DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Office of Audit Services, Region VII
601 East 12th Street, Room 0429
Kansas City, MO 64106

March 25, 2010

Report Number: A-07-09-00311

Ms. Sandy Coston
President and Chief Executive Officer
First Coast Service Options, Inc.
532 Riverside Avenue
Jacksonville, FL 32202

Dear Ms. Coston:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Review of Medicare Contractor's Pension Segmentation Requirements at First Coast Service Options, Inc., for the Period January 1, 2003, to January 1, 2008*. We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://oig.hhs.gov.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-09-00311 in all correspondence.

Sincerely,

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

Enclosure

Direct Reply to HHS Action Official:

Ms. Nanette Foster Reilly
Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
601 East 12th Street, Room 235
Kansas City, MO 64106

Department of Health & Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE CONTRACTOR'S PENSION SEGMENTATION REQUIREMENTS AT FIRST COAST SERVICE OPTIONS, INC., FOR THE PERIOD JANUARY 1, 2003, TO JANUARY 1, 2008

Daniel R. Levinson
Inspector General

March 2010
A-07-09-00311

Office of Inspector General

http://oig.hhs.gov

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

First Coast Service Options, Inc., and Medicare

During our audit period, First Coast Service Options, Inc. (FCSO), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).

FCSO participates in a defined benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and Medicare contracts.

In resolution of our prior pension segmentation audit, FCSO executed a pension closing agreement with CMS to establish a final settlement of the January 1, 2003, Medicare segment asset base.

Pension Segmentation

Beginning with fiscal year 1988, CMS incorporated specific segmentation requirements into the Medicare contracts to ensure conformance with CAS 413. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

OBJECTIVE

Our objective was to determine whether FCSO complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the January 1, 2003, Medicare segment asset base established by an executed pension closing agreement with CMS, and

- updating the Medicare segment's assets from January 1, 2003, to January 1, 2008.

SUMMARY OF FINDINGS

FCSO properly implemented the January 1, 2003, Medicare segment asset base established by an executed pension closing agreement with CMS. However, FCSO did not always comply with the Medicare contracts' pension segmentation requirements when updating Medicare segment

assets to January 1, 2008. As a result, FCSO overstated the Medicare segment pension assets by $637,976. The overstatement occurred primarily because FCSO used an incorrect methodology to compute the segment's 2003 investment earnings, less administrative expenses.

RECOMMENDATIONS

We recommend that FCSO:

- decrease Medicare segment pension assets as of January 1, 2008, by $637,976 and
- implement controls to ensure that the Medicare segment's assets are updated in accordance with the Medicare contracts.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our recommendations. FCSO's comments are included in their entirety as Appendix B.

TABLE OF CONTENTS

Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulation
FCSO	First Coast Service Options, Inc.
WAV	weighted average value

INTRODUCTION

BACKGROUND

First Coast Service Options, Inc., and Medicare

During our audit period, First Coast Service Options, Inc. (FCSO), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).[1]

FCSO participates in a defined benefit pension plan, which is a deferred compensation plan in which an employer makes actuarially determined contributions to fund an employee's retirement benefit as defined by the plan's terms.[2]

Since its inception, Medicare has paid a portion of contractors' contributions to their pension plans. These contributions are allowable Medicare costs subject to the criteria set forth in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and Medicare contracts.

In resolution of our prior pension segmentation audit (A-07-04-00172, issued February 8, 2005), FCSO executed a pension closing agreement with CMS to establish a final settlement of the January 1, 2003, Medicare segment asset base.

Federal Requirements

CAS 412 addresses the determination and measurement of pension cost components. It also addresses the assignment of pension costs to appropriate accounting periods.

CAS 413 addresses the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

Pension Segmentation

CMS incorporated CAS 412 and 413 into the Medicare contracts effective October 1, 1980. Beginning with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contracts define a segment and specify the methodology for the identification and initial allocation of pension assets to the segment. The contracts require Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, CAS, and the Medicare contracts.

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[1] FCSO's parent company, Blue Cross Blue Shield of Florida, Inc., novated the contracts to FCSO effective October 1, 2003. Prior to that, FCSO managed the contracts by special power of attorney on behalf of its parent company.

[2] FCSO participates in employee benefit plans of its parent company, such as the defined benefit pension plan.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether FCSO complied with Federal requirements and the Medicare contracts' pension segmentation requirements when:

- implementing the January 1, 2003, Medicare segment asset base established by an executed pension closing agreement with CMS, and

- updating the Medicare segment's assets from January 1, 2003, to January 1, 2008.

Scope

We reviewed FCSO's implementation of the pension closing agreement, identification of its Medicare segment, and update of the Medicare segment's assets from January 1, 2003, to January 1, 2008.

Achieving our objective did not require us to review FCSO's overall internal control structure. However, we reviewed controls relating to the implementation of the pension closing agreement, the identification of the Medicare segment, and the update of the Medicare segment's assets.

We performed fieldwork at FCSO's office in Jacksonville, Florida, during February and March 2009.

Methodology

To accomplish our objective, we did the following:

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

- We reviewed Closing Agreement No. PEN-01 executed between CMS and FCSO. We used this information to identify the Medicare segment assets as of January 1, 2003.

- We reviewed the annual actuarial valuation reports prepared by FCSO's actuarial consulting firm, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment assets.

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

- We interviewed FCSO staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.

- We reviewed FCSO's accounting records to verify the Medicare segment identification and benefit payments made to the Medicare segment.

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

- We reviewed the CMS actuaries' methodology and calculations.

We performed this review in conjunction with our audit of FCSO's pension costs claimed for Medicare reimbursement (A-07-09-00312) and used the information obtained during that audit in this review.

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 objective.

FINDINGS AND RECOMMENDATIONS

FCSO properly implemented the January 1, 2003, Medicare segment asset base established by an executed pension closing agreement with CMS. However, FCSO did not always comply with the Medicare contracts' pension segmentation requirements when updating Medicare segment assets to January 1, 2008. As a result, FCSO overstated the Medicare segment pension assets by $637,976. The overstatement occurred primarily because FCSO used an incorrect methodology to compute the segment's 2003 investment earnings, less administrative expenses.

Appendix A presents details of the Medicare segment's pension assets from January 1, 2003, to January 1, 2008, as determined during our audit. Table 1 summarizes the audit adjustments required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per OIG	Per FCSO	Difference
Update of Medicare Segment Assets			
Earnings, net expenses	$24,722,708	$26,344,032	($1,621,324)
Contributions and Transferred Prepayment Credits	25,602,368	25,145,133	457,235
Transfers	(13,403,699)	(14,054,249)	650,550
Benefit Payments	(22,602,938)	(22,478,501)	(124,437)
Overstatement of Medicare segment assets			**($637,976)**

PENSION CLOSING AGREEMENT

FCSO executed a pension closing agreement with CMS to establish a final settlement of the January 1, 2003, Medicare segment asset base. FCSO properly used the January 1, 2003, closing agreement Medicare segment asset base in its computations.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

Federal Requirements

The Medicare contracts state that "… the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)." CAS 413.50(c)(7) requires that the asset base be adjusted 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 weighted average value (WAV) of assets to total company WAV of assets.

In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities. For plan years beginning after March 30, 1995, the CAS requires that the amount of assets transferred equal the actuarial accrued liabilities as determined using the accrued benefit cost method.

Furthermore, 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.

Earnings, Net Expenses Overstated

FCSO overstated investment earnings, less administrative expenses, by $1,621,324 for the Medicare segment. The overstatement occurred primarily because FCSO used an incorrect methodology to determine the segment's 2003 earnings and expenses. Because of this error, as well as misstatements in the values of other asset update components (all discussed below), FCSO misstated the Medicare segment asset base throughout the update period, leading to incorrect earnings and expense allocations.

In our audited update, we allocated earnings and expenses based on the applicable CAS requirements. The overstatement of earnings and expenses led to an overstatement of Medicare segment assets of $1,621,324.

Contributions and Transferred Prepayment Credits Understated

FCSO understated contributions and transferred prepayment credits by $457,235 for the Medicare segment. The understatement was due to incorrect calculations of assigned pension

costs which were caused by FCSO's misstatements of the Medicare segment asset base during the audit period. As a result, FCSO understated the Medicare segment assets by $457,235.

The audited contributions and transferred prepayment credits are based on the assignable pension costs. In compliance with the CAS, we applied prepayment credits first to current-year assignable pension costs because the credits were available at the beginning of the year, and then updated any remaining credits with interest to the next measurement (valuation) date. We then allocated contributions as needed to assigned pension costs as of the date of deposit.

Net Transfers Understated

FCSO understated the participant transfer adjustments in its update of Medicare segment assets by $650,550. FCSO made adjustments for transfers in its update of segment assets; however, FCSO incorrectly identified the participants who transferred in and out of the segment. As a result, FCSO understated its Medicare segment assets by $650,550.

Benefit Payments Understated

FCSO understated benefit payments by $124,437 for the Medicare segment because it did not include annuity payments made to Medicare segment participants as required by CAS 413.50(c)(7). In compliance with the CAS, we based the Medicare segment's benefit payments on actual payments to Medicare segment retirees. As a result of FCSO's understatement of Medicare segment benefit payments, Medicare segment assets are overstated by $124,437.

RECOMMENDATIONS

We recommend that FCSO:

- decrease Medicare segment pension assets as of January 1, 2008, by $637,976 and
- implement controls to ensure that the Medicare segment's assets are updated in accordance with the Medicare contracts.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our recommendations. FCSO's comments are included in their entirety as Appendix B.

OTHER MATTER

During our review, we determined that FCSO properly identified $3,133,668 of accumulated unallowable unfunded pension costs ($877,488 as an unallowable component of Medicare segment pension costs and $2,256,180 as an unallowable component of the "Other" segment pension costs) as of January 1, 2008.

APPENDIXES

APPENDIX A: STATEMENT OF MARKET VALUE OF PENSION ASSETS
FOR FIRST COAST SERVICE OPTIONS, INC.,
FOR THE PERIOD JANUARY 1, 2003, TO JANUARY 1, 2008

Description		Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2003	1/	$341,383,271	$302,636,860	$38,746,411
Transferred Prepayment Credits	2/	0	(4,308,849)	4,308,849
Contributions	3/	72,013,397	72,013,397	0
Earnings	4/	60,121,854	52,917,467	7,204,387
Benefit Payments	5/	(45,301,270)	(35,628,111)	(9,673,159)
Expenses	6/	(1,371,084)	(1,206,787)	(164,297)
Transfers	7/	0	3,588,954	(3,588,954)
Assets January 1, 2004		426,846,168	390,012,931	36,833,237
Transferred Prepayment Credits		0	(4,657,241)	4,657,241
Contributions		66,154,448	66,154,448	0
Earnings		43,862,345	39,499,696	4,362,649
Benefit Payments		(25,901,786)	(25,254,773)	(647,013)
Expenses		(1,649,935)	(1,485,829)	(164,106)
Transfers		0	2,153,594	(2,153,594)
Assets January 1, 2005		509,311,240	466,422,826	42,888,414
Transferred Prepayment Credits		0	(5,176,549)	5,176,549
Contributions		53,032,360	53,032,360	0
Earnings		37,228,744	33,679,381	3,549,363
Benefit Payments		(30,797,690)	(28,846,301)	(1,951,389)
Expenses		(1,576,788)	(1,426,458)	(150,330)
Transfers		0	1,392,207	(1,392,207)
Assets January 1, 2006		567,197,866	519,077,466	48,120,400
Transferred Prepayment Credits		0	(5,704,239)	5,704,239
Contributions		15,000,000	15,000,000	0
Earnings		67,020,286	60,719,574	6,300,712
Benefit Payments		(45,539,885)	(40,256,134)	(5,283,751)
Expenses		(1,933,028)	(1,751,300)	(181,728)
Transfers		0	4,111,937	(4,111,937)
Assets January 1, 2007		601,745,239	551,197,304	50,547,935
Transferred Prepayment Credits		0	(5,755,490)	5,755,490
Contributions		0	0	0
Earnings		44,638,275	40,436,878	4,201,397
Benefit Payments		(60,713,949)	(55,666,323)	(5,047,626)
Expenses		(2,500,390)	(2,265,051)	(235,339)
Transfers		0	2,157,007	(2,157,007)
Assets January 1, 2008		$583,169,175	$530,104,325	$53,064,850
Per FCSO	8/	$583,169,175	$529,466,349	$53,702,826
Asset Variance	9/	$0	$637,976	($637,976)

FOOTNOTES

1/ We obtained the Medicare segment assets as of January 1, 2003, from Closing Agreement No. PEN-01. The Centers for Medicare and Medicaid Services and First Coast Service Options, Inc. (FCSO), entered into and executed this closing agreement in order to establish a final settlement of the January 1, 2003, Medicare segment asset base. The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segment. All pension 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 in order to reduce interest costs to the Federal Government. 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 Department of Labor/Internal Revenue Service Forms 5500. 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 pension costs in the future.

4/ We obtained investment earnings from actuarial valuation reports and documents prepared by FCSO's actuarial consulting firm. We allocated net investment earnings based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets as required by the Cost Accounting Standards (CAS).

5/ We based the Medicare segment's benefit payments on actual payments to Medicare segment retirees. We obtained information on the benefit payments from documents provided by FCSO.

6/ We allocated administrative expenses to the Medicare segment in proportion to investment earnings.

7/ We identified participant transfers between segments by comparing valuation data files provided by FCSO. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.

8/ We obtained total asset amounts as of January 1, 2008, from documents prepared by FCSO's actuarial consulting firm.

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

APPENDIX B: AUDITEE COMMENTS

MEDICARE

Sandy Coston
CEO & President
First Ccast Service Options, Inc.
Sandy.Coston@fcso.com

March 12, 2010

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

Dear Mr. Cogley:

Reference: A-07-09-00311

The purpose of this letter is to submit our response to the Department of Health and Human Services Office of Inspector General's draft report for the review of First Coast Service Options' (FCSO) segmentation of Medicare pension assets for fiscal years 2004-2007.

We agree with the report finding regarding the overstatement of Medicare segment pension assets by $637,976 and will take the following actions to ensure the report recommendations are implemented:

1) Make the adjustments necessary to decrease the Medicare segment pension assets as of January 1, 2008 by $637,976.

Additionally, we are working with our actuaries to ensure pension costs are claimed in accordance with applicable Medicare contractual requirements.

We appreciate the opportunity to review and provide our comments prior to release of the final report. If you have any questions regarding our response, please contact Mr. Gregory England at 904-791-8364.

Sincerely,

Sandy Coston

Sandy Coston

cc: Jonathan Hogan, VP & CFO, FCSO
Gregory England, Director of Internal Audit, FCSO
Brenda Francisco, Director of Medicare Reporting, FCSO
Cheryl Mose, VP & Corporate Controller, BCBSF
Jay Pinkerton, VP, JP Morgan

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