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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 the Federal Employees Health Benefits  
Program Operations of Kaiser Foundation Health  
Plan of the Northwest**

**Report No. 1C-57-00-08-028**

**Date: February 3, 2009**

-- CAUTION --

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Office of the  
Inspector General

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

**AUDIT REPORT**

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Kaiser Foundation Health Plan of the Northwest  
Contract Number 1047 - Plan Code 57  
Portland, Oregon**

Report No. 1C-57-00-08-028

Date: February 3, 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

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**EXECUTIVE SUMMARY**

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**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Kaiser Foundation Health Plan of the Northwest  
Contract Number 1047 - Plan Code 57  
Portland, Oregon**

**Report No. 1C-57-00-08-028**

**Date: February 3, 2009**

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Kaiser Foundation Health Plan of the Northwest in Portland, Oregon. The audit covered contract years 2005 through 2008 and was conducted at the Plan's office in Portland, Oregon. This report discusses the Plan's incorrect application of the medical rate adjustment factors in the development of the FEHBP's 2008 high and standard option rates. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in 2005, 2006, and 2007.

We determined that the FEHBP's rates were overstated by \$259,816 in contract year 2008 because the Plan applied incorrect medical rate adjustment factors in the development of the FEHBP's 2008 high and standard option rates. However, because the Plan applied additional credit adjustments to the FEHBP's high and standard option rates, no additional costs are due 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 Kaiser Foundation Health Plan of the Northwest (Plan). The audit covered contract years 2005 through 2008 and was conducted at the Plan's office in Portland, Oregon. The audit was conducted pursuant to the provisions of Contract CS 1047; 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.

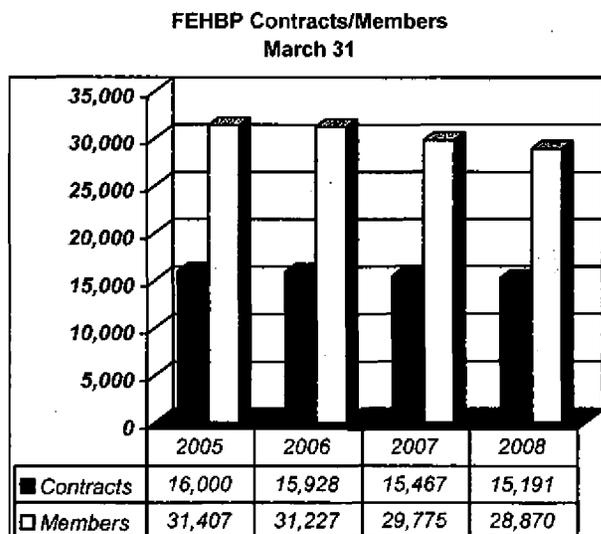
## Background

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 1960 and provides health benefits to FEHBP members throughout Portland and Salem, Oregon, and throughout Vancouver and Longview, Washington. The last full-scope audit covered contract years 2000 through 2004. All noted exceptions were resolved and amounts questioned were returned to OPM.

The preliminary results of this audit were discussed with Plan officials at an exit conference. A draft report was also provided to the Plan for review and comment. The Plan's response to the draft report contained sufficient documentation to resolve the draft report's findings.

## II. OBJECTIVES, SCOPE, AND METHODOLOGY

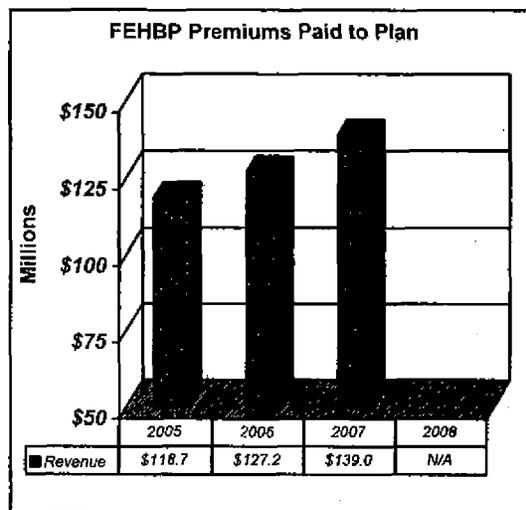
### Objectives

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 2005 through 2008. For contract years 2005 through 2007, the FEHBP paid approximately \$385 million in premiums to the Plan<sup>1</sup>. 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.

<sup>1</sup> The Subscription Income Report for 2008 was not available at the time this report was completed.

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 Portland, Oregon, during August 2008. Additional audit work was completed at our office in 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, 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 FINDING AND RECOMMENDATION**

#### **Premium Rates**

##### **1. Defective Pricing**

**\$259,816**

The Certificate of Accurate Pricing the Plan signed in 2008 was defective. In accordance with federal regulations, the FEHBP is therefore due a price adjustment for that year. Application of the defective pricing remedy shows that the FEHBP is entitled to a premium adjustment totaling \$259,816 (see Exhibit B). We found that the FEHBP rates were developed in accordance with OPM's rules and regulations for contract years 2005, 2006, and 2007.

#### **2008**

Our audit shows that the Plan applied incorrect medical rate adjustment factors (RAFs) in the FEHBP's 2008 rate development. During our claims review, we determined that the Plan included [REDACTED] in the [REDACTED] experience. As a result, the medical RAFs were overstated. In the 2008 reconciliation, the Plan applied medical RAFs of [REDACTED] for the high option and [REDACTED] for the standard option. After removing the [REDACTED] the revised medical RAFs are [REDACTED] for the high option and [REDACTED] for the standard option. As a result, the FEHBP rates were overstated by \$259,816. However, because the Plan applied additional credit adjustments to FEHBP's high and standard option rates, no additional costs are due the FEHBP.

#### **Plan's Comments (See Appendix):**

The Plan states that the amount questioned by the auditors (plus lost investment income) is offset by an additional discount given to the FEHBP in 2008. The Plan agrees no money is due the FEHBP because of credit adjustments the Plan gave the FEHBP which exceeded the amount questioned in 2008.

#### **Recommendation**

Since we verified that the additional credits the Plan included in the FEHBP's 2008 rates offset the \$259,816 overcharge, no further action is required.

## **IV. MAJOR CONTRIBUTORS TO THIS REPORT**

### **Community-Rated Audits Group**

██████████ Auditor-In-Charge

██████████ Auditor

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██████████ Chief

██████████ Senior Team Leader

**Kaiser Foundation Health Plan of the Northwest  
Summary of Questioned Costs**

**Defective Pricing Questioned Costs:**

Contract Year 2008	\$259,816
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Total Defective Pricing Questioned Costs	<u>\$259,816</u>
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**Kaiser Foundation Health Plan of the Northwest  
Defective Pricing Questioned Costs**

**2008**

**High Option**

FEHBP Line 5 - Reconciled Rate  
FEHBP Line 5 - Audited Rate

Self

Family

Overcharge

To Annualize Overcharge:

x 3/31/08 enrollment

x Pay Periods

Subtotal

	<u>Self</u>	<u>Family</u>
FEHBP Line 5 - Reconciled Rate		
FEHBP Line 5 - Audited Rate		
Overcharge		

	<u>26</u>	<u>26</u>

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**\$121,429**

**Standard Option**

FEHBP Line 5 - Reconciled Rate  
FEHBP Line 5 - Audited Rate

Overcharge

To Annualize Overcharge:

x 3/31/08 enrollment

x Pay Periods

Subtotal

FEHBP Line 5 - Reconciled Rate		
FEHBP Line 5 - Audited Rate		
Overcharge		

	<u>26</u>	<u>26</u>

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**\$138,387**

Total 2008 Defective Pricing Questioned Costs

**\$259,816**

January 9, 2009

*Via E-mail*

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

Re: Kaiser Foundation Health Plan of the Northwest  
Response to Draft of a Proposed Report 1C-57-00-08-028 (December 8, 2008)

Dear ██████████

This letter responds to your correspondence of December 8, 2008, which enclosed a Draft Report on the operations of Kaiser Foundation Health Plan of the Northwest ("Carrier") for contract years 2005 through 2008 under the FEHBP ("Draft Report"). As we have discussed with Auditor-In Charge ██████████ this response resolves the concerns outlined in the Draft Report.

The Draft Report requested reimbursement of \$259,816 (plus lost investment income) because the Carrier's medical rate adjustment factors (RAFs) for 2008 incorrectly included ██████████ in the ██████████ experience. As the Carrier subsequently pointed out to the auditors, this amount is more than offset by the discount that the Carrier gave FEHBP for 2008. See attached document entitled "Discount Calculation Using Revised RAFs" ("Discount Calculation" tab of the Excel spreadsheet and "Summary without Discount" tab, footnote 1b). In aggregate, the Carrier's FEHBP discount for 2008 totals more than \$ ██████████

As agreed with ██████████ because the FEHBP discount completely offsets the concerns raised in the Draft Audit Report, the final report will be clean.

This response contains commercial and financial information that is proprietary and confidential to the Carrier. Disclosure of this information would cause substantial harm to the Carrier's competitive position. OPM is requested to treat this document as confidential. This material is exempt from disclosure under Section 552(b)(4) of Title 5 of the United States Code.

[REDACTED]  
January 9, 2009  
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Please do not hesitate to contact me if you have any questions or need any additional information. You can reach me at [REDACTED] Thank you.

Sincerely,

[REDACTED]

Attachment

cc:

[REDACTED]  
Chief, Insurance Group III  
OPM Insurance Program Services

[REDACTED]  
Lead Auditor, Community Rated Audits Group

[REDACTED]  
Kaiser Foundation Health Plan of the Northwest