



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-07-06-00203

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 Medicare Segment Assets for the Nonqualified Defined-Benefit Pension Plans for Highmark, Inc. & Predecessors from January 1, 1992, To January 1, 2003." 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.

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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. To facilitate identification, please refer to report number A-07-06-00203 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 MEDICARE SEGMENT
ASSETS FOR THE NONQUALIFIED
DEFINED-BENEFIT PENSION PLANS
FOR HIGHMARK, INC. &
PREDECESSORS FROM JANUARY 1,
1992, TO JANUARY 1, 2003**



**Daniel R. Levinson
Inspector General**

**JANUARY 2006
A-07-06-00203**

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

Highmark, Inc. (Highmark) administers Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). Highmark was formed with the merger of Veritus, Inc. (Veritus) and Pennsylvania Blue Shield (PBS) in December 1996. Prior to the merger, Veritus administered Medicare Part A operations and PBS administered Medicare Part B operations under cost reimbursement contracts with CMS. This report will address the findings for Veritus's and PBS's nonqualified defined-benefit plan (NQDBP) Medicare segment assets as of January 1, 1998, and Highmark's NQDBP Medicare segment assets as of January 1, 2003.

Veritus maintained a nonqualified defined-benefit plan (NQDBP), called an Excess Benefit Plan, and PBS maintained a NQDBP, which consisted of two plans (1) Pennsylvania Blue Shield Supplemental Employee Retirement Plan and Pennsylvania Blue Shield Deferred Compensation Supplemental Plan. Highmark merged these plans into one and maintains a NQDBP to restore pension accruals that were reduced as a result of deferred compensation or statutory limits.

The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the Medicare segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with Cost Accounting Standards 412 and 413.

OBJECTIVES

Our objectives were to determine if the pension segmentation requirements of the Medicare contract were followed while updating the NQDBP Medicare segment assets for:

- Veritus from January 1, 1994, to January 1, 1998,
- PBS from January 1, 1992, to January 1, 1998, and
- Highmark from January 1, 1998, to January 1, 2003.

SUMMARY OF FINDINGS

Highmark and its predecessors did not fully comply with the Medicare contracts' pension segmentation requirements while updating the NQDBP Medicare segment assets. As a result, Veritus understated the Medicare segment assets for the NQDBP by \$9,476 as of January 1, 1998. PBS overstated the Medicare segment assets for the NQDBP by \$46,999 as of January 1, 1998. Highmark understated Medicare segment assets for the NQDBP for Medicare Part A by \$4,057 and overstated Medicare segment assets for Medicare Part B by \$50,351 as of January 1, 2003.

RECOMMENDATIONS

We recommend that:

- Veritus increase its NQDBP Medicare segment assets by \$9,476, and recognize \$13,484 of Medicare segment assets as of January 1, 1998;
- PBS decrease its NQDBP Medicare segment assets by \$46,999 and recognize \$367,210 of Medicare segment assets as of January 1, 1998; and
- Highmark increase its NQDBP Medicare Part A segment assets by \$4,057, decrease NQDBP Medicare Part B segment assets by \$50,351, and recognize Medicare segment assets of \$227,868 and \$409,562, respectively, as of January 1, 2003.

AUDITEE'S COMMENTS

Highmark agreed with the recommendation to increase its NQDBP Medicare Part A segment assets and decrease NQDBP Medicare Part B segment as of January 1, 2003. However, Highmark stated that it is unnecessary to adjust the Veritus or PBS Medicare segment assets as of January 1, 1998.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We agree that the recommendations made to adjust the NQDBP Medicare segment assets for Veritus and PBS as of January 1, 1998, were included in the roll-up of Medicare segment Part A and Part B assets from January 1, 1998, to January 1, 2003. However, we maintain that it is necessary to recommend the adjustments to the Medicare segment assets for Veritus and PBS as of January 1, 1998, because Veritus and PBS maintained two separate NQDBPs until Highmark merged the plans as of January 1, 1998.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
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
NQDBP	nonqualified defined-benefit pension plan
OIG	Office of Inspector General
PBS	Pennsylvania Blue Shield
Veritus	Veritus, Inc. of Pennsylvania

INTRODUCTION

BACKGROUND

Medicare

Highmark, Inc. (Highmark) administers Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS). Highmark was formed with the merger of Veritus, Inc. (Veritus) and Pennsylvania Blue Shield (PBS) in December 1996. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and Medicare contract.

This report will address the findings for Veritus's and PBS's nonqualified defined-benefit plan (NQDBP) Medicare segment assets as of January 1, 1998, and Highmark's NQDBP Medicare segment assets as of January 1, 2003. For the purpose of this report, Veritus will be used to address the finding concerning the Part A NQDBP segment assets for the period January 1, 1994, to January 1, 1998; PBS will be used to address the findings concerning the Medicare Part B NQDBP segment assets for the period January 1, 1992, to January 1, 1998; and Highmark will be used to address the findings concerning the Medicare Part A and Part B NQDBP segment assets for the period January 1, 1998, to January 1, 2003.

Nonqualified Pension Plans

Highmark merged Veritus's nonqualified defined-benefit pension plan with PBS's nonqualified defined-benefit pension plans on December 31, 1997, to create the Highmark Supplemental Retirement Plan effective January 1, 1998. Prior to the merger, both Veritus and PBS had maintained nonqualified defined-benefit pension plans that restored pension accruals reduced as a result of deferred compensation or the statutory limits due to the Internal Revenue Code sections 401(a)(17) and 415.

Veritus maintained a NQDBP, called an Excess Benefit Plan (EBP), which covered the period January 1, 1994, to January 1, 1998; and PBS maintained a NQDBP, which consisted of two plans (1) Pennsylvania Blue Shield Supplemental Employee Retirement Plan and (2) Pennsylvania Blue Shield Deferred Compensation Supplemental Plan, from January 1, 1992, to January 1, 1998.

Segmentation Requirements

The Medicare contract defines a segment and specifies the methodology for the identification of the Medicare segment. Furthermore, the contract requires Medicare segment assets to be updated for each year in accordance with Cost Accounting Standards (CAS) 412 and 413.

Regulations

CAS 412 regulates the determination and measurement of pension cost components. 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.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine if the pension segmentation requirements of the Medicare contract were followed while updating the NQDBP Medicare segment assets for:

- Veritus from January 1, 1994, to January 1, 1998,
- PBS from January 1, 1992, to January 1, 1998, and
- Highmark from January 1, 1998, to January 1, 2003.

Scope

The review covered the updates of NQDBP Medicare segment assets for Highmark and for both Veritus and PBS, which are the predecessor companies of Highmark. We reviewed Veritus's, PBS's, and Highmark's updates of NQDBP assets. Achieving our objectives did not require that we review the overall internal control structure. However, we did review controls relating to the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We conducted this review in conjunction with our reviews of the nonqualified defined-benefit cost claimed reports for Veritus (A-07-06-00200), PBS (A-07-06-00201), and Highmark (A-07-06-00202). 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

In performing this review, we used information provided by the contractor's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, transfers, investment earnings, and administrative expenses. We reviewed the contractor's accounting records, pension plan documents, and annual actuarial valuation reports. The CMS

Office of the Actuary staff used the documents to calculate the NQDBP assets as of January 1, 1998, and January 1, 2003. We reviewed the methodology and calculations.

The appendixes present details for the updated NQDBP assets for Veritus from January 1, 1994, to January 1, 1998 (Appendix A); for PBS from January 1, 1992, to January 1, 1998 (Appendix B); and for Highmark from January 1, 1998, to January 1, 2003 (Appendix C).

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

FINDINGS AND RECOMMENDATIONS

Veritus understated the Medicare segment assets for the NQDBP by \$9,476 as of January 1, 1998. PBS overstated the Medicare segment assets for the NQDBP by \$46,999 as of January 1, 1998. Highmark understated Medicare segment assets for the NQDBP for Medicare Part A by \$4,057 and overstated Medicare segment assets for Medicare Part B by \$50,351 as of January 1, 2003. The understatement and overstatement of assets occurred because Highmark and its predecessors did not fully comply with the Medicare contracts' pension segmentation requirements while updating the NQDBP Medicare segment assets.

MEDICARE CONTRACT & COST ACCOUNTING STANDARDS

Medicare Contract

The Medicare contract identifies 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 that: "The pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7)."

Cost Accounting Standards

The CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accruals, 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, the 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 Federal Government.

COMPONENTS OF ASSET UPDATE

Veritus

Veritus identified \$4,008 of NQDBP Medicare segment assets as of January 1, 1998; however we determined that the Medicare segment assets should be \$13,484. The understatement of assets occurred because Veritus did not fully comply with the Medicare contract’s pension segmentation requirements while updating the NQDBP Medicare segment assets. As a result, Veritus understated Medicare segment assets by \$9,476.

Table 1: Summary of Asset Adjustments	
	Veritus
Contributions & Prepayment Credits	\$2,988
Transfers	3,234
Earnings and Expenses	3,254
(Over)/UnderStatement	\$9,476

Contributions and Prepayment Credits Understated

Veritus’s update methodology did not equitably assign pension contributions to the Medicare segment. In addition, Veritus failed to identify prepayment credits. As a result, Veritus understated segment assets by \$2,988.

For the years in the update when Veritus’s contributions exceeded the required funding of the CAS pension costs, a prepayment credit was identified. According to the CAS, amounts funded in excess of pension costs (or prepayments) shall be carried forward with interest to fund future CAS pension costs. In our audited update, we accounted for the excess contributions and made prepayment adjustments to fund CAS pension costs of the Medicare segment.

Transfers Understated

In 1995, Veritus transferred Medicare segment participant(s)’s accrued liability into the Medicare segment; however, it failed to transfer in the corresponding assets. This caused a material difference in the segment’s ratio of pension plan assets to actuarial accrued liabilities; therefore, transfers were required. As a result, Veritus understated Medicare segment assets by \$3,234.

Earnings and Expenses Understated

Veritus understated its investment earnings, less administrative expenses, by \$3,254 because it developed the Medicare asset base using incorrect contribution, prepayment credit, and transfer

amounts. In our audited update, we allocated earnings and expenses based upon the applicable CAS requirements.

Pennsylvania Blue Shield

PBS identified \$414,209 of NQDBP Medicare segment assets as of January 1, 1998; however, we determined that the Medicare segment assets should be \$367,210. The overstatement of assets occurred because PBS did not fully comply with the Medicare contract's pension segmentation requirements while updating the NQDBP Medicare segment assets. As a result, PBS overstated Medicare segment assets by \$46,999.

	PBS
Contributions & Prepayment Credits	(\$45,818)
Earnings and Expenses	(1,181)
(Over)/UnderStatement	(\$46,999)

Contributions and Prepayment Credits Overstated

PBS's update methodology did not equitably assign pension contributions to the Medicare segment. In addition, PBS failed to identify prepayment credits. As a result, PBS overstated segment assets by \$45,818.

For the years in the update when PBS's contributions exceeded the required funding of the CAS pension costs, a prepayment credit was identified. According to the CAS, amounts funded in excess of pension costs (or prepayments) shall be carried forward with interest to fund future CAS pension costs. In our audited update, we accounted for the excess contributions and made prepayment adjustments to fund CAS pension costs of the Medicare segment.

Earnings and Expenses Overstated

PBS overstated its investment earnings, less administrative expenses, by \$1,181 because it developed the Medicare asset base using incorrect contribution and prepayment credit amounts. In our audited update, we allocated earnings and expenses based upon the applicable CAS requirements.

Highmark

As of January 1, 2003, Highmark identified \$223,811 of NQDBP Medicare segment assets for Medicare Part A and \$459,913 for Medicare Part B; however, we determined that the segment assets should be \$227,868 for Medicare Part A and \$409,562 for Medicare Part B. The understatement and overstatement of assets occurred because Highmark did not fully comply with the Medicare contracts' pension segmentation requirements while updating the NQDBP Medicare segment assets. As a result, Highmark understated Medicare segment A assets by \$4,057 and overstated Medicare segment B assets by \$50,351.

Table 3: Summary of Asset Adjustments		
	Part A	Part B
Other Transactions	\$9,476	(\$46,999)
Contributions & Prepayment Credits	(17,579)	(10,257)
Earnings and Expenses	12,160	6,905
(Over)/UnderStatement	\$4,057	(\$50,351)

Beginning Value of Assets

Highmark's update of Medicare Part A and Part B assets did not properly identify the Medicare segment assets associated with the Veritus plan merger and the PBS plan merger. The initial assets as of January 1, 1998, were understated by \$9,476 for Medicare Part A and were overstated by \$46,999 for Medicare Part B.

Contributions and Prepayment Credits Overstated

Highmark's update methodology did not equitably assign pension contributions to the Medicare segment. In addition, Highmark failed to identify prepayment credits. As a result, Highmark overstated segment assets by \$17,579 for Part A and \$10,257 for Part B.

For the years in the update when Highmark's contributions exceeded the required funding of the CAS pension costs, a prepayment credit was identified. According to the CAS, amounts funded in excess of pension costs (or prepayments) shall be carried forward with interest to fund future CAS pension costs. In our audited update, we accounted for the excess contributions and made prepayment adjustments to fund CAS pension costs of the Medicare segment.

Earnings and Expenses Understated

Highmark understated allocable investment earnings, less administrative expenses, by \$12,160 for Medicare Part A and \$6,905 for Part B, because it developed the Medicare asset base using incorrect Medicare segment assets as of January 1, 1998, contribution, and prepayment credit amounts. In our audited update, we allocated earnings and expenses based upon the applicable CAS requirements.

RECOMMENDATIONS

We recommend that:

- Veritus increase its NQDBP Medicare segment assets by \$9,476 and recognize \$13,484 of Medicare segment assets as of January 1, 1998;
- PBS decrease its NQDBP Medicare segment assets by \$46,999 and recognize \$367,210 of Medicare segment assets as of January 1, 1998; and

- Highmark increase its NQDBP Medicare Part A segment assets by \$4,057, decrease NQDBP Medicare Part B segment assets by \$50,351, and recognize Medicare segment assets of \$227,868 and \$409,562, respectively, as of January 1, 2003.

AUDITEE'S COMMENTS

Highmark's comments are summarized in the following paragraph and presented in their entirety as Appendix D.

Highmark stated that:

[It] agrees with the recommendation to increase its Nonqualified Defined-Benefit Pension Plan (NQDBP) Medicare Part A segment assets by \$4,057, decrease NQDBP Medicare Part B segment assets by \$50,351, and recognize Medicare segment assets of \$227,868 and \$409,562, respectively, as of January 1, 2003. However, because of the cumulative nature of pension accounting, Highmark believes it is unnecessary to adjust Veritus or PBS Medicare segment assets as of January 1, 1998. Highmark believes these adjustments were made by the CMS Office of the Actuary as it rolled-forward the segment assets to January 1, 2003. Adjustment of the January 1, 2003, assets to those recommended by OIG should correct the segment assets for future valuations.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We agree that the recommendations made to adjust the NQDBP Medicare segment assets for Veritus and PBS as of January 1, 1998, were included by the CMS Office of the Actuary in the roll-up of Medicare segment Part A and Part B assets from January 1, 1998, to January 1, 2003. However, we maintain that it is necessary to recommend the adjustments to the Medicare segment assets for Veritus and PBS as of January 1, 1998, because PBS and Veritus maintained two separate NQDBPs until Highmark merged the NQDBPs as of January 1, 1998.

APPENDIXES

Veritus, Inc.
Statement of Excess Benefit Plan Assets
For the Period
January 1, 1994, to January 1, 1998

Description		Total Company	Other Segment	Medicare
Assets January 1, 1994	1/	0	0	0
Prepayment Transfer		0	0	0
Contribution	2/	33,321	33,321	0
Earnings		0	0	0
Benefit Payments	3/	(33,321)	(33,321)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1995		0	0	0
Prepayment Transfer		0	0	0
Contribution		909,726	909,726	0
Earnings		0	0	0
Benefit Payments		(45,898)	(45,898)	0
Expenses		0	0	0
Transfers	4/	0	(3,234)	3,234
Assets January 1, 1996		863,828	860,594	3,234
Prepayment Transfer	5/	0	(1,495)	1,495
Contribution		641,159	638,922	2,237
Earnings	6/	133,722	133,082	640
Benefit Payments		(98,130)	(98,130)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1997		1,540,579	1,532,973	7,606
Prepayment Transfer		0	(2,562)	2,562
Contribution		528,673	527,994	679
Earnings		380,745	378,108	2,637
Benefit Payments		(165,146)	(165,146)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1998		\$2,284,851	\$2,271,367	\$13,484
Per Veritus	8/	\$2,284,851	\$2,280,843	\$4,008
Asset Variance	9/	\$0	(\$9,476)	\$9,476

Veritus, Inc.
Statement of Excess Benefit Plan Assets
For the Period
January 1, 1994, to January 1, 1998

FOOTNOTES

- 1/ We obtained the initial assets as of January 1, 1994, from the actuarial valuation report. 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 costs in the future.
- 3/ We obtained the Medicare segment benefit payment from the actuarial valuation reports. We accepted the Medicare segment benefit payments as identified by Veritus, Inc. (Veritus).
- 4/ We obtained the transfer adjustments from the actuarial valuation reports.
- 5/ 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 Federal Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 6/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets as required by the Cost Accounting Standards (CAS).
- 7/ We calculated the total Medicare segment administrative expenses based on a ratio segment earnings to total company earnings.
- 8/ We obtained total asset amounts as of January 1, 1998, from Veritus's actuarial valuation report.
- 9/ The asset variance represents the difference between our calculation of Medicare segment assets and Veritus's market value of assets shown in its valuation report.

Pennsylvania Blue Shield
Statement of Nonqualified Defined-Benefit Plan Assets
For the Period
January 1, 1992, to January 1, 1998

Description	Total Company	Other Segment	Medicare	
Assets January 1, 1992	1/	0	0	0
Prepayment Transfer		0	0	0
Contribution		0	0	0
Earnings		0	0	0
Benefit Payments		0	0	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1993		0	0	0
Prepayment Transfer		0	0	0
Contribution	<u>2/</u>	2,921	2,921	0
Earnings		0	0	0
Benefit Payments	3/	(2,921)	(2,921)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1994		0	0	0
Prepayment Transfer		0	0	0
Contribution		2,921	2,921	0
Earnings		0	0	0
Benefit Payments		(2,921)	(2,921)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1995		0	0	0
Prepayment Transfer		0	0	0
Contribution		1,620,657	1,512,256	108,401
Earnings		0	0	0
Benefit Payments		(2,928)	(2,928)	0
Expenses		0	0	0
Transfers		0	0	0
Assets January 1, 1996		1,617,729	1,509,328	108,401

Pennsylvania Blue Shield
Statement of Nonqualified Defined-Benefit Plan Assets
For the Period
January 1, 1992, to January 1, 1998

Description		Total Company	Other Segment	Medicare
Assets January 1, 1996		1,617,729	1,509,328	108,401
Prepayment Transfer	<u>4/</u>	0	(7,765)	7,765
Contribution		1,859,147	1,697,199	161,948
Earnings	<u>5/</u>	105,756	97,728	8,028
Benefit Payments		0	0	0
Expenses		0	0	0
Transfers	<u>6/</u>	0	22,759	(22,759)
Assets January 1, 1997		3,582,632	3,319,249	263,383
Prepayment Transfer		0	(20,977)	20,977
Contribution		1,750,544	1,687,109	63,435
Earnings		305,968	283,174	22,794
Benefit Payments		(135,998)	(133,514)	(2,484)
Expenses	<u>7/</u>	(750)	(694)	(56)
Transfers		0	839	(839)
Assets January 1, 1998		\$5,502,396	\$5,135,186	\$367,210
Per PBS	<u>8/</u>	\$5,502,396	\$5,088,187	\$414,209
Asset Variance	<u>9/</u>	\$0	\$46,999	(\$46,999)

Pennsylvania Blue Shield
Statement of Nonqualified Defined-Benefit Plan Assets
For the Period
January 1, 1992, to January 1, 1998

FOOTNOTES

- 1/ We obtained the initial assets as of January 1, 1992, from the actuarial valuation report. 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 costs in the future.
- 3/ We obtained the Medicare segment benefit payment from the actuarial valuation reports. We accepted the Medicare segment benefit payments as identified by Pennsylvania Blue Shield (PBS).
- 4/ 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 Federal Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 5/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets as required by the CAS.
- 6/ We obtained the transfer adjustments from the actuarial valuation reports.
- 7/ We calculated the total Medicare segment administrative expenses based on a ratio segment earnings to total company earnings.
- 8/ We obtained total asset amounts as of January 1, 1998, from PBS's actuarial valuation report.
- 9/ The asset variance represents the difference between our calculation of Medicare segment assets and PBS's market value of assets shown in its valuation report.

Highmark, Inc.
Statement of Nonqualified Defined-Benefit Plan Assets
For the Period
January 1, 1998, to January 1, 2003

Description		Total Company	Other Segment	Medicare Part A	Medicare Part B
Assets January 1, 1998	1/	7,787,247	7,406,553	13,484	367,210
Prepayment Transfer	2/	0	(90,043)	90,043	0
Contribution	3/	3,013,056	2,896,652	116,404	0
Earnings	4/	1,913,805	1,800,989	31,158	81,658
Benefit Payments	5/	(296,621)	(293,640)	0	(2,981)
Expenses	6/	(34,631)	(32,589)	(564)	(1,478)
Transfers	7/	0	(867)	0	867
Assets January 1, 1999		12,382,856	11,687,055	250,525	445,276
Prepayment Transfer		0	(38,585)	0	38,585
Contribution		3,846,652	3,792,486	0	54,166
Earnings		1,585,828	1,497,341	29,567	58,920
Benefit Payments		(287,570)	(284,589)	0	(2,981)
Expenses		(38,563)	(36,411)	(719)	(1,433)
Transfers		0	0	0	0
Assets January 1, 2000		17,489,203	16,617,297	279,373	592,533
Prepayment Transfer		0	0	0	0
Contribution		3,742,948	3,742,948	0	0
Earnings		(1,057,822)	(1,008,110)	(15,956)	(33,756)
Benefit Payments		(285,272)	(282,291)	0	(2,981)
Expenses		(454,703)	(433,334)	(6,859)	(14,510)
Transfers		0	0	0	0
Assets January 1, 2001		19,434,354	18,636,510	256,558	541,286
Prepayment Transfer		0	(20,670)	20,670	0
Contribution		4,467,292	4,449,108	18,184	0
Earnings		(2,022,916)	(1,942,051)	(27,794)	(53,071)
Benefit Payments		(394,807)	(391,689)	0	(3,118)
Expenses		(484,324)	(464,964)	(6,654)	(12,706)
Transfers		0	0	0	0
Assets January 1, 2002		20,999,599	20,266,244	260,964	472,391

Highmark, Inc.
Statement of Nonqualified Defined-Benefit Plan Assets
For the Period
January 1, 1998, to January 1, 2003

Description	Total Company	Other Segment	Medicare Part A	Medicare Part B
Assets January 1, 2002	20,999,599	20,266,244	260,964	472,391
Prepayment Transfer	0	0	0	0
Contribution	3,406,924	3,406,924		0
Earnings	(2,255,313)	(2,179,760)	(26,943)	(48,610)
Benefit Payments	(413,668)	(410,550)		(3,118)
Expenses	(515,020)	(497,766)	(6,153)	(11,101)
Transfers	0	0		0
Assets January 1, 2003	\$21,222,522	\$20,585,092	\$227,868	\$409,562
Per Highmark	<u>8/</u> \$21,222,522	\$20,538,798	\$223,811	\$459,913
Asset Variance	<u>9/</u> \$0	\$46,294	\$4,057	(\$50,351)

FOOTNOTES

- 1/ We obtained the total company asset value as of January 1, 1998, from the actuarial valuation reports. We obtained Medicare Part A segment assets from Appendix A and Medicare Part B segment from Appendix B as of January 1, 1998. The amounts shown for the "Other" segment represent the difference between the total company and the Medicare segments. All pension assets are shown at market value.
- 2/ 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 Federal Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 3/ We obtained total company contribution amounts from the actuarial valuation reports. We allocated total company contributions to the Medicare segments 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 costs in the future.
- 4/ We obtained investment earnings from actuarial valuation reports. We allocated investment earnings based on the ratio of the segment's weighted average valued (WAV) of assets to total company WAV of assets as required by CAS.
- 5/ We obtained the Medicare segment benefit payment from the actuarial valuation reports. We accepted the Medicare segment benefit payments as identified by Highmark, Inc. (Highmark).
- 6/ We calculated the total Medicare segment administrative expenses based on a ratio segment earnings to total company earnings.
- 7/ We obtained the transfer adjustments from the actuarial valuation reports.
- 8/ We obtained total asset amounts as of January 1, 2003, from Highmark's actuarial valuation report.
- 9/ The asset variance represents the difference between our calculation of Medicare segment assets and Highmark's market value of assets shown in its valuation report.

January 12, 2006

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

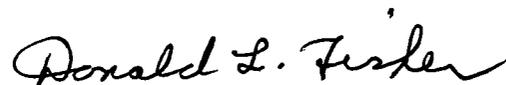
RE: A-07-06-00200 (“Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Veritus, Inc. for Fiscal Years 1996 Through 1997”)
A-07-06-00201 (“Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Pennsylvania Blue Shield for Fiscal Years 1993 Through 1997”)
A-07-06-00202 (“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,



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 Medicare Segment Assets
For the Nonqualified Defined-Benefit
Pension Plans for Highmark, Inc.
& Predecessors from**

January 1, 1992 to January 1, 2003

**Highmark's Comments to OIG Draft Report
A07-06-00203**

Highmark's Comments on the Report Number A-07-06-00203

Highmark agrees with the recommendation to increase its Nonqualified Defined-Benefit Pension Plan (NQDBP) Medicare Part A segment assets by \$4,057, decrease NQDBP Medicare Part B segment assets by \$50,351, and recognize Medicare segment assets of \$227,868 and \$409,562, respectively, as of January 1, 2003. However, because of the cumulative nature of pension accounting, Highmark believes it is unnecessary to adjust Veritus or PBS Medicare segment assets as of January 1, 1998. Highmark believes these adjustments were made by the CMS Office of the Actuary as it rolled-forward the segment assets to January 1, 2003. Adjustment of the January 1, 2003, assets to those recommended by OIG should correct the segment assets for future valuations.

In reviewing the report, it appears that the CMS Office of the Actuary developed the methodology used for computing allowable NQDBP costs based on PBS's historical practices and the retroactive application of new rules under CAS(412), which prescribe the recovery of nonqualified pension plan costs under Government contracts for years starting after March 30, 1995, and a recent decision of the United States Court of Appeals for the Federal Circuit (*Eastman Kodak Company v. Donald H. Rumsfeld, Secretary of Defense*). These differences in methodology, when combined with utilization of slightly different Medicare LOB Percentage by OIG than those provided by Highmark, contributed to the NQDBP Cost Claimed Variance. In addition, because of the cumulative nature of pension accounting, variance in one year may contribute to cost variances and/or variances in segment assets in subsequent years.

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.

To help assure future consistency in the actuarial methodologies utilized by the CMS Office of the Actuary and Highmark's actuary in the allocation of investment income, administrative expenses, etc., among segments, Highmark respectfully requests copies of the actuarial valuations/workpapers that support the NQDBP cost and asset values as determined by OIG.