



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

OCT 9 2008

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

Report Number: A-04-08-04023

Mr. Bruce W. Hughes, President
Palmetto Government Benefits Administrators
2300 Springdale Drive, Building 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' Medicare Part B 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-04-08-04023 in all correspondence.

Sincerely,

A handwritten signature in cursive script that reads "Peter J. Barbera".

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'
MEDICARE PART B FINAL
ADMINISTRATIVE COST PROPOSALS
FOR FISCAL YEARS
2004 THROUGH 2006**



Daniel R. Levinson
Inspector General

October 2008
A-04-08-04023

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. Specifically, these evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness in departmental programs. To promote impact, the reports also present practical recommendations for improving program operations.

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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

BACKGROUND

Title XVIII of the Social Security 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). 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 Part B claims for South Carolina, Ohio, and West Virginia. Palmetto reported administrative costs totaling \$150,232,712 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 cost proposals \$31,687 that it was unable to support with adequate documentation. These unallowable costs were for subcontracts (\$31,553) and electronic data processing equipment (\$134). Because Palmetto was unable to provide accounting records to fully support the costs reported and 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 \$31,687 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 \$31,687; however, Palmetto believes that \$31,553 of the \$31,687 is allowable and can be supported. Palmetto said that it would continue to search for proper documentation of these costs and, when located, submit it to CMS. Palmetto agreed with our recommendation to strengthen its policies and procedures.

OFFICE OF INSPECTOR GENERAL RESPONSE

We continue to recommend that Palmetto refund \$31,687 of unallowable costs pending submission of adequate supporting documentation to CMS.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security 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). 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 Part B claims for South Carolina, Ohio, and West Virginia.

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 \$150,232,712. This total included pension costs of \$4,244,764 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 cost proposals \$31,687 that it was unable to support with adequate documentation. These unallowable costs were for subcontracts (\$31,553) and electronic data processing equipment (\$134). Because Palmetto was unable to provide accounting records to fully support the costs reported and 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 \$31,687 that it claimed in its cost proposals. The unsupported expenditures were included in the following cost categories:

- \$31,553 for subcontracts in FY 2005 and
- \$134 for electronic data processing equipment in FY 2004.

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 \$31,687, 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 \$31,687 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 \$31,687; however, Palmetto believes that \$31,553 of the \$31,687 is allowable and can be supported. Palmetto said that it would continue to search for proper documentation of these costs and, when located, submit it to CMS. Palmetto agreed with our recommendation to strengthen its policies and procedures.

OFFICE OF INSPECTOR GENERAL RESPONSE

We continue to recommend that Palmetto refund \$31,687 of unallowable costs pending submission of adequate supporting documentation to CMS.

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 48,056 employee pay periods related to \$78,213,917 Medicare Part B 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 (FY) 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 FYs 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	\$ 33,214,414	\$ 30,675,893	\$ 26,256,079	\$ 90,146,386
Fringe Benefits	9,009,887	9,375,172	8,171,353	26,556,412
Facilities or Occupancy	3,307,049	4,091,413	3,334,891	10,733,353
EDP Equipment	4,551,168	5,460,500	1,553,580	11,565,248
Subcontracts	5,231,272	5,398,924	3,958,497	14,588,693
Outside Professional Services	49,260	58,429	17,296	124,985
Telephone & Telegraph	875,847	783,221	474,737	2,133,805
Postage & Express	6,619,421	5,013,158	6,955,033	18,587,612
Furniture & Equipment	621,558	743,261	296,451	1,661,270
Materials & Supplies	1,466,751	3,469,869	961,386	5,898,006
Travel	454,541	453,163	387,583	1,295,287
Return on Investment	122,279	18,891	56,569	197,739
Miscellaneous	707,103	1,583,457	4,220,397	6,510,957
Other	0	0	0	0
Credits	(13,262,093)	(14,469,301)	(13,774,556)	(41,505,950)
Forward Funding	0	25,428	1,713,481	1,738,909
Total Costs Claimed on FACP	\$ 52,968,457	\$ 52,681,478	\$ 44,582,777	\$150,232,712
OIG Recommended Disallowance*	(134)	(31,553)	0	(31,687)
OIG Recommended for Acceptance	\$ 52,968,323	\$ 52,649,925	\$ 44,582,777	\$150,201,025

* See Appendix C

APPENDIX C

OFFICE OF INSPECTOR GENERAL RECOMMENDED COST DISALLOWANCES
For Fiscal Years (FY) 2004 and 2005

<u>Finding Categories</u>	<u>FY 2004</u>	<u>FY 2005</u>	<u>Total Part B Disallowances</u>
Unallowable Costs			
Subcontracts	0	31,553	31,553
Electronic Data Processing Equipment	134	0	134
Total OIG Recommended Disallowances	<u>\$134</u>	<u>\$31,553</u>	<u>\$31,687</u>

Palmetto GBA
Final Administrative Cost Proposal Part B
Fiscal Year 2004 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	\$ 36,500,800	\$ 37,207,857	\$ (707,057)
Appeals	3,804,200	3,821,060	(16,860)
Beneficiary Inquiries	3,725,700	3,521,825	203,875
PM Provider Communication	262,300	246,484	15,816
Participating Physicians	165,800	158,765	7,035
Productivity Investments	573,400	516,744	56,656
Provider Enrollment	4,202,500	3,972,037	230,463
Provider Telephone Inquiries	5,155,900	4,967,918	187,982
Credits	<u>(13,022,200)</u>	<u>(13,247,270)</u>	<u>225,070</u>
Subtotal Program Management	41,368,400	41,165,420	202,980
<u>Medicare Integrity Program</u>			
Medical Review	5,316,400	5,163,164	153,236
Medicare Secondary Payer Pre-Payment	689,600	661,336	28,264
Benefit Integrity	120,000	121,031	(1,031)
Local Provider Education & Training	1,230,400	1,120,759	109,641
Provider Communications	1,083,700	1,021,466	62,234
Medicare Secondary Payer Post-Payment	<u>3,595,600</u>	<u>3,715,281</u>	<u>(119,681)</u>
Subtotal Medicare Integrity Program	12,035,700	11,803,037	232,663
Totals	<u>\$ 53,404,100</u>	<u>\$ 52,968,457</u>	<u>\$ 435,643</u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 4) and Notification of Budget Approval (Supplement No. 18).

Palmetto GBA
Final Administrative Cost Proposal Part B
Fiscal Year 2005 Comparison of Administrative Costs Claimed to Budget Authorization

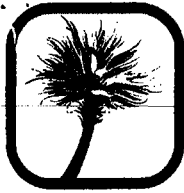
Operation	Budget <u>Authorization</u>	Administrative <u>Costs Claimed</u>	Variance Favorable <u>(Unfavorable)</u>
<u>Program Management</u>			
Bills/Claims Payment	\$ 38,746,500	\$ 37,799,612	\$ 946,888
Appeals	4,322,800	4,276,079	46,721
Beneficiary Inquiries	3,500,200	3,353,602	146,598
PM Provider Communication	218,700	223,755	(5,055)
Participating Physicians	215,900	188,570	27,330
Productivity Investments	136,600	96,008	40,592
Provider Enrollment	4,106,200	3,984,514	121,686
Provider Telephone Inquiries	6,112,100	5,859,817	252,283
Credits	(14,047,800)	(14,460,411)	412,611
Subtotal Program Management	<u>43,311,200</u>	<u>41,321,546</u>	<u>1,989,654</u>
<u>Medicare Integrity Program</u>			
Medical Review	4,297,300	4,182,277	115,023
Medicare Secondary Payer Pre-Payment	485,800	469,447	16,353
Benefit Integrity	94,000	89,076	4,924
Local Provider Education & Training	1,041,400	1,026,657	14,743
Provider Communications	979,200	942,905	36,295
Medicare Secondary Payer Post-Payment	3,422,400	3,208,683	213,717
MMA Regulatory Reform	-	554,279	(554,279)
HIGLAS Transition	-	886,608	(886,608)
Subtotal Medicare Integrity Program	<u>10,320,100</u>	<u>11,359,932</u>	<u>(1,039,832)</u>
Totals	<u><u>\$ 53,631,300</u></u>	<u><u>\$ 52,681,478</u></u>	<u><u>\$ 949,822</u></u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 4) and Notification of Budget Approval (Supplement No. 12).

Palmetto GBA
Final Administrative Cost Proposal Part B
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	\$ 32,385,200	\$ 31,780,247	\$ 604,953
Appeals	4,612,200	4,776,478	(164,278)
Beneficiary Inquiries	2,165,000	2,139,835	25,165
PM Provider Communication	300,600	402,591	(101,991)
Participating Physicians	82,600	82,666	(66)
Productivity Investments	54,000	15,883	38,117
Provider Enrollment	3,847,600	3,925,369	(77,769)
Provider Telephone Inquiries	3,961,200	3,741,576	219,624
Credits	(13,797,200)	(13,767,472)	(29,728)
Subtotal Program Management	<u>33,611,200</u>	<u>33,097,173</u>	<u>514,027</u>
<u>Medicare Integrity Program</u>			
Medical Review	4,303,400	4,201,209	102,191
Medicare Secondary Payer Pre-Payment	482,500	468,442	14,058
Benefit Integrity	34,100	30,726	3,374
Local Provider Education & Training	795,900	769,192	26,708
Provider Communications	754,500	741,555	12,945
Productivity Investments	0	58,509	(58,509)
Medicare Secondary Payer Post-Payment	2,876,300	2,715,971	160,329
HIGLAS Transition	(1,000,000)	2,500,000	(2,500,000)
Subtotal Medicare Integrity Program	<u>9,246,700</u>	<u>11,485,604</u>	<u>(2,238,904)</u>
Totals	<u>\$ 42,857,900</u>	<u>\$ 44,582,777</u>	<u>\$ (1,724,877)</u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 0) and Notification of Budget Approval (Supplement No. 21).

**Palmetto GBA**

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-04-07-04023

Dear Mr. Barbera:

We are responding to your draft audit report dated June 25, 2008 entitled "Audit of Palmetto Government Benefits Administrators' Medicare Part B 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 \$492,677 reported in its cost proposals that did not reconcile to its general ledger;
- Refund to the Federal Government \$480,612 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 that the unreconciled amount of \$492,677 has been reconciled and this recommended adjustment has been eliminated. We agree with this revised recommendation.
- Since the date of the draft audit report, we have received updated information from the OIG auditors indicating that the unallowable costs have been reduced to \$31,687. Palmetto GBA believes that \$31,553 of the unallowed amount, which represents a single journal entry, is allowable and can be supported. We will continue to search for the proper documentation of these costs and, when located, provide the documentation to CMS.
- Palmetto 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 standardizes and automates processed 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.

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.

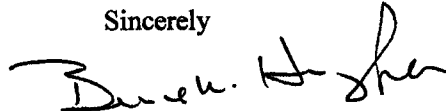
Mr. Peter J. Barbera

August 8, 2008

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

Sincerely

A handwritten signature in black ink, appearing to read "Bruce Horton". The signature is written in a cursive style with a large initial "B".

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