



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

DEC 15 2006

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

Report Number: A-07-06-00217

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

Dear Ms. Coston:

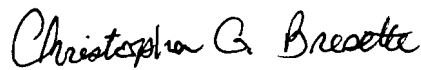
Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Supplemental Executive Retirement Plan Costs Claimed by First Coast Service Options for Medicare Reimbursement for Fiscal Years 2003 Through 2005." A copy 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](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-06-00217 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 SUPPLEMENTAL  
EXECUTIVE RETIREMENT PLAN  
COSTS CLAIMED BY FIRST COAST  
SERVICE OPTIONS FOR  
MEDICARE REIMBURSEMENT  
FOR FISCAL YEARS 2003  
THROUGH 2005**



Daniel R. Levinson  
Inspector General

December 2006  
A-07-06-00217

# *Office of Inspector General*

<http://oig.hhs.gov>

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The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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# *Notices*

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**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

## **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 (FCSO) administers Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and the Medicare contract.

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 addition, part 31 of the FAR states a cost must be reasonable in order to be allowable.

The Supplemental Executive Retirement Plan (SERP), in which FCSO participates, is maintained primarily to provide deferred compensation to a select group of management or highly compensated employees. The SERP is a nonqualified pension plan designed to restore benefits lost due to the Internal Revenue Code limits under the regular qualified plan.

### **OBJECTIVE**

Our objective was to determine the allowability of the SERP costs claimed by FCSO for Medicare reimbursement for fiscal years (FYs) 2003–2005.

### **SUMMARY OF FINDING**

FCSO claimed unallowable SERP costs for FYs 2003–2005. During this period, the allowable SERP costs were \$332,880. However, FCSO claimed SERP costs of \$414,300 for Medicare reimbursement. FCSO did not claim SERP costs in accordance with the FAR and the CAS. As a result, FCSO claimed \$81,420 of unallowable SERP costs.

### **RECOMMENDATIONS**

We recommend that FCSO revise its Final Administrative Cost Proposals for FYs 2003–2005 to reduce its claimed SERP costs by \$81,420. We also recommend that FCSO claim future SERP costs in accordance with the FAR and the CAS.

### **AUDITEE'S COMMENTS**

FCSO does not agree with the compensation benchmarks used in our calculations to establish and limit the reasonableness of SERP costs. However, FCSO has decided to revise its claims for FYs 2003–2005 to reduce claimed SERP costs by \$81,420. FCSO did not comment on our second recommendation to claim future SERP costs in accordance with the FAR and the CAS. FCSO's response is included in its entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

FCSO's decision to reduce claimed SERP costs by \$81,420 reflects a small adjustment to our original calculations. We agree with this adjustment.

# INTRODUCTION

## BACKGROUND

### FCSO and Medicare

First Coast Service Options (FCSO) administers Medicare Parts A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS).<sup>1</sup> In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and the Medicare contract.

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 addition, part 31 of the FAR states a cost must be reasonable in order to be allowable.

The Supplemental Executive Retirement Plan (SERP), in which FCSO participates,<sup>2</sup> is maintained primarily to provide deferred compensation to a select group of management or highly compensated employees. The SERP is a nonqualified defined benefit pension plan designed to restore benefits lost due to the Internal Revenue Code limits under the regular qualified plan.

## OBJECTIVE, SCOPE, AND METHODOLOGY

### Objective

Our objective was to determine the allowability of the SERP costs claimed by FCSO for Medicare reimbursement for fiscal years (FYs) 2003–2005.

### Scope

We reviewed FCSO's SERP costs claimed on its Final Administrative Cost Proposals (FACPs) for FYs 2003–2005. Achieving the objective did not require that we review FCSO's internal control structure. However, we did review the controls related to the SERP costs FCSO claimed for Medicare reimbursement to ensure that SERP costs were allowable in accordance with the FAR and the CAS.

We performed onsite audit work at FCSO's office in Jacksonville, Florida during February 2006.

### Methodology

We obtained information from FCSO and its consulting actuary regarding costs associated with the SERP for FYs 2003–2005. We identified the SERP costs for the total company including the

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<sup>1</sup>Prior to October 1, 2003, FCSO managed the contracts under a special power of attorney on behalf of its parent organization, Blue Cross Blue Shield of Florida, Inc. (BCBSF). BCBSF novated the contracts to FCSO after October 1, 2003.

<sup>2</sup>FCSO participates in its parent organization's SERP.



Medicare segment. FCSO provided us with information on its SERP benefit payments and Medicare lines of business percentages. The CMS Office of the Actuary calculated the allowable amortizable benefit for participants who received a lump-sum benefit payment in accordance with the FAR and the CAS. We reviewed the methodology and calculations used by the CMS Office of the Actuary. Where applicable, the calculations incorporated our determination of reasonable salaries.

We performed this review in conjunction with our audits of pension segmentation requirements (A-07-04-00172) and of pension costs claimed for Medicare reimbursement (A-07-04-00180). We also used the information obtained and reviewed during these audits in performing this review.

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

### **FINDING AND RECOMMENDATIONS**

FCSO claimed SERP costs that were unallowable for Medicare reimbursement for FYs 2003–2005 because it did not claim SERP costs in accordance with the FAR and the CAS. Therefore, FCSO claimed unallowable SERP costs of \$81,420 for FYs 2003–2005.

FAR 31.201-2(a) states, in part, that a cost must be reasonable to be allowable. FAR 31.205-6(b)(2) provides that comparable market data be used to evaluate the reasonableness of compensation. Furthermore, FAR 31.201-6(a) states: “When an unallowable cost is incurred, its directly associated costs are also unallowable.” SERP pension benefits are directly associated with compensation because the benefit is based on the salary history of the recipient.

According to the CAS 412-50(b)(3), the cost of defined-benefit pension plans that is accounted for under the pay-as-you-go cost method shall be based on the net amount of any periodic benefits paid, and a level annual installment required to amortize any lump-sum benefit payments over 15 years. The amortization can include an interest component.

We compared allowable SERP costs with the SERP costs claimed on FCSO’s FACPs, as shown in the table below.

<b>SERP COST CLAIMED VARIANCE</b>			
<b>Fiscal Year</b>	<b>Per OIG</b>	<b>Per FCSO</b>	<b>Difference</b>
2003	\$144,288	\$141,829	\$2,459
2004	149,638	208,191	(58,553)
2005	38,954	64,280	(25,326)
<b>Total</b>	<b>\$332,880</b>	<b>\$414,300</b>	<b>(\$81,420)</b>

For FYs 2003–2005, allowable SERP costs were \$332,880; however, FCSO claimed SERP costs of \$414,300 for Medicare reimbursement. The overclaim occurred because FCSO did not claim SERP costs in accordance with the FAR and the CAS.

FCSO elected to account for SERP costs based on the pay-as-you-go accounting method. Costs were based on periodic payments made to SERP recipients, plus a 15 year amortization of lump

sum SERP payments. FCSO omitted several SERP payments from its claim and did not include an interest component in the determination of the amortization installments. Our calculations took into account both the omitted SERP payments and an allowable interest component in the lump sum amortizations. The amortizations were based on the interest rate used to determine costs for the qualified defined benefit pension plan.

FCSO's claim also included an amortization charge for a SERP lump sum payment that, for Medicare reimbursement, should have been computed using reasonable salaries. By not limiting the associated salaries to a reasonable level, FCSO overstated the allocable SERP payment. This resulted in an overclaim of SERP costs for Medicare reimbursement. As stated above, if a portion of compensation is unreasonable, it is unallowable for purposes of computing any directly associated costs. Our calculations applied a reasonable limit to the associated salaries in order to determine allowable SERP costs for Medicare reimbursement.<sup>3</sup>

## **RECOMMENDATIONS**

We recommend that FCSO revise its FACPs for FYs 2003–2005 to reduce its claimed SERP costs by \$81,420. We also recommend that FCSO claim future SERP costs in accordance with the FAR and the CAS.

## **AUDITEE'S COMMENTS**

FCSO does not agree with the benchmarks used in our calculations to establish and limit the reasonableness of compensation upon which the claimed SERP costs were based. FCSO has determined, however, that the proposed adjustment does not justify further contention of the issue and will revise its claims for FYs 2003–2005 to reduce claimed SERP costs by \$81,420. FCSO did not comment on our second recommendation to claim future SERP costs in accordance with the FAR and the CAS. FCSO's response is included in its entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

FCSO's decision to reduce claimed SERP costs by \$81,420 reflects a small adjustment to our original calculations. We agree with this adjustment.

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<sup>3</sup>We used the FAR 31.205-6(p) executive compensation limits as a comparable market benchmark of reasonable compensation.

# **APPENDIXES**

**FIRST COAST SERVICE OPTIONS  
STATEMENT OF ALLOWABLE SERP COSTS  
FOR FISCAL YEARS 2003-2005**

Fiscal Year	Amortized Allocable Lump- Sum Benefit Payments 1/	Allocable Annuity Benefit Payments 2/	Allocable Total Benefit Payments 3/	Medicare LOB% 4/	Medicare Allowable SERP Costs 5/
2003	\$ 53,682	\$ 1,148,716	\$ 1,202,398	12.00%	\$ 144,288
2004	310,295	1,153,874	1,464,169	10.22%	149,638
2005	120,065	292,147	412,212	9.45%	38,954
	<u>\$ 484,042</u>	<u>\$ 2,594,737</u>	<u>\$ 3,078,779</u>		<u>\$ 332,880</u>

**FOOTNOTES**

- 1/ FCSO provided schedules of lump-sum benefit payments. These were verified against supporting documentation. In accordance with CAS 412.50 (b)(3), we amortized the allocable lump sum benefit payments, including an interest equivalent, over a 15 year period. The interest component was computed at the rate used to determine costs for the qualified pension plan. The rate was 8% for payments made during fiscal year (FY) 2003 and 7.5% for payments made during FYs 2004 and 2005.
- 2/ FCSO provided a schedule of annuity payments for each FY. These were verified against supporting documentation.
- 3/ Allocable total benefit payments are the sum of (i) amortized allocable lump-sum benefit payments and (ii) allocable annuity benefit payments.
- 4/ FCSO provided the total company Medicare line of business (LOB) percentage for each FY. We verified the percentages and determined that they were reasonable.
- 5/ Medicare allowable SERP costs are the allocable total benefit payments multiplied by the Medicare LOB%. For FY 2005, we followed FCSO and its parent organization's corporate sensitive data decision to exclude certain SERP costs.



A CMS CONTRACTED INTERMEDIARY & CARRIER



**MEDICARE**

December 7, 2006

Sandy Coston  
President & COO  
First Coast Service Options  
Sandy.Coston@fcsso.com

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 12<sup>th</sup> Street, Room 284A  
Kansas City, Missouri 64106

**Reference: A-07-06-00217**


Dear Mr. Cogley:

We previously transmitted via e-mail our comments, proposed revisions, and management response regarding the Department of Health and Human Services, Office of Inspector General's draft report for the review of Supplemental Executive Retirement Benefits (SERP) claimed by First Coast Service Options, Inc. (FCSO) for Medicare reimbursement for fiscal years 2003 – 2005. We have included the management response as an attachment to this letter, for your reference.

During this review, FCSO engaged the OIG and CMS in extensive dialogue regarding the allowability of certain SERP costs. We again reiterate our disagreement with the methodology and principles underlying the recommendation to reduce claimed SERP costs. We have determined, however, that such an amount does not justify the expense of further contention for either party. Therefore, FCSO will revise claims for fiscal years 2003-2005 to reduce claimed SERP costs by \$81,420.

We appreciate the opportunity to review and provide comments prior to release of the final report. If you have any questions regarding our response, please contact Mr. Gregory W. England at 904-791-8364.

Sincerely,

  
Sandy Coston

Attachment

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

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532 Riverside Avenue, Jacksonville, Florida 32202  
Tel: 904-791-8409  
Fax: 904-357-6344  
www.fcsso.com

**Management Response**

*FCSO does not agree with the benchmarks used to establish and limit the reasonableness of compensation upon which the claimed SERP costs were based. We have determined, however, that the proposed adjustment does not justify further contention of the issue and will revise our claims for fiscal years 2003-2005 to reduce claimed SERP costs by \$81,420.*