Palmetto GBA Claimed Substantially Allowable Costs on Its Part A Final Administrative Cost Proposals for Fiscal Years 2010 and 2011

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

Lori S. Pilcher
Regional Inspector General

March 2013
A-04-12-04027
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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

Palmetto claimed administrative costs that substantially complied with the Federal Acquisition Regulation and the Medicare contract. Of the $36,513,901 in costs that we reviewed, $12,691 was not allowable.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts with CMS provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. After the close of each fiscal year (FY), contractors submit a Final Administrative Cost Proposal (cost proposal) reporting Medicare costs. Once CMS accepts the cost proposal, the contractor and CMS negotiate a final settlement of allowable administrative costs.

From October 1, 2009, through January 24, 2011, CMS contracted with Palmetto GBA (Palmetto) to process Part A claims for North Carolina and South Carolina and Regional Home Health claims for multiple states. CMS requested that we perform an audit of the Part A and Regional Home Health cost proposals that Palmetto submitted for this period.

The objective of this review was to determine whether the administrative costs that Palmetto reported on its cost proposals were allowable, allocable, and reasonable in accordance with part 31 of the Federal Acquisition Regulation (FAR) and the Medicare contract.

BACKGROUND

The Medicare contract between CMS and Palmetto set forth principles of reimbursement for administrative costs. The contract cites part 31 of the FAR (48 CFR chapter 1) as the guiding regulation for the Medicare contract and provides additional guidelines for specific cost areas.

Palmetto is a single-member, limited liability company owned by BlueCross BlueShield of South Carolina (BlueCross). BlueCross allocates costs to Palmetto both directly and indirectly. Palmetto then claims a portion of these costs on its cost proposals.

WHAT WE FOUND

Palmetto claimed administrative costs that substantially complied with the FAR and the Medicare contract. Of the $36,513,901 in costs that we reviewed, $36,501,210 was allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract. However, Palmetto claimed $12,691 in its cost proposals that was not allowable, including:

- $10,619 of home office indirect costs that exceeded the allocable amount and
- $2,072 of unallowable costs.
Palmetto claimed these unallowable costs because BlueCross allocated home office costs to Palmetto that exceeded the amount allocable to Palmetto and the Medicare contract. In accordance with our previous audit recommendations (report numbers A-04-11-04013 and A-04-11-04018), BlueCross implemented a year-end true-up process to correct inherent rounding differences in its home office cost allocation process and resolve this excessive allocation of costs for FY 2011, but BlueCross had not yet done so for FY 2010.

BlueCross also allocated to Palmetto costs that were unallowable according to part 31 of the FAR. Palmetto then claimed these costs on its cost proposals. Palmetto claimed these unallowable costs because BlueCross did not have sufficient controls in place to identify and classify unallowable costs.

WHAT WE RECOMMEND

We recommend that Palmetto:

- reduce the costs claimed on its cost proposals by $12,691,
- continue to have BlueCross perform a year-end true-up process to correct inherent rounding differences in its home office costs allocation process, and
- work with BlueCross to improve internal controls to identify unallowable costs.

PALMETTO GBA COMMENTS

In comments on our draft report, Palmetto concurred with our recommendations and described the corrective actions it had taken.
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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts with CMS provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. After the close of each fiscal year (FY), contractors submit a Final Administrative Cost Proposal (cost proposal) reporting Medicare costs. Once CMS accepts the cost proposal, the contractor and CMS negotiate a final settlement of allowable administrative costs.

From October 1, 2009, through January 24, 2011, CMS contracted with Palmetto GBA (Palmetto) to process Part A claims for North Carolina and South Carolina and Regional Home Health claims for Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Kentucky, Louisiana, Mississippi, New Mexico, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, and Texas. CMS requested that we perform an audit of the Part A and Regional Home Health cost proposals that Palmetto submitted for this period.

OBJECTIVE

The objective of this review was to determine whether the administrative costs that Palmetto reported on its cost proposals were allowable, allocable, and reasonable in accordance with part 31 of the Federal Acquisition Regulation (FAR) and the Medicare contract.

BACKGROUND

The Medicare contract between CMS and Palmetto set forth principles of reimbursement for administrative costs. The contract cites part 31 of the FAR (48 CFR chapter 1) as the guiding regulation for the Medicare contract and provides additional guidelines for specific cost areas.

Palmetto is a single-member, limited liability company owned by BlueCross BlueShield of South Carolina (BlueCross). BlueCross allocates costs to Palmetto both directly and indirectly through indirect cost pools.1 Palmetto then claims a portion of these costs incurred at BlueCross on its cost proposals.

HOW WE CONDUCTED THIS REVIEW

Our audit covered the period October 1, 2009, through January 24, 2011.2 For this period, Palmetto claimed administrative costs to CMS totaling $38,415,231. This total included

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1 Indirect cost pool means a grouping of incurred costs identified with two or more objectives but not identified specifically with any final cost objective (48 CFR § 9904.401–30(a)(4)).

2 CMS’s contract with Palmetto did not extend through all of FY 2011 because CMS transitioned from its previous contracts with intermediaries and carriers to new contracts with Medicare Administrative Contractors.
pension costs of $1,901,330 that we did not review because they will be the subject of a separate review. We therefore reviewed $36,513,901 in administrative costs.

We limited our internal control review to those controls related to the recording and reporting of costs on the cost proposals. We accomplished our objective through substantive testing. Appendix A contains the details of our audit scope and methodology and Appendix B contains a summary of the administrative costs we reviewed. See Appendix C for a list of related OIG reports.

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 findings and conclusions based on our audit objectives.

**FINDINGS**

Palmetto claimed administrative costs that substantially complied with the FAR and the Medicare contract. Of the $36,513,901 in costs that we reviewed, $36,501,210 was allowable, allocable, and reasonable in accordance with part 31 of the FAR and the Medicare contract. However, Palmetto claimed $12,691 in its cost proposals that was not allowable, including:

- $10,619 of home office indirect costs that exceeded the allocable amount and
- $2,072 of unallowable costs.

Palmetto claimed these unallowable costs because BlueCross allocated home office costs to Palmetto that exceeded the amount allocable to Palmetto and the Medicare contract. In accordance with our previous audit recommendations (report numbers A-04-11-04013 and A-04-11-04018), BlueCross implemented a year-end true-up process to correct inherent rounding differences in its home office cost allocation process and resolve this excessive allocation of costs for FY 2011, but BlueCross had not yet done so for FY 2010.

BlueCross also allocated to Palmetto costs that were unallowable according to part 31 of the FAR. Palmetto then claimed these costs on its cost proposals. Palmetto claimed these unallowable costs because BlueCross did not have sufficient controls in place to identify and classify unallowable costs.

**BLUECROSS OVER_ALLOCATED INDIRECT COSTS**

According to FAR § 31.201-2(d), Palmetto is responsible for “... maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles....” Furthermore,
FAR § 31.203(d) states that “once an appropriate basis for allocating indirect costs has been accepted, the contractor shall not fragment the base by removing individual elements.”

For FY 2010, the total home office indirect costs that BlueCross allocated to Palmetto exceeded the allocable amount by $98,489. Of the $98,489, Palmetto allocated $10,619 to Palmetto’s Part A contract and claimed that amount on its cost proposal. However, contrary to FAR § 31.201-2(d), Palmetto could not support that these expenses were allocable to the Part A contract.

Palmetto claimed excessive home office indirect costs because BlueCross allocated indirect costs to Palmetto in excess of the allocable amount. BlueCross did not adhere to FAR § 31.203(d) when, at various points in the allocation process, it dropped allocations to certain elements because it allocated by account, by cost center, rather than in the aggregate. Palmetto officials explained that BlueCross’ allocation methodology is necessary to preserve transaction-level information and that some rounding is inherent.

For FY 2011, in accordance with recommendations from our previous audits (report numbers A-04-11-04013 and A-04-11-04018), BlueCross implemented a year-end true-up process to correct inherent rounding differences in its home office cost allocation process.

**BLUECROSS ALLOCATED UNALLOWABLE COSTS**

As mentioned above, according to FAR § 31.201-2(d), Palmetto is responsible for “... maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles....” Additionally, FAR § 31.205 provides a compilation of costs that are unallowable and places limits on the amounts of certain other costs that are otherwise allowable.

We identified $85,430 in costs incurred at BlueCross that the FAR identifies as unallowable but BlueCross recorded to allowable accounts. Of the $85,430, BlueCross allocated $32,435 to Palmetto. Palmetto then allocated $2,072 to the Part A contract and claimed it on its cost proposals.

Palmetto claimed these unallowable costs because BlueCross did not have sufficient controls in place to identify and classify unallowable costs. Examples of such unallowable costs included payments for alcohol (FAR § 31.205-51), governmental penalties (FAR § 31.205-15(a)), public relations and advertising (FAR § 31.205-1), corporate restructuring (FAR § 31.205-27), and taxes on unallowable costs when invoices included both allowable and unallowable costs (FAR § 31.201-2(d)).

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3 In BlueCross’ case, the elements included the lines of business or other cost pools.
RECOMMENDATIONS

We recommend that Palmetto:

• reduce the costs claimed on its cost proposals by $12,691,

• continue to have BlueCross perform a year-end true-up process to correct inherent rounding differences in its home office cost allocation process, and

• work with BlueCross to improve internal controls to identify unallowable costs.

PALMETTO GBA COMMENTS

In comments on our draft report, Palmetto concurred with our recommendations and described the corrective actions it had taken. Palmetto’s comments are included in their entirety as Appendix D.
APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered the period October 1, 2009, through January 24, 2011. For this period, Palmetto claimed administrative costs to CMS totaling $38,415,231. This total included pension costs of $1,901,330 that we did not review because they will be the subject of a separate review. We therefore reviewed $36,513,901 in administrative costs. We limited our internal control review to those controls related to the recording and reporting of costs on the cost proposals. We accomplished our objective through substantive testing.

We conducted fieldwork at Palmetto and BlueCross offices in Columbia, South Carolina.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidelines, including the FAR § 31.201-2(d), the Medicare Financial Management Manual, chapter 2, section 190.3, and Palmetto’s contract with CMS;

- interviewed officials at Palmetto and BlueCross about their cost accumulation processes for cost proposals and gained an understanding of their cost allocation systems;

- reviewed external audit reports, including independent auditor’s reports, reports related to Palmetto’s internal controls, and prior Office of Inspector General reports;

- reconciled the cost proposals for FYs 2010 and 2011 to Palmetto’s accounting records;

- tested costs for reasonableness, allowability, and allocability by judgmentally selecting journal entries, invoices, expense reports, payroll journals, and personnel records;

- recalculated the home office cost allocations of indirect cost pools using the allocation statistical bases provided by BlueCross and determined the excess allocated to Palmetto and, more specifically, the portion that Palmetto allocated to the Part A contract; and

- verified whether BlueCross had implemented a true-up process to correct the inherent rounding errors in its home office cost allocation process.

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 findings and conclusions based on our audit objectives.
APPENDIX B:
FINAL ADMINISTRATIVE COST PROPOSALS WITH
RECOMMENDED COSTS FOR ACCEPTANCE AND
DISALLOWANCE FOR FISCAL YEARS 2010 AND 2011

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>Fiscal Year 2010</th>
<th>Fiscal Year 2011</th>
<th>Total</th>
</tr>
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<tbody>
<tr>
<td>Salaries and Wages</td>
<td>$8,035,276</td>
<td>$2,010,949</td>
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<td>Fringe Benefits</td>
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<td>Facilities or Occupancy</td>
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<td>Subcontracts</td>
<td>2,130,191</td>
<td>526,268</td>
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<td>Outside Professional Services</td>
<td>206,269</td>
<td>117,300</td>
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<td>Postage and Express</td>
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<td>Furniture and Equipment</td>
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<td>0</td>
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<td>Materials and Supplies</td>
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<td>34,119</td>
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<td>Travel</td>
<td>343,093</td>
<td>78,308</td>
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<td>Return on Investment</td>
<td>292,241</td>
<td>42,567</td>
<td>334,808</td>
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<td>Miscellaneous</td>
<td>19,688,352</td>
<td>4,857,489</td>
<td>24,545,841</td>
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<td>Other</td>
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<td>Credits</td>
<td>(3,963,213)</td>
<td>(2,786,462)</td>
<td>(6,749,675)</td>
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<td>Forward Funding</td>
<td>0</td>
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<tr>
<td><strong>Total Costs Claimed</strong></td>
<td>$32,246,401</td>
<td>$6,168,830</td>
<td>$38,415,231</td>
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<td>Less Pension Costs Not Reviewed</td>
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<td>425,040</td>
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<td><strong>Total CostsReviewed</strong></td>
<td>$30,770,111</td>
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<td>Less: Recommended Disallowances</td>
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<tr>
<td>Over-allocated Indirect Costs</td>
<td>$10,619</td>
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<td>$10,619</td>
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<td>Unallowable Costs</td>
<td>1,923</td>
<td>149</td>
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<td><strong>Total Recommended Disallowances</strong></td>
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<td><strong>Recommended for Acceptance</strong></td>
<td>$30,757,569</td>
<td>$5,743,641</td>
<td>$36,501,210</td>
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### APPENDIX C: RELATED OFFICE OF INSPECTOR GENERAL REPORTS

#### AUDITS OF FINAL ADMINISTRATIVE COST PROPOSALS

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<tr>
<th>Report Title</th>
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<tbody>
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<td>Audit of Palmetto GBA’s Railroad Retirement Board Final Administrative Cost Proposals for Fiscal Years 2007 and 2008</td>
<td>A-04-11-04018</td>
<td>06/29/12</td>
</tr>
<tr>
<td>Audit of Palmetto GBA’s Medicare Part B Final Administrative Cost Proposals for Fiscal Years 2007 Through 2009</td>
<td>A-04-11-04013</td>
<td>02/23/12</td>
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<tr>
<td>Review of Blue Cross and Blue Shield of Georgia, Inc.’s Medicare Final Administrative Cost Proposals for the Period October 1, 2006, Through May 4, 2009</td>
<td>A-04-10-00068</td>
<td>08/16/11</td>
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<tr>
<td>Audit of HealthNow New York, Inc.’s Medicare Part B Final Administrative Cost Proposal for Fiscal Year 2008</td>
<td>A-02-09-01039</td>
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<tr>
<td>Review of CIGNA Government Services Durable Medical Equipment Regional Carrier Final Administrative Cost Proposals for Fiscal Years 2004 Through 2006</td>
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<td>Review of CIGNA Government Services Part B Final Administrative Cost Proposals for Fiscal Years 2004 Through 2006</td>
<td>A-04-07-00031</td>
<td>03/16/11</td>
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<td>Audit of Cooperativa de Seguros de Vida de Puerto Rico’s Final Administrative Cost Proposal for Fiscal Year 2009</td>
<td>A-02-10-01019</td>
<td>02/16/11</td>
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<tr>
<td>Audit of Cooperativa de Seguros de Vida de Puerto Rico’s Final Administrative Cost Proposal for Fiscal Year 2008</td>
<td>A-02-09-01031</td>
<td>12/28/10</td>
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<td>A-05-09-00097</td>
<td>06/15/10</td>
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<td>Audit of Palmetto Government Benefits Administrators’ Durable Medical Equipment Regional Carrier Final Administrative Cost Proposals for Fiscal Year 2007</td>
<td>A-04-08-04025</td>
<td>11/04/09</td>
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<td>Review of Wheatlands Administrative Services, Inc.’s Final Administrative Cost Proposals for Fiscal Years 2005 Through 2008</td>
<td>A-07-08-04137</td>
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<td>Audit of Pinnacle Business Solutions, Inc.’s, Medicare Part A Final Administrative Cost Proposals for Fiscal Years 2005 Through 2007</td>
<td>A-06-08-00015</td>
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<td>Audit of HealthNow New York, Inc.’s, Medicare Part B Final Administrative Cost Proposals for Fiscal Years 2005 Through 2007</td>
<td>A-02-08-01003</td>
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<td>Review of CareFirst Blue Cross/Blue Shield of Maryland Medicare Part A Final Administrative Cost Proposals for Fiscal Years 2003 - 2005</td>
<td>A-03-06-00002</td>
<td>02/10/09</td>
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<td>Audit of Palmetto Government Benefits Administrators’ Durable Medical Equipment Regional Carrier Final Administrative Cost Proposals for Fiscal Years 2004 Through 2006</td>
<td>A-04-07-04018</td>
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<td>Audit of Palmetto Government Benefits Administrators’ Railroad Retirement Board Final Administrative Cost Proposals for Fiscal Years 2002 Through 2006</td>
<td>A-04-07-04019</td>
<td>08/20/08</td>
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</tbody>
</table>
APPENDIX D: PALMETTO GBA COMMENTS

February 11, 2013

Lori S. Pilcher
Regional Inspector General for Audit Services
Region IV
61 Forsyth Street, SW, Suite 3T41
Atlanta, Georgia 30303

Dear Ms. Pilcher:

RE: Audit Report Number A-04-12-04027


The recommendations contained in the draft report and our responses to the recommendations are provided below.

We recommend that Palmetto GBA:

• reduce the costs claimed on its cost proposals by $12,691,
• continue to have BlueCross perform a year-end true-up process to correct inherent rounding differences in its home office cost allocation process, and
• work with BlueCross to improve internal controls to identify unallowable costs.

Contractor Response:

• Palmetto GBA concurs with this recommendation and will reduce the cost proposals by $12,691.
• Palmetto GBA concurs with this recommendation. BlueCross Home Office is continuing to perform year end true ups related to the inherent rounding differences in its cost allocation process. Below is a description of the true up process provided by the Home Office.

Summary
The purpose of this email is to explain two prior-year costing adjustments that will be made in the first quarter of 2012 to satisfy government cost accounting requirements and relieve...
outstanding audit concerns. Cost & Budget does not expect these adjustments to result in significant changes to allocated cost by business segment for 2011. A handful of large LOBs will reflect a change in allocated cost of $100k - $200k for the year, but most of the rounding adjustments will offset within a segment.

Detail
Cost & Budget will implement a new process in 2012 to satisfy government cost accounting requirements and relieve outstanding audit concerns. The new process will include two prior-year cost allocation adjustments during the first quarter of 2012. Any billings or cost reports related to government contracts will need to be adjusted accordingly. It is important for internal management to note that Cost & Budget does not expect these adjustments to result in significant changes in allocated cost for 2011.

The cost allocation adjustments will take the form of journal entries and will be reflected in a new cost center (Cost Center 034) which will be used exclusively for these prior year cost allocation adjustments. The total cost in Cost Center 034 will be $0.00; however amounts will be reflected, both positive and negative, per line of business (LOB). The first entry will be made in the January 2012 costing cycle. The second entry will be made during February costing. Each entry will be by LOB and will have the appropriate natural account detail. In addition, the related Home Office cost pools will be documented in the description field for use with government reporting. Again, these entries should not result in significant allocation changes.

January Entry
The purpose of this adjustment is to match the timing of cost and allocation statistics. Historically, some allocation stats used by Cost & Budget were on a one month lag due to the availability of current month information within the time allotted for the monthly costing cycle. In order to be in compliance with government cost accounting regulations, cost allocations in a calendar year must be based statistical data from that calendar year. Allocations based on statistics that lag one month are not in compliance with government regulations. Therefore, a January entry will be made to “true-up” 2011 cost allocations using pool statistics based on calendar year activity.

February Entry
The purpose of this adjustment is to enable Cost and Budget to apply cost allocations to LOBs using dollar amount increments that are not limited to two decimals places. BCBSSC cost allocations are applied to a minimum amount of $0.01. This system process results in very small, but numerous rounding errors that are detectable by government auditors in total. This issue has resulted in an audit finding during a recent Part B audit. Therefore, starting with the 2011 calendar year, Cost & Budget will run a costing model in the first quarter of the following year using the necessary decimal places to eliminate 1) the rounding error in the costing system and 2) the risk of future government audit findings. A handful of large LOBs will reflect
a change in allocated cost of $100k - $200k for the year, but most of the rounding adjustments will offset each other within a segment).

- Palmetto GBA concurs with this recommendation. Palmetto GBA received the following from the Home Office where the allocations originate in regards to identifying unallowable cost:

Prior to the entry of the final payment into the accounting system, expenses related to management meetings will be reviewed by cost accountants and direct reports with expertise in assuring allowable vs. unallowable costs. This will ensure expenses are appropriately coded to the correct allowable and unallowable natural accounts prior to the home office allocation process. In addition, a new general ledger account has been established to capture unallowable lodging taxes. The account number is 6513, Non-Allowable Lodging Taxes.

If you have any questions, please feel free to contact me at 803-763-1176 or Joe Wright at 803-763-5544.

Sincerely

cc: Joe Wright, Palmetto GBA
    Mark Wimple, OIG