Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

FIRST COAST SERVICE OPTIONS, INC., UNDERSTATED ITS MEDICARE SEGMENT PENSION 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

October 2017
A-07-16-00494

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.

Report in Brief
Date: October 2017
Report No. A-07-16-00494

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL

Why OIG Did This Review

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards 412 and 413.

The HHS, OIG, Office of Audit Services, Region VII pension audit team reviews the Medicare segment pension assets to ensure compliance with Federal regulations.

Previous OIG reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

Our objectives were to determine whether First Coast Service Options, Inc. (FCSO), complied with Federal requirements, the Medicare contracts' pension segmentation requirements, and its established cost accounting practices when (1) implementing our prior audit recommendation, and (2) updating the Medicare segment pension assets from January 1, 2008, through December 31, 2010.

How OIG Did This Review

We reviewed FCSO's implementation of the prior audit recommendation; identification of its Medicare segment; and its update of the Medicare segment's pension assets from January 1, 2008, through December 31, 2010.

First Coast Service Options, Inc., Understated Its Medicare Segment Pension Assets

What OIG Found

FCSO implemented the prior audit recommendation; however, FCSO did not correctly update the Medicare segment pension assets in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Specifically, FCSO identified Medicare segment pension assets of $33.6 million as of December 31, 2010; however, we determined that the Medicare segment pension assets were $34.6 million as of that date. Therefore, FCSO understated the Medicare segment pension assets by $1.0 million. This understatement occurred primarily because FCSO incorrectly identified its participant transfers.

What OIG Recommends and Auditee Comments

We recommend that FCSO increase its Medicare segment pension assets by $1.0 million and recognize $34.6 million as the Medicare segment pension assets as of December 31, 2010, and establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

In written comments on our draft report, FCSO agreed with our first recommendation and stated that it would increase Medicare segment assets. FCSO added that due to its pension curtailment triggered by the pension freeze effective December 31, 2010, our second recommendation, regarding the establishment of policies and procedures, is moot as no further billing or allocation of pension cost has been calculated or recorded.

We maintain that our recommendations are valid as stated. While it is true that FCSO froze its pension plan effective December 31, 2010, we believe that FCSO should continue to update its pension plan assets and calculate and claim any CAS pension costs that it incurred subsequent to that date. Establishment and implementation of policies and procedures would, in our view, go a long way toward ensuring that FCSO correctly claims pension costs.

The full report can be found at https://oig.hhs.gov/oas/reports/region7/71600494.asp.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

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, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors through Final Administrative Cost Proposals and/or Incurred Cost Proposals (ICPs).

OBJECTIVES

Our objectives were to determine whether First Coast Service Options, Inc., (FCSO), complied with Federal requirements, the Medicare contracts' pension segmentation requirements, and its established cost accounting practices when (1) implementing the prior audit recommendation to decrease the Medicare segment assets as of January 1, 2008, and (2) updating the Medicare segment pension assets from January 1, 2008, through December 31, 2010.

BACKGROUND

First Coast Service Options, Inc., and Medicare

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 A West jurisdiction and the Medicare Part B North jurisdiction; these contracts were originally awarded to FCSO in calendar years (CYs) 2004 and 2006, respectively.[3] On July 9, 2010, the QIC contract was formally novated from FCSO to C2C. Although C2C was created as a separate segment, its participants were included in the FCSO Medicare segment; however, C2C filed separate ICPs when claiming costs for Medicare reimbursement for the QIC contract. Therefore, the CAS pension costs were calculated in total for the FCSO Medicare segment and were then allocated between the FCSO FACPs and ICPs and the C2C ICPs. Subsequently, on August 5, 2011, C2C was sold to TMF Health Quality Institute.

This report addresses the update of the Medicare segment pension assets for the period January 1, 2008, through December 31, 2010. We are addressing the pension costs claimed by FCSO in a separate review.

Prior Pension Segmentation Audit

We performed a prior pension segmentation audit at FCSO (A-07-09-00311, issued March 25, 2010), which brought the Medicare segment pension assets to January 1, 2008. We recommended that FCSO decrease its Medicare segment pension assets by $637,976 and, as a result, recognize $53,064,850 as the Medicare segment pension assets as of January 1, 2008.

HOW WE CONDUCTED THIS REVIEW

We reviewed FCSO's implementation of the prior audit recommendation; identification of its Medicare segment; and its update of the Medicare segment's pension assets from January 1, 2008, through December 31, 2010.

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

[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 A West jurisdiction includes 24 U.S States and 3 U.S. territories. The QIC Part B North jurisdiction includes 35 northern States, the District of Columbia, and 3 U.S. territories.

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.

FINDINGS

FCSO implemented the prior audit recommendation; however, FCSO did not correctly update the Medicare segment pension assets from January 1, 2008, through December 31, 2010, in accordance with Federal regulations and the Medicare contracts' pension segmentation requirements. Specifically, FCSO identified Medicare segment pension assets of $33,567,159 as of December 31, 2010; however, we determined that the Medicare segment pension assets were $34,600,992 as of that date. Therefore, FCSO understated the Medicare segment pension assets by $1,033,833. This understatement occurred primarily because FCSO incorrectly identified its participant transfers when updating the Medicare segment's pension assets from January 1, 2008, through December 31, 2010.

Appendix B identifies the details of the Medicare segment's pension assets from January 1, 2008, through December 31, 2010, as determined during our audit. Table 1 below summarizes the audit adjustments required to update the Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per Audit	Per FCSO	Difference
Prior Audit Recommendation	$53,064,850	$53,064,850	$0
Update of Medicare Segments' Assets			
Net Transfers Out	(10,029,371)	(10,759,921)	730,550
Contributions and Prepayment Credits	$12,834,800	$12,750,947	83,853
Benefits Payments	(16,413,209)	(16,409,289)	(3,920)
Earnings, Net of Expenses	(4,856,078)	(5,079,428)	223,350
Understatement of Medicare Segment Assets			**$1,033,833**

PRIOR AUDIT RECOMMENDATION

FCSO implemented the prior audit recommendation (A-07-09-00311, issued March 25, 2010), which recommended that FCSO decrease its Medicare segment pension assets by $637,976 and, as a result, $53,064,850 as the Medicare segment pension assets as of January 1, 2008.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

The Medicare contracts require Medicare contractors to update the Medicare segment pension assets yearly in accordance with the CAS. The CAS requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses.

For details on the Federal requirements and the relevant language of the Medicare contracts, see Appendix C.

Net Transfers Out Overstated

FCSO overstated net transfers out of its Medicare segment by $730,550. The overstatement occurred primarily because FCSO incorrectly identified its participant transfers out of the Medicare segment. This overstatement of the net transfer adjustment resulted in an understatement of the Medicare segment pension assets by $730,550. Table 2 below shows the differences between the net transfers proposed by FCSO and the net transfers that we calculated during our review.

Table 2: Net Transfers Out of the Medicare Segment

	Per Audit	Per FCSO	Difference
2008	($918,283)	($1,585,041)	$666,758
2009	(4,166,346)	(4,149,795)	(16,551)
2010	(4,944,742)	(5,025,085)	80,343
Total	**($10,029,371)**	**($10,759,921)**	**$730,550**

Contributions and Transferred Prepayment Credits Understated

The audited contributions and transferred prepayment credits[4] are based on the assignable pension costs.[5] 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 to assigned pension costs, as needed, as of the date of deposit. For additional details on these Federal requirements, see Appendix C.

FCSO understated contributions and transferred prepayment credits by $83,853 for its Medicare segment. The understatement occurred primarily because of differences in the asset base used to compute the assignable pension costs. Table 3 on the following page shows the

[4] A prepayment credit is the amount funded in excess of the pension costs assigned to a cost accounting period that is carried forward for future recognition.

[5] These are assigned to a specific cost accounting period.

differences between the contributions and prepayment credits proposed by FCSO and the contributions and prepayment credits that we calculated during our review.

Table 3: Contributions and Transferred Prepayment Credits

	Per Audit	Per FCSO	Difference
2008	$5,768,493	$5,516,712	$251,781
2009	3,839,475	3,918,629	(79,154)
2010	3,226,832	3,315,606	(88,774)
Total	**$12,834,800**	**$12,750,947**	**$83,853**

Benefit Payments Understated

FCSO understated benefit payments by $3,920 for the Medicare segment because it did not include one benefit payment made to a Medicare segment participant. 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 were overstated by $3,920.

Earnings, Net of Expenses, Understated

FCSO understated investment earnings, less administrative expenses, by $223,350 for its Medicare segment, because it used incorrect net transfers, incorrect contributions and transferred prepayment credits, and incorrect benefit payments (all discussed above) to develop the Medicare segment pension asset base. In our audited update, we allocated earnings, net of expenses based on the applicable CAS requirements. For details on applicable Federal requirements, see Appendix C. Table 4 below shows the differences between the net earnings proposed by FCSO and the net earnings that we calculated during our review.

Table 4: Net Investment Earnings

	Per Audit	Per FCSO	Difference
2008	($14,560,065)	($14,492,426)	($67,639)
2009	6,116,380	5,910,329	206,051
2010	3,587,607	3,502,669	84,938
Total	**($4,856,078)**	**($5,079,428)**	**$223,350**

RECOMMENDATIONS

We recommend that FCSO:

- increase its Medicare segment pension assets by $1,033,833, and recognize $34,600,992 as the Medicare segment pension assets as of December 31, 2010, and

- establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our first recommendation and stated that it would increase Medicare segment assets.[6] FCSO added that due to its pension curtailment triggered by the pension freeze effective December 31, 2010, our second recommendation, regarding the establishment of policies and procedures, is moot as no further billing or allocation of pension cost has been calculated or recorded.

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

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing FCSO's comments, we maintain that our recommendations are valid as stated. Although FCSO suggests that the need to establish policies and procedures is moot, we disagree. While it is true that FCSO froze its pension plan effective December 31, 2010, we believe that FCSO should continue to update its pension plan assets and calculate and claim any CAS pension costs that it incurred subsequent to that date. Establishment and implementation of policies and procedures as stated in our second recommendation would, in our view, go a long way toward ensuring that FCSO claims pension costs in accordance with Federal regulations and the relevant language of the Medicare contracts.

[6] FCSO's comments speak of our recommendations in the singular rather than plural number and use rounded dollar amounts in the context of our first recommendation. These facts indicate simply that FCSO oriented its comments on our Report in Brief rather than on the report itself.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed FCSO's implementation of the prior audit recommendation; identification of its Medicare segment; and its update of the Medicare segment's pension assets from January 1, 2008, through December 31, 2010.

Achieving our objective did not require that we review FCSO's overall internal control structures. We reviewed controls relating to the identification of the Medicare segment and to the updates of the Medicare segment assets to ensure adherence to the Medicare contracts, CAS 412, and CAS 413.

We performed fieldwork at FCSO in Jacksonville, Florida.

METHODOLOGY

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the Federal Acquisition Regulation, 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 pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment's 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 participants.

- We reviewed the prior segmentation audit performed at FCSO (A-07-09-00311, issued March 25, 2010) to determine the beginning market value of assets for the Medicare segment.

- We provided the CMS Office of the Actuary, which provides technical actuarial advice, with the actuarial information necessary for it to calculate the Medicare segment's pension assets from January 1, 2008, through December 31, 2010.

- We reviewed the CMS actuaries' methodology and calculations.

- We provided the results of the review to FCSO officials on June 28, 2017.

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

- First *Coast Service Options, Inc., Understated Its Allocable Pension Costs* (A-07-16-00493) and

- *First Coast Service Options, Inc., Generally Claimed Allowable Medicare Pension Costs* (A-07-16-00495).

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 MEDICARE SEGMENT PENSION ASSETS
FOR THE PERIOD JANUARY 1, 2008, THROUGH DECEMBER 31, 2010

Description		Total Company	Other Segment	Medicare Segment
Assets January 1, 2008	1/	$583,169,175	$530,104,325	$53,064,850
Prepayment Credits	2/	0	(5,768,493)	5,768,493
Contributions	3/	40,000,000	40,000,000	0
Earnings	4/	(143,972,148)	(129,612,619)	(14,359,529)
Benefit Payments	5/	(79,504,499)	(70,236,709)	(9,267,790)
Administrative Expenses	6/	(2,010,618)	(1,810,082)	(200,536)
Transfers	7/	0	918,283	(918,283)
Assets January 1, 2009		$397,681,910	$363,594,705	$34,087,205
Prepayment Credits		0	(3,839,475)	3,839,475
Contributions		65,000,000	65,000,000	0
Earnings		64,237,828	58,077,276	6,160,552
Benefit Payments		(63,750,979)	(58,060,939)	(5,690,040)
Administrative Expenses		(460,597)	(416,425)	(44,172)
Transfers		0	4,166,346	(4,166,346)
Assets January 1, 2010		$462,708,162	$428,521,488	$34,186,674
Prepayment Credits		0	(3,226,832)	3,226,832
Contributions		50,000,000	50,000,000	0
Earnings		44,332,401	40,633,557	3,698,844
Benefit Payments		(46,022,504)	(44,567,125)	(1,455,379)
Administrative Expenses		(1,333,226)	(1,221,989)	(111,237)
Transfers		0	4,944,742	(4,944,742)
Assets December 31, 2010		$509,684,833	$475,083,841	$34,600,992
Per FCSO	8/	509,684,833	476,117,674	33,567,159
Asset Variance	9/	0	1,033,833	(1,033,833)

ENDNOTES

1/ We determined the Medicare segment pension assets as of January 1, 2008, based on our prior segmentation audit of FCSO (A-07-09-00311, issued March 25, 2010). 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/ Transferred prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order 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 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 net investment earnings from the actuarial valuation reports. 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 CAS.

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

6/ In accordance with the CAS, 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 from documents prepared by FCSO's actuarial consulting firm.

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

APPENDIX C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION

FEDERAL REGULATIONS

Federal regulations (CAS 412.50(a)(4)) require 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.

Federal regulations (CAS 413.50(c)(7)) require 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 WAV of assets to Total Company WAV of assets.

Federal regulations (CAS 413.50(c)(8)) require 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.

MEDICARE CONTRACTS

The Medicare 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 Medicare contracts state that "… the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)."

APPENDIX D: AUDITEE COMMENTS

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

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

September 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-07-16-00494

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 Pension Assets*" and reviewed.

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

Recommendation:

First Coast increase its Medicare segment pension assets by $1.0 million and recognize $34.6 million as the Medicare segment pension assets as of December 31, 2010, and establish policies and procedures to ensure compliance with Federal regulations and the pension segmentation language of the Medicare contracts.

Response:

First Coast agrees with the recommendation. Medicare assets will be increased. Due to the pension curtailment triggered with the pension freeze effective December 31, 2010 we believe the recommendation for adoption of policies and procedures is now moot as no further billing or allocation of pension cost has been calculated/recorded.

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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