



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

DEC 07 2006

Report Number: A-07-06-00225

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

Dear Ms. Coston:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Segmented Postretirement Benefit Assets at First Coast Service Options from January 1, 2002 To January 1, 2005." A copy of this report will be forwarded to the HHS action official noted on the following page for review and any action deemed necessary.

The action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, extension 274, or Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-06-00225 in all correspondence.

Sincerely yours,

for 
Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

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

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF SEGMENTED
POSTRETIREMENT BENEFIT
ASSETS AT FIRST COAST SERVICE
OPTIONS FROM JANUARY 1, 2002
TO JANUARY 1, 2005**



Daniel R. Levinson
Inspector General

December 2006
A-07-06-00225

Office of Inspector General

<http://oig.hhs.gov>

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OAS FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

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

In 2002, FCSO submitted a request to CMS to change to segmented accrual accounting for PRBs. FCSO also established a Voluntary Employee Benefit Association (VEBA) trust for the purpose of funding annual accruals. As part of its request, FCSO identified and updated Medicare segment PRB assets from January 1, 2002 to January 1, 2005.

OBJECTIVE

Our objective was to determine whether FCSO properly identified and updated the Medicare segment's portion of PRB assets from January 1, 2002 to January 1, 2005.

SUMMARY OF FINDINGS

FCSO did not properly update the Medicare segment's PRB assets from January 1, 2002 to January 1, 2005. As a result, FCSO understated segment assets as of January 1, 2005 by \$13,018. The understatement resulted from the approach used in allocating contributions and prepayment credits to the Medicare segment.

RECOMMENDATION

We recommend that FCSO increase the Medicare segment PRB assets by \$13,018 as of January 1, 2005.

AUDITEE'S COMMENTS

FCSO agreed with our recommendation and stated that it would increase its Medicare segment pension assets by \$13,018 as of January 1, 2005.

INTRODUCTION

BACKGROUND

FCSO and Medicare

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

Regulations

Medicare reimburses a portion of the funded accruals that contractors charge for their PRB plans. The FAR states that accrual accounting may be used to determine allowable PRB costs if the cost is measured and assigned (actuarially determined) according to generally accepted accounting principles. FAR 31.205-6(o) requires that PRB accrual costs be funded into a dedicated trust fund, such as a Voluntary Employee Benefit Association (VEBA) trust. The FAR also states that allowable costs must be funded by the time set for filing the Federal income tax return or any extension thereof, and must comply with the applicable standards promulgated by the CAS Board.

FCSO's Request To Use Segmented PRB Accrual Accounting

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

In 2002, FCSO submitted a request to CMS to change to segmented accrual accounting for PRBs. FCSO, through its parent company, participates in a VEBA trust for the purpose of funding annual accruals.² Since the request specified segmented accounting for the Medicare segment, FCSO identified and updated the Medicare segment's PRB assets from January 1, 2002 to January 1, 2005.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether FCSO properly identified and updated the Medicare segment's portion of PRB assets from January 1, 2002 to January 1, 2005.

¹FCSO's parent company, Blue Cross Blue Shield of Florida, Inc., novated the contracts to FCSO effective October 1, 2003. Prior to that, FCSO managed the contracts by special power of attorney on behalf of its parent company.

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

Scope

We reviewed FCSO's identification of the Medicare segment, and its identification and update of Medicare PRB assets from January 1, 2002, to January 1, 2005.

Achieving our objectives did not require us to review FCSO's overall internal control structure. However, in response to FCSO's implementation of segmented PRB accounting, we did review controls relating to the identification of the Medicare segment and the update of the segment PRB assets.

We performed fieldwork at FCSO's office in Jacksonville, Florida during February 2006.

Methodology

In performing this review, we used information provided by FCSO's actuarial consulting firm. The information included assets, post retirement benefit obligations, service costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed FCSO's accounting records, PRB plan documents, VEBA trust transaction documents, and PRB actuarial valuation reports, which included Statement of Financial Accounting Standards 106 information. The CMS Office of the Actuary staff used the documents, with relevant provisions of CAS 413 serving as authoritative guidance, to calculate Medicare segment PRB assets as of January 1, 2005. We reviewed the methodology and calculations.

We performed this review in conjunction with our audit of PRB costs claimed for Medicare reimbursement (A-07-06-00213). We used the information obtained and reviewed during that audit in performing this review. We also used information obtained and reviewed in conjunction with our audit of pension segmentation requirements (A-07-04-00172). The information included the identification of the Medicare segment and the Medicare segment participants.

Details of the Medicare segment's updated PRB assets from January 1, 2002, to January 1, 2005, are presented as Appendix A.

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

FINDINGS AND RECOMMENDATION

In the Medicare segment PRB asset update, FCSO did not properly account for contributions and prepayments, or earnings and expenses. We compared our audited rollup of segment assets (\$5,344,237) to FCSO's proposed segment assets (\$5,331,219), and determined that FCSO understated Medicare segment PRB assets as of January 1, 2005.

The primary reason for the understatement was the actuarial approach used by FCSO in allocating contributions and prepayment credits to the Medicare segment. This led to an overstatement of contributions and prepayments as well as an understatement of earnings and expenses. As a result, FCSO understated the January 1, 2005, Medicare segment PRB assets by \$13,018. The accumulated understatement of Medicare segment assets is shown in Table 1.

Table 1: Summary of PRB Asset Adjustments	
Contributions and Prepayment Transfers	(\$112,912)
Earnings and Expenses	125,930
(Over)/Understatement	\$13,018

COMPONENTS OF ASSET UPDATE

Contributions and Prepayment Transfers Overstated

FCSO's proposed contributions were overstated by \$112,912. FCSO's actuarial approach for allocating contributions and prepayment credits to the Medicare segment's PRB assets is the primary reason for the difference between audited and proposed contributions and prepayment transfers. FCSO's methodology did not first use prepayment credits, which are available at the beginning of the year, to cover current year accrued costs.

Earnings and Expenses Understated

Moreover, FCSO's investment earnings were understated by \$125,930. The understatement of net investment earnings was also due to the approach used to allocate proposed contributions and prepayment credits.

UNDERSTATEMENT OF MEDICARE SEGMENT PRB ASSETS

These discrepancies resulted from the fact that FCSO did not properly update the Medicare segment's PRB assets. As a result, the Medicare segment's PRB assets were understated by \$13,018 as of January 1, 2005.

RECOMMENDATION

We recommend that FCSO increase the Medicare segment PRB assets by \$13,018 as of January 1, 2005.

AUDITEE'S COMMENTS

FCSO agreed with our recommendation and stated that it would increase its Medicare segment pension assets by \$13,018 as of January 1, 2005.

OTHER MATTERS

In its request to change to segmented accrual accounting, FCSO stated that it would make adjustments for participants who transfer into and out of the Medicare segment. However, FCSO's asset update did not contain participant transfer adjustments. While we determined there was no material effect during the current audit period, we must point out that future asset updates could be misstated if FCSO does not properly adjust for transfers.

APPENDIXES

**First Coast Service Options
Statement of Medicare PRB Assets
For The Period
January 1, 2002 To January 1, 2005**

APPENDIX A

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Description		Total Company	Other Segment	Medicare Segment
Assets January 1, 2002	<u>1/</u>	\$0	\$0	\$0
Prepayment Transfer		0	0	0
Contributions	<u>2/</u>	13,342,000	11,390,636	1,951,364
Claims Paid	<u>3/</u>	0	0	0
Claims Reimbursed	<u>4/</u>	(2,255,000)	(1,733,278)	(521,722)
Investment Return	<u>5/</u>	4,267	3,717	550
Transfers	<u>6/</u>	0	0	0
Assets January 1, 2003		11,091,267	9,661,075	1,430,192
Prepayment Transfer	<u>7/</u>	0	(575,532)	575,532
Contributions		18,861,000	16,960,541	1,900,459
Claims Paid		0	0	0
Claims Reimbursed		(2,286,449)	(1,656,591)	(629,858)
Investment Return		128,167	105,666	22,501
Transfers		0	0	0
Assets January 1, 2004		27,793,985	24,495,159	3,298,826
Prepayment Transfer		0	(1,903,276)	1,903,276
Contributions		18,126,000	17,398,552	727,448
Claims Paid		0	0	0
Claims Reimbursed		(3,566,236)	(2,634,801)	(931,435)
Investment Return		1,894,960	1,548,838	346,122
Transfers		0	0	0
Assets January 1, 2005		\$44,248,709	\$38,904,472	\$5,344,237
Per FCSO	<u>8/</u>	\$44,248,709	\$38,917,490	\$5,331,219
Asset Variance	<u>9/</u>	\$0	(\$13,018)	\$13,018

**First Coast Service Options
Statement of Medicare PRB Assets
For The Period
January 1, 2002 To January 1, 2005**

FOOTNOTES

- 1/ We obtained Total Company assets from PRB actuarial valuation reports. The Total Company represents the parent company of First Coast Service Option's (FCSO), Blue Cross Blue Shield of Florida. Since 2002 was the year the trust was established, there were no initial assets assigned to the Medicare Segment. The Medicare Segment represents FCSO. The amounts shown for the Other Segment represent the difference between the Total Company and the Medicare Segment. All PRB assets are shown at market value.
- 2/ We obtained Total Company contribution amounts from the PRB actuarial valuation reports and trust transaction documentation. We allocated Total Company contributions to the Medicare Segment based on the ratio of the Medicare Segment funding target divided by the Total Company funding target. Contributions in excess of the funding targets were treated as prepayment credits and accounted for in the Other Segment until needed to fund PRB costs in the future. For 2002, the amounts shown include the amounts deposited into the trust and benefits paid from non-trust funds. For all subsequent years, the amounts here represent funds deposited into the trust. Contributions deposited after the end of the year and prior to the tax filing deadline were discounted at the FAS 106 long-term rate of return from the date of deposit to the end of the plan year to which they were assigned.
- 3/ Claims paid represent benefits paid directly from the trust fund.
- 4/ Claims Reimbursed represent the amounts previously paid from corporate funds and now reimbursed by the trust. We obtained Claims Reimbursed amounts from documents provided by FCSO and prepared by its actuarial consulting firm.
- 5/ We obtained investment earnings from the PRB actuarial valuation reports and documents prepared by FCSO's actuarial consulting firm. We allocated investment earnings based on the ratio of the segment's Weighted Average Value (WAV) of assets to Total Company WAV of assets. FCSO used the same methodology.
- 6/ FCSO stated that it would make asset transfers to account for participant transfers between segments. However, FCSO made no such adjustments. We determined that participant transfers during the audit period were immaterial. See Other Matters section of report.

**First Coast Service Options
Statement of Medicare PRB Assets
For The Period
January 1, 2002 To January 1, 2005**

APPENDIX A
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- 7/ A prepayment credit represents the accumulated value of premature funding from the previous year(s) and is available as of the first day of the plan year to cover, or help cover, the cost assigned to that period. Prepayment credits are accounted for as a part of the Other Segment assets and are transferred to the Medicare Segment as of the first day of each plan year to cover the cost assigned to that year.
- 8/ We obtained asset amounts as of January 1, 2005, from the 2005 PRB actuarial valuation report.
- 9/ The asset variance represents the difference between our calculation of Medicare Segment assets and FCSO's market value of assets.



A CMS CONTRACTED INTERMEDIARY & CARRIER



MEDICARE

Sandy Coston
President & COO
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November 28, 2006

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

Reference: A-07-06-00225

Dear Mr. Cogley:

This letter is in response to the Department of Health and Human Services, Office of Inspector General's draft report for the review of First Coast Service Options, Inc.'s segmentation of post-retirement benefit assets for the period January 1, 2002 - January 1, 2005.

We agree with the report finding regarding the understatement of Medicare segment assets and will take the following action to ensure the report recommendation is implemented:

Make adjustments to increase the Medicare segment pension assets by \$13,018 as of January 1, 2005.

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

Sincerely,

Sandy Coston

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

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