

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**HIGHMARK MEDICARE SERVICES, INC.,
UNDERSTATED ITS MEDICARE SEGMENT
PENSION ASSETS AND UNDERSTATED
THE MEDICARE SEGMENT EXCESS
PENSION LIABILITIES
AS OF JANUARY 1, 2012**

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Regional Inspector General

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Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

Highmark Medicare Services, Inc., a terminated Medicare contractor, understated the Medicare segment pension assets by \$4,000 as of January 1, 2012. In addition, Highmark understated the Medicare segment excess pension liabilities by \$147,000 as a result of the Medicare segment closing on January 1, 2012.

WHY WE DID THIS REVIEW

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. In addition, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare pension assets and liabilities in accordance with the CAS. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

The objectives of this review were to determine whether Highmark Medicare Services, Inc. (Highmark), complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendations to decrease the Medicare Part A segment pension assets and increase the Medicare Part B segment pension assets as of January 1, 2002, (2) updating the Medicare segment's pension assets from January 1, 2002, to January 1, 2012, and (3) determining the Medicare segment excess pension liabilities as a result of the Medicare segment closing.

BACKGROUND

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

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

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

We performed a prior pension segmentation audit at Highmark (A-07-04-03050, issued January 21, 2005), which brought the Medicare Parts A and B segment pension assets to January 1, 2002. We recommended that Highmark decrease its Medicare Part A segment pension assets by \$2,663,777 and, as a result, recognize \$10,808,230 as the Medicare Part A segment pension assets as of January 1, 2002. We also recommended that Highmark increase its Medicare Part B segment pension assets by \$2,394,501 and, as a result, recognize \$41,701,031 as the Medicare Part B segment pension assets as of January 1, 2002.

In addition, upon the termination of its Medicare contracts, Highmark identified Medicare segment excess pension liabilities of \$5,590,092.

WHAT WE FOUND

Highmark implemented the prior audit recommendations to recognize \$10,808,230 as the Medicare Part A segment pension assets and \$41,701,031 as the Medicare Part B segment pension assets as of January 1, 2002. However, Highmark did not correctly update the Medicare segment pension assets from January 1, 2002, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of \$82,681,744 as of January 1, 2012; however, we determined that the Medicare segment pension assets were \$82,685,679. Therefore, Highmark understated the Medicare segment pension assets by \$3,935.

Regarding our third objective, Highmark computed the Medicare segment excess pension liabilities to be \$5,590,092 as of January 1, 2012 (the effective date of the sale of Highmark); however, we determined that the Medicare segment excess pension liabilities were \$5,736,689 as of that date. Highmark understated the Medicare segment excess pension liabilities by \$146,597, because of differences in the identification of the Medicare segment participants and the Medicare segment pension assets.

WHAT WE RECOMMEND

We recommend that Highmark:

- increase Medicare segment pension assets as of January 1, 2012, by \$3,935 and recognize \$82,685,679 as the Medicare segment pension assets,
- increase the Medicare segment excess pension liabilities by \$146,597 and recognize \$5,736,689 as the Medicare segment excess pension liabilities as of January 1, 2012, and
- work with CMS officials to determine Medicare's share of the Medicare segment excess pension liabilities as of January 1, 2012.

AUDITEE COMMENTS

In written comments on our draft report, Highmark concurred with our recommendations and described corrective actions that it would take.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are required to separately account for the Medicare segment pension plan assets based on the requirements of their Medicare contracts and Cost Accounting Standards (CAS) 412 and 413. The Centers for Medicare & Medicaid Services (CMS) incorporated this requirement into the Medicare contracts beginning with fiscal year 1988. In addition, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare pension assets and liabilities in accordance with the CAS. Previous Office of Inspector General reviews found that Medicare contractors did not always correctly identify and update the segmented pension assets.

OBJECTIVES

Our objectives were to determine whether Highmark Medicare Services, Inc. (Highmark), complied with Federal requirements and the Medicare contracts' pension segmentation requirements when (1) implementing the prior audit recommendation to decrease the Medicare Part A segment pension assets and increase the Medicare Part B segment pension assets as of January 1, 2002, (2) updating the Medicare segment's pension assets from January 1, 2002, to January 1, 2012, and (3) determining the Medicare segment excess pension liabilities as a result of the contract termination.

BACKGROUND

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

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

With the implementation of Medicare contracting reform,¹ Highmark continued to perform Medicare work after being awarded the MAC (Jurisdiction 12) contract on October 24, 2007.² While performing its MAC work, Highmark also functioned as a Medicare Part A fiscal

¹ Section 911 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. No. 108-173, required CMS to transfer the functions of fiscal intermediaries and carriers to Medicare administrative contractors (MACs) between October 2005 and October 2011. Most, but not all, of the MACs are fully operational; for jurisdictions where the MACs are not fully operational, the fiscal intermediaries and carriers continue to process claims. For purposes of this report, the term "Medicare contractor" means the fiscal intermediary, carrier, or MAC, whichever is applicable.

² Jurisdiction 12 consists of the States of Delaware, Maryland, New Jersey, and Pennsylvania, and the District of Columbia.

intermediary and Part B carrier, with those contracts terminating in July 2008 and December 2008, respectively. Highmark continued to work as the Jurisdiction 12 MAC until January 1, 2012, when Highmark, Inc., sold its wholly owned subsidiary, Highmark, to DSO.

We performed a prior pension segmentation audit at Highmark (A-07-04-03050, issued January 21, 2005), which brought the Medicare Parts A and B segment pension assets to January 1, 2002. We recommended that Highmark decrease its Medicare Part A segment pension assets by \$2,663,777 and, as a result, recognize \$10,808,230 as the Medicare Part A segment pension assets as of January 1, 2002. We also recommended that Highmark increase its Medicare Part B segment pension assets by \$2,394,501 and, as a result, recognize \$41,701,031 as the Medicare Part B segment pension assets as of January 1, 2002.

In addition, upon the termination of its Medicare contracts, Highmark identified Medicare segment excess pension liabilities of \$5,590,092.

HOW WE CONDUCTED THIS REVIEW

We reviewed Highmark's implementation of the prior audit recommendation; identification of its Medicare segment; update of Medicare segment assets from January 1, 2002, to January 1, 2012; and the Medicare segment's closing calculation as of January 1, 2012.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDINGS

Highmark implemented the prior audit recommendations to recognize \$10,808,230 as the Medicare Part A segment pension assets and \$41,701,031 as the Medicare Part B segment pension assets as of January 1, 2002. However, Highmark did not correctly update the Medicare segment pension assets from January 1, 2002, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of \$82,681,744 as of January 1, 2012; however, we determined that the Medicare segment pension assets were \$82,685,679. Therefore, Highmark understated the Medicare segment pension assets by \$3,935.

Appendix B presents details of the Medicare segment's pension assets from January 1, 2002, to January 1, 2012, as determined during our audit. Table 1 on the following page summarizes the audit adjustments required to update Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments			
	Per Audit	Per Highmark	Difference
Prior Audit Recommendation			
Medicare Segment A	\$10,808,230	\$10,808,230	\$0
Medicare Segment B	41,701,031	41,701,031	0
Update of Medicare Segment Assets			
Contributions and Prepayment Credits	22,507,438	23,265,711	(758,273)
Benefit Payments	(27,605,563)	(27,920,060)	314,497
Net Transfers Out	(1,374,806)	(1,167,083)	(207,723)
Earnings, Net of Expenses	36,757,824	36,102,390	655,434
Understatement of Medicare Segment Assets			\$3,935

Regarding our third objective, the CAS requires that a segment closing adjustment be made to recognize the Medicare segment excess pension liabilities as a result of the termination of the Medicare contracts. Highmark computed the Medicare segment excess pension liabilities to be \$5,590,092 as of January 1, 2012 (the effective date of the sale of Highmark); however, we determined that the Medicare segment excess pension liabilities were \$5,736,689 as of that date. Highmark understated the Medicare segment excess pension liabilities by \$146,597, because of differences in the identification of the Medicare segment participants and the Medicare segment pension assets.

PRIOR AUDIT RECOMMENDATIONS

Highmark implemented the prior audit recommendations (A-07-04-03050), which recommended that (1) Highmark decrease its Medicare Part A segment pension assets by \$2,663,777 and, as a result, recognize \$10,808,230 as the Medicare Part A segment pension assets as of January 1, 2002, and (2) Highmark increase its Medicare Part B segment pension assets by \$2,394,501 and, as a result, recognize \$41,701,031 as the Medicare Part B segment pension assets as of January 1, 2002.

UPDATE OF MEDICARE SEGMENT PENSION ASSETS

The Medicare contracts require Medicare contractors to update the Medicare segment pension assets yearly in accordance with the CAS. The CAS requires that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses.

For details on the Federal requirements and the relevant language of the Medicare contracts, see Appendix C.

Highmark did not correctly update the Medicare segment pension assets from January 1, 2002, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of \$82,681,744 as of January 1, 2012; however, we determined that the Medicare segment pension assets were \$82,685,679. Therefore, Highmark understated the

Medicare segment pension assets by \$3,935. The following are our findings regarding the update of the Medicare segment pension assets from January 1, 2002, to January 1, 2012.

Contributions and Transferred Prepayment Credits Overstated

The audited contributions and transferred prepayment credits³ are based on the assignable pension costs.⁴ In compliance with the CAS, we applied prepayment credits first to current-year assignable pension costs (because the credits were available at the beginning of the year) and then updated any remaining credits with interest to the next measurement (valuation) date. We then allocated contributions to assigned pension costs, as needed, as of the date of deposit. For additional details on these Federal requirements, see Appendix C.

Highmark overstated contributions and transferred prepayment credits by \$758,273 for the Medicare segment. The overstatement occurred primarily because of differences in the asset base used to compute the assignable pension costs. Table 2 below shows the differences between the contributions and prepayment credits proposed by Highmark and the contributions and prepayment credits that we calculated during our review.

Table 2: Contributions and Transferred Prepayment Credits			
	Per Audit	Per Highmark	Difference
2002	\$516,786	\$516,786	0
2003	1,849,871	1,901,727	(51,856)
2004	1,773,004	1,838,992	(65,988)
2005	2,015,049	2,131,861	(116,812)
2006	1,961,562	2,092,244	(130,682)
2007	1,766,434	1,906,833	(140,399)
2008	1,700,340	1,823,382	(123,042)
2009	4,215,170	4,258,979	(43,809)
2010	3,376,929	3,412,982	(36,053)
2011	3,332,293	3,381,925	(49,632)
Total	\$22,507,438	\$23,265,711	(\$758,273)

Benefit Payments Overstated

Highmark overstated benefit payments by \$314,497 because Highmark did not correctly identify some Medicare segment participants' benefit payments during the audit period. Table 3 on the following page shows the differences between the Medicare segment benefit payments proposed by Highmark and the benefit payments that we determined during our review.

³ A prepayment credit is the amount funded in excess of the pension costs assigned to a cost accounting period that is carried forward for future recognition.

⁴ These are assigned to a specific cost accounting period.

Table 3: Benefit Payments			
	Per Audit	Per Highmark	Difference
2002	\$2,431,864	\$2,411,436	\$20,428
2003	2,399,291	2,511,326	(112,035)
2004	2,349,421	2,456,884	(107,463)
2005	2,356,711	2,465,021	(108,310)
2006	2,560,500	2,668,810	(108,310)
2007	2,594,186	2,574,027	20,159
2008	2,731,092	2,710,933	20,159
2009	2,940,965	2,920,806	20,159
2010	3,403,433	3,382,876	20,557
2011	3,838,100	3,817,941	20,159
Total	\$27,605,563	\$27,920,060	(\$314,497)

Net Transfers Understated

Highmark understated net transfers out of the Medicare segment by \$207,723. The understatement occurred primarily because Highmark incorrectly transferred Medicare segment participants out of the Medicare segment. This understatement of the net transfer adjustment resulted in an overstatement of the Medicare segment assets by \$207,723.

Earnings, Net of Expenses Understated

Highmark understated investment earnings, less administrative expenses, by \$655,434 for the Medicare segment, because it used incorrect contributions and transferred prepayment credits, benefit payments, and net transfers (all discussed above), to develop the Medicare segment pension asset base. In our audited update, we allocated earnings, net of expenses based on the applicable CAS requirements. Table 4 on the following page shows the differences between Highmark's proposed earnings, net of expenses and the amounts that we calculated during our review. For details on applicable Federal requirements, see Appendix C.

Table 4: Earnings, Net of Expenses			
	Per Audit	Per Highmark	Difference
2002	(\$4,497,838)	(\$4,498,732)	\$894
2003	9,041,812	8,831,117	210,695
2004	6,305,814	6,167,726	138,088
2005	4,603,725	4,461,797	141,928
2006	7,627,484	7,429,285	198,199
2007	4,885,503	4,771,467	114,036
2008	(17,589,143)	(17,150,838)	(438,305)
2009	8,861,547	8,747,734	113,813
2010	8,501,006	8,415,258	85,748
2011	9,017,914	8,927,576	90,338
Total	\$36,757,824	\$36,102,390	\$655,434

MEDICARE SEGMENT EXCESS PENSION LIABILITIES

Federal regulations (Appendix C) require Highmark to compute a Medicare segment closing adjustment as a result of the termination of its Medicare contract.⁵ Highmark identified \$5,590,092 in Medicare segment excess pension liabilities as of January 1, 2012. However, we calculated the Medicare segment excess pension liabilities to be \$5,736,689 as of that date. Therefore, Highmark understated the excess pension liabilities by \$146,597. The understatement occurred because Highmark (a) incorrectly identified the final Medicare segment participants as of January 1, 2012, and (b) understated the Medicare segment's final market value of pension assets as of January 1, 2012.

RECOMMENDATIONS

We recommend that Highmark:

- increase Medicare segment pension assets as of January 1, 2012, by \$3,935 and recognize \$82,685,679 as the Medicare segment pension assets,
- increase the Medicare segment excess pension liabilities by \$146,597 and recognize \$5,736,689 as the Medicare segment excess pension liabilities as of January 1, 2012, and
- work with CMS officials to determine Medicare's share of the Medicare segment excess pension liabilities as of January 1, 2012.

⁵ CAS 413.50(c)(12) requires that Medicare's share of the excess pension liabilities be determined using a fraction of which the numerator is the sum of all pension plan costs allocated to the contract and the denominator is the sum of the total pension costs assigned to cost accounting periods during those same years. Because Highmark began using indirect cost rates for its MAC pension costs and given the fact that those indirect cost rates have not been finalized, we cannot readily determine the sum of the pension plan costs allocated to all contracts. As a result, we cannot calculate the percentage necessary to determine Medicare's share of the Medicare segment excess pension liabilities as of January 1, 2012. However, Appendix D of this report provides the necessary information for CMS to calculate the fraction and thus determine Medicare's share of the excess pension liabilities, once Highmark's indirect cost rates are finalized.

AUDITEE COMMENTS

In written comments on our draft report, Highmark concurred with our recommendations and described corrective actions that it would take. Specifically, Highmark agreed to increase the Medicare segment pension assets by \$3,935 (from \$82,681,744 to \$82,685,679) as of January 1, 2012, and to increase the Medicare segment excess pension liabilities by \$146,597 and recognize \$5,736,689 as the Medicare segment excess pension liabilities as of January 1, 2012. In addition, Highmark agreed to work with CMS officials to finalize Medicare's share of the Medicare segment excess pension liabilities as of January 1, 2012.

Highmark's comments are included in their entirety as Appendix E.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed Highmark's implementation of the prior audit recommendation; identification of its Medicare segment; update of Medicare segment assets from January 1, 2002, to January 1, 2012; and the Medicare segment's closing calculation as of January 1, 2012.

Achieving our objective did not require that we review Highmark's overall internal control structure. We reviewed controls relating to the identification of the Medicare segment, the update of the Medicare segment's assets, and the Medicare segment's final assets and liabilities to ensure adherence to the Medicare contracts, CAS 412, and CAS 413.

We performed fieldwork at Highmark in Camp Hill, Pennsylvania, in September 2012.

METHODOLOGY

To accomplish our objectives, we took the following steps:

- We reviewed the portions of the Federal Acquisition Regulation, CAS, and the Medicare contracts applicable to this audit.
- We reviewed the annual actuarial valuation reports prepared by Highmark's actuarial consulting firms, which included the pension plan's assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We used this information to calculate the Medicare segment assets.
- We obtained and reviewed the pension plan documents and Department of Labor/Internal Revenue Service Forms 5500 used in calculating the Medicare segment assets.
- We interviewed Highmark staff responsible for identifying the Medicare segment to determine whether the segment was properly identified in accordance with the Medicare contracts.
- We reviewed Highmark's accounting records to verify the segment identification and benefit payments made to the Medicare segment.
- We reviewed the Medicare segment closing calculation prepared by Highmark's staff and its actuarial consulting firms.
- We reviewed the prior segmentation audit performed at Highmark (A-07-04-03050) to determine the beginning market value of assets.
- We provided the CMS Office of the Actuary with the actuarial information necessary for it to calculate the Medicare segment pension assets from January 1, 2002, to

January 1, 2012, and the Medicare segment's excess pension liabilities as of January 1, 2012.

- We reviewed the CMS actuaries' methodology and calculations.
- We provided the results of the review to Highmark officials on July 12, 2013.

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

- *Highmark Medicare Services, Inc., Claimed Some Unallowable Medicare Pension Costs for Fiscal Years 2003 Through 2009 (A-07-13-00415); and*
- *Highmark Medicare Services, Inc., Overstated Its Allocable Pension Costs for Calendar Years 2008 Through 2011 (A-07-13-00416).*

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

**APPENDIX B: STATEMENT OF MARKET VALUE OF PENSION ASSETS
FOR HIGHMARK MEDICARE SERVICES, INC.,
FOR THE PERIOD JANUARY 1, 2002, TO JANUARY 1, 2012**

Description		Total Company	Other Segments	Medicare A Segment	Medicare B Segment	Gateway Segment
Assets January 1, 2002	1/	\$419,745,788	\$367,236,527	\$10,808,230	\$41,701,031	
Prepayment Credits	2/	0	(272,072)	272,072	0	
Contributions	3/	59,915,212	59,670,498	244,714	0	
Other Transactions	4/	(862,648)	(754,173)	(22,772)	(85,703)	
Earnings	5/	(34,575,239)	(30,312,688)	(898,632)	(3,363,919)	
Benefit Payments	6/	(16,373,150)	(13,941,286)	(463,348)	(1,968,516)	
Administrative Expenses	7/	(1,908,513)	(1,673,226)	(49,603)	(185,684)	
Transfers	8/	0	(108,367)	397,217	(288,850)	
Assets January 1, 2003		\$425,941,450	\$379,845,213	\$10,287,878	\$35,808,359	\$0
Prepayment Credits		0	(1,849,871)	872,345	977,526	
Contributions		50,000,000	50,000,000	0	0	
Other Transactions		0	0	0	0	
Earnings		86,339,891	77,070,688	2,165,171	7,104,032	
Benefit Payments		(16,843,823)	(14,444,532)	(481,658)	(1,917,633)	
Administrative Expenses		(2,118,081)	(1,890,690)	(53,116)	(174,275)	
Transfers		0	277,739	6,034	(283,773)	
Assets January 1, 2004		\$543,319,437	\$489,008,547	\$12,796,654	\$41,514,236	\$0
Prepayment Credits		0	(1,773,004)	864,322	908,682	0
Contributions		50,049,628	50,049,628	0	0	0
Other Transactions	9/	6,251,774	0	0	0	6,251,774
Earnings		66,493,103	59,885,499	1,614,062	4,993,542	0
Benefit Payments		(17,309,109)	(14,959,688)	(496,242)	(1,853,179)	0
Administrative Expenses		(3,036,951)	(2,735,161)	(73,719)	(228,071)	0
Transfers		0	123,277	(60,148)	32,074	(95,203)
Assets January 1, 2005		\$645,767,882	\$579,599,098	\$14,644,929	\$45,367,284	\$6,156,571
Prepayment Credits		0	(2,700,970)	909,461	1,105,588	685,921
Contributions		66,196,005	66,196,005	0	0	0
Other Transactions	10/	0	0	50,789,364	(50,789,364)	0
Earnings		52,730,381	47,258,669	1,162,309	3,757,354	552,049
Benefit Payments		(18,109,618)	(15,723,982)	(2,356,711)	0	(28,925)
Administrative Expenses		(3,386,312)	(3,034,922)	(74,643)	(241,295)	(35,452)
Transfers		0	300,626	(1,219,194)	800,433	118,135
Assets January 1, 2006		\$743,198,338	\$671,894,524	\$63,855,515	\$0	\$7,448,299

Description	Total Company	Other Segments	Medicare Segment	Gateway Segment
Assets January 1, 2006	\$743,198,338	\$671,894,524	\$63,855,515	\$7,448,299
Prepayment Credits	0	(2,869,698)	1,961,562	908,136
Contributions	48,295,628	48,295,628	0	0
Other Transactions	0	0	0	0
Earnings	92,498,009	83,522,299	7,948,969	1,026,741
Benefit Payments	(19,303,328)	(16,701,965)	(2,560,500)	(40,863)
Administrative Expenses	(3,740,958)	(3,377,948)	(321,485)	(41,525)
Transfers	0	262,752	(385,373)	122,621
Assets January 1, 2007	\$860,947,689	\$781,025,592	\$70,498,688	\$9,423,409
Prepayment Credits	0	(2,853,037)	1,766,434	1,086,603
Contributions	50,189,900	50,189,900	0	0
Other Transactions	0	0	0	0
Earnings	63,914,398	57,921,804	5,221,438	771,156
Benefit Payments	(20,726,511)	(18,074,889)	(2,594,186)	(57,436)
Administrative Expenses	(4,112,103)	(3,726,554)	(335,935)	(49,614)
Transfers	0	445,484	(415,474)	(30,010)
Assets January 1, 2008	\$950,213,373	\$864,928,300	\$74,140,965	\$11,144,108
Prepayment Credits	0	(3,083,064)	1,700,340	1,382,724
Contributions	251,581,464	251,581,464	0	0
Other Transactions	0	0	0	0
Earnings	(224,311,425)	(204,125,823)	(17,288,811)	(2,896,791)
Benefit Payments	(22,266,581)	(19,439,087)	(2,731,092)	(96,402)
Administrative Expenses	(3,896,623)	(3,545,969)	(300,332)	(50,322)
Transfers	0	(271,543)	260,076	11,467
Assets January 1, 2009	\$951,320,208	\$886,044,278	\$55,781,146	\$9,494,784
Prepayment Credits	0	(6,383,660)	4,215,170	2,168,490
Contributions	38,399,318	38,399,318	0	0
Other Transactions	0	0	0	0
Earnings	149,711,496	138,793,181	9,110,115	1,808,200
Benefit Payments	(24,170,319)	(21,135,537)	(2,940,965)	(93,817)
Administrative Expenses	(4,084,853)	(3,786,949)	(248,568)	(49,336)
Transfers	0	(122,852)	(70,465)	193,317
Assets January 1, 2010	\$1,111,175,850	\$1,031,807,779	\$65,846,433	\$13,521,638
Prepayment Credits	0	(3,919,500)	3,376,929	542,571
Contributions	51,000,000	51,000,000	0	0
Other Transactions	11/ 789,658	730,469	49,194	9,995
Earnings	148,749,264	138,065,155	8,850,481	1,833,628
Benefit Payments	(29,412,418)	(25,858,999)	(3,403,433)	(149,986)
Administrative Expenses	(5,873,593)	(5,451,714)	(349,475)	(72,404)
Transfers	0	126,012	(15,984)	(110,028)
Assets January 1, 2011	\$1,276,428,761	\$1,186,499,202	\$74,354,145	\$15,575,414

Description		Total Company	Other Segments	Medicare Segment	Gateway Segment
Assets January 1, 2011		\$1,276,428,761	\$1,186,499,202	\$74,354,145	\$15,575,414
Prepayment Credits		0	(4,689,416)	3,332,293	1,357,123
Contributions		60,880,000	60,880,000	0	0
Other Transactions		0	0	0	0
Earnings		162,094,325	150,601,222	9,414,582	2,078,521
Benefit Payments		(35,512,827)	(31,265,011)	(3,838,100)	(409,716)
Administrative Expenses		(6,829,582)	(6,345,339)	(396,668)	(87,575)
Transfers		0	170,147	(180,573)	10,426
Assets January 1, 2012		\$1,457,060,677	\$1,355,850,805	\$82,685,679	\$18,524,193
Per Highmark	12/	1,457,060,677	1,355,905,594	82,681,744	18,473,339
Asset Variance	13/	0	54,789	(3,935)	(50,854)

ENDNOTES

- 1/ We determined the Medicare Parts A and B segment pension assets as of January 1, 2002, based on our prior segmentation audit of Highmark, Inc., of Pennsylvania (A-07-04-03050). 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/ Transferred prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to avoid incurring unallowable interest. 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 and Department of Labor/Internal Revenue Service Forms 5500. 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 prepayment credits and accounted for in the Other segment until needed to fund pension costs in the future.
- 4/ The Other transactions in calendar year (CY) 2002 represent a Mass Mutual prior year adjustment on January 1, 2002. We obtained the Mass Mutual prior year adjustment amounts as of January 1, 2002, from Highmark's 2003 revised CAS asset rollup. These Other transactions impacted both Medicare segments' pension assets.
- 5/ We obtained net investment earnings from the actuarial valuation reports. We allocated net investment earnings based on the ratio of each segment's weighted average value (WAV) of assets to Total Company WAV of assets as required by the CAS.
- 6/ We based each Medicare segment's benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by Highmark.
- 7/ In accordance with CAS, we allocated administrative expenses to each Medicare segment in proportion to investment earnings.
- 8/ We identified participant transfers between segments by comparing valuation data files provided by Highmark. Asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 9/ The Other transactions in CY 2004 represent the merger of the Gateway segment into Highmark on January 1, 2005. We obtained the Gateway pension asset amount as of January 1, 2005, from Highmark's 2005 revised CAS asset rollup. These Other transactions did not impact the Medicare segment pension assets.
- 10/ The Other transactions in CY 2005 represent the combination of the Medicare Parts A and B segments into one Medicare segment, effective January 1, 2006.
- 11/ The Other transactions in CY 2010 represent the difference between the January 1, 2010, Total Company asset amount on Highmark's 2010 and 2011 revised CAS asset rollups. These Other transactions were allocated to each segment based on the beginning-of-the-year market value of assets.
- 12/ We obtained total asset amounts from documents prepared by Highmark's actuarial consulting firm.
- 13/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Highmark's calculation of the Medicare segment pension assets. In addition, Highmark maintained and separately accounted for the Gateway segment in its CAS asset rollups. Because the Gateway segment was accounted for separately by Highmark, we followed the same methodology. Although we identified a Gateway segment asset variance, we will not report on this difference since the Gateway segment does not perform Medicare work and therefore is not subject to our review. However, it was necessary to roll forward the Gateway segment pension assets to properly calculate the Medicare segment pension assets.

APPENDIX C: FEDERAL REQUIREMENTS RELATED TO PENSION SEGMENTATION AND SEGMENT CLOSING ADJUSTMENT

PENSION SEGMENTATION

Federal Regulations

Federal regulations (CAS 412.50(a)(4)) require that contributions in excess of the pension cost assigned to the period be recognized as prepayment credits and accumulated at the assumed valuation interest rate until applied to future period costs. Prepayment credits that have not been applied to fund pension costs are excluded from the value of assets used to compute pension costs.

Federal regulations (CAS 413.50(c)(7)) require that the asset base be adjusted by contributions, permitted unfunded accruals, income, benefit payments, and expenses. For plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's WAV of assets to Total Company WAV of assets.

Federal regulations (CAS 413.50(c)(8)) require 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.

Medicare Contracts

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 are charged to the Medicare agreement/contract, and these salary dollars represent 40% or more of the total salary dollars charged to the Medicare agreement/contract.

Furthermore, the Medicare contracts state that "... the pension assets allocated to each Medicare Segment shall be adjusted in accordance with CAS 413.50(c)(7)."

MEDICARE SEGMENT EXCESS PENSION LIABILITIES

Federal Regulations

Federal regulations (CAS 413.50(c)(12)) state:

If a segment is closed, if there is a pension plan termination, or if there is a curtailment of benefits, the contractor shall determine the difference between the actuarial liability for the segment and the market value of the assets allocated to the segment, irrespective of whether or not the pension plan is terminated. The difference between the market value of the assets and the actuarial accrued liability for the segment represents an adjustment of previously-determined pension costs.

(i) The determination of the actuarial accrued liability shall be made using the accrued benefit cost method. The actuarial assumptions employed shall be consistent with the current and prior long term assumptions used in the measurement of pension costs

(ii) ... The market value of the assets shall be reduced by the accumulated value of prepayment credits, if any. Conversely, the market value of assets shall be increased by the current value of any unfunded actuarial liability separately identified and maintained in accordance with 9904.412-50(a)(2).

(iii) The calculation of the difference between the market value of the assets and the actuarial accrued liability shall be made as of the date of the event (e.g., contract termination, plan amendment, plant closure) that caused the closing of the segment, pension plan termination, or curtailment of benefits. If such a date is not readily determinable, or if its use can result in an inequitable calculation, the contracting parties shall agree on an appropriate date.

(iv) Pension plan improvements adopted within 60 months of the date of the event which increase the actuarial accrued liability shall be recognized on a prorata basis using the number of months the date of adoption preceded the event date. Plan improvements mandated by law or collective bargaining agreement are not subject to this phase-in.

Medicare Contracts

In the event of a contract termination, the Medicare contracts require contractors to follow the segment closing provision of the CAS. Furthermore, in situations such as contract terminations, the Medicare contracts require contractors to identify excess Medicare pension assets and liabilities in accordance with CAS 413.

**APPENDIX D: ALLOWABLE AND ALLOCABLE TITLE XVIII PENSION COSTS FOR
HIGHMARK MEDICARE SERVICES, INC., FOR FISCAL YEARS 1992 THROUGH 2009**

Fiscal Year	Medicare A Segment Pension Costs Charged to Medicare	Total Medicare A Segment Pension Costs	Medicare B Segment Pension Costs Charged to Medicare	Total Medicare B Segment Pension Costs	Total Medicare Pension Costs Charged to Medicare (A + C)	Total Medicare Segment Pension Costs (B + D)
<u>1/</u>	(A)	(B)	(C)	(D)	(E)	(F)
1992	0	0	0	0	0	0
1993	55,213	62,051	0	0	55,213	62,051
1994	18,981	20,684	303,825	316,353	322,806	337,037
1995	94,469	94,469	929,240	932,036	1,023,709	1,026,505
1996	80,632	81,225	1,787,413	1,791,175	1,868,045	1,872,400
1997	293,692	302,703	2,120,416	2,121,265	2,414,108	2,423,968
1998	92,511	95,375	1,971,662	1,972,476	2,064,173	2,067,851
1999	0	0	1,823,522	1,823,705	1,823,522	1,823,705
2000	0	0	442,311	448,591	442,311	448,591
2001	70,458	70,458	0	0	70,458	70,458
2002	408,643	408,643	0	0	408,643	408,643
2003	778,731	782,644	733,145	733,145	1,511,876	1,515,789
2004	866,328	866,328	925,893	925,893	1,792,221	1,792,221
2005	768,133	1,954,538	1,171,159	1,954,538	1,939,292	1,954,538
2006	805,181	1,974,934	1,169,753	1,974,934	1,974,934	1,974,934
2007	783,447	1,815,216	1,031,769	1,815,216	1,815,216	1,815,216
2008	448,102	1,716,864	747,008	1,716,864	1,195,110	1,716,864
2009	0	425,085	11,817	425,085	11,817	425,085
Total	\$5,564,521	\$10,671,217	\$15,168,933	\$18,951,276	\$20,733,454	\$21,735,856

ENDNOTE

1/ This table shows the allocable and allowable Title XVIII pension costs based on the audited pension costs as determined during the pension audits related to the Highmark Medicare Parts A and B segments. The information for the Medicare Part A segment for fiscal years (FY) 1992 through 1997 was obtained during a prior audit (A-07-04-00170). The information for the Medicare Part B segment for FYs 1992 through 1997 was obtained during a prior audit (A-07-04-00171). The information for the Medicare Parts A and B segments for FYs 1998 through 2002 was obtained during a prior audit (A-07-04-00163). The information for fiscal years 2003 through 2009 was obtained during the current review (A-07-13-00415).

APPENDIX E: AUDITEE COMMENTS



December 9, 2013

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

Subject: OIG Report Number A-07-13-00414

Dear Mr. Cogley:

Thank you for affording Highmark Inc. ("Highmark") this opportunity to comment on the U.S. Department of Health and Human Services, Office of Inspector General ("OIG"), draft report entitled *Highmark Medicare Services, Inc., Understated Its Medicare Segment Pension Assets and Understated the Medicare Segment Excess Pension Liabilities as of January 1, 2012*.

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

1. Highmark agrees that the Medicare segment pension assets as of January 1, 2012 should be increased by \$3,935 from \$82,681,744 to \$82,685,679.
2. Highmark agrees that the Medicare segment excess pension liabilities should be increased by \$146,597, and that Highmark should thus recognize Medicare segment excess pension liabilities of \$5,736,689 as of January 1, 2012.
3. As OIG recognizes in note 5 of the above-referenced report, "CAS 413.50(c)(12) requires that Medicare's share of the excess pension liabilities be determined using a fraction of which the numerator is the sum of all pension plan costs allocated to the contract and the denominator is the sum of the total pension costs assigned to cost accounting periods during those same years." Highmark believes that there is no question that this calculation results in a 100% allocation of Medicare segment excess pension liabilities to CMS for the period at issue. Highmark therefore agrees with the recommendation that we should continue to work with CMS officials to finalize CMS's share of the Medicare segment excess pension liabilities as of January 1, 2012, which Highmark calculates is \$5,736,689.

While we concur with the overall recommendations in this report, Highmark's detailed examination of the individual data elements identified various minor transposition and other differences that Highmark does not contest because the net impact of these items is immaterial

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to the overall findings.

As Highmark concurs with the recommendations in the above-referenced report, our external actuary developed revised figures to utilize in our examination of draft reports A-07-13-00415 and A-07-13-00416.

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

Sincerely,



Janine K. Colinear
Chief Accounting Officer
Highmark Inc.

 Highmark Medicare Services Inc. Response (A-07-13-00414)