



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

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# Final Audit Report

**Subject:**

**Audit of the Federal Employees Health Benefits  
Program Operations at Health Net of California –  
Southern Region**

**Report No. 1C-LP-00-11-027**

**Date: December 22, 2011**



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  
Health Net of California - Southern Region  
Contract Number 2002 - Plan Code LP  
Woodland Hills, California**

Report No. 1C-LP-00-11-027

Date: 12/22/11

A handwritten signature in black ink, appearing to read "Michael R. Esser", written over a horizontal line.

**Michael R. Esser**  
**Assistant Inspector General**  
**for Audits**



## UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Office of the  
Inspector General

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### EXECUTIVE SUMMARY

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**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Health Net of California – Southern Region  
Contract Number 2002 - Plan Code LP  
Woodland Hills, California**

**Report No. 1C-LP-00-11-027**

**Date: 12/22/11**

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Health Net of California – Southern Region (Plan). The audit covered contract years 2008 through 2010 and was conducted at the Plan's office in Woodland Hills, California. Additional field work was performed in Jacksonville, Florida and Cranberry Township, Pennsylvania.

The report questions \$277,265 for inappropriate health benefit charges to the FEHBP in contract year 2008. The questioned amount included \$244,814 for defective pricing and \$32,451 due to the FEHBP for lost investment income, calculated through November 30, 2011. We determined that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in 2009 and 2010.

For contract year 2008, we determined that the FEHBP's rates were overstated by \$244,814 due to defective pricing. More specifically, the Plan did not apply a similarly sized subscriber group discount to the FEHBP's rates. In addition, the Plan did not credit the FEHBP's rates for a state-mandated assessment that was included in the retention charge.

Consistent with the FEHBP regulations and contract, the FEHBP is due \$32,451 for lost investment income, calculated through November 30, 2011 on the defective pricing finding. In

addition, we recommend that the contracting officer recover lost investment income starting December 1, 2011 until all defective pricing amounts have been returned to the FEHBP.

## CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY.....	i
I. INTRODUCTION AND BACKGROUND.....	1
II. OBJECTIVES, SCOPE, AND METHODOLOGY .....	3
III. AUDIT FINDINGS AND RECOMMENDATIONS.....	5
Premium Rate Review .....	5
1. Defective Pricing.....	5
2. Lost Investment Income .....	6
IV. MAJOR CONTRIBUTORS TO THIS REPORT .....	7
Exhibit A (Summary of Questioned Costs)	
Exhibit B (Defective Pricing Questioned Costs)	
Exhibit C (Lost Investment Income)	
Appendix (Health Net of California – Southern Region November 16, 2011 response to the draft report)	

# **I. INTRODUCTION AND BACKGROUND**

## **Introduction**

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Health Net of California – Southern Region (Plan). The audit covered contract years 2008 through 2010 and was conducted at the Plan’s office in Woodland Hills, California. The audit was conducted pursuant to the provisions of Contract CS 2002; 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.

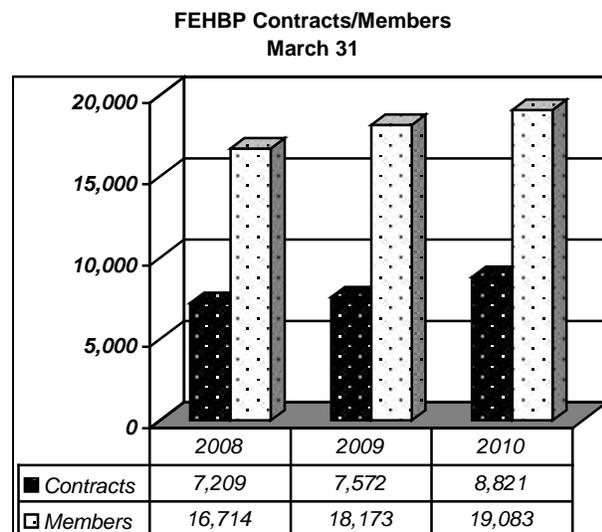
## **Background**

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 2008 and provides health benefits to FEHBP members in Southern California. This is the first audit of the Plan conducted by our office since the start of its participation in the FEHBP.

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 preparation of this report and included, as appropriate, as the Appendix.

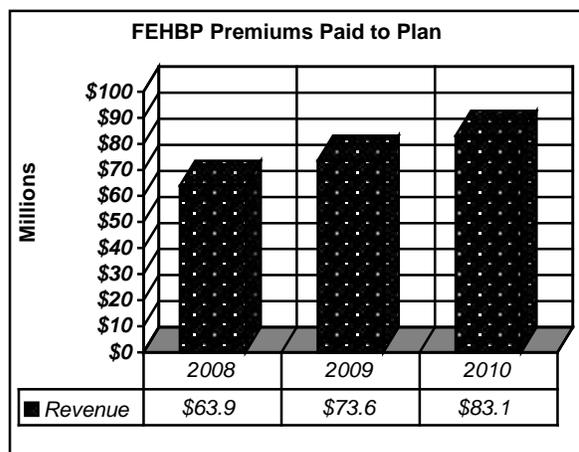
## **II. OBJECTIVES, SCOPE, AND METHODOLOGY**

### **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 through 2010. For these contract years, the FEHBP paid approximately \$220.6 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 Woodland Hills, California during April 2011. Additional audit work was completed at our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania.

### **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, 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 Rate Review**

##### **1. Defective Pricing \$244,814**

The Certificate of Accurate Pricing that Health Net of California – Southern Region (Plan) signed for contract year 2008 was defective. Therefore, in accordance with federal regulations, the Federal Employees Health Benefits Program (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 \$244,814 (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 years 2009 and 2010.

Federal Employee Health Benefits Acquisition Regulation (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 a similarly sized subscriber group (SSSG). SSSGs are the Plan’s two employer groups closest in subscriber size to the FEHBP. If it is found that the FEHBP was charged higher than a market price rate (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 rate.

#### **2008**

We agree with the Plan’s selection of [REDACTED] and [REDACTED] as SSSGs for contract year 2008. Our analysis of the rates charged to the SSSGs shows that [REDACTED] received a [REDACTED] percent discount and [REDACTED] received a [REDACTED] percent discount. The Plan applied a [REDACTED] percent discount to the FEHBP’s rates.

In addition, we reviewed the FEHBP’s rates and found that the Plan failed to remove a state-mandated assessment from its retention loading. The assessment is charged by the California Department of Managed Health Care to fund its program.

State assessments are unallowable costs identified by the 2008 Community Rating Instructions, which prohibits the imposition of taxes, fees, or other monetary payment, directly or indirectly, on FEHBP premiums by any State, the District of Columbia, or the Commonwealth of Puerto Rico, or by any political subdivision or other governmental authority of those entities. As a result, we re-developed the FEHBP’s rates by removing the assessment and applying the appropriate discount. A comparison of the reconciled line 5 rates to our audited line 5 rates shows that the FEHBP was overcharged \$244,814 in contract year 2008 (see Exhibit B).

**Plan's Comments (see Appendix):**

The Plan concurs with our findings.

**Recommendation 1**

We recommend that the contracting officer require the Plan to return \$244,814 to the FEHBP for defective pricing in contract year 2008.

**2. Lost Investment Income **\$32,451****

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 2008. We determined that the FEHBP is due \$32,451 for lost investment income, calculated through November 30, 2011 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning December 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 agrees and will include lost investment income calculated through the current date when it remits payment to OPM for defective pricing charges.

**Recommendation 2**

We recommend that the contracting officer require the Plan to return \$32,451 to the FEHBP for lost investment income for the period January 1, 2008 through November 30, 2011. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning December 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

██████████, Auditor

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██████████ Chief

██████████, Senior Team Leader

**Health Net of California - Southern Region  
Summary of Questioned Costs**

Defective Pricing Questioned Costs:

Contract Year 2008	\$244,814
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Total Defective Pricing Questioned Costs:	\$244,814
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Lost Investment Income:	<u>\$32,451</u>
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<b>Total Questioned Costs:</b>	<b><u>\$277,265</u></b>
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**Health Net of California - Southern Region  
Defective Pricing Questioned Costs**

**2008 - High Option**

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	[REDACTED]	[REDACTED]	
FEHBP Line 5 - Audited Rate	[REDACTED]	[REDACTED]	
Overcharge	[REDACTED]	[REDACTED]	
To Annualize Overcharge:			
3/31/08 enrollment	[REDACTED]	[REDACTED]	
Pay Periods	26	26	
Subtotal	\$ [REDACTED]	[REDACTED]	
Total 2008 - High Option Defective Pricing Questioned Costs			<u>\$241,435</u>

**2008 - Standard Option**

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	[REDACTED]	[REDACTED]	
FEHBP Line 5 - Audited Rate	[REDACTED]	[REDACTED]	
Overcharge	[REDACTED]	[REDACTED]	
To Annualize Overcharge:			
3/31/08 enrollment	[REDACTED]	[REDACTED]	
Pay Periods	26	26	
Subtotal	[REDACTED]	[REDACTED]	
Total 2008 - Standard Option Defective Pricing Questioned Costs			<u>\$3,379</u>

**Total Defective Pricing Questioned Costs** **\$244,814**

**Health Net of California - Southern Region  
Lost Investment Income**

<b>Year</b>	2008	2009	2010	2011	Total
<b>Audit Findings:</b>					
1. Defective Pricing	\$244,814	\$0	\$0	\$0	\$244,814
Totals (per year):	\$244,814	\$0	\$0	\$0	\$244,814
Cumulative Totals:	\$244,814	\$244,814	\$244,814	\$244,814	\$244,814
Avg. Interest Rate (per year):	4.9375%	5.2500%	3.1875%	2.5625%	
Interest on Prior Years Findings:	\$0	\$12,853	\$7,803	\$5,751	\$26,407
Current Years Interest:	\$6,044	\$0	\$0	\$0	\$6,044
Total Cumulative Interest Calculated Through November 30, 2011:	\$6,044	\$12,853	\$7,803	\$5,751	<b>\$32,451</b>

APPENDIX

**From:** [REDACTED]  
**To:** [REDACTED]  
**Cc:** [REDACTED]  
**Subject:** Health Net of CA's response to DRAFT Audit Report for Plan LP  
**Date:** Wednesday, November 16, 2011 12:30:29 PM

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Hello [REDACTED]

Thank you for the opportunity to review and comment on OPM's Draft Audit report for Plan LP.

Health Net of California recognizes and does not contest the findings in OPM's Draft Audit Report No. 1C-LP-00-11-027 (October 20, 2011), covering the 2008 - 2010 plan years for Health Net of CA Plan LP. Health Net of California does not question the overstatement of contract year 2008 rates by \$244,814 as identified in this audit report, nor do we question the determination of lost investment income.

With respect to the payment of amounts due to OPM, does Health Net wait until the Final Audit Report is issued, or should the amounts be remitted before then? In either case, how should we account for lost investment income starting October 1, 2011, to the time of payment, as identified in the Draft Audit Report?

Lastly, it is our understanding that we do not need to submit our response on CD since we are not contesting any of the findings. Please let me know if that is not the case.

Thanks,

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[REDACTED]  
Account Manager, Major Accounts, Health Net of California  
Phone: [REDACTED]  
License [REDACTED] | [www.healthnet.com](http://www.healthnet.com)

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