



U.S. 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 at Health Net of Arizona, Inc.**

**Report No. 1C-A7-00-12-028**

**Date: September 27, 2012**

**-- CAUTION --**

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## 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-A7-00-12-028

Date: September 27, 2012



**Michael R. Esser**  
**Assistant Inspector General**  
**for Audits**

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## EXECUTIVE SUMMARY

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**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-A7-00-12-028**

**Date: September 27, 2012**

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 2009 through 2011, and was conducted at the Plan's office in Woodland Hills, California.

This report questions \$585,590 for inappropriate health benefit charges to the FEHBP in contract year 2010. The questioned amount includes \$554,733 for defective pricing and \$30,857 due the FEHBP for lost investment income, calculated through September 30, 2012. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's (OPM) rules and regulations in contract years 2009 and 2011.

In 2010, the Plan applied an autism loading to the FEHBP rates. The loading relates to the state-mandated coverage of medically necessary services and therapies for the diagnosis and treatment of Autism Spectrum Disorder. Per OPM's contracting officer, the FEHBP is not required to follow state-mandated benefits. Regardless, the FEHBP has always provided coverage for medically necessary services, so the cost of medically necessary autism services would be included in the claims experience used to develop the FEHBP premium rates and no additional loading is necessary.

Consistent with the FEHBP regulations and contract, the FEHBP is due \$30,857 for lost investment income, calculated through September 30, 2012, on the defective pricing finding. In addition, we recommend that the contracting officer recover lost investment income starting October 1, 2012, 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). The audit covered contract years 2009 through 2011, and was conducted at the Plan's office in Woodland Hills, California. 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.

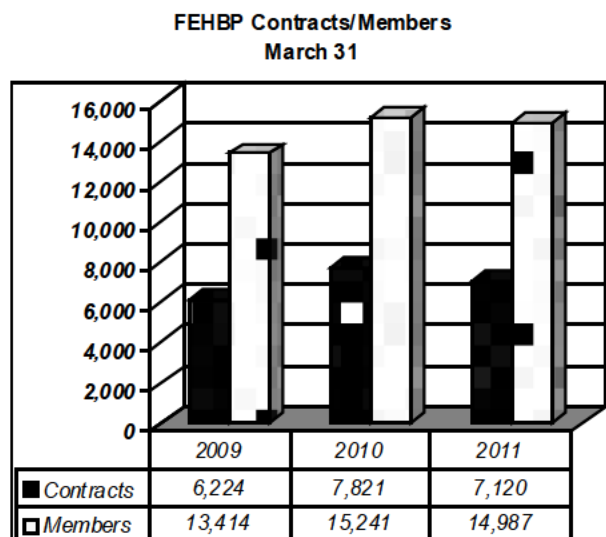
## **Background**

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 Healthcare and Insurance Office. 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 of the Plan conducted by our office was a full scope audit of contract years 2006 through 2008. That audit identified \$80,747 in defective pricing, including \$11,530 in lost investment income. All issues identified in the previous audit have been resolved.

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's comments were considered in preparation of this report and included, as appropriate, in the Appendix.

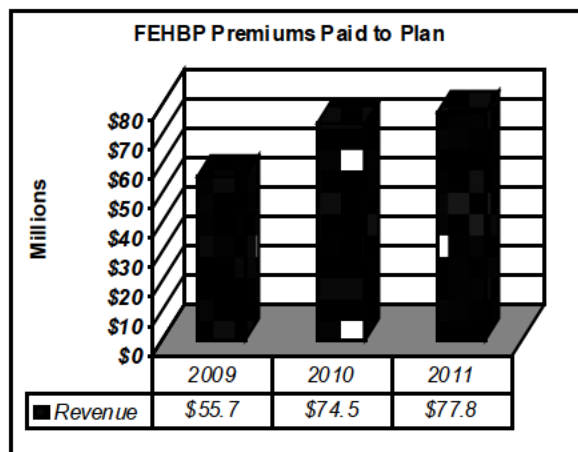
## **II. OBJECTIVES, SCOPE, AND METHODOLOGY**

### **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 2009 through 2011. For these contract years, the FEHBP paid approximately \$208 million 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 billings and enrollment 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 2012. Additional audit work was completed at our offices in Cranberry Township, Pennsylvania and 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 (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 policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

### **III. AUDIT FINDINGS AND RECOMMENDATIONS**

#### **Premium Rate Review**

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

**\$554,733**

The Certificate of Accurate Pricing the Plan signed for contract year 2010 was defective. In accordance with federal regulations, the FEHBP is therefore due a rate reduction for this year. Application of the defective pricing remedy shows that the FEHBP is entitled to a premium adjustment totaling \$554,733 (see Exhibit A). We found that the FEHBP rates were developed in accordance with OPM rules and regulations in contract years 2009 and 2011.

FEHBAR 1652.215-70 provides that 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 SSSGs. SSSGs are the Plan's two employer groups closest in size to the FEHBP. If it is found that the FEHBP was charged higher than a 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.

#### **2010**

The Plan applied a [REDACTED] per-member-per-month (PMPM) charge to all groups for state-mandated coverage of medically necessary services and therapies for the diagnosis and treatment of Autism Spectrum Disorder (ASD). Per OPM's contracting officer, medically necessary services associated with ASD have always been covered under the FEHBP contract. Therefore the cost of these services would be included in the claims experience used to develop the FEHBP rates. Any non-medically necessary services related to ASD would not be a covered benefit under the FEHBP contract and should not be charged to the FEHBP.

We recalculated the FEHBP rates by removing the \$ [REDACTED] ASD loading. A comparison of our audited rates to the Plan's reconciled rates shows that the FEHBP was overcharged \$554,733 in contract year 2010 (see Exhibit B).

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

The Plan agrees with our finding.

## **Recommendation 1**

We recommend that the contracting officer require the Plan to return \$554,733 to the FEHBP for defective pricing in contract year 2010.

### **2. Lost Investment Income**

**\$30,857**

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 finding in contract year 2010. We determined that the FEHBP is due \$30,857 for lost investment income, calculated through September 30, 2012 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning October 1, 2012, 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 \$30,857 to the FEHBP for lost investment income for the period January 1, 2010, through September 30, 2012. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning October 1, 2012, until all defective pricing amounts have been returned to the FEHBP.

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

The Plan agrees with our finding.

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

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

██████████, Auditor-in-Charge

██████████, Lead Auditor

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██████████., Chief

██████████, Senior Team Leader

**Health Net of Arizona, Inc.  
Summary of Questioned Costs**

Defective Pricing Questioned Costs

Contract Year 2010 \$554,733

Total Defective Pricing Questioned Costs **\$554,733**

Lost Investment Income **\$30,857**

Total Questioned Costs **\$585,590**

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

**2010**

<b>High Option</b>	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	█	█	
FEHBP Line 5 - Audited Rate	█	█	
Bi-weekly Overcharge	█	█	
To Annualize Overcharge:			
3/31/2010 Enrollment	█	█	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	█	█	<b>\$518,144</b>
<b>Standard Option</b>	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	\$ █	█	
FEHBP Line 5 - Audited Rate	█	█	
Bi-weekly Overcharge	█	█	
To Annualize Overcharge:			
3/31/2010 Enrollment	█	█	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	█	█	<b><u>\$36,589</u></b>
<b>Total 2010 Defective Pricing Questioned Costs</b>			<b><u>\$554,733</u></b>

**EXHIBIT C**

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

<b>Year</b>	2010	2011	30-Sep-2012	Total
<b>Audit Findings:</b>				
1. Defective Pricing	\$554,733	\$0	\$0	\$554,733
<hr/>				
Totals (per year):	\$554,733	\$0	\$0	\$554,733
Cumulative Totals:	\$554,733	\$554,733	\$554,733	\$554,733
Avg. Interest Rate (per year):	3.1875%	2.5625%	1.8750%	
Interest on Prior Years Findings:	\$0	\$14,215	\$7,801	\$22,016
Current Years Interest:	\$8,841	\$0	\$0	\$8,841
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Total Cumulative Interest Calculated Through September 30, 2012:	\$8,841	\$14,215	\$7,801	<b>\$30,857</b>

# APPENDIX



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[www.healthnet.com](http://www.healthnet.com)

August 6, 2012

[REDACTED]  
U.S. Office of Personnel Management  
Office of the Inspector General  
800 Cranberry Woods Drive, Suite 270  
Cranberry Township, PA 16066

Re: Draft of Audit Report No. 1C-A7-00-12-028  
Health Net of Arizona, Inc.

Dear [REDACTED]

This letter is 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 2009 through 2011.

## I. PLAN RESPONSE

In this section, we summarize the findings and recommendations contained in the Draft Audit Report and any additional considerations.

### A. 2010 State Mandated Autism Spectrum Disorder Enhanced Benefit

For contract year 2010, the Draft Audit Report contains preliminary findings that the Plan incorrectly charged a premium for Enhanced Autism Benefits. The Audit report included that the FEHBP is not required to follow state mandated benefits. The enhanced benefit became an Arizona state-mandated benefit for all commercial groups beginning at their renewals from July, 2009, forward through 2010. It included non-medically necessary Applied Behavioral Analysis (ABA). All of the Health Net of Arizona commercial groups, including the FEHB group were charged an additional premium for the benefit.

Health Net acknowledges OPMs' re-calculation and agrees to return the overcharge for defective pricing and lost investment income for 2010.

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# APPENDIX

**Deleted by OIG – Not relevant to the Final Report**

Sincerely,

A handwritten signature in black ink, appearing to read "Bret A. Morris".

Bret A. Morris  
President, Health Net of Arizona

CC:

