Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

FIRST COAST SERVICE OPTIONS, INC., UNDERSTATED ITS MEDICARE SEGMENT AND OVERSTATED ITS OTHER SEGMENT ALLOCABLE POSTRETIREMENT BENEFIT COSTS

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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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.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their postretirement benefit (PRB) costs, which are funded by direct payments to beneficiaries or contributions to a dedicated trust fund. The amount of PRB 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) as required by the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors have not always complied with Federal requirements when claiming PRB costs for Medicare reimbursement.

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).

For this review, we focused on one Medicare contractor, First Coast Service Options, Inc. (FCSO). In particular, we examined the Medicare segment and Other segment allocable PRB costs that FCSO used to calculate the indirect cost rates in its ICPs.

OBJECTIVE

Our objective of this review was to determine whether the PRB costs that FCSO calculated, under the provisions of its MAC contract, for calendar years (CYs) 2008 through 2012 complied with Federal requirements.

BACKGROUND

First Coast Service Options, Inc.

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 Cost Accounting Standards (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.

Effective May 16, 2008, FCSO amended its 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.[4]

During our audit period, FCSO administered both fiscal intermediary and carrier contracts and MAC-related contracts. This report addresses the allocable PRB costs calculated by FCSO and C2C (collectively referred to as "allocable PRB costs") under the provisions of their MAC-related contracts and QIC-related contracts, respectively. (FCSO maintained the C2C pension assets and the related participants under FCSO's pension assets. Although a PRB cost was computed

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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.

[4] A cost-plus-award-fee contract is a cost reimbursement contract that provides for a fee consisting of (a) a base amount fixed at inception of the contract and (b) an award amount, based upon a judgmental evaluation by the Federal Government.

for the FCSO segment, a portion of FCSO's allocable PRB costs were allocated to C2C and included in that entity's ICP to compute the final indirect cost rates.)

We are addressing the allowable PRB costs claimed by FCSO under the provisions of its fiscal intermediary and carrier contracts in a separate review.

Medicare Reimbursement of Postretirement Benefit Costs

CMS reimburses a portion of the funded accruals that contractors charge for their PRB plans. FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be (1) determined in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 715-60 (formerly Statement of Financial Accounting Standards (SFAS) 106)[5] and (2) funded by payments to an insurer or into a dedicated trust, such as a VEBA trust.

Under the provisions of Medicare contracting reform, CMS transferred the functions of the fiscal intermediaries and carriers, which had executed the fiscal intermediary and carrier contracts, to MACs. Under the MAC-contracts, the method by which Medicare reimbursed PRB costs to the contractors 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 in the contracts.

HOW WE CONDUCTED THIS REVIEW

We reviewed $41,586,744 of allocable PRB costs used in the calculation of the indirect cost rates for the MAC-related contracts for CYs 2008 through 2012.

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.

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[5] Effective for financial statements issued for periods ending after September 15, 2009, the FASB ASC became the single source of authoritative accounting and reporting standards applicable for all nongovernmental entities. SFAS 106 is now referred to as ASC 715-60. Thus in 2010, FCSO began identifying its PRB obligations using ASC 715-60.

FINDINGS

The allocable PRB costs that FCSO calculated under the provisions of its MAC contract for CYs 2008 through 2012 did not always comply with Federal requirements. Specifically, neither the Medicare segment nor the Other segment allocable PRB costs that FCSO used to calculate the indirect cost rates in its ICPs complied with Federal requirements. For CYs 2008 through 2012:

- FCSO used Medicare segment PRB costs of $6,923,572 to calculate its indirect cost rates in its ICPs; however, we determined that the Medicare segment PRB costs that should have been used to calculate the indirect cost rates were $6,973,959. Thus, FCSO understated the Medicare segment PRB costs used to calculate its indirect cost rates by $50,387.

- FCSO used Other segment PRB costs of $34,663,172 to calculate its indirect cost rates in its ICPs; however, we determined that the Other segment PRB costs that should have been used to calculate the indirect cost rates were $31,305,288. Thus, FCSO overstated the Other segment PRB costs used to calculate its indirect cost rates by $3,357,884.

These misstatements occurred because FCSO did not calculate its allocable PRB costs in accordance with the FAR.

CMS will use the information contained in this report and the related report (A-07-17-00500; Appendix A) when determining the allowable Medicare segment PRB costs for FCSO.[6]

MEDICARE SEGMENT POSTRETIREMENT BENEFIT COSTS

FCSO used Medicare segment accrued PRB costs of $6,923,572 to calculate its indirect cost rates for the Medicare segment for CYs 2008 through 2012. We calculated the accrued PRB costs for the Medicare segment for CYs 2008 through 2012 in accordance with the FAR. For details on the Federal requirements, see Appendix B.

We determined that the allocable PRB costs (that is, the Medicare segment PRB costs that FCSO should have used to calculate the indirect cost rates) for CYs 2008 through 2012 were $6,973,959. Thus, FCSO understated its allocable PRB costs by $50,387. More specifically, FCSO did not calculate its allocable PRB costs in accordance with the FAR.

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[6] Our review of the allocable PRB costs for FCSO identified the amount of PRB costs that should have been used to allocate PRB costs to the Medicare and Other segments. CMS will use the information in this report, as well as the information from our review of the fiscal intermediary and carrier contract PRB costs claimed by FCSO (A-07-17-00500), to determine the allowable PRB costs for FCSO. 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 FCSO.

Table 1 below shows the difference between the Medicare segment PRB costs that we calculated and the PRB costs that FCSO used to calculate its indirect cost rates for CYs 2008 through 2012. Appendix C contains additional details on PRB costs.

Table 1: Comparison of Postretirement Benefit Costs for the Medicare Segment

Medicare Segment Postretirement Benefit Costs			
Calendar Year	**Per Audit**	**Per FCSO**	**Difference**
2008	$3,145,984	$3,099,415	$46,569
2009	2,525,889	2,510,451	15,438
2010	298,230	304,037	(5,807)
2011	538,342	537,366	976
2012	465,514	472,303	(6,789)
Total	**$6,973,959**	**$6,923,572**	**$50,387**

OTHER SEGMENT POSTRETIREMENT BENEFIT COSTS

FCSO used Other segment accrued PRB costs of $34,663,172 to calculate its indirect cost rates for the Other segment for CYs 2008 through 2012. We calculated the accrued PRB costs for the Other segment for CYs 2008 through 2012 in accordance with the FAR. For details on the Federal requirements, see Appendix B.

We determined that the accrued PRB costs for the Other segment for CYs 2008 through 2012 were $31,305,288. Thus, FCSO overstated the Other segment PRB costs used to calculate its indirect cost rates for this time period by $3,357,884. This overstatement occurred because FCSO used incorrect PRB costs when calculating the indirect cost rates for this time period. More specifically, this overstatement of PRB costs occurred because FCSO did not calculate its allocable PRB costs in accordance with the FAR.

Table 2 on the following page shows the difference between the Other segment PRB costs that we calculated and the PRB costs that FCSO used to calculate its indirect cost rates for CYs 2008 through 2012. Appendix C contains additional details on PRB costs.

Table 2: Comparison of Postretirement Benefit Costs for the Other Segment

Other Segment Postretirement Benefit Costs			
Calendar Year	**Per Audit**	**Per FCSO**	**Difference**
2008	$13,574,438	$13,373,499	$200,939
2009	13,514,444	14,055,700	(541,256)
2010	885,390	1,513,957	(628,567)
2011	1,882,978	3,006,387	(1,123,409)
2012	1,448,038	2,713,629	(1,265,591)
Total	**$31,305,288**	**$34,663,172**	**($3,357,884)**

RECOMMENDATIONS

We recommend that FCSO:

- increase the Medicare segment PRB costs used to calculate its indirect cost rates by $50,387 for CYs 2008 through 2012 and

- decrease the Other segment PRB costs used to calculate its indirect cost rates by $3,357,884 for CYs 2008 through 2012.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our recommendations and stated that it would adjust its indirect cost rates.

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

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed $41,586,744 of allocable PRB costs used in the calculation of the indirect cost rates for the MAC-related contracts for CYs 2008 through 2012.

Achieving our objective did not require that we review FCSO's overall internal control structure. We reviewed the internal controls related to the PRB costs claimed on the ICPs to ensure that those costs were allocable in accordance with the FAR and the MAC contract.

We performed our fieldwork at FCSO in Jacksonville, Florida.

METHODOLOGY

To accomplish our objective, we:

- reviewed the provisions of the FAR and the MAC contract applicable to this audit;
- reviewed accounting records and ICP information provided by FCSO to identify the amount of PRB costs used to calculate its indirect cost rates for CYs 2008 through 2012;
- used information that FCSO's actuarial consulting firm provided, including information on VEBA assets, PRB obligations, service costs, contributions, claims paid, claims reimbursed, investment earnings, and administrative expenses;
- examined FCSO's accounting records, PRB plan documents, and annual actuarial valuation reports, which included ASC 715-60 information;
- determined the extent to which FCSO funded PRB costs with contributions to the VEBA trust fund, accumulated prepayment credits, and direct benefit payments;
- engaged the CMS Office of the Actuary to calculate the PRB costs on the basis of the ASC 715-60 methodology applied in accordance with FAR 31.205-6(o);
- reviewed and verified the CMS actuaries' methodology and calculations and used this information to calculate the PRB costs for CYs 2008 through 2012; and
- 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 this review:

- *First Coast Service Options, Inc., Overstated Its Medicare Segment Postretirement Benefit Assets* (A-07-17-00499) and

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

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 POSTRETIREMENT BENEFIT COSTS

FEDERAL REGULATIONS

If a contractor elects to use accrual accounting, Federal regulations (FAR 31.205-6(o)) require that PRB accrual costs be determined in accordance with ASC 715-60 (formerly SFAS 106) and funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust. The FAR states that accrual accounting may be used to determine the allowable PRB costs if the cost is measured and assigned (actuarially determined) based on amortization of any transition obligation. The FAR also states that allowable costs must be funded by the time set for filing the Federal income tax return or any extension thereof and must comply with the applicable standards promulgated by the Actuarial Standards Board.

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.

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: ALLOCABLE POSTRETIREMENT BENEFIT COSTS FOR FIRST COAST SERVICE OPTIONS, INC., FOR CALENDAR YEARS 2008 THROUGH 2012

Date	Description		Total Company	Other Segment	Medicare Segment
2008	Contributions	1/	$18,500,000	$17,486,049	$1,013,951
	Discount for interest	2/	(849,678)	(803,109)	(46,569)
January 1, 2008	Present value contributions	3/	17,650,322	16,682,940	967,382
	Prepayment credit applied	4/	11,331,428	9,199,395	2,132,033
	Present value of funding	5/	28,981,750	25,882,335	3,099,415
January 1, 2008	Funding Target	6/	16,472,914	13,373,499	3,099,415
	Percentage funded	7/		100%	100%
	Funded PRB cost	8/		13,373,499	3,099,415
	Allowable interest	9/		200,939	46,569
2008	CY Allocable PRB Cost	10/	$16,720,422	13,574,438	3,145,984

Date	Description	Total Company	Other Segment	Medicare Segment
2009	Contributions	$18,000,000	$17,536,570	$463,430
	Discount for interest	(833,657)	(812,194)	(21,463)
January 1, 2009	Present value contributions	17,166,343	16,724,376	441,967
	Prepayment credit applied	13,134,278	11,066,009	2,068,269
	Present value of funding	30,300,621	27,790,385	2,510,236
January 1, 2009	Funding Target	15,940,931	13,430,695	2,510,236
	Percentage funded		100%	100%
	Funded PRB cost		13,430,695	2,510,236
	Allowable interest		83,749	15,653
2009	CY Allocable PRB Cost	$16,040,333	13,514,444	2,525,889

Date	Description	Total Company	Other Segment	Medicare Segment
2010	Contributions	$6,500,000	$6,500,000	$0
	Discount for interest	(295,100)	(295,100)	0
January 1, 2010	Present value contributions	6,204,900	6,204,900	-
	Prepayment credit applied	1,183,620	885,390	298,230
	Present value of funding	7,388,520	7,090,290	298,230
January 1, 2010	Funding Target	1,183,620	885,390	298,230
	Percentage funded		100%	100%
	Funded PRB cost		885,390	298,230
	Allowable interest		0	0
2010	CY Allocable PRB cost	$1,183,620	885,390	298,230

Date	Description	Total Company	Other Segment	Medicare Segment
2011	Contributions	$6,500,000	$6,500,000	$0
	Discount for interest	(295,967)	(295,967)	0
January 1, 2011	Present value contributions	6,204,033	6,204,033	-
	Prepayment credit applied	2,421,320	1,882,978	538,342
	Present value of funding	8,625,353	8,087,011	538,342
January 1, 2011	Funding Target	2,421,320	1,882,978	538,342
	Percentage funded		100%	100%
	Funded PRB cost		1,882,978	538,342
	Allowable interest		0	0
2011	CY Allocable PRB cost	$2,421,320	1,882,978	538,342

Date	Description	Total Company	Other Segment	Medicare Segment
2012	Contributions	$0	$0	$0
	Discount for interest	0	0	0
January 1, 2012	Present value contributions	-	-	-
	Prepayment credit applied	1,913,552	1,448,038	465,514
	Present value of funding	1,913,552	1,448,038	465,514
January 1, 2012	Funding Target	1,913,552	1,448,038	465,514
	Percentage funded		100%	100%
	Funded PRB cost		1,448,038	465,514
	Allowable interest		0	0
2012	CY Allocable PRB cost	1,913,552	1,448,038	465,514

ENDNOTES

1/ We obtained the contributions from FCSO's trust statements. The contributions included deposits made during the plan year (PY) and the discounted value of accrued contributions, if any, deposited after the end of the PY but within the time allowed for filing tax returns.

2/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions and actual contribution amounts. Interest is determined using the expected long-term rate of return assumption as reported in the PRB actuarial valuation report.

3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the CY.

4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year funding target. A prepayment credit is carried forward, with interest, to fund future PRB costs.

5/ The present value of funding represents the present value of contributions plus prepayment credits plus direct benefit payments. This is the amount of funding that is available to cover the funding target measured at the first day of the CY.

6/ The funding target is based on the assignable PRB cost computed during our review. The funding target must be funded by accumulated prepayment credits, current year contributions, or direct benefit payments to satisfy the funding requirement contained in the FAR.

7/ The percentage of costs funded is a measure of the portion of the funding target that was funded during the CY. Because any funding in excess of the funding target is accounted for as a prepayment, the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the funding target. For purposes of illustration, the percentage of costs funded has been rounded to four decimal places.

8/ We computed the funded PRB cost as the funding target multiplied by the percent funded. If the percentage funded was less than 100 percent, we set the funded PRB costs to equal the present value of funding.

9/ We assumed that interest on the funded PRB cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(o)(4), which provides that interest costs are unallowable if caused by a delay in funding beyond 30 days after the end of each quarter to which they are assignable.

10/ The CY allocable PRB cost is the amount of PRB costs that may be allocated for contract cost purposes.

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

Harvey B. Dikter
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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
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Reference: A-07-17-00502

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., Understated Its Medicare Segment and Overstated Its Other Segment Allocable Postretirement Benefit Costs*" and reviewed.

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

Recommendation:

First Coast increase the Medicare segment PRB cost used to calculate its indirect cost rates by $50,387 for CYs 2008 through 2012, and decrease the Other segment PRB costs used to calculate its indirect costs rates by $3,357,884 for CYs 2008 through 2012.

Response:

First Coast agrees with the recommendation. The Incurred Cost Proposals and related indirect cost rates for CYs 2008 through 2012 are currently under audit. Based on materiality and guidance from the Centers for Medicare and Medicaid Services, First Coast will adjust its indirect cost rates.

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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