

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**PALMETTO GOVERNMENT BENEFITS
ADMINISTRATOR, LLC, CLAIMED
UNALLOWABLE MEDICARE
SUPPLEMENTAL EXECUTIVE
RETIREMENT PLAN III COSTS 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.*



**Patrick J. Cogley
Regional Inspector General
for Audit Services**

**October 2014
A-07-14-00441**

Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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EXECUTIVE SUMMARY

Palmetto Government Benefits Administrator, LLC, claimed unallowable Supplemental Executive Retirement Plan III costs of approximately \$14,000 for Medicare reimbursement for fiscal years 2010 and 2011.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify SERP costs.

For this review, we focused on one Medicare contractor, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Medicare segment and Other segment allowable SERP III costs that Palmetto claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs).

The objective of this review was to determine whether the fiscal years (FYs) 2010 and 2011 SERP III costs that Palmetto claimed for reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

During our audit period, Palmetto was a subsidiary of Blue Cross Blue Shield of South Carolina, whose home office is in Columbia, South Carolina. Palmetto administered Medicare Part A fiscal intermediary and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform, Palmetto continued to perform Medicare work after being awarded the Medicare administrative contractors (MAC) contracts for Medicare Parts A and B Jurisdiction 1 and Jurisdiction 11 (including home health and hospice services), effective October 25, 2007, and May 21, 2010, respectively.

This report addresses the SERP III costs claimed by Palmetto under the provisions of its fiscal intermediary and carrier contracts. We are addressing the SERP III costs claimed by Palmetto under the provisions of its MAC contracts in a separate review.

WHAT WE FOUND

Palmetto's claims for SERP III costs for FYs 2010 and 2011, under the provisions of its fiscal intermediary and carrier contracts, were unallowable for Medicare reimbursement. Palmetto submitted SERP III costs of \$13,784 for Medicare reimbursement on its FYs 2010 and 2011

FACPs. Palmetto claimed these unallowable SERP III costs because it did not claim costs in accordance with Federal regulations.

WHAT WE RECOMMEND

We recommend that Palmetto revise its FACPs for FYs 2010 and 2011 to eliminate its claim of \$13,784 for Medicare SERP III costs.

AUDITEE COMMENTS AND OUR RESPONSE

In written comments on our draft report, Palmetto did not concur with our recommendation, for two reasons. Palmetto said that the change it made in its SERP III (which formed the basis of our finding) was unintentional. Palmetto also said that because it was amending the SERP III plan document to make the plan compliant with the FAR as a pension plan, it would be burdensome for Palmetto to have to account for the SERP III as initially compliant with the FAR, and then as noncompliant for a time period, and then as compliant once again.

Palmetto suggested, as an alternative to our recommendation, a course of action in which Palmetto would correct its “inadvertent change” to the SERP III by amending the plan retroactively and restoring the offer of a benefit that is payable for life at the option of the employee. Palmetto also stated that it had established a policy that its defined-benefit plans may not be amended without considering the CAS effects, so as to avoid any future unintended changes to its plans.

Nothing in Palmetto’s comments caused us to change our finding or recommendation. We based our audit on the plan document in effect at the time of our review. We suggest that Palmetto consult with CMS (the cognizant Federal agency) to explore whether a retroactive plan amendment is permissible and what effects such an amendment would have on future cost accounting periods. We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify SERP costs.

For this review, we focused on one Medicare contractor, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Medicare segment and Other segment allowable SERP III costs that Palmetto claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs).

OBJECTIVE

Our objective was to determine whether the fiscal years (FYs) 2010 and 2011 SERP III costs that Palmetto claimed for reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

Palmetto Government Benefits Administrator

During our audit period, Palmetto was a subsidiary of Blue Cross Blue Shield of South Carolina (BCBS South Carolina), whose home office is in Columbia, South Carolina. Palmetto administered Medicare Part A fiscal intermediary and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of Medicare contracting reform,¹ Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 1² and Jurisdiction 11,³ effective October 25, 2007, and May 21, 2010, respectively.

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to Medicare administrative contractors (MACs) between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

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

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

Supplemental Executive Retirement Plan III

BCBS South Carolina sponsors a SERP III whose primary purpose is to provide a benefit to a select group of management or highly compensated employees.⁴ The SERP III is designed to supplement benefits payable under BCBS South Carolina's retirement plans. Because Palmetto was a subsidiary of BCBS South Carolina during our audit period, Palmetto employees were eligible to participate in this SERP III.

BCBS South Carolina defined its SERP III as a nonqualified defined-benefit pension plan and calculated its costs pursuant to CAS 412.

This report addresses the SERP III costs claimed by Palmetto under the provisions of its fiscal intermediary and carrier contracts. We are addressing the SERP III costs claimed by Palmetto under the provisions of its MAC contracts in a separate review.

HOW WE CONDUCTED THIS REVIEW

We reviewed \$13,784 of SERP III costs claimed by Palmetto for Medicare reimbursement on its FACPs for FYs 2010 and 2011.

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

Appendix A contains details of our audit scope and methodology.

FINDING

Palmetto's claims for SERP III costs for FYs 2010 and 2011, under the provisions of its fiscal intermediary and carrier contracts, were unallowable for Medicare reimbursement. Palmetto submitted SERP III costs of \$13,784 for Medicare reimbursement on its FYs 2010 and 2011 FACPs. Palmetto claimed these unallowable SERP III costs because it did not claim costs in accordance with Federal regulations.

⁴ In addition to its SERP III, BCBS South Carolina sponsored two other SERPs during our audit period. We will review and issue a separate report on the SERP I covering the period of FYs 2005 through 2011. BCBS South Carolina created and terminated the SERP II during our audit period. We reviewed financial information for the SERP II and determined that no costs were charged to Medicare; therefore, we will not issue a separate report on that plan.

UNALLOWABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN III COSTS

Supplemental Executive Retirement Plan III Costs Claimed

Palmetto claimed SERP III costs of \$13,784 for Medicare reimbursement, under its fiscal intermediary and carrier contracts, on its FYs 2010 and 2011 FACPs. BCBS South Carolina and Palmetto calculated Palmetto's SERP III costs on the premise that the SERP III was a nonqualified defined-benefit pension plan.

Costs Based on Nonqualified Defined-Benefit Pension Plan

The Medicare contracts require that SERP costs be calculated in accordance with the FAR and the CAS. BCBS South Carolina defined its SERP III as a nonqualified defined-benefit pension plan and, accordingly, calculated the plan's costs as specified in CAS 412. However, BCBS South Carolina's SERP III did not offer a benefit that is payable for life at the option of the employees; therefore it did not qualify as a "pension plan" as defined in FAR 31.001. Thus, Palmetto did not claim costs in accordance with Federal regulations.

Palmetto should have calculated its SERP III costs in accordance with FAR 31.205-6(k) and CAS 415. Specifically, Palmetto should have identified its SERP III costs in accordance with the regulations for a deferred compensation plan and should then have calculated those costs in accordance with the FAR and CAS 415.

For details on the Federal requirements, see Appendix B.

Effect of Incorrectly Calculated Costs

In light of these considerations, we recalculated Palmetto's SERP III costs in accordance with CAS 415 and determined that Palmetto had no allowable SERP III costs for FYs 2010 and 2011. In accordance with CAS 415, we based the allowable costs on actual payments to SERP III participants. During FYs 2010 and 2011, no benefit payments were paid to SERP III participants; therefore, there were no allowable costs for the SERP III during this time period. Thus, Palmetto claimed \$13,784 of unallowable Medicare SERP III costs on its FACPs for FYs 2010 and 2011. Palmetto claimed these unallowable SERP III costs because it based its claims for Medicare reimbursement on an incorrectly calculated amount that, due to the incorrect classification of the SERP III as a pension plan, did not comply with Federal regulations.

The table below compares our calculation of allowable SERP III costs with the costs claimed on Palmetto's FACPs for FYs 2010 and 2011.

Fiscal Year	Allowable Per Audit	Claimed by Palmetto	Difference
2010	\$0	\$7,068	(\$7,068)
2011	0	6,716	(6,716)
Total	\$0	\$13,784	(\$13,784)

RECOMMENDATION

We recommend that Palmetto revise its FACP's for FYs 2010 and 2011 to eliminate its claim of \$13,784 for Medicare SERP III costs.

AUDITEE COMMENTS

In written comments on our draft report, Palmetto did not concur with our recommendation, for two reasons. Palmetto said that the change it made in its SERP III (to remove the benefit that is payable for life at the option of the employee) was unintentional, in the sense that Palmetto sought to simplify elections for its retirees. Palmetto stated that its intent was that the SERP III would continue to be recognized as a pension plan, but added that it "... did not consider that removing the life time payout option would change this status."

Palmetto also said that because it was amending the SERP III plan document to reinstate the lifetime payout option and make the plan compliant with the FAR as a pension plan, it would be burdensome for Palmetto to have to account for the SERP III as initially compliant with the FAR, and then as noncompliant for a time period, and then as compliant once again.

Palmetto thus suggested, as an alternative to our recommendation, a course of action in which Palmetto would correct its "inadvertent change" to the SERP III by restoring the offer of a benefit that is payable for life at the option of the employee. Palmetto requested that this corrective action be considered effective retroactive to the effective date of the amendment removing the lifetime payout option. Palmetto also stated that it had established a policy that its defined-benefit plans may not be amended without considering the CAS effects, so as to avoid any future unintended changes to its plans.

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

OFFICE OF INSPECTOR GENERAL RESPONSE

Nothing in Palmetto's comments caused us to change our finding or recommendation. We based our audit on the plan document in effect at the time of our review. This document did not offer a benefit that is payable for life, as required by FAR 31.001; therefore, the SERP III as constituted at the time of our review did not meet the definition of a pension plan as specified in the relevant criteria. We suggest that Palmetto consult with CMS (the cognizant Federal agency) to explore whether a retroactive plan amendment is permissible and what effects such an amendment would have on future cost accounting periods. We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed \$13,784 of SERP III costs that Palmetto claimed for Medicare reimbursement on its FACPs for FYs 2010 and 2011.

Achieving our objective did not require that we review Palmetto's overall internal control structure. We reviewed the internal controls related to the SERP III costs claimed for Medicare reimbursement to ensure that those costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We conducted our audit work in July 2013.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed BCBS South Carolina's SERP III plan document;
- reviewed accounting records and information provided by Palmetto to identify the amount of SERP III costs claimed for Medicare reimbursement for FYs 2010 and 2011;
- calculated allowable SERP III costs in accordance with applicable provisions of the FAR and the CAS; and
- provided the results of our review to Palmetto officials on April 23, 2014.

We performed this review in conjunction with the following audit and used the information obtained during this audit: *Blue Cross Blue Shield of South Carolina Overstated Its Allocable Medicare Supplemental Executive Retirement Plan III Costs for Calendar Years 2010 and 2011* (A-07-14-00442).

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

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO REIMBURSEMENT OF SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS

FAR 31.001 defines a pension plan as follows:

“Pension plan” means a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirements, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees, may be an integral part of a pension plan.

The allowability of costs for deferred compensation plans is governed by FAR 31.205-6. FAR 31.205-6(k) states that costs shall be measured, assigned, and allocated in accordance with CAS 415.

Federal regulation (CAS 415.40(a)) states that the cost of deferred compensation shall be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee.

Federal regulation (CAS 415.50(a)) states:

The contractor shall be deemed to have incurred an obligation for the cost of deferred compensation when all of the following conditions have been met. However, for awards which require that the employee perform future service in order to receive the benefits, the obligation is deemed to have been incurred as the future service is performed for that part of the award attributable to such future service:

- (1) There is a requirement to make the future payment(s) which the contractor cannot unilaterally avoid.
- (2) The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor.
- (3) The amount of the future payment can be measured with reasonable accuracy.
- (4) The recipient of the award is known.
- (5) If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur.
- (6) For stock options, there must be a reasonable probability that the options ultimately will be exercised.

Federal regulation (CAS 415.50(b)) states: “If any of the conditions in [CAS 415.50(a)] is not met, the cost of deferred compensation shall be assignable only to the cost accounting period or periods in which the compensation is paid to the employee.”

APPENDIX C: AUDITEE COMMENTS



PALMETTO GBA
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JOE WRIGHT
Vice President & CFO

September 15, 2014

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

Re: Report Number A-07-14-00441

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report dated July 15, 2014 and entitled *Palmetto Government Benefits Administrators, LLC, Claimed Unallowable Medicare Supplemental Executive Retirement Plan III Costs for Fiscal Years 2010 and 2011*. We appreciate the extension until September 15, 2014 to submit our response in conjunction with our response to related audits.

The report contains the following recommendation:

We recommend that Palmetto revise its FACPs for FYs 2010 and 2011 to eliminate its claim of \$13,784 for Medicare SERP III costs.

We do not concur with the recommendation and offer an alternative corrective action. Our reason for non-concurrence is two-fold. First, and most significantly, the change to the SERP III plan was unintentional. The amendment was made to conform the SERP III election options to those provided under the Preferred Savings Plan (our non-qualified defined contribution plan) and thereby simplify elections for our retirees. The amendment would enable them to manage both of their nonqualified plans with one election. Of course the intent was that the plan would continue to be recognized as a pension plan but, unfortunately, we did not consider that removing the life time payout option would change this status.

Second, since we are in the process of amending the plan to reinstate the lifetime payout which will make the plan FAR compliant as a pension plan it would be burdensome to account for the plan as being initially FAR compliant followed by a noncompliant period and then finally revert back to being FAR compliant again. This would create the need for future calculations to account for the plan as a deferred compensation plan as well as a pension plan.

Mr. Patrick J. Cogley
September 15, 2014
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Our alternative action is to correct our inadvertent change to the SERP III plan by restoring the offer of a benefit that is payable for life at the option of the employee. This amendment is not complicated and will be completed as soon as possible. We request that this corrective action be considered effective retroactively to the effective date of the amendment removing the lifetime payout option. Further, we have established a policy that our defined benefit plans may not be amended without considering the CAS effects to avoid any future unintended changes to our plans such as this.

We appreciate the opportunity to comment on the recommendation. Please let me know if you have questions or need additional information regarding our response. My contact information is 803-763-5544 or joe.wright@palmettogba.com.

Sincerely,

A handwritten signature in blue ink, appearing to read "Joe Wright". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Cc: Bruce Hughes, BCBSSC
Joe Johnson, Palmetto GBA