



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

November 5, 2004

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

Report Number: A-07-04-00169

Donald L. Fisher  
Vice President  
Compensation, Benefits, HRIS, and Risk Management  
Highmark, Inc.  
1800 Center Street  
P.O. Box 890089  
Camp Hill, Pennsylvania 17089-0089

Dear Mr. Fisher:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) report entitled "Review of Medicare Contractor's Pension Segmentation Requirements, Pennsylvania Blue Shield for the period covering January 1, 1992 to December 31, 1997." A copy of this report will be forwarded to the HHS action official noted on the next page for her 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 publicly to the extent information contained therein is not subject to exemptions of the Act that the Department chooses to exercise. (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, ext. 225, or Jenenne Tambke, Audit Manager, at (573) 893-8338, ext. 21, or through email at [Jenenne.Tambke@oig.hhs.gov](mailto:Jenenne.Tambke@oig.hhs.gov). Please refer to report number A-07-04-00169 in all correspondence.

Sincerely yours,

James P. Aasmundstad  
Regional Inspector General  
for Audit Services

Enclosures - as stated

Page 2 -- Donald L. Fisher

**Direct Reply to HHS Action Official:**

Nancy B. O'Connor  
Acting Regional Administrator, Region III  
Centers for Medicare & Medicaid Services  
Public Ledger Building, Suite 216  
150 South Independence Mall West  
Philadelphia, Pennsylvania 19106

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
CONTRACTOR'S PENSION  
SEGMENTATION REQUIREMENTS,  
PENNSYLVANIA BLUE SHIELD FOR  
THE PERIOD COVERING JANUARY 1,  
1992 TO DECEMBER 31, 1997**



**NOVEMBER 2004  
A-07-04-00169**

# *Office of Inspector General*

<http://oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The OIG's 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 in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

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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 information contained therein 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 awarding agency will make final determination on these matters.



## **EXECUTIVE SUMMARY**

### **BACKGROUND**

Pennsylvania Blue Shield (PBS) administered Medicare Part B operations under a cost reimbursement contract with Centers for Medicare & Medicaid Services (CMS) until it merged with Veritus Inc. (Veritus) on December 6, 1996, to form Highmark, Inc. (Highmark).

On December 31, 1997, Highmark merged the Veritus pension plan into the PBS pension plan. Effective January 1, 1998, the PBS plan was amended and restated, and became the pension plan for Highmark. For the purpose of this report, PBS will be used to address the findings concerning the Part B pension plan segment assets for the period January 1, 1992, to December 31, 1997.

Starting with fiscal year 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards (CAS) 412 and 413.

We previously conducted a segmentation review (A-07-93-00712) that addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1992.

### **OBJECTIVES**

The objectives of our review were to determine if PBS:

- implemented our prior audit recommendation
- complied with the pension segmentation requirements of the Medicare contract while updating Medicare segment assets from January 1, 1992, to December 31, 1997

### **SUMMARY OF FINDINGS**

The PBS implemented our prior audit recommendation. However, PBS did not comply with the Medicare contract's pension segmentation requirements while updating Medicare segment assets from January 1, 1992, to December 31, 1997. As a result, PBS understated Medicare segment pension assets by \$1,214,985. The PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract and that Medicare segment assets were updated in accordance with CAS 412 and 413.

### **RECOMMENDATIONS**

We recommend that PBS increase the Medicare segment pension assets by \$1,214,985 and recognize segment assets of \$37,438,341 as of December 31, 1997.

## **AUDITEE'S COMMENTS**

The PBS's comments are summarized in the following paragraphs and its redacted comments are presented in its entirety on appendix B.

The PBS disagreed with our report and stated that it:

“...does not concur that the Medicare segment assets were understated by \$1,214,985 because PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract, and the Medicare segment assets were not updated in accordance with CAS 412 and 413.”

The PBS contends that:

- OIG assigned certain participants to incorrect segments
- most of OIG's findings concerning the understatement of segment assets was due to a retroactive application of a recent decision handed down by the U.S. Court of Appeals concerning reassignable pension costs
- OIG incorrectly identified PBS's Medicare segment cost centers

## **OIG RESPONSE**

We partially disagree with PBS's assertion concerning the understatement of Medicare segment assets.

Our identification of the Medicare segment assets was in accordance with the Medicare contract, and the update of assets was in accordance with CAS 412 and 413. During the course of the audit, we reviewed our identification of the participants and cost centers comprising the Medicare segment with representatives of PBS and obtained their concurrence. The findings and recommendation of this report are based upon that identification. Therefore, our position has not changed, and we recommend that PBS increase the Medicare segment pension assets by \$1,214,985 and recognize segment assets of \$37,438,341 as of December 31, 1997.

However, we acknowledge that a recent decision by the U.S. Court of Appeals affected the method used by PBS to measure and assign pension costs to periods. The method employed by CMS actuaries reflected this decision and did have a material impact upon the difference between claimed and allowable pension costs used to update the Medicare assets.

## TABLE OF CONTENTS

	<b><u>Page</u></b>
<b>INTRODUCTION</b>	1
<b>BACKGROUND</b>	1
Medicare	1
Regulations	1
<b>OBJECTIVES, SCOPE, AND METHODOLOGY</b>	1
Objectives	1
Scope	2
Methodology	2
<b>FINDINGS AND RECOMMENDATIONS</b>	2
<b>CRITERIA - MEDICARE CONTRACT &amp; CAS</b>	2
Medicare Contract	2
CAS	3
<b>CONDITION - COMPONENTS OF ASSET UPDATE</b>	3
Contributions Overstated	3
Prepayment Credits Not Identified	4
Benefit Payments Understated	4
Transfers Overstated	4
Earnings and Expenses Understated	5
<b>CAUSE - LACK OF ADEQUATE CONTROLS</b>	5
<b>EFFECT - OVERSTATEMENT OF MEDICARE SEGMENT ASSETS</b>	5
<b>RECOMMENDATION</b>	5
<b>AUDITEE'S COMMENTS</b>	6
<b>OIG'S RESPONSE</b>	6
<b>APPENDIXES</b>	
<b>PENNSYLVANIA BLUE SHIELD     STATEMENT OF MEDICARE PENSION ASSETS</b>	A
<b>PENNSYLVANIA BLUE SHIELD'S WRITTEN RESPONSE</b>	B

## **Glossary of Abbreviations and Acronyms**

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulations
OIG	Office of Inspector General
PBS	Pennsylvania Blue Shield
WAV	Weighted Average Value

# INTRODUCTION

## BACKGROUND

### Medicare

The PBS administered Medicare Part B operations under cost reimbursement contract with CMS until it merged with Veritus on December 6, 1996, to form Highmark. In claiming costs, contractors must follow cost reimbursement principles contained in Federal Acquisition Regulations (FAR), CAS, and the Medicare contract.

On December 31, 1997, Highmark merged the Veritus pension plan into the PBS pension plan. Effective January 1, 1998, the PBS plan was amended and restated, and became the pension plan for Highmark. For the purpose of this report, PBS will be used to address the findings concerning the Part B pension plan segment assets for the period January 1, 1992, to December 31, 1997.

CMS incorporated segmentation requirements into Medicare contracts starting in FY 1988. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

We previously conducted a segmentation review (A-07-93-00712) that addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1992.

### Regulations

The CAS 412 regulates the determination and measurement of pension cost components. It also regulates the assignment of pension costs to appropriate accounting periods.

The CAS 413 regulates 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.

## OBJECTIVES, SCOPE, AND METHODOLOGY

### Objectives

The objectives of our review were to determine if PBS:

- implemented our prior audit recommendation
- complied with the pension segmentation requirements of the Medicare contract while updating Medicare segment assets from January 1, 1992, to December 31, 1997

## **Scope**

We reviewed PBS's identification of the Medicare segment and its update of Medicare assets from January 1, 1992, to December 31, 1997. Achieving our objectives did not require that we review PBS's overall internal control structure. However, we did review controls relating to the identification of the Medicare segment and the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We performed onsite audit work at PBS's office in Camp Hill, PA.

## **Methodology**

In performing this review, we used information provided by PBS's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed PBS's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. The CMS Office of the Actuary staff used the documents to calculate Medicare segment assets as of December 31, 1997. We reviewed the methodology and calculations.

We performed this review in conjunction with our audits of unfunded pension costs (A-07-04-00173) and pension costs claimed for Medicare reimbursement (A-07-04-00171). The information obtained and reviewed during the audits also was used in performing this review.

Details for the updated pension assets of the Medicare segment from January 1, 1992, to December 31, 1997, are presented on appendix A.

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

## **FINDINGS AND RECOMMENDATION**

The PBS implemented the recommendation from the prior audit. However, PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract, and the Medicare segment was not updated in accordance with CAS 412 and 413. As a result, as of December 31, 1997, PBS understated the Medicare segment assets by \$1,214,985.

### **CRITERIA - MEDICARE CONTRACT & CAS**

#### **Medicare Contract**

The Medicare contracts identify a Medicare segment as:

“ . . .any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.”

Furthermore, the Medicare contract states “. . .the pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7).”

## **CAS**

The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, income, benefit payments, and expenses. In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment’s ratio of pension plan assets to actuarial accrued liabilities.

Furthermore, CAS 412.50(a)(4) states that for contractors with prepayment credits, the credits represent funds available to the contractors at the beginning of plan years. The funds should be applied first to satisfy funding requirements in order to reduce interest costs to the Government.

## **CONDITION - COMPONENTS OF ASSET UPDATE**

### **Contributions Understated**

The PBS’s update methodology did not equitably assign pension contributions to the Medicare segment, because it did not correctly identify the Medicare segment in accordance with the Medicare contract. As a result, PBS understated segment assets by \$198,485.

The audited update of Medicare segment assets assigned contributions to the Medicare segment using the pension costs as calculated by CMS Office of the Actuary. The Medicare segment assets increase by \$198,485 in the audited update due to differences in assigned contributions. A comparison of PBS’s and our calculation of pension contributions follows:

## CONTRIBUTIONS

Year	OIG	PBS	Difference
1992	\$0	\$0	\$0
1993	0	0	0
1994	421,804	129,328	292,476
1995	1,102,113	910,104	192,009
1996	1,073,202	1,005,648	67,554
1997	1,911,322	2,264,876	(353,554)
<b>Totals</b>	<b>\$4,508,441</b>	<b>\$4,309,956</b>	<b>\$198,485</b>

### Prepayment Credits Not Identified

The PBS failed to identify prepayment credits allocable to the Medicare segment and therefore understated the Medicare segment prepayment credits by \$1,191,071. For the years 1996 and 1997, PBS's assigned contributions exceeded the required funding of the CAS pension cost. According to CAS 412-50(c)(1), amounts funded in excess of pension costs (or prepayment) shall be carried forward with interest to fund future CAS pension costs. We considered the excess contributions in our computations and allocated prepayment credits as needed to the Medicare segment to fund CAS pension costs.

### Benefit Payments Understated

Due to the incorrect identification of the Medicare segment participants, PBS's update of segment assets did not properly identify benefit payments to retirees from the Medicare segment. We identified the actual benefits paid to the retirees from the Medicare segment and assigned the costs to the Medicare segment. This resulted in an understatement of Medicare segment benefit payments by \$37,348.

### Transfers Overstated

The PBS made adjustments for transfers (representing the movement of participants in and out of the segment each year) in its update of segment assets from January 1, 1992, to December 31, 1997. However, PBS incorrectly identified the participants who transferred in and out of the segment resulting in an overstatement of Medicare segment assets of \$1,175,350. Transfers for the audited update of Medicare segment assets were adjusted based on our revisions to the Medicare segment.

A comparison of OIG and PBS's calculations of net asset transfers into the Medicare segment is shown in the schedule below.

**Net Asset Transfers into the Medicare Segment**

<b>Year</b>	<b>OIG</b>	<b>PBS</b>	<b>Difference</b>
1992	(\$6,096)	(\$67,148)	\$61,052
1993	(939,674)	(1,118,590)	178,916
1994	(940,506)	(1,544,572)	604,066
1995	(1,607,398)	(887,356)	(720,042)
1996	(1,732,984)	(433,642)	(1,299,342)
<b>Totals</b>	<b><u>(\$5,226,658)</u></b>	<b><u>(\$4,051,308)</u></b>	<b><u>(\$1,175,350)</u></b>

**Earnings and Expenses Understated**

The PBS's investment earnings, less administrative expenses, were understated by \$1,038,127. The understatement occurred because the Medicare asset base was developed using incorrect contribution, prepayment credit, transfer, and benefit amounts (discussed above). It was PBS's practice to allocate investment income to the Medicare segment based on the time weighted value of assets. Administrative expenses to the segment were allocated in proportion to the allocation of earnings.

Additionally, for plan years beginning after March 30, 1995, CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets. The audited update of Medicare segment assets reflects the required change in methodology.

**CAUSE - LACK OF ADEQUATE CONTROLS**

The PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract and that Medicare segment pension assets were updated in accordance with CAS 412 and 413.

**EFFECT - OVERSTATEMENT OF MEDICARE SEGMENT ASSETS**

As of December 31, 1997, PBS understated Medicare segment pension assets by \$1,214,985.

**RECOMMENDATION**

We recommend that PBS increase the Medicare segment pension assets by \$1,214,985 as of December 31, 1997.

## **AUDITEE'S COMMENTS**

The PBS's comments are summarized in the following paragraphs and its redacted comments are presented in its entirety on appendix B.

The PBS disagreed with our report and stated that it:

“...does not concur that the Medicare segment assets were understated by \$1,214,985 because PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract, and the Medicare segment assets were not updated in accordance with CAS 412 and 413.”

The PBS contends that:

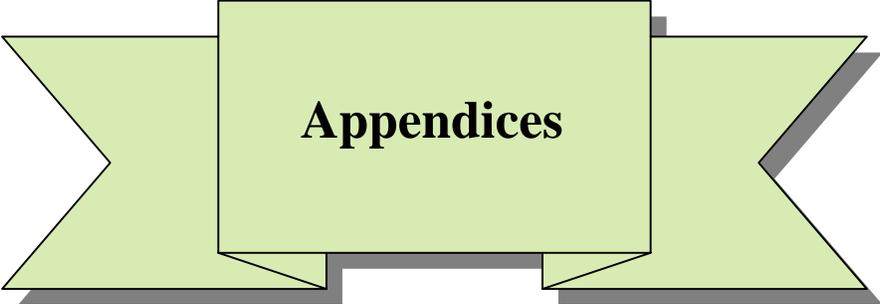
- OIG assigned certain participants to incorrect segments
- most of the OIG's findings concerning the understatement of segment assets was due to a retroactive application of a recent decision handed down by the U.S. Court of Appeals concerning reassignable pension costs
- OIG incorrectly identified PBS's Medicare segment cost centers

## **OIG RESPONSE**

We partially disagree with PBS's assertion concerning the understatement of Medicare segment assets.

Our identification of the Medicare segment assets was in accordance with the Medicare Contract and the update of assets was in accordance with CAS 412 and 413. During the course of the audit, we reviewed our identification of the participants and cost centers comprising the Medicare segment with representatives of PBS and obtained their concurrence. The findings and recommendation of this report are based upon that identification. Therefore, our position has not changed, and we recommend that PBS increase the Medicare segment pension assets by \$1,214,985 and recognize segment assets of \$37,438,341 as of December 31, 1997.

However, we acknowledge that a recent decision by the U.S. Court of Appeals affected the method used by PBS to measure and assign pension costs to periods. The method employed by CMS actuaries reflected this decision and did have a material impact upon the difference between claimed and allowable pension costs used to update the Medicare assets.



**Appendices**

Pennsylvania Blue Shield (PBS)  
Statement of Medicare Pension Assets  
For the Period  
January 1, 1992, to December 31, 1997

Description	Total Company	Other Segment	Medicare
Assets January 1, 1992	<u>1/</u> \$92,448,008	\$71,181,023	\$21,266,985
Prepayment Transfer	0	0	0
Contributions	<u>2/</u> 0	0	0
KPHE Transfer	<u>3/</u> (92,289)	(92,289)	0
Earnings	<u>4/</u> 7,202,426	5,545,561	1,656,865
Benefit Payments	<u>5/</u> (1,965,075)	(1,435,467)	(529,608)
Expenses	<u>6/</u> (445,842)	(343,279)	(102,563)
Transfers	<u>7/</u> 0	6,096	(6,096)
Assets January 1, 1993	97,147,228	74,861,645	22,285,583
Asset Value Adjustment	<u>8/</u> (14,187)	(10,933)	(3,254)
Prepayment Transfer	0	0	0
Contribution	0	0	0
Earnings	13,693,019	10,551,839	3,141,180
Benefit Payments	(2,087,855)	(1,539,751)	(548,104)
Expenses	(486,323)	(374,760)	(111,563)
Transfers	0	939,674	(939,674)
Assets January 1, 1994	108,251,882	84,427,714	23,824,168
Asset Value Adjustment	(15,106)	(11,781)	(3,325)
Prepayment Transfer	0	0	0
Contribution	<u>9/</u> 421,804	0	421,804
Earnings	505,781	394,468	111,313
Benefit Payments	(2,113,365)	(1,500,782)	(612,583)
Expenses	(528,701)	(412,344)	(116,357)
Transfers	0	940,506	(940,506)
Assets January 1, 1995	106,522,295	83,837,781	22,684,514

Pennsylvania Blue Shield (PBS)  
Statement of Medicare Pension Assets  
For the Period  
January 1, 1992, to December 31, 1997

Description	Total Company	Other Segment	Medicare
Assets January 1, 1995	\$106,522,295	\$83,837,781	\$22,684,514
Prepayment Transfer	0	0	0
Contribution	7,981,344	6,879,231	1,102,113
Earnings	25,954,964	20,427,710	5,527,254
Benefit Payments	(2,507,718)	(1,872,376)	(635,342)
Expenses	(462,502)	(364,010)	(98,492)
Transfers	0	1,607,398	(1,607,398)
Assets January 1, 1996	137,488,383	110,515,734	26,972,649
Prepayment Transfer	<u>10/</u> 0	(947,660)	947,660
Contribution	4,717,604	3,644,402	1,073,202
Earnings	21,348,753	17,014,425	4,334,328
Benefit Payments	(2,510,424)	(1,913,570)	(596,854)
Expenses	(583,768)	(465,249)	(118,519)
Transfers	0	1,732,984	(1,732,984)
Assets January 1, 1997	160,460,548	129,581,066	30,879,482
Prepayment Transfer	0	(243,411)	243,411
Contribution	10,617,076	8,705,754	1,911,322
Earnings	33,709,687	27,251,849	6,457,838
Benefit Payments	(6,415,756)	(4,498,546)	(1,917,210)
Expenses	(712,538)	(576,036)	(136,502)
Assets December 31, 1997	\$197,659,017	\$160,220,676	\$37,438,341
Per PBS	<u>11/</u> \$197,659,017	\$161,435,661	\$36,223,356
Asset Variance	<u>12/</u> \$0	(\$1,214,985)	\$1,214,985

Pennsylvania Blue Shield (PBS)  
Statement of Medicare Pension Assets  
For the Period  
January 1, 1992, to December 31, 1997

**FOOTNOTES**

- 1/ We determined the Medicare segment assets as of January 1, 1992, in our prior review of PBS's pension segmentation (A-07-93-00712). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.
- 2/ We obtained total company contribution amounts from the actuarial valuation reports. We allocated total company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the total company funding target. Contributions in excess of the funding targets were treated as prepayments credits and accounted for in the Other segment until needed to fund pension cost in future.
- 3/ KPHE net assets transferred out represent a transaction involving business units outside the Medicare segment and therefore does not affect the Medicare segment.
- 4/ We obtained investment earnings from actuarial valuation reports. The PBS allocated its investment earnings based on a ratio of the time weighted value of assets for all years. We allocated investment earning for years prior to 1996 using PBS's methodology. For years starting with 1996, we allocated investment earnings based on the ratio of the segment's WAV of assets to total company WAV of assets as required by CAS.
- 5/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. The PBS provided us with supporting documentation for benefit payment amounts to plan retirees. We used actual benefit payments for Medicare segment retirees.
- 6/ We allocated administrative expenses to the Medicare segment in proportion to investment income. The PBS used the same methodology.

Pennsylvania Blue Shield (PBS)  
Statement of Medicare Pension Assets  
For the Period  
January 1, 1992, to December 31, 1997

- 7/ We identified participant transfers between segments by comparing valuation data files provided by PBS. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. For transfers occurring prior to the 1996 plan year, asset transfers reflected the funding level of the segment from which the participant transferred, based on the actuarial liability and the asset value used for cost purposes. We calculated the funding leveling as the assets divided by the liabilities. If the funding level was greater than one, we transferred assets equal to the participant's liability. For plan years starting with 1996, asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with CAS.
- 8/ Adjustments made by PBS to the beginning of the year market value of the assets from the previous valuation report.
- 9/ The Other segment had no assignable cost in 1994, therefore 100 percent of the contributions were allocated to the Medicare segment.
- 10/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to reduce interest costs to the Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 11/ We obtained total asset amounts as of December 31, 1997, from PBS's actuarial valuation report prior to transfer adjustments.
- 12/ The asset variance represents the difference between the OIG calculation of Medicare segment assets and PBS's market value of assets shown in its valuation report.



October 14, 2004

Mr. James P. Aasmundstad  
Regional Inspector General for Audit Services  
DHHS, OIG  
601 East 12<sup>th</sup> Street  
Room 284A  
Kansas City, Missouri 64106

**RE: A-07-04-00169 (“Review of Medicare Contractor’s Pension Segmentation Requirements, Pennsylvania Blue Shield”)**  
**A-07-04-00171 (“Review of Pension Costs Claimed for Medicare Reimbursement by Pennsylvania Blue Shield for Fiscal Year 1992 through 1997”)**  
**A-07-04-00173 (“Audit of Pennsylvania Blue Shield’s Unfunded Pension Costs for the Period covering 1992 through 1996”)**

Dear Mr. Aasmundstad:

Attached is our response to your letters dated August 18, 2004, requesting comments on your draft reports A-07-04-00169 entitled, “Review of Medicare Contractor’s Pension Segmentation Requirements, Pennsylvania Blue Shield” for the period covering January 1, 1992 to December 31, 1997; A-07-04-00171 entitled, “Review of Pension Costs Claimed for Medicare Reimbursement by Pennsylvania Blue Shield for Fiscal Year 1992 through 1997;” and A-07-04-00173 entitled, “Audit of Pennsylvania Blue Shield’s Unfunded Pension Costs for the period covering 1992 through 1996.”

If you have any questions, please feel free to contact me at 717-302-4175.

Sincerely,

Donald L. Fisher, Vice President  
Compensation, Benefits, HRIS &  
Risk Management

cc: James Chiado  
Elizabeth Farbacher  
Patrick Kiley  
Anthony Lobato  
Gayeta Porter

**Corporate Offices:**

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

**Review of Medicare Contractor's  
Pension Segmentation Requirements,  
Pennsylvania Blue Shield**

**January 1, 1992 to December 31, 1997**

**Highmark Comments to OIG Draft Report  
A-07-04-00169**

## Highmark's Comments on Report Number A-07-04-00169

Highmark does not concur that the Medicare segment assets were understated by \$1,214,985 because PBS did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract, and that the Medicare segment assets were not updated in accordance with CAS 412 and 413. Highmark disagrees with OIG's segment assignment of certain participants identified in the attached Exhibits I and II and also believes that most of the understatement of segment assets was the result of OIG's retroactive application of a recent decision of the United States Court of Appeals for the Federal Circuit (*Eastman Kodak Company vs. Donald H. Rumsfeld, Secretary of Defense*). Highmark suggests that OIG's audit report should separately identify the amount due to the retroactive application of the recent Kodak "full funding limit" that was not a part of the measurement and assignment practices that were previously followed by either OIG or Highmark's pension actuary, and the amount due to the incorrect assignment of cost centers to the Medicare segment, after revising their calculations for the participants identified in Exhibits I and II.

Highmark agrees that several cost centers were incorrectly assigned, but believes it was due to human error and a different interpretation of the segment definition, rather than an inherent lack of adequate controls. Of 58 cost centers that OIG did not include in their identification of the Medicare segment, only 2 (cost centers 129 and 623) were inappropriately assigned to the Medicare segment by PBS. These two cost centers were identified by OIG during their previous pension audit that was completed in 1994. Following receipt of the audit reports in 1994, these cost centers were correctly assigned to the Indirect segment for future valuations.

In addition, OIG inappropriately excluded cost center 106, Medicare Systems Support and Development, from the Medicare segment for 1996 and 1997. This cost center was moved from Xact Medicare Services (Medicare B Business Unit) to the Information Services Group (Corporate Unit) in 1995, but continued to perform anywhere from 90-100% in support of Medicare B activity. The cost center was assigned to the Indirect segment in 1995 in error by Pennsylvania Blue Shield, but reassigned to the Medicare B segment in 1996 and 1997. OIG correctly reassigned the participants in cost center 106 to the Medicare B segment in 1995, but transferred them to the Indirect segment in 1996 and 1997 in error. The other cost centers, which

were originally assigned to the Medicare segment, had not been closed in the Financial system, but were excluded by the PBS pension actuary prior to completing the pension valuation, because there were no participants in those cost centers.

There were 32 cost centers that OIG included in the identification of the Medicare segment that were missing for one or more years from the cost center listing that Highmark provided. Of the 32 cost centers identified by OIG, only 4 cost centers (031, 163, 250 and 384) that contained participants, were not appropriately assigned to the Medicare segment by Highmark's actuary. Cost center 005, SVP, Government Business, was transferred from the Medicare B segment during 1996 to the Indirect segment. Prior to August 1996, the cost center supported Medicare B but, after the transfer, no cost was allocated to the Medicare B line of business. Therefore, this cost center was appropriately assigned to the Indirect segment by Highmark's actuary for 1997. In addition, Highmark's pension actuary utilizes a segment indicator on all participants (actives, retirees and vested terms); therefore, it is not necessary to continue to identify cost centers for retirees or terminated participants. The segment indicator for retirees and vested terms doesn't change following termination. Most of the remaining cost centers, which were not assigned to the Medicare segment, had no active employees, or the employees were correctly assigned by Highmark's pension actuary.

In order to identify differences between OIG's and Pennsylvania Blue Shield's assignment of participants to the Medicare B segment, Highmark's pension actuary compared OIG participant listings for each year with their valuation files. Any differences were researched to determine the correct segment assignment, using the Medicare definition of segment as: "any organizational component of the contractor, such as, division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement in which the majority of the salary dollars is allocated to the Medicare agreement/contract." Based on Highmark's research, Highmark believes that OIG was incorrect on the segment assignment for the participants listed on the attached Exhibits I and II. The exhibits identify the participants, the participant's cost center, the valuation years impacted, and an explanation for why Highmark believes that OIG should change their segment assignment and recalculate the impact on the assets assigned to the Medicare segment.

Participants not included in the Medicare B Segment by OIG that should be

Segment	Cost Center		Valuation Impacted	Explanation
	Number	Name		
Medicare B	186	Medicare Medical Director	1994 1995	Based on provisions of Pennsylvania Blue Shield's pension plan, became 100% vested when he reached age 65 in 1979, with 5 years of credited service from 1970-1975. He is an eligible retiree who terminated from a cost center that allocated more than 50% to Medicare B. was not considered an eligible participant prior to 1994 but, upon research, Pennsylvania Blue Shield determined that he was entitled to a benefit under the Plan. He was credited with 5 years of service, and a liability was established for his benefit in 1994.
Medicare B	020	Medicare Incoming Mail	1995 1996 1997	Participant is a retiree who terminated in 1986 from a cost center that allocated more than 50% to Medicare. Because participant was not identified as an exception during OIG's initial audit of Pennsylvania Blue Shield pension costs and segmentation, Highmark believes that Participant's assignment to the Medicare segment was appropriate.
Medicare B	399	Provider Telephone and General Inquiry Services	1995 1996 1997	Participant is a retiree who terminated in 1988 from a cost center that allocated more than 50% to Medicare. Because participant was not identified as an exception during OIG's initial audit of Pennsylvania Blue Shield pension costs and segmentation, Highmark believes that Participant's assignment to the Medicare segment was appropriate. Participant returned to work in a part-time position in 1995, but didn't accrue any additional service.
Medicare B	020	Medicare Incoming Mail	1995 1996	Participant is a retiree who terminated in 1979 from a cost center that allocated more than 50% to Medicare. Because participant was not identified as an exception during OIG's initial audit of Pennsylvania Blue Shield pension costs and segmentation, Highmark believes that Participant's assignment to the Medicare segment was appropriate.
Medicare B	398	Medicare Beneficiary Telephone Services	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.

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Participants not included in the Medicare B Segment by OIG that should be

Segment	Cost Center		Valuation Impacted	Explanation
	Number	Name		
Medicare B	914	Medicare Appeals	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	121	Medicare Microfilming	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	687	Medicare Medical Unit A	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	398	Medicare Beneficiary Telephone Services	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	185	Medicare Medical Review	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	211	Medicare Accounts Receivable	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	398	Medicare Beneficiary Telephone Services	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	431	Medicare Provider Telephone Services	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	686	Xact Medicare Clerical Specialties	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	431	Medicare Provider Telephone Services	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.

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Participants **not** included in the Medicare B Segment by OIG that **should be**

Segment	Cost Center		Valuation Impacted	Explanation
	Number	Name		
Medicare B	164	Xact Development Select Claims Adjudication	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	1049	Medical Unit B	1996	Participant is a vested termination who terminated in 1995 from a cost center that allocated more than 50% to Medicare.
Medicare B	020	Medicare Incoming Mail (Spouse)	1997	Surviving spouse of [redacted] who retired from cost center 020 in the Medicare B segment.
Medicare B	433	General Information	1997	Participant is a vested termination who terminated 1996 from a cost center that allocated more than 50% to Medicare.

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Participants not included in the Medicare B Segment by OIG that should be

	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
<b>Data Redacted by OAS Auditors.</b>	Medicare B	106	Medicare Systems Support and	1996	This cost center was moved from HGSA (Government Business Unit) to ISG (Corporate Unit) in 1995, but continued to perform anywhere from 90-100% in support of Medicare B activity. This cost center should be included in the Medicare B segment for 1996 and 1997. In 1998, it was moved to the Indirect segment as a consequence of the new cost allocation system, where it became part of the allocation of centralized services.
	Medicare B	106	Development	1996 & 1997	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1997	
	Medicare B	106		1996	
	Medicare B	106		1996	
	Medicare B	106		1996	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996	
	Medicare B	106		1996	
	Medicare B	106		1996	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996	
	Medicare B	106		1996 & 1997	
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	Medicare B	106		1996 & 1997	
	Medicare B	106		1996	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996 & 1997	
	Medicare B	106		1996 & 1997	
Medicare B	106		1996		
Medicare B	106		1996		
Medicare B	106		1996-1997		
Medicare B	106		1996		

Participants included in the Medicare B Segment by OIG that should not be

Segment	Cost Center		Valuation	Explanation
	Number	Name	Impacted	
Indirect	005	SVP, Govt Business, thru July 1996. Name changed to SVP, Middle Atlantic Region, during August 1996.	1997	Cost center was transferred from Medicare B segment during 1996 to the Indirect Segment. Through July 1996, the cost center supported Medicare B, but after transfer, no cost was allocated to the Medicare B line of business. As of 12/31/96, the cost center should be assigned to the Indirect segment.
Indirect	005	SVP, Govt Business, thru July 1996. Name changed to SVP, Middle Atlantic Region, during August 1996.	1997	Cost center was transferred from Medicare B segment during 1996 to the Indirect Segment. Through July 1996, the cost center supported Medicare B, but after transfer, no cost was allocated to the Medicare B line of business. As of 12/31/96, the cost center should be assigned to the Indirect segment.
Indirect	189	PA/DE Champus	1994 1995 1996 1997	Participant is a retiree who terminated in 1981 from a cost center that allocated less than 50% to Medicare B. Because participant was not identified as an exception during OIG's initial audit of Pennsylvania Blue Shield pension cost and segmentation, Highmark believes that Participant's assignment to the Indirect segment was appropriate.
Indirect	077	Employee Relations	1994 1995 1996 1997	Participant is a retiree who terminated in 1984 from a cost center that allocated less than 50% to Medicare B. Because participant was not identified as an exception during OIG's initial audit of Pennsylvania Blue Shield pension cost and segmentation, Highmark believes that Participant's assignment to the Indirect segment was appropriate.
Indirect	375	Assistant Controller Cost Accounting	1996	The cost center moved in February 1996 from Xact (Director Medicare Financial Services) to Corporate Finance and supported the entire corporation. In 1996, less than 50% of this cost center was allocated to Medicare B.

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