

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**FIRST COAST SERVICE OPTIONS,
INC., UNDERSTATED ITS
ALLOCABLE PENSION COSTS**

*Inquiries about this report may be addressed to the Office of Public Affairs at
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Gloria L. Jarmon
Deputy Inspector General
for Audit Services

October 2017
A-07-16-00493

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-07-16-00493



Why OIG Did This Review

The Centers for Medicare & Medicaid Services (CMS) reimburses Medicare contractors for a portion of their pension costs, which are funded by the annual contributions that these contractors make to their pension plans.

At CMS's request, the HHS, OIG, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit plans and any other pension-related cost elements claimed by Medicare administrative contractors (MACs) through Incurred Cost Proposals (ICPs).

Previous OIG reviews found that Medicare contractors did not always comply with Federal requirements when claiming pension costs for Medicare reimbursement.

Our objective was to determine whether the allocable qualified defined-benefit plan pension costs that First Coast Service Options, Inc. (FCSO), used to calculate the indirect cost rates in its ICPs, under the provisions of its MAC contracts, for calendar years (CYs) 2008 through 2010 complied with Federal requirements.

How OIG Did This Review

We reviewed \$135.9 million of pension costs used by FCSO in the calculation of the indirect cost rates for its MAC-related contracts for CYs 2008 through 2010.

First Coast Service Options, Inc., Understated Its Allocable Pension Costs

What OIG Found

Neither the Medicare segment nor the Other segment pension costs that FCSO used to calculate the indirect cost rates in its ICPs complied with Federal requirements. Specifically, for CYs 2008 through 2010, FCSO used Medicare segment allocable pension costs of \$12.7 million to calculate its indirect cost rates in its ICPs; however, we determined that the Medicare segment pension costs that should have been used to calculate the indirect cost rates were \$12.8 million. Thus, FCSO understated the Medicare segment allocable pension costs used to calculate its indirect cost rates by \$147,268.

In addition, FCSO used Other segment allocable pension costs of \$123.2 million to calculate its indirect cost rates in its ICPs; however, we determined that the Other segment allocable pension costs that should have been used to calculate the indirect cost rates were \$124.4 million. Thus, FCSO understated the Other segment allocable pension costs used to calculate its indirect cost rates by \$1.2 million.

These understatements occurred primarily because FCSO used incorrect Cost Accounting Standards pension costs to calculate its indirect cost rates for CYs 2008 through 2010.

What OIG Recommends and Auditee Comments

We recommend that FCSO increase the Medicare segment allocable pension costs used to calculate its indirect cost rates for CYs 2008 through 2010 by \$147,268, and increase the Other segment allocable pension costs used to calculate its indirect cost rates for CYs 2008 through 2010 by \$1.2 million.

FCSO agreed with our recommendations and stated that it would work with CMS to address the findings.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their pension costs, which are funded by the annual contributions that these contractors make to their pension plans. The amount of pension costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the allocability and cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and Cost Accounting Standards (CAS) as required by the Medicare contracts. Previous Office of Inspector General (OIG) reviews found that Medicare contractors have not always complied with Federal requirements when claiming pension costs for Medicare reimbursement.

At CMS's request, the OIG, 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 and/or Incurred Cost Proposals (ICPs).

For this review, we focused on one Medicare contractor, First Coast Service Options, Inc. (FCSO). In particular, we examined the Medicare segment and Other segment allocable pension costs that FCSO used to calculate the indirect cost rates in its ICPs.

OBJECTIVE

Our objective was to determine whether the allocable qualified defined-benefit plan pension costs that FCSO used to calculate the indirect cost rates in its ICPs, under the provisions of its MAC contracts, for calendar years (CYs) 2008 through 2010 complied with Federal requirements.

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 9² 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 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 to both the FCSO and C2C ICPs. Subsequently, on August 5, 2011, C2C was sold to TMF Health Quality Institute. C2C did not administer any fiscal intermediary and carrier contracts.

Effective May 16, 2008, FCSO amended its disclosure statements to implement pooled costing. Under the provisions of their MAC-related contracts, Medicare contractors use pooled costing to calculate the indirect cost rates that they report on their ICPs. The FAR requires Medicare contractors to file final indirect cost rates on their ICPs 6 months after the year end. In turn, CMS uses the indirect cost rates in reimbursing costs under cost-reimbursement contracts.

This report addresses the Medicare segment allocable pension costs that FCSO calculated under the provisions of its MAC-related contracts. We are addressing the allowable pension costs that FCSO claimed under the provisions of its fiscal intermediary and carrier contracts in a separate review.

Medicare Reimbursement of Pension Costs

CMS reimburses a portion of the Medicare contractors' annual pension costs, which are funded by the annual contributions that these contractors make to their pension plans. To be allowable for Medicare reimbursement, pension costs 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.

¹ 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.

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.

Under the provisions of the contracts that CMS developed with the Medicare contractors as part of the implementation of the MMA, the method by which Medicare reimbursed pension costs to the contractor changed from a cost reimbursement basis to an indirect cost basis. In accordance with the FAR and the MAC contract, reimbursement of costs was now based on indirect cost rates determined by the contract.

HOW WE CONDUCTED THIS REVIEW

We reviewed \$135,896,630 of allocable pension costs used by FCSO in the calculation of the indirect cost rates for its MAC-related contracts for CYs 2008 through 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 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

Neither the Medicare segment nor the Other segment allocable pension costs that FCSO used to calculate the indirect cost rates in its ICPs complied with Federal requirements. Specifically, for CYs 2008 through 2010:

- FCSO used Medicare segment allocable pension costs of \$12,687,532 to calculate its indirect cost rates in its ICPs; however, we determined that the Medicare segment allocable pension costs that should have been used to calculate the indirect cost rates were \$12,834,800. Thus, FCSO understated the Medicare segment allocable pension costs used to calculate its indirect cost rates by \$147,268.
- FCSO used Other segment allocable pension costs of \$123,209,098 to calculate its indirect cost rates in its ICPs; however, we determined that the Other segment allocable pension costs that should have been used to calculate the indirect cost rates were \$124,414,946. Thus, FCSO understated the Other segment allocable pension costs used to calculate its indirect cost rates by \$1,205,848.

These understatements occurred primarily because FCSO used incorrect CAS pension costs to calculate its indirect cost rates for CYs 2008 through 2010.

UNDERSTATEMENT OF MEDICARE SEGMENT ALLOCABLE PENSION COSTS

Allocable Medicare Segment Pension Costs

FCSO used allocable pension costs of \$12,687,532 to calculate its indirect cost rates for the Medicare segment for CYs 2008 through 2010. We calculated CAS-based pension costs for CYs 2008 through 2010 for the Medicare segment in accordance with CAS 412 and 413. For details on the Federal requirements, see Appendix B.

Understated Medicare Segment Allocable Pension Costs

We determined that the Medicare segment allocable pension costs for FCSO for CYs 2008 through 2010 were \$12,834,800. Thus, FCSO understated the Medicare segment allocable pension costs used to calculate its indirect cost rates for this time period by \$147,268. These understatements occurred primarily because FCSO used incorrect CAS pension costs to calculate its indirect cost rates for CYs 2008 through 2010.

Table 1 below shows the difference between the Medicare segment CAS-based allocable pension costs that we calculated and the pension costs that FCSO used to calculate its indirect cost rates for CYs 2008 through 2010. Appendix C contains additional details on pension costs.

Table 1: Comparison of Allocable Pension Costs for the Medicare Segment

Calendar Year	Per Audit	Per FCSO	Difference
2008	\$5,768,493	\$5,453,297	\$315,196
2009	3,839,475	3,918,629	(79,154)
2010	3,226,832	3,315,606	(88,774)
Total	\$12,834,800	\$12,687,532	\$147,268

UNDERSTATEMENT OF OTHER SEGMENT ALLOCABLE PENSION COSTS

Allocable Other Segment Pension Costs

FCSO used allocable pension costs of \$123,209,098 to calculate its indirect cost rates for the Other segment for CYs 2008 through 2010. We calculated CAS-based pension costs for CYs 2008 through 2010 for the Other segment in accordance with CAS 412 and 413. For details on the Federal requirements, see Appendix B.

Understated Other Segment Allocable Pension Costs

We determined that the Other segment allocable pension costs for FCSO for CYs 2008 through 2010 were \$124,414,946. Thus, FCSO understated the Other segment allocable pension costs used to calculate its indirect cost rates for this time period by \$1,205,848. These

understatements occurred primarily because FCSO used incorrect CAS pension costs to calculate its indirect cost rates for CYs 2008 through 2010.

Table 2 below shows the difference between the Other segment CAS-based allocable pension costs that we calculated and the pension costs that FCSO used to calculate its indirect cost rates for CYs 2008 through 2010. Appendix C contains additional details on pension costs.

Table 2: Comparison of Pension Costs for the Other Segment

Calendar Year	Per Audit	Per FCSO	Difference
2008	\$43,881,947	\$42,315,377	\$1,566,570
2009	41,198,189	41,377,766	(179,577)
2010	39,334,810	39,515,955	(181,145)
Total	\$124,414,946	\$123,209,098	(\$1,205,848)

OIG will use the information contained in this report and the related fiscal intermediary and carrier contract report (A-07-16-00495) to determine the allowable Medicare and Other segment allocable pension costs for FCSO.⁴

RECOMMENDATIONS

We recommend that FCSO:

- increase the Medicare segment allocable pension costs used to calculate its indirect cost rates for CYs 2008 through 2010 by \$147,268 and
- increase the Other segment allocable pension costs used to calculate its indirect cost rates for CYs 2008 through 2010 by \$1,205,848.

AUDITEE COMMENTS

In written comments on our draft report, FCSO agreed with our recommendations and stated that it would work with CMS to address the findings.⁵ FCSO's comments appear in their entirety as Appendix D.

⁴ Our review of the allocable pension costs for FCSO identified the amount of pension costs that should have been used to allocate pension costs to the Medicare segment. OIG will use the information in this report, as well as the information from our reviews of the fiscal intermediary and carrier contract pension costs claimed by FCSO (A-07-17-00495), to determine the allowable pension costs for FCSO. In addition, FCSO will use the information provided by the audit organization that reviews the ICPs (regarding their compliance with the CAS) to determine the final indirect cost rates for FCSO.

⁵ FCSO's comments speak of our recommendations and findings in the singular rather than plural number and use a rounded dollar amount in the context of our second 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 \$135,896,630 of allocable pension costs used by FCSO in the calculation of the indirect cost rates for its MAC-related contracts for CYs 2008 through 2010.

Achieving our objective did not require that we review FCSO's overall internal control structure. We reviewed the internal controls related to the pension costs claimed for Medicare reimbursement to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed our fieldwork at FCSO in Jacksonville, Florida.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed information provided by FCSO to identify the amount of pension costs used in its calculation of its indirect cost rates for CYs 2008 through 2010;
- used information that FCSO's actuarial consulting firms provided, including information on the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses;
- examined FCSO's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Forms 5500;
- determined the extent to which FCSO funded CAS-based pension costs with contributions to the pension trust fund and accumulated prepayment credits;
- engaged the CMS Office of the Actuary, which provides technical actuarial advice, to calculate the allocable pension costs based on the CAS (the calculations were based on separately computed CAS-based pension costs for the Medicare segment);
- reviewed the CMS actuaries' methodology and calculations; and
- 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 these audits for this review:

- *First Coast Service Options, Inc., Understated Its Medicare Segment Pension Assets (A-07-16-00494)* 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 finding and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO REIMBURSEMENT OF PENSION COSTS

FEDERAL REGULATIONS

Federal regulations (FAR 52.216-7(a)(1)) address the invoicing requirements and the allowability of payments as determined by the Contracting Officer in accordance with FAR subpart 31.2.

Federal regulations (FAR 31.205-6(j)) require Medicare contractors to measure, assign, and allocate the costs of all defined-benefit pension plans in accordance with CAS 412 and 413. This regulation also addresses the allowability of pension costs and requires that contractors fund the pension costs assigned to contract periods by making contributions to the pension plan.

Federal regulations (CAS 412) (as amended) address the determination and measurement of pension cost components. This regulation also addresses the assignment of pension costs to appropriate accounting periods.

Federal regulations (CAS 413) (as amended) address the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

MEDICARE CONTRACTS

The Medicare contracts require FCSO to submit invoices in accordance with FAR 52.216-7, "Allowable Cost & Payment." Furthermore, FAR 52.216-7(a)(1) addresses the invoicing requirements and the allowability of payments as determined by the Contracting Officer in accordance with FAR subpart 31.2.

**APPENDIX C: ALLOCABLE PENSION COSTS
FOR FIRST COAST SERVICE OPTIONS, INC.,
FOR CALENDAR YEARS 2008 THROUGH 2010**

Date	Description		Total Company	"Other" Segment	Medicare Segment
2008	Contributions	<u>1/</u>	\$40,000,000	\$40,000,000	\$0
	Discount for Interest	<u>2/</u>	(\$2,790,698)	(\$2,790,698)	\$0
January 1, 2008	Present Value Contributions	<u>3/</u>	\$37,209,302	\$37,209,302	\$0
	Prepayment Credit Applied	<u>4/</u>	\$49,650,440	\$43,881,947	\$5,768,493
	Present Value of Funding	<u>5/</u>	\$86,859,742	\$81,091,249	\$5,768,493
January 1, 2008	CAS Funding Target	<u>6/</u>	\$49,650,440	\$43,881,947	\$5,768,493
	Percentage Funded	<u>7/</u>		100.00%	100.00%
	Funded Pension Cost	<u>8/</u>		\$43,881,947	\$5,768,493
	Allowable Interest	<u>9/</u>		\$0	\$0
2008	CY Allocable Pension Cost	<u>10/</u>		\$43,881,947	\$5,768,493

Date	Description		Total Company	"Other" Segment	Medicare Segment
2009	Contributions		\$65,000,000	\$65,000,000	\$0
	Discount for Interest		(\$4,814,815)	(\$4,814,815)	\$0
January 1, 2009	Present Value Contributions		\$60,185,185	\$60,185,185	\$0
	Prepayment Credit Applied		\$45,037,664	\$41,198,189	\$3,839,475
	Present Value of Funding		\$105,222,849	\$101,383,374	\$3,839,475
January 1, 2009	CAS Funding Target		\$45,037,664	\$41,198,189	\$3,839,475
	Percentage Funded			100.00%	100.00%
	Funded Pension Cost			\$41,198,189	\$3,839,475
	Allowable Interest			\$0	\$0
2009	CY Allocable Pension Cost			\$41,198,189	\$3,839,475

Date	Description	Total Company	"Other" Segment	Medicare Segment
2010	Contributions	\$50,000,000	\$50,000,000	\$0
	Discount for Interest	(\$3,488,372)	(\$3,488,372)	\$0
January 1, 2010	Present Value Contributions	\$46,511,628	\$46,511,628	\$0
	Prepayment Credit Applied	\$42,561,642	\$39,334,810	\$3,226,832
	Present Value of Funding	\$89,073,270	\$85,846,438	\$3,226,832
January 1, 2010	CAS Funding Target	\$42,561,642	\$39,334,810	\$3,226,832
	Percentage Funded		100.00%	100.00%
	Funded Pension Cost		\$39,334,810	\$3,226,832
	Allowable Interest		\$0	\$0
2010	CY Allocable Pension Cost		\$39,334,810	\$3,226,832

ENDNOTES

- 1/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the CY and accrued contributions deposited after the end of the CY but within the time allowed for filing tax returns. We determined the contributions allocated to the Medicare segment during the pension segmentation review (A-07-16-00494) and pension costs claimed for Medicare reimbursement review (A-07-16-00495). The amounts shown for the "Other" segment represent the difference between the Total Company and the Medicare segments.
- 2/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation 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 CAS valuation interest rate) and actual contribution amounts.
- 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 CY. For purposes of this Appendix, we deemed deposits made after the end of the CY to have been made on the final day of the CY, consistent with the method established by the Employee Retirement Income Security Act prior to the implementation of the Pension Protection Act.
- 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 CAS funding target. A prepayment credit is carried forward, with interest, to fund future CAS pension costs.
- 5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the CY.
- 6/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the FAR 31.205-6(j)(2)(i).

- 7/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the CY. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimal places.
- 8/ We computed the funded CAS-based pension cost as the CAS funding target multiplied by the percent funded.
- 9/ We assumed that interest on the funded CAS-based pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.
- 10/ The CY allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes.

APPENDIX D: AUDITEE COMMENTS



Harvey B. Dikter
President & CEO
First Coast Service Options, Inc.
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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-07-16-00493

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 Allocable Pension Costs*" and reviewed.

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

Recommendation:

First Coast increase the Medicare segment allocable pension costs used to calculate its indirect cost rates for CYs 2008 through 2010 by \$147,268, and increase the Other segment allocable pension costs used to calculate its indirect costs rates for CYs 2008 through 2010 by \$1.2 million.

Response:

First Coast agrees with the recommendation. The Incurred Cost Proposals and related indirect cost rates for CY's 2008 through 2010 are currently under audit. First Coast will work collaboratively with the Centers for Medicare & Medicaid Services to address the finding consistent with the agencies determination of its materiality and in conjunction with settlement of multiple outstanding audits related to FYs 2008 and 2009.

If you have any questions, please contact Mr. Gregory W. England at (904) 791-8364.

Sincerely,

Harvey B. Dikter

cc: Gregory W. England