



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-07-06-00201

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

Dear Mr. Fisher:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Pennsylvania Blue Shield for Fiscal Years 1993 Through 1997." A copy of this report will be forwarded to the HHS action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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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-07-06-00201 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
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Philadelphia, Pennsylvania 19106

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF NONQUALIFIED
DEFINED-BENEFIT PENSION PLAN
COSTS CLAIMED BY PENNSYLVANIA
BLUE SHIELD FOR FISCAL YEARS
1993 THROUGH 1997**



**Daniel R. Levinson
Inspector General**

**JANUARY 2006
A-07-06-00201**

Office of Inspector General

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In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services, reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

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



EXECUTIVE SUMMARY

BACKGROUND

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

PBS's nonqualified defined-benefit pension plan (NQDBP) consisted of two plans used to restore pension accrual forfeited as a result of deferred compensation or statutory limits.

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

OBJECTIVE

Our objective was to determine the allowability of the NQDBP costs PBS claimed for Medicare reimbursement for fiscal years (FY) 1993 through 1997.

SUMMARY OF FINDING

PBS underclaimed \$100,676 in allowable NQDBP costs for FYs 1993 through 1997 because it did not claim all of the allowable NQDBP costs allowed by the CAS. PBS claimed NQDBP costs of \$429,301 for Medicare reimbursement; however, the allowable NQDBP costs were \$529,977.

RECOMMENDATION

We recommend that PBS revise its Final Administrative Cost Proposals (FACP) for FYs 1993 through 1997 or submit a claim for additional allowable NQDBP costs of \$100,676.

AUDITEE'S COMMENTS

PBS agreed with our finding and recommendation.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
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

Pennsylvania Blue Shield (PBS) administered Medicare Part B operations under a cost reimbursement contract with the Centers for Medicare & Medicaid Services (CMS) until it merged with Veritus, Inc. (Veritus) on December 6, 1996, to form Highmark, Inc. (Highmark). For the purposes of this report, the term PBS will be used to address the findings concerning the Medicare Part B nonqualified defined-benefit pension plan (NQDBP) costs claimed for fiscal years (FY) 1993 through 1997. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), Cost Accounting Standards (CAS), and Medicare contract.

Medicare reimburses a portion of the annual contributions that contractors make to their pension plans. To be allowable for Medicare reimbursement, pension costs must be (1) measured, assigned, and allocated in accordance with CAS 412 and 413 and (2) funded as specified by part 31 of the FAR.

PBS Nonqualified Pension Plans

As of January 1, 1990, PBS established its NQDBP, which consisted of two plans (1) Pennsylvania Blue Shield Supplemental Employee Retirement Plan and (2) Pennsylvania Blue Shield Deferred Compensation Supplemental Plan. PBS maintained the nonqualified defined-benefit pension plans to restore pension accruals that were not provided through the qualified defined-benefit pension plan as a result of elective deferrals of compensation or statutory limits due to the Internal Revenue Code sections 401(a)(17) and 415.

Regulations

The determination and allocation of pension costs are addressed by the Medicare contract, which states: “The calculation of and accounting for pension costs charged to this agreement/contract are governed by the Federal Acquisition Regulation and Cost Accounting Standards 412 and 413.”

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

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

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

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

CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine the allowability of the NQDBP costs PBS claimed for Medicare reimbursement for FYs 1993 through 1997.

Scope

We reviewed PBS's NQDBP costs claimed on its Final Administrative Cost Proposals (FACP) for FYs 1993 through 1997. PBS was unable to identify and provide documentation for the indirect segment costs claimed on the FACP for FYs 1994 and 1995; therefore, we limited the scope of costs claimed for FYs 1994 and 1995 to the Medicare segment costs. Achieving the objective did not require a review of PBS's internal control structure. However, we did review the controls relating to the NQDBP costs claimed for Medicare reimbursement to ensure that NQDBP costs were allowable in accordance with the CAS.

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

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

Methodology

We identified PBS's NQDBP costs for the total company and for the Medicare segment. We also determined the extent to which PBS funded the NQDBP costs with contributions to the trust fund and accumulated prepayment credits. Using this information, we calculated NQDBP costs that are allowable for Medicare reimbursement for FYs 1993 through 1997. The calculations were based on separately computed NQDBP costs for the Medicare segment and total company NQDBP costs. The CMS Office of the Actuary developed the methodology used for computing allowable NQDBP costs based on PBS's historical practices. Appendix A presents the details on the pension costs and contributions.

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

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

FINDING AND RECOMMENDATION

PBS underclaimed \$100,676 in allowable NQDBP costs for FYs 1993 through 1997. We calculated the allowable NQDBP costs for FYs 1993 through 1997 to be \$529,977. We compared allowable NQDBP costs to the NQDBP costs PBS claimed on its FACPs as shown in the table.

NQDBP Cost Claimed Variance

Fiscal Year	Per PBS	Per OIG	Difference
1993	\$0	\$15,696	(\$15,696)
1994	29,156	18,359	10,797
1995	15,619	11,284	4,335
1996	209,208	260,546	(51,338)
1997	175,318	224,092	(48,774)
	<u>\$429,301</u>	<u>\$529,977</u>	<u>(\$100,676)</u>

PBS claimed NQDBP costs of \$429,301 for Medicare reimbursement; however, the allowable NQDBP costs were \$529,977. PBS underclaimed NQDBP costs because it did not claim all of the allowable NQDBP costs allowed in accordance with the CAS.

RECOMMENDATION

PBS should revise its FACPs for FYs 1993 through 1997 or submit a claim for additional allowable NQDBP costs of \$100,676.

AUDITEE'S COMMENTS

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

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We commend PBS for its action to address the recommendation.

APPENDIXES

Pennsylvania Blue Shield
Statement of Allowable Nonqualified Defined-Benefit Pension Plan Costs
For Fiscal Years 1993 Through 1997

Date	Description	Total Company	Other Segment	Medicare Segment
1992	Contributions	<u>1/</u> \$0	\$0	\$0
7.50%	Discount For Interest	<u>2/</u> 0	0	0
1/1/92	Present Value	<u>3/</u> 0	0	0
1/1/92	Prepayment Credit	<u>4/</u> 0	0	0
1/1/92	Present Value Of Funding	<u>5/</u> 0	0	0
1/1/92	Assigned Pension Costs	<u>6/</u> 82,734	73,077	9,657
1/1/92	CAS Funding Target	<u>7/</u> 82,734	73,077	9,657
1/1/92	Percentage Funded	<u>8/</u>	n/a	n/a
1/1/92	Period Pension Cost	<u>9/</u>	73,077	9,657
	Allowable Interest	<u>10/</u>	0	0
	Allocable Pension Cost	<u>11/</u>	73,077	9,657

1993	Contributions	\$2,921	\$2,921	\$0
7.25%	Discount For Interest	<u>(99)</u>	(99)	0
1/1/93	Present Value	<u>2,822</u>	2,822	0
1/1/93	Prepayment Credit	<u>0</u>	0	0
1/1/93	Present Value Of Funding	<u>2,822</u>	2,822	0
1/1/93	Assigned Pension Costs	<u>92,776</u>	85,277	7,499
1/1/93	CAS Funding Target	<u>92,776</u>	85,277	7,499
1/1/93	Percentage Funded		n/a	n/a
1/1/93	Period Pension Cost		85,277	7,499
	Allowable Interest		<u>2,992</u>	0
	Allocable Pension Cost		88,269	7,499
1993	Fiscal Year Pension Cost	<u>12/</u>	84,471	8,039
	Medicare LOB Percentage	<u>13/</u>	9.62%	94.16%
	Allowable Pension Cost	<u>14/</u> <u>\$15,696</u>	<u>\$8,126</u>	<u>\$7,570</u>

Pennsylvania Blue Shield
Statement of Allowable Nonqualified Defined-Benefit Pension Plan Costs
For Fiscal Years 1993 Through 1997

Date	Description	Total Company	Other Segment	Medicare Segment
1994	Contributions	\$2,921	\$2,921	\$0
6.50%	Discount For Interest	(89)	(89)	0
1/1/94	Present Value	2,832	2,832	0
1/1/94	Prepayment Credit	0	0	0
1/1/94	Present Value Of Funding	2,832	2,832	0
1/1/94	Assigned Pension Costs	352,872	329,884	22,988
1/1/94	CAS Funding Target	352,872	329,884	22,988
1/1/94	Percentage Funded		n/a	n/a
1/1/94	Period Pension Cost		329,884	22,988
	Allowable Interest		10,367	0
	Allocable Pension Cost		340,251	22,988
1994	Fiscal Year Pension Cost		n/a	19,116
	Medicare LOB Percentage		9.62%	96.04%
	Allowable Pension Cost	15/ \$18,359	n/a	\$18,359

Date	Description	Total Company	Other Segment	Medicare Segment
1995	Contributions	\$1,620,657	\$1,512,256	\$108,401
8.15%	Discount For Interest	(122,020)	(113,858)	(8,162)
1/1/95	Present Value	1,498,637	1,398,398	100,239
1/1/95	Prepayment Credit	0	0	0
1/1/95	Present Value Of Funding	1,498,637	1,398,398	100,239
1/1/95	Assigned Pension Costs	282,326	275,302	7,023
1/1/95	CAS Funding Target	282,326	275,302	7,023
1/1/95	Percentage Funded		n/a	n/a
1/1/95	Period Pension Cost		275,302	7,023
	Allowable Interest		15,893	405
	Allocable Pension Cost		291,195	7,428
1995	Fiscal Year Pension Cost		n/a	11,318
	Medicare LOB Percentage		9.62%	99.70%
	Allowable Pension Cost	15/ \$11,284	n/a	\$11,284

Pennsylvania Blue Shield
Statement of Allowable Nonqualified Defined-Benefit Pension Plan Costs
For Fiscal Years 1993 Through 1997

Date	Description	Total Company	Other Segment	Medicare Segment
1996	Contributions	\$1,859,147	\$1,697,199	\$161,948
8.50%	Discount For Interest	(99,273)	(90,625)	(8,648)
1/1/96	Present Value	1,759,874	1,606,574	153,300
1/1/96	Prepayment Credit	298,834	267,463	31,371
1/1/96	Present Value Of Funding	2,058,708	1,874,037	184,671
1/1/96	Assigned Pension Costs	1,759,122	1,574,451	184,671
1/1/96	CAS Funding Target	1,759,122	1,574,451	184,671
1/1/96	Percentage Funded		100.00%	100.00%
1/1/96	Period Pension Cost		1,574,451	184,671
	Allowable Interest		73,726	8,648
	Allocable Pension Cost		1,648,177	193,319
1996	Fiscal Year Pension Cost		1,308,932	146,846
	Medicare LOB Percentage		8.71%	99.79%
	Allowable Pension Cost	\$260,546	\$114,008	\$146,538

Date	Description	Total Company	Other Segment	Medicare Segment
1997	Contributions	\$1,750,544	\$1,687,109	\$63,435
8.50%	Discount For Interest	(93,545)	(90,155)	(3,390)
1/1/97	Present Value	1,656,999	1,596,954	60,045
1/1/97	Prepayment Credit	325,051	304,074	20,977
1/1/97	Present Value Of Funding	1,982,050	1,901,028	81,022
1/1/97	Assigned Pension Costs	1,255,510	1,174,488	81,022
1/1/97	CAS Funding Target	1,255,510	1,174,488	81,022
1/1/97	Percentage Funded		100.00%	100.00%
1/1/97	Period Pension Cost		1,174,488	81,022
	Allowable Interest		49,139	3,390
	Allocable Pension Cost		1,223,627	84,412
1997	Fiscal Year Pension Cost		1,329,765	111,639
	Medicare LOB Percentage		8.46%	99.96%
	Allowable Pension Cost	\$224,092	\$112,498	\$111,594

FOOTNOTES

- 1/ We obtained total company contribution amounts from the valuation reports. The contributions included deposits made during the plan year and accrued contributions deposited after the end of the plan year but within the time allowed for filing tax returns.
- 2/ We subtracted interest that is included in the contributions deposited after January 1 of each year to discount the contributions back to their beginning of the year value. For purposes of this appendix, we computed the interest as the difference between the present value of contributions, at the valuation interest rate, and actual contribution amounts.
- 3/ The present value of contributions is the value of the contributions discounted from the date of deposit back to January 1. For purposes of this Appendix, we deemed deposits made after the end of the plan year to have been made on the final day of the plan year.
- 4/ A prepayment credit represents the accumulated value of premature funding from the previous year(s). A prepayment credit is created when contributions, plus interest, exceed the end-of-year Cost Accounting Standards (CAS) funding target. A prepayment credit may be carried forward, with interest, to fund future nonqualified defined benefit pension (NQDBP) costs.
- 5/ The present value of funding represents the present value of contributions plus prepayment credits. This is the amount of funding that is available to cover the CAS funding target measured at January 1 of each year.
- 6/ The assigned pension costs, computed at January 1 of each year, provides the basis to compute the allowable pension cost that can be charged to Medicare.
- 7/ The CAS funding target must be funded by current or prepaid contributions to satisfy the funding requirement of FAR 31.205-6(j)(3)(i)(B). This was effective the first plan year after March 30, 1995.
- 8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the plan year. Since any funding in excess of the CAS funding target is considered premature funding in accordance with CAS 412.50(a)(7), the funded ratio may not exceed 100 percent. We computed the percentage funded as the present value of funding divided by the CAS funding target. For purposes of illustration, the percentage of funding has been rounded to four decimals. Prior to the first plan year after March 30, 1995, funding was not required as long as the provisions of CAS 412 were met for defined benefit pension plans with a compellable benefit.
- 9/ We computed the period pension cost to be equal to the CAS funding target if funded at least at the complement to the current corporate tax rate. The CAS funding target is reduced proportionately for funding at less than the complement to the rate. Beginning in 1995, Pennsylvania Blue Shield always funded 100 percent of the CAS funding target, the period pension cost is equal to the CAS funding target for all years.

Pennsylvania Blue Shield
Statement of Allowable Nonqualified Defined-Benefit Pension Plan Costs
For Fiscal Years 1993 Through 1997

- 10/ We assumed interest on the period pension cost is to accrue in the same proportion as the interest on contributions bears to the present value of funding. However, we limited interest by Federal Acquisition Regulations (FAR) 31.205-6(j)(3)(iii), which does not permit the allowable interest to exceed the interest that would accrue if the CAS funding target were funded in four equal installments deposited within 30 days of the end of the quarter.
- 11/ The allocable pension cost is the amount of pension cost that may be allocated for contract cost purposes.
- 12/ We converted the plan year allocable pension costs to a Federal fiscal year basis (October 1 through September 30). We calculated the fiscal year pension costs as 1/4 of the prior year's costs plus 3/4 of the current year's costs. Costs charged to the Medicare contract should consist of the Medicare segment's direct pension costs plus pension costs attributable to indirect Medicare operations.
- 13/ We calculated allowable pension costs of the Medicare and other segments based on the Medicare Line of Business (LOB) percentage of each segment. We obtained the percentages from documents provided by PBS.
- 14/ We computed the allowable Medicare pension cost as the fiscal year pension cost multiplied by the Medicare LOB percentage.
- 15/ The allowable costs for the Other segment were not applicable. PBS only provided the direct Medicare segment costs claimed for FYs 1994 and 1995; therefore, only the Medicare segment allowable costs were calculated.

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

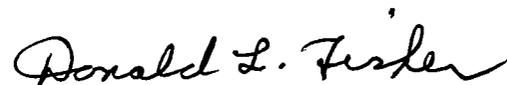
RE: A-07-06-00200 (“Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Veritus, Inc. for Fiscal Years 1996 Through 1997”)
A-07-06-00201 (“Review of Nonqualified Defined-Benefit Pension Plan Costs Claimed by Pennsylvania Blue Shield for Fiscal Years 1993 Through 1997”)
A-07-06-00202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

Fiscal Years 1993 through 1997

**Highmark's Comments to OIG Draft Report
A07-06-00201**

Highmark's Comments on the Report Number A-07-06-00201

Highmark agrees with the recommendation to submit a claim for additional allowable Nonqualified Defined-Benefit Pension Plan (NQDBP) costs of \$100,676.

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.