

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**PALMETTO GOVERNMENT BENEFITS
ADMINISTRATOR, LLC,
CLAIMED SOME UNALLOWABLE
PENSION COSTS THROUGH ITS
INCURRED COST PROPOSALS**

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Deputy Inspector General
for Audit Services

January 2018
A-07-17-00506

Office of Inspector General

<https://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.

Report in Brief

Date: January 2018

Report No. A-07-17-00506

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL



Why OIG Did This Review

The Centers for Medicare & Medicaid Services (CMS) reimburses Medicare contractors for a portion of their pension costs, which are funded by the annual contributions that these contractors make to their pension plans.

At CMS's request, the HHS, OIG, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare contractors through Incurred Cost Proposals (ICPs).

Our objective was to determine whether the calendar years (CYs) 2010 and 2011 pension costs that Palmetto Government Benefits Administrator, LLC (Palmetto), claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

How OIG Did This Review

We reviewed \$9.9 million of pension costs that Palmetto claimed for Medicare reimbursement on its ICPs for CYs 2010 and 2011.

Palmetto Government Benefits Administrator, LLC, Claimed Some Unallowable Pension Costs Through Its Incurred Cost Proposals

What OIG Found

The CYs 2010 and 2011 pension costs that Palmetto claimed for Medicare reimbursement, and reported on its ICPs, were not always allowable and correctly claimed. Specifically, Palmetto claimed pension costs of \$9.9 million for Medicare reimbursement, through its ICPs, for CYs 2010 and 2011. However, we determined that the allowable pension during this period were \$9.8 million. The difference, \$95,038, represented unallowable Medicare pension costs that Palmetto claimed on its ICPs for CYs 2010 and 2011. Palmetto claimed these unallowable Medicare pension costs primarily because it (1) did not allocate the correct pension costs to Palmetto and (2) used incorrect indirect cost rates when claiming pension costs for Medicare reimbursement.

What OIG Recommends and Auditee Comments

We recommend that Palmetto work with CMS to ensure that its final settlement of contract costs reflects a decrease in Medicare pension costs of \$95,038 for CYs 2010 and 2011.

Palmetto concurred with our recommendation.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their pension costs, which are funded by the annual contributions that these contractors make to their pension plans. The amount of pension costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), the Cost Accounting Standards (CAS), where applicable, and the Medicare contracts. Previous Office of Inspector General (OIG) reviews found that Medicare contractors have not always complied with Federal requirements when claiming pension costs for Medicare reimbursement.

At CMS's request, the OIG, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit (PRB), and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors (MACs) through Final Administrative Cost Proposals and/or Incurred Cost Proposals (ICPs).

For this review, we focused on one Medicare contractor, Palmetto Government Benefits Administrator, LLC (Palmetto). In particular, we examined the Palmetto Medicare segment and Other segment pension costs that Palmetto claimed for Medicare reimbursement and reported on its ICPs.

OBJECTIVE

Our objective of this review was to determine whether the calendar years (CYs) 2010 and 2011¹ pension costs that Palmetto claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

BACKGROUND

Palmetto Government Benefits Administrator, LLC

During our audit period, Palmetto was a subsidiary of Blue Cross Blue Shield of South Carolina (BCBS South Carolina), whose home office is in Columbia, South Carolina. Palmetto administered Medicare Part A fiscal intermediary and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. With the implementation of

¹ For CYs 2007 through 2009, the Defense Contract Audit Agency incorporated the results of our allocable pension and PRB audits (A-07-17-00505, A-07-17-00509, and A-07-16-00485, respectively) into its ICP audit. Therefore, we will not report on pension or PRB costs for CYs 2007 through 2009.

Medicare contracting reform,² Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 1 and Jurisdiction 11 (including home health and hospice services) effective October 25, 2007, and May 21, 2010, respectively.^{3, 4}

The disclosure statement that Palmetto submits to CMS indicates that Palmetto uses pooled cost accounting. Medicare contractors use pooled cost accounting to calculate the indirect cost rates (whose computations include pension and PRB costs⁵) that they submit on their ICPs. The indirect cost rates are used to calculate contract costs reported on the ICPs. CMS uses these indirect cost rates in determining the final indirect cost rates for each contract.⁶

The Palmetto Medicare segment employees participated in BCBS South Carolina's qualified defined-benefit pension plan and its PRB plan.⁷

Medicare Reimbursement of Pension Costs

CMS reimburses a portion of the annual contributions that contractors make to their pension plans. The pension costs are included in the computation of the indirect cost rates reported on the ICPs. In turn, CMS uses indirect cost rates in reimbursing costs under cost reimbursement contracts. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413 and (2) funded as specified by Part 31 of the FAR. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, the CAS, and the Medicare contracts. The cognizant Contracting Officer

² Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. During the audit period most, but not all, of the MACs were fully operational; for jurisdictions where the MACs were not fully operational, the fiscal intermediaries and carriers continued to process claims.

³ Medicare Parts A and B Jurisdiction 1 consists of the States of California, Hawaii, and Nevada, and the Territories of American Samoa, Guam, and the Northern Mariana Islands.

⁴ Medicare Parts A and B Jurisdiction 11 consists of the States of North Carolina, South Carolina, Virginia, and West Virginia (but excludes Part B for the counties of Arlington and Fairfax in Virginia and the city of Alexandria in Virginia). Jurisdiction 11 also includes home health and hospice services provided in the States of Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Kentucky, Louisiana, Mississippi, New Mexico, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, and Texas.

⁵ On September 21, 2017, CMS executed an advance agreement with BCBS South Carolina that closed PRB costs for the period prior to January 1, 2012. Therefore, we do not opine on the PRB costs, but we incorporated the CY 2011 costs from that agreement into our own calculations to determine the indirect cost rates for that year.

⁶ At the end of each CY, each contractor submits to CMS an ICP that reports the Medicare direct and indirect costs that the contractor incurred during that year. The ICP and supporting data provide the basis for the CMS Contracting Office and the Medicare contractor to determine the final billing rates for allowable Medicare costs.

⁷ Palmetto's pension costs includes both direct Medicare segment costs and the home office costs allocated to Palmetto by BCBS South Carolina.

will perform a final settlement with the contractor to determine the final indirect cost rates. The final indirect cost rates ultimately determine the final costs of each contract.⁸

Previous Audits of Allocable Pension Costs

We previously reviewed Palmetto's and BCBS South Carolina's allocable pension costs (A-07-17-00505, issued on July 6, 2017, and A-07-17-00509, issued on August 31, 2017). Those audit reports identified the allocable pension costs that Palmetto should have used when calculating its indirect cost rates for CYs 2010 and 2011. We recommended in the first of these reports that Palmetto increase the Medicare segment pension costs used to calculate its indirect cost rates for CYs 2006 through 2012 by \$143,261, and in the second of these reports that BCBS South Carolina decrease the allocable pension costs used to calculate its Medicare segments' indirect cost rates for CYs 2006 through 2012 by \$6,193,748.

Incurred Cost Proposal Audit

At CMS's request, Figliozi & Company CPAs P.C. (Figliozi) performed an audit of the ICPs that Palmetto submitted for CYs 2010 and 2011. The objective of the Figliozi ICP audit was to determine whether costs included in the ICPs were reasonable, allocable to the contract, and allowable in accordance with the FAR and the U.S. Department of Health and Human Services Acquisition Regulation System. Figliozi also reviewed the adequacy of Palmetto's accounting system as it related to the costs claimed on its ICPs. Figliozi excluded qualified defined-benefit pension plan costs from the scope of its ICP audit.

For this audit, we relied on Figliozi's findings and recommendations when computing the allowable pension costs discussed in this report.

We incorporated the results of Figliozi's audit into our computations of the audited indirect cost rates, and ultimately the pension costs claimed, for the contracts subject to the FAR. CMS will use our report on allowable pension costs, as well as the Figliozi audit report, to determine the final indirect cost rates and the total allowable contract costs for Palmetto for CYs 2010 and 2011.

HOW WE CONDUCTED THIS REVIEW

We reviewed \$9,909,460 of Medicare pension costs that Palmetto claimed for Medicare reimbursement on its ICPs for CYs 2010 and 2011.

Achieving our objective did not require that we review Palmetto's overall internal control structure. We limited our review to the internal controls related to the pension costs that were

⁸ In accordance with FAR 42.705-1(5)(ii) and FAR 42.705-1(5)(iii)(B), the cognizant Contracting Officer shall "[p]repare a written indirect cost rate agreement conforming to the requirements of the contracts" and perform a "[r]econciliation of all costs questioned, with identification of items and amounts allowed or disallowed in the final settlement," respectively.

included in Palmetto's ICPs and ultimately used as the basis for Medicare reimbursement, to ensure that these costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

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 finding and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDING

The CYs 2010 and 2011 pension costs that Palmetto claimed for Medicare reimbursement, and reported on its ICPs, were not always allowable and correctly claimed. Specifically, Palmetto claimed pension costs of \$9,909,460 for Medicare reimbursement, through its ICPs, for CYs 2010 and 2011. However, we determined that the allowable pension costs during this period were \$9,814,421. The difference, \$95,038, represented unallowable Medicare pension costs that Palmetto claimed on its ICPs for CYs 2010 and 2011. Palmetto claimed these unallowable Medicare pension costs primarily because it (1) did not allocate the correct pension costs to Palmetto (as described in "Previous Audits of Allocable Pension Costs" above) and (2) used incorrect indirect cost rates when claiming pension costs for Medicare reimbursement.

CLAIMED MEDICARE PENSION COSTS

Palmetto claimed Medicare pension costs of \$9,909,460 on its ICPs for CYs 2010 and 2011. We calculated the allowable Medicare pension costs based on separately computed CAS-based pension costs for the Medicare segment and the Other segment in accordance with CAS 412 and 413.

UNALLOWABLE MEDICARE PENSION COSTS CLAIMED

After incorporating the results of the Figliozzi ICP audits and the allocable costs from our prior pension costs reports, we determined that the allowable CAS-based pension costs for CYs 2010 and 2011 were \$9,814,421. Thus, Palmetto claimed \$95,038 of unallowable Medicare pension costs on its ICPs for CYs 2010 and 2011. This overclaim occurred primarily because Palmetto based its claim for Medicare reimbursement on incorrectly calculated CAS pension costs.

During our prior audit, we determined the allocable pension costs for the Medicare segment and the Other segment. We used these allocable pension costs to determine the allowable pension costs for Medicare reimbursement. Tables 1 and 2 on the following page show the allocable CAS-based pension costs that we determined for CYs 2010 and 2011.

Table 1: Medicare Segment Allocable Pension Costs

Calendar Year	Allocable Per Previous Audit	Per Palmetto	Difference
2010	\$5,650,955	\$5,601,487	\$49,468
2011	5,334,690	5,426,966	(92,276)
Total	\$10,985,645	\$11,028,453	(\$42,808)

Table 2: Other Segment Allocable Pension Costs

Calendar Year	Allocable Per Previous Audit	Per BCBS South Carolina	Difference
2010	\$50,736,124	\$51,580,283	(\$844,159)
2011	50,062,318	50,717,302	(654,984)
Total	\$100,798,442	\$102,297,585	(\$1,499,143)

We then used this information to adjust the indirect cost rates (i.e., fringe benefit and general and administrative rates) and, in turn, to calculate the information presented in Table 3 below. Our calculation is not presented in this report because those rate calculations that Palmetto used in its ICPs, and to which we referred as part of our review, are proprietary information.

Accordingly, Table 3 below compares the Medicare segment pension costs that we calculated (using our adjusted indirect cost rates) to the pension costs that Palmetto claimed for Medicare reimbursement on its ICPs for CYs 2010 and 2011.

Table 3: Comparison of Allowable and Claimed Pension Costs⁹

Calendar Year	Per Audit	Per Palmetto	Difference
2010	\$4,011,982	\$3,998,546	\$13,436
2011	5,802,439	5,910,913	(108,474)
Total Overclaim of Pension Costs	\$9,814,421	\$9,909,460	(\$95,038)

⁹ Our calculations incorporated the rate ceiling associated with the Medicare Parts A and B contracts. We applied the indirect cost rates associated with these contracts when computing the allowable pension costs for the Medicare Parts A and B contracts. The amounts identified in this table represent the allowable Medicare pension costs during our audit period; they do not represent the total allowable costs on the ICPs.

RECOMMENDATION

We recommend that Palmetto work with CMS to ensure that its final settlement of contract costs reflects a decrease in Medicare pension costs of \$95,038 for CYs 2010 and 2011.

AUDITEE COMMENTS

In written comments on our draft report, Palmetto concurred with our recommendation. Palmetto's comments appear in their entirety as Appendix C.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed \$9,909,460 of Medicare pension costs that Palmetto reported on its ICPs for CYs 2010 and 2011.

Achieving our objective did not require that we review Palmetto's overall internal control structure. We limited our review to the internal controls related to the pension costs that were included in Palmetto's ICPs and ultimately used as the basis for Medicare reimbursement, to ensure that these costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed our fieldwork at Palmetto in Columbia, South Carolina.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed information provided by Palmetto and BCBS South Carolina to identify the amount of pension costs used in Palmetto's calculation of its indirect cost rates for CYs 2010 and 2011;
- reviewed the results of Figliozzi's ICP audit and incorporated those results into our calculations of allowable pension costs;
- incorporated information from our previous audit reports (A-07-17-00505, issued on July 6, 2017; and A-07-17-00509, issued on August 31, 2017) and the PRB advance agreement that CMS executed with BCBS South Carolina (footnote 5); and
- provided the results of this review to Palmetto officials on September 25, 2017.

We performed this review in conjunction with the following audits and used the information obtained during these audits for this review:

- *Palmetto Government Benefits Administrator, LLC, Understated Its Medicare Segment Allocable Pension Costs* (A-07-17-00505, issued on July 6, 2017) and
- *Blue Cross Blue Shield of South Carolina Overstated Its Allocable Qualified Pension Plan Costs* (A-07-17-00509, issued on August 31, 2017).

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 finding and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO REIMBURSEMENT OF PENSION COSTS

FEDERAL REGULATIONS

Federal regulations (FAR 31.205-6(j)) address the allowability of pension costs and require that contractors fund the pension costs assigned to contract periods by making contributions to the pension plan.

Federal regulations (FAR 52.216-7(a)(1)) address the invoicing requirements and the allowability of payments as determined by the Contracting Officer in accordance with FAR subpart 31.2.

Federal regulations (CAS 403) address the allocation of the expenses of a home office to the segments of the organization based on beneficial or causal relationship. These regulations also address the allocation of residual home office expenses to segments.

Federal regulations (CAS 412) (as amended) address the determination and measurement of pension cost components. These regulations also address the assignment of pension costs to appropriate accounting periods.

Federal regulations (CAS 413) (as amended) address the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

MEDICARE CONTRACTS

The Medicare contracts require Palmetto to submit invoices in accordance with FAR 52.216-7, "Allowable Cost & Payment." (See our citation to FAR 52.216-7(a)(1) in "Federal Regulations" above.)

APPENDIX C: AUDITEE COMMENTS



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KENNETH LEWIS
Vice President and CFO

January 12, 2018

Patrick J. Cogley
Regional Inspector General for Audit Services
Office of Audit Services, Region VII
601 East 12th Street, Room 0429
Kansas City, MO 64106

Re: Report Number A-07-17-00506

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report entitled *Palmetto Government Benefits Administrator, LLC, Claimed some Unallowable Pension Costs Through Its Incurred Cost Proposals*.

The report contains the following recommendation:

- We recommend that Palmetto work with CMS to ensure that its final settlement of contract costs reflects a decrease in Medicare pension costs of \$95,038 for CYs 2010 and 2011.

Palmetto concurs with the OIG recommendations and does not have any additional comments or questions.

We appreciate the opportunity to comment on the recommendations. Please let me know if you have questions or need additional information regarding our response.

Sincerely,

/Kenneth Lewis/

Kenneth Lewis
Vice President and CFO

Cc: Louis McElveen, BCBSSC
Bruce Hughes, Celerian Group
Joe Johnson, Palmetto GBA