Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

FIRST COAST SERVICE OPTIONS, INC., OVERSTATED ITS MEDICARE SEGMENT POSTRETIREMENT BENEFIT ASSETS

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

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Deputy Inspector General
for Audit Services

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Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

TABLE OF CONTENTS

INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of Medicare contractors' costs for postretirement benefit (PRB) plans. In claiming these costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards (CAS). First Coast Service Options, Inc. (FCSO), elected to use segmented accrual accounting for its PRB plans.

At CMS's request, the Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-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).

We used the Medicare contracts' pension segmentation requirements as authoritative guidance. The fiscal intermediary and carrier contracts require that the pension assets be allocated to each Medicare segment and adjusted in accordance with CAS 413. In turn, CAS 413 requires these contractors to update the pension assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses. These PRB assets are calculated by the contractors' actuarial consulting firms and are usually included as CAS exhibits (that is, the update of the PRB assets as of January 1 of each year under review) in the contractors' PRB plan actuarial valuation reports. The Medicare segment PRB assets are integral to calculating the allowable Medicare PRB costs.

Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the Medicare segment PRB assets. Specifically, our prior PRB segmentation audit report of FCSO (A-07-09-00314, issued May 5, 2010) found that FCSO did not correctly identify and update its Medicare segment PRB assets.

OBJECTIVES

Our objectives were to determine whether FCSO complied with Federal requirements when (1) implementing the prior audit recommendation to decrease the Medicare segment PRB assets as of January 1, 2008, and (2) updating the Medicare segment PRB assets with contributions, permitted unfunded accruals, income, claims paid, participant transfers, and administrative expenses in its CAS exhibits from January 1, 2008, to January 1, 2013.

BACKGROUND

During our audit period, FCSO and C2C Innovative Solutions, Inc. (C2C), were wholly owned subsidiaries of Diversified Service Options, Inc., a holding company created and owned by Blue Cross and Blue Shield of Florida, Inc. (BCBS Florida), whose office is located in Jacksonville, Florida. FCSO administered Medicare Parts A and B operations under cost reimbursement contracts with CMS until its contractual relationships ended on February 13, 2009, and February 1, 2009, respectively.

With the implementation of Medicare contracting reform,[1] FCSO continued to perform Medicare work after being awarded the MAC contract for Medicare Parts A and B Jurisdiction 9[2] effective September 12, 2008.

On April 2, 2007, C2C was created to perform additional Medicare work under the Qualified Independent Contractors (QIC) contract for the Medicare Part B North jurisdiction; this contract was originally awarded to FCSO in 2004.[3] On July 9, 2010, the QIC contract was novated from FCSO to C2C. Although C2C was created as a separate segment, BCBS Florida computed PRB costs for FCSO and C2C on a composite basis and allocated those costs to the two entities; however, C2C filed separate ICPs when claiming costs for Medicare reimbursement for the QIC contract. Therefore, the CAS PRB costs were calculated in total for the FCSO Medicare segment, and allocated to both the FCSO and C2C ICPs. Subsequently, on August 5, 2011, C2C was sold to TMF Health Quality Institute.

FCSO and C2C participate in a voluntary employee benefit association (VEBA) trust for the purpose of funding annual PRB accruals offered by BCBS Florida. Furthermore, FCSO's accounting practice, approved by CMS, uses segmented accrual accounting for its PRB plans.

Our prior PRB segmentation audit (A-07-09-00314, issued May 5, 2010) updated the Medicare segment PRB assets to January 1, 2008. We recommended that FCSO decrease its Medicare segment pension assets by $835,995 and, as a result, recognize $14,236,857 as the Medicare segment PRB assets as of January 1, 2008.

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[1] 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. 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.

[2] Medicare Parts A and B Jurisdiction 9 consists of the State of Florida and the territories of Puerto Rico and the U.S. Virgin Islands.

[3] The QIC Part B North jurisdiction includes 35 northern States, the District of Columbia, and 3 U.S. territories.

HOW WE CONDUCTED THIS REVIEW

We reviewed FCSO's implementation of the prior audit recommendation; identification of its PRB Medicare segment; and update of the Medicare segment PRB assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses in its CAS exhibits from January 1, 2008, to January 1, 2013.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDINGS

FCSO implemented our prior audit recommendation to recognize $14,236,857 as the Medicare segment PRB assets as of January 1, 2008.

Regarding our second objective, FCSO did not fully comply with Federal requirements when updating the Medicare segment PRB assets in its CAS exhibits from January 1, 2008, to January 1, 2013. FCSO identified Medicare segment PRB assets of $22,522,214 as of January 1, 2013; however, we determined that the Medicare segment PRB assets were $17,525,123. Therefore, FCSO overstated the Medicare segment PRB assets by $4,997,091. FCSO overstated the Medicare segment PRB assets primarily because it used an incorrect methodology when transferring prepayment credits to the Medicare segment throughout the audit period.

Appendix B presents details of FCSO's PRB plan assets from January 1, 2008, to January 1, 2013, as determined during our audit. Table 1 below summarizes the audit adjustments required to update FCSO's Medicare segment PRB assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per Audit	Per FCSO	Difference
Prior Audit Recommendation	$14,236,857	$14,236,857	$0
Update of Medicare Segment Assets			
Contributions and prepayment credits	6,979,769	11,086,539	(4,106,770)
Investment Earnings (net of expenses)	2,487,489	3,377,810	(890,321)
Claims Paid	(6,178,992)	(6,178,992)	0
Overstatement of Medicare Segment Assets as of January 1, 2013			**($4,997,091)**

PRIOR AUDIT RECOMMENDATION

FCSO implemented our prior audit recommendation (A-07-09-00314, issued May 5, 2010) that it decrease Medicare segment PRB assets by $835,995 and recognize $14,236,857 as the Medicare segment PRB assets as of January 1, 2008.

UPDATE OF MEDICARE SEGMENT POSTRETIREMENT BENEFIT ASSETS

FCSO elected to use segmented accrual accounting for its PRB plan. We used the Medicare contracts' pension segmentation requirements as authoritative guidance. The Medicare contracts state that "… the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)." For details on the Federal requirements, see Appendix C.

FCSO did not fully comply with Federal requirements when updating the Medicare segment PRB assets in its CAS exhibits from January 1, 2008, to January 1, 2013. The following are our findings regarding the update of the Medicare segment PRB assets from January 1, 2008, to January 1, 2013.

Contributions and Transferred Prepayment Credits Overstated

FCSO overstated contributions and transferred prepayment credits by $4,106,770 for the Medicare segment. The overstatement occurred because FCSO used an incorrect methodology to transfer prepayment credits to the Medicare segment throughout the audit period. To determine the correct update of the Medicare segment's PRB assets, we limited each year's transferred prepayment credit to the beginning-of-year CAS PRB cost assigned to that year.

A comparison of FCSO's and our calculations of contributions and transferred prepayment credits for the Medicare segment appears in Table 2 below.

Table 2: Contributions and Transferred Prepayment Credits for the Medicare Segment

Year	Per Audit	Per FCSO	Difference
2008	$3,145,984	$3,146,116	($132)
2009	2,531,699	2,535,799	(4,100)
2010	298,230	2,410,937	(2,112,707)
2011	538,342	2,993,687	(2,455,345)
2012	465,514	0	465,514
Total	**$6,979,769**	**$11,086,539**	**($4,106,770)**

Investment Earnings (Net of Expenses) Overstated

FCSO overstated investment earnings, less administrative expenses, by $890,321 for the Medicare segment because it used incorrect contributions and transferred prepayment credits (discussed above) to develop the Medicare segment PRB asset base. In our calculation of the Medicare segment PRB assets as of January 1, 2013, we allocated investment earnings (net of expenses) based on the applicable CAS requirements. For details on applicable Federal requirements, see Appendix C.

A comparison of FCSO's and our calculations of net investment earnings for the Medicare segment appears in Table 3 below.

Table 3: Net Investment Earnings for the Medicare Segment			
Year	**Per Audit**	**Per FCSO**	**Difference**
2008	($4,032,343)	($4,033,982)	$1,639
2009	2,666,815	2,624,940	41,875
2010	993,573	1,128,043	(134,470)
2011	651,432	845,393	(193,961)
2012	2,208,012	2,813,416	(605,404)
Total	**$2,487,489**	**$3,377,810**	**($890,321)**

RECOMMENDATION

We recommend that FCSO decrease its Medicare segment PRB assets by $4,997,091 as of January 1, 2013.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our recommendation and stated that the Medicare segment PRB assets would be decreased.

FCSO's comments appear in their entirety as Appendix D.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed FCSO's implementation of the prior audit recommendation; identification of its PRB Medicare segment; and update of the Medicare segment PRB assets with contributions, permitted unfunded accruals, income, benefit payments (claims paid), participant transfers, and administrative expenses in its CAS exhibits from January 1, 2008, to January 1, 2013.

Achieving our objectives did not require us to review FCSO's overall internal control structure. We reviewed controls relating to the identification of the PRB Medicare segment and the update of the Medicare segment's PRB assets.

We performed fieldwork at FCSO in Jacksonville, Florida.

METHODOLOGY

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the FAR, CAS, and the Medicare contracts applicable to this audit.

- We reviewed the annual actuarial valuation reports prepared by FCSO's actuarial consulting firm, which included the PRB plan's assets, PRB obligations, service costs, contributions, claims paid, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment PRB assets.

- We obtained and reviewed the PRB plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Medicare segment PRB assets.

- We interviewed FCSO staff responsible for determining and implementing the methodology that FCSO used in its identification of the PRB Medicare segment.

- We reviewed FCSO's accounting records to verify the PRB Medicare segment identification.

- We reviewed the prior PRB segmentation audit performed at FCSO (A-07-09-00314, issued May 5, 2010) to determine the beginning market value of assets.

- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment PRB assets from January 1, 2008, to January 1, 2013.

- We reviewed the CMS actuaries' methodology and calculations.

- We provided the results of this review to FCSO officials on February 23, 2017.

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

- *First Coast Service Options, Inc., Did Not Claim Some Allowable Medicare Postretirement Benefit Costs* (A-07-17-00500) and

- *First Coast Service Options, Inc., Understated Its Medicare Segment and Overstated Its Other Segment Allocable Postretirement Benefit Costs* (A-07-17-00502).

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: FIRST COAST SERVICE OPTIONS, INC., STATEMENT OF MARKET VALUE OF POSTRETIREMENT BENEFIT PLAN ASSETS FOR THE PERIOD JANUARY 1, 2008, TO JANUARY 1, 2013

Description		Total Company	Other Segment	Medicare Segment
Assets January 1, 2008	1/	$90,415,420	$76,178,563	$14,236,857
Prepayment credits	2/	0	(2,132,033)	2,132,033
Contributions	3/	18,500,000	17,486,049	1,013,951
Claims Reimbursed	4/	(7,913,663)	(6,252,567)	(1,661,096)
Investment return	5/	(22,397,117)	(18,364,774)	(4,032,343)
Assets January 1, 2009		$78,604,640	$66,915,238	$11,689,402
Prepayment credits		0	(2,068,269)	2,068,269
Contributions		18,000,000	17,536,570	463,430
Claims Reimbursed		(8,267,842)	(6,463,543)	(1,804,299)
Investment return		15,329,512	12,662,697	2,666,815
Assets January 1, 2010		$103,666,310	$88,582,693	$15,083,617
Prepayment credits		0	(298,230)	298,230
Contributions		6,500,000	6,500,000	0
Claims Reimbursed		(5,200,000)	(4,168,140)	(1,031,860)
Investment return		6,720,495	5,726,922	993,573
Assets January 1, 2011		$111,686,805	$96,343,245	$15,343,560
Prepayment credits		0	(538,342)	538,342
Contributions		6,500,000	6,500,000	0
Claims Reimbursed		(5,300,000)	(4,344,366)	(955,634)
Investment return		4,595,517	3,944,085	651,432
Assets January 1, 2012		$117,482,322	$101,904,622	$15,577,700
Prepayment credits		0	(465,514)	465,514
Contributions		0	0	0
Claims Reimbursed		(4,100,000)	(3,373,897)	(726,103)
Investment return		16,174,952	13,966,940	2,208,012
Assets January 1, 2013		$129,557,274	$112,032,151	$17,525,123
Per FCSO	6/	129,557,274	107,035,060	22,522,214
Asset variance	7/	0	(4,997,091)	4,997,091

ENDNOTES

1/ We determined the Medicare segment PRB assets as of January 1, 2008, based on our prior segmentation audit of FCSO (A-07-09-00314). The amounts shown for the Other segment represent the difference between the Total Company and the Medicare segment. All PRB assets are shown at market value.

2/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current-year contributions to avoid incurring unallowable interest. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.

3/ We obtained Total Company contribution amounts from the actuarial valuation reports and VEBA trust statements. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the Total Company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the Other segment until needed to fund PRB costs in the future. The amounts represent funds deposited in the trust.

4/ Claims paid represents benefits reimbursements from the trust fund for claims paid. We obtained Medicare segment claims paid amounts from documents prepared by FCSO's actuarial consulting firm.

5/ We obtained investment returns from the PRB actuarial valuation reports. We allocated net investment returns based on the ratio of the segment's weighted average value (WAV) of assets to Total Company WAV of assets as required by the CAS.

6/ We obtained the asset amount as of January 1, 2013, from documents prepared by FCSO's actuarial consulting firm.

7/ The asset variance represents the difference between our calculation of the Medicare segment PRB assets and FCSO's calculation of the Medicare segment PRB assets.

APPENDIX C: FEDERAL REQUIREMENTS RELATED TO POSTRETIREMENT BENEFIT SEGMENTATION

FEDERAL REGULATIONS

FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be (1) measured and assigned in accordance with generally accepted accounting principles, (2) funded in a dedicated trust fund, such as a VEBA trust, and (3) calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

CAS 412.50(a)(4) requires that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future-period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

CAS 413.50(c)(7) requires that the asset base be updated by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's WAV of assets to the Total Company WAV of assets.

MEDICARE CONTRACTS

The fiscal intermediary and carrier contracts identify a Medicare segment as:

> … any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:
>
> 1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
>
> 2. Less than a majority of the salary dollars are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the fiscal intermediary and carrier contracts state that "… the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)."

FIRST COAST
SERVICE OPTIONS, INC.
WHEN EXPERIENCE COUNTS & QUALITY MATTERS

Harvey B. Dikter
President & CEO
First Coast Service Options, Inc.
harvey.dikter@fcso.com

May 22, 2017

Mr. 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

Reference: A-07-17-00499

Dear Mr. Cogley:

We received the U.S. Department of Health & Human Services, Office of Inspector General (OIG) draft report entitled, "*First Coast Service Options Inc., Overstated Its Medicare Segment Postretirement Benefit Assets"* and reviewed.

In the draft report, you outlined a recommendation that we have addressed as follows:

Recommendation:

First Coast decrease its Medicare segment PRB assets by $4,997,091 as of January 1, 2013.

Response:

First Coast agrees with this recommendation. Medicare segment PRB assets will be decreased.

If you have any questions, please contact Mr. Gregory W. England at (904) 791-8364.

Sincerely,

Harvey B. Dikter

cc: Gregory W. England

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