



Office of Audit Services, Region IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, GA 30303

November 4, 2009

Report Number: A-04-08-04025

Mr. Bruce W. Hughes, President and Chief Operating Officer
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 Year 2007." 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.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 404-562-7800 or contact Mark Wimple, Audit Manager, at (919) 790-2765, extension 24, or through email at Mark.Wimple@oig.hhs.gov. Please refer to report number A-04-08-04025 in all correspondence.

Sincerely,

/Peter J. Barbera/
Regional Inspector General
for Audit Services

Enclosure

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
PROPOSAL FOR FISCAL YEAR 2007**



Daniel R. Levinson
Inspector General

November 2009
A-04-08-04025

Office of Inspector General

<http://oig.hhs.gov>

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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). 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, 2006, through September 30, 2007, 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. CMS terminated the DME claims processing contract on June 1, 2007. CMS guidelines require contractors to file costs incurred prior to the contract termination as administrative costs and to file costs incurred subsequent to the termination on a separate termination voucher. Palmetto reported administrative costs totaling \$39,341,092 in its Final Administrative Cost Proposal (FACP) for fiscal year 2007. (See Appendix A.)

OBJECTIVE

Our objective was to determine whether the administrative costs that Palmetto reported on its DME FACP 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, contrary to CMS guidelines, Palmetto: (1) did not submit a budget for its contract termination costs and (2) claimed \$733,006 on its FACP for employee severance payments that resulted from termination of the DME claims processing contract.

RECOMMENDATIONS

We recommend that Palmetto:

- submit a termination cost budget to CMS for the costs related to the termination of the DME claims processing contract and
- follow CMS guidelines in the future when terminating contracts including claiming the costs on a termination voucher.

PALMETTO COMMENTS

In its written comments to our report, Palmetto agreed with our findings and recommendations and stated that it would submit a termination cost budget to CMS and would use a termination voucher in the future. Palmetto's comments are included in their entirety as Appendix C.

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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). 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 (FACP) reporting Medicare costs. Once CMS accepts an FACP, the contractor and CMS negotiate a final settlement of allowable administrative costs.

During our audit period (FY 2007), 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.

CMS terminated the DME claims processing contract with Palmetto on June 1, 2007. CMS guidelines require contractors to file costs incurred prior to the contract termination as administrative costs and to file costs incurred subsequent to the termination on a separate termination voucher. 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 DME FACP 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, 2006, through September 30, 2007 (FY 2007). For this period, Palmetto reported administrative costs to CMS totaling \$39,341,092. This total included pension costs of \$1,926,579 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 July 2008 through April 2009.

Methodology

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidelines;
- reconciled the FY 2007 cost proposal to Palmetto's accounting records;
- performed analytical tests of Palmetto's trial balances;
- selected and reviewed a judgmental sample of invoices, expense vouchers, expense 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 judgmental sample of 30 individual employee pay periods and verified that the amount paid was in accordance with the employee's pay rate, that the salary was charged to the correct cost center, and that the number of hours paid agreed with the time sheets;
- selected a sample of the 30 highest employee severance payments and, using Palmetto's severance policy, recalculated the amount paid to verify that the severance paid to these employees was in accordance with the severance policy; 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, contrary to CMS guidelines, Palmetto: (1) did not submit a budget for its contract termination costs and (2) claimed \$733,006 on its FACP for employee severance payments that resulted from termination of the DME claims processing contract.

NO TERMINATION BUDGET SUBMITTED

Palmetto officials did not submit a budget to CMS for costs related to the termination of the DME claims processing contract. Section 8.4 of CMS's DME Regional Carrier (DMERC) Workload Closeout Handbook states that ". . . once termination costs can be reasonably estimated, a hardcopy of the termination budget should be submitted to the appropriate Regional Office and to Central Office."

TERMINATION COSTS CLAIMED ON FINAL ADMINISTRATIVE COST PROPOSAL

On the FACP, Palmetto claimed \$733,006 of severance payments to employees that resulted from termination of the DME claims processing contract. Section 8.4 of CMS's DMERC Workload Closeout Handbook states that "[t]ermination costs are not to be included in the FACP; only vouchers may be used to claim reimbursement of termination costs." Palmetto accurately computed and paid the \$733,006 in accordance with its severance policy. Therefore, the costs are allowable. We are only disclosing that Palmetto did not follow proper procedures in claiming the costs.

RECOMMENDATIONS

We recommend that Palmetto:

- submit a termination cost budget to CMS for the costs related to the termination of the DME claims processing contract and
- follow CMS guidelines in the future when terminating contracts including claiming the costs on a termination voucher.

PALMETTO COMMENTS

In its written comments to our report, Palmetto agreed with our findings and recommendations and stated that it would submit a termination cost budget to CMS and would use a termination voucher in the future. Palmetto's comments are included in their entirety as Appendix C.

APPENDIXES

**APPENDIX A: Palmetto GBA
Final Administrative Cost Proposal - Durable Medical Equipment
Fiscal Year 2007 Costs Claimed**

Salaries & Wages	\$	17,912,466
Fringe Benefits		8,233,494
Facilities or Occupancy		2,500,337
EDP Equipment		2,101,738
Subcontracts		4,125,342
Outside Professional Services		229,185
Telephone & Telegraph		564,384
Postage & Express		4,316,566
Furniture & Equipment		296,961
Materials & Supplies		647,155
Travel		450,977
Return on Investment		110,546
Miscellaneous		1,654,804
Other		0
Credits		(3,802,863)
Forward Funding		0
Total Costs Claimed on FACP	<u>\$</u>	<u>39,341,092</u>

APPENDIX B: Palmetto GBA
Final Administrative Cost Proposal - Durable Medical Equipment
Fiscal Year 2007 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	\$ 18,454,665	\$ 16,907,778	\$1,546,887
Appeals	3,661,400	4,001,882	(340,482)
Beneficiary Inquiries	685,900	1,089,600	(403,700)
Productivity Investment	178,000	0	178,000
Provider Telephone Inquiries	3,203,600	3,424,114	(220,514)
Provider Outreach & Education	555,600	498,839	56,761
Credits	<u>(3,893,600)</u>	<u>(3,787,719)</u>	<u>(105,881)</u>
Subtotal Program Management	22,845,565	22,134,494	711,071
<u>Medicare Integrity Program</u>			
Medical Review	100,000	10,857	89,143
Medicare Secondary Payer Pre-Payment	167,500	172,852	(5,352)
Benefits Integrity	64,000	104,346	(40,346)
Productivity Investment	15,700,000	15,761,141	(61,141)
Medicare Secondary Payer Post-Payment	95,300	72,833	22,467
Provider Outreach & Education	999,500	1,084,569	(85,069)
Subtotal Medicare Integrity Program	<u>17,126,300</u>	<u>17,206,598</u>	<u>(80,298)</u>
Totals	<u><u>\$ 39,971,865</u></u>	<u><u>\$ 39,341,092</u></u>	<u><u>\$630,773</u></u>

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 1) and Notification of Budget Approval (Supplement No. 12).

APPENDIX C: PALMETTO COMMENTS



Bruce W. Hughes
President and Chief Operating Officer

October 21, 2009

Peter J. Barbera
Regional Inspector General
for Audit Services
Office of Inspector General
Office of Audit Services
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

Dear Mr. Barbera:

We are submitting this letter in response to Audit Report A-04-08-04025 entitled "Audit of Palmetto Government Benefits Administrators' Durable Medical Equipment Regional Carrier (DMERC) Final Administrative Cost Proposal for Fiscal Year 2007."

The report contained the following recommendations:

We recommend that Palmetto:

- submit a termination costs budget to CMS for the costs related to the termination of the DME claims processing contract and
- follow CMS guidelines in the future when terminating contracts including claiming the costs on a termination voucher.

We agree with the report and the recommendations and will submit a termination cost budget to CMS and take the actions necessary to follow the CMS guidelines in the future. We would like to point out that this was an unusual situation since all work under our contract did not end completely at the time the DMERC portion of the contract ended. We continued to submit an Interim Expenditure Report under contractor number 885 for work performed under the National Supplier Clearing House and/or the Statistical Analysis Durable Medical Equipment Regional Contractor contracts through June 2008. However, as stated, we will use the termination voucher in the future.

Thank you for the opportunity to respond to the recommendations.

Sincerely,

/Bruce W. Hughes/