Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

HIGHMARK MEDICARE SERVICES, INC., OVERSTATED ITS ALLOCABLE MEDICARE POSTRETIREMENT BENEFIT PLAN COSTS FOR CALENDAR YEARS 2008 THROUGH 2011

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
for Audit Services

November 2014
A-07-14-00439

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., overstated its allocable postretirement benefit plan costs by $11.2 million for calendar years 2008 through 2011.

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 allocable PRB costs (referred to in this report as "PRB costs") that Highmark used to calculate the indirect cost rates in its incurred cost proposals (ICPs).

The objective of this review was to determine whether the allocable PRB costs that Highmark used to calculate the indirect cost rates in its ICPs, under the provisions of its Medicare administrative contractor (MAC) contracts, for calendar years (CYs) 2008 through 2011 complied with Federal requirements.

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.

With the implementation of Medicare contracting reform, Highmark continued to perform Medicare work after being awarded the 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 used in its calculation of its indirect cost rates under the provisions of its MAC-related contracts. We will address the allowable PRB costs that Highmark claimed under the provisions of its fiscal intermediary and carrier contracts in a separate review.

Under the provisions of Medicare contracting reform, CMS transferred the functions of the fiscal intermediaries and contract carriers, that had executed the fiscal intermediary and carrier contracts, to MACs. Under the MAC contracts, the method by which Medicare reimbursed PRB costs to the contractor changed from a cost reimbursement basis to an indirect cost basis. In accordance with the FAR and the MAC contracts, reimbursement of indirect costs was now based on indirect cost rates that met the negotiated indirect cost rates determined in the contracts.

Effective January 1, 1998, Highmark amended its disclosure statement to implement pooled costing. Medicare contractors use pooled costing to calculate the indirect cost rates that they submit on their ICPs. The PRB costs are included in the computation of the indirect cost rates reported on the ICPs.

We reviewed $74,844,563 of PRB costs used by Highmark in the calculation of its indirect cost rates, under the provisions of its MAC contracts, for CYs 2008 through 2011.

WHAT WE FOUND

Highmark used allocable PRB costs of $74,844,563 to calculate the indirect cost rates in its ICPs; however, we determined that the PRB costs that Highmark should have used to calculate the indirect cost rates during this period were $63,617,602. Thus, Highmark overstated the PRB costs used to calculate its indirect cost rates for CYs 2008 through 2011 by $11,226,961 ($10,353,599 related to Highmark's Other segments and $873,362 related to the Medicare segment). These overstatements occurred primarily because Highmark used incorrect PRB costs to calculate its indirect cost rates for CYs 2008 through 2011.

WHAT WE RECOMMEND

We recommend that Highmark:

- decrease the allocable PRB costs used to calculate the indirect cost rates by $11,226,961 for CYs 2008 through 2011 and

- work with CMS to determine the allowable PRB cost related to the MAC contract.

AUDITEE COMMENTS AND OUR RESPONSE

In written comments on our draft report, Highmark did not directly address our recommendations. However, Highmark's comments suggest that it did not agree with our recommendation to decrease the allocable Medicare PRB costs used to calculate the indirect cost rates by $11,226,961.

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 (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.)

Nothing in Highmark's comments caused us to change our finding or recommendations. 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 allocable PRB costs (referred to in this report as "PRB costs") that Highmark used to calculate the indirect cost rates in its incurred cost proposals (ICPs).

OBJECTIVE

Our objective was to determine whether the allocable PRB costs that Highmark used to calculate the indirect cost rates in its ICPs, under the provisions of its Medicare administrative contractor (MAC) contracts, for calendar years (CYs) 2008 through 2011 complied with Federal requirements.

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.

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 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.

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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 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 terms "Medicare contractor" and "MAC" mean 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.

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 used in its calculation of its indirect cost rates under the provisions of its MAC-related contracts. We will address the allowable PRB costs that Highmark claimed under the provisions of its fiscal intermediary and carrier contracts in a separate review.

Highmark sponsors a PRB plan called the Highmark Retiree Welfare Benefits Plan. This plan is an employee welfare benefit plan whose purpose 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, 1998, Highmark amended its disclosure statement to implement pooled costing. Medicare contractors use pooled costing to calculate the indirect cost rates that they submit on their ICPs. The PRB costs are included in the computation of the indirect cost rates reported on the ICPs. The FAR requires Medicare contractors to file final indirect cost rates on their ICPs 6 months after the year end. In turn, CMS uses these indirect cost rates when reimbursing costs for cost-plus-award-fee contracts.[3]

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, such as a VEBA trust.

Under the provisions of Medicare contracting reform, CMS transferred the functions of the fiscal intermediaries and contract carriers, that had executed the fiscal intermediary and carrier contracts, to MACs. Under the MAC contracts, the method by which Medicare reimbursed PRB costs to the contractor changed from a cost reimbursement basis to an indirect cost basis. In accordance with the FAR and the MAC contracts, reimbursement of indirect costs was now based on indirect cost rates that met the negotiated indirect cost rates determined in the contracts.

HOW WE CONDUCTED THIS REVIEW

We reviewed $74,844,563 of PRB costs used by Highmark in the calculation of its indirect cost rates, under the provisions of its MAC contracts, for CYs 2008 through 2011.

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.

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[3] A cost-plus-award-fee contract is a cost reimbursement contract that provides for a fee consisting of (a) a base amount fixed at inception of the contract and (b) an award amount, based on a judgmental evaluation by the Federal Government.

Appendix A contains details of our audit scope and methodology.

FINDING

Highmark used allocable PRB costs of $74,844,563 to calculate the indirect cost rates in its ICPs; however, we determined that the PRB costs that Highmark should have used to calculate the indirect cost rates during this period were $63,617,602. Thus, Highmark overstated the PRB costs used to calculate its indirect cost rates for CYs 2008 through 2011 by $11,226,961 ($10,353,599 related to Highmark's Other segments and $873,362 related to the Medicare segment). These overstatements occurred primarily because Highmark used incorrect PRB costs to calculate its indirect cost rates for CYs 2008 through 2011.

CMS should use the information contained in this report and the related report (A-07-14-00438) when determining the allowable Medicare segment PRB cost for Highmark.[4]

TOTAL COMPANY POSTRETIREMENT BENEFIT COSTS

Highmark used Total Company PRB costs of $74,844,563 to calculate its indirect cost rates for CYs 2008 through 2011. We calculated PRB costs for this period in accordance with the FAR. For details on the Federal requirements, see Appendix B.

We determined that the accrued PRB costs for the Total Company were $63,617,602 for CYs 2008 through 2011. Thus, Highmark overstated the Total Company PRB costs used to calculate its indirect cost rates for this period by $11,226,961. This overstatement occurred primarily because Highmark incorrectly calculated the assignable PRB costs for this period. More specifically, the overstatement of PRB costs was due to unallowable interest that Highmark included in its PRB cost calculations.

COMPARISON OF TOTAL COMPANY POSTRETIREMENT BENEFIT COSTS

The table on the following page shows the differences between the Total Company PRB costs that we calculated and the PRB costs that Highmark used to calculate its indirect cost rates for CYs 2008 through 2011. Appendix C contains additional details on PRB costs.

[4] Our review of the allocable PRB costs for Highmark identified the amount of PRB costs that should have been used to allocate PRB costs to the Medicare and Other segments. CMS should use the information in this report, as well as the information from our review of the fiscal intermediary and carrier contract PRB costs claimed by Highmark (A-07-14-00438), to determine the allowable PRB costs for Highmark. In addition, CMS will use the information provided by the audit organization that reviews the ICPs (regarding their compliance with the CAS) to determine the final indirect cost rates for Highmark.

Table: Comparison of Total Company Postretirement Benefit Costs

Total Company Postretirement Benefit Costs			
Calendar Year	**Per Audit**	**Per Highmark**	**Difference**
2008	$8,966,954	$11,015,261	$(2,048,307)
2009	13,402,442	15,868,126	(2,465,684)
2010	17,679,678	21,738,344	(4,058,666)
2011	23,568,528	26,222,832	(2,654,304)
Total	**$63,617,602**	**$74,844,563**	**($11,226,961)**

RECOMMENDATIONS

We recommend that Highmark:

- decrease the allocable PRB costs used to calculate the indirect cost rates by $11,226,961 for CYs 2008 through 2011 and

- work with CMS to determine the allowable PRB cost related to the MAC contract.

AUDITEE COMMENTS

In written comments on our draft report, Highmark did not directly address our recommendations. However, Highmark's comments suggest that it did not agree with our recommendation to decrease the allocable Medicare PRB costs used to calculate the indirect cost rates by $11,226,961.

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[5] 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.

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[5] *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).

OFFICE OF INSPECTOR GENERAL RESPONSE

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. 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 $74,844,563 of Total Company PRB costs used by Highmark in the calculation of its indirect cost rates, under the provisions of its MAC contracts, for CYs 2008 through 2011.

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 to ensure that these costs were allocable in accordance with the FAR and the MAC contract.

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 MAC contracts applicable to this audit;

- reviewed accounting records and ICP information provided by Highmark to identify the amount of PRB costs used to calculate Highmark's indirect cost rates for CYs 2008 through 2011;

- 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 fund, accumulated prepayment credits, and direct payment;

- 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 during FYs 2008 through 2011; 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., Claimed Some Unallowable Medicare Postretirement Benefit Costs for Fiscal Years 2003 Through 2009* (A-07-14-00438).

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 REQUIREMENTS RELATED TO REIMBURSEMENT OF POSTRETIREMENT BENEFIT COSTS

FEDERAL REGULATIONS

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.

Federal regulations (FAR 52.216-7(a)(1)) address the invoicing requirements and the allowability of payments as determined by the Contracting Officer in accordance with FAR subpart 31.2.

MEDICARE CONTRACTS

The contracts state: "Once each month following the effective date of this contract, the Contractor may submit to the Government an invoice for payment, in accordance with FAR clause 52.216-7, 'Allowable Cost & Payment.'"

APPENDIX C: ALLOCABLE POSTRETIREMENT BENEFIT COSTS FOR HIGHMARK MEDICARE SERVICES, INC., FOR CALENDAR YEARS 2008 THROUGH 2011

Date	Description		Total Company	Other Segment
2008	Contributions	1/	$32,704,340	$32,704,340
	Discount for Interest	2/	($1,314,245)	($1,314,245)
January 1, 2008	Present Value Contributions	3/	$31,390,095	$31,390,095
	Prepayment Credit Applied	4/	$12,621,039	$12,621,039
	Present Value of Funding	5/	$44,011,134	$44,011,134
January 1, 2008	CAS Funding Target	6/	$12,621,039	$12,621,039
	Percentage Funded	7/		100.00%
	Funded PRB Cost	8/		$12,621,039
	Unallowable Interest	9/		(3,654,085)
	Allowable Interest	10/		0
2008	CY Allocable PRB Cost	11/		$8,966,954

Date	Description		Total Company	Other Segment
2009	Contributions		$22,673,054	$22,673,054
	Discount for Interest		($733,052)	($733,052)
January 1, 2009	Present Value Contributions		$21,940,002	$21,940,002
	Prepayment Credit Applied		$17,004,180	$17,004,180
	Present Value of Funding		$38,944,182	$38,944,182
January 1, 2009	CAS Funding Target		$17,004,180	$17,004,180
	Percentage Funded			100.00%
	Funded PRB Cost			$17,004,180
	Unallowable Interest			(3,601,738)
	Allowable Interest			$0
2009	CY Allocable PRB Cost			$13,402,442

Date	Description		Total Company	Other Segment
2010	Contributions		$4,573,144	$4,573,144
	Discount for Interest		($72,655)	($72,655)
January 1, 2010	Present Value Contributions		$4,500,489	$4,500,489
	Prepayment Credit Applied		$21,169,890	$21,169,890
	Present Value of Funding		$25,670,379	$25,670,379
January 1, 2010	CAS Funding Target		$21,169,890	$21,169,890
	Percentage Funded			100.00%
	Funded PRB Cost			$21,169,890
	Unallowable Interest			($3,490,212)
	Allowable Interest			$0
2010	CY Allocable PRB Cost			$17,679,678

Date	Description		Total Company	Other Segment
2011	Contributions		$20,489,945	$20,489,945
	Discount for Interest		($659,775)	($659,775)
January 1, 2011	Present Value Contributions		$19,830,170	$19,830,170
	Prepayment Credit Applied		$26,577,332	$26,577,332
	Present Value of Funding		$46,407,502	$46,407,502
January 1, 2011	CAS Funding Target		$26,577,332	$26,577,332
	Percentage Funded			100.00%
	Funded PRB Cost			$26,577,332
	Unallowable Interest			($3,008,804)
	Allowable Interest			$0
2011	CY Allocable PRB Cost			$23,568,528

ENDNOTES

1/ 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 can 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.

2/ 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.

3/ 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.

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

5/ 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.

6/ The CAS funding target is based on the assignable PRB costs 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.

7/ 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.

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

9/ 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.

10/ 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 the quarter to which they are assignable.

11/ The CY allocable PRB cost is the amount of PRB costs that may be allocated for contract purposes.

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-07-14-00439</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 Calendar Years 2008 Through 2011.*

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 for calendar years 2008 through 2011 related to interest included in the postretirement benefit costs claimed by Highmark.

Highmark noted that postretirement benefit costs claimed in calendar years 2008 through 2011 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 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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