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US OFFICE OF PERSONNEL MANAGEMENT  
OFFICE OF THE INSPECTOR GENERAL  
OFFICE OF AUDITS

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# Final Audit Report

**Subject:**

**AUDIT OF AXA ASSISTANCE  
AS ADMINISTRATOR FOR THE  
PANAMA CANAL AREA BENEFIT PLAN  
MIAMI, FLORIDA**

**Report No. 1B-43-00-08-048**

**Date: May 20, 2009**

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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  
Employee Organization Plan

AXA Assistance  
as Administrator for the  
Panama Canal Area Benefit Plan

Contract CS 1066

Plan Code 43

Miami, Florida

REPORT NO. 1B-43-00-08-048

DATE: May 20, 2009

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  
Employee Organization Plan

AXA Assistance  
as Administrator for the  
Panama Canal Area Benefit Plan

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Contract CS 1066                      Plan Code 43  
Miami, Florida

REPORT NO. 1B-43-00-08-048

DATE: May 20, 2009

This final audit report on the Federal Employees Health Benefits Program (FEHBP) operations at AXA Assistance (AXA), as administrator for the Panama Canal Area Benefit Plan, in Miami, Florida, questions \$371,160 in administrative expenses and \$73,257 in cash management practices. AXA agrees (*A*) with \$192,696, disagrees (*D*) with \$206,532, and did not respond (*NR*) to \$45,189 of the questioned costs. Lost investment income (LII) on the questioned costs amounts to \$15,774.

Our limited scope audit was conducted in accordance with Government Auditing Standards. The audit covered capitation payments, miscellaneous health benefit payments and credits, and administrative expenses for contract years 2006 and 2007 as reported in the Annual Accounting Statements. We also reviewed AXA's cash management practices related to FEHBP funds for contract years 2006 and 2007. In addition, we reviewed the close-out costs of the former administrator, Health Network America, and the start-up costs of AXA.

Questioned items are summarized, as follows:

## HEALTH BENEFIT CHARGES

The audit disclosed no findings pertaining to capitation payments and miscellaneous health benefit payments and credits. Overall, we concluded that the capitation payments charged to the FEHBP were paid in accordance with the provider agreements. Also, we concluded that the health benefit refunds and recoveries were promptly returned to the FEHBP.

## ADMINISTRATIVE EXPENSES

- **Unapproved Subcontract (D)** **Procedural**

AXA charged the FEHBP \$998,984 from January 2006 through June 2008 for a subcontract with Redbridge Network and Healthcare, Inc. (Redbridge) for which prior approval was not sought from the Office of Personnel Management's (OPM) contracting officer. However, even though prior approval was not sought from OPM, the contracting officer was/is aware of AXA's contractual relationship with Redbridge. Therefore, since the contracting officer was/is aware of AXA's contractual relationship with Redbridge and since the services provided by Redbridge are allowable, reasonable and/or necessary tasks for administering the Panama Canal Area Benefit Plan, we are reporting this issue as a procedural finding.
- **Allocation of Home Office Expenses** **\$223,953**

AXA allocated indirect/overhead expenses to the FEHBP using estimated allocation percentages instead of actual. As a result, the FEHBP was overcharged for indirect/overhead expenses in 2007. AXA agrees with \$90,678 (A) and disagrees with \$133,275 (D) of the questioned charges.
- **Excess Letter of Credit Drawdown for Administrative Expenses (A)** **\$76,361**

AXA withdrew \$74,651 from the letter of credit account in excess of the administrative expense contractual limitation for 2006. As a result, the FEHBP is due \$76,361, consisting of \$74,651 for the excess drawdown and \$1,710 for LII.
- **Unsupported Consulting Expenses (NR)** **\$45,189**

AXA charged the FEHBP for unsupported, unnecessary and/or unreasonable consulting expenses in 2006. AXA did not respond to these questioned charges.
- **Unallocable Tax on the Service Charge (A)** **\$25,657**

AXA inadvertently charged the FEHBP \$24,653 for an unallocable ITBMS (Impuesto de Transferencias de Bienes Muebles y Servicios) tax on the service charges from January 2006 through May 2008. As a result, the FEHBP is due \$25,657, consisting of \$24,653 for unallocable taxes and \$1,004 for LII.

## **CASH MANAGEMENT**

- **Lost Investment Income on Excess Funds (D)** **\$73,257**

AXA did not invest excess FEHBP funds held in the Banistmo Bank account (located in Panama) from January 2006 through May 2008. As a result, the FEHBP is due LII of \$73,257 on these funds.

## **OTHER ITEMS REVIEWED**

At the request of the Office of Personnel Management's contracting officer, we also reviewed the following items:

- Close-out costs of the former administrator, Health Network America, and
- Start-up costs of AXA.

Our audit disclosed no audit findings for these items.

## **LOST INVESTMENT INCOME ON AUDIT FINDINGS**

As a result of our audit findings presented in this audit report, the FEHBP is due LII of **\$15,774**, calculated through December 31, 2008.

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## **I. INTRODUCTION AND BACKGROUND**

### **INTRODUCTION**

This final audit report details the findings, conclusions, and recommendations resulting from our limited scope audit of the Federal Employees Health Benefits Program (FEHBP) operations at AXA Assistance (AXA) as administrator for the Panama Canal Area Benefit Plan (Plan). AXA is located in Miami, Florida.

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 (FEHB) 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. OPM's Center for Retirement and Insurance Services has overall responsibility for administration of the FEHBP. The provisions of the FEHB Act are implemented by OPM through regulations, which are codified in Title 5, Chapter 1, Part 890 of the Code of Federal Regulations (CFR). Health insurance coverage is made available through contracts with various health insurance carriers.

The Panama Canal Area Benefit Plan is an employee organization plan offering fee-for-service benefits with a point of service (POS) option. The POS option is available to Plan members residing in the Republic of Panama. The Plan is authorized under Contract CS 1066 between the Association of Retirees of the Panama Canal Area (Association) and OPM. The Plan is sponsored and administered by the Association. Enrollment in the Plan is open to members of the Association (Panama Canal Area) who are eligible for coverage under the FEHBP, and annuitants who reside in Panama that were previously enrolled in the Plan.

Health Network America (HNA) administered the claim payments for the Plan for contract years 1998 through 2005. Starting in 2006, AXA Assistance, as a Third Party Administrator, administers the claim payments for the Plan.

Compliance with laws and regulations applicable to the FEHBP is the responsibility of the Association and AXA management. Also, management of AXA is responsible for establishing and maintaining a system of internal controls.

All findings from our previous audit of the Plan (Report No. 1B-43-00-05-081, dated August 22, 2006), covering contract years 1999 through 2004, have been satisfactorily resolved.

The results of our audit were provided to AXA in written audit inquiries; discussed with AXA officials throughout the audit and at an exit conference; and were presented in detail in a draft report, dated August 8, 2008. AXA's comments offered in response to the draft report were considered in preparing our final report and are included as an Appendix to this report.

## **II. OBJECTIVES, SCOPE, AND METHODOLOGY**

### **OBJECTIVES**

The objectives of our audit were to determine whether AXA charged costs and provided services to FEHBP members in accordance with the terms of the contract. Specifically, our objectives were as follows:

#### **Health Benefit Charges**

- To determine whether AXA complied with contract provisions relative to capitation payments.
- To determine whether miscellaneous payments charged to the FEHBP were in compliance with the terms of the contract.
- To determine whether credits and miscellaneous income relating to FEHBP benefit payments were returned promptly to the FEHBP.

#### **Administrative Expenses**

- To determine whether administrative expenses, including HNA's close-out costs and AXA's start-up costs, charged to the contract were actual, allowable, necessary, and reasonable expenses incurred in accordance with the terms of the contract and applicable regulations.

#### **Cash Management**

- To determine whether AXA handled FEHBP funds in accordance with applicable laws and regulations concerning cash management in the FEHBP.

### **SCOPE**

We conducted our 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.

We reviewed the Plan's FEHBP Annual Accounting Statements for contract years 2006 and 2007. During this period, AXA paid approximately \$102 million in health benefit charges and \$10 million in administrative expenses (See Figure 1 and Schedule A).

Specifically, we reviewed approximately \$13 million in capitation payments made in 2006 and 2007. In addition, we reviewed miscellaneous health benefit payments and credits (e.g., refunds and subrogation recoveries), administrative expenses, and cash management for 2006 and 2007. In addition, we reviewed the close-out costs of the former administrator, Health Network America, and the start-up costs of AXA for 2005 and 2006.

In planning and conducting our audit, we obtained an understanding of AXA's internal control structure to help determine the nature, timing, and extent of our auditing procedures. This was determined to be the most effective approach to select areas of audit. For those areas selected, we primarily relied on substantive tests of transactions and not tests of controls. Based on our testing, we did not identify any significant matters involving AXA's internal control structure and its operation. However, since our audit would not necessarily disclose all significant matters in the internal control structure, we do not express an opinion on AXA's system of internal controls taken as a whole.

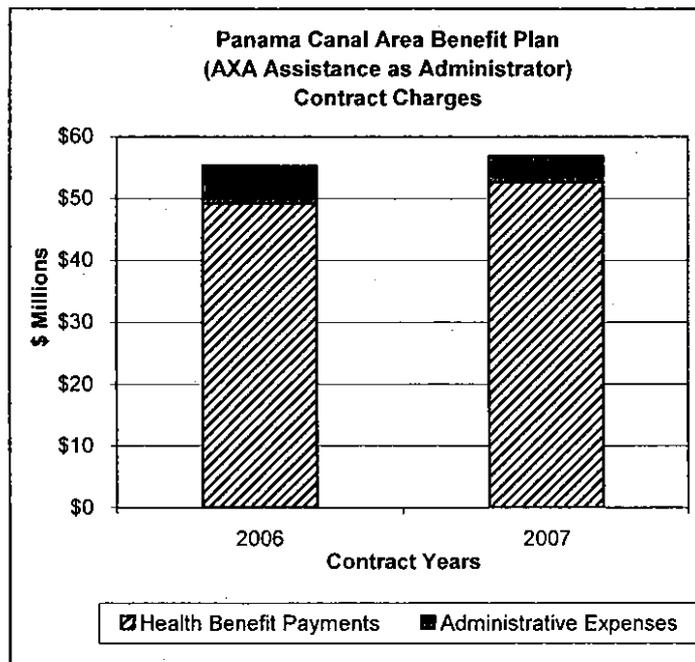


Figure 1 – Contract Charges

We also conducted tests to determine whether AXA had complied with the contract, the applicable procurement regulations (i.e., Federal Acquisition Regulations (FAR) and Federal Employees Health Benefits Acquisition Regulations (FEHBAR), as appropriate), and the laws and regulations governing the FEHBP. The results of our tests indicate that, with respect to the items tested, AXA did not comply with all provisions of the contract and federal procurement regulations. Exceptions noted in the areas reviewed are set forth in detail in the "Audit Findings and Recommendations" section of this audit report. With respect to the items not tested, nothing came to our attention that caused us to believe that AXA had not complied, in all material respects, with those provisions.

In conducting our audit, we relied to varying degrees on computer-generated data provided by AXA. Due to time constraints, we did not verify the reliability of the data generated by the various information systems involved. However, while utilizing the computer-generated data during our audit testing, nothing came to our attention to cause us to doubt its reliability. We believe that the data was sufficient to achieve our audit objectives.

The audit was performed at AXA's office in Miami, Florida from June 2 through June 27, 2008. Audit fieldwork was also performed at our offices in Washington, D.C. and Jacksonville, Florida.

## **METHODOLOGY**

We obtained an understanding of the internal controls over AXA's financial and cost accounting systems by inquiry of AXA officials.

To test AXA's compliance with the FEHBP health benefit provisions, we judgmentally selected and reviewed 32 capitation payments, totaling \$12,546,309 (from a universe of 120 capitation payments, totaling \$35,931,087), from 2006 and 2007. Our sample included eight monthly capitation payments to Clinica San Fernando Hospital, eight monthly capitation payments to Paitilla Hospital, eight monthly capitation payments to Panama Canal Eye Network, four monthly capitation payments to Clinica Boyd, and four monthly capitation payments to Indelco. We used the FEHBP contract, the Plan's benefit brochure, and AXA's provider agreements to determine the allowability of these capitation payments. The results of the sample were not projected to the universe of capitation payments.

We interviewed AXA personnel and reviewed AXA's policies, procedures, and accounting records during our audit of miscellaneous health benefit payments and credits. We judgmentally selected and reviewed 51 health benefit refunds and recoveries, totaling \$271,535 (from a universe of 685 refunds and recoveries, totaling \$378,404), to determine if refunds and recoveries were promptly returned to the FEHBP. Our sample included all refunds and recoveries greater than \$1,000. The results of the sample were not projected to the universe of refunds and recoveries.

We judgmentally reviewed administrative expenses charged to the FEHBP for contract years 2006 and 2007. Specifically, we reviewed administrative expenses relating to cost centers, expense accounts, out-of-system adjustments, prior period adjustments, employee health benefits, executive compensation, subcontracts, non-recurring projects, lobbying, return on investment, and Health Insurance Portability and Accountability Act of 1996 compliance. We also reviewed the close-out costs of the former administrator, Health Network America, and the start-up costs of AXA for 2005 and 2006. We used the FEHBP contract, the FAR, and the FEHBAR to determine the allowability, allocability, and reasonableness of charges.

We also reviewed AXA's cash management to determine whether AXA handled FEHBP funds in accordance with Contract CS 1066 and applicable laws and regulations.

### **III. AUDIT FINDINGS AND RECOMMENDATIONS**

#### **A. HEALTH BENEFIT CHARGES**

The audit disclosed no findings pertaining to capitation payments and miscellaneous health benefit payments and credits. Overall, we concluded that the capitation payments charged to the FEHBP were paid in accordance with the provider agreements. Also, we concluded that the health benefit refunds and recoveries were promptly returned to the FEHBP.

#### **B. ADMINISTRATIVE EXPENSES**

##### **1. Unapproved Subcontract**

##### **Procedural**

AXA charged the FEHBP \$998,984 from January 2006 through June 2008 for a subcontract with Redbridge Network and Healthcare, Inc. (Redbridge) for which prior approval was not sought from the contracting officer. As a result, the FEHBP was charged for unapproved subcontract costs.

Contract CS 1066, Part 1, Section 1.16 states, "(a) The Carrier will notify the Contracting Officer in writing at least 30 days in advance of entering into any subcontract . . . if the amount of the subcontract or modification charged to the FEHB Program equals or exceeds \$550,000 and is at least 25 percent of the total subcontract cost. . . . In determining whether the amount chargeable to the FEHB Program contract for a given subcontract or modification equals or exceeds the \$550,000 threshold, the following rules apply: (1) For initial advance notification, the Carrier shall add the total cost/price for the base year and all options, including quantity or service options and option periods. . . . (c) The Carrier will obtain the Contracting Officer's written consent before placing any subcontract for which advance notification is required under paragraph (a) of this clause."

Contract CS 1066, Part III, section 3.2 (b)(1) states, "The Carrier may charge a cost to the contract for a contract term if the cost is actual, allowable, allocable, and reasonable."

On September 21, 2005, AXA entered into a subcontract with Redbridge to lead the implementation process of AXA's contract with the Panama Canal Area Benefit Plan (PCABP). The Redbridge subcontract also included a clause stating that Redbridge would provide on-going account management functions and track competitors to defend the account and strengthen AXA's position for subsequent yearly renewals. The terms of the subcontract consisted of a yearly retainer fee of \$400,000 and full reimbursement of expenses related to the PCABP project, including travel and entertainment. The duration of the subcontract is the same length of time as the contract between AXA and the PCABP. The PCABP contracted with AXA for a period of three years starting on January 1, 2006. Therefore, we determined that the cost of the Redbridge subcontract would be \$1.2 million ( $\$400,000 \times 3 \text{ years} = \$1,200,000$ ) plus related expenses over the three-year period.

This subcontract exceeded the \$550,000 threshold requiring written consent from OPM's contracting officer. Formal approval of this three-year subcontract was never sought or received from the contracting officer. Although Redbridge was referred to in the original proposal to OPM, the terms and compensation details were not included in the proposal. In addition, AXA did not provide documentation supporting the development of Redbridge's annual service fee of \$400,000.

We also noted in the 2008 Redbridge subcontract that AXA will pay Redbridge 10 percent of the pre-approved annual administrative expense budget of \$3.6 million as the annual service fee. No additional documentation was provided by AXA or Redbridge to support the development of this 10 percent figure.

On October 17, 2005, OPM's contracting officer approved reimbursement of start-up and non-recurring costs that were incurred by AXA/Redbridge for the PCABP. The approval was solely for pre-contract costs incurred during the implementation stage. After implementation, AXA continued to charge the FEHBP for services provided by Redbridge without receiving approval from the contracting officer.

We obtained and reviewed statements of work performed by Redbridge. We identified that Redbridge provided AXA with account management for services including, but not limited to, the following:

- Preparing for and representing AXA at Asociacion de Jubilados del Area Canalera (AJAC) board meetings;
- Managing provider enrollment and negotiations;
- Assisting with provider relations and provider network development;
- Handling staff changes;
- Implementing programs and processes with medical management;
- Coordinating installation of the new member card system;
- Discussing information technology (IT) issues, including claims system (MAG), medical software (CAS), and web portal issues; and
- Conferring on a regular basis with AXA management and providing general oversight.

All these services are allowable, reasonable, and/or necessary tasks for administering the Panama Canal Area Benefit Plan.

Likewise, AXA charged the FEHBP for overhead support, which included executive management, human resources, and information technology services provided by the Chicago and Mexico offices. Also, AXA charged the FEHBP for administrative salaries, including but not limited to, a human resource supervisor, a finance supervisor, an IT supervisor, a network provider director, and several medical managers in the Panama office. Based on our review, there could be a duplication of effort between AXA and Redbridge in managing and administrating the PCABP. Services provided under the Redbridge subcontract are the same or similar to services already provided by AXA.

In summary, the FEHBP was charged for subcontract costs for which prior approval was not sought from OPM's contracting officer. However, even though prior approval was not sought from OPM, the contracting officer was/is aware of AXA's contractual relationship with Redbridge. Therefore, since the contracting officer was/is aware of AXA's contractual relationship with Redbridge and since the services provided by Redbridge are allowable, reasonable and/or necessary tasks for administering the Panama Canal Area Benefit Plan, we are reporting this issue as a procedural finding.

**AXA's Response:**

AXA disagrees with the finding.

AXA states, "Prior to the formation of AXA Florida, AXA Assistance USA prepared and submitted a proposal in June 2005 to the Plan (via AON Consulting) for third party administrative services. This proposal detailed the types of administrative services to be provided to the Plan, including network management, claims processing and recordkeeping, eligibility determinations, fraud prevention, coordination of benefits, medical management. . . . The proposal expressly identified Redbridge Network & Healthcare ('Redbridge') as a company with which AXA would partner in providing the administrative services to the Plan. . . . Specifically, Redbridge was identified as a company that 'provides international third party administration business development and account management support services' and was listed as one of two companies to which AXA would subcontract certain administrative services. . . . the proposal provided in-depth background on both AXA and Redbridge. . . . the proposal identified the management team that would be responsible for the delivery of administrative services to the Plan and this list included individuals from both AXA and Redbridge. . . . Also, the rates and fees proposed . . . were based on a build up that included both AXA's and Redbridge's administrative costs. . . . Finally, when AXA submitted the proposal to the Plan, it stated as follows: 'We are pleased to present this proposal with our global business development partner, Redbridge Network & Healthcare, a highly experienced organization in the international benefits industry.' . . .

When the administrative services contract award decision was made, AJAC, on behalf of the Plan, notified Redbridge – rather than AXA – of the award to AXA/Redbridge: 'The Association of Retirees from The Canal Area (AJAC) take . . . this opportunity to notify you that your organization was awarded the contract as our TPA for 2006, starting as of September 15.' . . . Among the individuals copied on this correspondence were [REDACTED] and [REDACTED] both OPM contracting officers. . . . Redbridge acknowledged the notice of award on behalf of AXA and itself: 'It is my great pleasure to accept this news on behalf of AXA and our organization. . . . I would like to report that we have already begun discussions to organize the implementation of the Panama Canal Area Benefit Plan effective immediately for January 1st start date. . . . The OPM contracting officers were copied on this correspondence as well. . . .

Subsequent to the award of the contract, Redbridge provided a variety of administrative services to AJAC to supplement those provided by AXA. For example, Redbridge was

the primary point of contact with AJAC representatives and met with AJAC on a regular basis to discuss . . . hospital and provider contracting issues, provider problems, OPM governance, program development, personnel, and even administrative expense issues . . . Redbridge also met with OPM personnel to discuss issues associated with the provision of administrative services to AJAC, and assisted AJAC in preparing presentations for OPM. . . . AXA and Redbridge provided different services to AJAC; there was no duplication of services. . . . The OPM contracting officer approved government reimbursement of start-up and non-recurring costs incurred by 'AXA Assistance/ Redbridge Network & Healthcare' for the Plan. . . .

On September 21, 2005, AXA and Redbridge formalized their contractual relationship. . . . The agreement signed by the two parties provided that Redbridge would assume the lead for implementation of the administrative services and manage the conversion from the prior administrative service provider to AXA. . . . The parties agreed that AXA would compensate Redbridge for its services in the amount of \$33,333 a month, for a total annual fee of \$400,000, plus reimbursement of reasonable expenses related to the project, such as travel. . . . The annual fee in AXA's agreement with Redbridge (\$400,000) was the same amount as was included in the budget used to develop the proposed rates and fees in Section E of the AXA/Redbridge proposal. . . . The term of the agreement between AXA and Redbridge was designated as the duration of the contract between AXA and AJAC. . . .

In December 2005, AXA entered into a Health Benefit Administrative Services Agreement with AJAC, effective January 1, 2006. . . . The AJAC/AXA Contract identifies AJAC as the contractor under Contract No. CS1066 with OPM, and describes AXA's role as the subcontractor to AJAC for purposes of providing administrative services. . . . Section 4.1 provides that AJAC 'represents and warrants to AXA that it has the power and authority to execute this Agreement under the terms of [Contract No. CS1066] . . . and that the terms of this Agreement may be carried out by the Parties without conflict with or default under [Contract No. CS1066] or applicable Laws.' . . . The AJAC/AXA Contract is made subject to applicable laws and regulations, including the FEHBA, FEHBAR, and FAR and it flows down to AXA 'applicable clauses' in the FEHBAR clause matrix . . . Section 5.2 specified that for application of the clauses, AJAC took the position of 'the government' or 'OPM,' and AXA took the position of the 'contractor' or 'carrier.' . . . Appendix B of the AJAC/AXA Contract governs the payment amounts to AXA and provides for actual administrative expenses to be reimbursed (not to exceed the applicable contractual expense limitation), plus the reimbursement of taxes and payment of a service charge. . . . Because the value of the contract exceeds \$550,000, OPM would have reviewed and approved the AJAC/AXA Contract, pursuant to Section 1.16 of Contract No. CS1066 (FEHBAR 1652.244-70, Subcontracts). The AJAC/AXA Contract was originally executed for a three-year period, with one-year renewal terms, but at the end of 2007, the term of the AJAC/AXA Contract was revised to a one-year contract, with one-year renewal terms."

AXA also states, "The Draft Audit Report finding concerning Redbridge's costs is unsupported for a number of reasons. First, the requirement in Contract No. CS1066 for

prior approval of subcontracts does not apply to the Redbridge agreement because it does not meet the threshold amount that triggers the requirement for prior approval. Second, AJAC, the party in the position to approve the Redbridge agreement, did so via ratification or, alternatively, appropriately waived the requirement for advance approval. Third, if OPM also has the right to approve the Redbridge agreement, it has approved it via ratification or, alternatively, appropriately waived the requirement for advance approval.”

**OIG Comments:**

Our position is that AXA should have sought approval from the contracting officer for the Redbridge subcontract as required by Contract CS 1066. Although Redbridge was referred to as management consultants in AXA’s original proposal, the costs associated with Redbridge were not included. Therefore, the contracting officer was not aware of the extent of Redbridge’s subcontract costs. Contract CS 1066, Part 1, Section 1.16, states “(a) The Carrier will notify the Contracting Officer in writing at least 30 days in advance of entering into any subcontract . . . if the amount of the subcontract or modification charged to the FEHB Program equals or exceeds \$550,000 and is at least 25 percent of the total subcontract cost.” The term of the subcontract with Redbridge was for three years starting with 2006 as the base year and 2007 and 2008 as the option periods. The subcontract cost for each year totaled \$400,000. Therefore, AXA’s subcontract with Redbridge totaled \$1.2 million (\$400,000 \* 3 years) from 2006 through 2008, which required prior approval of the contracting officer.

**Recommendation 1**

We recommend that the contracting officer instruct AXA to submit the Redbridge subcontract arrangement for approval going forward. Also, the contracting officer should require AXA to provide documentation supporting how Redbridge’s annual service fees of \$400,000 were developed, calculated, and/or negotiated for 2006 and 2007. In addition, the contracting officer should require AXA to provide documentation supporting how Redbridges’s service fee arrangement (10 percent of the pre-approved annual administrative expense budget) was developed, calculated, and/or negotiated for 2008.

**2. Allocation of Home Office Expenses \$223,953**

AXA allocated indirect/overhead expenses to the FEHBP using estimated allocation percentages instead of actual. As a result, the FEHBP was overcharged \$223,953 for indirect/overhead expenses in 2007.

Contract CS 1066, Part III, section 3.2 (b)(1) states, “The Carrier may charge a cost to the contract for a contract term if the cost is actual, allowable, allocable, and reasonable.”

Contract CS 1066, Appendix B (Subscription Rates, Charges, Allowances and Limitations), states that the administrative expenses must be actual, but not to exceed the contractual expense limitation.

48 CFR 31.201-4 states, "A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it –

- (a) Is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown."

In 2006 and 2007, AXA allocated indirect/overhead administrative expenses from the Chicago and Mexico offices using two types of allocation methods (three-factor and full time employee (FTE)). The three-factor method allocated expenses relating to administrative overhead. The FTE method allocated expenses specifically relating to human resources and information technology in Chicago. Since there is a direct relationship with the FTE method and human resources/information technology expenses, this method is reasonable and appropriate for these types of expenses. In our recalculation of the three-factor method, we identified those expenses that were allocated by the FTE method and then excluded those expenses from the three-factor method allocation base for Chicago.

During our review of the three-factor method, we found that AXA used budgeted numbers for the three-factor components (revenues, assets, and salaries). AXA should have used actual amounts as reported in the company's financial statements and the home office's (Chicago) financial statements. AXA allocated 19 percent and 17 percent of Chicago's overhead expenses to the FEHBP in 2006 and 2007, respectively. Based on our recalculations using actual numbers in the three-factor method, we determined that 24 percent and 11 percent should have been applied to Chicago's overhead expenses in 2006 and 2007, respectively. Consequently, AXA undercharged the FEHBP \$189,589 in 2006 and overcharged the FEHBP \$103,113 in 2007 for Chicago's overhead expenses.

In 2006 and 2007, the Mexico office offered oversight to the Panama office, and therefore, incurred overhead expenses similar to a home office. Although the Mexico office is truly not the home office for AXA Assistance Florida, the Mexico office did incur indirect expenses for salaries, benefits, and telephone. On average, AXA allocated 29 percent and 31 percent of Mexico's indirect expenses to the FEHBP in 2006 and 2007, respectively. However, we determined that 24 percent and 11 percent should have been applied to Mexico's indirect expenses in 2006 and 2007, respectively. Consequently, AXA overcharged the FEHBP \$16,176 in 2006 and \$120,840 in 2007 for Mexico's indirect expenses.

In total for contract year 2006, the FEHBP was net undercharged by \$173,413 (\$189,589 undercharge + \$16,176 overcharge) for indirect/overhead expenses. However, since AXA reached the administrative expense ceiling for contract year 2006, no monetary adjustment is required.

In total for contract year 2007, the FEHBP was overcharged by \$223,953 (\$103,113 + \$120,840) for indirect/overhead expenses. Since AXA did not exceed the administrative expense ceiling for contract year 2007, the FEHBP is due \$223,953 for these overcharges.

**AXA's Response:**

AXA agrees with \$90,678 and disagrees with \$133,275 of the questioned overcharges for 2007.

AXA states, "During the audit AXA and the OIG auditors discussed and agreed to apply one allocation percentage for the Home Office (Chicago) and the Mexico Office since the previous percentage used was based on budgeted numbers instead of actual numbers. After the new percentage was calculated, the results were to apply 24% and 10.9% to 2006 and 2007, respectively, to the overhead expenses incurred by the Chicago office and the Mexico office. The new percentages were applied using an actual corporate base of administrative expenses from both offices.

Applying the percentage calculated, 24.9% and 10.9%, to the respective years, AXA concluded that the Plan was overcharged \$90,000 and not \$223,000 as the OIG auditors are claiming. Our view on this is that all types of indirect expenses including salaries from the Chicago office should be included in the corporate base because it gives a true picture of the amount of support that the Chicago office dedicates and contributes to the Plan. . . .

The OIG calculation excludes from the base for the Chicago Office the FTE expenses for the Human Resources and Information Technology departments, both of which support the Plan activities. We respectfully request a review of such and the finding adjusted accordingly in the final audit report."

**OIG Comments:**

AXA did not provide additional documentation that changed our position. We will continue to exclude the FTE expenses (human resource and information technology expenses) from the allocation base since these expenses were already allocated to the FEHBP by AXA using the FTE method. By including the FTE expenses in the three-factor method allocation base, AXA would be allocating these expenses twice to the FEHBP. Since human resource and information technology expenses have a direct relationship with the FTE count, allocating these expenses to the FEHBP using the FTE ratio is a reasonable and appropriate method.

**Recommendation 2**

We recommend that the contracting officer disallow \$223,953 for indirect/overhead expenses that were overcharged to the FEHBP in 2007.

### **3. Excess Letter of Credit Drawdown for Administrative Expenses**

**\$76,361**

AXA withdrew \$74,651 from the letter of credit (LOC) account in excess of the administrative expense contractual limitation for 2006. As a result, the FEHBP is due \$76,361, consisting of \$74,651 for the excess drawdown and \$1,710 for lost investment income (LII).

Contract CS 1066, Part III, section 3.2 (b)(1) states, "The Carrier may charge a cost to the contract for a contract term if the cost is actual, allowable, allocable, and reasonable." Also, Appendix B (Subscription Rates, Charges, Allowances and Limitations) of the contract states that the administrative expenses must be actual, but not to exceed the contractual expense limitation.

Contract CS 1066, Part III, section 3.4(d) states, "Investment income lost as a result of unallowable, unallocable, or unreasonable charges against the contract shall be paid from the first day of the contract term following the contract term in which the unallowable charge was made and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision."

48 CFR 52.232-17(a) states, "all amounts that become payable by the Contractor . . . shall bear simple interest from the date due . . . The interest rate shall be the interest rate established by the Secretary of the Treasury as provided in Section 611 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (e) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid."

During our reconciliation of the LOC drawdowns for administrative expenses to the contractual expense limitation, we identified that AXA withdrew \$74,651 in excess of the administrative expense limitation for contract year 2006. The Plan's contractual expense limitation for contract year 2006 totaled \$4,154,329; however, AXA withdrew \$4,228,980 from the LOC account for administrative expenses. As a result, the FEHBP is due \$76,361, consisting of \$74,651 for the excess LOC drawdown and \$1,710 for LII on the excess drawdown calculated through June 25, 2008.

#### **AXA's Response:**

AXA agrees with the finding and will credit the FEHBP for the excess LOC drawdown as well as the LII on the excess drawdown.

#### **Recommendation 3**

We recommend that the contracting officer ensure that AXA credits the FEHBP \$74,651 for the excess LOC drawdown.

#### **Recommendation 4**

We recommend that the contracting officer ensure that AXA credits the FEHBP \$1,710 for LII on the excess LOC drawdown (plus interest accruing after June 25, 2008).

#### **4. Unsupported Consulting Expenses \$45,189**

AXA charged the FEHBP \$45,189 for unsupported, unnecessary and/or unreasonable consulting expenses in 2006.

Contract CS 1066, Part III, Section 3.2 (b) (1) states, "The Carrier may charge a cost to the contract for a contract term if the cost is actual, allowable, allocable, and reasonable."

48 CFR 31.201-3 (a) states, "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable."

We identified expenses paid to Millennium International Healthcare Strategies, Inc. (Millennium) during our review of consulting expenses. AXA entered into an agreement with Ponce de Leon from Millennium, dated September 21, 2005. Ponce de Leon agreed to develop a specific provider contracting plan and strategy for AXA by January 2006. The payment terms of the agreement, \$10,000 per month plus business related expenses, were for four months from October 2005 through January 2006. However, we identified expenses paid to Millennium after the agreement term ended. These payments made after January 2006 were unsupported, unnecessary, and/or unreasonable costs to the FEHBP. As a result, the FEHBP is due \$45,189 for these consulting expenses.

#### **AXA's Response:**

AXA did not respond to this finding in their response to the draft audit report.

#### **OIG Comments:**

AXA did not provide additional documentation to support the questioned consulting expenses of \$45,189. Therefore, we will continue to question this amount as unsupported, unnecessary and/or unreasonable.

## **Recommendation 5**

We recommend that the contracting officer disallow \$45,189 in unsupported, unnecessary and/or unreasonable consulting expenses that were charged to the FEHBP in 2006.

### **5. Unallocable Tax on the Service Charge**

**\$25,657**

AXA inadvertently charged the FEHBP \$24,653 for an unallocable ITBMS (Impuesto de Transferencias de Bienes Muebles y Servicios) tax on the service charges from January 2006 through May 2008. As a result, the FEHBP is due \$25,657, consisting of \$24,653 for unallocable taxes and \$1,004 for LII.

Contract CS 1066, Part III, section 3.2 (b)(1) states, "The Carrier may charge a cost to the contract for a contract term if the cost is actual, allowable, allocable, and reasonable. In addition, the Carrier must: (i) on request, document and make available accounting support for the cost to justify that the cost is actual, reasonable and necessary; and (ii) determine the cost in accordance with: (A) the terms of this contract . . . ." Part III, section 3.7(a) states, "Any service charge negotiated shall be set forth in Appendix B and shall be the total profit that can be charged to the contract."

Contract CS 1066, Part III, section 3.4(d) states, "Investment income lost as a result of unallowable, unallocable, or unreasonable charges against the contract shall be paid from the first day of the contract term following the contract term in which the unallowable charge was made and shall end on the earlier of: (1) the date the amounts are returned to the Special Reserve (or the Office of Personnel Management); (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's Final Decision."

48 CFR 52.232-17(a) states, "all amounts that become payable by the Contractor . . . shall bear simple interest from the date due . . . The interest rate shall be the interest rate established by the Secretary of the Treasury as provided in Section 611 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (e) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid."

During our review of the LOC drawdowns in 2006 and 2007, we identified ITBMS taxes that were computed on the service charges and subsequently charged to the FEHBP. The ITBMS tax is equivalent to a sales tax. The ITBMS tax (five percent) is assessed on the service charge that the Panama office receives from AXA. AXA shares fifty percent of the service charge with the Panama office. The service charge is paid to AXA by OPM. In our opinion, a tax on the service charge is not chargeable (an unnecessary cost) to the FEHBP.

We quantified the total ITBMS taxes charged to the FEHBP from January 2006 through May 2008 and assessed LII on the principle amount. As a result, the FEHBP is due \$25,657, consisting of \$24,653 for unallocable taxes and \$1,004 for LII calculated through June 5, 2008.

**AXA's Response:**

AXA agrees with the finding and returned the questioned amounts to the LOC account on June 5 and June 13, 2008.

**Recommendation 6**

Since we verified that AXA returned \$24,653 to the FHEBP for the unallocable tax charges, no further action is required.

**Recommendation 7**

Since we verified that AXA returned \$1,004 to the FEHBP for LII on the unallocable tax charges, no further action is required.

**C. CASH MANAGEMENT**

**1. Lost Investment Income on Excess Funds** **\$73,257**

AXA did not invest excess FEHBP funds held in the Banistmo Bank account (located in Panama) from January 2006 through May 2008. As a result, the FEHBP is due \$73,257 for LII on these funds.

Contract CS 1066, Part III, section 3.4(a) states, "The Carrier shall invest and reinvest all FEHB funds on hand that are in excess of the funds needed to promptly discharge the obligations incurred under this contract. The Carrier shall seek to maximize investment income with prudent consideration to the safety and liquidity of investments." In addition, section 3.4(e) states, "Investment income lost as a result of failure to credit income due the contract or failure to place excess funds in income producing investments and accounts shall be paid from the date the funds should have been invested . . . ."

48 CFR 52.232-17(a) states, "all amounts that become payable by the Contractor . . . shall bear simple interest from the date due . . . The interest rate shall be the interest rate established by the Secretary of the Treasury as provided in Section 611 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (e) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid."

During our review of investment income, we found that AXA held excess FEHBP funds in a non-interest bearing Banistmo Bank account from January 2006 through May 2008. In accordance with the FEHBP contract, all excess FEHBP funds should be placed in

income producing investments and accounts. AXA stated that it did not invest excess funds due to the volatility in the Latin American markets and only kept enough funds in this account to cover claims and capitation payments. On average, we noted that there was an excess daily balance remaining in this account of \$789,180 in 2006 and \$427,097 in 2007. We also identified an average excess daily balance in this account of \$360,629 from January 2008 through May 2008.

We calculated the LII amount for each month by multiplying the average daily balance by the applicable semiannual Treasury rate. We calculated LII of \$42,541 and \$23,579 in 2006 and 2007, respectively, on the excess funds. We also calculated LII of \$7,137 on the excess funds for the period January 2008 through May 2008. As a result, the FEHBP is due LII of \$73,257 on the excess FEHBP funds that were not being invested from January 2006 through May 2008.

**AXA's Response:**

AXA disagrees with the finding. AXA states, "even if AXA agreed with the OIG in the fact that the funds need to be invested, we would like the OIG to consider that AXA already opened a saving account at Banistmo Bank, in Panama, but it took 3 months to do it, due to all the paperwork involved. . . . Also, the interest rate paid on investments in Panama is only 1.5% per year, and the OIG is applying the standard Federal interest rate. Also, as stated before, AXA did not invest the excess funds due to the volatility in the Latin America markets and AXA only left funds in the account to cover claims and capitation payments. This balance was never used for any other purpose. . . ."

Considering that AXA's intention was to protect FEHBP funds from any economic risk and that the earning would have been minimal if AXA had invested the money in Panama, we respectfully request that the OIG reconsider and spare AXA from having to pay the high amount of LII on excess funds that were imposed and remove this finding from the final audit report."

**OIG Comments:**

AXA did not invest the excess FEHBP funds as required by Contract CS 1066, Part III, section 3.4(a). Therefore, AXA is liable for the investment income lost on these funds.

**Recommendation 8**

We recommend that the contracting officer direct AXA to credit the FEHBP \$73,257 for LII on the excess FEHBP funds that were not properly invested from January 2006 through May 2008 (plus interest accruing after May 31, 2008).

**D. OTHER ITEMS REVIEWED**

At the request of OPM’s contracting officer, we also reviewed the following items:

- Close-out costs of the former administrator, Health Network America, and
- Start-up costs of AXA.

Our audit disclosed no audit findings for these items.

**E. LOST INVESTMENT INCOME ON AUDIT FINDINGS \$15,774**

As a result of the audit findings presented in this report, the FEHBP is due LII of \$15,774 from January 1, 2007 through December 31, 2008.

48 CFR 52.232-17(a) states, “all amounts that become payable by the Contractor . . . shall bear simple interest from the date due . . . The interest rate shall be the interest rate established by the Secretary of the Treasury as provided in Section 611 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (e) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid.”

We computed investment income that would have been earned using the semiannual rates specified by the Secretary of the Treasury. Our computations show that the FEHBP is due LII of \$15,774 from January 1, 2007 through December 31, 2008 on questioned costs for contract years 2006 and 2007 (see Schedule C).

**AXA's Response:**

The draft audit report did not include an audit finding for LII. Therefore, AXA did not address this item in its reply.

**Recommendation 9**

We recommend that the contracting officer direct AXA to credit \$15,774 (plus interest accruing after December 31, 2008) to the Special Reserve for LII on audit findings.

## IV. MAJOR CONTRIBUTORS TO THIS REPORT

### Experience-Rated Audits Group

██████████ Team Leader

██████████ Auditor

██████████ Auditor

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██████████ Chief ██████████

██████████ Senior Team Leader

### Community-Rated Audits Group

██████████ Senior Team Leader

## V. SCHEDULES

AXA ASSISTANCE  
AS ADMINISTRATOR FOR THE PANAMA CANAL AREA BENEFIT PLAN  
MIAMI, FLORIDA

## CONTRACT CHARGES

CONTRACT CHARGES	2006	2007	TOTAL
<b>A. HEALTH BENEFIT CHARGES</b>			
PLAN CODE 43			
CLAIM PAYMENTS	\$49,104,480	\$50,508,389	\$99,612,869
OTHER ADJUSTMENTS	90,984	2,137,978	2,228,962
<b>TOTAL</b>	<b>\$49,195,464</b>	<b>\$52,646,367</b>	<b>\$101,841,831</b>
<b>B. ADMINISTRATIVE EXPENSES</b>			
PLAN CODE 43	\$5,108,817	\$4,280,144	\$9,388,961
PRIOR PERIOD ADJUSTMENTS	960,587	0	960,587
<b>TOTAL</b>	<b>\$6,069,404</b>	<b>\$4,280,144</b>	<b>\$10,349,548</b>
<b>C. SERVICE CHARGE</b>	<b>\$429,929</b>	<b>\$389,518</b>	<b>\$819,447</b>
<b>TOTAL CONTRACT CHARGES</b>	<b>\$55,694,797</b>	<b>\$57,316,029</b>	<b>\$113,010,826</b>

AXA ASSISTANCE  
AS ADMINISTRATOR FOR THE PANAMA CANAL AREA BENEFIT PLAN  
MIAMI, FLORIDA

QUESTIONED CHARGES

AUDIT FINDINGS	2006	2007	2008	TOTAL
<b>A. HEALTH BENEFIT CHARGES</b>	\$0	\$0	\$0	\$0
<b>B. ADMINISTRATIVE EXPENSES</b>				
1. Unapproved Subcontract ( <i>Procedural</i> )	\$0	\$0	\$0	<i>Procedural</i> \$0
2. Allocation of Home Office Expenses*	0	223,953	0	223,953
3. Excess Letter of Credit Drawdown for Administrative Expenses**	74,651	0	1,710	76,361
4. Unsupported Consulting Expenses*	45,189	0	0	45,189
5. Unallocable Tax on the Service Charge**	10,748	10,326	4,583	25,657
<b>TOTAL ADMINISTRATIVE EXPENSES</b>	<b>\$130,588</b>	<b>\$234,279</b>	<b>\$6,293</b>	<b>\$371,160</b>
<b>C. CASH MANAGEMENT</b>				
1. Lost Investment Income on Excess Funds**	\$42,541	\$23,579	\$7,137	\$73,257
<b>D. OTHER ITEMS REVIEWED</b>	\$0	\$0	\$0	\$0
<b>E. LOST INVESTMENT INCOME ON AUDIT FINDINGS</b>	\$0	\$2,485	\$13,289	\$15,774
<b>TOTAL QUESTIONED CHARGES</b>	<b>\$173,129</b>	<b>\$260,343</b>	<b>\$26,719</b>	<b>\$460,191</b>

\* The audit finding is subject to calculation of lost investment income on Schedule C.

\*\* The audit finding is not subject to calculation of lost investment income on Schedule C.

AXA ASSISTANCE  
AS ADMINISTRATOR FOR THE PANAMA CANAL AREA BENEFIT PLAN  
MIAMI, FLORIDA

LOST INVESTMENT INCOME CALCULATION

LOST INVESTMENT INCOME	2006	2007	2008	TOTAL
<b>A. QUESTIONED CHARGES (Subject to Lost Investment Income)</b>				
Allocation of Home Office Expenses	\$0	\$223,953	\$0	\$223,953
Unsupported Consulting Expenses	45,189	0	0	45,189
<b>TOTAL ADMINISTRATIVE EXPENSES</b>	<b>\$45,189</b>	<b>\$223,953</b>	<b>\$0</b>	<b>\$269,142</b>
<b>B. LOST INVESTMENT INCOME CALCULATION - Simple Interest Method</b>				
a. Prior Year's Total Questioned (Principal)	\$0	\$45,189	\$223,953	
b. Cumulative Total	<u>0</u>	<u>0</u>	<u>45,189</u>	
c. Total	\$0	\$45,189	\$269,142	
d. Treasury Rate: January 1 - June 30	5.125%	5.250%	4.750%	
e. Interest (d * c)	\$0	\$1,186	\$6,392	\$7,578
f. Treasury Rate: July 1 - December 31	5.750%	5.750%	5.125%	
g. Interest (f * c)	\$0	\$1,299	\$6,897	\$8,196
<b>Total Interest By Year (e + g)</b>	<b>\$0</b>	<b>\$2,485</b>	<b>\$13,289</b>	<b>\$15,774</b>



October 2, 2008

██████████  
U.S. Office of Personnel Management  
Office of the Inspector General  
1900 E. Street, NW  
Room 6400  
Washington, D. C. 20415-1100

Re: Response to OPM Report No. 1B-43-00-08-048, Draft of a Proposed Report, "Report on the Audit of AXA Assistance Florida As Administrator for the Panama Canal Area Benefit Plan"

Dear ██████████

AXA Assistance Florida, Inc. hereby submits its response to the Draft "Report on the Audit of AXA Assistance Florida As Administrator for the Panama Canal Area Benefit Plan" ("Draft Audit Report"), dated August 8, 2008, of the Office of Personnel Management ("OPM") Office of Inspector General ("OIG"). This response addresses Audit Findings and Recommendations regarding Unapproved Subcontract and Consulting Expenses, as associated with Redbridge Network and Healthcare, Inc.; Allocation of Home Office Expenses; Excess Letter of Credit Drawdown for Administrative Expenses; Unallocable Tax on Service Charge; and Lost Investment Income on FEHBP Funds.

## I. Background

AXA Assistance Florida, Inc. (“AXA Florida”) was formed in 2005 by AXA Assistance USA, Inc. (collectively, “AXA”), an entity that is part of the AXA Group of Companies, a world-wide global insurance and financial services enterprise. AXA Florida was formed to perform administrative services for the Asociación de Jubilados del Área Canalera (“AJAC”) in its capacity as group health plan insurance board for the Panama Canal Area Benefit Plan (“the Plan”). The Plan provides health benefits to qualified individuals pursuant to the Federal Employees Health Benefits Program.

Prior to the formation of AXA Florida, AXA Assistance USA prepared and submitted a proposal in June 2005 to the Plan (via AON Consulting) for third party administrative services. This proposal detailed the types of administrative services to be provided to the Plan, including network management, claims processing and recordkeeping, eligibility determinations, fraud prevention, coordination of benefits, medical management. See Exh. 1 (AXA Assistance USA/Redbridge proposal). The proposal expressly identified Redbridge Network & Healthcare (“Redbridge”) as a company with which AXA would partner in providing the administrative services to the Plan. *Id.* at 1, 16, 19. Specifically, Redbridge was identified as a company that “provides international third party administration business development and account management support services” and was listed as one of two companies to which AXA would subcontract certain administrative services. *Id.* at 1. In section F of the proposal, titled “Company Background & History,” the proposal provided

in-depth background on both AXA and Redbridge. *Id.* at 16. Section G of the proposal identified the management team that would be responsible for the delivery of administrative services to the Plan and this list included individuals from both AXA and Redbridge. *Id.* at 17-19. Also, the rates and fees proposed in Section E were based on a build up that included both AXA's and Redbridge's administrative costs. *See* Exh. 2, ¶ 3 (Decl. of Olivier Van Poperinghe). Finally, when AXA submitted the proposal to the Plan, it stated as follows: "We are pleased to present this proposal with our global business development partner, Redbridge Network & Healthcare, a highly experienced organization in the international benefits industry."<sup>1</sup> Exh. 1 at i.

When the administrative services contract award decision was made, AJAC, on behalf of the Plan, notified Redbridge -- rather than AXA -- of the award to AXA/Redbridge: "The Association of Retirees from The Canal Area (AJAC) take [sic] this opportunity to notify you that your organization was awarded the contract as our TPA for 2006, starting as of September 15." *See* Exh. 4 (Sept. 15, 2005 email from [REDACTED] AJAC, to [REDACTED] Redbridge). Among the individuals copied on this correspondence were [REDACTED] and [REDACTED], both OPM contracting officers. *Id.* Redbridge acknowledged the notice of award on behalf of

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<sup>1</sup> Redbridge also submitted a copy of the proposal to the Plan, with a cover letter stating: "Please find attached a proposal from AXA Assistance USA for the administration of the Panama Canal Area Benefit Plan, as requested. Redbridge Network & Healthcare provides business development and account management support to AXA for large cases, and we will have direct responsibilities for the deliverables in this proposal." *See* Exh. 3 (June 8, 2005 ltr. from [REDACTED] Redbridge, to [REDACTED] AON Consulting).

AXA and itself: "It is my great pleasure to accept this news on behalf of AXA and our organization. . . . I would like to report that we have already begun discussions to organize the implementation of the Panama Canal Area Benefit Plan effective immediately for January 1<sup>st</sup> start date. Mr. [REDACTED] [of AXA] and I will meet with [an AON representative] . . . for a planning session and we will be in close contact with you throughout this process beginning next week. See Exh. 5 (Sept. 16, 2005 email from [REDACTED], Redbridge, to [REDACTED] AJAC). The OPM contracting officers were copied on this correspondence as well. *Id.*

Subsequent to the award of the contract, Redbridge provided a variety of administrative services to AJAC to supplement those provided by AXA. For example, Redbridge was the primary point of contact with AJAC representatives and met with AJAC on a regular basis to discuss, *e.g.*, hospital and provider contracting issues, provider problems, OPM governance, program development, personnel, and even administrative expense issues. Exh. 2, ¶ 6. Redbridge also met with OPM personnel to discuss issues associated with the provision of administrative services to AJAC, and assisted AJAC in preparing presentations for OPM. *Id.*, ¶ 7. AXA and Redbridge provided different services to AJAC; there was no duplication of services. *Id.*, ¶ 5. The OPM contracting officer approved government reimbursement of start-up and non-recurring costs incurred by "AXA Assistance/Redbridge Network & Healthcare" for the Plan. See Exh. 6 (undated ltr. from [REDACTED] OPM, to [REDACTED] AXA).

On September 21, 2005, AXA and Redbridge formalized their contractual relationship. *See* Exh. 7 (Sept. 21, 2005 AXA/Redbridge agreement). The agreement signed by the two parties provided that Redbridge would assume the lead for implementation of the administrative services and manage the conversion from the prior administrative service provider to AXA. *Id.* at 1. The parties agreed that AXA would compensate Redbridge for its services in the amount of \$33,333 a month, for a total annual fee of \$400,000, plus reimbursement of reasonable expenses related to the project, such as travel. *Id.* at 1-2. The annual fee in AXA's agreement with Redbridge (\$400,000) was the same amount as was included in the budget used to develop the proposed rates and fees in Section E of the AXA/Redbridge proposal. Exh. 2, ¶ 3. The term of the agreement between AXA and Redbridge was designated as the duration of the contract between AXA and AJAC. Exh. 7 at 2.

In December 2005, AXA entered into a Health Benefit Administrative Services Agreement with AJAC, effective January 1, 2006. *See* Exh. 8 (AJAC/AXA Contract). The AJAC/AXA Contract identifies AJAC as the contractor under Contract No. CS1066 with OPM, and describes AXA's role as the subcontractor to AJAC for purposes of providing administrative services. *Id.* at 1, § 2.1. Section 4.1 provides that AJAC "represents and warrants to AXA that it has the power and authority to execute this Agreement under the terms of [Contract No. CS1066] in [sic] behalf of the Plan and OPM and that the terms of this Agreement may be carried out by the Parties without conflict with or default under [Contract No.

CS1066] or applicable Laws.” *Id.* § 4.1. The AJAC/AXA Contract is made subject to applicable laws and regulations, including the FEHBA, FEHBAR, and FAR and it flows down to AXA “applicable clauses” in the FEHBAR clause matrix at 48 CFR § 1652.3. *Id.* § 5.2. Section 5.2 specified that for application of the clauses, AJAC took the position of “the government” or “OPM,” and AXA took the position of the “contractor” or “carrier.”<sup>2</sup> *Id.* Appendix B of the AJAC/AXA Contract governs the payment amounts to AXA and provides for actual administrative expenses to be reimbursed (not to exceed the applicable contractual expense limitation), plus the reimbursement of taxes and payment of a service charge.<sup>3</sup> *Id.* at App. B; App. B in Amendment No. 2008. Because the value of the contract exceeds \$550,000, OPM would have reviewed and approved the AJAC/AXA Contract, pursuant to Section 1.16 of Contract No. CS1066 (FEHBAR 1652.244-70, Subcontracts). The AJAC/AXA Contract was originally executed for a three-year period, with one-year renewal terms, but at the end of 2007, the term of the AJAC/AXA Contract was revised to a one-year contract, with one-year renewal terms. *Id.* § 9.1 in Amendment No. 2008.

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<sup>2</sup> This language was omitted in the revision of section 5.2, effective January 1, 2008. Exh. 8 at § 5.2 in Amendment No. 2008.

<sup>3</sup> The contractual expense limitation in the original agreement, effective January 1, 2006, was \$4,134,895, and the service charge amount was \$429,929. The contractual expense limitation in Amendment No. 2008, effective January 1, 2008, was \$3,600,000, and the service charge amount was \$400,000.

## **II. Response to Audit Findings**

### **A. Unapproved Subcontract and Consulting Expenses**

The Draft Audit Report found that AXA charged FEHBP \$998,984 between January 2006 and June 2008 for costs associated with AXA's contract with Redbridge. Audit Report at 1. The Redbridge costs consisted of \$980,000 in fees plus \$18,984 in travel expenses. *Id.* at 2. The auditors determined that AXA's contract with Redbridge was subject to Section 1.16 in Contract CS 1066, which requires the carrier to obtain written consent from the OPM contracting officer before entering into a subcontract that exceeds \$550,000. *Id.* Because AXA had not obtained written consent from the OPM contracting officer, the auditors deemed the Redbridge costs to be unallowable. *Id.* at 2.

The Draft Audit Report finding concerning Redbridge's costs is unsupported for a number of reasons. First, the requirement in Contract No. CS1066 for prior approval of subcontracts does not apply to the Redbridge agreement because it does not meet the threshold amount that triggers the requirement for prior approval. Second, AJAC, the party in the position to approve the Redbridge agreement, did so via ratification or, alternatively, appropriately waived the requirement for advance approval. Third, if OPM also has the right to approve the Redbridge agreement, it has approved it via ratification or, alternatively, appropriately waived the requirement for advance approval.

1. The Redbridge Agreement Falls Below The Prior Approval Threshold Amount

FEHBAR 1652.244-70, incorporated into No. CS1066 at Section 1.16, requires prior approval of subcontracts in certain situations. Specifically, the regulation states: "The Carrier will notify the Contracting Officer in writing at least 30 days in advance of entering into any subcontract or subcontract modification, . . . , if the amount of the subcontract or modification charged to the FEHB Program equals or exceeds \$550,000 and is at least 25 percent of the total subcontract cost. . . . For initial advance notification, the Carrier shall add the total cost/price for the base year and all options, including quantity or service options and option periods." 48 CFR §§ 1652.244-70(a), 1652.244-70(a)(1) (Contract No. CS1066 §§ 1.16(a), 1.16(a)(1)). AXA's agreement with Redbridge was a de-facto one-year base contract with a value of \$400,000, and no option periods. As such, it did not reach the threshold value of \$550,000 for which prior approval is required under section 1652.244-70(a) (section 1.16(a) of Contract No. CS1066).

AJAC's contract with OPM, Contract No. CS1066, is a one-year contract renewable at the option of OPM. 48 CFR § 1652.249-70. The AJAC/AXA Contract – a subcontract to AJAC's Contract No. CS1066, and approved by OPM – is fundamentally a one-year contract because its performance is entirely dependent upon AJAC performing Contract No. CS1066. If OPM were to decline to renew Contract No. CS1066 with AJAC, then AJAC would cease to have need for AXA's administrative services. AJAC exists only to oversee the Plan and it conducts no business other than that related to the Plan, so it would have no reason to continue

to use AXA's administrative services if it were no longer an OPM contractor. While there is not a specific termination provision in the AJAC/AXA Contract addressing its termination due to a non-renewal of AJAC's contract with OPM, AJAC and AXA would certainly agree to terminate their Contract in the circumstance where AJAC no longer held a contract with OPM.<sup>4</sup> Exh. 2, ¶ 4. Similarly, if OPM were to decline to renew Contract No. CS1066 with AJAC, then AJAC and AXA would cease to have need for Redbridge's administrative services. The Redbridge agreement specifically states that it is coterminous with the duration of the AJAC/AXA Contract, so termination of the AJAC/AXA Contract would result in termination of the Redbridge agreement. Thus, because both the AJAC/AXA Contract and the Redbridge agreement are dependent on AJAC holding Contract No. CS1066, which is a one-year contract, both the AJAC/AXA Contract and the Redbridge agreement are de-facto one-year contracts as well.

Because the Redbridge agreement is a de-facto one-year contract, the value of the base year is \$33,333 a month, or \$400,000 total. The Redbridge agreement does not provide for option years. Thus, the value of the Redbridge agreement was well below the \$550,000 threshold for obtaining prior approval. Accordingly, AXA was not required to obtain approval for the Redbridge agreement prior to entering into it in September 2005, and there is no basis now for OPM to disallow the costs associated with the Redbridge agreement.

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<sup>4</sup> In fact, while the original AJAC/AXA Contract was drafted as a three-year contract, the sole purpose for this three-year term was to provide AXA with a sufficient basis for the amortization of capital expenditures. Exh. 2, ¶ 4.

2. OPM Lacks Authority to Approve the Redbridge Agreement; AJAC Holds that Authority and Ratified the Agreement Or, Alternatively, Waived the Requirement for Prior Approval

The audit report findings concerning the Redbridge costs are based on the mistaken premise that OPM has authority to require prior approval of AXA's subcontracts. In fact, there is no direct contractual relationship between OPM and AXA. Furthermore, the OPM-approved contract between AJAC and AXA does not provide for prior approval by OPM of subcontracts entered into by AXA. Exh. 8 (AJAC/AXA Contract). This lack of privity and the lack of an express contract provision granting approval authority to OPM establishes beyond a doubt that OPM does not have authority to disapprove a subcontract entered into by AXA. Instead, to the extent the AJAC/AXA Contract incorporates FEHBAR 1652.244-70, AJAC is the entity with authority to require and grant prior approval of AXA's subcontracts.<sup>5</sup>

According to FEHBAR 1652.244-70, approval by AJAC could occur in several ways in addition to the standard prior written consent method. First, AJAC could "ratify in writing any such subcontract for which written consent was not obtained. Ratification will constitute the consent of [AJAC]." 48 CFR § 1652.244-70(c). Second, AJAC could waive the requirement for advance notification and consent where "[AXA] and subcontractor [here, Redbridge] submit an application or renewal as a contractor team arrangement . . . and (1) [AJAC] evaluated the arrangement

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<sup>5</sup> Section 1.16 of Contract No. CS1066 is not incorporated or referenced anywhere in the AJAC/AXA Contract. See Exh. 8 (AJAC/AXA Contract).

during negotiation of the contract . . . and (2) [Redbridge's] price and/or costs were included in [AXA's] rates that were reviewed and approved by [AJAC] during negotiation of the contract . . . ." *Id.* § 1652.244-70(d). The facts demonstrate that AJAC approval has been granted, or, alternatively, appropriately waived such that the Redbridge costs are allowable.

AJAC clearly approved the Redbridge agreement via ratification from the time of award of the contract to AXA. Specifically, AJAC notified Redbridge, rather than AXA, of the award of the contract to AXA, thereby directly acknowledging – and accepting – Redbridge's participation in the performance of the AJAC/AXA Contract. Exh. 4. AJAC then received acceptance of the contract award from Redbridge as well as definitive information about steps Redbridge and AXA would be taking in the near future to initiate the provision of administrative services to AJAC. Exh. 5. Throughout the time period audited by OPM, AJAC met with Redbridge representatives concerning the AJAC/AXA Contract on a regular basis to discuss substantive issues associated with the provision of administrative services by AXA and Redbridge to AJAC. Exh. 2, ¶ 6. Thus, AJAC's express actions, including direct communication with Redbridge and multiple meetings with Redbridge, have unquestionably served to ratify AXA's agreement with Redbridge. Furthermore, and equally important, AJAC's express inactions – namely, the fact that AJAC has never required AXA to terminate its agreement with Redbridge nor has it taken any action to terminate Redbridge's participation in or contribution to

the performance of the AJAC/AXA Contract – also have clearly ratified AXA’s agreement with Redbridge.

Alternatively, AJAC has appropriately waived the requirement for advance notification because AXA and Redbridge presented themselves as team members in the proposal they submitted to AJAC (via AON Consulting). The proposal identified Redbridge as AXA’s partner in providing administrative services to AJAC and provided the same type of background information on the Redbridge organization and its leaders as it provided for AXA. Exh. 1 at 1, 16-19. AJAC assessed Redbridge’s information alongside AXA’s information and evaluated the arrangement between the parties in order to make the award decision to AXA and Redbridge. Furthermore, the rates and fees included in the proposal reflected both AXA and Redbridge expenses, so AJAC reviewed and approved the Redbridge expenses in the course of evaluating and awarding the proposal. Exh. 1 at 15; Exh. 2, ¶ 3. Thus, AJAC’s evaluation of Redbridge and its proposed expenses, in the form of a teaming arrangement, and subsequent award of the contract to AXA and Redbridge, constitutes a waiver of any requirement AXA might have had to obtain advance approval of its agreement with Redbridge.

Because AJAC properly ratified AXA’s agreement with Redbridge or waived the requirement for advance consent due to the fact that AXA and Redbridge had a

teaming arrangement, there is no valid basis to disallow Redbridge's fees and costs incurred in providing administrative services to AJAC.<sup>6</sup>

3. If OPM Has Authority to Approve the Redbridge Agreement, It Approved the Agreement via Ratification Or, Alternatively, Waived the Requirement for Prior Approval

If the AJAC/AXA Contract were to be interpreted as giving OPM authority to approve AXA's subcontracts, then the rules governing subcontract approval, as discussed above in Section II.A.2, would apply to OPM. Specifically, OPM would be found to have approved the Redbridge agreement through ratification, or alternatively, would be found to have appropriately waived the requirement for prior approval based on the teaming arrangement between AXA and Redbridge. See FEHBAR §§ 1652.244-70(c), (d).

OPM has approved the Redbridge agreement via ratification from the time of award of the contract to AXA. OPM was included on AJAC's notification to Redbridge of the award of the contract to AXA and Redbridge, and it was included on Redbridge's written response to this notice of award. Exhs. 4,5. On at least several occasions after award of the contract, OPM met with Redbridge representatives to discuss issues associated with the AJAC/AXA Contract. Exh 2, ¶ 7. Also, the OPM contracting officer approved government reimbursement of start-up and non-recurring costs incurred by AXA and Redbridge. Exh. 6. At no

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<sup>6</sup> As stated in Section I above, there has been no duplication of effort between AXA and Redbridge such that there is a basis to disallow some portion of Redbridge's fees as duplicative of amounts paid to AXA. Redbridge's work for AJAC has been separate and distinct from AXA's services. Exh. 2, ¶ 5.

time prior to the draft audit finding has OPM taken any action to end Redbridge's participation in the AJAC/AXA Contract, nor has it directed AJAC or AXA to take action to terminate Redbridge. Thus, OPM's knowledge of and acquiescence in Redbridge's services provided pursuant to the AJAC/AXA Contract – as well as OPM's direct communication with Redbridge and approval of prior incurred costs by Redbridge – undeniably demonstrate ratification of AXA's agreement with Redbridge.

Alternatively, OPM has appropriately waived the requirement for advance notification because OPM was involved in the evaluation of proposals for administrative services for the Plan, and thus would have evaluated the proposal submitted by AXA and Redbridge in which they clearly presented themselves as team members. Exh. 1 at 1, 16-19. OPM would have assessed Redbridge's information alongside AXA's information and evaluated the arrangement between the parties in order to participate in the award decision to AXA and Redbridge. Because the rates and fees included in the proposal reflected both AXA and Redbridge expenses, OPM would have reviewed and approved the Redbridge expenses in the course of evaluating and awarding the proposal. Exh. 1 at 15; Exh. 2, ¶ 3. Thus, OPM's evaluation of Redbridge and its proposed expenses, in the form of a teaming arrangement, and subsequent award of the contract to AXA and Redbridge, constitutes a waiver of any requirement AXA might have had to obtain advance approval of its agreement with Redbridge.

Because OPM properly ratified AXA's agreement with Redbridge or waived the requirement for advance consent due to the fact that AXA and Redbridge had a teaming arrangement, the draft audit report's disallowance of Redbridge's fees and costs incurred in providing administrative services to AJAC is unsupported.

**Conclusion on Unapproved Subcontract Expenses finding:**

As discussed above, the preliminary findings and conclusion by the OPM OIG on the Redbridge administrative costs are wholly incorrect and meritless. AXA requests that its comments be considered and the draft audit findings be revised accordingly prior to issuance of a final audit report.

**B. Allocation of Home Office Expenses**

AXA accepts the \$90,678 finding and respectfully requests that the OPM OIG reconsider the \$133,275 finding regarding overcharges for 2007. AXA's request for reconsideration is based on the following:

During the audit AXA and the OIG auditors discussed and agreed to apply one allocation percentage for the Home Office (Chicago) and the Mexico Office since the previous percentage used was based on budgeted numbers instead of actual numbers. After the new percentage was calculated, the results were to apply 24% and 10.9% to 2006 and 2007, respectively, to the overhead expenses incurred by the Chicago office and the Mexico office. The new percentages were applied using an actual corporate base of administrative expenses from both offices.

Applying the percentage calculated, 24.9% and 10.9%, to the respective years, AXA concluded that the Plan was overcharged \$90,000 and not \$223,000 as the

OIG auditors are claiming. Our view on this is that all types of indirect expenses including salaries from the Chicago office should be included in the corporate base because it gives a true picture of the amount of support that the Chicago office dedicates and contributes to the Plan.

**Conclusion on Home Office Expenses finding:**

The OIG calculation excludes from the base for the Chicago Office the FTE expenses for the Human Resources and Information Technology departments, both of which support the Plan activities. We respectfully request a review of such and the finding adjusted accordingly in the final audit report.

**C. Excess Letter of Credit Drawdown for Administrative Expenses**

AXA accepts the audit finding and will credit the FEHBP the excess LOC drawdown as well as the LII on the excess LOC drawdown.

**D. Unallocable Tax on Service Charge**

AXA accepts the audit finding and returned the questioned amounts to the LOC account on June 5 and June 13, 2008.

**E. Lost Investment Income on FEHBP Funds**

In this OIG finding, even if AXA agreed with the OIG in the fact that the funds need to be invested, we would like the OIG to consider that AXA already opened a saving account at Banistmo Bank, in Panama, but it took 3 months to do it, due to all the paperwork involved. See Exh. 9. Also, the interest rate paid on investments in Panama is only 1.5% per year, and the OIG is applying the standard Federal interest rate. Also, as stated before, AXA did not invest the excess funds

due to the volatility in the Latin America markets and AXA only left funds in the account to cover claims and capitation payments. This balance was never used for any other purpose.

**Conclusion on Lost Investment Income finding:**

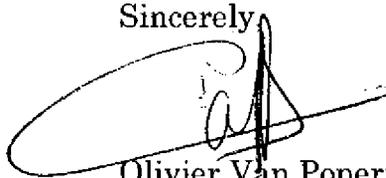
Considering that AXA's intention was to protect FEHBP funds from any economic risk and that the earning would have been minimal if AXA had invested the money in Panama, we respectfully request that the OIG reconsider and spare AXA from having to pay the high amount of LII on excess funds that were imposed and remove this finding from the final audit report.

\* \* \*

AXA appreciates the opportunity to respond to the Draft Audit Report.

Please direct all questions regarding AXA's response to Lynn Mc Givern, Corporate Counsel at [REDACTED] or phone [REDACTED] or Beatriz Sousa, Chief Financial Officer, [REDACTED] or phone [REDACTED]

Sincerely,



Olivier Van Poperinghe  
Chief Executive Officer  
AXA Assistance USA