



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

Final Audit Report

Subject:

Audit of the Federal Employees Health Benefits Program Operations of FirstCare – West Texas

Report No. 1C-CK-00-08-063

Date: September 30, 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
Comprehensive Medical Plan - Community-Rated
First Care – West Texas
Contract Number 2321 - Plan Code CK
Austin, Texas**

Report No. 1C-CK-00-08-063

Date: September 30, 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
Comprehensive Medical Plan - Community-Rated
First Care – West Texas
Contract Number 2321 - Plan Code CK
Austin, Texas**

Report No. 1C-CK-00-08-063

Date September 30, 2009

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at First Care – West Texas (Plan). The audit covered contract years 2004 through 2008 and was conducted at the Plan's office in Austin, Texas. Additional field work was performed at our field office in Jacksonville, Florida. This report questions \$561,007 for defective pricing in 2005 and 2006, including \$95,411 for related lost investment income. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in contract years 2004, 2007, and 2008

We determined that the FEHBP rates were overstated by \$384,782 for contract year 2005 because the Plan incorrectly calculated a benefit adjustment factor and did not apply a similarly sized subscriber group (SSSG) discount to the FEHBP rates. In addition, we determined that the FEHBP rates were overstated by \$80,814 for contract year 2006 because the Plan did not apply an SSSG discount to the FEHBP rates. Also, the Plan could not provide adequate documentation to support the rates charged to the FEHBP and the SSSGs for all years audited.

Consistent with the contract, the FEHBP is due \$95,411 for lost investment income, calculated through July 31, 2009, on the defective pricing findings in 2005 and 2006. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning August 1, 2009, until the funds have been returned to the FEHBP.

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I. INTRODUCTION AND BACKGROUND

Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at First Care – West Texas (Plan). The audit covered contract years 2004 through 2008 and was conducted at the Plan’s office in Austin, Texas. The audit was conducted pursuant to the provisions of Contract CS 2321; 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.

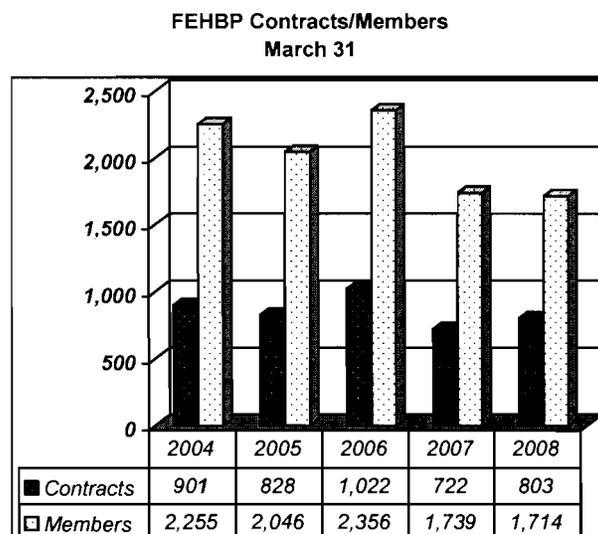
Background

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 Center for Retirement and Insurance Services. The provisions of the Federal Employees Health Benefits Act are implemented by OPM through regulations codified in Chapter 1, Part 890 of Title 5, CFR. Health insurance coverage is provided through contracts with health insurance carriers who provide service benefits, indemnity benefits, or comprehensive medical services.

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

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

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



The Plan has participated in the FEHBP since 1988 and provides health benefits to FEHBP members throughout west Texas. The last full-scope audit covered contract years 1999 through 2003. All issues related to that audit have been resolved.

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

II. OBJECTIVES, SCOPE, AND METHODOLOGY

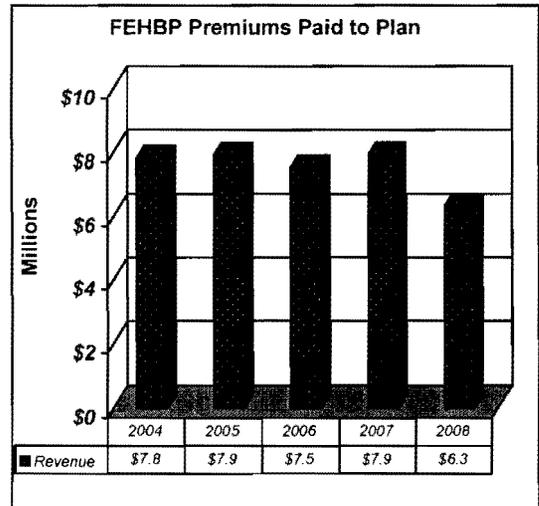
Objectives

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

Scope

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This performance audit covered contract years 2004 through 2008. During this period, the FEHBP paid approximately \$37.4 million in premiums to the Plan. The premiums paid for each contract year audited are shown on the chart to the right.



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 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 Austin, Texas, during September 2008. Additional audit work was completed at our offices in Cranberry Township, Pennsylvania; Jacksonville, Florida; and Washington, D.C.

Methodology

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

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

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rates

1. Defective Pricing

\$465,596

The Certificates of Accurate Pricing the Plan signed in contract years 2005 and 2006 were defective. In accordance with federal regulations, the FEHBP is therefore due a price reduction for these years. Application of the defective pricing remedies shows that the FEHBP is entitled to premium adjustments totaling \$465,596 (see Exhibit A). We found that the FEHBP rates were developed in accordance with OPM's rules and regulations in contract years 2004, 2007 and 2008.

Carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing which certifies that proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an SSSG. If it is found that the FEHBP was charged higher than the 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.

2005

We agree with the Plan's selection of [REDACTED] and [REDACTED] as the SSSGs for contract year 2005. Our analysis of the rates charged to the SSSGs shows that [REDACTED] received a [REDACTED] percent discount, which was not applied to the FEHBP audited rates. [REDACTED] did not receive any discount.

In reviewing the FEHBP rates, we found that the Plan erroneously calculated a benefit adjustment factor based on a change from a \$100 inpatient admission copay to a \$500 inpatient admission copay. The Plan's calculation included a [REDACTED] benefit adjustment factor on a separate line in the rate development. However, upon further review we found that the [REDACTED] benefit adjustment factor was also included within the medical benefit adjustment calculations, resulting in the FEHBP being charged twice for that factor. Therefore, we removed the individual benefit adjustment factor line item. This resulted in a total benefit adjustment factor of [REDACTED]

We re-developed the FEHBP's rates using a benefit adjustment factor of [REDACTED] and by applying the [REDACTED] percent discount given to [REDACTED]. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$384,782 in 2005 (see Exhibit B).

Plan's Comments (See Appendix):

The Plan disagrees with the methodology used by the auditors to determine the discount given to [REDACTED]. The Plan states that the calculation for revenue should be based on the membership

of the richer plan and not the membership of both benefit packages being offered. In addition, the Plan agreed that the total benefit adjustment factor for the FEHBP should be [REDACTED]. As a result of the items above, the Plan states that the FEHBP is owed \$115,751 for contract year 2005.

OIG's Response to the Plan's Comments:

The Plan stated that the methodology used to determine discounts is not appropriate for groups that convert from one benefit plan to two benefit plan offerings nor would it be appropriate for any group that has more than one benefit offering. When groups convert from one plan to two it is a common practice to use a weighted average of the two plans to determine the total revenue for the group. As a result, we continue to recommend that the FEHBP rates be adjusted by the [REDACTED] percent discount provided to a similarly sized subscriber group.

Additionally, according to correspondence provided by the Plan during the audit, the benefit calculation for the FEHBP is correct. The result was a medical benefit factor of [REDACTED] which was used in the audited rates. As a result, we agree with the Plan and recommend that the FEHBP rates be adjusted by the total benefit adjustment factor of [REDACTED].

2006

We agree with the Plan's selection of [REDACTED] and [REDACTED] as the SSSGs for contract year 2006. Our analysis of the rates charged to the SSSGs shows that [REDACTED] received a [REDACTED] percent discount, which was not applied to the FEHBP. [REDACTED] did not receive a discount.

We re-developed the FEHBP's rates by applying the [REDACTED] percent discount given to [REDACTED]. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$80,814 in 2006 (see Exhibit B).

Plan's Comments (See Appendix):

The Plan states that the rate reduction is the result of using a lower rate for the large claim pooling charge. The Plan agreed that the FEHBP is due \$80,814 for contract year 2006.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$465,596 to the FEHBP for defective pricing in contract years 2005 and 2006.

2. Lost Investment Income

\$95,411

In accordance with FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing findings in contract years 2005 and 2006. We determined that the FEHBP is due \$95,411 for lost investment income, calculated through July 31, 2009 (see Exhibit C). In addition, the FEHBP

is entitled to lost investment income for the period beginning August 1, 2009, until all defective pricing 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 regulations state 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.

We calculated the lost investment income amount based on the United States Department of the Treasury's semiannual cost of capital rates.

Plan's Comments (See Appendix):

The Plan believes its response should result in the adjustment of the lost investment charge.

OIG's Response to the Plan's Comments:

Lost investment income should be calculated on the defective pricing amounts actually due the FEHBP. Therefore, our lost investment income calculation is based on the defective pricing amounts discussed in this report and has been adjusted accordingly.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$95,411 to the FEHBP for lost investment income, calculated through July 31, 2009, on the 2005 and 2006 findings. We also recommend that the contracting officer recover lost investment income on amounts due for the period beginning August 1, 2009, until the funds have been returned to the FEHBP.

3. Records Retention

The Plan did not provide adequate documentation to support the rates charged to the FEHBP and the SSSGs for all years audited. The Federal Acquisitions Regulations 1652.204-70 requires the carrier to retain all records for six years after the end of the contract term to which the records relate.

Without appropriate supporting documentation, it is difficult to determine if the FEHBP rates were established in accordance with the Plan's contract, applicable regulations, and OPM community-rating guidelines. Under these circumstances, we may have to depend on other data, and at times, different rating methodologies to determine the appropriateness of the FEHBP rates. The outcome of our analysis based on the best information available may result

in a less desirable outcome to the Plan. Therefore, it is in the best interest of a plan to retain the information needed to verify the FEHBP and the SSSGs rates.

Plan's Comments (See Appendix):

The Plan did not provide any additional comment on this item.

Recommendation 3

We recommend that the contracting officer assess the maximum penalty allowed in the contract between OPM and the Plan for the Plan's breach of the records retention clause.

In addition, we recommend that the contracting officer inform the Plan that:

- OPM expects it to fully comply with the records retention provisions of the contract and all applicable regulations;
- it should maintain copies of all pertinent rating documents that show the factors and calculations the Plan uses in developing the actual rates for the FEHBP and the groups closest in size to the FEHBP for each unaudited year;
- it should maintain copies of the enrollment reports and other necessary supporting documents for the FEHBP and the groups closest in size to the FEHBP for each unaudited year; and
- the applicable community-rated performance factors described in FEHBAR 1609.7101-2 will be adversely affected if information requested during audits is not provided.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

██████████ Auditor-In-Charge

██████████ Auditor



██████████ Chief

██████████ Senior Team Leader

**First Care - West Texas
Summary of Questioned Costs**

Defective Pricing Questioned Costs:

Contract Year 2005	\$384,782
Contract Year 2006	\$80,814

Total Defective Pricing Questioned Costs: \$465,596

Lost Investment Income: \$95,411

Total Questioned Costs: **\$561,007**

**First Care - West Texas
Defective Pricing Questioned Costs**

2005

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate			
FEHBP Line 5 - Audited Rate			
Overcharge			
To Annualize Overcharge:			
x 3/16/05 enrollment			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Total 2005 Defective Pricing Questioned Costs			\$384,782

2006

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate			
FEHBP Line 5 - Audited Rate			
Overcharge			
To Annualize Overcharge:			
x 3/16/06 enrollment			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Total 2006 Defective Pricing Questioned Costs			\$80,814
Total Defective Pricing Questioned Costs			<u>\$465,596</u>

**First Care - West Texas
Lost Investment Income**

Year	2005	2006	2007	2008	2009	Total
Audit Findings:						
1. Defective Pricing	\$384,782	\$80,814	\$0	\$0	\$0	\$465,596
Totals (per year):	\$384,782	\$80,814	\$0	\$0	\$0	\$465,596
Cumulative Totals:	\$384,782	\$465,596	\$465,596	\$465,596	\$465,596	\$465,596
Avg. Interest Rate (per year):	4.3750%	5.4375%	5.5000%	4.9375%	5.6250%	
Interest on Prior Years Findings:	\$0	\$20,923	\$25,608	\$22,989	\$15,277	\$84,797
Current Years Interest:	\$8,417	\$2,197	\$0	\$0	\$0	\$10,614
Total Cumulative Interest Calculated Through July 31, 2009:	\$8,417	\$23,120	\$25,608	\$22,989	\$15,277	\$95,411

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May 14, 2009

██████████
Chief, Community-Rated Audits Group
U.S. Office of Personnel Management
Office of Inspector General
1900 E Street, NW
Room 6400
Washington, D.C. 20415-1100

Dear ██████████

This is in response to your Supplemental Draft Audit letter dated April 24, 2009 for carrier CK that was received on May 4, 2009. We have completed our evaluation of the Draft Audit and our response follows.

1. **2005 defective pricing item – ██████████ discount to have been applied from ██████████ rate development**
Our position is that the methodology used to determine discounts is not appropriate for groups that convert from one benefit plan to two benefit offerings nor would it be appropriate for any group that has more than one benefit offering. When groups convert from one plan to two there is always a leaner benefit which means by using a weighted average of the two plans will always result in a lower revenue than was initially rated which is the desired result of the group. Additionally there is no way of knowing how many employees will take which plan therefore the methodology of rating the group is to determine the appropriate rate change based on the current benefits then apply benefit factors to produce the two benefits. The more accurate measure is to use the richer plan and assume all of the membership chose that plan and then measure it against the original rates as shown in Exhibit B in the ██████████ tab. The net change to rates as shown in the Audit report is mainly a function of actual enrollment in each plan and does not, in and of itself, represent a discount given to ██████████
2. **2005 adjustment to claims for benefit changes**
We disagree with the Audit findings that the benefit calculation is incorrect. There was a proposal by Plan CK to change the 2004 benefits that included a \$500 inpatient per admit copay. FEHBP accepted all of the benefit changes with the exception of the \$500 per admit copay and asked for a \$100 per day copay up to a maximum of \$500 per admission. Since we did not have the exact plan requested, we chose a benefit plan that had all of the benefit changes except the desired inpatient copay which was the original proposed plan with the \$500 per admission copay and then converted it to the desired \$100 per day copay by applying actuarial techniques. The methodology applied here is a standard underwriting technique for applying benefit changes. Therefore, we took the ██████████ plan which is a \$500/admit plan but it had all of our other benefit changes that were accepted by FEHBP and then estimated the value of converting the inpatient copay component to the \$100/day (5 day max). This calculation is illustrated in Exhibit A and it shows how the ██████████ benefit factor adjustment is the correct adjustment.
3. **2005 comparison of Plan's Reconciled Line 5 and Audited Line 5 Rates**
As a result of items listed in Sections 1 and 2 above, we believe that the amount of overcharge is not \$476,380 but \$115,751 as shown in Tab labeled "Exhibit A_Adj" in the Excel file, "CK Exhibit B".
4. **2006 defective rating item – ██████████ discount to have been applied from ██████████ rate development**
The rate reduction is the result of the use of a lower rate for large claim pooling and we agree that this is a discount which resulted in an \$80,814 overcharge.

Deleted by OIG – Not relevant to the Final Report

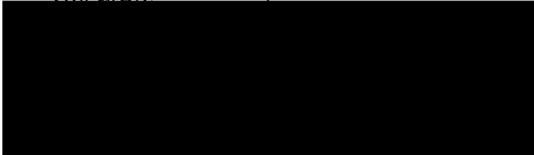
6. Lost Investment Income

As a result of the above findings, we believe this value needs to be adjusted accordingly.

Thank you for the opportunity to respond to the supplemental draft audit report. If you have any questions or concerns about our interpretations of the findings, please do not hesitate to contact me.

Thank you.

Sincerely,



Vice President of Actuarial Services
FirstCare Health Plans

Attachments