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-07-09-00315

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 Postretirement Benefit Costs Claimed for Medicare Reimbursement by First Coast Service Options, Inc., for Fiscal Years 2006 and 2007*. 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-07-09-00315 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
Office of Financial Management
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, MD 21244-1850

Department of Health & Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF POSTRETIREMENT BENEFIT COSTS CLAIMED FOR MEDICARE REIMBURSEMENT BY FIRST COAST SERVICE OPTIONS, INC., FOR FISCAL YEARS 2006 AND 2007

Daniel R. Levinson
Inspector General

May 2010
A-07-09-00315

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).

In claiming postretirement benefit (PRB) costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation and applicable Cost Accounting Standards (CAS), as required by the Medicare contracts.

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

Following the close of each fiscal year (FY), FCSO submitted a Final Administrative Cost Proposal (FACP) to CMS reporting the administrative costs of performing Medicare functions during the year. The accrued PRB cost is part of the administrative cost of performing Medicare functions and, as such, is claimed on each FY's FACP.

OBJECTIVE

Our objective was to determine the allowability of accrued PRB costs that FCSO claimed for Medicare reimbursement for FYs 2006 and 2007.

SUMMARY OF FINDING

FCSO claimed some unallowable Medicare accrued PRB costs for FYs 2006 and 2007. The overclaim occurred primarily because FCSO based its claims on overstated end-of-year CAS PRB costs. FCSO used the overstated end-of-year CAS PRB costs to claim accrued PRB costs of $6,845,282 for Medicare reimbursement. We calculated allowable accrued PRB costs for FYs 2006 and 2007, based on separately computed CAS PRB costs for the Medicare segment and the "Other" segment, to be $6,477,898, a difference of $367,384.

RECOMMENDATIONS

We recommend that FCSO:

- decrease its FACP accrued PRB costs by $367,384 and
- ensure that future accrued PRB cost claims are in accordance with the Medicare contracts.

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.

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). In claiming postretirement benefit (PRB) 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 trust for the purpose of funding annual accruals.[1] Furthermore, FCSO's accounting practice, approved by CMS, uses segmented accrual accounting for PRBs.

Medicare Reimbursement of Postretirement Benefit Costs

CMS reimburses a portion of the funded accruals that contractors charge for their PRB plans. To be allowable for Medicare reimbursement, FAR 31.205-6(o) requires that PRB accrual costs be (1) determined in accordance with Statement of Financial Accounting Standards (SFAS) 106 and (2) funded into a dedicated trust fund, such as a voluntary employee benefit association (VEBA) trust.

Following the close of each fiscal year (FY), FCSO submitted a Final Administrative Cost Proposal (FACP) to CMS reporting the administrative costs of performing Medicare functions during the year. The accrued PRB cost is part of the administrative cost of performing Medicare functions and, as such, is claimed on each FY's FACP.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of accrued PRB costs that FCSO claimed for Medicare reimbursement for FYs 2006 and 2007.

Scope

We reviewed $6,845,282 of accrued PRB costs that FCSO claimed for Medicare reimbursement on its FACPs for FYs 2006 and 2007. Achieving our objective did not require that we review FCSO's overall internal control structure. However, we reviewed internal controls relating to the accrued PRB costs claimed for Medicare reimbursement to ensure that the accrued PRB costs were allowable in accordance with the FAR.

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[1] FCSO participates in employee benefit plans, such as the VEBA trust, of its parent company, Blue Cross Blue Shield of Florida, Inc.

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

Methodology

We reviewed the applicable portions of the FAR, CAS, and Medicare contracts. Additionally, we reviewed FCSO's FACPs to identify the amount of accrued PRB costs claimed for Medicare reimbursement for FYs 2006 and 2007. We also determined the extent to which FCSO funded CAS PRB costs with contributions to the VEBA trust fund and accumulated prepayment credits or with direct payment of benefits.

In performing this review, we used information provided by FCSO's actuarial consulting firm, which included the VEBA assets, PRB obligations, service costs, contributions, claims paid, claims reimbursed, investment earnings, and administrative expenses. We reviewed FCSO's accounting records, the PRB plan documents, VEBA trust transaction documents, and PRB actuarial valuation reports, which included SFAS 106 information. The CMS Office of the Actuary used the information to develop PRB costs for FCSO based on SFAS 106 methodology pursuant to the FAR. In turn, we reviewed and accepted the actuarial data and used it to calculate the accrued PRB costs that were allowable for Medicare reimbursement for FYs 2006 and 2007. We based our calculations on separately computed CAS PRB costs for the Medicare segment and the "Other" segment.

We performed this review in conjunction with our audits of FCSO's segmented PRB assets (A-07-09-00314) and pension costs claimed for Medicare reimbursement (A-07-09-00312). We used the information obtained and reviewed during those audits in performing 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 finding and conclusions based on our audit objective.

FINDING AND RECOMMENDATIONS

FCSO claimed some unallowable Medicare accrued PRB costs for FYs 2006 and 2007. The overclaim occurred primarily because FCSO based its claims on overstated end-of-year CAS PRB costs. FCSO used the overstated end-of-year CAS PRB costs to claim accrued PRB costs of $6,845,282 for Medicare reimbursement. We calculated allowable accrued PRB costs for FYs 2006 and 2007, based on separately computed CAS PRB costs for the Medicare segment and the "Other" segment, to be $6,477,898, a difference of $367,384.

FEDERAL REQUIREMENTS

The FAR states that accrual accounting may be used to determine the allowable PRB costs if the cost is measured and assigned (actuarially determined) according to generally accepted accounting principles based on amortization of any transition obligation.[2] 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.

UNALLOWABLE ACCRUED POSTRETIREMENT BENEFIT COSTS CLAIMED

FCSO claimed $367,384 of unallowable Medicare accrued PRB costs for FYs 2006 and 2007. During that period, FCSO claimed accrued PRB costs of $6,845,282 for Medicare reimbursement. Following FCSO's practice of segmented accrual accounting for PRBs, we calculated allowable accrued PRB costs based on separately computed CAS PRB costs for the Medicare segment and the "Other" segment. Based on the terms of the Medicare contracts, the allowable CAS accrued PRB costs for this period totaled $6,477,898.

The following table compares allowable accrued PRB costs with the accrued PRB costs claimed on FCSO's FACPs. Appendix A contains details on allowable PRB costs and contributions.

Comparison of Allowable PRB Costs and Claimed PRB Costs

	Medicare PRB Costs		
	Allowable	Claimed	
Fiscal Year	Per Audit	By FCSO	Difference
2006	$3,065,845	$3,212,276	($146,431)
2007	3,412,053	3,633,006	(220,953)
Total	**$6,477,898**	**$6,845,282**	**($367,384)**

FCSO based its claims for Medicare reimbursement on end-of-year CAS PRB costs. However, those CAS PRB costs were overstated in that they exceeded the CAS PRB costs that were allowable as determined during our audit. We considered available funding and used the beginning-of-year CAS PRB costs in our computations of allowable PRB costs. In addition, FCSO based its FY 2007 claim on an incorrect Medicare allocation. As a result of these errors, FCSO claimed $367,384 of unallowable accrued PRB costs.

RECOMMENDATIONS

We recommend that FCSO:

- decrease its FACP accrued PRB costs by $367,384 and

- ensure that future accrued PRB cost claims are in accordance with the Medicare contracts.

[2] Costs attributable to past service (transition obligation) must be assigned under the delayed recognition methodology described in paragraphs 112 and 113 of SFAS 106.

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: FIRST COAST SERVICE OPTIONS, INC.
STATEMENT OF ALLOWABLE ACCRUED POSTRETIREMENT BENEFIT COSTS
FOR FISCAL YEARS 2006 AND 2007

Date	Description		Total Company	Other Segment	Medicare Segment	Total Medicare
2005	Allocable PRB Cost	1/		$11,272,918	$2,765,630	
	Medicare LOB* Percentage	2/		1.45%	89.24%	
	Plan Year Allowable PRB Cost	3/		$163,457	$2,468,048	
2006	Contributions	4/	$16,751,773	$16,751,773	$0	
5.00%	Discount for Interest	5/	($797,703)	($797,703)	$0	
January 1, 2006	Present Value Of Contributions	6/	$15,954,070	$15,954,070	$0	
	Prepayment Credit Applied	7/	$17,584,066	$14,084,665	$3,499,401	
	Present Value Of Funding	8/	$33,538,136	$30,038,735	$3,499,401	
January 1, 2006	Current Period Funding Requirement	9/	$17,584,066	$14,084,665	$3,499,401	
	Percentage Funded	10/		100.00%	100.00%	
	Funded PRB Cost	11/		$14,084,665	$3,499,401	
	Allowable Interest	12/		$0	$0	
	Allocable PRB Cost			$14,084,665	$3,499,401	
	Medicare LOB* Percentage			1.52%	85.63%	
	Plan Year Allowable PRB Cost			$214,087	$2,996,537	
2006	Fiscal Year Allowable PRB Cost	13/		$201,430	$2,864,415	$3,065,845

Date	Description	Total Company	Other Segment	Medicare Segment	Total Medicare
2007	Contributions	$11,016,610	$11,016,610	$0	
5.00%	Discount for Interest	($524,600)	($524,600)	$0	
January 1, 2007	Present Value Of Contributions	$10,492,010	$10,492,010	$0	
	Prepayment Credit Applied	$19,388,381	$15,634,298	$3,754,083	
	Present Value Of Funding	$29,880,391	$26,126,308	$3,754,083	
January 1, 2007	Current Period Funding Requirement	$19,388,381	$15,634,298	$3,754,083	
	Percentage Funded		100.00%	100.00%	
	Funded PRB Cost		$15,634,298	$3,754,083	
	Allowable Interest		$0	$0	
	Allocable PRB Cost		$15,634,298	$3,754,083	
	Medicare LOB* Percentage		1.14%	87.93%	
	Plan Year Allowable PRB Cost		$178,231	$3,300,965	
2007	Fiscal Year Allowable PRB Cost		$187,195	$3,224,858	$3,412,053

* Line of business.

FOOTNOTES

1/ The allocable postretirement benefit (PRB) cost is the amount of PRB cost that may be allocated for contract costing purposes. The allocable PRB costs for 2005 were obtained from our prior review (A-07-06-00213, issued December 7, 2006).

2/ We calculated allowable PRB costs of the Medicare and "Other" segments based on the Medicare line of business (LOB) percentage of each segment. We obtained the percentages from information provided by First Coast Service Options, Inc. (FCSO). The 2005 Medicare LOB percentages were obtained from our prior review.

3/ We computed the allowable Medicare PRB cost as the allocable PRB cost multiplied by the Medicare LOB percentage.

4/ We obtained Total Company contribution amounts from the PRB actuarial valuation reports and trust transaction documentation that included the dates of deposits. The "Other" segment represents the difference between the Total Company and the Medicare segment. Total contributions to the trust fund are the deposits made to the voluntary employee benefit association (VEBA) trust fund. Such contributions can be used to satisfy the funding requirements of Federal Acquisition Regulation (FAR) 31.205-6(o)(2)(iii) and Cost Accounting Standards (CAS) 416-50(a)(1)(v)(A). The contributions included deposits made during the plan year and the discounted value of accrued contributions, if any, deposited after the end of the plan year but within the time allowed for filing tax returns.

5/ We subtracted the interest that is included in the contributions deposited after the beginning of each plan 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 at the valuation interest rate and actual contribution amounts. Interest is determined using the expected long-term rate of return assumption as reported in the PRB actuarial valuation report.

6/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the plan year.

7/ 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 Current Period Funding Requirement. A prepayment credit may be carried forward, with interest, to the first of each subsequent plan year until needed to fund future PRB costs. The accumulated value of prepayment credits is available as of the first day of the plan year and is applied as of the first day of the plan year to cover the cost assigned to the period.

8/ The present value of funding represents the present value of contributions plus applied prepayment credits. This is the amount of funding that is available to cover the Current Period Funding Requirement measured at the first day of each plan year.

9/ The Current Period Funding Requirement is based upon the assignable CAS PRB costs computed during our review. The Current Period Funding Requirement must be funded by accumulated prepayment credits or current year contributions to satisfy the funding requirement of the FAR.

10/ The percentage of costs funded is a measure of the portion of the Current Period Funding Requirement that was funded during the plan year. Since any funding in excess of the Current Period Funding Requirement is premature funding of future period costs, the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the Current Period Funding Requirement. For purposes of this calculation, the percentage of funding has been rounded to four decimals.

11/ We computed the funded PRB cost as the Current Period Funding Requirement multiplied by the percent funded.

12/ We assumed that interest on the funded PRB cost, less the applied prepayment credit, accrues in the same proportion that 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 the each quarter to which they are assignable.

13/ We converted the plan year allowable PRB costs to a Federal fiscal year (FY) basis (October 1 through September 30). We calculated the FY PRB costs as 1/4 of the prior year's allowable costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct PRB costs plus PRB costs attributable to indirect Medicare operations.

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 21, 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 East 12th Street, Room 0429
Kansas City, Missouri 64106

Reference: A-07-09-00315

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 Post Retirement Benefit (PRB) costs claimed by First Coast Service Options, Inc.'s Medicare reimbursement for fiscal years 2006-2007.

We agree with the report finding regarding the over claimed PRB costs and will take the following actions to ensure the report recommendations are implemented:

- Follow CMS guidelines for fiscal years 2006-2007 to decrease the claimed PRB costs by $367,384, and
- Ensure that future accrued PRB cost claims are in accordance with the Medicare contracts.

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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