

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**FIRST COAST SERVICE OPTIONS, INC.,
GENERALLY CLAIMED ALLOWABLE
PENSION COSTS THROUGH ITS
INCURRED COST PROPOSALS**

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

July 2018
A-07-18-00534

Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

Report in Brief

Date: July 2018

Report No. A-07-18-00534

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL



Why OIG Did This Review

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

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

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

Our objective was to determine whether the calendar years (CYs) 2008 through 2010 pension costs that First Coast Service Options, Inc. (FCSO), claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

How OIG Did This Review

We reviewed \$6.68 million of Medicare pension costs that FCSO reported on its ICPs for CYs 2008 through 2010.

First Coast Service Options, Inc., Generally Claimed Allowable Pension Costs Through Its Incurred Cost Proposals

What OIG Found

The CYs 2008 through 2010 pension costs that FCSO claimed for Medicare reimbursement, and reported on its ICPs, were generally allowable and correctly claimed. Specifically, FCSO claimed Medicare pension costs of \$6.68 million for Medicare reimbursement, through its ICPs, for CYs 2008 through 2010. However, we determined that the allowable Cost Accounting Standards-based pension costs during this period were \$6.64 million. The difference, \$43,835, represented unallowable Medicare pension costs that FCSO claimed on its ICPs for CYs 2008 through 2010. FCSO claimed these unallowable Medicare pension costs primarily because it based its claim for Medicare reimbursement on incorrectly computed assignable pension costs.

What OIG Recommends and Auditee Comments

We recommend that FCSO work with CMS to ensure that FCSO's final settlement of contract costs reflects a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

FCSO concurred with our recommendation and stated that it would work with CMS to ensure that final settlement costs reflect a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

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INTRODUCTION

WHY WE DID THIS REVIEW

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

At CMS's request, the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services, Region VII pension audit team reviews the cost elements related to qualified defined-benefit, nonqualified defined-benefit, postretirement benefit, and any other pension-related cost elements claimed by Medicare fiscal intermediaries and carrier contractors and Medicare administrative contractors (MACs) through Final Administrative Cost Proposals and/or Incurred Cost Proposals (ICPs).

For this review, we focused on one Medicare contractor, First Coast Service Options, Inc. (FCSO). In particular, we examined the FCSO Medicare segment and Other segment pension costs that FCSO claimed for Medicare reimbursement and reported on its ICPs.

OBJECTIVE

Our objective was to determine whether the calendar years (CYs) 2008 through 2010 pension costs that FCSO claimed for Medicare reimbursement, and reported on its ICPs, were allowable and correctly claimed.

BACKGROUND

First Coast Service Options, Inc.

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 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 (after our audit period), C2C was sold to TMF Health Quality Institute.

FCSO and C2C employees participated in a qualified 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 qualified pension plan, which triggered a curtailment of employee benefits under CAS 413. This report addresses the Medicare segment allowable pension costs that FCSO claimed under the provisions of its MAC-related contracts.

The disclosure statement that FCSO submits to CMS states that FCSO uses pooled cost accounting. Medicare contractors use pooled costing to calculate the indirect cost rates that they submit on their ICPs. The pension costs are included in the computations of the indirect cost rates reported on the ICPs. CMS uses these indirect cost rates when reimbursing costs for cost-plus-award-fee type contracts.^{4, 5}

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.

⁴ A cost-plus-award-fee contract is a cost reimbursement contract that provides a fee consisting of (a) a base amount fixed at inception of the contract and (b) an award amount, based on a judgmental evaluation by the Federal Government.

⁵ At the end of each CY, each MAC submits to CMS an ICP that reports the Medicare direct and indirect costs that the contractor incurred during that year. The ICP and supporting data provide the basis for the CMS Contracting Officer and the Medicare contractor to determine the final billing rates for allowable Medicare costs.

Medicare Reimbursement of Pension Costs

CMS reimburses a portion of the annual contributions that contractors make to their pension plans. The pension costs are included in the computation of the indirect cost rates reported on the ICPs. In turn, CMS uses indirect cost rates in reimbursing costs under cost-reimbursement contracts. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413 and (2) funded as specified by part 31 of the FAR. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, the CAS, and the Medicare contracts. The cognizant Contracting Officer will perform a final settlement with the contractor to determine the final indirect cost rates. These rates ultimately determine the final costs of each contract.⁶

Previous Audit of Allocable Pension Costs

We previously reviewed FCSO's allocable pension costs (A-07-16-00493, Oct. 30, 2017). This report identified the allocable pension costs that FCSO should have used when calculating its indirect cost rates for CYs 2008 through 2010. We recommended that FCSO:

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

Incurred Cost Proposal Audits

At CMS's request, the Defense Contracting Audit Agency (DCAA), Mayer Hoffman McCann P.C. (MHM), and CliftonLarsenAllen LLP (CLA) performed audits of the ICPs that FCSO and C2C⁷ submitted for CYs 2008 through 2010. The objectives of the DCAA, MHM, and CLA reviews were to determine whether the costs were allowable in accordance with the FAR and the HHS Acquisition Regulations.

For this audit, we relied on the DCAA, MHM, and CLA audits' findings and recommendations when computing the allowable pension costs discussed in this report.

⁶ In accordance with FAR 42.705-1(b)(5)(ii) and FAR 42.705-1(b)(5)(iii)(B), the cognizant Contracting Officer shall "[p]repare a written indirect cost rate agreement conforming to the requirements of the contracts" and perform a "[r]econciliation of all costs questioned, with identification of items and amounts allowed or disallowed in the final settlement," respectively.

⁷ C2C's ICP audit for CYs 2008 and 2009 determined that the ICP submissions were inadequate. We received resubmitted ICPs from C2C and used those resubmissions in our calculation of the PRB costs claimed for C2C. The resubmitted ICPs have not been reviewed or audited to determine whether the costs were allowable in accordance with the FAR and the HHS Acquisition Regulations.

We incorporated the results of the DCAA, MHM, and CLA audits into our computations of the audited indirect cost rates, and ultimately the pension costs claimed, for the contracts subject to the FAR. CMS will use our report on allowable pension costs, as well as the DCAA, MHM, and CLA audit reports, to determine the final indirect cost rates and the total allowable contract costs for FCSO for CYs 2008 through 2010.

HOW WE CONDUCTED THIS REVIEW

We reviewed \$6,682,088 of Medicare pension costs that FCSO reported on its ICPs for CYs 2008 through 2010.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

Appendix A contains details of our audit scope and methodology.

FINDING

The CYs 2008 through 2010 pension costs that FCSO claimed for Medicare reimbursement, and reported on its ICPs, were generally allowable and correctly claimed. Specifically, FCSO claimed Medicare pension costs of \$6,682,088 for Medicare reimbursement, through its ICPs, for CYs 2008 through 2010. However, we determined that the allowable CAS-based pension costs during this period were \$6,638,253. The difference, \$43,835, represented unallowable Medicare pension costs that FCSO claimed on its ICPs for CYs 2008 through 2010. FCSO claimed these unallowable Medicare pension costs primarily because it based its claim for Medicare reimbursement on incorrectly computed assignable pension costs.

CLAIMED MEDICARE PENSION COSTS

FCSO claimed pension costs of \$6,682,088 for CYs 2008 through 2010. We calculated the allowable Medicare pension costs based on separately computed CAS-based pension costs for the Medicare segment and the Other segment in accordance with CAS 412 and 413.

UNALLOWABLE MEDICARE PENSION COSTS CLAIMED

After incorporating the results of the DCAA, MHM, and CLA ICP audits and the allocable costs from our previous review of FCSO's allocable pension costs (A-07-16-00493) into our calculations of costs for this audit, we determined that the allowable CAS-based pension costs for CYs 2008 through 2010 were \$6,638,253. Thus, FCSO claimed \$43,835 of unallowable Medicare pension costs on its ICPs for CYs 2008 through 2010. This overclaim occurred

primarily because FCSO based its allowable pension costs on incorrectly computed assignable pension costs.

During our previous audit (A-07-16-00493, Oct. 30, 2017), we determined the allocable pension costs for the Medicare segment and the Other segment and then used those costs to determine the allowable pension costs for Medicare reimbursement. Tables 1 and 2 below show the allocable CAS-based pension costs that we determined for the Medicare segment and the Other segment, respectively, for CYs 2008 through 2010.

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

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

Table 2: Comparison of Allocable Pension Costs for the Other Segment

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

We then used this information to adjust the indirect cost rates (i.e., fringe, general and administrative, and overhead rates) and, in turn, to calculate the information presented in Table 3 on the following page. Our calculation is not presented in this report because those rate calculations that FCSO used in its ICPs, and to which we referred as part of our review, are proprietary information.

Accordingly, Table 3 on the following page compares the Medicare pension costs that we calculated (using our adjusted indirect cost rates) to the pension costs that FCSO claimed for Medicare reimbursement for CYs 2008 through 2010.

Table 3: Medicare Pension Costs⁸

Calendar Year	Per Audit	Per FCSO⁹	Difference
2008	\$1,598,128	\$1,572,588	\$25,540
2009	2,458,877	2,482,269	(23,392)
2010	2,581,248	2,627,231	(45,983)
Total Overclaim of Pension Costs	\$6,638,253	\$6,682,088	(\$43,835)

RECOMMENDATION

We recommend that FCSO work with CMS to ensure that FCSO's final settlement of contract costs reflects a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

AUDITEE COMMENTS

In written comments on our draft report, FCSO concurred with our recommendation and stated that it would work with CMS to ensure that final settlement costs reflect a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

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

⁸ Our calculations incorporated the rate ceilings associated with the Medicare Parts A and B contracts. We applied the indirect cost rates associated with these contracts when computing the allowable pension costs for the Medicare Parts A and B contracts. The amounts identified in this table represent the allowable Medicare pension costs during our audit period and do not represent the total allowable costs on the ICPs.

⁹ We calculated the CY "Per FCSO" amounts for each CY by taking the "Per Audit" amount less the "Difference" amount. Because of the complexity of the ICP calculations, and the difficulty involved in tracking one specific plan's costs throughout the ICP, we used a percentage of the differences to allocate the total ICP difference to the qualified pension plan. While we computed the amounts contained in the "Per FCSO" column, we believe that these are a material representation of the costs actually claimed by FCSO.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed \$6,682,088 of Medicare pension costs that FCSO reported on its ICPs for CYs 2008 through 2010.

Achieving our objective did not require that we review FCSO's overall internal control structure. We limited our review to the internal controls related to the pension costs that were included in FCSO's ICPs and ultimately used as the basis for Medicare reimbursement, to ensure that the pension costs were allocable in accordance with the CAS and allowable in accordance with the FAR.

We performed our fieldwork at FCSO in Jacksonville, Florida.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed information provided by FCSO to identify the amount of pension costs claimed for Medicare reimbursement for CYs 2008 through 2010;
- reviewed the results of the DCAA, MHM, and CLA ICP audits and incorporated those results into our calculations of allowable pension costs;
- incorporated information from our previous audit report (A-07-16-00493; see below); 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 those audits for this review:

- *First Coast Service Options, Inc., Understated Its Allocable Pension Costs* (A-07-16-00493, Oct. 30, 2017),
- *First Coast Service Options, Inc.'s, Postretirement Benefit Costs Were Reasonable and Allowable* (A-07-17-00501),
- *First Coast Service Options, Inc., Overstated Medicare's Share of the Medicare Segment Excess Pension Liabilities* (A-07-18-00535), 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 finding and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REQUIREMENTS RELATED TO REIMBURSEMENT OF PENSION COSTS

FEDERAL REGULATIONS

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

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

Federal regulations (CAS 403) address the allocation of the expenses of an organization's home office to the segments of the organization based on beneficial or causal relationship. These regulations also address the allocation of residual home office expenses to segments.

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

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

MEDICARE CONTRACTS

The Medicare contracts require FCSO to submit invoices in accordance with FAR 52.216-7, "Allowable Cost & Payment." (See our citation to FAR 52.216-7(a)(1) in "Federal Regulations" above.)

APPENDIX C: AUDITEE COMMENTS



Harvey B. Dikter
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First Coast Service Options, Inc.
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May 30, 2018

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

Reference: A-07-18-00534

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., Generally Claimed Allowable Pension Costs Through Its Incurred Cost Proposals"*.

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

Recommendation:

First Coast work with CMS to ensure FCSO's final settlement of contract costs reflect a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

Response:

First Coast concurs with the recommendation and will work with CMS to ensure final settlement costs reflect a decrease in Medicare pension costs of \$43,835 for CYs 2008 through 2010.

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