



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

JAN 20 2006

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

Report Number A-07-06-00200

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 U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Veritus, Inc. for Fiscal Years 1996 Through 1997." A copy of this report will be forwarded to the HHS action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. 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 issued to the Department's grantees and contractors are made available to the public to the extent the information is not subject to exemptions in 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. 274, or contact 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). To facilitate identification, please refer to report number A-07-06-00200 in all correspondence.

Sincerely yours,

Patrick J. Cogley,  
Regional Inspector General  
for Audit Services

Enclosures

**Direct Reply to HHS Action Official:**

Nancy B. O'Connor  
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 NONQUALIFIED  
DEFINED-BENEFIT PENSION PLAN  
COSTS CLAIMED BY VERITUS, INC.  
FOR FISCAL YEARS 1996  
THROUGH 1997**



**Daniel R. Levinson  
Inspector General**

**JANUARY 2006  
A-07-06-00200**

# ***Office of Inspector General***

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## **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**

Veritus, Inc. of Pennsylvania (Veritus) administered Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS) from the inception of the Medicare program until it merged with Pennsylvania Blue Shield (PBS) on December 6, 1996, to form Highmark, Inc. (Highmark). This report will address findings related to Veritus.

Veritus had a nonqualified defined-benefit pension plan, called an Excess Benefit Plan (EBP), to restore benefits in excess, if any, of the amount provided by the regular qualified plan.

In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations, Cost Accounting Standards (CAS), and Medicare contract.

### **OBJECTIVE**

Our objective was to determine the allowability of EBP costs Veritus claimed for Medicare reimbursement for fiscal years (FY) 1996 through 1997.

### **SUMMARY OF FINDING**

Veritus underclaimed \$23,728 in allowable EBP costs for FYs 1996 through 1997 because it did not claim all of the allowable EBP costs allowed by the CAS. Veritus claimed EBP costs of \$6,079 for Medicare reimbursement; however, the allowable EBP costs were \$29,807.

### **RECOMMENDATION**

We recommend that Veritus revise its Final Administrative Cost Proposals (FACP) for FYs 1996 through 1997 or submit a claim for additional allowable EBP costs of \$23,728.

### **AUDITEE'S COMMENTS**

Veritus agreed with our finding and recommendation.

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## **Glossary of Abbreviations and Acronyms**

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
EBP	Excess Benefit Plan
FACP	Final Administrative Cost Proposal
FAR	Federal Acquisition Regulations
FY	fiscal year
HHS	U.S. Department of Health and Human Services
Highmark	Highmark, Inc.
LOB	Line of Business
OIG	Office of Inspector General
PBS	Pennsylvania Blue Shield
Veritus	Veritus, Inc. of Pennsylvania

# INTRODUCTION

## BACKGROUND

### Medicare

Veritus, Inc. of Pennsylvania (Veritus) administered Medicare Part A operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS) from the inception of the Medicare program until it merged with Pennsylvania Blue Shield (PBS) on December 6, 1996, to form Highmark, Inc. (Highmark). For the purposes of this report, the term Veritus will be used to address the findings concerning the Medicare Part A Excess Benefit Plan (EBP) costs claimed for fiscal years (FY) 1996 through 1997. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and Medicare contract.

Medicare reimburses a portion of the annual contributions that 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.

### Veritus Excess Benefit Plan

Veritus established its EBP on January 1, 1994, to provide retirement, death, and termination benefits to participants in its qualified pension plan. The EBP is a nonqualified defined-benefit pension plan designed to restore benefits in excess, if any, of the amount provided by the regular qualified defined-benefit pension plan due to limits specified in the Internal Revenue Code sections 401(a)(17) and 415.

### Regulations

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.”

According to CAS 412.50(c)(3), “The cost of nonqualified defined-benefit pension plans shall be assigned to cost accounting periods in the same manner as qualified plans . . . under the following conditions:

- (i) The contractor, in disclosing or establishing cost accounting practices, elects to have a plan so accounted for;
- (ii) The plan is funded through the use of a funding agency; and,
- (iii) The right to a pension benefit is nonforfeitable and is communicated to the participants.”

FAR 31.205-6(j) addresses allowability of pension costs and requires that funding substantiate pension costs assigned to contract periods.

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

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.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

Our objective was to determine the allowability of EBP costs Veritus claimed for Medicare reimbursement for FYs 1996 through 1997.

### **Scope**

Veritus was unable to identify the amount of EBP costs claimed prior to FY 1996; therefore, we limited the scope of our review to EBP costs claimed on the Financial Administrative Cost Proposals (FACP) for FYs 1996 through 1997. We reviewed Veritus's EBP costs claimed on its FACPs for FYs 1996 through 1997. Veritus was unable to identify and provide documentation for the indirect costs claimed on the FY 1996 FACP; therefore, we limited the scope of costs claimed for FY 1996 to the Medicare segment costs. Achieving the objective did not require a review of Veritus's internal control structure. However, we did review the controls relating to the EBP costs claimed for Medicare reimbursement to ensure that EBP costs were allowable in accordance with the CAS.

This review was done in conjunction with our review of Veritus's nonqualified defined-benefit pension segmentation (A-07-05-00203). We used the information obtained and reviewed during that audit in performing this review.

We performed fieldwork at Highmark's corporate office in Camp Hill, PA, during September 2003, November 2003, and January 2004.

### **Methodology**

We identified Veritus's EBP costs for the total company and for the Medicare segment. We also determined the extent to which Veritus funded the EBP costs with contributions to the trust fund and accumulated prepayment credits. Using this information, we calculated EBP costs that are allowable for Medicare reimbursement for FYs 1996 through 1997. The calculations were based on separately computed EBP costs for the Medicare segment and total company EBP costs. The CMS Office of the Actuary developed the methodology used for computing allowable EBP costs based on Veritus's historical practices. Appendix A presents the details on the pension costs and contributions.

In performing our review, we used information provided by Veritus’s actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We examined Veritus’s accounting records and annual actuarial valuation reports.

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

**FINDING AND RECOMMENDATION**

Veritus underclaimed \$23,728 in allowable EBP costs for FYs 1996 through 1997. We calculated the allowable EBP costs for FYs 1996 through 1997 to be \$29,807. We compared allowable EBP costs to the EBP costs Veritus claimed on its FACPs as shown in the table.

**EBP Cost Claimed Variance**

<b>Fiscal Year</b>	<b>Per Veritus</b>	<b>Per OIG</b>	<b>Difference</b>
<b>1996</b>	\$4,551	\$13,425	(\$8,874)
<b>1997</b>	1,528	16,382	(14,854)
<b>Total</b>	<b>\$6,079</b>	<b>\$29,807</b>	<b>(\$23,728)</b>

Veritus claimed EBP costs of \$6,079 for Medicare reimbursement; however, the allowable EBP costs were \$29,807. As a result, Veritus did not claim \$23,728 of allowable EBP pension costs. Veritus underclaimed costs because it did not claim all of the allowable EBP costs in accordance with the CAS.

**RECOMMENDATION**

Veritus should revise its FACPs for FYs 1996 through 1997 or submit a claim for additional allowable EBP costs of \$23,728.

**AUDITEE’S COMMENTS**

Veritus agreed with our finding and recommendation. Veritus’s response is included in its entirety as Appendix B.

**OFFICE OF INSPECTOR GENERAL’S RESPONSE**

We commend Veritus for its action to address the recommendation.

# **APPENDIXES**

**Veritus, Inc. of Pennsylvania**  
**Statement of Allowable Excess Benefit Plan Costs**  
**For Fiscal Years 1996 Through 1997**

Date	Description	Total Company	Other Segment	Medicare Segment
1995	Contributions	<u>1/</u> \$909,726	\$0	\$0
8.50%	Discount for Interest	<u>2/</u> (69,473)	0	0
1/1/95	Present Value	<u>3/</u> 840,253	0	0
1/1/95	Prepayment Credit	<u>4/</u> 0	0	0
1/1/95	Present Value of Funding	<u>5/</u> 840,253	0	0
1/1/95	Assigned Pension Costs	<u>6/</u> 353,902	0	0
1/1/95	CAS Funding Target	<u>7/</u> 353,902	0	0
1/1/95	Percentage Funded	<u>8/</u> n/a	n/a	n/a
1/1/95	Period Pension Cost	<u>9/</u> 353,902	0	0
	Allowable Interest	<u>10/</u> 21,308	0	0
	Allocable Pension Cost	<u>11/</u> 375,210	0	0
1995	Fiscal Year Pension Cost	n/a	n/a	n/a
	Total Medicare Percentage	<u>12/</u>	1.93%	11.35%
	Allowable Pension Cost	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>

1996	Contributions	\$641,159	\$638,922	\$2,237
8.50%	Discount for Interest	(447)	(445)	(2)
1/1/96	Present Value	640,712	638,477	2,235
1/1/96	Prepayment Credit	184,027	182,532	1,495
1/1/96	Present Value of Funding	824,739	821,009	3,730
1/1/96	Assigned Pension Costs	459,162	455,432	3,730
1/1/96	CAS Funding Target	459,162	455,432	3,730
1/1/96	Percentage Funded		100.00%	100.00%
1/1/96	Period Pension Cost		455,432	3,730
	Allowable Interest		190	2
	Allocable Pension Cost		455,622	3,732
1996	Fiscal Year Pension Cost	<u>13/</u>	n/a	2,799
	Medicare LOB Percentage	<u>14/</u>	1.37%	99.27%
	Allowable Pension Cost	<u>15/</u> \$13,425	<u>16/</u> n/a	<u>\$13,425</u>

**Veritus, Inc. of Pennsylvania**  
**Statement of Allowable Excess Benefit Plan Costs**  
**For Fiscal Years 1996 Through 1997**

**APPENDIX A**  
**Page 2 of 3**

Date	Description	Total Company	Other Segment	Medicare Segment
1997	Contributions	\$528,673	\$527,994	\$679
8.50%	Discount for Interest	(40,443)	(40,391)	(52)
1/1/97	Present Value	488,230	487,603	627
1/1/97	Prepayment Credit	396,651	394,089	2,562
1/1/97	Present Value of Funding	884,881	881,692	3,189
1/1/97	Assigned Pension Costs	493,756	490,567	3,189
1/1/97	CAS Funding Target	493,756	490,567	3,189
1/1/97	Percentage Funded		100.00%	100.00%
1/1/97	Period Pension Cost		490,567	3,189
	Allowable Interest		5,809	38
	Allocable Pension Cost		496,376	3,227
1997	Fiscal Year Pension Cost		486,188	3,353
	Medicare LOB Percentage		2.68%	99.96%
	Allowable Pension Cost	\$16,382	\$13,030	\$3,352

**FOOTNOTES**

- 1/ We obtained total company contribution amounts from the valuation reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns.
- 2/ We subtracted interest that is included in the contributions deposited after January 1 of each 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 valuation interest rate, and actual contribution amounts.
- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year.
- 4/ 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 Cost Accounting Standard (CAS) funding target. A prepayment credit may be carried forward, with interest, to fund future non-qualified defined benefit pension (NQDBP) costs.
- 5/ 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 January 1 of each year.

**Veritus, Inc. of Pennsylvania**  
**Statement of Allowable Excess Benefit Plan Costs**  
**For Fiscal Years 1996 Through 1997**

**APPENDIX A**  
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- 6/ The assigned pension costs, computed at January 1 of each year, provides the basis to compute the allowable pension cost that can be charged to Medicare.
- 7/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of Federal Acquisition Regulations (FAR) 31.205-6(j)(3)(i)(B).
- 8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), 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 decimals. Prior to the first plan year after March 30, 1995, funding was not required as long as the provisions of CAS 412 were met for defined benefit pension plans with a compellable benefit.
- 9/ We computed the period pension cost to be equal to the CAS funding target if funded at least at the complement to the current corporate tax rate. The CAS funding target is reduced proportionately for funding at less than the complement to the rate. Since Veritus always funded 100 percent of the CAS funding target, the period pension cost is equal to the CAS funding target for all years.
- 10/ We assumed interest on the period pension cost is to accrue in the same proportion as the interest on contributions bears to the present value of funding. However, we limited interest based on FAR 31.205-6(j)(3)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target were funded in four equal installments deposited within 30 days of the end of the quarter.
- 11/ The allocable pension cost is the amount of pension cost that may be allocated for contract cost purposes.
- 12/ The Medicare percentages used to allocate the total allowable NQDBP costs were developed from documents provided by Veritus.
- 13/ We converted the plan year allocable pension costs to a Federal fiscal year basis (October 1 through September 30). We calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 14/ We calculated allowable pension costs of the Medicare and other segments based on the Medicare Line of Business (LOB) percentage of each segment. We obtained the percentages from documents provided by Veritus.
- 15/ We computed the allowable Medicare pension cost as the fiscal year pension cost multiplied by the Medicare LOB percentage.
- 16/ The allowable costs for the Other segment were not applicable. Veritus only provided the direct Medicare segment costs claimed for FY 1996; therefore, we only calculated the Medicare segment allowable costs.



January 12, 2006

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

RE: A-07-06-00200 ("Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Veritus, Inc. for Fiscal Years 1996 Through 1997")  
A-07-06-00201 ("Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Pennsylvania Blue Shield for Fiscal Years 1993 Through 1997")  
A-07-06-00202 ("Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Highmark, Inc. for Fiscal Years 1998 Through 2002")  
A-07-06-00203 ("Review of Medicare Segment Assets for the Nonqualified Defined-Benefit Pension Plans for Highmark, Inc. & Predecessors from January 1, 1992 to January 1, 2003")

Dear Mr. Cogley:

Attached are our responses to your letters dated December 13, 2005, requesting comments on your draft reports referenced above.

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

Sincerely,

A handwritten signature in cursive script that reads "Donald L. Fisher".

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

DLF/*per*  
Attachments:

Cc: James Chiado  
Elizabeth Farbacher  
Thomas Hinkson  
Patrick Kiley  
Anthony Lobato

*Corporate Offices:*

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

**Review of Nonqualified Defined-Benefit  
Pension Plan Costs**

**Claimed by Veritus, Inc. for**

**Fiscal Years 1996 through 1997**

**Highmark's Comments to OIG Draft Report  
A07-06-00200**

**Highmark's Comments on the Report Number A-07-06-00200**

Highmark agrees with the recommendation to submit a claim for additional allowable Excess Benefit Plan costs of \$23,728.

It is Highmark's understanding that the CMS Office of the Actuary, in conjunction with the CMS Regional Office, will be developing an agreement that addresses the findings and recommendations in this report, as well as those included in the qualified pension and postretirement plan reports of Highmark Inc. and Predecessors.