



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

OCT 8 2008

REGION IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

Report Number: A-04-07-04018

Mr. Bruce W. Hughes, President
Palmetto Government Benefits Administrators
2300 Springdale Drive, BLDG One
Mail Code: AG-A03
Camden, South Carolina 29020

Dear Mr. Hughes:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Audit of Palmetto Government Benefits Administrators' Durable Medical Equipment Regional Carrier Final Administrative Cost Proposals for Fiscal Years 2004 Through 2006." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Mark Wimple, Audit Manager, at (919) 790-2765, extension 24, or through e-mail at Mark.Wimple@oig.hhs.gov. Please refer to report number A-04-07-04018 in all correspondence.

Sincerely,

Peter J. Barbera
Regional Inspector General
for Audit Services

Enclosure

Page 2 – Bruce W. Hughes

Direct Reply to HHS Action Official:

Nanette Foster Reilly, Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, Missouri 64106

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF PALMETTO GOVERNMENT
BENEFITS ADMINISTRATORS'
DURABLE MEDICAL EQUIPMENT
REGIONAL CARRIER FINAL
ADMINISTRATIVE COST PROPOSALS
FOR FISCAL YEARS
2004 THROUGH 2006**



Daniel R. Levinson
Inspector General

October 2008
A-04-07-04018

Office of Inspector General

<http://oig.hhs.gov>

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THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5).

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

BACKGROUND

Title XVIII of the Social Security Act (the Act) established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B). As a part of the Part B program, the Act provides for the coverage of Durable Medical Equipment (DME). The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts provide for reimbursement of allowable administrative costs incurred in processing Medicare claims.

During the audit period, which covered the period October 1, 2003, through September 30, 2006, CMS contracted with Palmetto Government Benefits Administrators (Palmetto) to serve as a Medicare contractor. Palmetto processed DME claims for Alabama, Arkansas, Colorado, Florida, Georgia, Kentucky, Louisiana, Mississippi, New Mexico, North Carolina, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas, and the Virgin Islands. Palmetto reported administrative costs totaling \$197,868,937 in its Final Administrative Cost Proposals (cost proposals) for fiscal years 2004 through 2006. (See Appendix B.)

OBJECTIVE

Our objective 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.

SUMMARY OF FINDINGS

Palmetto reported expenditures that substantially complied with the FAR and the Medicare contract provisions. However, Palmetto reported in its fiscal year 2004 cost proposal \$2,177 in electronic data processing equipment costs that it was unable to support with adequate documentation. Because Palmetto was unable to provide supporting documentation for certain individual costs claimed in the cost proposals, these costs did not meet the criteria for Federal reimbursement.

RECOMMENDATIONS

We recommend that Palmetto:

- refund to the Federal Government \$2,177 of unallowable costs and
- strengthen its policies and procedures for maintaining documentation to support that costs included on its cost proposals were incurred, allocable to the contract, and compliant with applicable cost principles.

PALMETTO COMMENTS

In its written comments to the draft report, Palmetto said that it had been notified by the Office of Inspector General that the unallowable costs had been reduced to \$2,177, and it agreed with this unallowable amount. In addition, Palmetto agreed with our recommendation to strengthen its policies and procedures.

OFFICE OF INSPECTOR GENERAL RESPONSE

In response to the draft report, Palmetto provided additional documentation supporting that the costs claimed on the cost proposals adequately reconciled to its general ledger. Accordingly, we have removed the recommendation included in our draft report regarding unreconciled costs.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act (the Act) established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program (Part A) and a related supplementary medical insurance program (Part B). As a part of the Part B program, the Act provides for the coverage of Durable Medical Equipment (DME). 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 a cost proposal, the contractor and CMS negotiate a final settlement of allowable administrative costs.

During our audit period (FYs 2004 through 2006), CMS contracted with Palmetto Government Benefits Administrators (Palmetto) to serve as a Medicare contractor. Palmetto processed DME claims for Alabama, Arkansas, Colorado, Florida, Georgia, Kentucky, Louisiana, Mississippi, New Mexico, North Carolina, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas, and the Virgin Islands.

The contract between Palmetto and CMS set forth principles of reimbursement for administrative costs. The contract cited the Federal Acquisition Regulation (FAR), 48 CFR, chapter 1, as regulatory principles to be followed for application to the Medicare contract and provided additional guidelines for specific cost areas.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective 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 FAR and the Medicare contract.

Scope

Our audit covered the period October 1, 2003, through September 30, 2006 (FYs 2004 through 2006). For this period, Palmetto reported administrative costs to CMS totaling \$197,868,937. This total included pension costs of \$7,582,939 that we excluded from this review because pension costs will be the subject of a separate audit.

In planning and performing our audit, we reviewed Palmetto's internal controls for allocating costs to cost objectives in accordance with the FAR and the Medicare contract. We conducted this analysis to accomplish our objective and not to provide assurance on the internal control structure.

We conducted fieldwork at Palmetto's office in Columbia, South Carolina, from April 2007 through December 2007.

Methodology

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidelines, including the FAR section 31.201-2(d), the Medicare Financial Management Manual, chapter 2, section 190.3 and Palmetto's contract with CMS;
- reconciled the cost proposals from FYs 2004 through 2006 to Palmetto's accounting records;
- performed analytical tests of Palmetto's trial balances;
- selected and reviewed a judgmental sample of invoices, expense vouchers and reports, and journal entries;
- interviewed Palmetto officials about their cost accumulation processes for cost proposals and gained an understanding of their cost allocation systems;
- reviewed payroll journals, corporate bonus plans, and personnel records;
- selected a stratified random sample of 105 individual employee pay periods and verified that the amount paid was in accordance with the employee's pay rate, the salary was charged to the correct cost center, and the number of hours paid agreed with the time sheets (Sampling Methodology Appendix A); and
- tested costs for allowability, allocability, and reasonableness.

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 objective.

FINDINGS AND RECOMMENDATIONS

Palmetto reported expenditures that substantially complied with the FAR and the Medicare contract provisions. However, Palmetto reported in its FY 2004 cost proposal \$2,177 in electronic data processing equipment costs that it was unable to support with adequate documentation. Because Palmetto was unable to provide supporting documentation for certain individual costs claimed in the cost proposals, these costs did not meet the criteria for Federal reimbursement.

UNALLOWABLE COSTS

Pursuant to FAR section 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” Likewise, chapter 2 section 190.3 of the Medicare Financial Management Manual states that the contractor must maintain records “. . . in such detail as will properly reflect all net costs, direct and indirect . . . for which reimbursement is claimed under the provisions of the agreement.”

Palmetto was unable to provide adequate supporting documentation for expenditures totaling \$2,177 that it claimed in the electronic data processing equipment category on its FY 2004 cost proposal.

Palmetto did not provide invoices, contracts, journal entries, expense vouchers, or other such documentation to support these expenses. Because Palmetto was unable to provide adequate supporting documentation for these costs totaling \$2,177, the costs were unallowable for Federal reimbursement.

Throughout our audit, Palmetto experienced difficulty and significant delays in obtaining evidence to support the expenses in its cost proposals. We believe that Palmetto could have minimized both its efforts and our audit delays by maintaining proper documentation to adequately support the costs claimed on the cost proposals.

RECOMMENDATIONS

We recommend that Palmetto:

- refund to the Federal Government \$2,177 of unallowable costs and
- strengthen its policies and procedures for maintaining documentation to support that costs included on its cost proposals were incurred, allocable to the contract, and compliant with applicable cost principles.

PALMETTO COMMENTS

In its written comments to the draft report, Palmetto said that it had been notified by the Office of Inspector General that the unallowable costs had been reduced to \$2,177, and it agreed with this unallowable amount. In addition, Palmetto agreed with our recommendation to strengthen its policies and procedures.

OFFICE OF INSPECTOR GENERAL RESPONSE

In response to the draft report, Palmetto provided additional documentation supporting that the costs claimed on the cost proposals adequately reconciled to its general ledger. Accordingly, we have removed the recommendation included in our draft report regarding unreconciled costs.

APPENDIXES

SAMPLING METHODOLOGY

OBJECTIVE

Our objective was to determine whether the salary costs that Palmetto reported on its cost proposals were allowable, allocable, and reasonable in accordance with part 31 of the Federal Acquisition Regulation and the Medicare contract.

POPULATION

The population consisted of 52,783 employee pay periods related to \$85,744,033 Medicare Durable Medical Equipment salaries and wages that were charged to Medicare from October 1, 2003, through September 30, 2006.

SAMPLE UNIT

The sample unit was an “employee pay period.”¹

SAMPLE DESIGN

We used a stratified random sample of employee pay periods for fiscal years 2004, 2005, and 2006. Each FY represented a separate stratum.

SAMPLE SIZE

We selected a sample of 105 employee pay periods that included 35 each from fiscal years 2004, 2005, and 2006.

¹An “employee pay period” consists of one employee’s salaries, wages, and related fringe benefits for one pay period.

FINAL ADMINISTRATIVE COST PROPOSALS
WITH OFFICE OF INSPECTOR GENERAL RECOMMENDED COST DISALLOWANCES AND ACCEPTANCES
For Fiscal Years (FY) 2004, 2005, and 2006

<u>Cost Category</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>Total</u>
Salaries & Wages	\$ 36,435,420	\$ 33,979,724	\$ 29,597,333	\$ 100,012,477
Fringe Benefits	10,871,945	11,560,079	9,748,608	32,180,632
Facilities or Occupancy	3,503,652	4,249,978	3,556,451	11,310,081
EDP Equipment	5,370,017	6,794,162	2,198,538	14,362,717
Subcontracts	6,535,045	5,764,174	4,247,181	16,546,400
Outside Professional Services	116,313	309,405	45,876	471,594
Telephone & Telegraph	831,093	630,272	472,172	1,933,537
Postage & Express	5,931,842	7,863,694	7,718,577	21,514,113
Furniture & Equipment	624,700	782,254	322,196	1,729,150
Materials & Supplies	1,329,033	1,399,900	860,907	3,589,840
Travel	915,687	874,935	731,577	2,522,199
Return on Investment	145,573	101,104	70,442	317,119
Miscellaneous	(45,997)	1,627,495	6,846,760	8,428,258
Other	0	1,097,627	0	1,097,627
Credits	(5,684,229)	(6,532,721)	(6,343,145)	(18,560,095)
Forward Funding	0	177,615	235,673	413,288
Total Costs Claimed on FACP	\$ 66,880,094	\$ 70,679,697	\$ 60,309,146	\$ 197,868,937
OIG Recommended Disallowance*	(2,177)	0	0	(2,177)
OIG Recommended for Acceptance	\$ 66,877,917	\$ 70,679,697	\$ 60,309,146	\$ 197,866,760

* See Appendix C

APPENDIX C

OFFICE OF INSPECTOR GENERAL RECOMMENDED COST DISALLOWANCES
For Fiscal Year (FY) 2004

<u>Finding Categories</u>	<u>FY 2004</u>	<u>Total Durable Medical Equipment Disallowances</u>
Unallowable Costs		
Electronic Data Processing Equipment	\$2,177	\$2,177
Total OIG Recommended Disallowances	<u><u>\$2,177</u></u>	<u><u>\$2,177</u></u>

Palmetto GBA
Final Administrative Cost Proposal Durable Medical Equipment
Fiscal Year 2004 Comparison of Administrative Costs Claimed to Budget Authorization

Operation	Budget Authorization	Administrative Costs Claimed	Variance Favorable (Unfavorable)
<u>Program Management</u>			
Bills/Claims Payment	\$ 24,325,700	\$ 23,904,307	\$ 421,393
Appeals	8,433,500	9,224,862	(791,362)
Beneficiary Inquiries	7,395,800	7,687,752	(291,952)
PM Provider Communication	537,700	519,085	18,615
Productivity Investments	696,200	861,262	(165,062)
Provider Telephone Inquiries	5,706,900	5,317,037	389,863
Credits	<u>(5,574,700)</u>	<u>(5,506,961)</u>	<u>(67,739)</u>
Subtotal Program Management	41,521,100	42,007,344	(486,244)
<u>Medicare Integrity Program</u>			
Medical Review	3,299,100	3,044,393	254,707
Medicare Secondary Payer Pre-Payment	392,200	377,898	14,302
Benefit Integrity	2,664,400	2,682,680	(18,280)
Local Provider Education & Training	592,201	650,698	(58,497)
Provider Communications	1,987,100	2,246,670	(259,570)
Productivity Investments	15,205,000	15,059,309	145,691
Medicare Secondary Payer Post-Payment	<u>848,900</u>	<u>811,102</u>	<u>37,798</u>
Subtotal Medicare Integrity Program	24,988,901	24,872,750	116,151
Totals	<u>\$ 66,510,001</u>	<u>\$ 66,880,094</u>	<u>\$ (370,093)</u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 5) and Notification of Budget Approval (Supplement No. 10).

Palmetto GBA
Final Administrative Cost Proposal Durable Medical Equipment
Fiscal Year 2005 Comparison of Administrative Costs Claimed to Budget Authorization

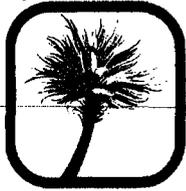
Operation	Budget Authorization	Administrative Costs Claimed	Variance Favorable (Unfavorable)
<u>Program Management</u>			
Bills/Claims Payment	\$ 29,319,000	\$ 28,690,818	\$ 628,182
Appeals	9,498,200	9,700,610	(202,410)
Beneficiary Inquiries	7,093,400	6,811,940	281,460
PM Provider Communication	472,600	452,464	20,136
Productivity Investments	256,500	201,827	54,673
Provider Telephone Inquiries	5,424,500	5,260,414	164,086
Credits	(6,307,700)	(6,292,303)	(15,397)
Subtotal Program Management	<u>45,756,500</u>	<u>44,825,770</u>	<u>930,730</u>
<u>Medicare Integrity Program</u>			
Medical Review	3,044,400	3,042,392	2,008
Medicare Secondary Payer Pre-Payment	372,700	370,622	2,078
Benefit Integrity	3,067,000	3,001,629	65,371
Local Provider Education & Training	586,000	603,660	(17,660)
Provider Communications	2,097,200	2,314,390	(217,190)
Productivity Investments	14,873,000	14,858,294	14,706
Medicare Secondary Payer Post-Payment	577,100	565,313	11,787
Subtotal Medicare Integrity Program	<u>24,617,400</u>	<u>24,756,300</u>	<u>(138,900)</u>
<u>Medicare Modernization Act Contracting Reform</u>	1,097,627	1,097,627	0
Totals	<u>\$ 71,471,527</u>	<u>\$ 70,679,697</u>	<u>\$ 791,830</u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 4) and Notification of Budget Approval (Supplement No. 11).

Palmetto GBA
Final Administrative Cost Proposal Durable Medical Equipment
Fiscal Year 2006 Comparison of Administrative Costs Claimed to Budget Authorization

Operation	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance Favorable (Unfavorable)</u>
<u>Program Management</u>			
Bills/Claims Payment	\$ 27,094,100	\$ 26,499,408	\$ 594,692
Appeals	9,720,642	9,895,731	(175,089)
Beneficiary Inquiries	3,885,800	4,070,991	(185,191)
PM Provider Communication	124,800	308,175	(183,375)
Productivity Investments	215,100	169,570	45,530
Provider Telephone Inquiries	4,199,900	4,302,544	(102,644)
Credits	(5,281,800)	(6,144,430)	862,630
Subtotal Program Management	<u>39,958,542</u>	<u>39,101,989</u>	<u>856,553</u>
<u>Medicare Integrity Program</u>			
Medical Review	1,109,600	1,140,869	(31,269)
Medicare Secondary Payer Pre-Payment	311,200	326,748	(15,548)
Benefit Integrity	1,400,900	1,470,791	(69,891)
Local Provider Education & Training	153,800	145,164	8,636
Provider Communications	2,279,500	2,289,739	(10,239)
Productivity Investment	15,503,300	15,392,071	111,229
Medicare Secondary Payer Post-Payment	435,800	441,775	(5,975)
Subtotal Medicare Integrity Program	<u>21,194,100</u>	<u>21,207,157</u>	<u>(13,057)</u>
Totals	<u>\$ 61,152,642</u>	<u>\$ 60,309,146</u>	<u>\$ 843,496</u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 0) and Notification of Budget Approval (Supplement No. 20).

**Palmetto GBA**SM

PARTNERS IN EXCELLENCE™

Bruce W. Hughes

President and Chief Operating Officer

August 8, 2008

Mr. Peter J. Barbera
Regional Inspector General for Audit Services
Region IV
60 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

RE: Audit Report Number A-04-07-04018

Dear Mr. Barbera:

We are responding to your draft audit report dated June 25, 2008 entitled "Audit of Palmetto Government Benefits Administrators' Durable Medical Equipment Regional Carrier Final Administrative Cost Proposals for Fiscal Years 2004 Through 2006." Thank you for the additional time to submit our response.

The draft report contained the following recommendations. Our responses to the recommendations are provided below.

We recommend that Palmetto:

- Refund to the Federal Government \$3,106,489 reported in its cost proposals that did not reconcile to its general ledger;
- Refund to the Federal Government \$23,402 of unallowable costs; and
- Strengthen its policies and procedures for maintaining documentation to support that costs included on its cost proposals were incurred, allocable to the contract, and compliant with applicable cost principles.

Contractor Response:

- Since the date of the draft audit report, we have received updated information from the OIG auditors indicating that the unreconciled amount is reduced to \$13,986 for FY 2005 and \$39,997 for FY 2006. While we recognize that there are difficulties reconciling amounts to the cost classification report lines on the FACP, our total costs claimed is fully reconciled to our general ledger. Palmetto GBA has maintained a consistent process of monthly reconciliation of all costs claimed to the general ledger throughout the periods covered by this audit. It is inequitable not to net under-supported and over-supported amounts to arrive at any adjustment to costs. In addition, we have reviewed many OIG audit reports that propose both increases and decreases to allowable costs and do not understand why that approach is not being followed in this case. Based on the fact that our total cost claimed are reconciled to our general ledger, we continue to disagree that this cost should be disallowed.
- Since the date of the draft audit, we have received updated information from the OIG auditors indicating that the unallowable costs have been reduced to \$2,177. Palmetto GBA agrees with this revised amount.

Office of Inspector General Note: Portions of this response are no longer applicable because we reduced the unreconcilable and unallowable costs based on additional documentation submitted by the auditee.

Mr. Peter J. Barbera

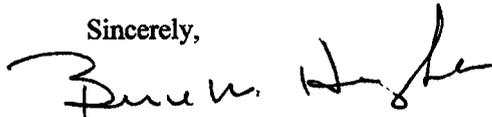
August 8, 2008

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- Palmetto GBA agrees with the recommendation to strengthen our policies and procedures for maintaining documentation to support that costs included on our cost proposals were incurred, allocable to the contract, and compliant with applicable cost principles. On October 1, 2007, we implemented a new accounting system that standardized and automates processes that were manual functions. We have also updated work instructions for the new system and will take any other steps deemed necessary to implement this recommendation.

If you have any questions, please feel free to contact me at 803-763-7130.

Sincerely,



cc: William R Horton, BCBSSC
Joe Wright, Palmetto GBA
Mark Wimple, OIG