

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**FIRST COAST SERVICE OPTIONS, INC.,
DID NOT CLAIM SOME MEDICARE
SUPPLEMENTAL EXECUTIVE
RETIREMENT PLAN 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-07-18-00536

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.

Report in Brief

Date: July 2018

Report No. A-07-18-00536

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



Why **OIG** Did This Review

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation, Cost Accounting Standards (CAS), and the Medicare contracts.

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 did not always correctly identify and claim SERP costs.

Our objective was to determine whether the calendar years (CYs) 2008 through 2010 SERP 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 \$2.46 million of SERP costs that FCSO reported on its ICPs for CYs 2008 through 2010.

First Coast Service Options, Inc., Did Not Claim Some Medicare Supplemental Executive Retirement Plan Costs Through Its Incurred Cost Proposals

What **OIG** Found

The CYs 2008 through 2010 SERP costs that FCSO claimed for Medicare reimbursement, and reported on its ICPs, were not always correctly claimed. Specifically, FCSO claimed Medicare SERP costs of \$2.46 million for Medicare reimbursement, through its ICPs, for CYs 2008 through 2010. However, we determined that the allowable SERP costs during this period were \$3.53 million. The difference, \$1.06 million, represented allowable Medicare SERP costs that FCSO did not claim on its ICPs for CYs 2008 through 2010. FCSO did not claim these allowable SERP costs primarily because it based its claims for Medicare reimbursement on incorrectly calculated CAS-based SERP 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 an increase in Medicare SERP costs of \$1.06 million for CYs 2008 through 2010.

FCSO concurred with our recommendation and stated that it would work with CMS to ensure that FCSO's final settlement of contract costs reflects an increase in Medicare SERP costs of \$1.06 million for CYs 2008 through 2010.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) reimburses a portion of its contractors' Supplemental Executive Retirement Plan (SERP) costs. In claiming SERP costs, contractors must follow 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 did not always correctly identify and claim SERP costs.

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 SERP 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 SERP 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 SERP 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.

BCBS Florida sponsors a SERP whose primary purpose is to provide a benefit to a select group of management or highly compensated employees. The SERP is designed to restore benefits to participants who lost benefits under the BCBS Florida qualified defined-benefit plan because of the Internal Revenue Code, sections 401(a)(17) and 415, limits.^{4, 5} This report addresses the SERP 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 SERP costs are included in the computations of the indirect cost

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 The Internal Revenue Code section 401(a)(17) limit is the maximum annual compensation that can be used to calculate pension benefits for a qualified defined-benefit plan.

⁵ Internal Revenue Code section 415 limits the amount of benefits that may be paid to a participant in a qualified defined-benefit plan.

rates reported on the ICPs. CMS uses these indirect cost rates when reimbursing costs for cost-plus-award-fee type contracts.^{6, 7}

Medicare Reimbursement of Supplemental Executive Retirement Plan Costs

CMS reimburses a portion of its contractors' SERP costs. The Medicare contracts require FCSO to calculate SERP costs in accordance with the FAR and CAS 412 and 413. The FAR and the CAS require that the costs for nonqualified defined-benefit plans be measured under either the accrual method or the pay-as-you-go method. For nonqualified defined-benefit plans that are not funded through the use of a funding agency, contractors must use the pay-as-you-go method to account for costs. This method is based on the actual benefits paid to participants, which are comprised of lump-sum payments plus annuity payments. 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.⁸ FCSO elected to claim SERP costs using the pay-as-you-go method of accounting.

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 C2C⁹ 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 SERP costs discussed in this report.

⁶ 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.

⁷ 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.

⁸ 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.

⁹ 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 SERP 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 SERP costs claimed, for the contracts subject to the FAR. CMS will use our report on allowable SERP 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 \$2,464,722 of Medicare SERP 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 SERP costs that FCSO claimed for Medicare reimbursement, and reported on its ICPs, were not always correctly claimed. Specifically, FCSO claimed Medicare SERP costs of \$2,464,722 for Medicare reimbursement, through its ICPs, for CYs 2008 through 2010. However, we determined that the allowable SERP costs during this period were \$3,529,358. The difference, \$1,064,636, represented allowable Medicare SERP costs that FCSO did not claim on its ICPs for CYs 2008 through 2010. FCSO did not claim these allowable SERP costs primarily because it based its claims for Medicare reimbursement on incorrectly calculated CAS-based SERP costs.

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS CLAIMED

FCSO claimed Medicare SERP costs of \$2,464,722 for CYs 2008 through 2010. We calculated the allowable Medicare SERP costs, which include both the Medicare and Other segment payments, in accordance with the FAR and the CAS. For details on the Federal requirements, see Appendix B.

ALLOCABLE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS UNDERSTATED

During this audit, we calculated the allocable SERP costs based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments. Our calculation included an allowable interest component in the amortization installment; to calculate this component, we used the interest rate identified in the qualified defined-benefit plan actuarial

valuation reports (Appendix A). Accordingly, we determined that the allocable pay-as-you-go SERP costs for CYs 2008 through 2010 totaled \$4,874,142. As discussed below, FCSO identified allocable SERP costs of \$2,083,988. Therefore, FCSO understated the allocable SERP costs by \$2,790,134.¹⁰ This underclaim occurred primarily because FCSO (1) did not use an interest component when amortizing its lump-sum payments' amortization installment and (2) did not claim SERP costs for the benefit payments paid to Other segment participants. We discuss each of these reasons in the next two sections of this report.

Costs Calculated Without an Interest Component

The Medicare contracts require FCSO to calculate SERP costs in accordance with the FAR and CAS 412 and 413. Contrary to Federal regulations at CAS 412.40(a)(3) (Appendix B), FCSO did not use an interest component in the determination of the amortization installment. Our calculations of the allowable SERP costs included both an allowable interest component in the lump-sum amortizations and the omitted Other segment SERP payments (discussed below). We based our amortization installments on the interest rate used to determine costs for the qualified defined-benefit pension plan.

Costs for Other Segment Participants Not Claimed

Effective January 1, 2005, FCSO made a management decision to no longer request Medicare reimbursement for SERP costs that relate to payments made to participants in the Other segment. Notwithstanding this decision, the Medicare contract allows contractors to claim a portion of their Other segment SERP costs for Medicare reimbursement. We obtained and reviewed a listing of the Other segment SERP lump-sum and annuity payments for CYs 2008 through 2010.¹¹ We calculated the allowable SERP costs for CYs 2008 through 2010 in accordance with the FAR and the CAS.

Table 1 on the following page shows the allocable SERP costs that we determined for the Medicare segment and the Other segment, respectively, for CYs 2008 through 2010.

¹⁰ The dollar amounts conveyed in this paragraph differ from those conveyed earlier in "Finding" and later in our recommendation. The reason is that this portion of our report discusses our calculations before we incorporated the results of the DCAA, MHM, and CLA ICP audits into those calculations.

¹¹ We recalculated two lump-sum benefit payments for the Other segment participants, using the compensation limits described in FAR 31.205-6(p) (Appendix B). Each of these payments was made on behalf of one of the five most highly compensated FCSO employees in management positions at each home office and each segment of the Medicare contractor and should have been limited to the compensation benchmarks determined by the Office of Federal Procurement Policy (OFPP). In our calculations for these two payments, we limited each participant's compensation for the year in which the participant was considered one of the five most highly compensated FCSO employees, in accordance with FAR 31.205-6(p).

Table 1: Medicare Allocable SERP Costs

Calendar Year	Per Audit	Per FCSO	Difference
2008	\$0	\$0	\$0
2009	2,317,131	1,461,854	855,277
2010	2,556,991	622,134	1,934,857
Total Allocable	\$4,874,122	\$2,083,988	\$2,790,134

ALLOWABLE MEDICARE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS NOT CLAIMED

After incorporating the results of the DCAA, MHM, and CLA ICP audits into our calculations of the allocable SERP costs which, as discussed earlier, FCSO understated, we determined that the allowable SERP costs for CYs 2008 through 2010 were \$3,529,358. Thus, FCSO did not claim \$1,064,636 of allowable Medicare SERP costs on its ICPs for CYs 2008 through 2010.

SUMMARY OF ALLOWABLE MEDICARE SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS NOT CLAIMED

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 2 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 2 on the following page compares the Medicare SERP costs that we calculated (using our adjusted indirect cost rates) to the SERP costs that FCSO claimed for Medicare reimbursement for CYs 2008 through 2010.

Table 2: Medicare Allowable SERP Costs¹²

Calendar Year	Per Audit	Per FCSO¹³	Difference
2008 ¹⁴	\$0	\$0	\$0
2009	1,483,937	1,421,507	62,430
2010	2,045,421	1,043,214	1,002,207
Total Underclaim of SERP Costs	\$3,529,358	\$2,464,722	\$1,064,636

RECOMMENDATION

We recommend that FCSO work with CMS to ensure that FCSO’s final settlement of contract costs reflects an increase in Medicare SERP costs of \$1,064,636 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 FCSO’s final settlement of contract costs reflects an increase in Medicare SERP costs of \$1.06 million for CYs 2008 through 2010.

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

OTHER MATTER

CMS requested that, during our review, we separately identify the costs associated with SERP payments for any cases in which any participant’s salary exceeded the executive compensation limit as determined by OFPP. We identified two SERP benefit payments that were based on compensation in excess of the compensation limits prescribed in FAR 31.205-6(p). While none of these participants was considered one of the top five most highly compensated executives at FCSO, the salaries used in their benefit payment calculations exceeded the compensation limits determined by OFPP. We identified these SERP benefit payments based on the benchmark for reasonable compensation that is provided by FAR 31.205-6(p) (Appendix B).

¹² 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 SERP costs for the Medicare Parts A and B contracts. The amounts identified in this table represent the allowable Medicare SERP costs during our audit period and do not represent the total allowable costs on the ICPs.

¹³ We calculated the “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 SERP. 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.

¹⁴ In CY 2008, FCSO claimed all SERP costs in its final administrative cost proposals. Therefore, we followed FCSO’s methodology for CY 2008 and did not allocate any SERP costs to the CY 2008 ICP.

We recalculated the two SERP benefit payments that we had identified, using the OFPP compensation limits as a benchmark for reasonableness. We determined that the SERP costs associated with these two payments, which FCSO made to participants during CYs 2008 through 2010, totaled \$83,664.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed \$2,464,722 of Medicare SERP 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 SERP costs that were included in FCSO's ICPs and ultimately used as the basis for Medicare reimbursement, to ensure that the SERP 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 SERP 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 SERP costs;
- calculated the allowable SERP costs, based on periodic payments made to SERP recipients, plus a 15-year amortization of lump-sum SERP payments, and including an allowable interest component in the amortization installment (which we calculated using the interest rate identified in the qualified defined-benefit plan actuarial valuation reports), in accordance with the applicable provisions of the FAR and the CAS; and
- provided the results of our review to FCSO officials on April 5, 2018.

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 SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN COSTS

FEDERAL REGULATIONS

Federal regulations (FAR 31.205-6(p)) state that costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, OFPP, are unallowable.

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 (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 412.40(a)(3)) state that for defined-benefit pension plans accounted for under the pay-as-you-go cost method, the components of pension cost for a cost accounting period are:

- the net amount of periodic benefits paid for the period, and
- an amortization installment, including an interest equivalent on the unamortized settlement amount, attributable to amounts paid to irrevocably settle an obligation for periodic benefits due in current and future cost accounting periods.

Federal regulations (CAS 412.50(b)(3)) state that for defined-benefit pension plans accounted for under the pay-as-you-go cost method, the amount of pension cost assignable to a cost accounting period shall be measured as the sum of:

- the net amount for any periodic benefits paid for that period and
- the level annual installment required to amortize over 15 years any lump-sum benefit payments.

Federal regulations (CAS 412.50(c)(3)) state that the cost of a nonqualified defined-benefit pension plan shall be assigned to cost accounting periods in the same manner as qualified plans under the following conditions:

- the contractor, in disclosing or establishing cost accounting practices, elects to have a plan so accounted for;

- the plan is funded through the use of a funding agency; and
- the right to a pension benefit is nonforfeitable and is communicated to the participants.

Federal regulations (CAS 412.50(c)(4)) state that the cost of a nonqualified defined-benefit pension plan must be assigned using the pay-as-you-go method if the plan does not meet all of the above requirements.

MEDICARE CONTRACTS

The determination and allocation of pension costs are addressed by the Medicare contract, which states: “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.” To be allowable for Medicare reimbursement, pension cost 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.

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.)



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-07-18-00536

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., Did Not Claim Some Medicare Supplemental Executive Retirement Plan 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 that FCISO’s final settlement of contract costs reflects an increase in Medicare SERP costs of \$1.06 million for CYs 2008 through 2010.

Response:

First Coast concurs with the recommendation and will work with CMS to ensure that FCISO’s final settlement of contract costs reflect an increase in Medicare SERP costs of \$1.06 million 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