BCBSA. In addition, BCBSSC has executed a statutorily required financial guarantee of \$75,000 on behalf of the Company in order for the Company to obtain a Third Party Administrator's license pursuant to the South Carolina insurance laws.

The Company recorded an estimated contingent liability for potential repayments of costs claimed on its contracts with CMS. The liability was \$702,000 and \$540,000 for the years ended December 31, 2003 and 2002, respectively.

The Company is obligated for additional capital contributions of up to \$726,000 to its affiliate, TriCenturion, LLC.

The Company has entered into certain non-cancelable operating leases in excess of one year as of December 31, 2003. The future minimum lease payments required under these leases are as follows (in thousands):

Year	Amount
2004	\$ 2,539
2005	\$ 1,100
2006	\$ 158
	\$ 3,797

Total rent expense during the year ended December 31, 2003 was \$7,330,000. There were no rental commitments in 2002.

In the ordinary course of business, there are various legal proceedings pending against the Company. Management believes the aggregate liabilities, if any, arising from legal actions would not have a material adverse effect on the financial position of the Company.

Note 7—CMS Contract Novation Status

As of January 1, 1999, BCBSSC's Medicare administrative services contracts are executed through the Company through a special power of attorney since CMS has not yet approved the novation of BCBSSC's contracts to the Company. The Company is uncertain as to when the novation will be completed.

As part of the novation process on January 1, 2003, fixed assets and employees were transferred from BCBSSC to the Company.

Note 8—Other Employee Benefit Plans

The Company's employees are part of the 401(k) plan sponsored by BCBSSC. Eligible employees may defer up to 15% of their salary with 50% of the first 6% of the deferral matched by the Company. For employees hired after January 1, 2003, there is a 2-year cliff-vesting schedule on the match contribution. For certain employees not covered by the BCBSSC defined benefit pension plan, the Company makes a discretionary contribution to the 401(k) plan which is 50% vested for employees with one year of service and fully vested for employees with two years of service. Employees must be employed on the last day of the year to be eligible for the discretionary contribution, unless terminated during the year due to retirement (age 55 and 5 years of service), death or disability. The discretionary contribution for 2003 was 6% of salary.

The cost of providing the 401(k) discretionary contribution was \$3,697,000 for the year ended December 31, 2003. The pension expense allocated to the Company under the BCBSSC pension plan was \$5,705,000 for the year ended December 31, 2003.

Note 9—Interest Expense

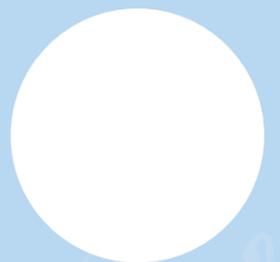
Fixed assets were transferred from BCBSSC to the Company in exchange for a promissory note in the amount of \$5,200,000. Interest expense in the amount of \$34,000 was recorded in relation to this loan. The note was subsequently liquidated through a capital contribution by BCBSSC.

Summary of Medicare Claims Processed

	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Part A Claims	2,542,405	2,705,727	2,986,567	3,052,671	3,169,558
Home Health Agency	5,834,628	5,543,410	4,658,625	4,823,746	4,992,376
Part A - North Carolina				4,108,902	4,451,030
Part B Claims	10,253,562	10,780,387	11,375,296	11,981,981	12,255,302
Part B - Ohio				8,182,248	33,409,892
Part B - WV				1,501,482	6,279,072
DMERC Claims	18,967,692	20,258,797	21,004,303	23,604,443	26,695,348
RRB Claims		603,635	12,295,928	14,234,696	12,761,960
Total Claims	37,598,287	39,891,956	52,320,719	71,490,169	104,015,538
% of National Total (Market Share)	4.33	4.4	85.62	7.12	9.88

Summary of Benefits Payment

	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Part A Benefits	\$2,113,843,461	\$2,489,317,352	\$2,966,461,834	\$7,518,397,017	\$8,791,075,464
HHA	\$4,694,738,102	\$4,252,676,308	\$4,367,737,605	\$4,537,471,172	\$4,626,434,776
Part B Benefits	\$569,310,915	\$640,403,371	\$739,783,860	\$1,490,906,556	\$3,640,256,309
DMERC Benefits	\$2,306,748,615	\$2,525,460,344	\$2,826,474,041	\$3,347,759,119	\$4,117,171,562
RRB Benefits	N/A	\$40,115,308	\$751,410,612	\$790,098,378	\$843,952,927
Total Benefits	\$9,684,641,093	\$9,947,972,683	\$11,651,867,952	\$17,684,632,242	\$22,018,891,038



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corporate **officers**



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President



Bruce Hughes
Executive Vice President &
Chief Operating Officer



Ann Archibald
Vice President &
Compliance Officer



Mike Barlow
Vice President
Ohio/West Virginia Operations



Dickie Butler
Vice President
Systems & Support/
Government Programs, EDI



Neal Burkhead
Vice President
Medicare Integrity Program



Roz Catoe
Vice President
Processing & Customer
Service



Elaine Myers
Assistant Vice President
Customer Service
Strategies & Education



Robin Spires
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Railroad Medicare



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Dee Dee Rowe
Secretary



Rick Wade
Assistant Vice President
Part B Operations

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board of directors



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Standing: Martin L. Kappert, Retired Deputy Assistant Secretary Health Affairs, Department of Defense, Washington, D.C.; Martha P. Mahaffey, Executive Vice President and COO, TrailBlazer Health Enterprises; Thomas J. Littlefield, PGBA, Vice President Regions 9, 10 and 12; Eileen T. Boyd, Managing Director, KPMG; Joseph F. Sullivan, Past Chairman of the Board, BlueCross BlueShield of South Carolina; Edwin R. Kohn, Consultant, Navy Research Advisory Committee, Retired Vice Admiral, US Navy



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Palmetto GBA 2003 Annual Report



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