

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 Health Net of Arizona, Inc.**

Report No. 1C-A7-00-09-030

Date: November 4, 2009

-- CAUTION --

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UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

AUDIT REPORT

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Health Net of Arizona, Inc.
Contract Number 2121 - Plan Code A7
Woodland Hills, California**

Report No: 1C-A7-00-09-030

Date: November 4, 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
Community-Rated Health Maintenance Organization
Health Net of Arizona, Inc.
Contract Number 2121 - Plan Code A7
Woodland Hills, California**

Report No. 1C-A7-00-09-030

Date: November 4, 2009

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Health Net of Arizona, Inc. (Plan). The audit covered contract years 2006 through 2008 and was conducted at the Plan's office in Woodland Hills, California. Additional field work was performed at our office in Jacksonville, Florida. This report questions \$80,747 for defective pricing in 2006, including \$11,530 for related lost investment income. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's (OPM) rules and regulations in contract years 2007 and 2008.

We determined that the FEHBP rates were overstated by \$69,217 for contract year 2006 because the Plan incorrectly calculated the vision rider by applying a service industry factor larger than what was applied to a similarly sized subscriber group.

Consistent with the FEHBP regulations and the contract, the FEHBP is due \$11,530 for lost investment income, calculated through August 31, 2009, on the defective pricing findings. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning September 1, 2009, until all defective pricing amounts have been returned to the FEHBP.

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I. INTRODUCTION AND BACKGROUND

Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Health Net of Arizona, Inc. (Plan) in Woodland Hills, California. The audit covered contract years 2006 through 2008. The audit was conducted pursuant to the provisions of Contract CS 2121; 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.

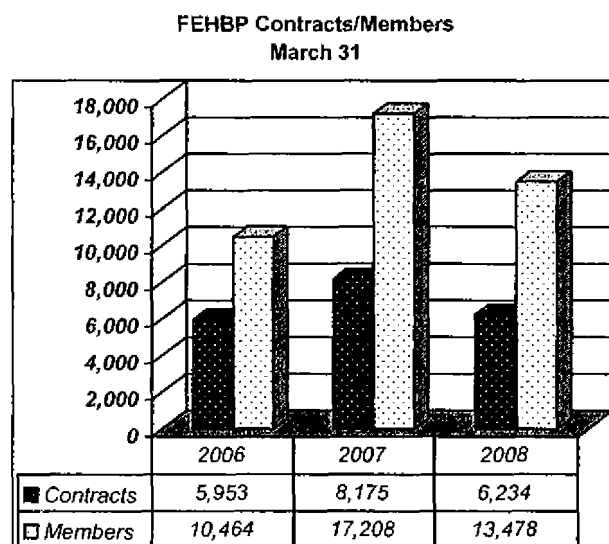
Background

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 1987 and provides health benefits to FEHBP members throughout the state of Arizona. The last audit conducted by our office covered contract years 2002 through 2005. As a result of that audit, we found that the Plan's rating of the FEHBP in contract years 2002 through 2005 was in accordance with the applicable laws, regulations, and OPM rating instructions.

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

II. OBJECTIVES, SCOPE, AND METHODOLOGY

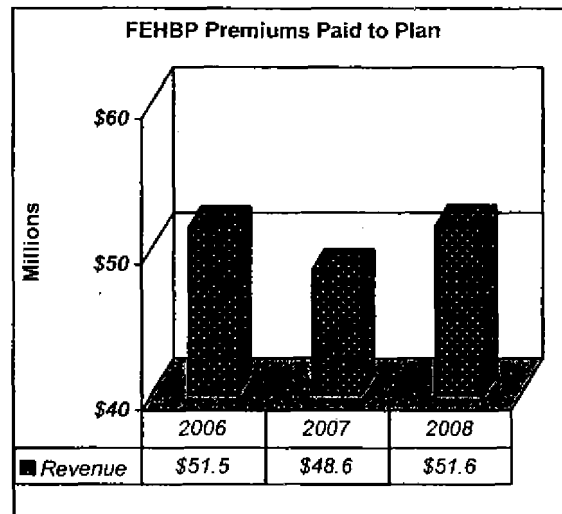
Objectives

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 2006 through 2008. For these contract years the FEHBP paid approximately \$151.7 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 Woodland Hills, California, during February 2009. Additional audit work was completed at our office in Jacksonville, Florida.

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, 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

\$69,217

The Certificate of Accurate Pricing the Plan signed for contract year 2006 was defective. In accordance with federal regulations, the Federal Employees Health Benefits Program (FEHBP) is therefore due a rate reduction for this year. Application of the defective pricing remedies shows that the FEHBP is entitled to premium adjustments totaling \$69,217 (see Exhibit A). We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's (OPM) rules and regulations in contract years 2007 and 2008.

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). If it is found that the FEHBP was charged higher than a market price (i.e., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price.

2006

In reviewing the FEHBP rates, we noted that the Plan incorrectly calculated the vision rider by applying a service industry factor (SIC) larger than what was applied to an SSSG. Based on OPM's rate instructions, the FEHBP should receive the lowest industry factor given to an SSSG. The Plan applied a [REDACTED] SIC to both SSSGs' vision rider calculations. Therefore, we re-developed the FEHBP rates by applying the [REDACTED] SIC factor to the vision rider. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$69,217 in 2006 (see Exhibit B).

Plan's Comments (See Appendix):

The Plan acknowledged OPM's re-calculation and agrees to return the overcharge of \$69,217 for 2006.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$69,217 to the FEHBP for defective pricing in contract year 2006.

2. Lost Investment Income

\$11,530

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 findings in contract year 2006. We determined that the FEHBP is due \$11,530 for lost investment income, calculated through August 31, 2009 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning September 1, 2009, until all defective pricing finding amounts have been returned to the FEHBP.

Federal Employees Health Benefits Acquisition Regulation 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.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$11,530 to the FEHBP for lost investment income for the period January 1, 2006, through August 31, 2009. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning September 1, 2009 until all defective pricing amounts have been returned to the FEHBP.

Plan's Comments (See Appendix):

The Plan did not provide any response regarding the lost investment income.

Claims Review

According to FEHBP Program Carrier Letters 2006-14 and 2007-09, the Office of Personnel Management requires all carriers to keep on file all data necessary to justify its Adjusted Community Rating (ACR) rate and save back-up copies of their claims databases for audit purposes. We reviewed FEHBP claims data for contract years 2007 and 2008. We ran queries on the claims data that relate to hospital, physician, prescription drugs, coordination of benefits, bundling of claims, and non-covered benefits according to the FEHBP benefit brochures.

1. Payment for Non-Covered Services

Our review of the 2007 and 2008 FEHBP claims data shows that the Plan paid for claims that related to elective abortion, which is a non-covered benefit according to the FEHBP benefit brochure. We queried claims data during the experience period of 2007 (January 1, 2004 through December 31, 2005) and 2008 (January 1, 2005 through December 31, 2006). We found that there were six instances of the Plan inappropriately paying for this benefit. The total paid amount was \$302 for 2007 and \$1,563 for 2008. We notified the Plan of our results and requested an explanation for payment of these claims. The Plan agreed that the abortion claims were paid erroneously. The Plan also noted that the plans (benefits) were configured incorrectly. We agree with the Plan that these claims were paid incorrectly. Additionally, the amount in question does not have a significant impact on the premium rates for 2008. We addressed this issue as a procedural issue because the Plan should not have covered the elective abortions.

Recommendation 3

We recommend that the contracting officer require the Plan to monitor its claims system that tracks elective abortions so that these claims are being reviewed and rejected as a non-covered benefit.

2. Coordination of Benefits with Medicare

To test the Plan's compliance with the FEHBP health benefit provisions related to coordination of benefits with Medicare, we selected a judgmental sample of potential uncoordinated claim lines that were identified in a computer search using SAS Enterprise Guide. We selected and reviewed 74 claims, totaling \$1,849,148 in payments, for coordination of benefits with Medicare in contract years 2007 and 2008. We notified the Plan of these potential uncoordinated claims and submitted the claim samples to the Plan for their review and response.

Generally, Medicare Part A covers 100 percent of inpatient care in hospitals, skilled nursing facilities, and hospice care. For each Medicare Benefit Period, there is a one-time deductible, followed by a daily copayment beginning with the 61st day. Beginning with the 91st day of the Medicare Benefit Period, Medicare Part A benefits may be exhausted, depending on whether the patient elects to use their Lifetime Reserve Days. For the uncoordinated Medicare Part A claims, we estimate that the FEHBP was overcharged for the total claim payment amounts. When applicable, we reduced the questioned amount by the Medicare deductible and/or Medicare copayment.

2007

The results of our tests indicate that, with respect to the items tested, the Plan did not fully comply with the provisions of the contract relative to coordination of benefits with Medicare. The auditors reviewed and summarized the Plan's responses. The Plan did not properly

coordinate a claim in 2004, totaling \$28,849, with Medicare as required by the FEHBP contract. As a result, the FEHBP paid as the primary insurer for this claim when Medicare was the primary insurer. Therefore, we estimate that the FEHBP was overcharged by \$28,849 for this claim. We removed the overpayment from the 2007 premium. The comparison showed that the overpayment did not have an effect on the premium rates for 2007. Therefore, this is a procedural issue because the Plan should have coordinated this claim with Medicare.

Recommendation 4

We recommend that the contracting officer require the Plan to ensure that they have procedures in place to review all claims incurred back to the Medicare effective dates when updated, other party liability information is added to their claims system. When Medicare eligibility is subsequently reported, the plans are expected to immediately determine if already paid claims are affected and, if so, to initiate the recovery process within 30 days.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

██████████ Auditor-In-Charge

██████████ Auditor

██████████ Auditor

██████████ Chief

██████████ Senior Team Leader

Health Net of Arizona, Inc.
Summary of Questioned Costs

Defective Pricing Questioned Costs:

Contract Year 2006 \$69,217

Lost Investment Income: \$11,530

Total Questioned Costs **\$80,747**

**Health Net of Arizona, Inc.
Defective Pricing Questioned Costs**

2006

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate			
FEHBP Line 5 - Audited Rate			
Overcharge			
To Annualize Overcharge:			
x March 31, 2006 enrollment			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Total 2006 Defective Pricing Questioned Costs			<u>\$69,217</u>

**Health Net of Arizona, Inc.
Lost Investment Income**

Year	2006	2007	2008	2009	Total
Audit Findings:					
I. Defective Pricing	\$69,217	\$0	\$0	\$0	\$69,217
<hr/>					
Totals (per year):	\$69,217	\$0	\$0	\$0	\$69,217
Cumulative Totals:	\$69,217	\$69,217	\$69,217	\$69,217	\$69,217
Avg. Interest Rate (per year):	5.4375%	5.5000%	4.9375%	5.2500%	
Interest on Prior Years Findings:	\$0	\$3,807	\$3,418	\$2,423	\$9,648
Current Years Interest:	\$1,882	\$0	\$0	\$0	\$1,882
<hr/>					
Total Cumulative Interest Calculated Through August 31, 2009:	\$1,882	\$3,807	\$3,418	\$2,423	\$11,530



Health Net

2009 AUG 17 AM 10:46

Health Net, Inc.
21650 Oxnard Street
Woodland Hills, CA 91367

August 11, 2009

[REDACTED]
Chief, Community-Rated Audits Group
Office of the Inspector General
Office of Personnel Management
1900 E Street, N.W.
Washington, D.C. 20415

Re: Draft of Audit Report No. 1C-A7-00-090-030
Health Net of Arizona, Inc.

Dear [REDACTED]

This letter and accompanying chart and exhibits are in response to the above-referenced Draft Audit Report on the Federal Employees Health Benefits Program ("FEHBP") operations at Health Net of Arizona, Inc. (the "Plan") for contract years 2006 through 2008. As discussed below, the Draft Audit Report contains a finding and recommendation that is incorrect and unsupported. As a result, the Draft Audit Report conveys an inaccurate description of the Plan's compliance with FEHBP rating requirements. Thus, Health Net believes that the Draft Audit Report requires revision before it is issued in final form.

I. PLAN RESPONSE

In this section, we summarize the findings and recommendations contained in the Draft Audit Report and any findings that we dispute. The discussion under this section is not intended to be exhaustive

A. Service Industry Factor Applied to FEHBP

For contract year 2006, the Draft Audit Report contains preliminary findings that the Plan incorrectly calculated the vision rider by applying a service industry factor (SIC) larger than what was applied to an SSSG. Specifically, the Draft Audit Report contains preliminary findings that the Plan applied a [REDACTED] SIC to both SSSGs' vision rider calculations. Therefore OPM re-developed the FEHBP rates by applying the [REDACTED] SIC factor to the vision rider.

Health Net acknowledges OPMs' re-calculation and agrees to return the overcharge of \$69,217 for 2006.



Health Net, Inc.
21650 Oxnard Street
Woodland Hills, CA 91367

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II. CONCLUSION

As discussed above and accompanying exhibits, the Draft Audit Report contains an error and unwarranted finding and recommended adjustment. We respectfully request that the OIG



Health Net

Health Net, Inc.
21650 Oxnard Street
Woodland Hills, CA 91367

reevaluate the Draft Audit Report's findings and recommendations in light of this submission and issue a final audit report that accurately reflects the Plan's rating of the FEHBP and SSSGs. Please contact the undersigned if you have any questions regarding this submission.

Sincerely,



Vice President, Corporate Actuarial

CC:Chuck Sowers, CEO, Health Net of Arizona, Inc.
Exhibits (2)