Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

HIGHMARK MEDICARE SERVICES, INC., CLAIMED SOME UNALLOWABLE MEDICARE POSTRETIREMENT BENEFIT COSTS FOR FISCAL YEARS 2003 THROUGH 2009

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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., claimed unallowable postretirement benefit costs of $1.4 million for Medicare reimbursement for fiscal years 2003 through 2009.

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their postretirement benefit (PRB) costs, which are funded by direct payments to beneficiaries or contributions to a dedicated trust fund. The amount of PRB costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) as required by the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors have not always complied with Federal requirements when claiming PRB costs for Medicare reimbursement.

For this review, we focused on one Medicare contractor, Highmark Medicare Services, Inc. (Highmark). In particular, we examined the Medicare segment and Other segment allowable PRB costs (referred to in this report as "PRB costs") that Highmark claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs).

The objective of this review was to determine whether the fiscal years (FYs) 2003 through 2009 PRB costs that Highmark claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

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.

During our audit period, Highmark administered both fiscal intermediary and carrier contracts and MAC-related contracts. This report will address the PRB costs that Highmark claimed under the provisions of its fiscal intermediary and carrier contracts. We will address the PRB costs that Highmark claimed under the provisions of its MAC contracts in a separate review.

We reviewed $6,534,904 of Medicare Part A and Medicare Part B PRB costs that Highmark claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2003 through 2009.

WHAT WE FOUND

Highmark claimed PRB costs of $6,534,904 for Medicare reimbursement for FYs 2003 through 2009; however, we determined that the allowable PRB costs during this period were $5,172,094. The difference, $1,362,810, represented unallowable fiscal intermediary and carrier contract PRB costs that Highmark claimed on its FACPs for FYs 2003 through 2009. Highmark claimed these unallowable PRB costs primarily because it incorrectly calculated the assignable PRB costs for this period.

WHAT WE RECOMMEND

We recommend that Highmark revise its FACPs for FYs 2003 through 2009 to reduce PRB costs by $1,362,810.

AUDITEE COMMENTS AND OUR RESPONSE

In written comments on our draft report, Highmark did not directly address our recommendation. However, Highmark's comments suggest that it did not agree with our recommendation to reduce its claimed Medicare PRB costs by $1,362,810.

Highmark provided information indicating that it agreed in part with our finding. However, Highmark did not agree with the methodology we used when applying prepayment credits and referred us to its comments on two of our previously issued reports as the rationale for its disagreement. In those reports, involving pension costs, Highmark did not concur with our "interpretation" of FAR 31.205-6(j)(2)(iii) as it relates to offsetting prepayment credits from the Cost Accounting Standards funding target. (We believe that Highmark meant to argue that our interpretation of FAR 31.205-6(o)(4) is incorrect, because FAR 31.205-6(j)(2)(iii) is the relevant criterion governing pension costs and FAR 31.205-6(o)(4) is the equivalent criterion governing PRB costs.)

Nothing in Highmark's comments caused us to change our finding or recommendation. We disagree with Highmark's assertions about our methodology for the calculation of PRB costs when prepayment credits exist.

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INTRODUCTION

WHY WE DID THIS REVIEW

Medicare contractors are eligible to be reimbursed a portion of their postretirement benefit (PRB) costs, which are funded by direct payments to beneficiaries or contributions to a dedicated trust fund. The amount of PRB costs that the Centers for Medicare & Medicaid Services (CMS) reimburses to the contractors is determined by the cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) as required by the Medicare contracts. Previous Office of Inspector General reviews found that Medicare contractors have not always complied with Federal requirements when claiming PRB costs for Medicare reimbursement.

For this review, we focused on one Medicare contractor, Highmark Medicare Services, Inc. (Highmark). In particular, we examined the Medicare segment and Other segment allowable PRB costs (referred to in this report as "PRB costs") that Highmark claimed for Medicare reimbursement on its Final Administrative Cost Proposals (FACPs).

OBJECTIVE

Our objective was to determine whether the fiscal years (FYs) 2003 through 2009 PRB costs that Highmark claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, were allowable and correctly claimed.

BACKGROUND

Highmark Medicare Services, Inc.

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

[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.

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 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.

During our audit period, Highmark administered both fiscal intermediary and carrier contracts and MAC-related contracts. This report will address the PRB costs that Highmark claimed under the provisions of its fiscal intermediary and carrier contracts. We will address the PRB costs that Highmark claimed under the provisions of its MAC contracts in a separate review.

Highmark sponsors a PRB plan called the Highmark Retiree Welfare Benefits Plan. The purpose of this PRB plan is to provide medical, dental, vision, prescription drug, and group life insurance benefits to eligible retirees and their dependents. Highmark claimed PRB costs using the accrual basis of accounting and funded those accrual costs through a Voluntary Employee Benefit Association (VEBA) trust.

Effective January 1, 2007, Highmark changed its accounting practice for the allocation of its PRB costs to Medicare from a salary-dollar basis to a full-time equivalent (FTE) basis. In September 2007, CMS finalized closing agreement PRB-01 with Highmark. This agreement allowed Highmark to use salary dollars to allocate PRB costs to its segments and salary line-of-business (LOB) percentages to allocate costs to Medicare.

Medicare Reimbursement of Postretirement Benefit Costs

CMS reimburses a portion of the funded accruals that contractors charge for their PRB plans. FAR 31.205-6(o) requires that, to be allowable for Medicare reimbursement, PRB accrual costs be (1) determined in accordance with Statement of Financial Accounting Standards (SFAS) 106 and (2) funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust.

HOW WE CONDUCTED THIS REVIEW

We reviewed $6,534,904 of Medicare Part A and Medicare Part B PRB costs that Highmark claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2003 through 2009.

Consistent with the provisions of closing agreement PRB-01, we allocated PRB costs to Highmark's segments using salary dollars and allocated costs to Medicare using salary LOB percentages for FYs 2003 through 2006. For FYs 2007 through 2009, we allocated PRB costs to Highmark's segments based on FTEs and allocated costs to Medicare using salary LOB percentages determined during our review of the qualified pension plan.[3]

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

[3] *Highmark Medicare Services, Inc., Claimed Some Unallowable Medicare Pension Costs for Fiscal Years 2003 Through 2009* (A-07-13-00415, issued March 26, 2014).

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 finding and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDING

Highmark claimed PRB costs of $6,534,904 for Medicare reimbursement for FYs 2003 through 2009; however, we determined that the allowable PRB costs during this period were $5,172,094. The difference, $1,362,810, represented unallowable fiscal intermediary and carrier contract PRB costs that Highmark claimed on its FACPs for FYs 2003 through 2009. Highmark claimed these unallowable PRB costs primarily because it incorrectly calculated the assignable PRB costs for this period.

CLAIMED POSTRETIREMENT BENEFIT COSTS

Highmark claimed PRB costs of $6,534,904 for Medicare reimbursement, under the provisions of its fiscal intermediary and carrier contracts, on its FACPs for FYs 2003 through 2009. We calculated the allowable Medicare PRB costs in accordance with the FAR. For details on the Federal requirements, see Appendix B.

UNALLOWABLE POSTRETIREMENT BENEFIT COSTS

We determined that the allowable PRB costs for FYs 2003 through 2009 were $5,172,094. Thus, Highmark claimed $1,362,810 of unallowable fiscal intermediary and carrier contract PRB costs on its FACPs for FYs 2003 through 2009. This overclaim occurred primarily because Highmark incorrectly calculated the assignable PRB costs for this time period. More specifically, Highmark revised its PRB cost calculations for calendar years (CYs) 2003 through 2006 but did not adjust its claims for Medicare reimbursement based on those revisions.

The table on the following page shows the differences between the allowable PRB costs and the PRB costs that Highmark claimed on its FACPs and that were reflected in its accounting documents. Appendix C contains additional details on allowable PRB costs.

Table: Comparison of Allowable PRB Costs and Claimed PRB Costs

PRB Costs			
Fiscal Year	**Allowable Per Audit**	**Claimed by Highmark**	**Difference**
2003	$1,099,979	$1,272,334	($172,355)
2004	1,093,311	1,377,506	(284,195)
2005	953,083	1,221,424	(268,341)
2006	831,468	1,137,941	(306,473)
2007	678,661	861,125	(182,464)
2008	473,488	579,153	(105,665)
2009	42,104	85,421	(43,317)
Total	**$5,172,094**	**$6,534,904**	**($1,362,810)**

RECOMMENDATION

We recommend that Highmark revise its FACPs for FYs 2003 through 2009 to reduce PRB costs by $1,362,810.

AUDITEE COMMENTS

In written comments on our draft report, Highmark did not directly address our recommendation. However, Highmark's comments suggest that it did not agree with our recommendation to reduce its claimed Medicare PRB costs by $1,362,810.

Highmark provided information indicating that it agreed in part with our finding. However, Highmark did not agree with the methodology we used when applying prepayment credits and referred us to its comments on two of our previously issued reports[4] as the rationale for its disagreement. In those reports, involving pension costs, Highmark did not concur with our "interpretation" of FAR 31.205-6(j)(2)(iii) as it relates to offsetting prepayment credits from the Cost Accounting Standards (CAS) funding target. (We believe that Highmark meant to argue that our interpretation of FAR 31.205-6(o)(4) is incorrect, because FAR 31.205-6(j)(2)(iii) is the relevant criterion governing pension costs and FAR 31.205-6(o)(4) is the equivalent criterion governing PRB costs.)

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

OFFICE OF INSPECTOR GENERAL RESPONSE

Nothing in Highmark's comments caused us to change our finding or recommendation.

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[4] *Highmark Medicare Services, Inc., Claimed Some Unallowable Medicare Pension Costs for Fiscal Years 2003 Through 2009* (A-07-13-00415, issued March 26, 2014) and *Highmark Medicare Services, Inc., Overstated Its Allocable Pension Costs for Calendar Years 2008 Through 2011* (A-07-13-00416, issued March 26, 2014).

We disagree with Highmark's assertions about our methodology for the calculation of PRB costs when prepayment credits exist. Although Highmark ostensibly asserted that our interpretation and application of prepayment credits are not supported by FAR 31.205-6(o)(4), that regulation states that "[i]ncreased PRB costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable." This provision applies to all cash contributions made to the VEBA trust. Because Highmark had made contributions in excess of the CAS funding target in previous years, the resulting prepayment credits were available on the first day of the year to cover the assignable PRB costs.

Highmark had already decided to fund these costs with contributions it made to the VEBA trust fund, and for that reason, these funds were unavailable to the contractor for any purpose other than funding PRB costs. Pursuant to FAR 31.201-2 and 31.201-3, it would not be reasonable for a prudent person in the conduct of competitive business to ignore the existence of available funds, earmarked for this purpose only, and thereby incur additional interest costs. By using current-period cash contributions in lieu of the available prepayment credits to liquidate its PRB costs, Highmark would effectively be incurring additional costs by delaying the funding of the assignable PRB costs.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed $6,534,904 of Medicare Part A and Medicare Part B PRB costs that Highmark claimed for Medicare reimbursement under the provisions of its fiscal intermediary and carrier contracts, and reported on its FACPs, for FYs 2003 through 2009.

Consistent with the provisions of closing agreement PRB-01, we allocated PRB costs to Highmark's segments using salary dollars and allocated costs to Medicare using salary LOB percentages for FYs 2003 through 2006. For FYs 2007 through 2009, we allocated PRB costs to Highmark's segments based on FTEs and allocated costs to Medicare using salary LOB percentages determined during our review of the qualified pension plan (footnote 3).

Achieving our objective did not require that we review Highmark's overall internal control structure. We reviewed the internal controls related to the PRB costs claimed for Medicare reimbursement to ensure that these costs were allocable in accordance with the FAR.

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

METHODOLOGY

To accomplish our objective, we:

- reviewed the portions of the FAR and the Medicare contracts applicable to this audit;
- reviewed accounting records and FACP information provided by Highmark to identify the amount of PRB costs claimed for Medicare reimbursement for FYs 2003 through 2009;
- used information that Highmark's actuarial consulting firm provided, including information on VEBA assets, PRB obligations, service costs, contributions, claims paid, claims reimbursed, investment earnings, and administrative expenses;
- examined Highmark's accounting records, pension plan documents, and annual actuarial valuation reports, which included SFAS 106 information;
- determined the extent to which Highmark funded PRB costs with contributions to the VEBA trust, accumulated prepayment credits, and direct benefit payments;
- engaged the CMS Office of the Actuary to calculate the PRB costs on the basis of the SFAS 106 methodology applied in accordance with FAR 31.205-6(o);
- reviewed and verified the CMS actuaries' methodology and calculations and used this information to calculate the PRB costs for the Medicare segment and the Other segment during FYs 2003 through 2009; and

- provided the results of our review to Highmark officials on April 4, 2014.

We performed this review in conjunction with the following audit and used the information obtained during that audit: *Highmark Medicare Services, Inc., Overstated Its Allocable Medicare Postretirement Benefit Plan Costs for Calendar Years 2008 Through 2011* (A-07-14-00439).

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 finding and conclusions based on our audit objectives.

APPENDIX B: FEDERAL REGULATIONS RELATED TO MEDICARE REIMBURSEMENT OF POSTRETIREMENT BENEFIT COSTS

Federal regulations (FAR 31.205-6(o)) require that PRB accrual costs be determined in accordance with SFAS 106 and funded by payments to an insurer or into a dedicated trust fund, such as a VEBA trust. The FAR states that accrual accounting may be used to determine the allowable PRB costs if the cost is measured and assigned (actuarially determined) according to generally accepted accounting principles based on amortization of any transition obligation. Costs attributable to past service (transition obligation) must be assigned under the delayed recognition methodology described in paragraphs 112 and 113 of SFAS 106. The FAR also states that allowable costs must be funded by the time set for filing the Federal income tax return or any extension thereof and must comply with the applicable standards promulgated by the Cost Accounting Standards Board.

APPENDIX C: ALLOWABLE POSTRETIREMENT BENEFIT PLAN COSTS FOR HIGHMARK MEDICARE SERVICES, INC., FOR FISCAL YEARS 2003 THROUGH 2009

Date	Description		Total Company	Other Segment	Medicare Part A Segment	Medicare Part B Segment	Gateway Segment	KHPC Segment	Total Medicare
2002	Allocable PRB cost	1/	13,359,929	12,535,622	295,254	529,053	$0	$0	
2003	Contributions	2/	20,408,288	$20,408,288	$0	$0	$0	$0	
	Discount for interest	3/	($692,187)	($692,187)	$0	$0	$0	$0	
January 1, 2003	Present value contributions	4/	19,716,101	19,716,101	-	-	-	-	
	Prepayment credit applied	5/	$764,919	$764,919	$0	$0	$0	$0	
	Present value of funding	6/	20,481,020	$20,481,020	$0	$0	$0	$0	
January 1, 2003	CAS funding target	7/	$22,159,171	$22,159,171	$0	$0	$0	$0	
	Percentage funded	8/		92.43%	0.00%	0.00%	0.00%	0.00%	
	Funded PRB cost	9/		$20,481,722	$0	$0	$0	$0	
	Unallowable interest	10/		($3,671,719)					
	Allowable interest	11/		$563,306	$0	$0	$0	$0	
	Total allocable PRB cost			$17,373,309	$0	$0	$0	$0	
	Allocation statistic	12/		87.80%	2.12%	3.68%	2.95%	3.45%	
	Allocable PRB cost by segment			15,253,765	368,314	639,338	512,513	599,379	
2003	FY PRB costs	13/		$14,574,229	$350,049	$611,767			
	Medicare Part A LOB* percentage	14/		0.33%	99.50%	n/a	n/a	n/a	
	Medicare Part B LOB* percentage	15/		0.63%	n/a	100.00%	n/a	n/a	
2003	Medicare Part A allowable FY PRB cost	16/		$48,095	$348,299				$396,394
2003	Medicare Part B allowable FY PRB cost	17/		$91,818		$611,767			$703,585
2003	Total allowable FY PRB cost	18/		$139,913	$348,299	$611,767	$0	$0	$1,099,979

Date	Description	Total Company	Other Segment	Medicare Part A Segment	Medicare Part B Segment	Gateway Segment	Total Medicare
2004	Contributions	$19,271,333	$19,271,333	$0	$0	$0	
	Discount for interest	($632,579)	($632,579)	$0	$0	$0	
January 1, 2004	Present value contributions	$18,638,754	$18,638,754	$0	$0	$0	
	Prepayment credit applied	$0	$0	$0	$0	$0	
	Present value of funding	$18,638,754	$18,638,754	$0	$0	$0	
January 1, 2004	CAS funding target	$19,011,163	$19,011,163	$0	$0	$0	
	Percentage funded		98.04%	0.00%	0.00%	0.00%	
	Funded PRB cost		$18,638,544	$0	$0	$0	
	Unallowable interest		($3,708,914)				
	Allowable interest		$506,695	$0	$0	$0	
2004	Total allocable PRB cost		$15,436,325	$0	$0	$0	
	Allocation statistic		90.65%	2.23%	3.74%	3.38%	
	Allocable PRB cost by segment		$13,993,029	$344,230	$577,319	$521,748	
	FY PRB costs		$14,308,213	$350,251	$592,824		
	Medicare Part A LOB* percentage		0.37%	100.00%	n/a	n/a	
	Medicare Part B LOB* percentage		0.68%	n/a	100.00%	n/a	
2004	Medicare Part A allowable FY PRB cost		$52,940	$350,251	n/a		$403,191
2004	Medicare Part B allowable FY PRB cost		$97,296	n/a	$592,824		$690,120
2004	Total allowable FY PRB cost		$150,236	$350,251	$592,824	$0	$1,093,311

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2005	Contributions		$17,977,050	$17,977,050	$0	$0	
	Discount for Interest		($589,823)	($589,823)	$0	$0	
January 1, 2005	Present value contributions		$17,387,227	$17,387,227	$0	$0	
	Prepayment credit applied		$0	$0	$0	$0	
	Present value of funding		$17,387,227	$17,387,227	$0	$0	
January 1, 2005	CAS funding target		$16,893,176	$16,893,176	$0	$0	
	Percentage funded			100.00%	0.00%	0.00%	
	Funded PRB cost			$16,893,176	$0	$0	
	Unallowable interest			($3,501,831)			
	Allowable interest			$454,272	$0	$0	
	Total allocable PRB cost			$13,845,617	$0	$0	
	Allocation statistic			90.53%	5.93%	3.54%	
	Allocable PRB cost by segment			$12,534,437	$821,045	$490,135	
2005	FY PRB costs	19/		$12,899,085	$846,171		
	Medicare Part A LOB* percentage			0.32%	39.30%	n/a	
	Medicare Part B LOB* percentage			0.56%	59.92%	n/a	
2005	Medicare Part A allowable FY PRB cost			$41,277	$332,545		$373,822
2005	Medicare Part B allowable FY PRB cost			$72,235	$507,026		$579,261
2005	Total allowable FY PRB cost			$113,512	$839,571	$0	$953,083

Date	Description	Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2006	Contributions	$55,956,966	$55,956,966	$0	$0	
	Discount for interest	($2,460,819)	($2,460,819)	$0	$0	
January 1, 2006	Present value contributions	$53,496,147	$53,496,147	$0	$0	
	Prepayment credit applied	$519,988	$519,988	$0	$0	
	Present value of funding	$54,016,135	$54,016,135	$0	$0	
January 1, 2006	CAS funding target	$15,276,719	$15,276,719	$0	$0	
	Percentage funded		100.00%	0.00%	0.00%	
	Funded PRB cost		$15,276,719	$0	$0	
	Unallowable interest		($3,349,577)			
	Allowable interest		$443,541	$0	$0	
	Total allocable PRB cost		$12,370,683			
	Allocation statistic		90.14%	5.82%	4.04%	
	Allocable PRB cost by segment		$11,150,934	$719,974	$499,776	
2006	FY PRB costs		$11,496,809	$745,242		
	Medicare Part A LOB* percentage		0.31%	40.77%	n/a	
	Medicare Part B LOB* percentage		0.44%	59.23%	n/a	
2006	Medicare Part A allowable FY PRB cost		$35,640	$303,835	$0	$339,475
2006	Medicare Part B allowable FY PRB cost		$50,586	$441,407	$0	$491,993
2006	Total allowable FY PRB cost		$86,226	$745,242	$0	$831,468

Date	Description	Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2007	Contributions	$18,080,485	$18,080,485	$0	$0	
	Discount for interest	($611,561)	($611,561)	$0	$0	
January 1, 2007	Present value contributions	$17,468,924	$17,468,924	$0	$0	
	Prepayment credit applied	$13,152,781	$13,152,780	$0	$0	
	Present value of funding	$30,621,705	$30,621,704	$0	$0	
January 1, 2007	CAS funding target	$13,152,781	$13,152,781	$0	$0	
	Percentage funded		100.00%	0.00%	0.00%	
	Funded PRB cost		$13,152,781	$0	$0	
	Unallowable interest		($3,654,085)	$0	$0	
	Allowable interest		$0	$0	$0	
	Total allocable PRB cost		$9,498,696			
	Allocation statistic		89.41%	6.19%	4.40%	
	Allocable PRB cost by segment		$8,492,784	$587,969	$417,943	
2007	FY PRB costs		$9,157,321	$620,970		
	Medicare Part A LOB* percentage		0.27%	43.16%	n/a	
	Medicare Part B LOB* percentage		0.36%	56.84%	n/a	
2007	Medicare Part A allowable FY PRB cost		$24,725	$268,011		$292,736
2007	Medicare Part B allowable FY PRB cost		$32,966	$352,959		$385,925
2007	Total allowable FY PRB cost		$57,691	$620,970	$0	$678,661

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2008	Contributions		$32,704,340	$32,704,340	$0	$0	
	Discount for interest		($1,314,245)	($1,314,245)	$0	$0	
January 1, 2008	Present value contributions		$31,390,095	$31,390,095	$0	$0	
	Prepayment credit applied		$12,621,039	$12,621,039	$0	$0	
	Present value of funding		$44,011,134	$44,011,134	$0	$0	
January 1, 2008	CAS funding target		$12,621,039	$12,621,039	$0	$0	
	Percentage funded			100.00%	0.00%	0.00%	
	Funded PRB cost			$12,621,039	$0	$0	
	Unallowable interest			($3,654,085)	$0	$0	
	Allowable interest			$0	$0	$0	
	Total allocable PRB cost			$8,966,954	$0	$0	
	Allocation statistic			88.34%	7.05%	4.61%	
	Allocable PRB cost By Segment			$7,921,407	$632,170	$413,377	
2008	FY allocable PRB costs			$8,064,251	$621,120		
	Medicare Part A LOB* percentage	20/		0.24%	26.10%	n/a	
	Medicare Part B LOB* percentage			0.27%	43.51%	n/a	
2008	Medicare Part A allowable FY PRB cost			$19,354	$162,112		$181,466
2008	Medicare Part B allowable FY PRB cost			$21,773	$270,249		$292,022
2008	Total allowable FY PRB cost			$41,127	$432,361	$0	$473,488

Date	Description		Total Company	Other Segment	Medicare Segment	Gateway Segment	Total Medicare
2009	FY allocable PRB costs			$1,980,352	$158,043	$103,344	
	Medicare LOB* percentage	21/		0.19%	24.26%	0.00%	
2009	Medicare Part B allowable FY PRB cost	22/		$3,763	$38,341	$0	$42,104

* Line of Business.

ENDNOTES

1/ The CY allocable PRB cost is the amount of PRB cost that may be allocated for contract cost purposes. We obtained the CY 2002 Total Company allocable PRB cost from our prior Highmark PRB review (A-07-04-00166), issued August 17, 2005. We obtained the CY 2002 Medicare Part A and Medicare Part B allocable PRB cost from documentation provided by CMS that supports the calculations in the Closing Agreement (HCFA 87-001-1.56, HCFA 87-025-2).

2/ We calculated Total Company contributions by taking the contribution amounts from the PRB actuarial valuation reports plus any direct benefit payments that were not reimbursed by the VEBA trust, as provided by Highmark. Direct benefit payments for each year are considered to be funded en masse in the middle of each CY. Such contributions may be used to satisfy the funding requirement of FAR 31.205-6(o)(2)(iii). The contributions included deposits made during the plan year (PY) and the discounted value of accrued contributions, if any, deposited after the end of the PY but within the time allowed for filing tax returns.

3/ We subtracted the interest that was included in the contributions deposited after the beginning of the valuation 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 and actual contribution amounts. Interest is determined using the expected long-term rate of return assumption as reported in the PRB actuarial valuation report.

4/ The present value of contributions is the value of the contributions discounted from the date of deposit back to the first day of the CY. For purposes of this Appendix, we deemed deposits made after the end of the CY to have been made on the final day of the CY, consistent with the method established by the Employee Retirement Income Security Act prior to the implementation of the Pension Protection Act.

5/ 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 CAS funding target. A prepayment credit is carried forward, with interest, to fund future PRB costs.

6/ The present value of funding represents the present value of contributions plus prepayment credits plus direct benefit payments. This is the amount of funding that is available to cover the CAS funding target measured at the first day of the CY.

7/ The CAS funding target is based on the assignable PRB cost computed during our review. The CAS funding target must be funded by accumulated prepayment credits, current year contributions, or direct benefit payments to satisfy the funding requirement contained in the FAR.

8/ The percentage of costs funded is a measure of the portion of the CAS funding target that was funded during the CY. Because any funding in excess of the CAS funding target is accounted for as a prepayment, 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 costs funded has been rounded to four decimal places.

9/ We computed the funded CAS-based PRB cost as the CAS funding target multiplied by the percent funded.

10/ Unallowable interest represents the interest cost attributable to the unallowable unfunded costs that are included in the current-period PRB cost (as determined in accordance with SFAS 106), discounted to the beginning of the year at the long-term interest rate.

11/ We assumed that interest on the funded PRB cost, less the prepayment credit, accrues in the same proportion as the interest on contributions bears to the present value of contributions. However, we limited the interest in accordance with FAR 31.205-6(o)(4), which provides that interest costs are unallowable if caused by a delay in funding beyond 30 days after the end of each quarter to which they are assignable.

12/ For FYs 2003 through 2006, we allocated PRB costs to Highmark’s segments based on salary dollars and allocated PRB costs to Medicare using the salary LOB percentages determined during our review of the qualified pension plan, based on CMS’s closing agreement PRB-01. For FYs 2007 through 2009, we used FTEs to allocate costs to Highmark’s segment and allocated PRB costs to Medicare using a salary LOB percentage determined during our review of the qualified pension plan.

13/ We converted the allowable PRB cost to an FY basis (October 1 through September 30). We calculated the FY PRB costs as 1/4 of the prior year’s costs plus 3/4 of the current year’s costs.

<u>14/</u> We calculated the Medicare Part A LOB percentages based on information provided by Highmark.

<u>15/</u> We calculated the Medicare Part B LOB percentages based on information provided by Highmark.

<u>16/</u> We computed the Medicare Part A allowable PRB cost as an FY PRB cost multiplied by the Medicare Part A LOB percentage. In accordance with CAS 412 and 413, the total Medicare Part A allowable PRB costs charged to the Medicare contract consisted of the Highmark Medicare segment's direct PRB costs plus Other segment PRB costs attributable to indirect Highmark Medicare operations.

<u>17/</u> We computed the Medicare Part B allowable PRB cost as an FY PRB cost multiplied by the Medicare Part B LOB percentage. In accordance with CAS 412 and 413, the total Medicare Part B allowable PRB costs charged to the Medicare contract consisted of the Highmark Medicare segment's direct PRB costs plus Other segment PRB costs attributable to indirect Highmark Medicare operations.

<u>18/</u> We computed the total allowable FY Medicare PRB cost as the sum of the Medicare Part A PRB cost and the Medicare Part B PRB cost.

<u>19/</u> Highmark combined its Medicare Part A and Part B segments on January 1, 2006. Therefore, we calculated the FY 2005 Medicare segment PRB costs as 1/4 of the prior year's Medicare Part A and Part B costs plus 3/4 of the combined segment's current year's costs.

<u>20/</u> The Medicare Part A LOB percentage is calculated for the period October 2007 through July 2008. The Medicare Part A business transitioned to the Jurisdiction 12 MAC contract effective July 2008. The MAC contracts' allocable PRB costs are calculated in a separate report on allocable PRB costs (A-07-14-00439).

<u>21/</u> The FY 2009 allocable PRB cost is calculated for the period October 2008 through December 2008. Highmark's Title XVIII contract transitioned to the MAC contract in December 2008.

<u>22/</u> The Medicare Part B LOB percentage is calculated for the period October 2008 through December 2008. The Medicare Part B business transitioned to the Jurisdiction 12 MAC contract effective December 2008. The MAC allocable PRB costs are calculated in a separate report on allocable PRB costs (A-07-14-00439).

APPENDIX D: AUDITEE COMMENTS

HIGHMARK

September 2, 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: <u>OIG Report Number A-07-14-00438</u>

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., Claimed Some Unallowable Medicare Postretirement Benefit Costs for Fiscal Years 2003 Through 2009.*

After careful review of both the draft report and additional detailed supplemental information, Highmark agrees that the primary driver for excess postretirement benefit costs claimed on the FACP reports for fiscal years 2003 through 2009 related to Medicare reimbursements that were not adjusted for revisions to RRP cost calculations in calendar years 2003 through 2006.

Highmark also noted that costs claimed on the FACP reports for fiscal years 2003 through 2009 included interest credits on unfunded costs and prepayment costs which were not considered in the OIG's determination of allowable postretirement benefit costs based on the retroactive application of the recommended methodology revisions. Highmark does not concur with OIG's practice of offsetting prepayment credits. Our rationale for this disagreement was outlined in our response OIG Report Number A-07-13-00415 and 00416.

Highmark's detailed examination of the individual data elements identified various minor transpositions, allocation and other differences that Highmark does not contest because the net impact of these items is immaterial to the overall 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

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HB004 (R3-05)