

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**FIRST COAST SERVICE OPTIONS, INC.,  
OVERSTATED MEDICARE'S SHARE OF  
THE MEDICARE SEGMENT EXCESS  
PENSION LIABILITIES**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
[Public.Affairs@oig.hhs.gov](mailto:Public.Affairs@oig.hhs.gov).*



Gloria L. Jarmon  
Deputy Inspector General  
for Audit Services

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# *Office of Inspector General*

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## Report in Brief

Date: September 2018  
Report No. A-07-18-00535



### 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 (CAS) 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 calculate Medicare's share of the Medicare segment excess pension assets or liabilities.

Our objectives were to determine whether First Coast Service Options, Inc. (FCSO), complied with Federal requirements when (1) implementing the previous audit recommendations to increase the Medicare segment assets as of December 31, 2010, and (2) determining Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its benefit curtailment.

### How OIG Did This Review

We reviewed \$10.3 million that FCSO proposed as Medicare's share of the Medicare segment excess pension liabilities as of December 31, 2010, as a result of its benefit curtailment.

## First Coast Service Options, Inc., Overstated Medicare's Share of the Medicare Segment Excess Pension Liabilities

### What OIG Found

FCSO implemented our previous audit recommendations and increased the Medicare pension asset amount by \$1.03 million to calculate Medicare's share of the Medicare segment's excess pension liabilities as of December 31, 2010.

Regarding our second objective, FCSO did not comply with Federal requirements when determining Medicare's share of the Medicare segment excess pension liabilities as of the benefit curtailment date. FCSO calculated Medicare's share of the excess pension liabilities as of December 31, 2010, to be \$10.3 million. We determined, however, that Medicare's share of the excess pension liabilities was \$3.7 million as of that date. Therefore, FCSO overstated Medicare's share of the Medicare segment pension liabilities by \$6.6 million. FCSO overstated the Medicare segment excess pension liabilities because its calculation used an unreasonable long-term interest rate and long-term lump sum conversion interest rate as of December 31, 2010, which did not comply with CAS 413.50(c)(12).

### What OIG Recommends and Auditee Comments

We recommend that FCSO decrease Medicare's share of the Medicare segment excess pension liabilities as of December 31, 2010, by \$6.6 million and recognize \$3.7 million as Medicare's share of the excess pension liabilities as a result of the benefit curtailment.

FCSO disagreed with several of the findings underlying our recommendation. Specifically, FCSO stated that its long-term interest rate and long-term lump sum conversion interest rate were proper actuarial assumptions and that we arbitrarily applied historical assumptions from a single point in time that predated the curtailment.

We maintain that our findings and recommendation remain valid. The long-term interest rate and long-term lump sum conversion interest rate that FCSO used were unreasonable and did not comply with Federal requirements. Actuarial assumptions should remain fairly stable from year to year; there were no actuarially sound reasons for the drops in the long-term interest rate and long-term lump sum conversion interest rate that FCSO used to compute its accrued liabilities as of December 31, 2010.

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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. In addition, in situations such as contract terminations or benefit curtailments, CAS 413 requires contractors to identify the difference between Medicare pension assets and liabilities allocated to the Medicare segment. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly calculate Medicare's share of the Medicare segment excess pension assets or liabilities.

At CMS's request, the U.S. Department of Health and Human Services, 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, Medicare administrative contractors (MACs) and other CAS-covered and Federal Acquisition Regulation (FAR)-covered contracts through Final Administrative Cost Proposals (FACPs) and/or Incurred Cost Proposals (ICPs).

For this review, we focused on one entity, First Coast Service Options, Inc. (FCSO). In particular, we examined Medicare's share of the Medicare segment pension liabilities that FCSO determined as a result of its benefit curtailment.

### OBJECTIVES

Our objectives were to determine whether FCSO complied with Federal requirements when (1) implementing the previous audit recommendations to increase the Medicare segment assets as of December 31, 2010, and (2) determining Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its benefit curtailment.

### 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 Part A fiscal intermediary and Part B carrier contract 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,<sup>1</sup> FCSO continued to perform Medicare work after being awarded the MAC contract for Medicare Parts A and B Jurisdiction 9<sup>2</sup> 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 had originally been awarded to FCSO in calendar years (CYs) 2004 and 2006, respectively.<sup>3</sup> 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, FCSO calculated the CAS pension costs in total for its Medicare segment and then allocated those costs 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.

FCSO and C2C employees participated in a defined-benefit pension plan called the Non-Contributory Retirement Program for Certain Employees of Blue Cross and Blue Shield of Florida, Inc. Effective December 31, 2010, BCBS Florida froze its pension plan, which triggered a curtailment of employee benefits under CAS 413. This report addresses FCSO's calculation of Medicare's share of the Medicare segment excess pension assets or liabilities as a result of its benefit curtailment.

Upon the curtailment of its pension plan, FCSO identified Medicare's share of the Medicare segment excess pension liabilities to be \$10,315,499 as of December 31, 2010.

### **Previous Pension Segmentation Audit**

We performed a previous pension segmentation audit at FCSO (A-07-16-00494, Oct. 30, 2017), which brought the Medicare segment pension assets to December 31, 2010. We recommended that FCSO increase the Medicare segment pension assets by \$1,033,833 and recognize \$34,600,992 as the Medicare segment pension assets as of December 31, 2010.

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<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> 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.

## **HOW WE CONDUCTED THIS REVIEW**

We reviewed FCSO's calculation of Medicare's share of its Medicare segment's excess pension liabilities, as of December 31, 2010, as a result of its benefit curtailment.

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**

FCSO agreed with our recommendations in the previous segmentation audit (A-07-16-00494) to increase the Medicare segment pension assets by \$1,033,833 as of December 31, 2010. Consequently, FCSO implemented our recommendations and increased the Medicare pension asset amount by \$1,033,833 to calculate Medicare's share of the Medicare segment's excess pension liabilities as of December 31, 2010.

Regarding our second objective, FCSO did not comply with Federal requirements when determining Medicare's share of the Medicare segment excess pension liabilities as of the benefit curtailment date. FCSO calculated Medicare's share of the excess pension liabilities as of December 31, 2010, to be \$10,315,499. We determined, however, that Medicare's share of the excess pension liabilities was \$3,685,907 as of that date. Therefore, FCSO overstated Medicare's share of the Medicare segment pension liabilities by \$6,629,592. FCSO overstated the Medicare segment excess pension liabilities because its calculation used an unreasonable long-term interest rate and long-term lump sum conversion interest rate as of December 31, 2010, which did not comply with CAS 413.50(c)(12).

## **PREVIOUS AUDIT RECOMMENDATIONS**

FCSO implemented the previous audit recommendations (A-07-16-00494), which recommended 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.

## **MEDICARE SEGMENT CURTAILMENT ADJUSTMENT**

### **Medicare Segment Excess Pension Liabilities as of December 31, 2010**

FCSO did not comply with Federal requirements when calculating the Medicare segment excess pension liabilities as of its benefit curtailment date. Federal regulations (Appendix B) require FCSO to have computed a Medicare segment curtailment adjustment as a result of the benefit

curtailment. FCSO identified \$10,577,829 in Medicare segment excess pension liabilities as of December 31, 2010. However, we calculated Medicare segment excess pension liabilities to be \$4,130,794 as of that date. (It is necessary to calculate the pension assets and liabilities as well as any adjustments for the Medicare segment before calculating Medicare's share. See Table 1 later in this report for details regarding the calculation of Medicare's share.) Therefore, FCSO overstated the Medicare segment excess pension liabilities by \$6,447,035.

FCSO overstated these liabilities because its calculation used an unreasonable long-term interest rate and long-term lump sum conversion interest rate that did not comply with CAS 413. Specifically, FCSO used a 6.50 percent long-term interest rate to compute its accrued liabilities; however, in consultation with CMS we used the historical rate of 7.50 percent, which complies with CAS 413.50(c)(12)(i) (Appendix B). Additionally, FCSO changed its interest rate and long-term lump sum conversion interest rate assumptions at year-end. In so doing, FCSO essentially reduced the interest rate assumptions used in its curtailment calculation from the interest rates it actually used throughout the year.

At our request, FCSO provided its justification for using the 6.50 percent long-term interest rate and its 6.00 percent long-term lump sum conversion interest rate used in its curtailment calculation. This justification attributed the decrease in the interest rates that FCSO used to (1) the plan's asset allocation and to (2) general market conditions. We forwarded that justification to the CMS Office of the Actuary (OACT) (with which we routinely consult on CAS requirements pertaining to Medicare segment pension audits) for review. After reviewing FCSO's justification, CMS OACT determined that the 6.50 percent long-term interest rate and the 6.00 percent long-term lump sum conversion interest rate assumptions did not reflect prior long-term assumptions as required by the CAS.

Accordingly, CMS OACT recommended that we request that FCSO recalculate the accrued liabilities as of December 31, 2010, using the historical long-term interest rate of 7.50 percent (the CAS valuation interest rate) and a 6.75 percent long-term lump sum conversion interest rate. FCSO did so and in turn, we used that 7.50 percent interest rate when calculating the accrued liabilities for this audit.

We used the Medicare segment excess pension liabilities to identify Medicare's share of the Medicare segment excess pension liabilities, as discussed below.

### **Medicare's Share of the Medicare Segment Excess Pension Liabilities**

FCSO calculated the aggregate Medicare percentage (that is, the percentage that reflects Medicare's share of the Medicare segment excess pension liabilities) as of December 31, 2010, to be 97.52 percent. We calculated the aggregate Medicare percentage to be 89.23 percent (Appendix C) using the Medicare segment pension costs developed during the previous pension costs claimed audits (A-07-95-01125, Dec. 7, 1995; A-07-04-00180, Feb. 8, 2005; and A-07-09-00312, Mar. 25, 2010) and the current pension costs claimed audits (A-07-16-00495 and

A-07-18-00534; Appendix A) as required by the CAS. For details on the Federal requirements regarding the aggregate Medicare percentage, see Appendix B.

FCSO calculated \$10,315,499 as Medicare’s share of the Medicare segment excess pension liabilities as of December 31, 2010; however, we calculated Medicare’s share of the Medicare segment excess pension liabilities to be \$3,685,907 as of that date. The difference, \$6,629,592, constituted Medicare segment pension liabilities that FCSO did not include in its curtailment adjustment. FCSO overstated Medicare’s share of the Medicare segment excess pension liabilities by \$6,629,592 primarily because it overstated the Medicare segment’s pension liabilities (as discussed above).

Table 1 below shows our calculation of Medicare’s share of the excess pension liabilities.

**Table 1: Medicare’s Share of Excess Pension Liabilities**

|   | <b>Per FCSO</b>       | <b>Per Audit</b>     | <b>Difference</b>    |
|---|-----------------------|----------------------|----------------------|
| Medicare Segment Assets as of December 31, 2010                   | \$34,600,992          | \$34,600,992         | \$0                  |
| Medicare Segment Liabilities as of December 31, 2010 <sup>4</sup> | 46,273,992            | 39,826,957           | 6,447,035            |
| Unallowable Unfunded Liability as of December 31, 2010            | 1,095,171             | 1,095,171            | 0                    |
| Medicare Segment Excess Pension Liabilities                       | (10,577,829)          | (4,130,794)          | (6,447,035)          |
| Aggregate Medicare Percentage                                     | 97.52%                | 89.23%               | 8.29%                |
| <b>Excess Liabilities Attributable to Medicare</b>                | <b>(\$10,315,499)</b> | <b>(\$3,685,907)</b> | <b>(\$6,629,592)</b> |

### **RECOMMENDATION**

We recommend that FCSO decrease Medicare’s share of the Medicare segment excess pension liabilities as of December 31, 2010, by \$6,629,592 and recognize \$3,685,907 as Medicare’s share of the Medicare segment excess pension liabilities as a result of the benefit curtailment.

### **AUDITEE COMMENTS**

In written comments on our draft report, FCSO disagreed with several of the findings underlying our recommendation. Specifically, FCSO disagreed with our findings that the Medicare segment liabilities as of December 31, 2010, were \$39,826,957, the Medicare segment excess pension liabilities were \$4,130,794, the aggregate Medicare percentage was

<sup>4</sup> As requested, FCSO provided us with the revised accrued liabilities for the Medicare segment using a 7.50 percent interest rate as of December 31, 2010. We used these revised liabilities in our calculation of the Medicare segment excess pension liabilities.

89.23 percent, and the excess liabilities attributable to Medicare were \$3,685,907.<sup>5</sup> The crux of the disagreement, as explained below, involves two actuarial assumptions used to calculate the Medicare segment liabilities as of December 31, 2010. FCSO implicitly disagreed with our recommendation to decrease Medicare's share of the Medicare segment excess pension liabilities as of December 31, 2010, by \$6,629,592 and recognize \$3,685,907 as Medicare's share of the Medicare segment excess pension liabilities as a result of the benefit curtailment. Specifically, FCSO asked us to revise our audit findings by accepting the actuarial assumptions it used to calculate the Medicare segment liabilities as of December 31, 2010, and the findings that follow.

FCSO maintained that a 6.50 percent long-term interest rate and 6.00 percent long-term lump sum conversion interest rate were the proper actuarial assumptions that we should have used. FCSO stated that we ignored the definition of "actuarial assumption" in CAS 413 and arbitrarily applied historical assumptions from a single point in time that predated the curtailment. FCSO also stated, in the context of the Federal requirement that actuarial assumptions be consistent with current and prior long-term assumptions (CAS 413.50(c)(12)(i); Appendix B), that we misinterpreted the plain meaning of the word "consistent" and disregarded CAS Board guidance that contractors may depart from historical assumptions when changed circumstances require that different assumptions be used to achieve reasonable estimates of future conditions. In this respect, FCSO said that consistency under CAS 413 "merely requires that the actuarial assumptions employed, to the extent they differ from current or prior long-term assumptions, be reconcilable with those current or prior long-term assumptions."

FCSO stated that its actuarial assumption of a 6.50 percent long-term interest rate reflected a change in the pension plan's investment policy and broader changed circumstances in the market. Specifically, FCSO stated that between January 1, 2010, and January 1, 2012, the pension plan shifted asset allocations toward debt securities. FCSO also stated that, since January 1, 2012, the expected return on the assets assumption it used for financial reporting purposes pursuant to generally accepted accounting principles (GAAP) has ranged from 5.50 to 5.75 percent.

FCSO added that its actuarial assumption of a 6.00 percent long-term lump sum conversion interest rate was reasonable because interest rates have averaged less than 6.00 percent over the past 7 years, from CY 2010 through April 2018.

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

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<sup>5</sup> FCSO did not dispute our finding that the unallowable unfunded liability as of December 31, 2010, was \$1,095,171. FCSO also did not dispute our finding that it implemented our recommendation from a previous audit (A-07-16-00494), such that Medicare segment assets as of December 31, 2010, were \$34,600,992.

## OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing FCSO's comments, we maintain that our use of the 7.50 percent long-term interest rate assumption and 6.75 percent long-term lump sum conversion interest rate assumption for the calculation of the Medicare segment accrued liabilities as of December 31, 2010, remains valid. We also maintain that FCSO's 6.50 percent long-term interest rate and 6.00 percent long-term lump sum conversion interest rate were unreasonable and did not comply with Federal requirements. Therefore, we maintain that our findings and recommendation remain valid.

Contractors measure pension costs and actuarial accrued liability<sup>6</sup> annually (typically on the same date each year) and as of the date of certain events, such as benefit curtailments. Actuarial assumptions are estimates of future conditions affecting pension costs (CAS 412.30(a)(3); CAS 413.30(a)(3)).<sup>7</sup> These include economic assumptions about the long-term lump sum conversion interest rate (or discount rate) and the expected long-term rate of return on assets.<sup>8</sup> For annual pension cost measurements, the CAS requires that each actuarial assumption "be separately identified and shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations" (CAS 412.40(b)(2)). As a general rule, actuarial assumptions should remain fairly stable from year to year: "Actuarial assumptions shall reflect long-term trends so as to avoid distortions caused by short-term fluctuations" (CAS 412-50(b)(4)).

Federal regulations state that when there is a curtailment of benefits, "the contractor shall determine the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment . . ." (CAS 413-50(c)(12)). This represents an adjustment of previously-determined pension costs. "The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. *The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs*" (CAS 413-50(c)(12)(i); emphasis added).

Further, the "calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made *as of the date of the event (e.g., . . . plan amendment . . .)* . . . that caused the . . . curtailment of benefits" (CAS 413.50(c)(12)(iii); emphasis added).

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<sup>6</sup> Actuarial accrued liability is the difference between the value of benefits already earned and assets.

<sup>7</sup> CAS 412 sets forth cost accounting standards for composition and measurement of pension cost and governs annual measurements of pension costs. CAS 413 sets forth cost accounting standards for adjustment and allocation of pension cost and governs adjustments of previously determined pension costs in the event of benefit curtailments or other events.

<sup>8</sup> Actuarial assumptions also include demographic assumptions about mortality rates and about when participants will retire and begin receiving benefits.

In the Preamble to the 1995 revisions to the CAS, the CAS Board stated: “Consistent with the requirement that actuarial assumptions be individual best-estimates of future long-term economic and demographic trends, this final rule requires that the assumptions used to determine the actuarial liability be consistent with the assumptions that have been in use.” Further, the CAS Board stated that it “does not intend this rule to prevent contractors from using assumptions that have been revised based on a persuasive actuarial experience study or a change in a plan’s investment policy” (60 Fed. Reg. 16539 (Mar. 30, 1995; emphasis added).

FCSO stated that we applied historical assumptions from a single point in time and that we do not understand the plain meaning of the word “consistent” as used in CAS 413. To the contrary, in accordance with the CAS requirement that actuarial assumptions used for curtailments be consistent with current and prior long-term assumptions, we looked to FCSO’s assumptions for annual CAS valuations from CYs 2004 through 2010, which are shown in Table 2 below.

**Table 2: FCSO CAS Valuations**

|   | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Long-Term Interest Rate (%)</b>              | 7.50        | 7.50        | 7.50        | 7.50        | 7.50        | 8.00        | 7.50        |
| <b>Long-Term Lump Sum Conversation Rate (%)</b> | 6.50        | 6.00        | 6.00        | 6.00        | 6.25        | 6.50        | 6.75        |

We used a 7.50 percent long-term interest rate because FCSO had used a 7.50 percent long-term interest rate every year from CY 2004 through CY 2010, except for CY 2009, when FCSO used an 8.00 percent long-term interest rate. There was no actuarially sound reason for a sudden drop of a full percentage point (from 7.50 percent to the 6.50 percent rate that FCSO used to compute its accrued liabilities) as of December 31, 2010.

We used a 6.75 percent long-term lump sum conversation interest rate because the rates that FCSO had used were trending upward from CY 2007 through CY 2010. We conservatively matched the rate used in CY 2010, rather than further increase the rate to comport with the trend. There was no actuarially sound reason for a sudden drop of half a percentage point (from 6.50 percent to the 6.00 percent rate that FCSO used) as of December 31, 2010.

FCSO emphasized the “forward-looking” and “predictive” nature of actuarial assumptions and stated that its assumptions were reasonable based on changed conditions or circumstances, but the changes mentioned occurred after the benefit curtailment date of December 31, 2010. FCSO said that its actuarial assumption of a 6.50 percent long-term interest rate reflected a change in the pension plan’s investment policy and changed circumstances in the market. Specifically, FCSO stated that between January 1, 2010, and January 1, 2012, the pension plan shifted asset allocations toward debt securities. FCSO also stated that, since January 1, 2012, expected return on the assets assumption it used for financial reporting purposes pursuant to GAAP ranged from 5.50 to 5.75 percent. However, this expected return was unknown as of

December 31, 2010, and is irrelevant to actuarial assumptions that are, according to CAS, “predictive” based on past information.

Likewise, FCSO stated that its actuarial assumption of a 6.00 percent long-term lump sum conversion interest rate was reasonable because interest rates averaged less than 6.00 percent over the past 7 years, from CY 2010 through April 2018, as demonstrated by the pension plan’s financial accounting assumptions and data from the U.S. Department of the Treasury. We reiterate, though, that whatever occurred after December 31, 2010, was unknown as of December 31, 2010. Moreover, the CAS Board has long held that financial accounting policies and procedures such as GAAP are inappropriate for measuring pension costs under CAS (76 Fed. Reg. 81296, 81298, 81301 (Dec. 27, 2011)).

Finally, the judicial and administrative decisions to which FCSO referred in its comments do not support FCSO’s actuarial assumptions that deviate so drastically from prior assumptions. In Raytheon v. United States, 105 Fed. Cl. 236 (Jul. 16, 2012), the contractor, Raytheon, changed a demographic assumption for CAS 413 purposes when a segment closed, assuming that participants would retire because of the segment closing. The Court held that Raytheon’s assumption was reasonable because one or more actuaries testified at trial that they knew from experience that when government contractors sell a segment, most retirement-eligible employees retire. Because Raytheon had this information as of the date of the segment closing, it was justified in changing an actuarial assumption. In Appeal of Gould, Inc., ASBCA No. 46759 (Sept. 19, 1997), the CAS Board held that it was unreasonable for the contractor to change, for CAS 413 purposes after a segment closing, interest rate assumptions that it had been using for CAS 412 purposes solely for purposes of CAS 413(c)(12).

The Board said: “It was not reasonable because the amount of interest which the assets in the master trust will earn . . . does not change because the division is sold.” Similarly, FCSO has not shown how the benefit curtailment would change interest rates. FCSO also has not shown what changes to the Plan’s investment policy, if any, were implemented because of the curtailment of benefits and how such changes, if any, justified changing long-standing long-term interest rate and long-term lump sum conversion interest rate assumptions.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

Upon the curtailment of its pension plan, FCSO identified Medicare's share of the Medicare segment excess pension liabilities to be \$10,315,499. We reviewed FCSO's calculation of Medicare's share of its Medicare segment's excess pension liabilities, as of December 31, 2010, as a result of its benefit curtailment.

Achieving our objective did not require that we review FCSO's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment and to the updates of the Medicare segment's 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:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed the curtailment calculation prepared by FCSO's actuarial consulting firm;
- reviewed our previous segmentation audit performed at FCSO (A-07-16-00494) to determine the December 31, 2010, market value of assets for the Medicare segment;
- obtained FCSO's justification for its use of a 6.50 percent long-term interest rate and the 6.00 percent long-term lump sum conversion interest rate in its calculation of its accrued liabilities, and consulted with CMS OACT as to whether that interest rate complied with the CAS;
- reviewed FCSO's accrued liabilities using the revised assumptions that CMS OACT recommended to us; and
- provided the results of our review to FCSO officials on April 5, 2018.

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),*

- *First Coast Service Options, Inc.'s, Postretirement Benefit Costs Were Reasonable and Allowable (A-07-17-00501),*
- *First Coast Service Options, Inc., Generally Claimed Allowable Pension Costs Through Its Incurred Cost Proposals (A-07-18-00534), and*
- *First Coast Service Options, Inc., Did Not Claim Some Medicare Supplemental Executive Retirement Plan Costs Through Its Incurred Cost Proposals (A-07-18-00536).*

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: FEDERAL REQUIREMENTS RELATED TO BENEFIT CURTAILMENT ADJUSTMENT

### FEDERAL REGULATIONS

Federal regulations (CAS 412.40(b)(2)) require that each actuarial assumption used to measure pension cost shall be separately identified and shall represent the contractor's best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations.

Federal regulations (CAS 412.50(a)(1)(iv)) require that if any assumptions are changed during an amortization period, the resulting increase or decrease in unfunded actuarial liability shall be separately amortized over no more than 30 years nor less than 10 years.

Federal regulations (CAS 413.50(c)(12)) state, in part:

If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.

- i. The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs. . . .
- ii. . . . The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).
- iii. The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.
- iv. Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be

recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

The methodology for determining the Federal Government's share of excess pension assets and liabilities is addressed by CAS 413.50(c)(12)(vi), which states:

The Government's share of the adjustment amount determined for a segment shall be the product of the adjustment amount and a fraction. The adjustment amount shall be reduced for any excise tax imposed upon assets withdrawn from the funding agency of a qualified pension plan. The numerator of such fraction shall be the **sum of the pension plan costs** allocated to all contracts and subcontracts (including Foreign Military Sales) subject to this Standard during a period of years representative of the Government's participation in the pension plan. The denominator of such fraction shall be the **total pension costs** assigned to cost accounting periods during those same years. This amount shall represent an adjustment of contract prices or cost allowance as appropriate. The adjustment may be recognized by modifying a single contract, several but not all contracts, or all contracts, or by use of any other suitable technique. [Emphasis added.]

## **MEDICARE CONTRACTS**

The Medicare contracts state: "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. The Secretary [of Health and Human Services] and the contractor agree that, for purposes of this agreement/contract, CAS 413 shall be interpreted and applied as specified herein."

**APPENDIX C: CALCULATION OF AGGREGATE MEDICARE PERCENTAGE**

| <b>Calendar Year</b> | <b>Allowable Medicare Segment Pension Costs From FACP's</b> | <b>Allowable Medicare Segment Pension Costs From ICP's</b> | <b>Total Allocable Medicare Segment Pension Costs</b> | <b>Medicare Aggregate Percentage</b> |
|----------------------|---|--|---|--------------------------------------|
| <b>1/</b>            | <b>(A) 2/</b>   | <b>(B) 3/</b>  | <b>(C) 4/</b>   | <b>((A+B)/C) 5/</b>                  |
| 1992                 | 1,185,812   |  | 1,188,427   |                                      |
| 1993                 | 1,518,540   |  | 1,550,638   |                                      |
| 1994                 | 1,755,534   |  | 1,784,079   |                                      |
| 1995                 | 1,342,511   |  | 1,371,869   |                                      |
| 1996                 | 2,318,575   |  | 2,362,518   |                                      |
| 1997                 | 2,192,987   |  | 2,270,643   |                                      |
| 1998                 | 1,845,657   |  | 2,034,903   |                                      |
| 1999                 | 1,930,865   |  | 2,193,915   |                                      |
| 2000                 | -   |  | -   |                                      |
| 2001                 | 2,116,107   |  | 2,555,994   |                                      |
| 2002                 | 2,461,582   |  | 3,050,666   |                                      |
| 2003                 | 3,933,548   |  | 4,308,849   |                                      |
| 2004                 | 4,262,307   |  | 4,657,241   |                                      |
| 2005                 | 4,683,742   |  | 5,176,549   |                                      |
| 2006                 | 5,006,611   |  | 5,704,239   |                                      |
| 2007                 | 5,060,802   |  | 5,755,490   |                                      |
| 2008                 | 4,448,085   | 1,320,408  | 5,768,493   |                                      |
| 2009                 | 41,466  | 2,458,877  | 3,839,475   |                                      |
| 2010                 | -   | 2,581,248  | 3,226,832   |                                      |
|                      |   |  |   |                                      |
|                      |   |  |   |                                      |
| <b>Total</b>         | <b>\$46,104,731</b>   | <b>\$6,360,533</b>   | <b>\$58,800,820</b>                                   | <b>89.23%</b>                        |

**ENDNOTES**

- 1/ We based the aggregate percentage on the audited pension costs developed during the previous pension costs claimed audits (A-07-95-01125, Dec. 7, 1995; A-07-04-00180, Feb. 8, 2005; and A-07-09-00312, Mar. 25, 2010) and the current pension costs claimed audits (A-07-16-00495 and A-07-18-00534) as required by the CAS.
- 2/ This column identifies the allowable Medicare segment pension costs that relate to the Legacy Medicare contract.
- 3/ This column identifies the allowable Medicare Parts A and B contract, Jurisdiction 9, segment pension costs that relate to the MAC contracts. In some instances, we limited the allowable pension costs from the ICP to equal 100 percent of the allocable pension costs. This was necessary because when using the actual allowable pension costs claimed from the ICPs, the line of business percentage exceeded 100 percent.
- 4/ This column identifies the total allocable Medicare segment pension costs during the contract period.

5/ In accordance with 9904.413-50(c)(12)(vi), we calculated the aggregate Medicare percentage by dividing the total of the Medicare segment's pension costs charged to Medicare (that is, the combined amounts from the two columns to the right of the "Calendar Year" column) by the total allocable Medicare segment pension costs pursuant to CAS 413.



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

June 6, 2018

Mr. Patrick J. Cogley  
Regional Inspector General for Audit Services  
Office of Audit Services, Region VII  
601 East 12<sup>th</sup> Street, Room 0429  
Kansas City, MO 64106

**Reference: A-07-18-00535**

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., Overstated Medicare's Share of the Medicare Segment Excess Pension Liabilities*".

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

**Recommendation:**

First Coast decrease Medicare's share of the Medicare segment excess pension liabilities as of December 31, 2010, by \$6.6 million and recognize \$3.7 million as Medicare's share of the excess pension liabilities as a result of the benefit curtailment.

**Response:**

As explained in the attached Memorandum of Law, First Coast's long-term interest rate and long-term lump sum conversion rates are reasonable actuarial assumptions as that term is defined in CAS413 because they are each "an estimate of future conditions affecting pension costs." 48 C.F.R. § 9904.413-30(a)(3). The Draft Report does not dispute this, but instead improperly uses historical, point-in-time assumptions that do not attempt to estimate future conditions as of the effective date of curtailment. Unlike HHS OIG's historical assumptions, First Coast's actuarial assumptions are "consistent with the current and prior long term assumptions used in the measurement of pension costs," as required by CAS 413. *Id.* § 9904.413-50(c)(12)(i). HHS OIG should therefore accept First Coast's actuarial assumptions and revise the Draft Audit Report accordingly.

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

Sincerely,

/Harvey B. Dikter/

cc: Jonathan Hogan  
Gregory W. England

Daniel P. Graham danielgraham@velaw.com  
Tel +1.202.639.6652 Fax +1.202.318.8462

Date: May 31, 2018  
To: Department of Health & Human Services, Office of the Inspector General  
From: Daniel P. Graham  
Subject: Draft Audit Report No. A-07-18-00535 entitled, *First Coast Service Options, Inc. Overstated Medicare's Share of the Medicare Segment Excess Pension Liabilities*

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First Coast Service Options, Inc. ("First Coast") submits this Memorandum of Law in response to the Department of Health and Human Services, Office of the Inspector General ("HHS OIG") draft Audit Report No. A-07-18-00535 (the "Draft Report"). The Draft Report concerns the adjustment of previously determined pension costs required by Cost Accounting Standard ("CAS") 413 as a result of First Coast's 2011 curtailment of benefits for Medicare Segment participants of the Blue Cross Blue Shield of Florida ("Florida Blue") defined benefit pension plan (the "Plan"). The Draft Report finds that First Coast "did not comply with Federal requirements when determining Medicare's share of the Medicare segment excess pension liabilities as of the benefit curtailment date." Draft Report at 3. Specifically, the Draft Report finds that First Coast "overstated the Medicare segment excess pension liabilities because its calculation used an unreasonable long-term interest rate and long-term lump sum conversion interest rate as of December 31, 2010, which did not comply with CAS 413.50(c)(12)." *Id.*

For the reasons set forth below, the Draft Report misinterprets and misapplies CAS 413. First Coast's long-term interest rate and long-term lump sum conversion rates are reasonable actuarial assumptions as that term is defined in CAS 413 because they are each "an estimate of future conditions

Vinson & Elkins LLP Attorneys at Law  
Austin Beijing Dallas Dubai Hong Kong Houston London Moscow  
New York Richmond Riyadh San Francisco Taipei Tokyo Washington

2200 Pennsylvania Avenue NW, Suite 500 West  
Washington, DC 20037-1701  
Tel +1.202.639.6500 Fax +1.202.639.6604 velaw.com

affecting pension costs.” 48 C.F.R. § 9904.413-30(a)(3). The Draft Report does not dispute this, nor does it offer any explanation why some other long-term interest rate or long-term lump sum conversion interest rate provides a better estimate of future conditions as of the effective date of curtailment. Instead, the Draft Report ignores the definition of “actuarial assumption” in CAS 413 and arbitrarily applies historical assumptions from a single point in time that pre-dates the curtailment.

The Draft Report asserts that these historical assumptions are necessary to comply with CAS 413’s requirement that the actuarial assumptions employed in calculating an adjustment of previously determined pension costs “shall be consistent with the current and prior long term assumptions used in the measurement of pension costs.” *Id.* § 9904.413-50(c)(12)(i). The Draft Report not only misinterprets the plain meaning of the word “consistent,” but also disregards repeated statements by the Cost Accounting Standards Board that this language contemplates that contractors will depart from historical assumptions when changed circumstances require that different assumptions be used to achieve a reasonable estimate of future conditions. Because First Coast has reconciled the actuarial assumptions employed for CAS 413 with prior long term assumptions based on changes in asset allocation and market conditions, HHS OIG should accept First Coast’s actuarial assumptions and revise the Draft Audit Report accordingly.

**1. CAS 413 Requires that Adjustments of Previously Determined Pension Costs Be Based on Actuarial Assumptions that Reflect Reasonable Estimates of Future Conditions as of the Effective Date of Curtailment.**

As a result of the 2011 curtailment, 48 C.F.R. § 9904.413-50(c)(12) requires First Coast to “determine the difference between the actuarial accrued liability for the segment and the market value of the assets allocated to the segment,” which difference “represents an adjustment of previously-determined pension costs.” That rule further requires that “the calculation of the difference between the

market value of the assets and the actuarial accrued liability shall be made as of the date of the event . . . that caused the . . . curtailment of benefits.” *Id.* § 9904.413-50(c)(12)(iii).

CAS 413 also provides that “[t]he actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs.” *Id.* § 9904.413-50(c)(12)(i). CAS 413 defines an “actuarial assumption” generally as “an estimate of future conditions affecting pension cost; for example, mortality rate, employee turnover, compensation levels, earnings on pension plan assets, changes in values of pension plan assets.” *Id.* § 9904.413-30(a)(3). CAS 413 therefore expressly defines actuarial assumptions as forward looking assumptions, and expressly requires that adjustments of previously determined pension costs be based on forward looking assumptions as of the date of the event triggering the adjustment (*i.e.*, the curtailment of benefits).

CAS 413 expressly incorporates the definitions of terms defined elsewhere in CAS, and expressly states that CAS 413 makes no modification to any terms defined elsewhere in CAS. 48 C.F.R. § 9904.413-30(a) & (b). CAS 412 provides the same definition of “actuarial assumption” as CAS 413. *Id.* § 9904.412-30(a)(3). Underscoring the forward-looking nature of that definition, CAS 412 elaborates that “[e]ach actuarial assumption used to measure pension cost shall be separately identified and shall represent the contractor’s best estimates of anticipated experience under the plan, taking into account past experience and reasonable expectations.” *Id.* § 9904.412-40(b)(2). CAS 412’s focus on “best estimates of anticipated experience” emphasizes the predictive nature of actuarial assumptions and the need to consider all information and experience available to the contractor. CAS 412 also makes clear that actuarial assumptions reflect “the contractor’s best estimates,” and that contractors are entitled to discretion in performing the inherently judgmental analyses that underlie any actuarial assumption.

**2. CAS 413's Consistency Requirement Does Not Require the Use of Historical Assumptions that Do Not Reflect Reasonable Estimates of Future Conditions.**

CAS 413 requires that the actuarial assumptions employed in calculating an adjustment of previously determined pension costs “shall be consistent with the current and prior long term assumptions used in the measurement of pension costs.” *Id.* § 9904.413-50(c)(12)(i). Because the terms “consistent with” are not defined in CAS, they must be given their plain and ordinary meaning. *See, e.g., Terry v. Principi*, 340 F.3d 1378, 1382–83 (Fed. Cir. 2003) (“In the absence of an express definition, we presume that Congress intended to give these words their ordinary meanings.”); *Alpough v. Nicholson*, 490 F.3d 1352, 1357 (Fed. Cir. 2007) (applying the same rule to regulations). The plain and ordinary meaning of the phrase “consistent with” is “having agreement with,” “harmonious,” “compatible,” and “not contradictory.” Black’s Law Dictionary at 308 (6<sup>th</sup> ed. 1990); *see generally Am. Express v. United States*, 262 F.3d 1376, 1381 n.5 (Fed. Cir. 2001) (“It is appropriate to consult dictionaries to discern the ordinary meaning of a term not explicitly defined by statute or regulation.”). Consistency under CAS 413 does not require that the actuarial assumptions employed be identical to any particular current or prior long term assumption—that would be impossible given that long-term assumptions often change over time. Instead, consistency under CAS 413 merely requires that the actuarial assumptions employed, to the extent they differ from current or prior long-term assumptions, be reconcilable with those current or prior long-term assumptions.

Particularly given CAS 413’s requirement that the actuarial assumptions employed be “an estimate of future conditions affecting pension cost,” and that adjustments are to be calculated “as of the date of” the curtailment, the actuarial assumptions employed are consistent with prior long-term assumptions to the extent that any difference is based on changed circumstances or new information justifying a different estimate of future conditions as of the date of curtailment. The CAS Board has

repeatedly made this point in explaining the meaning and regulatory intent behind CAS 413, stating that consistency does not “prevent contractors from using assumptions that have been revised based on . . . a change in a plan’s investment policy”:

Consistent with the requirement that actuarial assumptions be individual best-estimates of future long-term economic and demographic trends, this final rule requires that the assumptions used to determine the actuarial liability be consistent with the assumptions that have been in use. This is consistent with the fact that the pension plan is continuing even though the segment has closed or the earning of future benefits has been curtailed. The Board does not intend this rule to prevent contractors from using assumptions that have been revised based on a persuasive actuarial experience study or a change in a plan's investment policy.

Cost Accounting Standards for Composition, Measurement, Assignment, and Allocation of Pension Costs, 60 Fed. Reg. 16,534, 16,539 (Mar. 30, 1995). The Board repeated this point in 2010:

The segment closing provision continues to require that the actuarial accrued liability be based on “actuarial assumptions that are “consistent with the current and prior long term assumptions used in the measurement of pension costs.” The assumptions used to measure the going concern liability may be influenced by modifications to the investment policy for the plan based on changed circumstances (Gould, Inc., ASBCA 46759, Sept. 19, 1997) or a persuasive experience study. This is the same position the Board held when CAS 413 was amended in 1995 . . . .

Harmonization of Cost Accounting Standards 412 and 413 With the Pension Protection Act of 2006, 75 Fed. Reg. 25,982, 25,998 (May 10, 2010).

The Boards of Contract Appeals and Court of Federal Claims have also confirmed that a contractor can change actuarial assumptions if it can support the reasonableness of the change. For example, in *Raytheon Co. v. United States*, 105 Fed. Cl. 236 (2012), the contractor changed its actuarial assumptions with regard to the retirement of plan participants in preparing its segment closing adjustment calculations. The Court held that this was appropriate because “Raytheon was able to support the change in its retirement assumption with evidence to show the number of pension eligible

employees and with expert opinion to the effect that employees eligible to collect a retirement will ordinarily do so when a segment is closed.” 105 Fed. Cl. at 281. Similarly, in *Gould, Inc.*, ASBCA No. 29254, 97-2 BCA ¶ 59682 (1997), which the CAS Board cited in the preamble of the 2010 proposed rule, the Board analyzed whether it was reasonable for the contractor to change its interest rate assumptions. The Board recognized that this was a fact-based inquiry that needed to be considered “both on an assumption-by-assumption and an aggregate basis.” *Id.*

**3. The Actuarial Assumptions Employed by First Coast Are Reasonable Estimates of Estimates of Future Conditions; the Historical Assumptions Employed by HHS OIG Are Not.**

First Coast’s best estimate of the future rate of return on plan assets as of the curtailment date, January 1, 2011, is 6.50%. Although the long term interest rate assumption approved by CMS for measuring pension costs under CAS 412 was 7.50% as of January 1, 2010, First Coast’s lower assumption for 2011 reflects both a change in the Plan’s investment policy and broader changed circumstances in the market. Between January 1, 2010, and January 1, 2012, the Plan shifted its asset allocation from 35-45% debt securities to 80% debt securities. First Coast’s change in investment policy mirrors standard practice of pension plans to shift to more conservative, fixed-income asset allocations once benefits cease accruing under the plans. The reasonableness of First Coast’s 6.50% long-term interest rate assumption is confirmed by the Plan’s subsequent experience. Since January 1, 2012, the expected return on assets assumption used by First Coast for Generally Accepted Accounting Principles (“GAAP”) financial reporting purposes has ranged from 5.50% to 5.75%.

Additionally, First Coast’s best estimate of the long-term lump sum conversion interest rate as of the curtailment date, January 1, 2011, is 6.00%. Interest rates have continued to decline since 2010. The table below shows that interest rates for long-term high quality corporate debt securities have

averaged less than 6.00% over the past 7 years, using the Plan’s financial reporting discount rate assumption as a proxy for a single equivalent high quality corporate bond rate:

| Measurement Date | GAAP Financial Reporting Audited Discount Rate |
|------------------|--|
| 1/1/2018         | 3.75%  |
| 1/1/2017         | 4.40%  |
| 1/1/2016         | 4.75%  |
| 1/1/2015         | 4.25%  |
| 1/1/2014         | 5.25%  |
| 1/1/2013         | 4.50%  |
| 1/1/2012         | 5.00%  |
| 1/1/2011         | 6.00%  |
| 1/1/2010         | 6.50%  |

To further support this point using data from the U.S. Department of the Treasury, the Treasury High Quality Market (HQM) Corporate Bond Yield Curve shows the same trends with these types of interest rates, using the 20-year spot rate as a proxy for a single equivalent rate:

| Year                 | Range of 20-Year Spot Rates from HQM Corporate Bond Yield Curve | Average of 20-Year Spot Rates from HQM Corporate Bond Yield Curve |
|----------------------|---|---|
| 2018 (through April) | 4.00%-4.31%   | 4.21%   |
| 2017                 | 3.93%-4.50%   | 4.22%   |
| 2016                 | 3.92%-4.79%   | 4.34%   |
| 2015                 | 4.08%-4.85%   | 4.57%   |
| 2014                 | 4.42%-5.18%   | 4.74%   |
| 2013                 | 4.53%-5.41%   | 5.04%   |
| 2012                 | 4.34%-5.04%   | 4.66%   |
| 2011                 | 5.02%-6.11%   | 5.63%   |
| 2010                 | 5.55%-6.41%   | 5.97%   |

See <https://www.treasury.gov/resource-center/economic-policy/corp-bond-yield/Pages/Corp-Yield-Bond-Curve-Papers.aspx>.

If anything, First Coast's long-term interest rate and lump sum conversion interest rate assumptions could be considered optimistic in light of the declining interest rate environment. Use of assumptions (audited by PricewaterhouseCoopers) as of January 1, 2012, would yield a \$20,400,000 curtailment adjustment in First Coast's favor.<sup>1</sup>

Regardless, the reasonableness of First Coast's actuarial assumptions is confirmed by their use by the Office of Personnel Management ("OPM") in calculating the adjustment to Florida Blue's Federal Employee Health Benefits ("FEHB") contract for this same curtailment. Florida Blue and OPM used a CAS valuation interest rate of 6.50% and a long term lump sum conversion interest rate of 6.00% to calculate that adjustment, consistent with the rates that First Coast has employed.

By contrast, the Draft Audit Report uses "the historical rate of 7.50 percent" for the long-term interest rate assumption. Draft Report at 4. The Draft Audit Report states that use of this "historical rate" was based on "consultation with CMS," but otherwise provides no explanation how the rate was derived. Based on communications between HHS OIG and First Coast, First Coast understands that HHS OIG and CMS selected 7.50% because that was the long-term interest rate assumption as of January 1, 2010. Similarly, the Draft Audit Report uses a 6.75% long-term lump sum conversion interest rate assumption but provides no explanation how that assumption was derived. Again, First Coast understands from subsequent communications with HHS OIG that 6.75% was selected because that was the long-term lump sum conversion interest rate assumption as of January 1, 2010.

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<sup>1</sup> First Coast's assumptions are based on the date of the curtailment, but CAS 413 expressly contemplates that a different date can be used to calculate an adjustment if use of the curtailment date "can result in an inequitable calculation." 48 C.F.R. § 9904.413(c)(12)(iii). In the interest of reaching agreement with CMS on this issue, First Coast has not requested that a different date be used, only that CMS accept as reasonable the use of a 6.50% CAS valuation interest rate and a 6.00% long-term lump sum conversion interest rate.

The Draft Report does not attempt to explain how either assumption represents a reasonable estimate of future conditions as of the effective date of curtailment. The Draft Report acknowledges that First Coast provided an analysis of the plan's asset allocation and general market conditions to support the actuarial assumptions that First Coast employed. The Draft Report provides no discussion of First Coast's analysis, and does not attempt to refute First Coast's showing that the actuarial assumptions First Coast employed represent reasonable assumptions of future conditions as of the effective date of the curtailment. Instead, the Draft Report summarily concludes that CMS determined that First Coast's actuarial assumptions "do not reflect prior long-term assumptions as required by CAS," and states that the use of 2010 historical assumptions "complies with CAS 413.50(c)(12)(i)." Draft Report at 4. *Id.* The Draft Report does not address OPM's endorsement of First Coast's actuarial assumptions, or explain why different actuarial assumptions should be used to adjust costs on different contracts based on the same curtailment.

Accordingly, it is CMS, not First Coast, that has misapplied CAS 413. Arbitrarily selecting historical assumptions from a single year without any regard for changes in asset allocation and market conditions that caused those assumptions to change from one year to another, and which caused those assumptions to be different as of the effective date of the curtailment, does not in any way achieve the consistency required by CAS 413. HHS OIG's historical assumptions are simply that—point in time assumptions that have been overtaken by events. They do not satisfy the basic requirement of an actuarial assumption under CAS 413 or the requirement that adjustments be calculated as of the effective date of curtailment, because they do not attempt to represent estimates of future conditions affecting pension costs based on all information available as of the date of the curtailment.

\* \* \*

Based on the foregoing, HHS OIG should revise its Draft Audit Report and accept the actuarial assumptions employed by First Coast in calculating the adjustment of previously determined pension costs required as a result of the curtailment.