Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

HIGHMARK MEDICARE SERVICES, INC., OVERSTATED ITS NONQUALIFIED DEFINED-BENEFIT PLAN MEDICARE SEGMENT PENSION ASSETS AND OVERSTATED THE MEDICARE SEGMENT EXCESS PENSION LIABILITIES AS OF JANUARY 1, 2012

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

Patrick J. Cogley
Regional Inspector General

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Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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EXECUTIVE SUMMARY

Highmark Medicare Services, Inc. overstated the nonqualified defined-benefit plan Medicare segment pension assets by approximately $29,000 as of January 1, 2012. In addition, Highmark overstated the Medicare segment excess pension liabilities by approximately $376,000 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 increase the Medicare Part A segment pension assets and decrease the Medicare Part B segment pension assets as of January 1, 2003, (2) updating the Medicare segment's pension assets from January 1, 2003, to January 1, 2012, and (3) determining the Medicare segment excess pension assets/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, 2003, 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.

Highmark sponsors the Highmark Executive Retirement Restoration Plan (HERRP), whose primary purpose is to provide deferred compensation to a select group of management or highly compensated employees. The HERRP is a nonqualified defined-benefit plan designed to restore pension accruals that were not provided through the qualified defined-benefit pension plan as a result of elective deferrals of compensation or the statutory limits imposed by the Internal Revenue Code sections 401(a)(17) and 415.

We performed a prior pension segmentation audit at Highmark (A-07-06-00203, issued January 20, 2006), which brought the Medicare Parts A and B segment pension assets to January 1, 2003. We recommended that Highmark increase its Medicare Part A segment pension assets by $4,057 and, as a result, recognize $227,868 as the Medicare Part A segment pension assets as of January 1, 2003. We also recommended that Highmark decrease its Medicare Part B segment pension assets by $50,351 and, as a result, recognize $409,562 as the Medicare Part B segment pension assets as of January 1, 2003.

Upon the termination of its Medicare contracts, Highmark identified Medicare segment excess pension assets of $201,942. We examined these excess pension assets as part of the current review.

WHAT WE FOUND

Highmark did not fully implement the prior audit recommendations to recognize $227,868 as the Medicare Part A segment pension assets and $409,562 as the Medicare Part B segment pension assets as of January 1, 2003. Additionally, Highmark did not correctly update the Medicare segment pension assets from January 1, 2003, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of $1,428,072 as of January 1, 2012; however, we determined that the Medicare segment pension assets were $1,398,622 for that same period. Therefore, Highmark overstated the Medicare segment pension assets by $29,450.

Regarding our third objective, Highmark computed the Medicare segment excess pension assets to be $201,942 as of January 1, 2012 (the effective date that DSO acquired Highmark); however, we identified excess Medicare segment pension liabilities totaling $174,400 as of that date. Accordingly, Highmark overstated the Medicare segment excess pension liabilities by $376,342 because of differences in the final Medicare segment pension assets.

WHAT WE RECOMMEND

We recommend that Highmark:

- decrease Medicare segment pension assets as of January 1, 2012, by $29,450 and recognize $1,398,622 as the Medicare segment pension assets,

- decrease its final Medicare segment pension assets by $376,342 to recognize $174,400 as the Medicare segment excess pension liabilities as of January 1, 2012, and

- work with CMS 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.

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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 increase the Medicare Part A segment pension assets and decrease the Medicare Part B segment pension assets as of January 1, 2003, (2) updating the Medicare segment's pension assets from January 1, 2003, to January 1, 2012, and (3) determining the Medicare segment excess pension assets/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, 2003, 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,[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 intermediary and Part B carrier, with those contracts terminating in July 2008 and

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[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] Medicare Parts A and B Jurisdiction 12 consists of the States of Delaware, Maryland, New Jersey, and Pennsylvania, and the District of Columbia.

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.

Highmark sponsors the Highmark Executive Retirement Restoration Plan (HERRP), whose primary purpose is to provide deferred compensation to a select group of management or highly compensated employees. The HERRP is a nonqualified defined-benefit plan (NQDBP) designed to restore pension accruals that were not provided through the qualified defined-benefit pension plan as a result of elective deferrals of compensation or the statutory limits imposed by the Internal Revenue Code sections 401(a)(17) and 415.

We performed a prior pension segmentation audit at Highmark (A-07-06-00203, issued January 20, 2006), which brought the Medicare Parts A and B segment pension assets to January 1, 2003. We recommended that Highmark increase its Medicare Part A segment pension assets by $4,057 and, as a result, recognize $227,868 as the Medicare Part A segment pension assets as of January 1, 2003. We also recommended that Highmark decrease its Medicare Part B segment pension assets by $50,351 and, as a result, recognize $409,562 as the Medicare Part B segment pension assets as of January 1, 2003.

Upon the termination of its Medicare contracts, Highmark identified Medicare segment excess pension assets of $201,942. We examined these excess pension assets as part of the current review.

HOW WE CONDUCTED THIS REVIEW

We reviewed Highmark's implementation of the prior audit recommendations; identification of its Medicare segment; update of Medicare segment assets from January 1, 2003, 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 did not fully implement the prior audit recommendations to recognize $227,868 as the Medicare Part A segment pension assets and $409,562 as the Medicare Part B segment pension assets as of January 1, 2003. Additionally, Highmark did not correctly update the Medicare segment pension assets from January 1, 2003, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of $1,428,072 as of January 1, 2012; however, we determined that the Medicare segment pension assets were $1,398,622 for that same period. Therefore, Highmark overstated the Medicare segment pension assets by $29,450.

Appendix B presents details of the Medicare segment's pension assets from January 1, 2003, to January 1, 2012, as determined during our audit. Table 1 below summarizes the audit adjustments required to update the Medicare segment pension assets in accordance with Federal requirements.

Table 1: Summary of Audit Adjustments

	Per Audit	**Per Highmark**	**Difference**
Prior Audit Recommendation			
Medicare Part A Segment	$227,868	$227,911	$(43)
Medicare Part B Segment	409,562	409,640	(78)
Update of Medicare Segment Assets			
Contributions and Prepayment Credits	517,120	543,084	(25,964)
Benefit Payments	(60,013)	(60,013)	0
Net Transfers Out	(21,657)	(21,657)	0
Earnings, Net of Expenses	325,742	329,107	(3,365)
Overstatement of Medicare Segment Assets			**($29,450)**

Regarding our third objective, the CAS requires that a segment closing adjustment be made to recognize the Medicare segment excess pension assets/liabilities as a result of the closing of the Medicare segment. Highmark computed the Medicare segment excess pension assets to be $201,942 as of January 1, 2012 (the effective date that DSO acquired Highmark); however, we identified excess Medicare segment pension liabilities totaling $174,400 as of that date. Accordingly, Highmark overstated the Medicare segment excess pension liabilities by $376,342 because of differences in the final Medicare segment pension assets.

PRIOR AUDIT RECOMMENDATIONS

Highmark did not fully implement the prior audit recommendations (A-07-06-00203), which recommended that (1) Highmark increase its Medicare Part A segment pension assets by $4,057 and, as a result, recognize $227,868 as the Medicare Part A segment pension assets as of January 1, 2003, and (2) Highmark decrease its Medicare Part B segment pension assets by $50,351 and, as a result, recognize $409,562 as the Medicare Part B segment pension assets as of January 1, 2003. Highmark made an asset adjustment of $4,100 to increase the Medicare Part A segment pension assets at January 1, 2003. Additionally, Highmark made an asset adjustment of $50,273 to decrease the Medicare Part B segment pension assets at January 1, 2003. Therefore, Highmark overstated the January 1, 2003, Medicare Parts A and B segment pension assets by $43 and $78, respectively.

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, 2003, to January 1, 2012, in accordance with Federal requirements. Highmark identified Medicare segment pension assets of $1,428,072 as of January 1, 2012; however, we determined that the Medicare segment pension assets were $1,398,622 for that same period. Therefore, Highmark overstated the Medicare segment pension assets by $29,450. The following are our findings regarding the update of the Medicare segment pension assets from January 1, 2003, to January 1, 2012.

Contributions and Transferred Prepayment Credits Overstated

The audited contributions and transferred prepayment credits[3] 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 $25,964 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 calculated 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
2003	$0	$0	$0
2004	0	26,339	(26,339)
2005	112,188	119,640	(7,452)
2006	0	0	0
2007	68,300	64,951	3,349
2008	137,643	134,966	2,677
2009	198,989	197,188	1,801
2010	0	0	0
2011	0	0	0
Total	**$517,120**	**$543,084**	**($25,964)**

[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.

Earnings, Net of Expenses Overstated

Highmark overstated investment earnings, less administrative expenses, by $3,365 for the Medicare segment, primarily because it used incorrect contributions and transferred prepayment credits (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. For details on the applicable Federal requirements, see Appendix C.

Table 3 below shows the differences between Highmark's calculated earnings, net of expenses and the amounts that we calculated during our review.

Table 3: Earnings, Net of Expenses

	Per Audit	Per Highmark	Difference
2003	$82,938	$82,304	$634
2004	45,216	46,477	(1,261)
2005	13,872	13,845	27
2006	67,243	69,435	(2,192)
2007	43,553	44,403	(850)
2008	(279,348)	(281,462)	2,114
2009	182,186	180,560	1,626
2010	162,039	165,353	(3,314)
2011	8,043	8,192	(149)
Total	**$325,742**	**$329,107**	**$3,365**

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 $201,942 in Medicare segment excess pension assets as of January 1, 2012 (the effective date that DSO acquired Highmark). However, we identified Medicare segment excess pension liabilities totaling $174,400 as of that date. Therefore, Highmark overstated the excess pension assets by $376,342. Specifically, this overstatement occurred because Highmark (1) overstated the Medicare segment's final market value of pension assets and (2) incorrectly calculated the unallowable unfunded pension cost 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 because 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, and for this reason we have not associated a specific dollar amount with our third recommendation. 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.

RECOMMENDATIONS

We recommend that Highmark:

- decrease Medicare segment pension assets as of January 1, 2012, by $29,450 and recognize $1,398,622 as the Medicare segment pension assets,
- decrease its final Medicare segment pension assets by $376,342 to recognize $174,400 as the Medicare segment excess pension liabilities as of January 1, 2012, and
- work with CMS 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. Specifically, Highmark agreed to decrease the Medicare segment pension assets by $29,450 (from $1,428,072 to $1,398,622) as of January 1, 2012, and to decrease the Medicare segment excess pension liabilities by $376,342 and recognize $174,400 as 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 recommendations; identification of its Medicare segment; update of Medicare segment assets from January 1, 2003, 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 our 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 firm, which included the NQDBP 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 NQDBP documents 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 firm.

- We reviewed the prior segmentation audit performed at Highmark (A-07-06-00203) 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, 2003, 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 performed this review in conjunction with the following audits and used the information obtained during this review:

- *Highmark Medicare Services, Inc., Did Not Claim Some Allowable Medicare Nonqualified Defined-Benefit Plan Pension Costs for Fiscal Years 2003 Through 2009* (A-07-13-00430); and

- *Highmark Medicare Services, Inc., Understated Its Allocable Nonqualified Defined-Benefit Plan Pension Costs for Calendar Years 2008 Through 2011* (A-07-13-00431).

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 NONQUALIFIED DEFINED-BENEFIT PLAN PENSION ASSETS FOR HIGHMARK MEDICARE SERVICES, INC., FOR THE PERIOD JANUARY 1, 2003 THROUGH JANUARY 1, 2012

Description		Total Company	Other Segments	Medicare A Segment	Medicare B Segment	Gateway Segment
Assets January 1, 2003	1/	$21,222,522	$20,585,092	$227,868	$409,562	
Prepayment Credits		0	0	0	0	
Contributions	2/	5,124,928	5,124,928	0	0	
Other Transactions		0	0	0	0	
Earnings	3/	3,217,177	3,125,061	33,010	59,106	
Benefit Payments	4/	(4,558,778)	(4,555,660)	0	(3,118)	
Administrative Expenses	5/	(320,524)	(311,346)	(3,289)	(5,889)	
Transfers	6/	0	0	0	0	
Assets January 1, 2004		$24,685,325	$23,968,075	$257,589	$459,661	$0
Prepayment Credits		0	0	0	0	
Contributions		4,028,739	4,028,739	0	0	
Other Transactions		0	0	0	0	
Earnings		1,880,419	1,826,176	19,523	34,720	
Benefit Payments		(4,902,300)	(4,899,182)	0	(3,118)	
Administrative Expenses		(312,944)	(303,917)	(3,249)	(5,778)	
Transfers		0	0	0	0	
Assets January 1, 2005		$25,379,239	$24,619,891	$273,863	$485,485	$0
Prepayment Credits	7/	0	(196,095)	0	96,558	99,537
Contributions		5,088,303	5,056,560	0	15,630	16,113
Other Transactions	8/	0	0	607,175	(607,175)	0
Earnings		1,318,855	1,273,166	12,770	27,766	5,153
Benefit Payments		(1,045,803)	(1,042,685)	(3,118)	0	0
Administrative Expenses		(867,522)	(837,468)	(8,400)	(18,264)	(3,390)
Transfers		0	1,654	0	0	(1,654)
Assets January 1, 2006		$29,873,072	$28,875,023	$882,290	$0	$115,759
Prepayment Credits		0	(85,907)	0	0	85,907
Contributions		6,045,299	6,027,241	0	0	18,058
Other Transactions		0	0	0	0	0
Earnings		3,287,519	3,179,109	87,273	0	21,137
Benefit Payments		(1,184,486)	(1,181,368)	(3,118)	0	0
Administrative Expenses		(754,533)	(729,652)	(20,030)	0	(4,851)
Transfers		0	0	0	0	0
Assets January 1, 2007		$37,266,871	$36,084,446	$946,415	$0	$236,010

Description		Total Company	Other Segments	Medicare Segment	Gateway Segment
Assets January 1, 2007		$37,266,871	$36,084,446	$946,415	$236,010
Prepayment Credits		0	(157,859)	62,822	95,037
Contributions		6,239,907	6,226,144	5,478	8,285
Other Transactions		0	0	0	0
Earnings		2,517,704	2,434,443	62,611	20,650
Benefit Payments		(1,251,515)	(1,242,655)	(3,118)	(5,742)
Administrative Expenses		(766,350)	(741,006)	(19,058)	(6,286)
Transfers		0	0	0	0
Assets January 1, 2008		$44,006,617	$42,603,513	$1,055,150	$347,954
Prepayment Credits		0	(270,020)	115,541	154,479
Contributions		7,709,587	7,657,934	22,102	29,551
Other Transactions		0	0	0	0
Earnings		(10,354,405)	(9,980,652)	(260,503)	(113,250)
Benefit Payments		(3,786,571)	(3,769,673)	(3,118)	(13,780)
Administrative Expenses		(749,030)	(721,993)	(18,845)	(8,192)
Transfers		0	0	0	0
Assets January 1, 2009		$36,826,198	$35,519,109	$910,327	$396,762
Prepayment Credits		0	(338,593)	160,018	178,575
Contributions		9,059,068	8,976,607	38,971	43,490
Other Transactions		0	0	0	0
Earnings		6,811,334	6,500,364	201,251	109,719
Benefit Payments		(11,214,828)	(11,197,930)	(3,118)	(13,780)
Administrative Expenses		(645,241)	(615,782)	(19,065)	(10,394)
Transfers		0	0	0	0
Assets January 1, 2010		$40,836,531	$38,843,775	$1,288,384	$704,372
Prepayment Credits		0	0	0	0
Contributions		0	0	0	0
Other Transactions		0	0	0	0
Earnings		5,467,950	5,184,710	182,873	100,367
Benefit Payments		(5,675,704)	(5,626,855)	(35,069)	(13,780)
Administrative Expenses		(622,943)	(590,675)	(20,834)	(11,434)
Transfers		0	21,657	(21,657)	0
Assets January 1, 2011		$40,005,834	$37,832,612	$1,393,697	$779,525

Description		Total Company	Other Segments	Medicare Segment	Gateway Segment	Highmark West Virginia Segment
Assets January 1, 2011		$40,005,834	$37,832,612	$1,393,697	$779,525	$0
Prepayment Credits		0	(64,261)	0	0	64,261
Contributions		3,130,301	3,130,301	0	0	0
Other Transactions		0	0	0	0	0
Earnings		919,630	867,903	32,541	18,060	1,126
Benefit Payments		(5,349,096)	(5,300,036)	(3,118)	(13,780)	(32,162)
Administrative Expenses		(692,337)	(653,395)	(24,498)	(13,596)	(848)
Transfers		0	2,012	0	(2,012)	0
Assets January 1, 2012		$38,014,332	$35,815,136	$1,398,622	$768,197	$32,377
Per Highmark	9/	38,014,332	35,771,766	1,428,072	780,784	33,710
Asset Variance	10/	0	(43,370)	29,450	12,587	1,333

ENDNOTES

1/ We determined the Medicare Parts A and B segment pension assets as of January 1, 2003, based on our prior segmentation audit of Highmark, Inc., of Pennsylvania (A-07-06-00203). 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 prepayment credits and accounted for in the Other segment until needed to fund pension costs in the future

3/ 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.

4/ We based each Medicare segment's benefit payments on actual payments to Medicare retirees. We obtained the benefit payments from documents provided by Highmark.

5/ In accordance with the CAS, we allocated administrative expenses to each Medicare segment in proportion to investment earnings.

6/ 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.

7/ 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.

8/ The Other transactions represent the combination of the Medicare Parts A and B segments into one Medicare segment, effective January 1, 2006.

9/ We obtained total asset amounts from documents prepared by Highmark's actuarial consulting firm.

10/ The asset variance represents the difference between our calculation of Medicare segment pension assets and Highmark's calculation of the Medicare segment pension assets. Additionally, Highmark maintained and separately accounted for the Highmark West Virginia (HMV) and Gateway segments in its CAS asset rollups. Because the HMV and Gateway segments were accounted for separately by Highmark, we followed the same methodology. Although we identified HWV and Gateway asset variances, we will not report on these differences because these segments do not perform Medicare work and therefore are not subject to our review. However, it was necessary to roll forward the HWV and Gateway segment pension assets to properly calculate the Medicare segment pension assets as of January 1, 2012.

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 FISCAL INTERMEDIARY AND CARRIER CONTRACT NONQUALIFIED DEFINED-BENEFIT PLAN PENSION COSTS FOR THE PERIOD OF FISCAL YEARS 1993 THROUGH 2009

FY 1/	Medicare A Segment Pension Costs Charged to Medicare (A)	Total Medicare A Segment Pension Costs (B)	Medicare B Segment Pension Costs Charged to Medicare (C)	Total Medicare B Segment Pension Costs (D)	Total Medicare Pension Costs Charged to Medicare (A + C) (E)	Total Medicare Segment Pension Costs (B + D) (F)
1993	$0	$0	$7,570	$8,039	$7,570	$8,039
1994	0	0	18,359	19,116	18,359	19,116
1995	0	0	11,284	11,318	11,284	11,318
1996	2,779	2,799	146,538	146,846	149,317	149,645
1997	3,352	3,353	111,594	111,639	114,946	114,992
1998	150,973	155,642	21,019	21,103	171,992	176,745
1999	51,612	51,612	69,556	69,563	121,168	121,175
2000	0	0	22,863	23,188	22,863	23,188
2001	29,141	29,141	0	0	29,141	29,141
2002	9,714	9,714	0	0	9,714	9,714
2003	0	0	0	0	0	0
2004	0	0	0	0	0	0
2005	33,067	84,141	50,417	84,141	83,484	84,141
2006	11,435	28,047	16,612	28,047	28,047	28,047
2007	22,109	51,225	29,116	51,225	51,225	51,225
2008	31,400	120,307	52,346	120,307	83,746	120,307
2009	0	34,411	8,348	34,411	8,348	34,411
Total	**$345,582**	**$570,392**	**$565,622**	**$728,943**	**$911,204**	**$981,204**

ENDNOTE

1/ This table shows the allocable and allowable fiscal intermediary and carrier contract NQDBP 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 (FYs) 1996 through 1997 was obtained during a prior audit (A-07-06-00200). The information for the Medicare Part B segment for FYs 1992 through 1997 was obtained during a prior audit (A-07-06-00201). The information for the Medicare Parts A and B segments for FYs 1998 through 2002 was obtained during our prior audit (A-07-06-00202). The information for FYs 2003 through 2009 was obtained during the current review (A-07-13-00430).

APPENDIX E: AUDITEE COMMENTS

HIGHMARK

April 11, 2014

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-07-13-00429

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., Overstated Its Nonqualified Defined-Benefit Plan Medicare Segment Pension Assets and Overstated the Medicare Segment Excess Pension Liabilities as of January 1, 2012.*

We have carefully reviewed both the draft audit report and the additional detailed supplemental information received from the audit team. 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 decreased by $29,450 from $1,428,072 to $1,398,622.

2. Highmark agrees that the Medicare segment pension assets should be decreased by $376,342, and that Highmark should thus recognize Medicare segment excess pension liabilities of $174,400 as of January 1, 2012.

While we concur with the overall recommendations in this report, Highmark's detailed examination of the individual data elements identified various minor transpositions, CAS application and other differences that Highmark does not contest because the net impact of these items is immaterial to the overall pension and nonqualified pension audit findings.

Thank you again for affording Highmark the opportunity to comment on this report. Please do not hesitate to contact me if you have any questions regarding this response.

Sincerely,

Janine K. Colinear

Janine K. Colinear
Chief Accounting Officer

Corporate Offices:

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