

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**GROUP HEALTH INCORPORATED  
OVERSTATED ITS ALLOWABLE  
MEDICARE SUPPLEMENTAL EXECUTIVE  
RETIREMENT PLAN COSTS FOR  
CALENDAR YEARS 2009 THROUGH 2016**

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September 2020  
A-07-19-00582

# *Office of Inspector General*

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operating divisions will make final determination on these matters.

## Report in Brief

Date: September 2020  
Report No. A-07-19-00582

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



### Why OIG Did This Audit

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs.

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, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare contractors through Incurred Cost Proposals (ICPs).

Previous OIG audits found that Medicare contractors did not always correctly identify and claim SERP costs.

Our objective was to determine whether the calendar years (CYs) 2009 through 2016 SERP costs that Group Health Incorporated (GHI) claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

### How OIG Did This Audit

We reviewed \$874,007 of SERP costs that GHI claimed for Medicare reimbursement on its ICPs for CYs 2009 through 2016.

## Group Health Incorporated Overstated Its Allowable Medicare Supplemental Executive Retirement Plan Costs for Calendar Years 2009 Through 2016

### What OIG Found

The CYs 2009 through 2016 SERP costs that GHI claimed for Medicare reimbursement, and reported on its ICPs, were not always allowable and correctly claimed. Specifically, GHI claimed Medicare segment SERP costs of \$874,007 for Medicare reimbursement, through its ICPs, for CYs 2009 through 2016. However, we determined that the allowable SERP costs for this period were \$287,273. The difference, \$586,734, constituted unallowable Medicare SERP costs that GHI claimed on its ICPs for CYs 2009 through 2016. This overclaim occurred primarily because GHI did not amortize its lump-sum SERP payments.

### What OIG Recommends and Auditee Comments

We recommend that GHI work with CMS to revise its ICPs for CYs 2009 through 2016 to reduce its claimed SERP costs by \$586,734.

GHI did not directly address our recommendation. However, GHI's comments disagreeing with our findings in this and related reports suggested that it disagreed with our recommendation. Specifically, GHI stated that we incorrectly incorporated ceiling rates when determining GHI's final indirect cost rates for CYs 2009 through 2016. We maintain that we correctly incorporated ceiling rates when determining GHI's final indirect cost rates for CYs 2009 through 2016 and that, accordingly, all of our calculations of the allowable Medicare SERP costs remain valid. Therefore, we maintain that our finding and recommendation remain valid as well.

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## INTRODUCTION

### WHY WE DID THIS AUDIT

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts. Previous Office of Inspector General (OIG) audits found that Medicare contractors did not always correctly identify and claim SERP costs.

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) and CAS- and FAR-covered contracts through Final Administrative Cost Proposals, Incurred Cost Proposals (ICPs), or both.

For this audit, we focused on one entity, Group Health Incorporated (GHI). In particular, we examined the SERP costs that GHI claimed for Medicare reimbursement and reported on its ICPs.

### OBJECTIVE

Our objective was to determine whether the calendar years (CYs) 2009 through 2016 SERP costs that GHI claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

### BACKGROUND

#### Group Health Incorporated and Medicare

GHI, a subsidiary of EmblemHealth Services Company, LLC, administered Medicare operations under Coordination of Benefits (COB) contracts with CMS. During our audit period, GHI also performed Medicare work on the Medicare Secondary Payer Recovery and Benefit Coordination and Recovery (MSPRC) contracts.<sup>1</sup> GHI also performed work as a subcontractor on the Retiree Drug Subsidy (RDS) contract.

The disclosure statement that GHI submits to CMS states that GHI uses pooled cost accounting. Medicare contractors use pooled cost accounting to calculate the indirect cost rates (whose

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<sup>1</sup> Before September 2011, GHI performed Medicare work as a subcontractor on the MSPRC contract and the RDS contract. From September 2011 through February 2014, GHI performed Medicare work as the prime contractor on the MSPRC contracts.

computations include pension, PRB, and SERP costs) that they submit on their ICPs. Medicare contractors use the indirect cost rates to calculate the contract costs that they report on their ICPs. In turn, CMS uses these indirect cost rates in determining the final indirect cost rates for each contract.<sup>2</sup>

## **Group Health Incorporated Supplemental Executive Retirement Plan Costs**

GHI sponsors two SERPs: the Supplemental Executive Retirement Plan for EmblemHealth Services Company, LLC (SERP I), and the Supplemental Executive Retirement Plan II for EmblemHealth Services Company, LLC (SERP II). Both the SERP I and SERP II plans' purpose is to provide a competitive level of benefits in order to attract and retain well-qualified senior executives of EmblemHealth Services Company, LLC. GHI's SERPs are thus designed to restore benefits to participants who lost benefits under the GHI Local 153 Pension Plan, GHI Cash Balance Pension Plan, and EmblemHealth Services Company, LLC, Employees' Retirement Plan because of the Internal Revenue Code, sections 401(a) and 415, limits.<sup>3, 4</sup> This report addresses both the SERP I and SERP II plan costs that GHI claimed under the provisions of its MAC-related contracts.

## **Accounting Methodologies**

The Medicare contracts require GHI to calculate SERP costs in accordance with the FAR and CAS 412 and 413. The FAR and the CAS require that the costs for nonqualified defined-benefit plans be measured under either the accrual method or the pay-as-you-go method. Under the accrual method, allowable costs are based on the annual contributions that the employer deposits into its trust fund. For nonqualified defined-benefit plans that are not funded through the use of a funding agency, costs are to be accounted for under the pay-as-you-go method. This method is based on the actual benefits paid to participants, which are comprised of lump-sum payments and annuity payments.

## **Incurred Cost Proposal Audits**

At CMS's request, Figliozzi & Company, P.C. (Figliozzi), Kearney & Company, P.C. (Kearney), and Davis Farr, LLP (Farr), performed audits of the ICPs that GHI submitted for CYs 2009 through 2016. The objectives of the Figliozzi, Kearney, and Farr ICP audits were to determine whether

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<sup>2</sup> For each CY, each Medicare 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 Officer and the Medicare contractor to determine the final billing rates for allowable Medicare costs.

<sup>3</sup> The section 401(a)(17) limit is the maximum annual compensation that can be used to calculate pension benefits.

<sup>4</sup> Internal Revenue Code section 415 limits the amounts of benefits that may be paid to a participant in a defined-benefit plan. It also limits the amount of contributions that may be made to a participant's account in a defined-contribution plan.

costs were allowable in accordance with the FAR, the U.S. Department of Health and Human Services Acquisition Regulation, and the CAS.

For this audit, we relied on the Figliozi, Kearney, and Farr ICP audit findings and recommendations when computing the allowable SERP costs discussed in this report.

We incorporated the results of the Figliozi, Kearney, and Farr ICP audits into our computations of the audited indirect cost rates, and ultimately the SERP costs claimed, for the contracts subject to the FAR. CMS will use our report on allowable SERP costs, as well as the Figliozi, Kearney, and Farr ICP audit reports, to determine the final indirect cost rates and the total allowable contract costs for GHI for CYs 2009 through 2016. The cognizant Contracting Officer will perform a final settlement with the contractor to determine the final indirect cost rates. These rates ultimately determine the final costs of each contract.<sup>5</sup>

## **HOW WE CONDUCTED THIS AUDIT**

We reviewed \$874,007 of SERP costs that GHI claimed for Medicare reimbursement on its ICPs for CYs 2009 through 2016.

In accordance with the FAR and the CAS, we calculated the allowable SERP pension costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments. Our calculation included an allowable interest rate, for which we used the interest rate used to determine costs in the qualified defined-benefit plans. We incorporated the results of the Figliozi, Kearney, and Farr ICP audits into our calculations of allowable SERP costs.

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 2009 through 2016 SERP costs that GHI claimed for Medicare reimbursement, and reported on its ICPs, were not always allowable and correctly claimed. Specifically, GHI claimed Medicare segment SERP costs of \$874,007 for Medicare reimbursement, through its ICPs, for

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<sup>5</sup> In accordance with FAR 42.705-1(b)(5)(ii) and FAR 42.705-1(b)(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.

CYs 2009 through 2016. However, we determined that the allowable SERP costs for this period were \$287,273. The difference, \$586,734, constituted unallowable Medicare SERP costs that GHI claimed on its ICPs for CYs 2009 through 2016. This overclaim occurred primarily because GHI did not amortize its lump-sum SERP payments.

### **ALLOCABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS OVERSTATED**

During this audit (and before we incorporated the results of the Figliozi, Kearney, and Farr ICP audits), we calculated the allocable SERP pension costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments, in accordance with the FAR and the CAS. Our calculation included an allowable interest component in the amortization installment; to calculate this component, we applied the interest rate used to determine costs in the qualified defined-benefit plans. Accordingly, we determined that the allocable pay-as-you-go SERP costs for CYs 2009 through 2016 totaled \$293,547. As discussed below, GHI identified allocable SERP costs of \$1,003,046. Therefore, GHI overstated the allocable SERP costs by \$709,499.<sup>6</sup>

SERP costs are required to be calculated in accordance with the FAR and CAS 412 and 413. Contrary to Federal regulations at CAS 412.40(a)(3) (Appendix B), GHI did not amortize its lump-sum SERP payments. In accordance with those regulations, our calculations of the allowable SERP costs included a 15-year amortization of lump-sum SERP payments and an allowable interest component. We based our amortization installments on the interest rate used to determine costs for the qualified defined-benefit pension plans.

We used these allocable SERP costs to determine the allowable SERP costs for Medicare reimbursement. Table 1 on the following page compares the allocable SERP costs that we determined for CYs 2009 through 2016 with the costs that GHI reported for the same timeframe.

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<sup>6</sup> Because this section of the report discusses our calculations before we incorporated into them the results of the Figliozi, Kearney, and Farr ICP audits, the dollar amounts conveyed in this paragraph differ from those conveyed both earlier in the “Finding” section and later in our recommendation.

**Table 1: Medicare Segment Allocable SERP Costs**

<b>CY</b>	<b>Allocable Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	\$11,952	\$339,823	(\$327,871)
2010	20,650	371,018	(350,368)
2011	21,123	224,648	(203,525)
2012	52,002	0	52,002
2013	43,848	0	43,848
2014	48,926	0	48,926
2015	57,397	67,557	(10,160)
2016	37,649	0	37,649
<b>Total</b>	<b>\$293,547</b>	<b>\$1,003,046</b>	<b>(\$709,499)</b>

After performing the calculations discussed above, we then used the allocable cost information to adjust the indirect cost rates (i.e., the fringe benefit and general and administrative rates) and, in turn, to calculate the information presented in Table 2 later in this report. (Our calculation does not appear in this report because those rate computations that GHI used in its ICPs, and to which we referred as part of our review, are proprietary information.)

**SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS CLAIMED**

GHI claimed SERP costs of \$874,007 on its ICPs for CYs 2009 through 2016. We calculated the allowable Medicare SERP costs in accordance with the FAR and the CAS. For details on the Federal requirements, see Appendix B.

**UNALLOWABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS CLAIMED**

After incorporating the results of the Figliozzi, Kearney, and Farr ICP audits into the calculations discussed earlier in this report, we determined that the allowable SERP costs for CYs 2009 through 2016 were \$287,273. Thus, GHI claimed \$586,734 of unallowable SERP costs on its ICPs for CYs 2009 through 2016. This overclaim occurred primarily because GHI did not amortize its lump-sum SERP payments.

Accordingly, Table 2 on the following page compares the SERP costs that we calculated (using our adjusted indirect cost rates) with the SERP costs that GHI claimed for Medicare reimbursement for CYs 2009 through 2016.

**Table 2: Comparison of Allowable SERP Costs and Claimed SERP Costs<sup>7</sup>**

<b>CY</b>	<b>Allowable Per Audit</b>	<b>Per GHI</b>	<b>Difference</b>
2009	\$11,845	\$268,438	(\$256,593)
2010	14,363	324,704	(310,341)
2011	20,342	208,329	(187,987)
2012	53,135	0	53,135
2013	43,630	0	43,630
2014	49,466	0	49,466
2015	56,944	72,536	(15,592)
2016	37,548	0	37,548
<b>Total</b>	<b>\$287,273</b>	<b>\$874,007</b>	<b>(\$586,734)</b>

Because GHI did not calculate its SERP costs in accordance with Federal regulations, it claimed \$586,734 of unallowable SERP costs.

#### **RECOMMENDATION**

We recommend that Group Health Incorporated work with CMS to revise its ICPs for CYs 2009 through 2016 to reduce its claimed SERP costs by \$586,734.

#### **AUDITEE COMMENTS**

In written comments on our draft report, GHI did not directly address our recommendation. However, GHI's comments disagreeing with our findings in this and related reports (Appendix A), and with our findings in other current audits of GHI's qualified defined-benefit plans, suggested that it disagreed with our recommendation. Regarding this audit of GHI's claimed SERP costs, GHI disagreed with our use of the rate ceilings. Specifically, GHI stated that we incorrectly incorporated ceiling rates when determining GHI's final indirect cost rates for CYs 2009 through 2016. GHI's comments included a table, which we have added to this report as Table 3 on the following page, detailing the ceiling rates that we used in our calculations.

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<sup>7</sup> Our calculations incorporated the rate ceilings associated with the COB contracts. We applied the indirect cost rates associated with these contracts when calculating the allowable SERP costs for the COB contracts. The amounts identified in this table represent the allowable Medicare SERP costs during our audit period and do not represent the Total Company allowable costs on the ICPs.

**Table 3: Ceiling Rates Used by OIG**

	<b>Fringe</b>	<b>Overhead</b>
2010 COB	64.93%	
2010 RDS	65.93%	
2011 COB	68.37%	34.15%
2011 RDS		35.15%
2011 MSPRC		35.15%

GHI said that it agreed with our use of the 35.15 percent ceiling rate for the MSPRC contract. However, GHI disagreed with our use of the ceiling rates shown in Table 3 when we determined the pension costs for the COB and RDS contracts. GHI stated that both the COB and RDS contracts did not have ceiling rates during CYs 2010 and 2011.

GHI's comments (which also apply to our two related reports cited in Appendix A as well as other current audit reports) appear in their entirety as Appendix C.

#### **OFFICE OF INSPECTOR GENERAL RESPONSE**

The ceiling rates that GHI mentioned, and that we depicted in Table 3, are the rates we used when calculating the allowable pension costs for CYs 2010 and 2011. However, we disagree that those ceiling rates were inaccurate. We incorporated the results of the Kearney ICP audit for CYs 2010 and 2011, which recommended these ceiling rates, into our computations of the audited indirect cost rates. In GHI's response to the Kearney ICP audit recommendation, GHI agreed that its actual expenses for all contracts were higher than the ceiling that CMS had reviewed and approved. We maintain that we correctly incorporated ceiling rates when determining GHI's final indirect cost rates for CYs 2009 through 2016 and that, accordingly, all of our calculations of the allowable Medicare SERP costs remain valid. Therefore, we maintain that our finding and recommendation remain valid as well.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

We reviewed \$874,001 of Medicare SERP costs that GHI claimed for Medicare reimbursement on its ICPs for CYs 2009 through 2016.

Achieving our objective did not require that we review GHI's overall internal control structure. We reviewed the internal controls related to the SERP costs that were included in GHI'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 audit work at our office in Jefferson City, Missouri.

### METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed the SERP I and SERP II plan documents;
- reviewed accounting records and information provided by GHI to identify the amount of SERP costs claimed for Medicare reimbursement for CYs 2009 through 2016;
- calculated the allowable SERP costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments, and including an allowable interest component in the amortization installment (which we calculated with the interest rate used to determine costs for the qualified defined-benefit pension plan), in accordance with applicable provisions of the FAR and the CAS;
- reviewed the results of the Figliozzi, Kearney, and Farr ICP audits and incorporated those results into our calculations of allowable SERP costs; and
- provided the results of our audit to GHI officials on April 23, 2020.

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

- *Group Health Incorporated Did Not Claim Some Allowable Medicare Pension Costs for Calendar Years 2009 Through 2016 (A-07-19-00581)* and

- *Group Health Incorporated Claimed Some Unallowable Medicare Postretirement Benefit Costs for Calendar Years 2009 Through 2016 (A-07-19-00583).*

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 SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS**

### **FEDERAL REGULATIONS**

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

Federal regulations (CAS 412.40(a)(3)) state that for defined-benefit pension plans accounted for under the pay-as-you-go cost method, the components of pension cost for a cost accounting period are:

- the net amount of periodic benefits paid for the period, and
- an amortization installment, including an interest equivalent on the unamortized settlement amount, attributable to amounts paid to irrevocably settle an obligation for periodic benefits due in current and future cost accounting periods.

Federal regulations (CAS 412.50(b)(3)) state that for defined-benefit plans accounted for under the pay-as-you-go cost method, the amount of pension cost assignable to a cost accounting period shall be measured as the sum of:

- the net amount for any periodic benefits paid that period and
- the level annual installment required to amortize over 15 years any lump-sum benefit payments.

Federal regulations (CAS 412.50(c)(3)) state that the cost of a nonqualified defined-benefit pension plan shall be assigned to cost accounting periods in the same manner as the cost of qualified plans under the following conditions:

- the contractor, in disclosing or establishing cost accounting practices, elects to have a plan so accounted for;
- the plan is funded through the use of a funding agency; and
- the right to a pension benefit is nonforfeitable and is communicated to the participants.

Federal regulations (CAS 412.50(c)(4)) state that the cost of a nonqualified defined-benefit pension plan must be assigned using the pay-as-you-go method if the plan does not meet all of the above requirements.

## **MEDICARE CONTRACTS**

The Medicare contracts require GHI 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.)