

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**

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September 2018
A-07-18-00535

Office of Inspector General

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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.

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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,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 the Medicare Part B North jurisdiction; these contracts had originally been 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, 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.

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to MACs between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

² Medicare Parts A and B Jurisdiction 9 consists of the State of Florida and the territories of Puerto Rico and the U.S. Virgin Islands.

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

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

	Per FCSO	Per Audit	Difference
Medicare Segment Assets as of December 31, 2010	\$34,600,992	\$34,600,992	\$0
Medicare Segment Liabilities as of December 31, 2010 ⁴	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%
Excess Liabilities Attributable to Medicare	(\$10,315,499)	(\$3,685,907)	(\$6,629,592)

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

⁴ 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 \$3,685,907.⁵ 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.

⁵ 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 liability⁶ 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)).⁷ 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.⁸ 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).

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

⁷ 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.

⁸ 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

	2004	2005	2006	2007	2008	2009	2010
Long-Term Interest Rate (%)	7.50	7.50	7.50	7.50	7.50	8.00	7.50
Long-Term Lump Sum Conversation Rate (%)	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."