



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Offices of Audit Services

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Report Number A-07-04-00175

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

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

Dear Mr. Fisher:

Enclosed are two copies of the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) report entitled "Audit of Veritus' Unfunded Pension Costs for the period covering 1993-1996." A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

The HHS action official named below 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 which 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). To facilitate identification, please refer to report number A-07-04-00175 in all correspondence.

Sincerely yours,

James P. Aasmundstad  
Regional Inspector General  
for Audit Services

Enclosure - as stated

Page 2 – Mr. 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, PA 19106

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF VERITUS' UNFUNDED  
PENSION COSTS FOR THE PERIOD  
COVERING 1993 THROUGH 1996**



**OCTOBER 2004  
A-07-04-00175**

# *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. (Veritus) administered Medicare Part A operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) until it merged with Pennsylvania Blue Shield (PBS) 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 purposes of this report, the term Veritus will be used to address the findings concerning Part A unfunded pension costs for the review period of 1993-1996.

### **OBJECTIVES**

The objectives of our review were to:

- determine if pension costs for plan years 1993-1996 were funded in accordance with the Federal Acquisition Regulations (FAR) and the Cost Accounting Standards (CAS)
- identify and properly account for any accumulated unfunded pension costs, including allowable and reassignable portions

### **SUMMARY OF FINDINGS**

The portion of pension costs Veritus allocated to the Medicare contracts for plan years 1993-1996 was funded in accordance with the FAR and the CAS. However, Veritus did not correctly identify nor properly account for the accumulated unfunded pension costs due to a lack of adequate policies and procedures.

The accumulated unfunded pension costs consist of the accumulated unallowable pension costs and the accumulated reassignable pension costs. Veritus overstated its accumulated unallowable pension costs for the Medicare segment by \$157,447. As of December 31, 1996, Veritus determined its accumulated unallowable pension costs for the Medicare segment were \$157,447; however, audited unallowable pension costs were \$0.

Veritus also overstated the accumulated reassignable pension costs for the Medicare segment by \$108,605. As of December 31, 1996, Veritus determined its accumulated reassignable pension costs for the Medicare segment were \$178,045; however, the audited reassignable costs were \$69,440.

### **RECOMMENDATION**

Veritus should decrease its accumulated unallowable unfunded costs by \$157,447 and its accumulated reassignable pension costs of the Medicare segment by \$108,605 as of December 31, 1996.

## **AUDITEE'S COMMENTS**

Veritus agreed with our recommendations to decrease the both the accumulated unallowable costs and accumulated reassignable pension costs as of December 31, 1996.

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## **Glossary of Abbreviations and Acronyms**

CAS	Cost Accounting Standards
CFR	Code of Federal Regulations
CMS	Centers for Medicare & Medicaid Services
ERISA	Employees Retirement Income Security Act of 1974
FAR	Federal Acquisition Regulations
OBRA 87	Omnibus Budget Reconciliation Act of 1987
OIG	Office of the Inspector General
PBS	Pennsylvania Blue Shield
TRA 86	Tax Reform Act of 1986

## INTRODUCTION

### BACKGROUND

#### Veritus and Medicare

Veritus administered Medicare Part A operations under cost reimbursement contracts. In claiming costs, contractors must follow cost reimbursement principles contained in the FAR, the CAS, and the Medicare contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. The payments are allowable pension costs under the FAR and its predecessor, the Federal Procurement Regulations (FPR). In 1980, the Medicare contracts and FPR incorporated CAS 412 and 413.

#### CAS

The CAS deals with stability between contract periods and requires that pension costs be consistently measured and assigned to contract periods, and allocated to cost objectives, including federal contracts. On March 30, 1995, the Office of Federal Procurement Policy, Cost Accounting Standards Board, revised the CAS relating to accounting for pension costs. Unless otherwise noted, the following CAS citations refer to the standards that were in effect before the revision. We refer to the postrevision standards as the revised CAS.

The CAS within 48 Code of Federal Regulations (CFR) 9904.412-50(a)(7) stated:

“If any portion of the pension costs computed for a cost accounting period is not funded in that period, no amount for interest on the portion not funded in that period shall be a component of pension cost of any future cost accounting period.”

Also, the CAS within 48 CFR 9904.412-50(a)(2) stated:

“Pension costs applicable to prior years that were specifically unallowable in accordance with then existing Government contractual provisions. . .shall be separately identified and eliminated from any unfunded actuarial liability being amortized. . . .”

The revised CAS within 48 CFR 9904.412-40(c) imposes the fundamental requirement:

“Assignment of pension cost. Except costs assigned to future periods by 9904.412-50(c)(2) and (5), the amount of pension cost computed for a cost accounting period is assignable to that period. . . .”

## **FAR**

The FAR addresses the allowability of pension costs and requires that pension costs assigned to contract periods be substantiated by funding. FAR, 48 CFR 31.205-6(j)(3)(i) and (iii), states:

“...costs of pension plans not funded in the year incurred, and all other components of pension costs...assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years...Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable.”

### **Conflict between the FAR Funding Requirement and Tax Limits**

Pension costs computed in accordance with the CAS typically differ from the contribution amount otherwise determined in accordance with the Employees Retirement Income Security Act of 1974 (ERISA), which added minimum funding requirements and amended the tax-deductible limits in the Internal Revenue Code.

Under tax laws in effect prior to 1986, employers could fund the CAS contribution in excess of the tax-deductible limit and any the excess could be carried forward to future years for future tax deductibility without penalty. Similarly, if contribution deposits exceeded the CAS computed amounts, the excess funding could be carried forward as a prepayment credit to fund allowable contract costs for future years.

The Tax Reform Act of 1986 (TRA 86) changed the effect of making pension plan contributions in excess of the tax-deductible limit. TRA86 imposed an excise tax of 10 percent on contributions in excess of the tax-deductible limit. The excise tax is cumulative from year to year and applied on a first-in/first-out basis considering carry-forwards and current year contributions.

The Omnibus Budget Reconciliation Act of 1987 (OBRA 87) added a “current liability” full funding limitation that lowered the tax-deductible limit for many plans, further increasing the conflict between the FAR funding requirement and the excise tax on nondeductible contributions. Many employers could not fund the CAS pension cost without incurring excise tax penalties, yet the FAR provided that unfunded CAS costs could not be carried forward to future years.

However, no conflict existed when the tax-deductible maximum equaled or exceeded the CAS pension cost. In that case, the full CAS pension cost could be funded without incurring a penalty, and any decision to fund less than the CAS cost was a voluntary financial action.

### **Revised CAS**

As previously noted, the CAS relating to accounting for pension costs was revised on March 30, 1995 and became applicable to contractors with the start of the first accounting period thereafter. The revised CAS removed the regulatory conflict between the funding limits of

ERISA and the period assignment provisions of the CAS. The transition provisions of the new rule (48 CFR 9904.412-64) allow the reassignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility. The contracting officer must approve method or methods used to reassign the unfunded pension costs.

The CAS revision does not remove the requirement to fund pension costs with contributions that are not in conflict with ERISA. If a contractor could have funded pension costs and chose not to, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and the CAS.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

### **Objectives**

Our first objective was to determine if the pension costs Veritus allocated to the Medicare contracts for plan years 1993-1996 were funded in accordance with FAR. Our second objective was to identify and properly account for any additional accumulated unfunded pension costs.

### **Scope**

Our review covered the period January 1, 1993 to December 31, 1996. Achieving our objectives did not require that we review Veritus' overall internal control structure. However, we did review the controls with regard to the funding of pension costs to ensure that the pension costs had been funded in accordance with the CAS and the FAR.

We performed this review in conjunction with our audits of Medicare segmentation (report number: A-07-04-00168) and pension costs claimed for Medicare reimbursement (report number: A-07-04-00170). The information obtained and reviewed during the audits also was used in performing this review.

We performed site work at Veritus' corporate office in Camp Hill, PA.

### **Methodology**

The CMS Office of the Actuary developed the methodology used for computing the CAS pension costs based on Veritus' historical practices.

In performing the review, we used information provided by Veritus' actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Veritus' accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. Using the documents, CMS pension actuarial staff calculated the assignable CAS pension costs for each year 1993-1996 for both the Medicare segment and the Other segment, which consists of the business units comprising the rest of the company. Additionally, the CMS pension actuarial staff determined the extent to which Veritus funded the pension costs with contributions to the pension trust fund. We reviewed the methodology for the

calculations and updated Veritus' unfunded pension costs for 1993-1996 for both the Medicare segment and Other segment.

We made our examination in accordance with generally accepted government auditing standards.

## **FINDING AND RECOMMENDATION**

Veritus funded the pension costs allocable to the Medicare contracts for plan years 1993-1996 in accordance with the FAR and the CAS. However, Veritus did not correctly identify nor properly account for its accumulated unfunded pension costs. Thus, Veritus overstated its accumulated unfunded pension costs by \$157,447 for its accumulated unallowable pension costs and by \$108,605 for its accumulated reassignable costs as of December 31, 1996.

### **PENSION COSTS ALLOCABLE TO MEDICARE**

The pension costs Veritus allocated to the Medicare contracts for plan years 1993-1996 were funded in accordance with the FAR and the CAS.

### **ACCUMULATED UNFUNDED PENSION COSTS**

Veritus did not correctly identify nor properly account for its accumulated unfunded pension costs as required by the revised CAS. The revised CAS requires the identification of the two components of the accumulated unfunded pension costs - the accumulated unallowable pension costs and the accumulated reassignable pension costs.

#### **Accumulated Unallowable Pension Costs**

Veritus overstated its accumulated unallowable pension costs for the Medicare segment by \$157,447. As of December 31, 1996, Veritus determined its accumulated unallowable pension costs for the Medicare segment were \$157,447; however, audited unallowable pension costs were \$0.

#### **Accumulated Reassignable Pension Costs**

Veritus also overstated the accumulated reassignable pension costs for the Medicare segment by \$108,605. As of December 31, 1996, Veritus determined its accumulated reassignable pension costs for the Medicare segment were \$178,045; however, the audited reassignable costs were \$69,440.

### **CRITERIA: THE CAS AND THE FAR**

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. The Medicare contract 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.”

Effective January 1, 1996, the revised CAS allows the assignment of prior period pension costs, with interest, which were not funded because they lacked tax deductibility as accumulated reassignable pension costs. However, the revision to the CAS does not remove the requirement to fund pension costs when contributions are tax deductible. If a contractor could have funded pension costs and chose not to, the costs and any accrued interest are unallowable in future periods. The unallowable portion of pension costs must be updated, with interest, per the FAR and the CAS.

**CONDITION: INCORRECT COMPUTATION OF THE ACCUMULATED UNFUNDED PENSION COSTS**

Veritus tracked its unallowable and reassignable pension costs with interest for the years 1993-1996. Veritus identified \$157,447 of accumulated unallowable pension costs entirely attributable to the Medicare segment. Additionally, Veritus identified \$178,045 of accumulated reassignable pension of which \$45,406 was attributable to the Medicare segment and \$132,639 was attributable to the Other segment.

However, the audited actual accumulated unallowable pension costs of the Medicare segment were \$0 as of December 31, 1996. Additionally, the audited accumulated reassignable costs totaled \$69,440 with \$1,526 attributable to the Medicare segment and \$67,914 attributable to the Other segment.

**CAUSE: LACK OF ADEQUATE CONTROLS**

Veritus did not have adequate controls in place to ensure that unallowable and reassignable pension costs were identified and accounted for properly in accordance with CAS requirements.

**EFFECT: OVERSTATEMENT OF ACCUMULATED UNFUNDED COSTS**

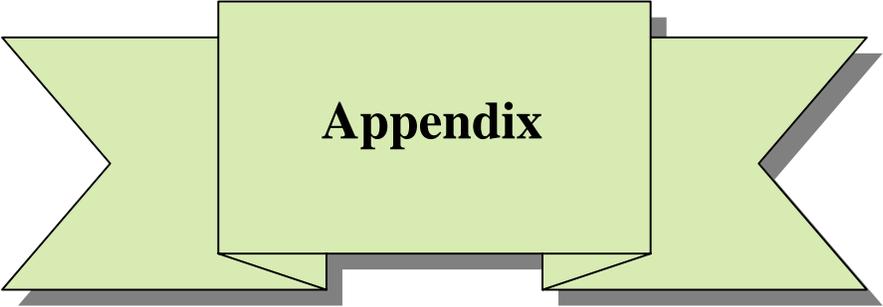
As of December 31, 1996, Veritus overstated the accumulated unallowable pension costs by \$157,447 and the accumulated reassignable pension costs by \$108,605.

**RECOMMENDATION**

Veritus should decrease the accumulated unallowable pension costs by \$157,447 and the accumulated reassignable pension costs of the Medicare segment by \$108,605 as of December 31, 1996.

## **AUDITEE'S COMMENTS**

Veritus agreed with our report. However, final adjustments to the accumulated unallowable costs and reassignable pension costs will be delayed until the Highmark audit is finalized (See Appendix A).





October 4, 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-07-04-00175, (“Audit of Veritus’ Unfunded Pension Costs for the period covering 1993 through 1996”)**

Dear Mr. Aasmundstad:

Attached is our response to your letters dated August 4, 2004, requesting comments on your draft reports A-07-04-00175 entitled “Audit of Veritus’ Unfunded Pension Costs for the period covering 1993 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

*DLF/per*

cc: James Chiado  
Elizabeth Farbacher  
Anthony Lobato  
Gayeta Porter

**Corporate Offices:**

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

**Audit of Veritus'  
Unfunded Pension Costs  
For the Period Covering 1993 through 1996**

**Highmark Comments to OIG Draft Report  
A-07-04-00175**

## **Highmark Comments on the OIG Draft Report Dated August 4, 2004**

Highmark agrees with the recommendations to decrease the Veritus Medicare accumulated unallowable costs by \$157,447 and to decrease its accumulated reassignable pension costs of the Medicare segment by \$108,605 as of December 31, 1996.

It is our understanding that OIG is in the process of auditing Highmark's unfunded pension costs from January 1, 1997 to December 31, 2003, and will be updating the accumulated unallowable costs and accumulated reassignable pension costs as part of that review. Therefore, to avoid duplication and minimize confusion, Highmark will delay final adjustments to the accumulated unallowable costs and reassignable pension costs until that audit is finalized.