

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**FIRST COAST SERVICE OPTIONS, INC.,
DID NOT CLAIM SOME MEDICARE
SUPPLEMENTAL EXECUTIVE
RETIREMENT PLAN COSTS FOR
FISCAL YEARS 2006 THROUGH 2009**

*Inquiries about this report may be addressed to the Office of Public Affairs at
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**Brian P. Ritchie
Assistant Inspector General
for Audit Services**

July 2016
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Office of Inspector General

<https://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

First Coast Service Options, Inc., a Medicare contractor, did not claim approximately \$740,000 of allowable Supplemental Executive Retirement Plan costs for fiscal years 2006 through 2009.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards, and the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and claim SERP costs.

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 (MACs) through Final Administrative Cost Proposals (FACPs) and/or Incurred Cost Proposals.

For this review, we focused on one Medicare contractor, First Coast Service Options, Inc. (First Coast). In particular, we examined the allowable Medicare segment SERP costs that First Coast claimed for Medicare reimbursement on its FACPs.

The objective of this review was to determine whether the fiscal years (FYs) 2006 through 2009 SERP costs that First Coast claimed for reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

During our audit period, First Coast was a wholly owned subsidiary 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. First Coast 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, First Coast continued to perform Medicare work after being awarded the MAC contract for Medicare Parts A and B Jurisdiction 9 effective September 12, 2008.

On April 2, 2007, C2C Solutions, Inc. (C2C), was created to perform additional Medicare work under the Qualified Independent Contractors (QIC) contract, which had originally been awarded to First Coast. C2C filed Incurred Cost Proposals when claiming costs for Medicare reimbursement for the QIC contract.

This report addresses the SERP costs that First Coast claimed under the provisions of its fiscal intermediary and carrier contracts. We are addressing the SERP costs that First Coast claimed under the provisions of its MAC contract in a separate review.

We reviewed \$145,704 of Medicare segment SERP costs that First Coast claimed for Medicare reimbursement on its FACPs for FYs 2006 through 2009.

WHAT WE FOUND

First Coast did not claim some allowable SERP costs for FYs 2006 through 2009 under its fiscal intermediary and carrier contracts. Specifically, First Coast claimed direct Medicare segment SERP costs of \$145,704 for Medicare reimbursement during FYs 2006 through 2009; however, we determined that allowable SERP costs during this period were \$886,017. The difference, \$740,313, constituted allowable Medicare SERP costs that First Coast did not claim on its FACPs for FYs 2006 through 2009. First Coast did not claim these allowable SERP costs primarily because (1) it did not use an interest component when amortizing its lump-sum payments' amortization installment and (2) it did not claim SERP costs for the benefit payments paid to Other segment participants.

WHAT WE RECOMMEND

We recommend that First Coast revise its FACPs for FYs 2006 through 2009 to claim the additional allowable SERP costs of \$740,313.

AUDITEE COMMENTS

In written comments on our draft report, First Coast concurred with our recommendation and said that it would claim the additional allowable SERP costs with guidance from CMS.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR), Cost Accounting Standards (CAS), and the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and claim SERP costs.

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 (MACs) through Final Administrative Cost Proposals (FACPs) and/or Incurred Cost Proposals.

For this review, we focused on one Medicare contractor, First Coast Service Options, Inc. (First Coast). In particular, we examined the allowable Medicare segment SERP costs that First Coast claimed for Medicare reimbursement on its FACPs.

OBJECTIVE

Our objective was to determine whether the fiscal years (FYs) 2006 through 2009¹ SERP costs that First Coast claimed for reimbursement under its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

First Coast Service Options, Inc., and Medicare

During our audit period, First Coast was a wholly owned subsidiary 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. First Coast 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.

¹ FY 2009 costs that First Coast claimed, and that we reviewed, extended through the February 2009 contract termination dates mentioned below.

With the implementation of Medicare contracting reform,² First Coast continued to perform Medicare work after being awarded the MAC contract for Medicare Parts A and B Jurisdiction 9 effective September 12, 2008.³

On April 2, 2007, C2C Solutions, Inc. (C2C), was created to perform additional Medicare work under the Qualified Independent Contractors (QIC) contract, which had originally been awarded to First Coast. C2C filed Incurred Cost Proposals when claiming costs for Medicare reimbursement for the QIC contract.

Accounting Methodologies

The Medicare contracts require First Coast to calculate SERP costs in accordance with the FAR and CAS 412 and 413. The FAR and the CAS require that the costs for nonqualified defined-benefit plans be measured under either the accrual method or the pay-as-you-go method. Under the accrual method, allowable costs are based on the annual contributions that the employer deposits into its trust fund. For nonqualified defined-benefit plans that are not funded through the use of a funding agency, costs are to be accounted for under the pay-as-you-go method. This method is based on the actual benefits paid to participants, which are comprised of lump-sum payments plus annuity payments.

Blue Cross Blue Shield of Florida Supplemental Executive Retirement Plan

BCBS Florida sponsors a SERP whose primary purpose is to provide a benefit to a select group of management or highly compensated employees. The SERP is designed to restore benefits to participants who lost benefits under the BCBS Florida qualified defined-benefit plan because of the Internal Revenue Code, sections 401(a)(17) and 415, limits.^{4, 5}

This report addresses the SERP costs that First Coast claimed under the provisions of its fiscal intermediary and carrier contracts. We are addressing the SERP costs that First Coast claimed under the provisions of its MAC contract in a separate review.

² Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), 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.

³ 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.

⁴ The section 401(a)(17) limit is the maximum annual compensation that can be used to calculate pension benefits.

⁵ Internal Revenue Code section 415 limits the amount of benefits that may be paid to a participant in a defined-benefit plan. It also limits the amount of contributions that may be made to a participant’s account in a defined contribution plan.

HOW WE CONDUCTED THIS REVIEW

We reviewed \$145,704 of Medicare segment SERP costs that First Coast claimed for Medicare reimbursement on its FACP for FYs 2006 through 2009.⁶

In accordance with the FAR and the CAS, we calculated the allowable SERP pension costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments. Our calculation included an allowable interest component in the amortization installment; to calculate this component, we used the interest rate identified in the qualified defined-benefit plan actuarial valuation reports.

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 objectives.

Appendix A contains details of our audit scope and methodology.

FINDING

First Coast did not claim some allowable SERP costs for FYs 2006 through 2009 under its fiscal intermediary and carrier contracts. Specifically, First Coast claimed direct Medicare segment SERP costs of \$145,704 for Medicare reimbursement during FYs 2006 through 2009; however, we determined that allowable SERP costs during this period were \$886,017.⁷ The difference, \$740,313, constituted allowable Medicare SERP costs that First Coast did not claim on its FACP for FYs 2006 through 2009. First Coast did not claim these allowable SERP costs primarily because (1) it did not use an interest component when amortizing its lump-sum payments' amortization installment and (2) it did not claim SERP costs for the benefit payments paid to Other segment participants.

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS CLAIMED

First Coast reported direct Medicare segment SERP costs of \$145,704 for Medicare reimbursement on its FACP for FYs 2006 through 2009. We calculated the allowable Medicare segment SERP costs, which include both the Medicare and Other segment payments, in accordance with FAR and the CAS. For details on the Federal requirements, see Appendix B.

⁶ Effective January 1, 2005, First Coast officials elected to request only direct Medicare segment SERP pension costs for Medicare reimbursement. Thus, First Coast no longer requests Medicare reimbursement for Other segment SERP pension costs.

⁷ The First Coast FACP did not include any SERP costs related to C2C employees; nor did we identify any allowable SERP costs related to C2C employees during our audit. Thus, C2C did not claim any SERP costs on the FACP. The C2C segment would have claimed SERP costs on its Incurred Cost Proposals.

ALLOWABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS NOT CLAIMED

We determined that the allowable SERP costs for FYs 2006 through 2009 were \$886,017. Thus, First Coast did not claim \$740,313 of allowable SERP costs on its FACP's for this time period. This underclaim occurred primarily because First Coast (1) did not use an interest component when amortizing its lump-sum payments' amortization installment, and thus did not claim \$98,306 in allowable SERP costs; and (2) did not claim SERP costs for the benefit payments paid to Other segment participants, and thus understated the allowable SERP costs by \$642,007.

In accordance with the FAR and the CAS, we calculated the allowable SERP pension costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments. Our calculation included an allowable interest component in the amortization installment; to calculate this component, we used the interest rate identified in the qualified defined-benefit plan actuarial valuation reports. Accordingly, we determined that the allowable pay-as-you-go SERP costs for FYs 2006 through 2009 totaled \$886,017.

Costs Calculated Without an Interest Component

The Medicare contracts require First Coast to calculate SERP costs in accordance with the FAR and CAS 412 and 413. First Coast did not use an interest component in the determination of the amortization installment as specified in CAS 412.50(b)(3) (Appendix B). This requirement states that the cost of a defined-benefit pension plan that is accounted for under the pay-as-you-go cost method shall be based on the net amount of any periodic benefits paid, and on a level annual installment required to amortize any lump-sum benefit payments over 15 years. Because First Coast did not use an interest component in its amortization calculation as required by CAS 412.50(b)(3), it did not claim \$98,306 in allowable SERP costs.

Our calculations of the allowable SERP costs included both an allowable interest component in the lump-sum amortizations and the omitted Other segment SERP payments (discussed below). We based our amortization installments on the interest rate used to determine costs for the qualified defined-benefit pension plan.

Costs for Other Segment Participants Not Claimed

Effective January 1, 2005, First Coast made a management decision to no longer request Medicare reimbursement for SERP costs that relate to payments made to participants in the Other segment. Notwithstanding this decision, the Medicare contract allows contractors to claim a portion of their Other segment SERP costs for Medicare reimbursement. We obtained and reviewed a listing of the Other segment SERP lump-sum and annuity payments for FYs 2006

through 2009.⁸ We calculated the allowable SERP costs for FYs 2006 through 2009, in accordance with the FAR and the CAS, to be \$886,017. Therefore, First Coast understated the allowable SERP costs by \$642,007 because it did not claim costs for the Other segment SERP benefit payments.

Summary of Allowable Supplemental Executive Retirement Plan Costs Not Claimed

The table below compares the allowable SERP costs with the costs claimed on First Coast’s FACPs. Appendix C contains additional details on the allowable costs.

<u>Table: Supplemental Executive Retirement Plan Costs</u>			
Fiscal Year	Per Audit	Per First Coast	Difference
2006	\$254,224	\$44,782	\$209,442
2007	231,883	46,465	185,418
2008	287,364	40,612	246,752
2009	112,546	13,845	98,701
Total	\$886,017	\$145,704	\$740,313

Because First Coast did not calculate its SERP costs in accordance with Federal regulations and the Medicare contracts’ requirements, it did not claim \$740,313 in allowable SERP costs.

RECOMMENDATION

We recommend that First Coast revise its FACPs for FYs 2006 through 2009 to claim the additional allowable SERP costs of \$740,313.

AUDITEE COMMENTS

In written comments on our draft report, First Coast concurred with our recommendation and said that it would claim the additional allowable SERP costs with guidance from CMS. First Coast’s comments appear in their entirety as Appendix D.

OTHER MATTER

During our review, CMS requested that we separately identify the costs associated with SERP payments for any cases in which any participant’s salary exceeded the executive compensation limit as determined by OFPP. We identified four SERP benefit payments that were based on compensation in excess of the compensation limits prescribed in FAR 31.205-6(p). While none

⁸ We recalculated two lump-sum benefit payments for the Other segment participants, using the compensation limits described in FAR 31.205-6(p) (Appendix B). Each of these two payments was made on behalf of one of the five most highly compensated First Coast employees in management positions at each home office and each segment of the Medicare contractor and should have been limited to the compensation benchmarks determined by the Office of Federal Procurement Policy (OFPP). In our calculations for these two payments, we limited each participant’s compensation for the year in which the participant was considered one of the five most highly compensated First Coast employees, in accordance with FAR 31.205-6(p).

of these participants was considered one of the top five most highly compensated executives at First Coast, the salaries used in their benefit payment calculations exceeded the compensation limits determined by OFPP. We identified these SERP benefit payments based on the benchmark for reasonable compensation that is provided by FAR 31.205-6(p) (Appendix B).

We recalculated the four SERP benefit payments that we had identified, using the OFPP compensation limits as a benchmark for reasonableness. We determined that the SERP costs associated with these four payments, which First Coast made to participants during FYs 2006 through 2009, totaled \$57,321.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed \$145,704 of Medicare segment SERP costs that First Coast claimed for Medicare reimbursement on its FACPs for FYs 2006 through 2009.

Achieving our objectives did not require us to review First Coast's overall internal control structure. We reviewed controls relating to the SERP costs claimed for Medicare reimbursement to ensure that those costs were allowable in accordance with the FAR and the CAS.

We performed our fieldwork at First Coast in Jacksonville, Florida.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed BCBS Florida's SERP plan document;
- reviewed accounting records and information provided by First Coast to identify the amount of SERP costs claimed for Medicare reimbursement for FYs 2006 through 2009;⁹
- reviewed Total Company benefit payment information provided by First Coast for the SERP;
- calculated the allowable SERP costs, based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments, and including an allowable interest component in the amortization installment (which we calculated using the interest rate identified in the qualified defined-benefit plan actuarial valuation reports), in accordance with applicable provisions of the FAR and the CAS; and
- provided the results of our review to First Coast officials on April 8, 2016.

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.

⁹ FY 2009 costs that First Coast claimed, and that we reviewed, extended through the February 2009 contract termination dates.

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS

FEDERAL REGULATIONS

Federal regulations (FAR 31.205-6(p)) state that costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, OFPP, are unallowable.

Federal regulations (CAS 412.40(a)(3)) state that for defined-benefit pension plans accounted for under the pay-as-you-go cost method, the components of pension cost for a cost accounting period are:

- the net amount of periodic benefits paid for the period, and
- an amortization installment, including an interest equivalent on the unamortized settlement amount, attributable to amounts paid to irrevocably settle an obligation for periodic benefits due in current and future cost accounting periods.

Federal regulations (CAS 412.50(b)(3)) state that for defined-benefit plans accounted for under the pay-as-you-go cost method, the amount of pension cost assignable to a cost accounting period shall be measured as the sum of:

- the net amount for any periodic benefits paid for that period and
- the level annual installment required to amortize over 15 years any lump-sum benefit payments.

Federal regulations (CAS 412.50(c)(3)) state that the cost of a nonqualified defined-benefit pension plan shall be assigned to cost accounting periods in the same manner as qualified plans under the following conditions:

- the contractor, in disclosing or establishing cost accounting practices, elects to have a plan so accounted for;
- the plan is funded through the use of a funding agency; and
- the right to a pension benefit is nonforfeitable and is communicated to the participants.

Federal regulations (CAS 412.50(c)(4)) state that the cost of a nonqualified defined-benefit pension plan must be assigned using the pay-as-you-go method if the plan does not meet all of the above requirements.

MEDICARE CONTRACTS

The determination and allocation of pension costs are addressed by the Medicare contract, which states: “The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413.” To be allowable for Medicare reimbursement, pension cost must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413 and (2) funded as specified by part 31 of the FAR.

**APPENDIX C: FIRST COAST SERVICE OPTIONS, INC., STATEMENT OF
ALLOWABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS**

Fiscal Year	SERP Lump-Sum Benefit Payments	SERP Annuity Benefit Payments	Total Benefit Payments	Medicare Ratio	Medicare FY Allowable Costs
	1/	2/	3/	4/	5/
2006	636,167	1,256,792	1,892,959	13.43%	254,224
2007	653,927	1,257,725	1,911,652	12.13%	231,883
2008	1,295,534	1,145,962	2,441,496	11.77%	287,364
2009	1,768,256	533,290	2,301,546	4.89%	112,546
Total	\$4,353,884	\$4,193,769	8,547,653		\$886,017

ENDNOTES

- 1/ First Coast provided a schedule of SERP lump-sum benefit payments for each FY. In accordance with FAR 31.205-6p, we limited participants' salaries in those calculations to the executive compensation limits. We amortized the lump-sum benefit payments, including an interest equivalent, over a 15-year period in accordance with CAS 412.50(b)(3). In computing the interest component for the amortized lump-sum benefit payments, we used the valuation interest rate identified in the qualified defined-benefit plan actuarial valuation reports.
- 2/ First Coast provided a schedule of SERP annuity payments for each FY.
- 3/ Allocable total benefit payments are the sum of the (i) SERP lump-sum benefit payment and the (ii) SERP annuity benefit payments.
- 4/ We calculated the Medicare ratio based on information provided by First Coast.
- 5/ We computed the FY allowable costs as the total benefit payments multiplied by the Medicare ratio. First Coast terminated its Medicare Part A and B carrier contracts in February 2009. Therefore, the FY 2009 pension costs are calculated as of February 2009.

APPENDIX D: AUDITEE COMMENTS



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June 21, 2016

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-07-16-00472

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., Did Not Claim Some Medicare Supplemental Executive Retirement Plan Costs for Fiscal Years 2006 through 2009*" and reviewed the findings and recommendations contained herein. We appreciate the opportunity to review and provide comments prior to release of the final report.

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

Recommendation:

We recommend that First Coast revise its FACP's for FYs 2006 through 2009 to claim the additional allowable SERP costs of \$740,313.

Response:

First Coast concurs with the recommendation and will claim additional allowable Supplemental Executive Retirement Plan Costs with guidance from The Centers for Medicare & Medicaid Services.

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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