

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**BLUE CROSS BLUE SHIELD OF SOUTH  
CAROLINA OVERSTATED ITS  
ALLOCABLE MEDICARE  
SUPPLEMENTAL EXECUTIVE  
RETIREMENT PLAN III COSTS FOR  
CALENDAR YEARS 2010 AND 2011**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
[Public.Affairs@oig.hhs.gov](mailto:Public.Affairs@oig.hhs.gov).*



**Patrick J. Cogley  
Regional Inspector General  
for Audit Services**

**November 2014  
A-07-14-00442**

# *Office of Inspector General*

<http://oig.hhs.gov/>

---

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 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. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

## *Office of Investigations*

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/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 for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

# *Notices*

---

## **THIS REPORT IS AVAILABLE TO THE PUBLIC**

at <http://oig.hhs.gov/>

Section 8M of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site.

## **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

***Blue Cross Blue Shield of South Carolina overstated its allocable Medicare Supplemental Executive Retirement Plan III costs by \$536,000 for calendar years 2010 and 2011.***

### WHY WE DID THIS REVIEW

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 the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify SERP costs.

For this review, we focused on one entity, Blue Cross Blue Shield of South Carolina (BCBS South Carolina). In particular, we examined the allocable costs that BCBS South Carolina calculated for its SERP III. BCBS South Carolina calculated Total Company (which for this report we refer to as "allocable costs") SERP III costs and allocated these costs to its subsidiaries (including its Medicare segments of Palmetto Government Benefits Administrator, LLC (Palmetto), CGS Administrators, LLC (CGS), and Companion Data Services, LLC (CDS)). In turn, Palmetto, CGS, and CDS used their allocated SERP III costs to calculate the indirect cost rates on each Medicare segment's incurred cost proposals (ICPs).

The objective of this review was to determine whether the allocable SERP III costs that BCBS South Carolina calculated, under the provisions of Palmetto's, CGS's, and CDS's Medicare administrative contractor (MAC) contracts, for calendar years (CYs) 2010 through 2011 complied with Federal requirements.

### BACKGROUND

During our audit period, Palmetto, CGS, and CDS were subsidiaries of BCBS South Carolina and administered Medicare functions for CMS. Specifically, Palmetto administered Medicare Part A fiscal intermediary and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. CGS administered Medicare Part B carrier contract operations under cost reimbursement contracts with CMS and continued to do so after its acquisition by BCBS South Carolina in June 2011.

With the implementation of Medicare contracting reform, Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 1 and Jurisdiction 11 effective October 25, 2007, and May 21, 2010, respectively. CGS continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 15 effective July 8, 2010. CDS began performing Medicare functions after being awarded the enterprise data centers contract with CMS effective March 10, 2006.

With the implementation of Medicare contracting reform, Palmetto, CGS, and CDS amended their disclosure statements to implement pooled costing. Under the provisions of their MAC-related contracts, Medicare contractors use pooled costing to calculate the indirect cost rates that they report on their ICPs. The FAR requires Medicare contractors to file final indirect cost rates on their ICPs 6 months after the year end. In turn, CMS uses the indirect cost rates in reimbursing costs under cost-reimbursement contracts.

Under the provisions of Medicare contracting reform, CMS transitioned the functions of the fiscal intermediaries and carriers, which had executed the Medicare fiscal intermediary and carrier contracts, to MACs. As part of this transition, the method by which Medicare reimbursed pension costs to the contractor changed from a cost reimbursement basis to an indirect cost basis. In accordance with the FAR and the MAC contract, reimbursement of indirect costs was now based on indirect cost rates that met the negotiated indirect cost rates determined by the contract.

This report addresses the Total Company allocable SERP III costs calculated by BCBS South Carolina under the provisions of Palmetto's, CGS's, and CDS's MAC-related contracts. We are addressing the SERP III costs claimed by Palmetto under the provisions of its fiscal intermediary and carrier contracts in a separate review.

We reviewed \$536,196 of Total Company SERP III costs used by BCBS South Carolina in the calculation of its indirect cost rates for Palmetto, CGS, and CDS, under the provisions of its MAC-related contracts, for CYs 2010 through 2011.

## **WHAT WE FOUND**

The SERP III costs that BCBS South Carolina calculated did not comply with Federal requirements. Specifically, for CYs 2010 and 2011 BCBS South Carolina identified allocable SERP III costs of \$536,196; however, we determined that these costs were unallowable. Thus, BCBS South Carolina overstated its allocable SERP III costs by \$536,196. This overstatement occurred because BCBS South Carolina did not calculate SERP III costs in accordance with Federal regulations.

## **WHAT WE RECOMMEND**

We recommend that BCBS South Carolina eliminate the \$536,196 of allocable SERP III costs used to calculate the indirect cost rates for CYs 2010 and 2011.

## **AUDITEE COMMENTS AND OUR RESPONSE**

In written comments on our draft report, BCBS South Carolina did not concur with our recommendation, for two reasons. BCBS South Carolina said that the change it made in its SERP III (which formed the basis of our finding) was unintentional. BCBS South Carolina also said that because it was amending the SERP III plan document to make the plan compliant with the FAR as a pension plan, it would be burdensome for BCBS South Carolina to have to account for the SERP III as initially compliant with the FAR, and then as noncompliant for a time period, and then as compliant once again.

BCBS South Carolina suggested, as an alternative to our recommendation, a course of action in which BCBS South Carolina would correct its “inadvertent change” to the SERP III by amending the plan retroactively and restoring the offer of a benefit that is payable for life at the option of the employee. BCBS South Carolina also stated that it had established a policy that its defined-benefit plans may not be amended without considering the CAS effects, so as to avoid any future unintended changes to its plans.

Nothing in BCBS South Carolina’s comments caused us to change our finding or recommendation. We based our audit on the plan document in effect at the time of our review. We suggest that BCBS South Carolina consult with CMS (the cognizant Federal agency) to explore whether a retroactive plan amendment is permissible and what effects such an amendment would have on future cost accounting periods. We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations.

## TABLE OF CONTENTS

INTRODUCTION .....	1
Why We Did This Review .....	1
Objective .....	1
Background .....	1
Supplemental Executive Retirement Plan III.....	2
Medicare Reimbursement of Supplemental Executive Retirement Plan III Costs.....	2
How We Conducted This Review.....	3
FINDING .....	3
Total Company Supplemental Executive Retirement Plan III Costs.....	3
Overstated Supplemental Executive Retirement Plan III Costs .....	3
Costs Based on Nonqualified Defined-Benefit Pension Plan .....	3
Overstatement of Allocable Supplemental Executive Retirement Plan III Costs.....	4
RECOMMENDATION .....	4
AUDITEE COMMENTS.....	5
OFFICE OF INSPECTOR GENERAL RESPONSE .....	5
OTHER MATTER .....	5
APPENDIXES	
A: Audit Scope and Methodology .....	6
B: Federal Requirements Related to Reimbursement of Supplement Executive Retirement Plan Costs.....	7
C: Auditee Comments.....	9

## INTRODUCTION

### WHY WE DID THIS REVIEW

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 the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify SERP costs.

For this review, we focused on one entity, Blue Cross Blue Shield of South Carolina (BCBS South Carolina). In particular, we examined the allocable costs that BCBS South Carolina calculated for its SERP III. BCBS South Carolina calculated Total Company (which for this report we refer to as "allocable costs") SERP III costs and allocated these costs to its subsidiaries (including its Medicare segments of Palmetto Government Benefits Administrator, LLC (Palmetto), CGS Administrators, LLC (CGS), and Companion Data Services, LLC (CDS)). In turn, Palmetto, CGS, and CDS used their allocated SERP III costs to calculate the indirect cost rates on each Medicare segment's incurred cost proposals (ICPs).

### OBJECTIVE

Our objective was to determine whether the allocable SERP III costs that BCBS South Carolina calculated, under the provisions of Palmetto's, CGS's, and CDS's Medicare administrative contractor (MAC) contracts, for calendar years (CYs) 2010 through 2011 complied with Federal requirements.

### BACKGROUND

During our audit period, Palmetto, CGS, and CDS were subsidiaries of BCBS South Carolina and administered Medicare functions for CMS. Specifically, Palmetto administered Medicare Part A fiscal intermediary and Medicare Part B carrier contract operations under cost reimbursement contracts with CMS. CGS administered Medicare Part B carrier contract operations under cost reimbursement contracts with CMS and continued to do so after its acquisition by BCBS South Carolina in June 2011.

With the implementation of Medicare contracting reform,<sup>1</sup> Palmetto continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B

---

<sup>1</sup> Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

Jurisdiction 1<sup>2</sup> and Jurisdiction 11<sup>3</sup> effective October 25, 2007, and May 21, 2010, respectively. CGS continued to perform Medicare work after being awarded the MAC contracts for Medicare Parts A and B Jurisdiction 15 effective July 8, 2010.<sup>4</sup> CDS began performing Medicare functions after being awarded the enterprise data centers contract with CMS effective March 10, 2006.

With the implementation of Medicare contracting reform, Palmetto, CGS, and CDS amended their disclosure statements to implement pooled costing. Under the provisions of their MAC-related contracts, Medicare contractors use pooled costing to calculate the indirect cost rates that they report on their ICPs. The FAR requires Medicare contractors to file final indirect cost rates on their ICPs 6 months after the year end. In turn, CMS uses the indirect cost rates in reimbursing costs under cost-reimbursement contracts.

### **Supplemental Executive Retirement Plan III**

BCBS South Carolina sponsors a SERP III whose primary purpose is to provide a benefit to a select group of management or highly compensated employees.<sup>5</sup> The SERP III is designed to supplement benefits payable under BCBS South Carolina's retirement plans.

BCBS South Carolina defined its SERP III as a nonqualified defined-benefit pension plan and calculated its costs pursuant to CAS 412.

### **Medicare Reimbursement of Supplemental Executive Retirement Plan III Costs**

Under the provisions of the contracts that CMS developed with the Medicare contractors as part of the implementation of the MMA, the method by which Medicare reimbursed pension costs to the contractor changed from a cost reimbursement basis to an indirect cost basis. In accordance with the FAR and the MAC contract, reimbursement of indirect costs was now based on indirect cost rates that met the negotiated indirect cost rates determined by the contract.

---

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> Medicare Parts A and B Jurisdiction 15 consists of the States of Kentucky and Ohio. Jurisdiction 15 also includes home health and hospice services provided in the States of Colorado, Delaware, Iowa, Kansas, Maryland, Missouri, Montana, Nebraska, North Dakota, Pennsylvania, South Dakota, Utah, Virginia, West Virginia, and Wyoming, and in the District of Columbia.

<sup>5</sup> In addition to its SERP III, BCBS South Carolina sponsored two other SERPs during our audit period. We will review and issue a separate report on the SERP I covering the period of fiscal years (FYs) 2005 through 2011. BCBS South Carolina created and terminated the SERP II during our audit period. We reviewed financial information for the SERP II and determined that no costs were charged to Medicare; therefore, we will not issue a separate report on that plan.

This report addresses the Total Company allocable SERP III costs calculated by BCBS South Carolina under the provisions of Palmetto's, CGS's, and CDS's MAC-related contracts. We are addressing the SERP III costs claimed by Palmetto under the provisions of its fiscal intermediary and carrier contracts in a separate review.

## **HOW WE CONDUCTED THIS REVIEW**

We reviewed \$536,196 of Total Company SERP III costs used by BCBS South Carolina in the calculation of its indirect cost rates for Palmetto, CGS, and CDS, under the provisions of its MAC-related contracts, for CYs 2010 through 2011.

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 SERP III costs that BCBS South Carolina calculated did not comply with Federal requirements. Specifically, for CYs 2010 and 2011 BCBS South Carolina identified allocable SERP III costs of \$536,196; however, we determined that these costs were unallowable. Thus, BCBS South Carolina overstated its allocable SERP III costs by \$536,196. This overstatement occurred because BCBS South Carolina did not calculate SERP III costs in accordance with Federal regulations.

## **TOTAL COMPANY SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN III COSTS**

BCBS South Carolina calculated allocable SERP III costs of \$536,196 for CYs 2010 and 2011. BCBS South Carolina calculated the SERP III costs on the premise that the SERP III was a nonqualified defined-benefit pension plan.

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

### **Costs Based on Nonqualified Defined-Benefit Pension Plan**

The Medicare contracts require that SERP costs be calculated in accordance with the FAR and the CAS. BCBS South Carolina defined its SERP III as a nonqualified defined-benefit pension plan and, accordingly, calculated the plan's costs as specified in CAS 412. However, BCBS South Carolina's SERP III did not offer a benefit that is payable for life at the option of the employees; therefore it did not qualify as a "pension plan" as defined in FAR 31.001. Thus, BCBS South Carolina did not calculate costs in accordance with Federal regulations.

BCBS South Carolina should have calculated its SERP III costs in accordance with FAR 31.205-6(k) and CAS 415. Specifically, BCBS South Carolina should have identified its SERP III costs in accordance with the regulations for a deferred compensation plan and should then have calculated those costs in accordance with the FAR and CAS 415.

For details on the Federal requirements, see Appendix B.

### **Overstatement of Allocable Supplemental Executive Retirement Plan III Costs**

In light of these considerations, we recalculated BCBS South Carolina’s SERP III costs in accordance with CAS 415 and determined that BCBS South Carolina had no allocable Total Company SERP III costs for CYs 2010 and 2011. In accordance with CAS 415, we based the allocable costs on actual payments to SERP III participants. During CYs 2010 and 2011, no benefit payments were paid to SERP III participants; therefore, there were no allocable costs for the SERP III during this time period. Thus, BCBS South Carolina overstated the Total Company SERP III costs for this time period by \$536,196. This overstatement occurred because BCBS South Carolina did not calculate costs in accordance with Federal regulations.

The table below shows the difference between the Total Company allocable SERP III costs that we calculated and the Total Company SERP III Costs that BCBS South Carolina used to calculate Palmetto’s, CGS’s, and CDS’s indirect cost rates for CYs 2010 through 2011.

<b><u>Table: Supplemental Executive Retirement Plan III Costs</u></b>			
<b>Calendar Year</b>	<b>Per Audit</b>	<b>Per BCBS South Carolina</b>	<b>Difference</b>
2010	\$0	\$181,303	(\$181,303)
2011	0	354,893	(354,893)
<b>Total</b>	<b>\$0</b>	<b>\$536,196</b>	<b>(\$536,196)</b>

CMS should use the information contained in this report and the related fiscal intermediary and carrier contract reports when determining the allowable Medicare segment SERP III costs for Palmetto, CGS, and CDS.<sup>6</sup>

### **RECOMMENDATION**

We recommend that BCBS South Carolina eliminate the \$536,196 of allocable SERP III costs used to calculate the indirect cost rates for CYs 2010 and 2011.

<sup>6</sup> Our review of the allocable SERP III costs for BCBS South Carolina identified the amount of SERP III costs that should have been used to allocate SERP III costs to Palmetto, CGS, and CDS. CMS should use the information in this report, as well as the information from our review of the fiscal intermediary and carrier contract SERP III costs claimed by Palmetto (A-07-14-00441) and CGS (“Other Matter” section below), to determine the allowable SERP III costs for Palmetto, CGS, and CDS. In addition, CMS will use the information provided by the audit organization that reviews the ICPs (regarding their compliance with the CAS) to determine the final indirect cost rates for Palmetto, CGS, and CDS.

## **AUDITEE COMMENTS**

In written comments on our draft report, BCBS South Carolina did not concur with our recommendation, for two reasons. BCBS South Carolina said that the change it made in its SERP III (to remove the benefit that is payable for life at the option of the employee) was unintentional, in the sense that BCBS South Carolina sought to simplify elections for its retirees. BCBS South Carolina stated that its intent was that the SERP III would continue to be recognized as a pension plan, but added that it "... did not consider that removing the life time payout option would change this status."

BCBS South Carolina also said that because it was amending the SERP III plan document to reinstate the lifetime payout option and make the plan compliant with the FAR as a pension plan, it would be burdensome for BCBS South Carolina to have to account for the SERP III as initially compliant with the FAR, and then as noncompliant for a time period, and then as compliant once again.

BCBS South Carolina thus suggested, as an alternative to our recommendation, a course of action in which BCBS South Carolina would correct its "inadvertent change" to the SERP III by restoring the offer of a benefit that is payable for life at the option of the employee. BCBS South Carolina requested that this corrective action be considered effective retroactive to the effective date of the amendment removing the lifetime payout option. BCBS South Carolina also stated that it had established a policy that its defined-benefit plans may not be amended without considering the CAS effects, so as to avoid any future unintended changes to its plans.

BCBS South Carolina's comments are included in their entirety as Appendix C.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

Nothing in BCBS South Carolina's comments caused us to change our finding or recommendation. We based our audit on the plan document in effect at the time of our review. This document did not offer a benefit that is payable for life, as required by FAR 31.001; therefore, the SERP III as constituted at the time of our review did not meet the definition of a pension plan as specified in the relevant criteria. We suggest that BCBS South Carolina consult with CMS (the cognizant Federal agency) to explore whether a retroactive plan amendment is permissible and what effects such an amendment would have on future cost accounting periods. We maintain that our finding and recommendation, as stated, remain valid and solidly supported by Federal regulations.

## **OTHER MATTER**

During our review of BCBS South Carolina's SERP III, we also reviewed the SERP III costs claimed by CGS during FYs 2010 and 2011. We determined that the fiscal intermediary and contract carrier costs claimed by CGS during this period were reasonable.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

We reviewed \$536,196 of allocable SERP III costs calculated by BCBS South Carolina, under the provisions of Palmetto's, CGS's, and CDS's MAC contracts, for CYs 2010 and 2011.

Achieving our objective did not require that we review BCBS South Carolina's overall internal control structure. We reviewed the internal controls related to the SERP III costs claimed for Medicare reimbursement to ensure that those costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We conducted our audit work in July 2013.

### METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed BCBS South Carolina's SERP III plan document;
- reviewed accounting records and ICP information provided by BCBS South Carolina to identify the Total Company SERP III costs used by BCBS South Carolina in the calculation of its indirect cost rates for Palmetto, CGS, and CDS; and
- provided the results of our review to BCBS South Carolina officials on May 7, 2014.

We performed this review in conjunction with the following audit and used the information obtained during this audit: *Palmetto Government Benefit Administrators, LLC, Claimed Unallowable Medicare Supplemental Executive Retirement Plan III Costs for Fiscal Years 2010 and 2011 (A-07-14-00441)*.

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 SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS**

### **FEDERAL REGULATIONS**

FAR 31.001 defines a pension plan as follows:

“Pension plan” means a deferred compensation plan established and maintained by one or more employers to provide systematically for the payment of benefits to plan participants after their retirements, provided that the benefits are paid for life or are payable for life at the option of the employees. Additional benefits such as permanent and total disability and death payments, and survivorship payments to beneficiaries of deceased employees, may be an integral part of a pension plan.

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

The allowability of costs for deferred compensation plans is governed by FAR 31.205-6. FAR 31.205-6(k) states that costs shall be measured, assigned, and allocated in accordance with CAS 415.

Federal regulation (CAS 415.40(a)) states that the cost of deferred compensation shall be assigned to the cost accounting period in which the contractor incurs an obligation to compensate the employee.

Federal regulation (CAS 415.50(a)) states:

The contractor shall be deemed to have incurred an obligation for the cost of deferred compensation when all of the following conditions have been met. However, for awards which require that the employee perform future service in order to receive the benefits, the obligation is deemed to have been incurred as the future service is performed for that part of the award attributable to such future service:

- (1) There is a requirement to make the future payment(s) which the contractor cannot unilaterally avoid.
- (2) The deferred compensation award is to be satisfied by a future payment of money, other assets, or shares of stock of the contractor.
- (3) The amount of the future payment can be measured with reasonable accuracy.
- (4) The recipient of the award is known.

- (5) If the terms of the award require that certain events must occur before an employee is entitled to receive the benefits, there is a reasonable probability that such events will occur.
- (6) For stock options, there must be a reasonable probability that the options ultimately will be exercised.

### **MEDICARE CONTRACTS**

The contracts state: “Once each month following the effective date of this contract, the Contractor may submit to the Government an invoice for payment, in accordance with FAR clause 52.216-7, ‘Allowable Cost & Payment.’”

## APPENDIX C: AUDITEE COMMENTS



BlueCross BlueShield of South Carolina  
I-20 East at Alpine Road  
Columbia, SC 29219-0001  
803.788.0222

SouthCarolinaBlues.com

September 15, 2014

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

Re: Report Number A-07-14-00442

Dear Mr. Cogley:

We are responding to the U.S. Department of Health and Human Services, Office of Inspector General, draft report dated August 1, 2014 and entitled *Blue Cross Blue Shield of South Carolina Overstated Its Allocable Medicare Supplemental Executive Retirement Plan III Costs for Calendar Years 2010 and 2011*. We appreciate the extension until September 15, 2014 to submit our response.

The report contains the following recommendation:

We recommend that BCBS South Carolina eliminate the \$536,196 of allowable SERP III costs used to calculate the indirect cost rates for CYs 2010 and 2011.

We do not concur with the recommendation and offer an alternative corrective action. Our reason for non-concurrence is two-fold. First, and most significantly, the change to the SERP III plan was unintentional. The amendment was made to conform the SERP III election options to those provided under the Preferred Savings Plan (our non-qualified defined contribution plan) and thereby simplify elections for our retirees. The amendment would enable them to manage both of their nonqualified plans with one election. Of course the intent was that the plan would continue to be recognized as a pension plan but, unfortunately, we did not consider that removing the life time payout option would change this status.

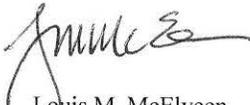
Second, since we are in the process of amending the plan to reinstate the lifetime payout which will make the plan FAR compliant as a pension plan it would be burdensome to account for the plan as being initially FAR compliant followed by a noncompliant period and then finally revert

back to being FAR compliant again. This would create the need for future calculations to account for the plan as a deferred compensation plan as well as a pension plan.

Our alternative action is to correct our inadvertent change to the SERP III plan by restoring the offer of a benefit that is payable for life at the option of the employee. This amendment is not complicated and will be completed as soon as possible. We request that this corrective action be considered effective retroactively to the effective date of the amendment removing the lifetime payout option. Further, we have established a policy that our defined benefit plans may not be amended without considering the CAS effects to avoid any future unintended changes to our plans such as this.

We appreciate the opportunity to comment on the recommendation. Please let me know if you have questions or need additional information regarding our response. My contact information is 803-264-6443 or [Louis.McElveen@cbssc.com](mailto:Louis.McElveen@cbssc.com).

Sincerely,



Louis M. McElveen  
VP Corporate Finance