TO:  
Kerry Weems  
Acting Administrator  
Centers for Medicare & Medicaid Services

FROM:  
Joseph E. Vengrin  
Deputy Inspector General for Audit Services

SUBJECT: Review of Supplemental Executive Retirement Plan Costs Claimed by Blue Cross Blue Shield of South Carolina for Medicare Reimbursement for Fiscal Years 1999–2004 (A-07-07-00234)

Attached is an advance copy of our final report on Supplemental Executive Retirement Plan (SERP) costs claimed by Blue Cross Blue Shield of South Carolina (South Carolina) for Medicare reimbursement. We will issue this report to South Carolina within 5 business days.

Our objective was to determine the allowability of the SERP costs that South Carolina claimed for Medicare reimbursement for fiscal years (FY) 1999–2004.

South Carolina’s claim for $5,920,947 in SERP costs for FYs 1999–2004 included some costs that were unreasonable and therefore unallowable for Medicare reimbursement. Specifically, executive salaries used to calculate SERP costs were $15,614,436 greater than the executive compensation limits established in Federal regulations. However, we were unable to determine the impact of these unallowable compensation costs on SERP costs because South Carolina did not provide us with the necessary documentation to support its SERP calculations. Therefore, we are setting aside the $5,920,947 in claimed SERP costs for adjudication by the Centers for Medicare & Medicaid Services (CMS).

We recommend that South Carolina work with CMS to determine the allowability of $5,920,947 in SERP costs claimed for FYs 1999–2004.

In written comments on our draft report, South Carolina concurred with our recommendation.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at George.Reeb@oig.hhs.gov. Please refer to report number A-07-07-00234 in all correspondence.

Attachment
REVIEW OF SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS CLAIMED BY BLUE CROSS BLUE SHIELD OF SOUTH CAROLINA FOR MEDICARE REIMBURSEMENT FOR FISCAL YEARS 1999–2004
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:

**Office of Audit Services**

The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

**Office of Evaluation and Inspections**

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.

**Office of Investigations**

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

**Office of Counsel to the Inspector General**

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG’s internal operations. OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within HHS. OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.
**Notices**

**THIS REPORT IS AVAILABLE TO THE PUBLIC**

at http://oig.hhs.gov

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR part 5.)

**OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.
OCR Text:

OCT 19 2007

Report Number: A-07-07-00234

Mr. Joseph D. Wright, CPA
Vice President and Chief Financial Officer
Blue Cross Blue Shield of South Carolina
P.O. Box 100134, AG-A15
Columbia, South Carolina 29202-3134

Dear Mr. Wright:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled “Review of Supplemental Executive Retirement Plan Costs Claimed by Blue Cross Blue Shield of South Carolina for Medicare Reimbursement for Fiscal Years 1999 Through 2004.” 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, within 10 business days after the final report is issued, it 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 at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-07-00234 in all correspondence.

Sincerely,

[Signature]

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure
Direct Reply to HHS Action Official:

Mr. Roger Perez
Regional Administrator, Region IV
Centers for Medicare & Medicaid Services
Atlanta Federal Center
61 Forsyth Street SW., Suite 4T20
Atlanta, Georgia 30303-8909
EXECUTIVE SUMMARY

BACKGROUND

Blue Cross Blue Shield of South Carolina (South Carolina) administers Medicare Part A and Part B operations in its Palmetto Government Benefit Administrators (Palmetto) and TrailBlazer Health Enterprises (TrailBlazer) subsidiaries under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

South Carolina maintains a Supplemental Executive Retirement Plan (SERP), which is a nonqualified pension plan designed to provide supplemental benefits to a select group of highly compensated employees. SERP benefits are in addition to those under the qualified pension plan and the nonqualified excess benefit plan. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), the Cost Accounting Standards, and their Medicare contracts.

OBJECTIVE

Our objective was to determine the allowability of the SERP costs that South Carolina claimed for Medicare reimbursement for fiscal years (FY) 1999–2004.

SUMMARY OF FINDING

South Carolina’s claim for $5,920,947 in SERP costs for FYs 1999–2004 included some costs that were unreasonable and therefore unallowable for Medicare reimbursement. Specifically, executive salaries used to calculate SERP costs were $15,614,436 greater than the executive compensation limits established in Federal regulations. However, we were unable to determine the impact of these unallowable compensation costs on SERP costs because South Carolina did not provide us with the necessary documentation to support its SERP calculations. Therefore, we are setting aside the $5,920,947 in claimed SERP costs for adjudication by CMS.

RECOMMENDATION

We recommend that South Carolina work with CMS to determine the allowability of $5,920,947 in SERP costs claimed for FYs 1999–2004.

AUDITEE’S COMMENTS

In written comments on our draft report, South Carolina concurred with our recommendation. South Carolina’s comments are included in their entirety as the Appendix.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>BACKGROUND</td>
<td>1</td>
</tr>
<tr>
<td>OBJECTIVE, SCOPE, AND METHODOLOGY</td>
<td>1</td>
</tr>
<tr>
<td>Objective</td>
<td>1</td>
</tr>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Methodology</td>
<td>1</td>
</tr>
<tr>
<td>FINDING AND RECOMMENDATION</td>
<td>2</td>
</tr>
<tr>
<td>SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS</td>
<td>2</td>
</tr>
<tr>
<td>Supplemental Executive Retirement Plan Costs Claimed</td>
<td>2</td>
</tr>
<tr>
<td>Unreasonable Compensation Costs</td>
<td>2</td>
</tr>
<tr>
<td>Impact of Unreasonable Compensation Costs on Supplemental Retirement Plan Costs Claimed</td>
<td>3</td>
</tr>
<tr>
<td>RECOMMENDATION</td>
<td>3</td>
</tr>
<tr>
<td>AUDITEE’S COMMENTS</td>
<td>3</td>
</tr>
<tr>
<td>APPENDIX</td>
<td></td>
</tr>
<tr>
<td>AUDITEE’S COMMENTS</td>
<td></td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
</tr>
<tr>
<td>--------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td>CAS</td>
<td>Cost Accounting Standards</td>
</tr>
<tr>
<td>CMS</td>
<td>Centers for Medicare &amp; Medicaid Services</td>
</tr>
<tr>
<td>FAR</td>
<td>Federal Acquisition Regulation</td>
</tr>
<tr>
<td>FY</td>
<td>fiscal year</td>
</tr>
<tr>
<td>SERP</td>
<td>Supplemental Executive Retirement Plan</td>
</tr>
</tbody>
</table>
INTRODUCTION

BACKGROUND

Blue Cross Blue Shield of South Carolina (South Carolina) administers Medicare Part A and Part B operations in its Palmetto Government Benefit Administrators (Palmetto) and TrailBlazer Health Enterprises (TrailBlazer) subsidiaries under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).1

South Carolina maintains a Supplemental Executive Retirement Plan (SERP), which is a nonqualified pension plan designed to provide supplemental benefits to a select group of highly compensated employees. SERP benefits are in addition to the retirement benefits provided under the qualified pension plan and the nonqualified excess benefit plan. South Carolina determined SERP costs for Medicare reimbursement on an accrual basis.

To be allowable for Medicare reimbursement, costs claimed for nonqualified defined-benefit pension plans must be in compliance with Cost Accounting Standard (CAS) 412. CAS 412 (48 CFR § 9904.412-50(c)(3)) states that a contractor may use accrual accounting to measure and assign nonqualified defined-benefit pension plan costs if the contractor so elects, the plan is funded, and the pension benefits are nonforfeitable. If the plan does not meet all of these requirements, the contractor must assign the plan’s costs using the pay-as-you-go method.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of the SERP costs that South Carolina claimed for Medicare reimbursement for fiscal years (FY) 1999–2004.

Scope

We reviewed the $5,920,947 in SERP costs that South Carolina claimed for Medicare reimbursement on its Final Administrative Cost Proposals for FYs 1999–2004. The objective did not require that we review South Carolina’s overall internal control structure. However, we did review the controls relating to the SERP costs claimed for Medicare reimbursement to ensure that costs were allowable pursuant to the Federal Acquisition Regulation (FAR).

We performed fieldwork at South Carolina’s corporate office in Columbia, South Carolina, in January 2007.

Methodology

We obtained information from South Carolina and its consulting actuary regarding South Carolina’s SERP costs for FYs 1999–2004. We identified Palmetto’s and TrailBlazer’s SERP costs that South Carolina claimed for Medicare reimbursement.

1South Carolina acquired TrailBlazer from Blue Cross Blue Shield of Texas in October 1999.
We performed our review in accordance with generally accepted government auditing standards.

**FINDING AND RECOMMENDATION**

**SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS**

FAR 31.201-2(a) states, in part, that a cost must be reasonable to be allowable. In addition, FAR 31.205-6(b)(2) provides that comparable market data be used to evaluate the reasonableness of compensation. Furthermore, FAR 31.201-6(a) states: “When an unallowable cost is incurred, its directly associated costs are also unallowable.” SERP pension benefits are directly associated with compensation because the benefit is based on the salary history of the recipient.

Additionally, FAR 31.205-6(p) states: “Costs incurred . . . for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year . . . are unallowable.”

**Supplemental Executive Retirement Plan Costs Claimed**

South Carolina claimed a total of $5,920,947 in accrued SERP costs for Medicare reimbursement, as shown in Table 1.

**Table 1: Accrued SERP Costs Claimed**

<table>
<thead>
<tr>
<th>FY</th>
<th>Palmetto</th>
<th>TrailBlazer</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$309,247</td>
<td>$0</td>
<td>$309,247</td>
</tr>
<tr>
<td>2000</td>
<td>207,794</td>
<td>257,322</td>
<td>465,116</td>
</tr>
<tr>
<td>2001</td>
<td>490,233</td>
<td>475,181</td>
<td>965,414</td>
</tr>
<tr>
<td>2002</td>
<td>561,627</td>
<td>616,718</td>
<td>1,178,345</td>
</tr>
<tr>
<td>2003</td>
<td>723,372</td>
<td>523,162</td>
<td>1,246,534</td>
</tr>
<tr>
<td>2004</td>
<td>1,014,543</td>
<td>741,748</td>
<td>1,756,291</td>
</tr>
<tr>
<td>Total</td>
<td>$3,306,816</td>
<td>$2,614,131</td>
<td>$5,920,947</td>
</tr>
</tbody>
</table>

**Unreasonable Compensation Costs**

We determined that these accrued costs were based on unreasonable associated compensation. Using the executive compensation limit specified in FAR 31.205-6(p) as a benchmark for evaluating the reasonableness of the compensation, we determined that the salaries used to calculate SERP costs for the six senior executives were $15,614,436 greater than the executive compensation limit for FYs 1999–2004, as shown in Table 2 on the next page.
Table 2: Unreasonable Executive Compensation

<table>
<thead>
<tr>
<th>FY</th>
<th>Actual Compensation</th>
<th>Executive Compensation Limit</th>
<th>Unreasonable Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$2,274,391</td>
<td>$2,057,916</td>
<td>$216,475</td>
</tr>
<tr>
<td>2000</td>
<td>3,193,324</td>
<td>2,118,060</td>
<td>1,075,264</td>
</tr>
<tr>
<td>2001</td>
<td>3,994,971</td>
<td>2,245,368</td>
<td>1,749,603</td>
</tr>
<tr>
<td>2002</td>
<td>4,984,980</td>
<td>2,326,698</td>
<td>2,658,282</td>
</tr>
<tr>
<td>2003</td>
<td>6,987,158</td>
<td>2,431,638</td>
<td>4,555,520</td>
</tr>
<tr>
<td>2004</td>
<td>7,956,398</td>
<td>2,597,106</td>
<td>5,359,292</td>
</tr>
<tr>
<td>Total</td>
<td>$29,391,222</td>
<td>$13,776,786</td>
<td>$15,614,436</td>
</tr>
</tbody>
</table>

Impact of Unreasonable Compensation Costs on Supplemental Retirement Plan Costs Claimed

Compensation costs are used in the calculation of allowable SERP costs. Because it did not limit the associated compensation to a reasonable level, South Carolina overstated its allowable SERP costs. This resulted in an overclaim of SERP costs for Medicare reimbursement.

South Carolina did not provide supporting documentation for its benefit formula, its computations of actuarial liabilities and normal costs, or its allocation of assignable costs, although we requested that it do so. Without this documentation, we were unable to determine the impact of the $15,614,436 in unallowable compensation costs on SERP costs. Therefore, we are setting aside the $5,920,947 in claimed SERP costs for adjudication by CMS.

RECOMMENDATION

We recommend that South Carolina work with CMS to determine the allowability of $5,920,947 in SERP costs claimed for FYs 1999–2004.

AUDITEE’S COMMENTS

In written comments on our draft report, South Carolina concurred with our recommendation. South Carolina’s comments are included in their entirety as the Appendix.
July 20, 2007

Patrick J. Cogley
Regional Inspector General for Audit Services
Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

RE: Audit Report Number A-07-07-00234

Dear Mr. Cogley:

We are responding to your draft audit report dated June 14, 2007 entitled “Review of Supplemental Executive Retirement Plan Costs Claimed by Blue Cross Blue Shield of South Carolina for Medicare Reimbursement for Fiscal Years 1999 Through 2004.”

The audit contained the following recommendation with which we concur.

Recommendation:
We recommend that South Carolina work with CMS to determine the allowability of $5,920,947 in SERP costs claimed for FYs 1999 through 2004.

Comment:
As recommended, we plan to work with CMS to determine the allowability of the SERP costs set aside during the audit.

If you have any questions, please feel free to contact me at 803-763-5544.

Sincerely,

[Signature]

Joe Wright

CC: Eric Shipley, OACT-CMS
William R. Horton, BCBSSC
Bruce Hughes, Palmetto GBA
Marti Mahaffey, Trailblazer
Bob Leichtie, BCBSSC