Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

HIGHMARK MEDICARE SERVICES, INC., CLAIMED SOME UNALLOWABLE MEDICARE PENSION COSTS FOR FISCAL YEARS 2003 THROUGH 2009

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

Gloria L. Jarmon
Deputy Inspector General

March 2014
A-07-13-00415

Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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EXECUTIVE SUMMARY

Highmark Medicare Services, Inc., claimed unallowable pension costs of $1.1 million for Medicare reimbursement for fiscal years 2003 through 2009.

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, Cost Accounting Standards (CAS), and Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always comply with Federal requirements when claiming pension costs for Medicare reimbursement.

The objective of this review was to determine whether the pension costs claimed by Highmark Medicare Services, Inc. (Highmark), for Medicare reimbursement for fiscal years (FYs) 2003 through 2009 were allowable and correctly claimed.

BACKGROUND

During our audit period, Highmark was a wholly owned subsidiary of Highmark, Inc., whose home office was in Camp Hill, Pennsylvania. Highmark administered Medicare Parts A and B operations under cost reimbursement contracts with CMS until the Medicare segment was sold to Diversified Services Options, Inc. (DSO), effective January 1, 2012.

During the period January 1, 2002, through January 1, 2006, Highmark maintained two Medicare segments: a Medicare Part A segment and a Medicare Part B segment. On January 1, 2006, Highmark consolidated the Medicare Parts A and B segments into a single Medicare segment.

With the implementation of Medicare contracting reform, Highmark continued to perform Medicare work after being awarded the Medicare administrative contractor (MAC) (Jurisdiction 12) contract on October 24, 2007. While performing its MAC work, Highmark also functioned as a Medicare Part A fiscal intermediary and Part B carrier, with those contracts terminating in July 2008 and December 2008, respectively. Highmark continued to work as the Jurisdiction 12 MAC until January 1, 2012, when Highmark, Inc., sold its wholly owned subsidiary, Highmark, to DSO.

WHAT WE FOUND

Highmark claimed pension costs of $12,942,825 for Medicare reimbursement; however, we determined that the allowable CAS-based pension costs during this period were $11,860,049. The difference, $1,082,776, represented unallowable Medicare pension costs that Highmark claimed on its Final Administrative Cost Proposals (FACPs) for FYs 2003 through 2009.

Highmark claimed these unallowable Medicare pension costs primarily because it based its claim for Medicare reimbursement on incorrectly calculated CAS pension costs.

WHAT WE RECOMMEND

We recommend that Highmark revise its FACPs for FYs 2003 through 2009 to reduce its claimed Medicare pension costs by $1,082,776.

AUDITEE COMMENTS AND OUR RESPONSE

In written comments on our draft report, Highmark did not directly address our recommendation. However, it is clear from the comments that Highmark did not agree with our recommendation to reduce its claimed Medicare pension costs by $1,082,776.

Highmark provided information indicating that it agreed in part with our finding and that it agreed with our recommendations in related report A-07-13-00414. Highmark did not, however, agree with the methodology we used when applying prepayment credits. Specifically, Highmark did not concur with our interpretation of FAR 31.205-6(j)(2)(iii) as it relates to offsetting prepayment credits from the CAS funding target.

Nothing in Highmark's comments caused us to change our finding or recommendation. We disagree with Highmark's assertions about our methodology for the calculation of pension costs when prepayment credits exist.

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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 Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors did not always comply with Federal requirements when claiming pension costs for Medicare reimbursement.

OBJECTIVE

Our objective was to determine whether the pension costs claimed by Highmark Medicare Services, Inc. (Highmark), for Medicare reimbursement for fiscal years (FYs) 2003 through 2009 were allowable and correctly claimed.

BACKGROUND

Highmark Medicare Services, Inc.

During our audit period, Highmark was a wholly owned subsidiary of Highmark, Inc., whose home office was in Camp Hill, Pennsylvania. Highmark administered Medicare Parts A and B operations under cost reimbursement contracts with CMS until the Medicare segment was sold to Diversified Services Options, Inc. (DSO), effective January 1, 2012.

During the period January 1, 2002, through January 1, 2006, Highmark maintained two Medicare segments: a Medicare Part A segment and a Medicare Part B segment. On January 1, 2006, Highmark consolidated the Medicare Parts A and B segments into a single Medicare segment.

With the implementation of Medicare contracting reform,[1] Highmark continued to perform Medicare work after being awarded the MAC (Jurisdiction 12) contract on October 24, 2007.[2] While performing its MAC work, Highmark also functioned as a Medicare Part A fiscal intermediary and Part B carrier, with those contracts terminating in July 2008 and December 2008, respectively. Highmark continued to work as the Jurisdiction 12 MAC until January 1, 2012, when Highmark, Inc., sold its wholly owned subsidiary, Highmark, to DSO.

[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 Medicare administrative contractors (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] Jurisdiction 12 consists of the States of Delaware, Maryland, New Jersey, and Pennsylvania, and the District of Columbia.

Medicare Reimbursement of Pension Costs

CMS reimburses a portion of the Medicare contractors' annual pension costs, which are funded by contributions that these contractors make to their pension plans. 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.

Beginning with FY 1988, CMS incorporated specific segmentation language into Medicare contracts that requires contractors to use either an allocation method or a separate calculation method to identify and claim pension costs for Medicare reimbursement. Under the allocation method, the contractor determines total plan CAS-based pension costs and allocates a share to Medicare. Under the separate calculation method, the contractor separately identifies the pension cost components for the Medicare segment. The contractor must use the separate calculation method if its result is materially different from that of the allocation method.

HOW WE CONDUCTED THIS REVIEW

We reviewed $12,942,825 of pension costs claimed by Highmark for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs) for FYs 2003 through 2009.

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.

FINDING

Highmark claimed pension costs of $12,942,825 for Medicare reimbursement; however, we determined that the allowable CAS-based pension costs during this period were $11,860,049. The difference, $1,082,776, represented unallowable Medicare pension costs that Highmark claimed on its FACPs for FYs 2003 through 2009. Highmark claimed these unallowable Medicare pension costs primarily because it based its claim for Medicare reimbursement on incorrectly calculated CAS pension costs.

CLAIMED PENSION COSTS

Highmark claimed Medicare pension costs of $12,942,825 for Medicare reimbursement on its FACPs for FYs 2003 through 2009. 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. For details on the Federal requirements, see Appendix B.

UNALLOWABLE PENSION COSTS CLAIMED

We determined that the allowable CAS-based pension costs for FYs 2003 through 2009 were $11,860,049. Thus, Highmark claimed $1,082,776 of unallowable Medicare pension costs on its FACPs for FYs 2003 through 2009. This overclaim occurred primarily because Highmark based its claim for Medicare reimbursement on incorrectly calculated CAS pension costs. Specifically, Highmark revised its CAS pension costs calculations for 2003 through 2007 but did not revise its claim for Medicare reimbursement on the basis of those revisions.

The table below shows the differences between the allowable CAS-based pension costs and the pension costs that Highmark claimed on its FACPs and that were reflected in its accounting documents. Appendix C contains additional details on allowable pension costs.

Table: Comparison of Allowable Pension Costs and Claimed Pension Costs

	Medicare Pension Costs		
Fiscal Year	**Allowable Per Audit**	**Claimed by Highmark**	**Difference**
2003	$1,758,378	$1,881,060	($122,682)
2004	2,093,160	2,312,190	(219,030)
2005	2,208,140	2,375,680	(167,540)
2006	2,235,247	2,626,277	(391,030)
2007	2,049,244	2,224,505	(175,261)
2008	1,394,002	1,402,261	(8,259)
2009	121,878	120,852	1,026
Total	**$11,860,049**	**$12,942,825**	**($1,082,776)**

RECOMMENDATION

We recommend that Highmark revise its FACPs for FYs 2003 through 2009 to reduce its claimed Medicare pension costs by $1,082,776.

AUDITEE COMMENTS

In written comments on our draft report, Highmark did not directly address our recommendation. However, it is clear from the comments that Highmark did not agree with our recommendation to reduce its claimed Medicare pension costs by $1,082,776.

Highmark provided information indicating that it agreed in part with our finding and that it agreed with our recommendations in related report A-07-13-00414 (Appendix A). Highmark did not, however, agree with the methodology we used when applying prepayment credits. Specifically, Highmark did not concur with our interpretation of FAR 31.205-6(j)(2)(iii) as it relates to offsetting prepayment credits from the CAS funding target.

Below is a summary of Highmark's comments. Highmark's comments appear in their entirety as Appendix D.

- Highmark agreed that it should have adjusted its FACPs for FYs 2003 through 2006 on the basis of the revised CAS pension cost calculations resulting from our prior audit (A-07-04-00163, mentioned in Appendix C, endnote 1).

- Highmark did not concur with our "interpretation" of FAR 31.205-6(j)(2)(iii) as it relates to offsetting prepayment credits from the CAS funding target. In this context, Highmark referred to the methodology described in Appendix C, endnote 10, according to which we, as Highmark stated, "… generally disallowed quarterly interest because of the existence of Highmark's prepayment credits." Highmark disagreed with this methodology because, it said, "FAR 31.205-6(j)(2)(iii) does not even reference prepayment credits." Highmark added that under its interpretation of the FAR, "… interest is only unallowable if payment is made 30 days after the end of each quarter." Highmark stated that because it submitted its quarterly cash contributions within 30 days after the end of each quarter, its accrued interest is allowable based on FAR 31.205-6(j)(2)(iii).[3]

- Highmark also stated that while it understood our position of applying prepayment credits as of the first day of the year, that position is not supported by FAR 31.205-6(j)(2)(iii). Highmark added that our method for applying the prepayment credits is inconsistent with FAR 31.205-6(j)(2)(iii) because it limits a contractor's ability to decide the timing of its pension contributions beyond the limitations imposed by that regulation.

- Further, Highmark said that our methodology of applying prepayment credits as of the first day of the year contravenes CAS Board policy that prepayment credits should have a neutral impact from a cost accounting perspective. According to Highmark, our position would "… unfairly penalize contractors who have prepayment credits by reducing their allowable pension expense."

On these bases, Highmark recalculated its claimed pension costs for Medicare reimbursement for FYs 2003 through 2009 as $12,657,422. Accordingly, Highmark identified additional allowable pension costs of $797,373 due to the interest on its quarterly cash contributions.

OFFICE OF INSPECTOR GENERAL RESPONSE

Nothing in Highmark's comments caused us to change our finding or recommendation.

We disagree with Highmark's assertions about our methodology for the calculation of pension costs when prepayment credits exist. Although Highmark stated that our interpretation and application of prepayment credits is not supported by FAR 31.205-6(j)(2)(iii), that regulation states that "[i]ncreased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable." This provision applies to all cash contributions made to the pension trust. Because Highmark had made contributions in excess of the CAS funding target in previous years, the resulting

[3] Highmark's comments included a table (shown at the bottom of the second page of Appendix D) depicting the deposit dates of Highmark's quarterly contributions.

prepayment credits were available on the first day of the year to cover the assignable pension costs.

Highmark had already decided to fund these costs with contributions it made into the pension trust fund, and for that reason, these funds were unavailable to the contractor for any other purpose but to fund pension costs. Pursuant to FAR 31.201-2 and 31.201-3, it would not be reasonable for a prudent person in the conduct of competitive business to ignore the existence of available funds, earmarked for this purpose only, and thereby incur additional interest costs. By using current-period cash contributions in lieu of the available prepayment credits to liquidate its pension costs, Highmark would effectively be incurring additional costs by delaying the funding of the assignable pension costs. Highmark's approach of applying cash contributions instead of prepayment credits would identify additional interest costs of $797,373 that would be reimbursable under that methodology.

Highmark's reference to a discussion in the preamble to the publication of the final CAS Pension Harmonization Rule (CAS 412.50(b)(7))[4] is not relevant to the application of prepayment credits in the manner discussed in this report. Rather, the CAS Board discusses how prepayment credits will be allocated an equal share of investment earnings and administrative expenses based on the fund's performance. Although Highmark did not receive interest for quarterly contributions, it received interest on its prepayment credits (those contributions that exceeded the CAS funding target) at the valuation rate of interest, as described in Appendix C, endnote 5. CAS 412.50(a)(4) states: "The accumulated value of such prepayment credits shall be adjusted for interest at the valuation rate of interest until applied towards pension cost in a future accounting period." In the context of our finding that Highmark incorrectly calculated CAS pension costs, and with respect to our methodology as described in Appendix C, endnote 10, this provision of the CAS, rather than the discussion cited by Highmark, constitutes the relevant criteria to determine reimbursable pension costs.

[4] 76 Fed. Reg. 81296, 81299 (Dec. 27, 2011).

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed $12,942,825 of pension costs that Highmark claimed for Medicare reimbursement on its FACPs for FYs 2003 through 2009.

Achieving our objective did not require that we review Highmark's overall internal control structure. We reviewed the internal controls related to the pension costs claimed 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 Highmark in Camp Hill, Pennsylvania, in September 2012.

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR, CAS, and Medicare contracts applicable to this audit;
- reviewed information provided by Highmark to identify the amount of pension costs claimed for Medicare reimbursement for FYs 2003 through 2009;
- used information that Highmark's actuarial consulting firms provided, including information on assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses;
- examined Highmark's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Forms 5500;
- determined the extent to which Highmark funded CAS-based pension costs with contributions to the pension trust fund and accumulated prepayment credits;
- engaged the CMS Office of the Actuary to calculate the allocable pension costs based on the CAS (the calculations were based on separately computed CAS-based pension costs for the Medicare segment and the Other segment);
- reviewed the CMS actuaries' methodology and calculations; and
- provided the results of the review to Highmark officials on July 12, 2013.

We performed this review in conjunction with the following audits and used the information obtained during these audits:

- *Highmark Medicare Services, Inc., Understated Its Medicare Segment Pension Assets and Understated the Medicare Segment Excess Pension Liabilities as of January 1, 2012* (A-07-13-00414) and

- *Highmark Medicare Services, Inc., Overstated Its Allocable Pension Costs for Calendar Years 2008 Through 2011* (A-07-13-00416).

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 31.205-6(j)) address 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 412) (as amended) address the determination and measurement of pension cost components. This regulation also addresses 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 address the determination and allocation of pension costs. The 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."

APPENDIX C: ALLOWABLE MEDICARE PENSION COSTS FOR HIGHMARK MEDICARE SERVICES, INC., FOR FISCAL YEARS 2003 THROUGH 2009

Date	Description		Total Company	Other Segment	Medicare Part A Segment	Medicare Part B Segment	Total Medicare
2002	Allocable pension costs	1/		$19,132,662	$513,542	$0	
2003	Contributions	2/	$50,000,000	$50,000,000	$0	$0	
	Discount for interest	3/	($2,377,037)	($2,377,037)	$0	$0	
January 1, 2003	Present value contributions	4/	$47,622,963	$47,622,963	$0	$0	
	Prepayment credit applied	5/	$29,708,683	$27,858,812	$872,345	$977,526	
	Present value of funding	6/	$77,331,646	$75,481,775	$872,345	$977,526	
January 1, 2003	CAS funding target	7/	$29,708,683	$27,858,812	$872,345	$977,526	
	Percentage funded	8/		100.00%	100.00%	100.00%	
	Funded pension cost	9/		$27,858,812	$872,345	$977,526	
	Allowable interest	10/		$0	$0	$0	
	Allocable pension cost			$27,858,812	$872,345	$977,526	
2003	FY allocable pension costs	11/		$25,677,275	$782,644	$733,145	
	Medicare Part A LOB* percentage	12/		0.33%	99.50%		
	Medicare Part B LOB* percentage	13/		0.63%		100.00%	
2003	Medicare Part A allowable FY pension cost	14/		$84,735	$778,731		$863,466
2003	Medicare Part B allowable FY pension cost	15/		$161,767		$733,145	$894,912
2003	Total allowable FY pension cost	16/		$246,502	$778,731	$733,145	$1,758,378

Date	Description	Total Company	Other Segment	Medicare Part A Segment	Medicare Part B Segment	Total Medicare
2004	Contributions	$50,049,628	$50,049,628	$0	$0	
	Discount for interest	($2,381,992)	($2,381,992)	$0	$0	
January 1, 2004	Present value contributions	$47,667,636	$47,667,636	$0	$0	
	Prepayment credit applied	$30,701,214	$28,928,210	$864,322	$908,682	
	Present value of funding	$78,368,850	$76,595,846	$864,322	$908,682	
January 1, 2004	CAS funding target	$30,701,214	$28,928,210	$864,322	$908,682	
	Percentage funded		100.00%	100.00%	100.00%	
	Funded pension cost		$28,928,210	$864,322	$908,682	
	Allowable interest		$0	$0	$0	
	Allocable pension cost		$28,928,210	$864,322	$908,682	
2004	FY allocable pension costs		$28,660,861	$866,328	$925,893	
	Medicare Part A LOB* percentage		0.37%	100.00%		
	Medicare Part B LOB* percentage		0.68%		100.00%	
2004	Medicare Part A allowable FY pension cost		$106,045	$866,328		$972,373
2004	Medicare Part B allowable FY pension cost		$194,894		$925,893	$1,120,787
2004	Total allowable FY pension cost		$300,939	$866,328	$925,893	$2,093,160

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2005	Contributions	17/	$66,196,005	$66,196,005	$0	$0	
	Discount for interest		($3,756,501)	($3,756,501)	$0	$0	
January 1, 2005	Present value contributions		$62,439,504	$62,439,504	$0	$0	
	Prepayment credit applied		$33,792,670	$31,091,700	$2,015,049	$685,921	
	Present value of funding		$96,232,174	$93,531,204	$2,015,049	$685,921	
January 1, 2005	CAS funding target		$33,792,670	$31,091,700	$2,015,049	$685,921	
	Percentage funded			100.00%	100.00%	100.00%	
	Funded pension cost			$31,091,700	$2,015,049	$685,921	
	Allowable interest			$0	$0	$0	
	Allocable pension cost			$31,091,700	$2,015,049	$685,921	
2005	FY allocable pension costs	18/		$30,550,828	$1,954,538	n/a	
	Medicare Part A LOB* percentage			0.32%	39.30%	n/a	
	Medicare Part B LOB* percentage			0.56%	59.92%	n/a	
2005	Medicare Part A allowable FY pension cost			$97,763	$768,133	n/a	$865,896
2005	Medicare Part B allowable FY pension cost			$171,085	$1,171,159	n/a	$1,342,244
2005	Total allowable FY pension cost			$268,848	$1,939,292	n/a	$2,208,140

Date	Description	Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2006	Contributions	$48,295,628	$48,295,628	$0	$0	
	Discount for interest	($2,285,993)	($2,285,993)	$0	$0	
January 1, 2006	Present value contributions	$46,009,635	$46,009,635	$0	$0	
	Prepayment credit applied	$38,783,752	$35,914,054	$1,961,562	$908,136	
	Present value of funding	$84,793,387	$81,923,689	$1,961,562	$908,136	
January 1, 2006	CAS funding target	$38,783,752	$35,914,054	$1,961,562	$908,136	
	Percentage funded		100.00%	100.00%	100.00%	
	Funded pension cost		$35,914,054	$1,961,562	$908,136	
	Allowable interest		$0	$0	$0	
	Allocable pension cost		$35,914,054	$1,961,562	$908,136	
2006	FY allocable pension costs		$34,708,466	$1,974,934	n/a	
	Medicare Part A LOB* percentage		0.31%	40.77%	n/a	
	Medicare Part B LOB* percentage		0.44%	59.23%	n/a	
2006	Medicare Part A allowable FY pension cost		$107,596	$805,181	n/a	$912,777
2006	Medicare Part B allowable FY pension cost		$152,717	$1,169,753	n/a	$1,322,470
2006	Total allowable FY pension cost		$260,313	$1,974,934	n/a	$2,235,247

Date	Description	Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2007	Contributions	$50,189,900	$50,189,900	$0	$0	
	Discount for interest	($2,375,655)	($2,375,655)	$0	$0	
January 1, 2007	Present value contributions	$47,814,245	$47,814,245	$0	$0	
	Prepayment credit applied	$40,411,395	$37,558,358	$1,766,434	$1,086,603	
	Present value of funding	$88,225,640	$85,372,603	$1,766,434	$1,086,603	
January 1, 2007	CAS funding target	$40,411,395	$37,558,358	$1,766,434	$1,086,603	
	Percentage funded		100.00%	100.00%	100.00%	
	Funded pension cost		$37,558,358	$1,766,434	$1,086,603	
	Allowable interest		$0	$0	$0	
	Allocable pension cost		$37,558,358	$1,766,434	$1,086,603	
2007	FY allocable pension costs		$37,147,282	$1,815,216	n/a	
	Medicare Part A LOB* percentage		0.27%	43.16%	n/a	
	Medicare Part B LOB* percentage		0.36%	56.84%	n/a	
2007	Medicare Part A allowable FY pension cost		$100,298	$783,447	n/a	$883,745
2007	Medicare Part B allowable FY pension cost		$133,730	$1,031,769	n/a	$1,165,499
2007	Total allowable FY pension cost		$234,028	$1,815,216	n/a	$2,049,244

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2008	Contributions		$251,581,464	$251,581,464	$0	$0	
	Discount for interest		($16,621,149)	($16,621,149)	$0	$0	
January 1, 2008	Present value contributions		$234,960,315	$234,960,315	$0	$0	
	Prepayment credit applied		$42,561,656	$39,478,592	$1,700,340	$1,382,724	
	Present value of funding		$277,521,971	$274,438,907	$1,700,340	$1,382,724	
January 1, 2008	CAS funding target		$42,561,656	$39,478,592	$1,700,340	$1,382,724	
	Percentage funded			100.00%	100.00%	100.00%	
	Funded pension cost			$39,478,592	$1,700,340	$1,382,724	
	Allowable interest			$0	$0	$0	
	Allocable pension cost			$39,478,592	$1,700,340	$1,382,724	
2008	FY allocable pension costs			$38,998,534	$1,716,864	n/a	
	Medicare Part A LOB* percentage	19/		0.24%	26.10%	n/a	
	Medicare Part B LOB* percentage			0.27%	43.51%	n/a	
2008	Medicare Part A allowable FY pension cost			$93,596	$448,102	n/a	$541,698
2008	Medicare Part B allowable FY pension cost			$105,296	$747,008	n/a	$852,304
2008	Total allowable FY pension cost+D240			$198,892	$1,195,110	n/a	$1,394,002

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2009	FY Allocable Pension costs	20/		$9,869,648	$425,085	n/a	
	Medicare Part B LOB* percentage	21/		0.19%	24.26%	n/a	
2009	Medicare Part B allowable FY pension cost			$18,752	$103,126	n/a	$121,878

* Line of business.

ENDNOTES

1/ The allocable CAS pension cost is the amount of pension cost that may be allocated for contract cost purposes. We obtained the 2002 calendar year (CY) allocable pension cost from our prior Highmark review (A-07-04-00163), issued January 21, 2005.

2/ We obtained Total Company contribution amounts and dates of deposit from Internal Revenue Service Form 5500 reports. The contributions included deposits made during the CY and accrued contributions deposited after the end of the CY but within the time allowed for filing tax returns. We determined the contributions allocated to the Medicare segment during the pension segmentation review (A-07-13-00414). The amounts shown for the Other segment represent the difference between the Total Company, the Medicare segments, and the Gateway segment. The Gateway segment does not perform Medicare operations.

3/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation year to discount the contributions back to their beginning-of-the-year value. For purposes of this Appendix, we computed the interest as the difference between the present value of contributions (at the CAS valuation interest rate) and actual contribution amounts.

4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the CY. For purposes of this Appendix, we deemed deposits made after the end of the CY to have been made on the final day of the CY, consistent with the method established by the Employee Retirement Income Security Act prior to the implementation of the Pension Protection Act.

5/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year CAS funding target. A prepayment credit is carried forward, with interest, to fund future CAS pension costs.

6/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the CY.

7/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of the FAR 31.205-6(j)(2)(i).

8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the CY. Because any funding in excess of the CAS funding target is accounted for as a prepayment in accordance with CAS 412.50(c)(1), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimal places.

9/ We computed the funded CAS-based pension cost as the CAS funding target multiplied by the percent funded.

10/ We assumed that interest on the funded CAS-based pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.

11/ We converted the allocable pension cost to an FY basis (October 1 through September 30). We calculated the FY pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs.

12/ We calculated the Medicare Part A line of business (LOB) percentages based on information provided by Highmark.

13/ We calculated the Medicare Part B LOB percentages based on information provided by Highmark.

14/ We computed the allowable Medicare Part A pension cost as an FY pension cost multiplied by the Medicare Part A LOB percentage. In accordance with CAS 412 and 413, the total Medicare Part A allowable pension costs charged to the Medicare contract consisted of the Highmark Medicare segment's direct pension costs plus Other segment pension costs attributable to indirect Highmark Medicare operations.

15/ We computed the allowable Medicare Part B pension cost as an FY pension cost multiplied by the Medicare Part B LOB percentage. In accordance with CAS 412 and 413, the total Medicare Part B allowable pension costs charged to the Medicare contract consisted of the Highmark Medicare segment's direct pension costs plus Other segment pension costs attributable to indirect Highmark Medicare operations.

16/ We computed the total allowable FY Medicare pension cost as the sum of the Medicare Part A pension cost and the Medicare Part B pension cost.

17/ The Gateway Pension Plan merged with the Highmark Pension Plan effective December 31, 2004. Therefore, the amounts shown for the Other segment represent the difference between the Total Company, the Medicare segments, and the Gateway segment. The Gateway segment does not perform Medicare operations.

18/ Highmark combined its Medicare Part A and Part B segments on January 1, 2006. Therefore, we calculated the FY Medicare segment pension costs as 1/4 of the prior year's Medicare Part A and Part B costs plus 3/4 of the combined segment's current year's costs.

19/ The Medicare Part A LOB percentage is calculated for the period October 2007 through July 2008. The Medicare Part A business transitioned to the Jurisdiction 12 (J12) MAC contract effective July 2008. The MAC allocable pension costs are calculated in a separate allocable pension cost report (A-07-13-00416).

20/ The 2009 FY allocable pension cost is calculated for the period October 2008 through December 2008. Highmark's Title XVIII contract transitioned to the MAC contract in December 2008.

21/ The Medicare Part B LOB percentage is calculated for the period October 2008 through December 2008. The Medicare Part B business transitioned to the J12 MAC contract effective December 2008. The MAC allocable pension costs are calculated in a separate allocable pension cost report (A-07-13-00416).

APPENDIX D: AUDITEE COMMENTS

HIGHMARK

December 9, 2013

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

Subject: OIG Report Number A-07-13-00415

Dear Mr. Cogley:

Thank you for affording Highmark Inc. ("Highmark") this opportunity to comment on the U.S. Department of Health and Human Services, Office of Inspector General ("OIG"), draft report entitled *Highmark Medicare Services, Inc., Claimed Some Unallowable Medicare Pension Costs for Fiscal Years 2003 Through 2009.*

We have carefully reviewed both the draft audit report and the additional detailed supplemental information received from the audit team. Our comments on the recommendations specific to this report are provided below:

1. Highmark agrees that the Final Administrative Cost Proposals (FACPs) were not revised for prior year audit findings specific to Fiscal Years (FYs) 2003-2006, the impact of which was a $363,232 decrease in pension costs. The results of the prior audit through FY 2002 were issued during 2007, and changes specific to FY 2007 were incorporated in the 2007 FACPs. The 2003-2006 FACPs were not revised specific to the pension plan findings based on the collective net impact of prior year audit findings in the pension, nonqualified pension and welfare plans. In consideration of the net impact of the collective findings, Highmark agrees that it should have adjusted its claim for Medicare reimbursement based on the revised CAS pension cost calculations resulting from the prior audit.

2. Highmark agrees that the recommendations in OIG Report No. A-07-13-00414 impact the Medicare segment pension costs. The impact of the demographic recommendations included in OIG Report No. A-07-13-00414 was an increase in CAS pension cost of $77,829.

Corporate Offices:
Camp Hill PA 17089
Fifth Avenue Place • 120 Fifth Avenue • Pittsburgh PA 15222-3099
www.highmark.com

3. Highmark does not concur with OIG's interpretation of FAR 31.205-6(j)(2)(iii) as it relates to offsetting the prepayment credits from the CAS funding target. Our rationale for this disagreement is outlined below.

The OIG audit report generally disallowed quarterly interest because of the existence of Highmark's prepayment credits. The OIG explained its rationale for disallowing quarterly interest in a footnote to the report:

> We assumed that interest on the funded CAS-based pension cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(j)(2)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target, less the prepayment credit, were funded in four equal installments deposited within 30 days after the end of the quarter.

OIG Report No. A-07-13-00415 at 14, n.10.

Highmark disagrees with the rationale offered by OIG because FAR 31.205-6(j)(2)(iii) provides no support for OIG's position that quarterly interest cannot accrue if the contractor has prepayment credits. FAR 31.205-6(j)(2)(iii) does not even reference prepayment credits. Instead, FAR 31.205-6(j)(2)(iii) simply provides that "[i]ncreased pension costs are unallowable if the increase is caused by a delay in funding beyond 30 days after each quarter of the year to which they are assignable." Accordingly, interest is only unallowable if payment is made 30 days after the end of each quarter. As shown below, Highmark submitted quarterly cash contributions within 30 days after the end of each quarter. The accrued interest on Highmark's quarterly pension payments is therefore allowable in accordance with the plain language of FAR 31.205-6(j)(2)(iii).

Highmark Qualified Pension Plan Contributions
April 15, 2003 - July 15, 2009

Contribution Date	Amount	Contribution Date	Amount	Contribution Date	Amount
7/15/2009	$ 19,199,659	4/13/2007	$12,547,475	12/15/2004	$12,512,407
4/15/2009	$ 19,199,659	12/15/2006	$12,073,907	10/15/2004	$12,512,407
12/15/2008	$ 12,895,366	10/13/2006	$12,073,907	7/15/2004	$12,512,407
12/15/2008	$ 200,000,000	7/14/2006	$12,073,907	4/15/2004	$12,512,407
10/15/2008	$ 12,895,366	4/13/2006	$12,073,907	12/15/2003	$12,500,000
4/15/2008	$ 12,895,366	4/11/2006	$20,000,000	10/15/2003	$12,500,000
4/15/2008	$ 12,895,366	12/15/2005	$11,712,726	7/14/2003	$12,500,000
12/14/2007	$ 12,547,475	10/14/2005	$11,712,725	4/15/2003	$12,500,000
10/15/2007	$ 12,547,475	7/15/2005	$11,712,725		
7/13/2007	$ 12,547,475	4/15/2005	$11,057,829		

We understand that OIG takes the position that contractors are required to apply prepayment credits as of the first day of the fiscal year. As discussed above, that position is not supported by FAR 31.205-6(j)(2)(iii), which does not reference prepayment credits. To the contrary, Highmark submits that OIG's position is inconsistent with FAR 31.205-6(j)(2)(iii), because it would limit a contractor's ability to decide the timing of its pension contributions beyond the limitations imposed by that regulation. OIG's position requires every contractor with prepayment credits to make 100% of its annual pension contribution (up to the amount of the prepayment credit) on the first day of the fiscal year. Such a position is contrary to the plain language of FAR 31.205-6(j)(2)(iii), which expressly allows contractors to make quarterly payments, and which expressly provides that interest on such payments is allowable so long as the payment is made within 30 days after the end of each quarter.

OIG has cited to no other authority that would require contractors to apply prepayment credits at the start of the fiscal year or risk having their accrued quarterly interest disallowed. Highmark respectfully submits that the OIG's position contravenes stated CAS Board policy that prepayment credits should be neutral from a cost accounting perspective. *See* 76 Fed. Reg. 81296, 81299 (Dec. 27, 2011) ("A decision to fund in excess of the CAS assigned cost should have a neutral impact on Government contract costing, although it might have a transitory negative impact on the contractor's cash flow."). OIG's position would unfairly penalize contractors who have prepayment credits by reducing their allowable pension expense. In particular, contractors without prepayment credits could recover interest on their quarterly pension contributions, while contractors with prepayment credits would not be entitled to such interest. This would be true even where the contractor, like Highmark, actually submitted cash contributions throughout the year, and thus actually accrued interest on its pension obligations. Where the CAS Board previously recognized that the use of prepayment credits should have a neutral impact on government contract cost accounting, OIG's position is unsupportable not simply as a matter of law, but also as a matter of policy.

Highmark recalculated claimed pension costs for Medicare reimbursement FYs 2003 through 2009 as $12,657,422. This amount includes the impact of Item No. 2 (*i.e.*, the recommendation of OIG Report No. A-07-13-00414), but does not reflect acceptance of Item No. 3 (i.e., the interest adjustment). The difference between the recalculated amount of $12,657,422 and the OIG Report amount of $11,860,049 of $797,373 was driven by the interest adjustments discussed above. Our actuary has developed these revised figures based on the information contained in OIG Report Nos. A-07-13-00414 and A-07-13-00416, and the additional detailed supplemental information received from the audit team.

Thank you again for affording Highmark the opportunity to comment on this report. We believe that resolution of the issues raised can best be achieved through an open dialogue between the government and Highmark. In that regard, please do not hesitate to contact me at (412) 544-6902 or through email at Janine.Colinear@Highmark.com if you have any questions regarding this response.

Sincerely,

Janine K. Colinear
Chief Accounting Officer
Highmark Inc.