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

Final Audit Report

Subject:

AUDIT OF THE FEDERAL EMPLOYEE GROUP LIFE INSURANCE PROGRAM OPERATIONS AT METROPOLITAN LIFE INSURANCE COMPANY

Report No. 2A-II-00-07-017

Date: December 15, 2008

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UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

AUDIT REPORT

Federal Employee Group Life Insurance Program
Contract No. 17000-G

Metropolitan Life Insurance Company
Jersey City, New Jersey

Report No. 2A-II-00-07-017 **Date: December 15, 2008**

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 Employee Group Life Insurance Program
Contract No. 17000-G

Metropolitan Life Insurance Company
Jersey City, New Jersey

Report No. 2A-II-00-07-017 **Date: December 15, 2008**

This report details the results of our audit of the Federal Employees Group Life Insurance (FEGLI) Program operations at the Metropolitan Life Insurance Company (MetLife). The audit covered claim benefits payments for fiscal year 2006, and miscellaneous payments and administrative expenses for fiscal years 2005 and 2006 as reported in the FEGLI Program financial statements. The report questions $465,336 in administrative expenses. Lost investment income on the questioned costs subject to lost investment income amounts to $72,129. Additionally, MetLife is commingling FEGLI cash and investment funds with its corporate cash and investment funds.

The questioned items are summarized below.

ADMINISTRATIVE EXPENSES

- **Depreciation Adjustment** **$292,367**

  MetLife did not credit FEGLI with a portion of the gain made on the sale of a building that housed FEGLI operations from 1954 through 1993.

- **Pension Expense** **$151,885**

MetLife did not calculate pension costs in accordance with the Federal regulations for 2005.

- **Limits on Executive Compensation** **$21,084**

MetLife overcharged the FEGLI Program $21,084 for executive compensation in 2005.

CASH MANAGEMENT

- **Commingling of Funds**

MetLife is commingling FEGLI cash and investment funds with its corporate cash and investment funds.

LOST INVESTMENT INCOME

The FEGLI Program is due $72,129 for lost investment income on the findings presented in the report that are subject to the recovery of lost investment income.

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I. INTRODUCTION AND BACKGROUND

INTRODUCTION

This report details the results of our audit of the Federal Employees' Group Life Insurance Program (FEGLI or Program) operations at the Metropolitan Life Insurance Company (MetLife) in Jersey City, New Jersey. 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 FEGLI Program was created in 1954 by the Federal Employees' Group Life Insurance Act (P.L. 83-598). OPM's Center for Retirement and Insurance Services (CRIS) has overall responsibility for administering the Program, including the publication of program regulations and agency guidelines; and the receipt, payment, and investment of agency withholdings and contributions. CRIS contracts with MetLife to provide life insurance coverage to employees, annuitants, and their family members (Contract No. 17000-G). Employee agencies are responsible for enrolling, informing and advising employees of program changes, determining eligibility, maintaining insurance records, withholding premiums from pay, remitting and reporting withholdings to OPM, and certifying salary and insurance coverage upon separation or death.

MetLife's responsibilities under the contract are carried out by the Office of FEGLI (OFEGLI), a separate unit of MetLife, which is located in Jersey City, New Jersey. OFEGLI is supervised by MetLife's Group Insurance Department. OPM's Insurance Services Programs office administers the contract with OFEGLI.

Compliance with laws and regulations applicable to the FEGLI Program is the responsibility of MetLife's management. Also, management of MetLife is responsible for establishing and maintaining a system of internal controls.

Our previous audit of MetLife (Report Number 2A-II-00-05-045, dated January 31, 2006), covered claim payments for fiscal year 2004, claim overpayments, administrative expenses and cash management policies and procedures for fiscal years 2000 through 2004. All findings questioned in this report were satisfactorily resolved.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES

The objectives of our audit were to determine whether MetLife charged costs to the FEGLI Program and provided services to FEGLI Program subscribers in accordance with the terms of the contract. Specifically, our objectives were as follows:

Benefits Charges

- To determine whether MetLife complied with the contract provisions relative to benefit payments.
- To determine whether overpayment recoveries were returned promptly to the FEGLI Program. Also, to determine whether MetLife made diligent efforts to recover overpayments.

Cash Management

- To determine whether MetLife handled FEGLI Program funds in accordance with applicable laws and regulations concerning cash management in the FEGLI Program.

Administrative Expenses

- To determine if the administrative expenses charged to the FEGLI Program were actual, necessary, and reasonable expenses incurred in accordance with the terms of the contract and applicable regulations.

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 audit findings and conclusions based on the 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 FEGLI Program financial statements for fiscal years 2005 and 2006. During this period, benefit charges totaled approximately $4.4 billion and administrative expenses totaled $16.9 million. Specifically, we reviewed claim payments in fiscal year 2006. We also reviewed claim overpayments, administrative expenses, and cash management activities for fiscal years 2005 and 2006.

In conducting the audit, we reviewed approximately $29,268,800 in claim payments made from October 1, 2005 through September 30, 2006, for proper adjudication. We also reviewed $3,645,572 in claim overpayments, $16,797,628 in administrative expenses and $850,151,372 in letter of credit (LOC) drawdowns for compliance with cash management policies and procedures.

We obtained an understanding of MetLife'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 MetLife'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 MetLife's system of internal controls taken as a whole.

We also conducted tests to determine whether MetLife had complied with the contract, the applicable procurement regulations (i.e., Federal Acquisition Regulations and Federal Employees Group Life Insurance Federal Acquisition Regulations, as appropriate), and the laws and regulations governing the FEGLI Program. 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 MetLife 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 MetLife. Due to time constraints, we did not verify the reliability of the data generated by MetLife's information systems. However, while utilizing the computer-generated data during audit testing, nothing came to our attention to cause us to doubt its reliability. We believe that the data was sufficient to achieve the audit objectives.

The audit was performed at MetLife's office in Jersey City, New Jersey from April 2, 2007 through April 27, 2007.

METHODOLOGY

To test MetLife's compliance with the contract provisions relative to claim payments, we selected and reviewed a judgmental sample of the 100 highest dollar value claims from a universe of 96,147 claims. Of the $2,233,934,034 in claim payments made from October 1, 2005 through September 30, 2006, we reviewed a total of $29,268,800. We also reviewed MetLife's case files and determined if the necessary documents were provided and if these claims were correctly calculated and paid.

To test MetLife's compliance regarding claim overpayments, we selected a judgmental sample of the 35 highest overpayment recoveries in fiscal years 2005 and 2006 (for a total of 70 overpayment recoveries), and reviewed MetLife's accounting records to determine if these recoveries were properly processed and timely returned to the FEGLI Program. The 70 overpayment recoveries we reviewed represented $3,645,752 of a total of $4,308,787 in recoveries.

To determine if administrative expenses were actual, necessary, and reasonable, we selected 15 natural accounts out of 98 natural expense accounts for potential review. Natural accounts are expense accounts (i.e. Rent, Utilities, etc.) that support the FEGLI program cost centers. The accounts were selected based on highest dollar amount and account name. From the 15 natural accounts, we selected 30 invoices for a detailed review based on the highest monthly transaction amounts. For each natural account, the month with the highest transaction amount was reviewed. We also reviewed each account description to ensure that only allowable costs were charged to the account. The 15 accounts represented $2,824,165 of the $11,225,947 charged to 98 natural expense accounts for fiscal years 2005 and 2006.

In addition, we selected and reviewed MetLife's LOC drawdowns to determine whether MetLife handled FEGLI Program cash in accordance with Contract No. 17000-G and applicable laws and regulations. To accomplish this, we selected and reviewed 92 LOC drawdown transactions that occurred during the months of March and June of 2005, and March and August of 2006. The 92 LOC drawdown samples represented $850,151,402 of the total of $4,394,936,299 in LOC drawdown transactions occurring during fiscal years 2005 and 2006.

Because the samples we selected and reviewed in performing the audit were not statistically based, the results could not be projected to the universe since it is unlikely that the results are representative of the universe taken as a whole.

We used the FEGLI Program contract; the Federal Acquisition Regulations; and the Federal Employees Group Life Insurance Federal Acquisition Regulations to determine allowable, allocable, and reasonable administrative expenses charged against the contract.

The results of the audit were provided to MetLife in written inquiries and were discussed with MetLife officials throughout the audit and at the exit conference. In addition, a draft report, dated April 17, 2008, was provided to MetLife for review and comment. MetLife's comments to the draft report were considered in preparing the final report and are included as an Appendix to this report.

III. AUDIT FINDINGS AND RECOMMENDATIONS

A. BENEFITS CHARGES

The results of our review showed that MetLife:

- Properly calculated and paid claims in fiscal year 2006; and
- Properly processed overpayment recoveries and timely returned the funds to the FEGLI program during fiscal years 2005 and 2006.

B. ADMINISTRATIVE EXPENSES

1. Depreciation Adjustment $292,367

MetLife did not credit FEGLI with a portion of the gain made on the sale of a building that housed FEGLI operations from 1954 through 1993. During this period FEGLI was charged depreciation for the occupied space. According to federal regulations, a gain from such a sale requires an adjustment of depreciation costs previously charged to the contract. FEGLI is due $292,367 for this adjustment.

Starting in 1954 and continuing through 1993, MetLife's FEGLI operations were conducted at One Madison Avenue in New York City. FEGLI occupied 10,000 square feet of the building's 1.4 million square feet. Although MetLife had fully depreciated the building before 1954, several improvements were made to the building while occupied by FEGLI. Part of the depreciation for these improvements was charged to FEGLI.

In 2005, MetLife sold One Madison Avenue for a gain. According to federal regulations, FEGLI is entitled to recover the depreciation it was charged during its period of occupancy. Specifically, 48 CFR 31.205-16 states that gains and losses from the sale, retirement, or distribution of depreciable property shall be included in the year it occurs as credits or charges to the cost grouping in which the depreciation or amortization applicable to those assets was included. It further states that gains and losses are considered to be adjustments of depreciation cost previously recognized. At the time of our audit, MetLife had not reimbursed FEGLI for the depreciation it was charged for the building.

MetLife performed an analysis, based on available information, to determine the amount of depreciation charged to FEGLI from 1954 through 1993. The estimate is based on FEGLI's percentage of occupancy (0.71 percent) at One Madison Avenue, applied against the total amount depreciated in each year. Based on our review of MetLife's calculations, we agree that FEGLI was charged $292,367 for depreciation during its period of occupancy. Therefore, we believe MetLife should credit FEGLI for this amount.

MetLife Comments:

MetLife contends that an adjustment to a previously closed accounting period is inconsistent with FEGLI regulations and contract provisions. However, it will not contest the audit finding.

OIG Comments:

We maintain our position that MetLife must credit the Program $292,367 for depreciation charged to the FEGLI Program during its periods of occupancy.

Recommendation 1

We recommend that the contracting officer require MetLife to credit the FEGLI Program $292,367 for depreciation expense charged to the program from 1954 through 1993.

2. Pension Expense **$151,885**

MetLife did not calculate pension costs in accordance with the Federal regulations for fiscal year 2005. As a result, FEGLI was overcharged $151,885.

48 CFR 31.205-6(j)(2) states, "The cost of all defined-benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of 48 CFR 9904.412, Cost accounting standard for composition and measurement of pension cost, and 48 CFR 9904.413, Adjustment and allocation of pension cost. The costs of all defined-contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of 48 CFR 9904.412 and 48 CFR 9904.413. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth in paragraph (j)(2)(i) and paragraph (j)(3) through (8) of this subsection." The regulations limit the amount of pension costs that may be charged to a government contract to:

- the amount of any cash contribution to the pension fund trustee, or
- the amount of expense calculated in accordance with CAS 412 and 413, whichever is lower.

If the cash contributions exceed the amount of expense calculated according to CAS 412 and 413, the excess contribution is considered a pre-funding of the pension plan. Amounts pre-funded may not be charged in future years when the cash contribution is lower than the CAS 412 and 413 expense calculation.

MetLife allocated a net amount of $381,243 ($529,652 less an adjustment of $148,409) for pension expenses to the FEGLI Program in 2005. We recalculated the pension costs by multiplying the lesser of the funded or CAS amount by the FEGLI's corporate allocation percentage (0.46%) and determined that only $229,358 should have been allocated to the Program. Therefore, the FEGLI Program was overcharged $151,885 in fiscal year 2005.

MetLife Comments:

MetLife agrees with this finding. In the future, it will limit pension costs allocated to the program in accordance with the applicable regulation.

Recommendation 2

We recommend that the contracting officer ensure that MetLife returns $151,885 in pension costs that were over-allocated to the FEGLI Program for fiscal year 2005.

3. Limits on Executive Compensation — $21,084

MetLife overcharged the FEGLI Program $21,084 for executive compensation in 2005.

48 CFR 31.205-6(p) limits the allowability of compensation for certain contractor personnel and limits the allowable compensation costs for senior executives to a benchmark amount established each year by the Office of Federal Procurement Policy. For 2005, the benchmark compensation amount limit was $473,318 and was applicable to the five most highly compensated employees in executive positions.

We reviewed the executive compensation MetLife charged to FEGLI in 2005 to determine if the allocated amount exceeded the benchmark compensation limit set by the Office of Federal Procurement Policy. We found that the charges exceeded the limit by $21,084.

MetLife Comments:

MetLife agrees with this finding. In the future, it will limit executive compensation costs allocated to the program in accordance with the applicable regulation.

Recommendation 3

We recommend that the contracting officer ensure that MetLife returns $21,084 in executive compensation costs charged to FEGLI in 2005.

C. CASH MANAGEMENT

1. Commingling of Funds

MetLife is commingling FEGLI cash and investment funds with its corporate cash and investment funds. As a result, FEGLI assets are not separately identifiable from the other assets controlled by MetLife.

According to 48 CFR 2152.232-71, Non-commingling of FEGLI Program funds, "(a) The Contractor must maintain FEGLI Program funds in such a manner as to be separately identifiable from other assets of the Contractor." However, if accounting techniques have been established to clearly measure FEGLI cash and investments, the regulations provide that a contractor can request the contracting officer to approve a modification of this provision.

In an April 12, 1996 letter, OPM informed MetLife that it concurred with its practice of investing FEGLI monies in an investment pool with other MetLife funds. OPM stated that it did not intend to preclude the procedures MetLife used to invest FEGLI funds and that the allocation of investment income appeared reasonable and equitable.

MetLife's investment objective is to provide liquidity and generate income while minimizing the erosion of the principal. MetLife's FEGLI investments generally mature within a year and are maintained in a money market pool that is not specific to FEGLI. Income from the investments represents allocations from MetLife's general account based on FEGLI's proportionate investment contribution balance for each investment year. The allocated amounts do not represent separately identifiable assets as called for in the FEGLI regulations. In addition, FEGLI cash is in a commingled MetLife investment pool. Confirming FEGLI cash with an independent source is also not possible.

MetLife's independent auditors also reported a concern with the commingling of FEGLI investment funds with other MetLife assets. In a management letter to MetLife concerning its audit of the FEGLI financial statements for fiscal year 2006, the auditors stated that "The short-term investment liquidity pool is not specific to the Program but represents cumulative daily cash transactions for the company allocated using prorates established to ascertain that total ledger debits equals credits for the line of business. As a result, these allocated amounts do not represent separately identifiable assets of the Program as required by the Life Insurance Federal Acquisition Regulations."

According to MetLife, establishing separately identifiable bank accounts and money market pools for FEGLI would diminish the flexibility of the investment manager and possibly result in diminished returns. While we agree that this could happen, we are generally opposed to the commingling of OPM and contractor assets.

In responding to an audit inquiry on this issue, MetLife said that it should have either established "separately identifiable segments within bank accounts and money market pools for cash and short-term investments of the Program and establish procedures to reconcile to bank statements and supporting documentation on a periodic basis," or obtained the contracting officers concurrence that a contract deviation is warranted.

MetLife Comments:

MetLife said that they are currently reviewing its management of FEGLI assets. In addition, they added that they will discuss this issue with the FEGLI Program Contracting Officer and take whatever appropriate action is directed by them.

OIG Comments:

We believe that OPM's contracting officer should reevaluate MetLife's investment procedures that were approved in 1996, in light of the situation existing today, to determine if approval of the procedures is still warranted. In addition, MetLife should take steps to change its procedures to ensure FEGLI funds are not commingled with the MetLife investment pool.

Recommendation 4

We recommend that the contracting officer analyze MetLife's procedures for handling FEGLI cash and investments to determine if OPM's approval of the procedures is still warranted. If the procedures are acceptable, the contracting officer should determine if a modification of the regulation requiring a contractor to maintain FEGLI funds in a manner as to be separately identifiable from other contractor assets is needed.

D. LOST INVESTMENT INCOME $72,129

The FEGLI Program is due $72,129 for lost investment income on the findings subject to the recovery of lost investment income.

48 CFR 2152.210-70 requires the contractor to invest and reinvest all excess FEGLI Program funds on hand, and to credit all investment income earned on those funds to the FEGLI Program. When the contractor fails to comply with these requirements, the contractor shall credit the FEGLI Program with investment income that would have been earned at the rates specified by the Secretary of the Treasury.

We computed investment income that would have been earned using the semiannual rates specified by the Secretary of the Treasury. The computations show that the Program is due $72,129 for lost investment income, calculated for the period from January 1, 2006 through September 30, 2008, on the applicable questioned costs.

OIG Comments:

The draft report did not include a section covering lost investment income on the audit findings. Therefore, MetLife did not address lost investment income in commenting on the draft report.

Recommendation 5

We recommend that the contracting officer direct MetLife to credit the FEGLI Program $72,129, plus interest accruing after September 30, 2008, for lost investment income.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Special Audits Group

[redacted], Auditor-In-Charge

[redacted], Auditor

[redacted] Auditor

Jill S. Henderson, Deputy Assistant Inspector General for Management [redacted]

[redacted], SAG Group Chief [redacted]

[redacted], Senior Team Leader

SCHEDULE A

METROPOLITAN LIFE INSURANCE COMPANY
JERSEY CITY, NEW JERSEY

CONTRACT COSTS AND QUESTIONED CHARGES

CONTRACT COSTS	2005	2006	TOTAL
A. BENEFITS CHARGES	$2,139,015,234	$2,271,582,494	$4,410,597,728
B. ADMINISTRATIVE EXPENSES	$8,430,859	$8,461,553	$16,892,412
TOTAL CONTRACT CHARGES	$2,147,446,093	$2,280,044,047	$4,427,490,140

QUESTIONED CHARGES	2005	2006	2007	2008	TOTAL
A. BENEFITS CHARGES	$0	$0	$0	$0	$0
B. ADMINISTRATIVE EXPENSES	$465,336	$0	$0	$0	$465,336
C. CASH MANAGEMENT	$0	$0	$0	$0	$0
D. LOST INVESTMENT INCOME	$0	$25,645	$27,374	$19,110	$72,129
TOTAL QUESTIONED CHARGES	$465,336	$25,645	$27,374	$19,110	$537,465

Schedule B

METROPOLITAN LIFE INSURANCE COMPANY
JERSEY CITY, NEW JERSEY

QUESTIONED CHARGES

QUESTIONED CHARGES	FY 2005	FY 2006	FY 2007	FY 2008	Total
A. BENEFITS CHARGES	$0	$0	$0	$0	$0
B. ADMINISTRATIVE EXPENSES					
1. Depreciation Adjustment	$292,367	$0	$0	$0	$292,367
2. Pension Expense	$151,885	$0	$0	$0	$151,885
3. Limits on Executive Compensation	$21,084	$0	$0	$0	$21,084
TOTAL ADMINISTRATIVE EXPENSES	$465,336	$0	$0	$0	$465,336
C. CASH MANAGEMENT					
1. Commingling of Funds (Procedural)	$0	$0	$0	$0	$0
TOTAL CASH MANAGEMENT	$0	$0	$0	$0	$0
D. LOST INVESTMENT INCOME	$0	$25,645	$27,374	$19,110	$72,129
TOTAL QUESTIONED CHARGES	$465,336	$25,645	$27,374	$19,110	$537,465

SCHEDULE C

METROPOLITAN LIFE INSURANCE COMPANY
JERSEY CITY, NEW JERSEY
LOST INVESTMENT INCOME CALCULATION
(from January 2006 through September 30, 2008)

	2005	2006	2007	2008	Total
QUESTIONED CHARGES (Subject to Lost Investment Income)					
ADMINISTRATIVE EXPENSE CHARGES					
1. Depreciation Adjustment	$292,367	$0	$0	$0	$292,367
2. Pension Costs	$151,885	$0	$0	$0	$151,885
3. Limits on Executive Compensation	$21,084	$0	$0	$0	$21,084
TOTAL	$465,336	$0	$0	$0	$465,336
LOST INVESTMENT INCOME CALCULATION					
a. Prior Year's Total Questioned (Principal)	$0	$465,336	$0	$0	$465,336
b. Cumulative Total (k)	$0	$0	490,981	518,355	
c. Total	$0	$465,336	$490,981	$518,355	
d. Treasury Rate: January 1 - June 30	4.250%	5.125%	5.250%	4.750%	
e. Interest (d * c)	$0	$11,924	$12,888	$12,311	$37,123
f. Total (c)	$0	$465,336	$490,981	$518,355	
g. Total (e + f)	$0	$477,260	$503,869	$530,666	
h. Treasury Rate: July 1 - December 31	4.500%	5.750%	5.750%	5.125%	
i. Interest (h * g)	$0	$13,721	$14,486	$6,799	$35,006
j. Total (g)	$0	$477,260	$503,869	$530,666	
k. Cumulative Total (Principal + Interest)	$0	$490,981	$518,355	$537,465	
Total Interest by Year (e + i)	$0	$25,645	$27,374	$19,110	$72,129

MetLife®

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[redacted]
Director
Client Services

September 10, 2008

[redacted]
Chief - Special Audits Group
U.S. Office of Personnel Management
1900 E Street NW, Rm. 6400
Washington, DC 20415-1100

RE: <u>FEGLI Audit Draft Report</u>

Dear Ms. May:

The following is our response to the four audit findings contained in the draft report dated April 17, 2008.

1. <u>Depreciation Adjustment</u>:

   As discussed, we believe that an adjustment to a previously closed accounting period is inconsistent with FEGLI regulations and contract provisions. However, we would not contest the Contracting Officer's recommendation for MetLife to reimburse the FEGLI program for these costs.

2. <u>Pension Expense/Costs</u>:

   We are in agreement with the recommendation presented and going forward we will limit pension costs allocated to the FEGLI program in accordance with the applicable regulation.

3. <u>Executive Compensation</u>:

   We are in agreement with the recommendation presented and going forward we will limit executive compensation costs allocated to the FEGLI program in accordance with the applicable regulation.

4. <u>Commingling of Funds</u>:

   MetLife is currently reviewing its management of FEGLI assets. We will be discussing this issue with the FEGLI Program Contracting Officer and will take whatever appropriate action as directed by them.

   If you have any questions, please let me know.

   Sincerely,

[redacted]