



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 Kaiser Foundation Health
Plan of the Mid-Atlantic States, Inc.**

Report No. 1C-E3-00-09-010

Date: August 6, 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 Mid-Atlantic States, Inc.
Contract Number 1763 - Plan Code E3
Rockville, Maryland**

Report No. 1C-E3-00-09-010

Date: August 6, 2009

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

EXECUTIVE SUMMARY

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Contract Number 1763 - Plan Code E3
Rockville, Maryland**

Report No. 1C-E3-00-09-010

Date: August 6, 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 Mid-Atlantic States, Inc. (Plan). The audit covered contract years 2006 through 2008 and was conducted at the Plan's office in Rockville, Maryland. This report questions \$7,545,775 for defective pricing in 2006 through 2008, including \$919,280 for related lost investment income.

For contract years 2006 through 2008, the Plan initially supplied the incorrect membership data for the FEHBP. We developed our audited rates using the correct membership data provided by the Plan. As a result, we determined that the FEHBP's rates were overcharged by \$2,593,923 in 2006 and \$4,810,121 in 2007. However, we determined that the Plan should be credited \$777,549 in 2008. The amount credited to the Plan in 2008 will be deducted from the total amounts due the FEHBP in 2006 and 2007.

Consistent with the FEHBP regulations and the contract, the FEHBP is due \$919,280 for lost investment income, calculated through June 30, 2009, on the defective pricing findings. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning July 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 Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. (Plan) in Rockville, Maryland. The audit covered contract years 2006 through 2008. The audit was conducted pursuant to the provisions of Contract CS 1763; 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.

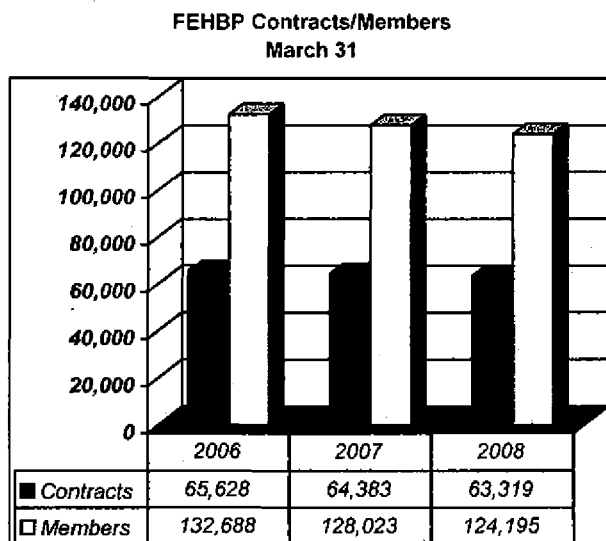
Background

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 1975 and provides health benefits to FEHBP members in Metropolitan Washington, D.C. and Metropolitan Baltimore, Maryland. The last audit conducted by our office covered contract years 2000 and 2002 through 2005. 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 and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan agrees with our findings.

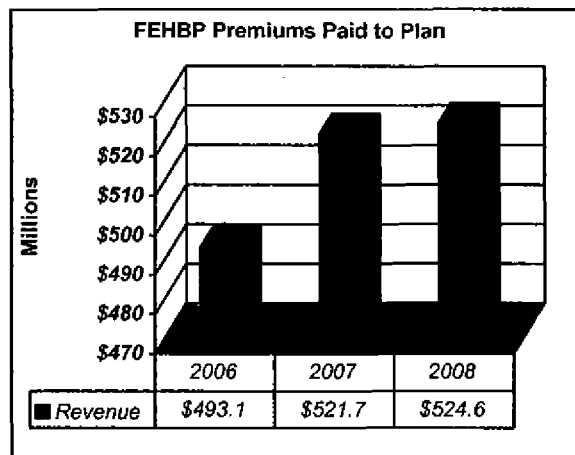
II. OBJECTIVES, SCOPE, AND METHODOLOGY

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 2006 through 2008. For these contract years the FEHBP paid approximately \$1.5 billion 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 Rockville, Maryland during October and November 2009. 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 (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

\$6,626,495

The Certificates of Accurate Pricing the Plan signed for contract years 2006, 2007, and 2008 were defective. In accordance with federal regulations, the FEHBP is therefore due a price adjustment for 2006 and 2007 and owes the Plan a rate increase for 2008. Application of the defective pricing remedies shows that the FEHBP is entitled to premium adjustments totaling \$6,626,495 (see Exhibit A).

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 an 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 through 2008

We agreed with the Plan's SSSG selections for all years under review. We verified that the largest SSSG discount was applied to the FEHBP rates in each year.

Our analysis of the rates charged to the FEHBP shows that the Plan used incorrect enrollment data in its original rate development. Prior to the release of our draft report, the Plan disclosed these errors and provided the corrected FEHBP enrollment data. As a result, we found that the FEHBP rates were overstated by \$2,593,923 for contract year 2006, \$4,810,121 for contract year 2007, and understated \$777,549 for contract year 2008 (see Exhibit B).

Recommendation 1

We recommend that the contracting officer require the Plan to return \$6,626,495 to the FEHBP for defective pricing in contract years 2006 through 2008.

2. Lost Investment Income

\$919,280

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 due the FEHBP in contract years 2006 and 2007. We determined that the FEHBP is due \$919,280 for lost investment income, calculated through June 30, 2009 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning July 1, 2009, 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.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$919,280 to the FEHBP for lost investment income for the period January 1, 2006 through June 30, 2009. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning July 1, 2009, until all defective pricing amounts have been returned to the FEHBP.

Plan's Comments

The Plan agrees with the findings.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

██████████ Auditor-In-Charge

██████████ Auditor

██████████ Acting Group Chief

██████████ Senior Team Leader

**Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Summary of Questioned Costs**

Defective Pricing Questioned Costs:

Contract Year 2006	\$2,593,923
Contract Year 2007	\$4,810,121
Contract Year 2008	<u>(\$777,549)</u>
Total Defective Pricing Questioned Costs	\$6,626,495
Lost Investment Income	<u>\$919,280</u>
Total Questioned Costs	<u>\$7,545,775</u>

**Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
 Defective Pricing Questioned Costs**

2006 Contract Year

High Option

	<u>Single</u>	<u>Family</u>	
Plan's Reconciled Rates			
Audited Rates			
Biweekly Overcharge			
To Annualize:			
x March 31, 2006 Headcount			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Amount Due FEHBP in 2006			\$2,840,333

Standard Option

	<u>Single</u>	<u>Family</u>	
Plan's Reconciled Rates			
Audited Rates			
Biweekly Undercharge			
To Annualize:			
x March 31, 2006 Headcount			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Amount Due Plan in 2006			(\$246,410)

Total 2006 Defective Pricing Questioned Costs \$2,593,923

**Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
 Defective Pricing Questioned Costs**

2007 Contract Year

High Option

Plan's Reconciled Rates
 Audited Rates
 Biweekly Overcharge
 To Annualize:
 x March 31, 2007 Headcount
 x Pay Periods
 Subtotal
 Amount Due FEHBP in 2007

Single Family

	26	26

\$4,616,805

Standard Option

Plan's Reconciled Rates
 Audited Rates
 Biweekly Overcharge
 To Annualize:
 x March 31, 2007 Headcount
 x Pay Periods
 Subtotal
 Amount Due FEHBP in 2007

Single Family

	26	26

\$193,316

Total 2007 Defective Pricing Questioned Costs

\$4,810,121

**Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Defective Pricing Questioned Costs**

2008 Contract Year

High Option

	<u>Single</u>	<u>Family</u>	
Plan's Reconciled Rates			
Audited Rates			
Biweekly Undercharge			
To Annualize:			
x March 31, 2008 Headcount			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Amount Due Plan in 2008			(\$732,326)

Standard Option

	<u>Single</u>	<u>Family</u>	
Plan's Reconciled Rates			
Audited Rates			
Biweekly Undercharge			
To Annualize:			
x March 31, 2008 Headcount			
x Pay Periods	<u>26</u>	<u>26</u>	
Subtotal			
Amount Due Plan in 2008			(\$45,223)

Total 2008 Defective Pricing Questioned Costs (\$777,549)

Total Defective Pricing Questioned Costs \$6,626,495


**Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Lost Investment Income**

Year	2006	2007	2008	2009	Total
Audit Findings:					
Defective Pricing	\$2,593,923	\$4,810,121	\$0	0	\$7,404,044
<hr/>					
Totals (per year):	\$2,593,923	\$4,810,121	\$0	\$0	\$7,404,044
Cumulative Totals:	\$2,593,923	\$7,404,044	\$7,404,044	\$7,404,044	\$7,404,044
Average Annual Interest Rate:	5.4375%	5.5000%	4.9375%	5.6250%	
Interest on Prior Years Findings:	\$0	\$142,666	\$365,575	\$208,239	\$716,480
Current Years Interest:	\$70,522	\$132,278	\$0	\$0	\$202,800
Total Cumulative Interest Through June 30, 2009	\$70,522	\$274,944	\$365,575	\$208,239	\$919,280



June 8, 2009

Sent via E-mail and First Class Mail


Chief, Community-Rated Audits Group
Office of Inspector General, Room 6400
US Office of Personnel Management
1900 E Street, NW
Washington, DC 20415-1100

Re: Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc.
Draft Audit Report No. 1C-E3-00-09-010 (May 7, 2009)

Dear 

We are in receipt of the above-referenced draft audit report on the Federal Employees Health Benefits Program ("FEHBP") operations at Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. (the "Carrier") for contract years 2006 through 2008.

The Carrier acknowledges that it informed OIG that it inadvertently used incorrect membership data in the FEHBP rate development for all the years under audit. It agrees to OIG's calculations of the amounts due FEHBP: \$6,627,382 for defective pricing in years 2006 through 2008, plus \$847,196 in lost investment income.

Thank you again for your attention to this matter.


Vice President, FEHBP Line of Business

cc: 