



U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS

Final Audit Report

Subject:

**Audit of the Federal Employees Health Benefits
Program Operations at Keystone Health Plan East,
Inc.**

Report No. 1C-ED-00-10-053

Date: July 25, 2011

-- CAUTION --

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Office of the
Inspector General

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

AUDIT REPORT

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Keystone Health Plan East, Inc.
Contract Number CS 2339 - Plan Code ED
Philadelphia, Pennsylvania**

Report No. IC-ED-00-10-053

Date: July 25, 2011

A handwritten signature in black ink, appearing to read "Michael R. Esser".

Michael R. Esser
Assistant Inspector General
for Audits



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

EXECUTIVE SUMMARY

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Keystone Health Plan East, Inc.
Contract Number CS 2339 - Plan Code ED
Philadelphia, Pennsylvania**

Report No. 1C-ED-00-10-053

Date: July 25, 2011

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Keystone Health Plan East, Inc. (Plan). The audit covered contract years 2008 and 2009 and was conducted at the Plan's office in Philadelphia, Pennsylvania.

This report questions \$2,168,423 for inappropriate health benefit charges to the FEHBP in contract year 2009. The questioned amount includes \$2,024,199 for defective pricing and \$144,224 due the FEHBP for lost investment income, calculated through June 30, 2011. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in contract year 2008.

For contract year 2009, we determined that the FEHBP's rates were overstated by \$2,024,199 due to defective pricing. More specifically, the Plan did not apply a similarly sized subscriber group discount to the FEHBP's rates and overcharged the FEHBP's vision and dental benefits.

Consistent with the FEHBP regulations and contract, the FEHBP is due \$144,224 for lost investment income, calculated through June 30, 2011, on the defective pricing finding. In addition, we recommend that the contracting officer recover lost investment income starting July 1, 2011, until all defective pricing amounts have been returned to the FEHBP.

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I. INTRODUCTION AND BACKGROUND

Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Keystone Health Plan East, Inc. (Plan) in Philadelphia, Pennsylvania. The audit covered contract years 2008 and 2009. The audit was conducted pursuant to the provisions of Contract CS 2339; 5 U.S.C. Chapter 89; and 5 Code of Federal Regulations (CFR) Chapter 1, Part 890. The audit was performed by the Office of Personnel Management's (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

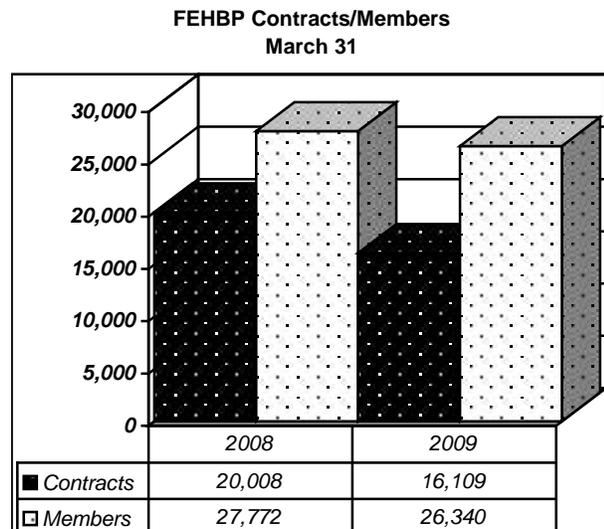
Background

The FEHBP was established by the Federal Employees Health Benefits Act (Public Law 86-382), enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for federal employees, annuitants, and dependents. The FEHBP is administered by OPM's Healthcare and Insurance Office. The provisions of the Federal Employees Health Benefits Act are implemented by OPM through regulations codified in Chapter 1, Part 890 of Title 5, CFR. Health insurance coverage is provided through contracts with health insurance carriers who provide service benefits, indemnity benefits, or comprehensive medical services.

Community-rated carriers participating in the FEHBP are subject to various federal, state and local laws, regulations, and ordinances. While most carriers are subject to state jurisdiction, many are further subject to the Health Maintenance Organization Act of 1973 (Public Law 93-222), as amended (i.e., many community-rated carriers are federally qualified). In addition, participation in the FEHBP subjects the carriers to the Federal Employees Health Benefits Act and implementing regulations promulgated by OPM.

The FEHBP should pay a market price rate, which is defined as the best rate offered to either of the two groups closest in size to the FEHBP. In contracting with community-rated carriers, OPM relies on carrier compliance with appropriate laws and regulations and, consequently, does not negotiate base rates. OPM negotiations relate primarily to the level of coverage and other unique features of the FEHBP.

The chart to the right shows the number of FEHBP contracts and members reported by the Plan as of March 31 for each contract year audited.



The Plan has participated in the FEHBP since 1988 and provides health benefits to FEHBP members in the Philadelphia area of Pennsylvania. The last audit conducted by our office was a full scope audit and covered contract years 2004 through 2007. All matters related to that audit have been resolved.

The preliminary results of this audit were discussed with Plan officials at an exit conference and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan's comments were considered in the preparation of this report and are included, as appropriate, as the Appendix.

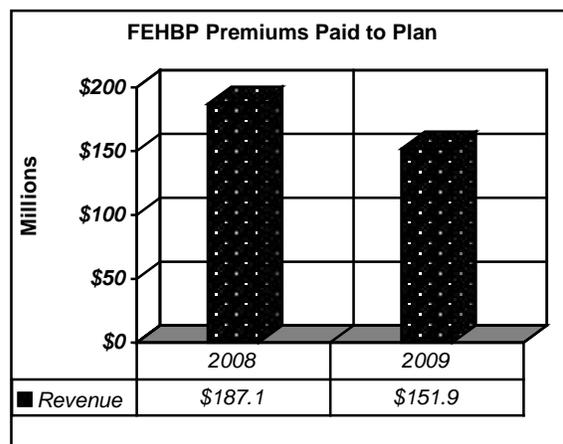
II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The primary objectives of the audit were to verify that the Plan offered market price rates to the FEHBP and to verify that the loadings to the FEHBP rates were reasonable and equitable. Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and regulations governing the FEHBP.

Scope

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.



This performance audit covered contract years 2008 and 2009. For these contract years, the FEHBP paid approximately \$339 million in premiums to the Plan. The premiums paid for each contract year audited are shown on the chart above.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM rate instructions. These audits are also designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts.

We obtained an understanding of the Plan's internal control structure, but we did not use this information to determine the nature, timing, and extent of our audit procedures. However, the audit included such tests of the Plan's rating system and such other auditing procedures considered necessary under the circumstances. Our review of internal controls was limited to the procedures the Plan has in place to ensure that:

- The appropriate similarly sized subscriber groups (SSSG) were selected;
- the rates charged to the FEHBP were the market price rates (i.e., equivalent to the best rate offered to the SSSGs); and
- the loadings to the FEHBP rates were reasonable and equitable.

In conducting the audit, we relied to varying degrees on computer-generated billing, enrollment, and claims data provided by the Plan. We did not verify the reliability of the data generated by the various information systems involved. However, nothing came to our attention during our audit testing utilizing the computer-generated data to cause us to doubt its reliability. We believe that the available data was sufficient to achieve our audit objectives. Except as noted above, the audit was conducted in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States.

The audit fieldwork was performed at the Plan's office in Philadelphia, Pennsylvania, during September 2010. Additional audit work was completed at our field offices in Jacksonville, Florida and Washington, D.C.

Methodology

We examined the Plan's federal rate submissions and related documents as a basis for validating the market price rates. Further, we examined claim payments to verify that the cost data used to develop the FEHBP rates was accurate, complete and valid. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the market price was actually charged to the FEHBP. Finally, we used the contract, the Federal Employees Health Benefits Acquisition Regulations (FEHBAR), and OPM's Rate Instructions to Community-Rated Carriers to determine the propriety of the FEHBP premiums and the reasonableness and acceptability of the Plan's rating system.

To gain an understanding of the internal controls in the Plan's rating system, we reviewed the Plan's rating system's policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rates

1. Defective Pricing

\$2,024,199

The Certificate of Accurate Pricing the Plan signed for contract year 2009 was defective. In accordance with federal regulations, the FEHBP is due a rate reduction for this year. Application of the defective pricing remedy shows that the FEHBP is entitled to a premium adjustment totaling \$2,024,199 (see Exhibit A). We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's (OPM) rules and regulations for contract year 2008.

FEHBAR 1652.215-70 provides that carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an SSSG. If it is found that the FEHBP was charged higher than a market price (i.e., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price.

2009

We agree with the Plan's selection of [REDACTED] as the SSSGs for contract year 2009. Our analysis of the rates charged to the SSSGs shows that [REDACTED] received a [REDACTED] percent discount and [REDACTED] received a [REDACTED] percent discount for contract year 2009. The Plan did not apply a discount to the FEHBP's rates in contract year 2009. Since the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG, the [REDACTED] percent discount given to [REDACTED] should have been applied to the FEHBP's rates for contract year 2009.

Further, the Plan uses filed community rates of the current and renewal years to determine the rate action for dental and vision benefits. The Plan determined an increase to the FEHBP's dental and vision rates, whereas the filed community rates remained the same for the current and renewal periods. The Plan did not provide sufficient documentation to support the FEHBP's increase.

Accordingly, we re-developed the FEHBP's rates by applying the [REDACTED] percent discount given to [REDACTED] and adjusting the dental and vision rates to the filed amounts. A comparison of the reconciled line 5 rates to our audited line 5 rates shows that the FEHBP was overcharged \$2,024,199 in 2009 (see Exhibit B).

Plan's Comments (See Appendix):

The Plan disagrees that [REDACTED] received a discount in contract year 2009. The Plan acknowledges that the group through negotiations received a lower than initially proposed increase for medical rates. The Plan asserts that such adjustments are permitted by the Commonwealth of Pennsylvania Insurance Department and are not considered deviations from its stated methodology. The Plan believes that since they did not set a rate lower than that determined according to the carrier's methodology, there is no discount.

In addition, the Plan disagrees with how the discount was calculated. The Plan believes that the discount is a result of medical and pharmacy rates, which are determined using adjusted community rating. The Plan feels that since dental and vision benefits are determined using a traditional community rating, these rates should be excluded from the discount calculation.

The Plan also discovered errors in the rate computation for [REDACTED]

The Plan did not provide any comments on the part of the finding concerning the dental and vision benefits.

OIG's Response to the Plan's Comments:

We disagree with the Plan's assertion that because it did not set a rate lower than that determined according to its methodology, there is no discount. The Plan gave [REDACTED] a rate advantage when it applied a lower than proposed rate increase. As stated by the 2009 Community Rating Guidelines "OPM requires the Federal group to be at least equivalent to the rates for the SSSGs. Therefore, we expect the Federal group to receive at least the largest rate discount and any other advantage given to either SSSG." This rate advantage or discount should have been applied to the FEHBP rates.

We also disagree with the Plan's argument that the discount calculation should exclude vision and dental benefits as they are rated using traditional community rating methodology. Since the Plan's methodology combines adjusted community rating (for the medical and pharmacy rates) and traditional community rating (for the vision and dental rates) to determine the overall billable rate, we believe that this methodology should be used when calculating any discounts.

We acknowledge the errors in the computation of the discount given to [REDACTED] and made the appropriate corrections. These corrections resulted in an increase in the amount of the overcharge to the FEHBP.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$2,024,199 to the FEHBP for defective pricing in contract year 2009.

2. Lost Investment Income

\$144,224

In accordance with the FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing finding in contract year 2009. We determined that the FEHBP is due \$144,224 for lost investment income, calculated through June 30, 2011 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning July 1, 2011, until all defective pricing finding amounts have been returned to the FEHBP.

FEHBAR 1652.215-70 provides that if any rate established in connection with the FEHBP contract was increased because the carrier furnished cost or pricing data that were not complete, accurate, or current as certified in its Certificate of Accurate Pricing, the rate shall be reduced by the amount of the overcharge caused by the defective data. In addition, when the rates are reduced due to defective pricing, the regulation states that the government is entitled to a refund and simple interest on the amount of the overcharge from the date the overcharge was paid to the carrier until the overcharge is liquidated.

Our calculation of lost investment income is based on the United States Department of the Treasury's semiannual cost of capital rates.

Plan's Comments (See Appendix):

The Plan disagrees with the SSSG discount finding in 2009, and as a result, believes that no lost investment income is due.

OIG's Response to the Plan's Comments:

We continue to believe that a defective pricing finding still exists for contract year 2009 and the lost investment income amount shown is based on the current amount due to the FEHBP.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$144,224 to the FEHBP for lost investment income for the period January 1, 2009, through June 30, 2011. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning July 1, 2011, until all defective pricing amounts have been returned to the FEHBP.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

██████████, Auditor-In-Charge

██████████, Auditor

██████████, Chief

██████████ Senior Team Leader

**Keystone Health Plan East, Inc.
Summary of Questioned Costs**

Defective Pricing Questioned Costs:

Contract Year 2009 \$2,024,199

Total Defective Pricing Questioned Costs: \$2,024,199

Lost Investment Income: \$144,224

Total Questioned Costs: **\$2,168,423**

**Keystone Health Plan East, Inc.
Defective Pricing Questioned Costs**

2009 - High Option

	<u>Self</u>	<u>Family</u>
FEHBP Line 5 - Reconciled Rate	█	█
FEHBP Line 5 - Audited Rate	█	█
Overcharge	█	█
To Annualize Overcharge:		
3/31/09 enrollment	█	█
Pay Periods	<u>26</u>	<u>26</u>
Subtotal	█	█

Total 2009 - High Option Defective Pricing Questioned Costs **\$1,978,311**

2009 - Standard Option

	<u>Self</u>	<u>Family</u>
FEHBP Line 5 - Reconciled Rate	█	█
FEHBP Line 5 - Audited Rate	█	█
Overcharge	█	█
To Annualize Overcharge:		
3/31/09 enrollment	█	█
Pay Periods	<u>26</u>	<u>26</u>
Subtotal	█	█

Total 2009 - Standard Option Defective Pricing Questioned Costs **\$45,888**

Total 2009 Defective Pricing Questioned Costs **\$2,024,199**

Keystone Health Plan East, Inc.
Lost Investment Income

Year	2008	2009	2010	2011	Total
Audit Findings:					
1. Defective Pricing	\$0	\$2,024,199	\$0	\$0	\$2,024,199
Totals (per year):	\$0	\$2,024,199	\$0	\$0	\$2,024,199
Cumulative Totals:	\$0	\$2,024,199	\$2,024,199	\$2,024,199	
Avg. Interest Rate (per year):	4.9375%	5.2500%	3.1875%	2.6250%	
Interest on Prior Years Findings:	\$0	\$0	\$64,521	\$26,568	\$91,089
Current Years Interest:	\$0	\$53,135	\$0	\$0	\$53,135
Total Cumulative Interest Calculated Through June 30, 2011	\$0	\$53,135	\$64,521	\$26,568	\$144,224



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May 31, 2011

BY EMAIL & OVERNIGHT MAIL

[REDACTED]
Chief, Community-Related Audits Group
Office of the Inspector General
United States Office of Personnel Management
1900 E Street, N.W.
Room 6400
Washington, D.C. 20415-1100

Re: Draft Audit Report No. 1C-ED-00-10-053 dated
February 7, 2011

Dear [REDACTED]

We are in receipt of the United States Office of Personnel Management's Draft Audit Report number 1C-ED-00-10-053 detailing the results of the Federal Employees Health Benefits Program ("FEHBP") operations at Keystone Health Plan East, Inc., in Philadelphia, Pennsylvania ("KHPE") for contract years 2008 and 2009 ("Draft Audit Report"). In its Draft Audit Report, OPM questions \$1,653,727 for inappropriate health benefit charges to the FEHBP in contract year 2009. The questioned amount in the Draft Audit Report includes \$1,586,785 for alleged defective pricing and \$66,942 due to the FEHBP for lost investment income calculated through December 31, 2010. In particular, the Draft Audit Report states that KHPE's FEHBP rates were overstated by \$1,586,785 because it did not "apply a similarly sized subscriber group (SSSG) discount to the FEHBP's medical rates" and "overcharged" FEHBP's dental and vision benefits. The Draft Audit Report sets forth that KHPE provided [REDACTED] discount to [REDACTED]. As set forth in greater detail in this letter, KHPE disagrees with the findings and conclusions contained in the Draft Audit Report because they are not in accordance with the FEHB regulations, are factually inaccurate, and contain calculation errors. The Certificate of Accurate Pricing that KHPE signed for 2009 was not defective. This letter addresses the findings in the Draft Audit Report that relates to the stated discount provided to [REDACTED].

Introduction

As part of the FEHBP process, KHPE entered into a contract with OPM to provide health care coverage for federal employees. KHPE submitted a certificate of accurate pricing in connection with its rates for 2009. In September, 2010, OPM through its auditor conducted an audit of KHPE's plan. The audit took place at KHPE's offices in Philadelphia, Pennsylvania.

KHPE was cooperative and provided access to all information required by the auditors to perform their work. At the conclusion of the auditors' work, there were questions and an exchange of emails between KHPE and the auditor-in-charge to gain a fuller understanding of the auditor's conclusions and some of the calculations set forth in her audit work papers.

On February 14, 2011, KHPE received the Draft Audit Report. The Draft Audit Report made two basic conclusions. First, that KHPE had provided a discount of [REDACTED] % to an SSSG that it had failed to provide to FEHBP. Second, that KHPE owed a significant amount of money to KHPE as a result of the discount and the lost investment income that is included in any loss calculation.

Contrary to the assertions in the Draft Audit Report, the SSSGs identified by the auditor in the Draft Audit Report did not receive a "rate lower than that determined according to [KHPE's] methodology." Instead, the SSSG's rate was determined by a methodology consistent with the methodology used to calculate FEHBP's rates. The SSSGs received negotiated rates within the range permitted by the filed renewal rating methodology in the Commonwealth of Pennsylvania. [REDACTED] received an adjusted community rate with an upward adjustment for the medical coverage, while the FEHBP received the appropriate adjusted community rate based on its claim experience and the filed methodology. This fact and the methodology used to calculate the adjusted community rate were disclosed to OPM by KHPE in May 2009 during its reconciliation. (See Exhibit A). The assumed "discount" described in the Draft Audit Report was not a discount, but instead, was a rate negotiated with the SSSG that is greater than the filed rating methodology indicates and within the range permitted by the approved rating methodology. That is, KHPE presented a proposed rate to the SSSG that consisted of both a base amount calculated using the adjusted community rating methodology and, as provided under Pennsylvania law, an upward adjustment to reflect additional risk that KHPE's underwriters determined to be associated with this group. During the subsequent negotiation, KHPE and the SSSG agreed to rates lower than the initial proposed increased rates but still greater than the filed rating methodology indicates, *i.e.*, KHPE reduced the percentage of the upward adjustment. The amount negotiated was approximately [REDACTED] less than the increase that was initially proposed and [REDACTED] greater than the filed rating methodology indicates. KHPE provided the auditor with the filed methodology, [REDACTED] renewal proposal, the information related to the adjusted community rating, and the reconciliation filed with the methodology. Despite this, the auditor concluded that the "movement" from the initial proposed rate to the final agreed upon rate between KHPE and [REDACTED] was a "discount."

For the pharmacy calculation, FEHBP received [REDACTED] % discount from the filed rating methodology in the 2009 reconciliation which exceeds the [REDACTED] % discount offered to the SSSG [REDACTED]. Therefore, no additional discount is appropriate.

Finally, the auditor made a series of calculation errors during the audit that led to substantial inaccuracies in the reported information, including cell references within Excel spreadsheet calculations, omission of premium rates and inaccurate keying of rate changes.

KHPE's Response to Draft Audit Report

Recommendation Number 1

We disagree with the Draft Audit Report's recommendation number 1 that KHPE return \$1,586,785 to the FEHBP for defective pricing in contract year 2009.

There was no defective pricing

The Draft Audit Report notes that [REDACTED] were selected as the SSSGs for contract year 2009.

48 CFR 1602.170-13(a) provides in relevant part that similarly sized subscriber groups are a comprehensive medical plan carrier's two employer groups that:

- (1) have a subscriber enrollment closest to the FEHBP subscriber enrollment;
- (2) use any rating method other than retrospective experience rating; and
- (3) meet the criteria specified in the rate instructions issued by OPM.

The Draft Audit Report accepts KHPE's representation that [REDACTED] were SSSGs. However, the Draft Audit Report does not examine the methodology utilized by KHPE to establish SSSG rates. KHPE uses an adjusted community rating to calculate the SSSG rate. As FEHB Carrier Letter No. 2006-14 notes, an adjusted community rating is one "which uses group-specific experience data to develop the FEHBP and SSSG rates." *Id.* (see Exhibit B); *see also*, 48 CFR 1602.170-2(b). If a carrier chooses to utilize an adjusted community rating method it may calculate the rates on a "prospective" method based on actual claims data.

Consistent with this rating methodology, KHPE collected the historical data from its past experience with [REDACTED] and determined a formula rate using the approved methodology that adjusted the subject premium prospectively to bring the value in line with trends and to prevent potential loss from the calculated risk. Afterward, additional costs were added as an upward adjustment to reflect additional risk determined by KHPE's underwriters. In sum, KHPE calculated that based on its actual claims experience, that [REDACTED] would need its rate increased [REDACTED] for medical benefits or [REDACTED] above the file formula results.

KHPE communicated an initial medical rate increase proposal of [REDACTED] to [REDACTED]. As a result of negotiations, [REDACTED] and KHPE agreed to a [REDACTED] rate increase. This information was kept in KHPE's files and was made available to the auditor. The auditor did not acknowledge that [REDACTED] has not received a discount. The "decrease" indicated by the auditor was merely the negotiated change that reduced the amount of the increase above the amount produced by the basic filed rate methodology.

KHPE's methodology was fully disclosed and filed with the Commonwealth of Pennsylvania Insurance Department on March 5, 2008 via email in a document titled: "Keystone Health Plan East (KHPE) Large Group Renewal Rating Methodology." (see Exhibit C). The methodology and filing was consistent with so-called "Act 159 of 1996" also known as "The Accident and Health Filing Reform Act." That Act provides that "rates developed for a specific group which do not deviate from the base rate or base rate formula by more than 15% may be used without filing with the Department [of Insurance]." The amount of the increase proposed to ██████████

KHPE did not violate its Certificate of Accurate Pricing.

OPM notes in the Draft Audit Report: "If it is determined that the FEHBP was charged higher than a market price (*i.e.* the best rate offered to an SSSG), a condition of defective pricing exists . . ." Draft Audit Report page one, at ¶ 3. The Draft Audit Report further states: "Our analysis of the rates charged to the SSSGs shows that ██████████ received a ██████████ percent discount . . . for contract year 2009 . . . [T]he Plan did not apply a discount to the FEHBP rates in contract year 2009." *Id.*

The Draft Audit Report is in error. There is no "discount" being provided by KHPE to ██████████. OPM's regulations are clear regarding what constitutes a "discount." 48 CFR 1652.216-70 which governs the determination of a "discount" provides: "The subscription rates agreed to in this contract shall be equivalent to the subscription rates given to the carrier's similarly sized subscriber groups (SSSGs) as defined . . . The subscription rates shall be applied consistently to the FEHBP and to the carriers' . . . SSSGs. *If an SSSG receives a rate lower than that determined according to the carrier's methodology, it is considered a discount. . . .* *Id.* (emphasis supplied).

As set forth above, KHPE disclosed (and filed) methodology did not change. The ██████████ rates were determined using an adjusted community rating methodology. FEHBP's rates were similarly determined using an adjusted community rating. See "Revision to Keystone Plan East 2009 Rate Reconciliation." (see Exhibit D). In the 2009 reconciliation, OPM requested at QA12 that KHPE explain how it determined its "line 1 rates." KHPE disclosed:

The FEHB medical and prescription drug proposals are adjusted community rated using actual claims data. This rating uses the FEHB's own historical claims costs plus capitated costs multiplied by a trend factor. This estimates the claims that will occur during the future proposal period. The trend factor takes into account anticipated increased benefit costs (inflation) and increased incidence of care (utilization).

The methodology utilized by KHPE for the SSSG was the same – the formula rate was determined in a consistent manner; however, state law permitted KHPE to obtain an upward adjustment for risk from ██████████. Further, the methodology was filed with the Department of Insurance and provided to the auditor during the audit.

Because KHPE did not determine a rate lower than that “determined according to the carrier’s methodology” there is no “discount.” In fact [REDACTED]’s rates included an upward adjustment. The auditor is noting that a reduction in the amount of the upward adjustment (the adjustment above the formula rate result) is a “discount.”

Calculation of the “Overcharge”

Although KHPE disagrees whether there is a discount, it notes that the auditor determined the amount of the overcharge by taking benefits that had been arrived at utilizing different methodologies. In this matter, although the “discount” would have been related to the medical and prescription benefits, which were based upon an adjusted community rating, the auditor erroneously calculated the loss by utilizing the dental and vision benefits rates that had been established using a community rate. See Draft Audit Report page 1 at ¶ 4. The Draft Audit Report states that KHPE uses “filed community rates of the current and renewal years to determine the rate action for dental and vision benefits.” *Id.* There is no authority for the proposition that OPM is permitted to disaggregate different parts of plans and benefits to calculate an overcharge amount. In this matter, the auditor based a conclusion that there had been a discount based on [REDACTED]’s final medical and prescription rate achieved through negotiation after the original proposed rate tendered to [REDACTED]. Although that rate had been calculated utilizing an adjusted community rating methodology, the auditor included in trying to calculate an overcharge, dental and vision benefit rates that had been determined by a community rate methodology.

Calculation Errors

KHPE made a request for some of the information compiled by the auditor. While reviewing the auditor’s work papers KHPE discovered several computation errors. Some of the errors include: (1) categories of information were left blank; (2) incorrect benefit amounts were entered into the spread sheet; (3) cell references within formula calculations refer to inappropriate cells, and (4) improper calculations based on mistaken auditor entries were present (see Exhibit E). These computation errors coupled with the methodology described above inhibit the appropriate calculation of the SSSG and the FEHBP rates and any potential overcharge noted in the Draft Audit Report. KHPE noted our concerns about these calculations to the auditor’s attention, but the auditor declined to discuss them further as the Draft Audit Report was in the process of review.

Below are specific calculations within the SSSG [REDACTED] rate development Excel file that we noted. Making these corrections results in a significantly different outcome.

- 1) & 2) In totaling each of the Medical, Rx, Vision & Dental subtotals to arrive at an overall case total premium for [REDACTED], the auditor mistakenly relied upon a singular medical plans value (I002), instead of the total Medical premium for both Audited & Billed Medical premium values.
 - 1. Total Audited Premium: AA29 is wrong cell for Medical Total, s/b AA31
 - 2. Total Billed Premium: AL29 is wrong cell for Medical Total, s/b AL31

May 31, 2011

Page 6

- 3) Auditor inserted inaccurate medical rates for singular medical plan "P013" under Billed Medical rates.
 - 3. Billed Medical Rates: For TOC P013 wrong rates input AF14...AI14.
- 4) Auditor omitted inserting any medical rate for singular medical plan "P074" under Billed Medical rates.
 - 4. Billed Medical Rates: For TOC P074 no rates input AF26...AI26.
- 5) Auditor's comparison of total Audited Medical Premium versus total Billed Premium to arrive at a perceived discount of [REDACTED] % is inaccurate as it is affected by the input errors as described above in items 3 & 4.
 - 5. Medical: Auditor compares cell AA31 to AL31 and finds a [REDACTED] discount".
- 6) Auditor does not recognize the greater level of discounting in the Fehbp Rx rating as compared to the level of discounting in [REDACTED] Rx rating. This is supported in the 2009 Rate Reconciliation, Att. IIIa, for Prescription Drug, (Source KHPE00720 & KHPE 00721).
 - 6. Auditor's Rx Rate Increase does not recognize greater Rx discount given to FEHBP.

Recommendation Number 2

We disagree with recommendation Number 2 that the contracting officer require the Plan to return \$66,942 to the FEHBP for lost investment income. As set forth above, there has been no defective pricing. As a result, there would be no lost investment income due to the government.

We look forward to our further dialogues regarding the audit.

Sincerely,

[REDACTED]
Senior Vice President
Actuarial and Underwriting
Independence Blue Cross

Cc: [REDACTED] Director External Audit, IBC