

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**PALMETTO GBA, LLC, APPLIED THE  
SENIOR EXECUTIVE COMPENSATION  
BENCHMARK IN ACCORDANCE WITH  
FEDERAL REGULATIONS**

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# *Office of Inspector General*

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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.

## INTRODUCTION

*Palmetto GBA, LLC, applied the senior executive compensation benchmark in accordance with Federal requirements. Our application of the existing benchmark to all employees resulted in no additional cost savings. Had the benchmark of \$487,000 been applied to all employees during our audit period, cost savings would have been about \$500,000 for 1 year. However, applying a benchmark equaling the salaries of the President and Vice President of the United States to all employees would have resulted in cost savings of up to \$2.2 million for 1 year.*

### 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, including allowable compensation to senior executives. After the close of each fiscal year (FY), contractors submit to CMS an Incurred Cost Proposal (ICP) reporting Medicare costs. After CMS accepts the ICP, the contractor and CMS negotiate a final settlement of allowable administrative costs.

The senior executive compensation benchmark increased to \$952,308 at the beginning of 2012. Some lawmakers advocate setting it at the President's salary of \$400,000, while others support the Vice President's salary of \$230,700 as a more appropriate benchmark.

### OBJECTIVE

The objective of this review was to determine whether Palmetto GBA, LLC (Palmetto), complied with Federal requirements to apply the senior executive compensation benchmark and to identify cost savings if Palmetto had applied to all employees the existing benchmark or a benchmark equaling the salaries of the President and Vice President of the United States.

### BACKGROUND

#### The Medicare Program

Title XVIII of the Social Security Act established the Medicare program. CMS administers the Medicare program through contractors that process and pay Medicare claims. Contracts between CMS and the Medicare contractors define the functions performed by the contractors and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims, including allowable compensation to executives.

#### Incurred Cost Proposals

Following the close of each FY, contractors submit to CMS an ICP that reports the Medicare administrative costs incurred during the year. The ICP provides the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative

costs. When claiming costs, Medicare contractors must follow cost reimbursement principles contained in part 31 of the Federal Acquisition Regulation (FAR) and other applicable criteria.

## **Federal Requirements**

Federal regulations state, “The total compensation for individual employees or job classes of employees must be reasonable for the work performed...” (48 CFR § 31.205-6(a)(2)). Additionally, 48 CFR § 31.205-6(p) states that costs incurred after January 1, 1998, for senior executive<sup>1</sup> compensation<sup>2</sup> in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, Office of Federal Procurement Policy, are unallowable. For calendar year (CY) 2013, the senior executive compensation benchmark was \$952,308.

Section 702 of the Bipartisan Budget Act of 2013 established a benchmark of \$487,000 per year on the amount the Federal Government will reimburse for all contractor-paid employee compensation on executive agency contracts awarded on or after June 24, 2014.<sup>3</sup> Additionally, the Department of Defense, General Services Administration, and National Aeronautics and Space Administration amended 48 CFR § 31.205-6(p) to change the applicability of the benchmark to include all employees, not just senior executives (also effective June 24, 2014).

## **Palmetto GBA, LLC**

Palmetto is currently one of nine Medicare Administrative Contractors. For CY 2013, CMS contracted with Palmetto for Jurisdiction 1 and 11, serving California, Nevada, Hawaii, American Samoa, Guam, the Northern Mariana Islands, North Carolina, South Carolina, Virginia, and West Virginia. For this period, Palmetto submitted ICPs to CMS claiming senior executive compensation totaling \$2,985,723. Of this amount, \$2,233,368 related to Palmetto employees, \$743,440 related to BlueCross BlueShield of South Carolina (BlueCross) employees, and \$8,915 related to National Government Services, Inc. (NGS), subcontract employees.

Palmetto, headquartered in Columbia, South Carolina, is a wholly owned subsidiary of BlueCross. BlueCross provided certain management and other operational support services for Palmetto, including general corporate administration. Accordingly, BlueCross allocated to Palmetto \$743,440 in senior executive compensation costs, which Palmetto claimed on its ICPs to CMS. Additionally, NGS allocated to Palmetto \$8,915 in senior executive compensation costs for operational support services involved in its contract with Palmetto.

## **HOW WE CONDUCTED THIS REVIEW**

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<sup>1</sup> Effective January 2, 1999, senior executive is defined as “the five most highly compensated employees in management positions at each home office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor’s headquarters.”

<sup>2</sup> Compensation is defined as “total amount of wages, salary, bonuses, deferred compensation, and employer contributions to defined contribution pension plans.”

<sup>3</sup> Although not effective until after our audit period, we also used this benchmark for comparative purposes.

Our audit covered the period January 1 through December 31, 2013 (audit period), and \$2,985,723 in senior executive compensation claimed on Palmetto's ICPs submitted to CMS.

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.

See the Appendix for the details of our scope and methodology.

## **RESULTS OF AUDIT**

Palmetto applied the senior executive compensation benchmark in accordance with Federal requirements. Our application of the existing benchmark to all employees resulted in no additional cost savings. Had the benchmark of \$487,000 been applied to all employees during our audit period, cost savings would have been about \$500,000 for 1 year. However, applying a benchmark equaling the salaries of the President and Vice President of the United States to all employees would have resulted in cost savings of up to \$2.2 million

For the audit period, Palmetto had applied the benchmark to senior executives, thus appropriately reducing costs on its ICPs to exclude \$900,061 in unallowable compensation in excess of the benchmark. The \$900,061 related to BlueCross employees, and BlueCross appropriately excluded this compensation from indirect allocations to Palmetto.

Following Federal requirements in effect during our audit period, Palmetto did not apply the benchmark to all employees. Had Palmetto done so, it would have realized no additional savings because Palmetto, BlueCross, and NGS had no nonsenior executives who received total compensation greater than the existing benchmark.

Palmetto had eight nonsenior executives who received compensation less than the existing benchmark but more than the \$230,700 salary of the Vice President of the United States with compensation totaling more than \$2 million. Additionally, we identified 28 such BlueCross employees with compensation totaling more than \$9 million.

Had the benchmark equaled the \$400,000 salary of the President of the United States, applying it to all employees would have resulted in \$805,775 in cost savings. Moreover, had the benchmark equaled the \$230,700 salary of the Vice President of the United States, applying it to all employees would have resulted in \$2,222,815 in cost savings for 1 year.

## **APPENDIX: AUDIT SCOPE AND METHODOLOGY**

### **SCOPE**

Our audit covered the period January 1 through December 31, 2013 (audit period), and \$2,985,723 in senior executive compensation claimed on Palmetto's ICPs submitted to CMS.

In planning and performing this audit, we reviewed Palmetto's internal controls for allocating costs to cost objectives in accordance with the FAR and the Medicare contract. Our objective did not require us to review Palmetto's overall internal control structure. We limited our review to obtaining an understanding of Palmetto's procedures for identifying and reporting cost claims to CMS. We used the latest ICPs that Palmetto gave us for each year of our audit period as the source for the amount of allowable senior executive compensation.

We conducted our audit work from July 2014 through February 2015.

### **METHODOLOGY**

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and guidance, including part 31 of the FAR and Palmetto's contract with CMS;
- selected and reviewed compensation for each employee earning a salary of \$230,700 or more;
- interviewed BlueCross and NGS officials about its cost allocation systems;
- reviewed payroll journals, corporate bonus plans, and personnel records;
- tested costs for allowability, allocability, and reasonableness;
- calculated cost savings when we applied to all employees the existing benchmark;
- calculated cost savings when we applied to all employees a benchmark equaling the \$400,000 and \$230,700 salaries of the President and Vice President of the United States; and
- calculated cost savings had we retroactively applied to all employees the \$487,000 benchmark established by section 702 of the Bipartisan Budget Act of 2013.

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.