



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

DEC 07 2006

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Report Number: A-07-06-00213

Ms. Sandy L. Coston
President & Chief Operating Officer
First Coast Service Options, Inc.
532 Riverside Avenue 20T
Jacksonville, Florida 32202

Dear Ms. Coston:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Postretirement Benefit Costs Claimed by First Coast Service Options for Medicare Reimbursement for Fiscal Years 2002 Through 2005." A copy of this report will be forwarded to the HHS action official noted on the following page for review and any action deemed necessary.

The action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the HHS action 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.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports are made available to the public to the extent the information is not subject to exemptions in the Act (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, extension 274, or 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-07-06-00213 in all correspondence.

Sincerely yours,


Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Mr. Roger Perez
Regional Administrator, Region 4
Centers for Medicare & Medicaid Services
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303-8909

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF POSTRETIREMENT
BENEFIT COSTS CLAIMED BY
FIRST COAST SERVICE OPTIONS
FOR MEDICARE
REIMBURSEMENT FOR FISCAL
YEARS 2002 THROUGH 2005**



Daniel R. Levinson
Inspector General

December 2006
A-07-06-00213

Office of Inspector General

<http://oig.hhs.gov>

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OAS FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

First Coast Service Options, Inc. (FCSO) administers Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). In claiming post retirement benefit (PRB) costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR) and applicable Cost Accounting Standards (CAS), as required by the Medicare contract. In addition, the Medicare contract and the Budget and Performance Requirements mandate that any change in accounting practice for PRB costs be submitted to CMS for approval.

In 2002, FCSO submitted a request to CMS to change to segmented accrual accounting for PRBs. FCSO also established a Voluntary Employee Benefit Association (VEBA) trust for the purpose of funding annual accruals. FCSO started claiming accrued PRB costs during 2002.

OBJECTIVE

Our objective was to determine the allowability of the PRB costs FCSO claimed for Medicare reimbursement on an accrual basis for fiscal years (FYs) 2002 through 2005.

SUMMARY OF FINDING

FCSO did not claim all accrued PRB costs that were allowable for Medicare reimbursement for FYs 2002 through 2005. During this period, the allowable accrued PRB costs were \$8,894,080. However, FCSO claimed accrued PRB costs of \$8,630,152 for Medicare reimbursement. FCSO therefore underclaimed \$263,928 of allowable PRB costs during this period because it did not claim PRB costs in accordance with its Medicare contract.

RECOMMENDATIONS

We recommend that FCSO revise its Final Administrative Cost Proposals (FACPs) to claim allowable accrued PRB costs of \$263,928 for FYs 2002 through 2005. We also recommend that FCSO claim future PRB costs in accordance with the Medicare contract.

AUDITEE'S COMMENTS

FCSO agreed with our recommendations and stated that it would revise its FACPs for FYs 2002 through 2005.

INTRODUCTION

BACKGROUND

FCSO and Medicare

First Coast Service Options, Inc. (FCSO) administers Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).¹ In claiming Post Retirement Benefit (PRB) costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), as required by the Medicare contract.

Medicare 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 Employees Benefit (VEBA) trust.

FCSO's Request To Use Segmented PRB Accrual Accounting

Since 1993, the Budget and Performance Requirements instructions sent to Medicare contractors have included a reminder of the special provisions regarding costs of PRB plans. The instructions specify that any change in accounting practice for PRB costs must be submitted to CMS in advance for approval.

In 2002, FCSO submitted a request to CMS to change to segmented accrual accounting for PRBs. FCSO, through its parent company, participates in a VEBA trust for the purpose of funding annual accruals.² FCSO started claiming accrued PRB costs during 2002.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of the PRB costs FCSO claimed for Medicare reimbursement on an accrual basis for fiscal years (FYs) 2002 through 2005.

Scope

We reviewed PRB costs that FCSO claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs) for FYs 2002 through 2005. Achieving the objective did not require that we review FCSO's overall internal control structure. However, we did review the internal controls related to the accrued PRB costs claimed for Medicare reimbursement to ensure that the PRB costs were allowable pursuant to the FAR.

¹FCSO'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.

²FCSO participates in employee benefit plans of its parent company, such as the VEBA trust.

We performed onsite audit work at FCSO's office in Jacksonville, Florida during February 2006.

Methodology

We identified FCSO's accrued PRB costs for the total company and for the Medicare segment. We also determined the extent to which FCSO funded the PRB costs with contributions to the VEBA trust fund or with direct payment of benefits. In performing our review, we used information provided by FCSO's actuarial consulting firm. The CMS Office of the Actuary staff used the information to develop PRB costs for FCSO based on SFAS 106 methodology pursuant to the FAR. Using this information, we calculated the PRB costs that were allowable for Medicare reimbursement for FYs 2002 through 2005. Appendix A contains the details of the PRB costs and contributions.

We performed this review in conjunction with our audits of segmented PRB assets (A-07-06-00225) and pension costs claimed for Medicare reimbursement (A-07-04-00180). We also used the information obtained and reviewed during these audits in performing this review.

We conducted our review in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATIONS

FCSO did not claim all accrued PRB costs that were allowable for Medicare reimbursement for FYs 2002 through 2005 because it did not claim PRB costs in accordance with its Medicare contract. Therefore, FCSO underclaimed \$263,928 of allowable accrued PRB costs during this period.

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.³ 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.

We compared allowable accrued PRB costs with the accrued PRB costs claimed on FCSO's FACPs, as shown in the table below.

ACCRUED PRB COSTS CLAIMED VARIANCE			
Fiscal Year	Per OIG	Per FCSO	Difference
2002	\$1,435,599	\$1,326,317	\$109,282
2003	2,351,982	2,397,526	(45,544)
2004	2,510,295	2,264,253	246,042
2005	2,596,204	2,642,056	(45,852)
Total	\$8,894,080	\$8,630,152	\$263,928

³Costs attributable to past service (transition obligation) must be assigned under the delayed recognition methodology described in paragraphs 112 and 113 of Financial Accounting Standards Board Statement 106.

For FYs 2002 through 2005, allowable accrued PRB costs were \$8,894,080; however, FCSO claimed accrued PRB costs of \$8,630,152 for Medicare reimbursement. The underclaim occurred because FCSO did not implement all of the changes necessary to claim PRB costs on a segmented accrual basis. Rather, FCSO incorrectly based its claim on an allocation of the contributions to the VEBA trust. Therefore, FCSO underclaimed \$263,928 of allowable accrued PRB costs during this period.

RECOMMENDATIONS

We recommend that FCSO revise its FACPs to claim allowable accrued PRB costs of \$263,928 for FYs 2002 through 2005. We also recommend that FCSO properly claim future PRB costs in accordance with the Medicare contract.

AUDITEE'S COMMENTS

FCSO agreed with our recommendations and stated that it would revise its FYs 2002 through 2005 FACPs by \$336,423 to reflect allowable PRB costs. This includes allowable accrued PRB costs of \$263,928 per our recommendation and pay as you go PRB costs for key employees of \$72,495.

OTHER MATTERS

For FYs 2002-2005, FCSO's approach in claiming accrued PRB costs omitted PRB costs for key employees. Subsequently, FCSO identified \$72,495 as the allowable key employee PRB costs. We reviewed and accepted FCSO's determination and calculations.

APPENDIXES

**FIRST COAST SERVICE OPTIONS
STATEMENT OF ALLOWABLE PRB COSTS
FOR FISCAL YEARS 2002 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
2002	Contributions	<u>1/</u> \$13,356,676	\$11,403,166	\$1,953,510
5.00%	Discount for Interest	<u>2/</u> (636,032)	(543,008)	(93,024)
	Present Value Of Contributions	<u>3/</u> 12,720,644	10,860,158	1,860,486
	Prepayment Credit	<u>4/</u> 0	0	0
	Present Value Of Funding	<u>5/</u> 12,720,644	10,860,158	1,860,486
	Current Period Funding Requirement	<u>6/</u> 9,994,210	8,133,724	1,860,486
	Percentage Funded	<u>7/</u>	100.00%	100.00%
	Funded PRB Cost	<u>8/</u>	8,133,724	1,860,486
	Allowable Interest	<u>9/</u>	288,069	65,892
	Allocable PRB Cost	<u>10/</u>	8,421,793	1,926,378
	Fiscal Year PRB Cost	<u>11/</u>	6,316,345	1,444,784
	Medicare LOB* Percentage	<u>12/</u>	2.97%	86.38%
	Allowable PRB Cost	<u>13/</u> <u>\$1,435,599</u>	<u>\$187,595</u>	<u>\$1,248,004</u>

2003	Contributions	\$18,894,667	\$16,990,816	\$1,903,851
5.00%	Discount for Interest	(899,746)	(809,086)	(90,660)
	Present Value Of Contributions	17,994,921	16,181,730	1,813,191
	Prepayment Credit	2,862,755	2,287,223	575,532
	Present Value Of Funding	20,857,676	18,468,953	2,388,723
	Current Period Funding Requirement	11,881,753	9,493,030	2,388,723
	Percentage Funded		100.00%	100.00%
	Funded PRB Cost		9,493,030	2,388,723
	Allowable Interest		255,206	64,217
	Allocable PRB Cost		9,748,236	2,452,940
	Fiscal Year PRB Cost		9,416,625	2,321,300
	Medicare LOB Percentage		2.68%	90.45%
	Allowable PRB Cost	<u>\$2,351,982</u>	<u>\$252,366</u>	<u>\$2,099,616</u>

* Line of business.

**FIRST COAST SERVICE OPTIONS
STATEMENT OF ALLOWABLE PRB COSTS
FOR FISCAL YEARS 2002 THROUGH 2005**

Date	Description	Total Company	Other Segment	Medicare Segment
2004	Contributions	\$18,165,696	\$17,436,655	\$729,041
5.00%	Discount for Interest	(865,033)	(830,316)	(34,717)
	Present Value Of Contributions	17,300,663	16,606,339	694,324
	Prepayment Credit	9,424,719	7,521,443	1,903,276
	Present Value Of Funding	26,725,382	24,127,782	2,597,600
	Current Period Funding Requirement	12,862,902	10,265,302	2,597,600
	Percentage Funded		100.00%	100.00%
	Funded PRB Cost		10,265,302	2,597,600
	Allowable Interest		97,178	24,591
	Allocable PRB Cost		10,362,480	2,622,191
	Fiscal Year PRB Cost		10,208,919	2,579,878
	Medicare LOB Percentage		1.80%	90.18%
	Allowable PRB Cost	<u>\$2,510,295</u>	<u>\$183,761</u>	<u>\$2,326,534</u>

2005	Contributions	\$19,837,762	\$19,837,762	\$0
5.00%	Discount for Interest	(944,655)	(944,655)	0
	Present Value Of Contributions	18,893,107	18,893,107	0
	Prepayment Credit	14,038,548	11,272,918	2,765,630
	Present Value Of Funding	32,931,655	30,166,025	2,765,630
	Current Period Funding Requirement	14,038,548	11,272,918	2,765,630
	Percentage Funded		100.00%	100.00%
	Funded PRB Cost		11,272,918	2,765,630
	Allowable Interest		0	0
	Allocable PRB Cost		11,272,918	2,765,630
	Fiscal Year PRB Cost		11,045,309	2,729,770
	Medicare LOB Percentage		1.45%	89.24%
	Allowable PRB Cost	<u>\$2,596,204</u>	<u>\$160,157</u>	<u>\$2,436,047</u>

**FIRST COAST SERVICE OPTIONS
STATEMENT OF ALLOWABLE PRB COSTS
FOR FISCAL YEARS 2002 THROUGH 2005**

FOOTNOTES

- 1/ We obtained total company contribution amounts from the PRB actuarial valuation reports and trust transaction documentation that included the dates of deposits. Total Company represents Blue Cross Blue Shield of Florida, the parent company of First Coast Service Options (FCSO). The Medicare Segment represents FCSO and the Other Segment is the difference between 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 Regulations (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 deposited after the end of the plan year but within the time allowed for filing tax returns. For 2002, the contributions shown include the amounts deposited into the trust and benefits paid from non-trust funds.
- 2/ 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 Statement of Financial Accounting Standards 106 expected long-term rate of return assumption.
- 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 plan year.
- 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 Current Period Funding Requirement. A prepayment credit may be carried forward, with interest, to the first of each subsequent plan years 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.
- 5/ The present value of funding represents the present value of contributions plus accumulated 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.
- 6/ The Current Period Funding Requirement must be funded by accumulated prepayment credits or current year contributions to satisfy the funding requirement of the FAR.
- 7/ 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.
- 8/ We computed the funded PRB cost as the Current Period Funding Requirement multiplied by the percent funded.
- 9/ 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.
- 10/ The allocable PRB cost is the amount of PRB cost that may be allocated for contract costing purposes.

**FIRST COAST SERVICE OPTIONS
STATEMENT OF ALLOWABLE PRB COSTS
FOR FISCAL YEARS 2002 THROUGH 2005**

APPENDIX A

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11/ We converted the plan year allocable 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 costs plus 3/4 of the current year's costs. FY 2002 PRB costs equal 3/4 of the calendar year 2002 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.

12/ FCSO provided the Medicare line of business percentages for the segment and indirect operations.

13/ We computed the allowable Medicare PRB cost as the FY PRB cost multiplied by the Medicare line of business percentage.



A CMS CONTRACTED INTERMEDIARY & CARRIER



MEDICARE

Sandy Coston
President & COO
First Coast Service Options
Sandy.Coston@fcsso.com

November 28, 2006

Mr. Patrick J. Cogley
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Inspector General
Office of Audit Services
601 East 12th Street, Room 284A
Kansas City, Missouri 64106

Reference: A-07-06-00213

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 Post Retirement Benefit (PRB) costs claimed by First Coast Service Options, Inc. for Medicare reimbursement for fiscal years 2002 – 2005.

We agree with the report finding regarding under claimed PRB costs and will take the following action to ensure the report recommendation is implemented:

File revised costs for fiscal years 2002 -2005 to reflect allowable accrued PRB costs of \$336,423.

We previously transmitted to your office, via facsimile, our comments and proposed revisions regarding the report. We appreciate the opportunity to provide comments prior to release of the final report. If you have any questions, please contact Mr. Gregory W. England at 904-791-8364.

Sincerely,

Sandy Coston

cc: Gregory W. England, Director of Internal Audit, FCSO
Bob Malinky, Compliance Officer, FCSO

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