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

May 5, 2010

Report Number: A-07-09-00314

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 Segment Postretirement Benefit Assets of First Coast Service Options, Inc., for the Period January 1, 2005, 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-07-09-00314 in all correspondence.

Sincerely,

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

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor
Acting Director & Chief Financial Officer
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Department of Health & Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MEDICARE SEGMENT POSTRETIREMENT BENEFIT ASSETS OF FIRST COAST SERVICE OPTIONS, INC., FOR THE PERIOD JANUARY 1, 2005, TO JANUARY 1, 2008

Daniel R. Levinson
Inspector General

May 2010
A-07-09-00314

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

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).

CMS reimburses a portion of contractors' costs for postretirement benefit (PRB) plans. In claiming these costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards, as required by the Medicare contracts.

FCSO participates in a voluntary employee benefit association trust for the purpose of funding annual PRB accruals. Furthermore, FCSO's accounting practice uses segmented accrual accounting for PRBs.

In resolution of our prior PRB segmentation audit, FCSO executed a PRB closing agreement with CMS to establish a final settlement of the January 1, 2005, Medicare segment PRB asset base. As required by its accounting practice, FCSO also updated the Medicare segment's PRB assets to January 1, 2008.

OBJECTIVE

Our objective was to determine whether FCSO correctly:

- implemented the January 1, 2005, Medicare segment PRB asset base established by the executed PRB closing agreement with CMS, and

- updated the Medicare segment's PRB assets from January 1, 2005, to January 1, 2008.

SUMMARY OF FINDINGS

FCSO correctly implemented the January 1, 2005, Medicare segment PRB asset base established by the executed PRB closing agreement with CMS. However, FCSO did not correctly update the Medicare segment's PRB assets from January 1, 2005, to January 1, 2008. As part of its accounting practice, FCSO was required to update the Medicare segment's PRB assets. However, FCSO made errors in its update computations. As a result, FCSO overstated the Medicare segment PRB assets as of January 1, 2008, by $835,995. In addition, contrary to its stated methodology, FCSO did not make adjustments for participants who transferred into and out of the Medicare segment. Although we determined that this error had no material effect during our review period, future asset updates may be materially misstated if FCSO does not properly adjust for transfers.

RECOMMENDATIONS

We recommend that FCSO:

- decrease Medicare segment PRB assets by $835,995 as of January 1, 2008, and

- make adjustments for participant transfers in future updates.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our finding and stated that it will implement our recommendations. FCSO's comments are included in their entirety as Appendix B.

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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).

CMS reimburses a portion of 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), as required by the Medicare contracts.

FCSO participates in a voluntary employee benefit association (VEBA) trust for the purpose of funding annual PRB accruals.[1] Furthermore, FCSO's accounting practice, approved by CMS, uses segmented accrual accounting for PRBs.

In resolution of our prior PRB segmentation audit (A-07-06-00225, issued December 7, 2006), FCSO executed a PRB closing agreement with CMS to establish a final settlement of the January 1, 2005, Medicare segment PRB asset base.
FCSO also updated the Medicare segment's PRB assets to January 1, 2008.

Federal Regulations

The FAR states that accrual accounting may be used to determine allowable PRB costs if the costs are measured and assigned (actuarially determined) in accordance with generally accepted accounting principles. FAR 31.205-6(o) requires that PRB accrual costs be funded in a dedicated trust fund, such as a VEBA trust. 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 CAS Board. In addition, FAR 31.205-19 requires self-insurance charges to be measured, assigned and allocated in accordance with CAS 416.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether FCSO correctly:

- implemented the January 1, 2005, Medicare segment PRB asset base established by the executed PRB closing agreement with CMS, and

[1] FCSO participates in employee benefit plans, such as the VEBA trust, of its parent company, Blue Cross Blue Shield of Florida, Inc. Costs associated with this VEBA trust are self-insurance charges as defined by the FAR.

- updated the Medicare segment's PRB assets from January 1, 2005, to January 1, 2008.

Scope

We reviewed FCSO's implementation of the PRB closing agreement, identification of the Medicare segment, and update of Medicare segment PRB assets from January 1, 2005, to January 1, 2008.

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

- We reviewed Closing Agreement No. PRB-01 executed between CMS and FCSO. We used this information to identify the Medicare segment PRB assets as of January 1, 2005.

- We reviewed the information provided by FCSO's actuarial consulting firm, which included the VEBA assets, PRB obligations, service costs, contributions, claims reimbursed, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment PRB assets.

- We reviewed the PRB plan documents, VEBA trust transaction documents, and PRB actuarial valuation reports. The valuation reports included Statement of Financial Accounting Standards (SFAS) 106 information. We used this information to calculate the Medicare segment PRB assets.

- We updated the segment asset bases for changes in the value attributable to contributions, income, benefit payments, and expenses. We also updated the permitted unfunded accruals for assumed interest earnings, new portions of permitted unfunded accruals, and direct benefit payments.

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

- We reviewed FCSO accounting records to verify the segment identification.

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

- We reviewed and accepted the CMS Office of the Actuary's methodology and calculations.

We performed this review in conjunction with our audit of FCSO's PRB costs claimed for Medicare reimbursement (A-07-09-00315) and used the information obtained during that audit in this review. We also used information obtained in conjunction with our audit of FCSO's pension segmentation (A-07-09-00311). That information included the identification of the Medicare segment and the Medicare segment participants.

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 correctly implemented the January 1, 2005, Medicare segment PRB asset base established by the executed PRB closing agreement with CMS. However, FCSO did not correctly update the Medicare segment's PRB assets from January 1, 2005, to January 1, 2008. As part of its accounting practice, FCSO was required to update the Medicare segment's PRB assets. However, FCSO made errors in its update computations. As a result, FCSO overstated the Medicare segment PRB assets as of January 1, 2008, by $835,995. In addition, contrary to its stated methodology, FCSO did not make adjustments for participants who transferred into and out of the Medicare segment. Although we determined that this error had no material effect during our review period, future asset updates may be materially misstated if FCSO does not properly adjust for transfers.

Appendix A presents details on the Medicare segment's PRB assets from January 1, 2005, to January 1, 2008, as determined during our audit. The following table summarizes the differences between our update and FCSO's update of these assets.

Summary of Audit Adjustments			
	Per Audit	**Per FCSO**	**Difference**
Contributions and Transferred Prepayment Credits	$ 10,019,114	$ 10,729,108	($709,994)
Earnings, Net Expenses	2,532,833	2,658,834	(126,001)
Overstatement			**($835,995)**

POSTRETIREMENT BENEFIT CLOSING AGREEMENT

FCSO executed a PRB closing agreement with CMS to establish a final settlement of the January 1, 2005, Medicare segment PRB asset base. FCSO correctly implemented the January 1, 2005, closing agreement Medicare segment PRB asset base in its update of Medicare segment PRB assets.

UPDATE OF MEDICARE SEGMENT POSTRETIREMENT BENEFIT ASSETS

Federal Requirements

FCSO elected to use segmented accrual accounting for PRBs as permitted by CAS 416-50(b)(2); CMS approved this election. Because FCSO elected this accounting practice, we applied the accrual methodologies of SFAS 106 separately for the Medicare and "Other" segments.

In addition, we used CAS 416-50(a)(1)(v)(C) to address contributions in excess of the PRB cost assigned to the period. Accordingly, contributions in excess of the PRB cost are recognized as prepayment credits. Because the unallocable excess funding is treated as a deposit (an investment of the contractor) in accordance with CAS 416-50(a)(1)(iv), it is accumulated at the long-term rate of return assumption until applied to future period costs. Prepayment credits that have not been applied to fund PRB costs are excluded from the value of assets used to compute PRB costs.

Contributions and Transferred Prepayment Credits Overstated

FCSO overstated contributions and transferred prepayment credits for the Medicare segment by $709,994. The overstatement occurred because FCSO used an incorrect methodology to transfer prepayment credits to the Medicare segment. 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.

Earnings, Net Expenses Overstated

FCSO overstated net investment earnings by $126,001 for the Medicare segment. The overstatement occurred because FCSO used incorrect amounts for transferred prepayment credits to update the Medicare segment asset base. The overstatement of net investment earnings led to a $126,001 overstatement of the Medicare segment assets.

Participant Transfers

As part of its segmented PRB accrual accounting practice, FCSO's stated methodology was to make adjustments for participants who transferred into and out of the Medicare segment. However, FCSO's asset update did not contain such adjustments. Although we determined that this error had no material effect during our review period, future asset updates may be materially misstated if FCSO does not properly adjust for transfers.

RECOMMENDATIONS

We recommend that FCSO:

- decrease Medicare segment PRB assets by $835,995 as of January 1, 2008, and
- make adjustments for participant transfers in future updates.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our finding and stated that it will implement our recommendations. FCSO's comments are included in their entirety as Appendix B.

APPENDIXES

APPENDIX A: STATEMENT OF MARKET VALUE OF POSTRETIREMENT BENEFIT ASSETS FOR FIRST COAST SERVICE OPTIONS, INC., FOR THE PERIOD JANUARY 1, 2005, TO JANUARY 1, 2008

Description		Total Company	"Other" Segment	Medicare Segment
Assets January 1, 2005	1/	$44,248,709	$38,904,472	$5,344,237
Transferred Prepayment Credits	2/	0	(2,765,630)	2,765,630
Contributions	3/	19,807,852	19,807,852	0
Claims Reimbursed	4/	(4,515,938)	(3,423,752)	(1,092,186)
Investment Return	5/	2,504,082	2,051,724	452,358
Assets January 1, 2006		62,044,705	54,574,666	7,470,039
Transferred Prepayment Credits		0	(3,499,401)	3,499,401
Contributions		16,728,771	16,728,771	0
Claims Reimbursed		(4,728,771)	(3,631,285)	(1,097,486)
Investment Return		7,192,060	5,930,718	1,261,342
Assets January 1, 2007		81,236,765	70,103,469	11,133,296
Transferred Prepayment Credits		0	(3,754,083)	3,754,083
Contributions		11,000,000	11,000,000	0
Claims Reimbursed		(6,312,333)	(4,842,678)	(1,469,655)
Investment Return		4,490,988	3,671,855	819,133
Assets January 1, 2008		$90,415,420	$76,178,563	$14,236,857
Per FCSO	6/	$90,415,420	$75,342,568	$15,072,852
Asset Variance	7/	$0	$835,995	($835,995)

FOOTNOTES

1/ We obtained Total Company assets from postretirement benefit (PRB) actuarial valuation reports. We obtained the Medicare segment PRB assets as of January 1, 2005, from Closing Agreement PRB-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, 2005, Medicare segment PRB asset base. 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/ A prepayment credit represents the accumulated value of premature funding from the previous year(s) and is available as of the first day of the plan year to cover, or help cover, the cost assigned to that period. Prepayment credits are accounted for as a part of the "Other" segment assets and are transferred to the Medicare segment as of the first day of each plan year to cover the cost assigned to that year.

3/ We obtained Total Company contribution amounts from PRB actuarial valuation reports and trust statements. We allocated Total Company contributions to the Medicare segment based on the ratio of the Medicare segment current-period funding requirement divided by the Total Company current-period funding requirement after the application of any accumulated prepayment credits. Contributions in excess of the current-period funding requirement 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 reimbursed represent the amounts previously paid from corporate funds and now reimbursed by the trust. We obtained Claims Reimbursed amounts from documents provided by FCSO and prepared by its actuarial consulting firm.

5/ We obtained investment earnings from the PRB 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.

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

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

APPENDIX B: AUDITEE COMMENTS

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

CMS
CENTERS for MEDICARE & MEDICAID SERVICES

MEDICARE

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

April 8, 2010

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Office of Audit Services, Region VII
601 Each 12th Street, Room 0429
Kansas City, Missouri 64106

Reference: A-07-09-00314

Dear Mr. Cogley:

This letter is in response to the Department of Health and Human Services, Office of Inspector General's draft report for the review of First Coast Service Options, Inc.'s segmentation of post-retirement benefit assets for the period January 1, 2005 to January 1, 2008.

We agree with the report finding regarding the overstatement of Medicare segment assets and will take the following action to ensure the report recommendation is implemented:

- Decrease the Medicare segment post retirement assets by $835,995 as of January 1, 2008; and
- Adjust participant transfers in future periods.

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

Sincerely,

Sandy Coston

Sandy Coston

cc: Jonathan Hogan, VP & CFO, First Coast Service Options, Inc.
Gregory England, Director of Internal Audit, First Coast Service Options, Inc.
Brenda Francisco, Director of Medicare Reporting, First Coast Service Options, Inc.
Cheryl Mose, VP & Corporate Controller, Blue Cross Blue Shield of Florida, Inc.
Jay Pinkerton, VP, Aon Consulting

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