



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 at PacifiCare of Texas, Inc.**

Report No. 1C-GF-00-12-030

Date: November 1, 2012

-- CAUTION --

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AUDIT REPORT

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
PacifiCare of Texas, Inc.
Contract Number CS 2908 - Plan Code GF
Cypress, California**

Report No. 1C-GF-00-12-030

Date: November 1, 2012



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

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EXECUTIVE SUMMARY

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
PacifiCare of Texas, Inc.
Contract Number CS 2908 - Plan Code GF
Cypress, California**

Report No. 1C-GF-00-12-030

Date: November 1, 2012

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at PacifiCare of Texas, Inc. (Plan). The audit covered contract years 2009 through 2011, and was conducted at the Plan's office in Cypress, California.

This report questions \$627,859 for inappropriate health benefit charges to the FEHBP in contract years 2009 through 2011. The questioned amount includes \$604,829 for defective pricing and \$23,030 due the FEHBP for lost investment income, calculated through October 31, 2012.

For contract years 2009 through 2011, we found the FEHBP was inappropriately charged a state assessment fee. We removed the state assessment fee from our audited FEHBP rates. We also found two FEHBP claims not properly coordinated with Medicare which increased the FEHBP rates in 2011. We determined the FEHBP was overcharged \$16,291 in 2009, \$158,245 in 2010, and \$430,293 in 2011.

Consistent with the FEHBP regulations and contract, the FEHBP is due \$23,030 for lost investment income, calculated through October 31, 2012, on the defective pricing findings. In addition, we recommend that the contracting officer recover lost investment income starting November 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 PacifiCare of Texas, Inc. (Plan). The audit covered contract years 2009 through 2011. The audit was conducted pursuant to the provisions of Contract CS 2908; 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.

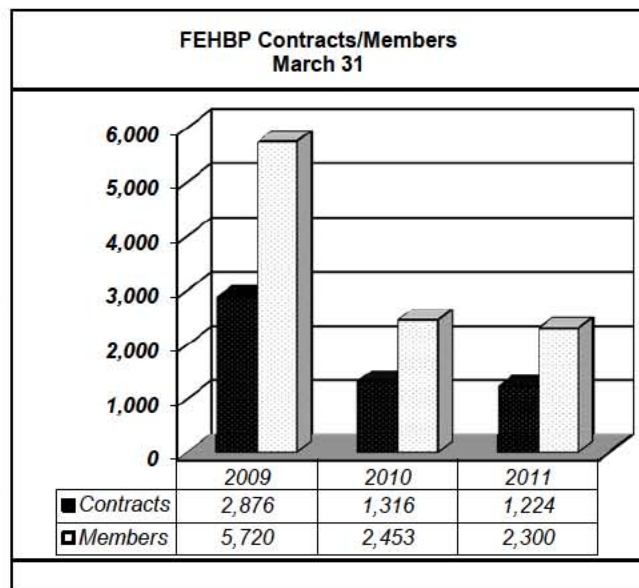
Background

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 1983 and provides health benefits to FEHBP members in the San Antonio, Texas area. The last audit of the Plan conducted by our office was a full scope audit of contract years 2006 through 2008. For that audit, we found the FEHBP rates were in accordance with applicable laws, regulations, and the Office of Personnel Management's rate instructions.

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.

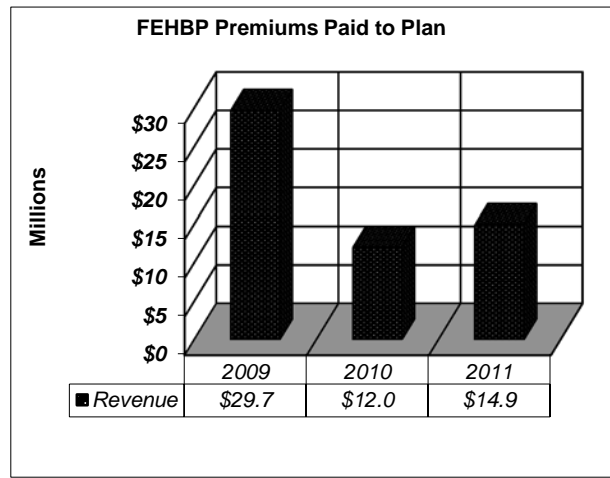
II. OBJECTIVES, SCOPE, AND METHODOLOGY

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 \$56.6 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 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 conducted during January 2012 in Cypress, California, and additional audit work was completed at our offices located 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, 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.

To test the Plan's compliance with the FEHBP health benefit provisions regarding coordination of benefits, we selected and reviewed a judgmental sample of claims for contract years 2009 through 2011. This audit included a 2009 sample of 12 claims from 286,604 claim lines, a 2010 sample of 6 claims from 27,237 claim lines, and a 2011 sample of 10 claims from 100,355 claim lines. The results from the samples were not projected to the population as a whole.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rate Review

1. Defective Pricing

\$604,829

The Certificates of Accurate Pricing Pacificare of Texas, Inc. (Plan) signed for contract years 2009 through 2011 were defective. In accordance with Federal regulations, the Federal Employees Health Benefits Program (FEHBP) is therefore due a rate reduction for these years. Application of the defective pricing remedy shows that the FEHBP is entitled to a premium adjustment totaling \$604,829 (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. FEHBP regulations refer to a market price rate in conjunction with the rates offered to similarly sized subscriber groups (SSSG). 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 the 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 rate.

Texas Health Insurance Pool (THIP)

During our review of contract years 2009 through 2011, we found the Plan inappropriately charged the FEHBP a 1.17 percent state tax assessment related to the THIP. The THIP provides medical insurance coverage for residents who are unable to obtain their own health insurance from individual commercial insurers.

5 U.S.C 8909(f)(1) prohibits the imposition of taxes, fees or other monetary payment, directly or indirectly, on FEHB premiums by any State, the District of Columbia, the Commonwealth of Puerto Rico, or by any political subdivision or other governmental authority of those entities. Further, the THIP filing instructions specifically state the FEHBP is not subject to the state assessment.

The Plan did not realize that the FEHBP is not subject to the THIP. As a result, the FEHBP is entitled to reclaim all charges associated with the THIP. These findings include \$16,291 for 2009, \$158,245 for 2010, and \$205,980 for 2011.

Plan's Comments (see Appendix):

The Plan agrees with our finding and acknowledges that the charges were incorrectly applied to the FEHBP. The Plan has corrected the THIP calculation for contract year 2012 and forward.

The Plan requested the audited work papers that support the calculation of the impact of removing the 1.17 percent attributable to the THIP. The Plan has not yet received those work

papers. The Plan reserved the right to challenge the calculation of the finding amounts based on the work papers.

OIG's Response to Plan's Comments:

We spoke with the Plan by telephone, as well as email follow-up, regarding the work papers they wanted to review. The Plan specifically requested our 2011 audited FEHBP rate development. We provided the Plan the work paper in support of our 2011 audit findings.

We granted a request from the Plan for an additional two-week extension so they could review our work paper. We contacted the Plan several days after the due date to follow up on their review. The Plan did not respond. Therefore, we moved forward with the final report.

2. Coordination of Benefits (COB)

During our COB review, we found two FEHBP claims not properly coordinated with Medicare that inappropriately increased the 2011 FEHBP rates. The paid amounts were \$77,400 and \$48,450. The Plan should have paid these claims as the secondary payor to Medicare. The Medicare rules set forth in the Plan's contract with OPM state when an annuitant or their covered spouse who are age 65 or over and has both Medicare and FEHBP coverage, the primary payor is Medicare and the secondary payor is this Plan.

The Plan states there was no COB information available at the time of the claim payments and once the COB information was available, it was beyond the 180-day Medicare recovery window. It is the Plan's responsibility to keep its COB information current.

We adjusted the FEHBP claims experience used in our audited rate development to account for the two COB claims. As a result, the FEHBP was overcharged \$224,313 in contract year 2011 (see Exhibit A).

Plan's Comments (see Appendix):

The Plan acknowledges that the two claims in question were not coordinated with Medicare. However, the Plan relied on information from the member regarding other coverage. This information is requested on a routine basis, and the Plan's systems are updated accordingly. The Plan feels strongly that the information utilized at the time of claim adjudication was correct, and therefore, the claims in question were processed appropriately according to the information provided by the respective members.

OIG's Response to Plan's Comments:

We maintain that these claims were not properly coordinated with Medicare. It is the Plan's responsibility to keep the Medicare status of its members current so that proper COB procedures are followed.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$604,829 to the FEHBP for defective pricing.

Recommendation 2

We recommend the contracting officer require the Plan to take the necessary steps to ensure that COB is performed in a timely, accurate, and effective manner.

3. Lost Investment Income **\$23,030**

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 years 2009 through 2011. We determined that the FEHBP is due \$23,030 for lost investment income, calculated through October 31, 2012 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning November 1, 2012, 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.

Plan's Comments (see Appendix):

The Plan agrees that the FEHBP is entitled to lost investment income on any overpayments due to the FEHBP. The Plan stated they calculated a different amount of overpayment for which the lost investment income calculation should be based on, and the FEHBP is due lost investment income only for that amount of overpayment.

OIG's Response to Plan's Comments

We were not made aware of the overpayment amount calculated by the Plan. We provided the requested work paper to the Plan to support our overpayment calculation. The Plan was granted two weeks to review our overpayment calculation. We contacted the Plan after the two-week period to discuss their review. The Plan did not respond, and we received no notification that the Plan disagrees with our overpayment calculation. Therefore, we will

move forward with the lost investment income calculation as it pertains to our calculation of the questioned costs.

Recommendation 3

We recommend that the contracting officer require the Plan to return \$23,030 to the FEHBP for lost investment income for the period January 1, 2009, through October 31, 2012. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning November 1, 2012, until all defective pricing amounts have been returned to the FEHBP.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

██████████, Auditor-in-Charge

██████████, Auditor

██████████, Auditor

██████████ Chief

██████████, Senior Team Leader

Pacificare of Texas, Inc.
Summary of Questioned Costs

Defective Pricing Questioned Costs

Contract Year 2009	\$16,291	
Contract Year 2010	\$158,245	
Contract Year 2011 ¹	<u>\$430,293</u>	
Total Defective Pricing Questioned Costs		\$604,829
Lost Investment Income:		<u>\$23,030</u>
Total Questioned Costs		<u>\$627,859</u>

¹ This represents \$205,980 for THIP and \$224,313 for COB errors.

**Pacificare of Texas, Inc.
Defective Pricing Questioned Costs**

2009

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	█	█	
FEHBP Line 5 - Audited Rate	█	█	
Bi-weekly Overcharge	█	█	
To Annualize Overcharge:			
March 31, 2009 Enrollment	█	█	
X 26 Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	█	█	
Total 2009 Defective Pricing Questioned Costs			\$16,291

2010

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	█	█	
FEHBP Line 5 - Audited Rate	█	█	
Bi-weekly Overcharge	█	█	
To Annualize Overcharge:			
March 31, 2010 Enrollment	█	█	
X 26 Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	█	█	
Total 2010 Defective Pricing Questioned Costs			\$158,245

2011

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	█	█	
FEHBP Line 5 - Audited Rate	█	█	
Bi-weekly Overcharge	█	█	
To Annualize Overcharge:			
March 31, 2011 Enrollment	█	█	
X 26 Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	█	█	
Total 2011 Defective Pricing Questioned Costs			\$430,293

Total Defective Pricing Questioned Costs **\$604,829**

Pacificare of Texas, Inc.
Lost Investment Income

Year	2009	2010	2011	31-Oct-2012	Total
Audit Findings:					
1. Defective Pricing	\$16,291	\$158,245	\$430,293	\$0	\$604,829
Totals (per year):	\$16,291	\$158,245	\$430,293	\$0	\$604,829
Cumulative Totals:	\$16,291	\$174,536	\$604,829	\$604,829	\$604,829
Avg. Interest Rate (per year):	5.2500%	3.1875%	2.5625%	1.8750%	
Interest on Prior Years Findings:	\$0	\$519	\$4,472	\$9,576	\$14,567
Current Years Interest:	\$428	\$2,522	\$5,513	\$0	\$8,463
Total Cumulative Interest Calculated Through October 31, 2012:	\$428	\$3,041	\$9,985	\$9,576	\$23,030

LLB&L

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August 17, 2012

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Chief, Community-Rated Audits Group
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Cranberry Township, Pennsylvania 16066

RE: Comments to the Draft Audit Report on PacifiCare of Texas, Plan Code GF, Report No. 1C-GF-00-12-030

Dear [REDACTED]

We represent PacifiCare of Texas, a UnitedHealthcare Company ("UnitedHealthcare") in connection with the above referenced matter. UnitedHealthcare Company is responding to this audit on behalf of PacifiCare of Texas ("PacifiCare," "PacifiCare of Texas," or "the Plan.")

On May 15, 2012, the United States Office of Personnel Management, Office of the Inspector General ("OPM/OIG") submitted to the Plan a "Draft Report" (1C-GF-00-12-030) ("Draft Report"), detailing the results of its audit of the Federal Employees Health Benefits Program ("FEHBP") operations of PacifiCare of Texas for Contract Years 2009 through 2011. Upon submission, OPM/OIG requested that the Plan provide comments to the Draft Report.

The Plan appreciates the opportunity to respond to this Draft Report and the willingness of OPM to help resolve the outstanding issues in this audit. The Plan has used its best efforts to obtain all relevant information to respond to the Draft Report's findings and recommendations. This Response will address each issue presented in the Draft Report.

DEFECTIVE PRICING

Texas Health Insurance Pool (THIP)

In its Draft Report, the auditors state that PacifiCare of Texas inappropriately charged the FEHBP a 1.17 percent state tax assessment related to the THIP. Upon further review, the Plan has determined that the amount charged to the FEHBP was in fact representative of the THIP from which the FEHBP is exempt. The Plan acknowledges that the charges were incorrectly applied to the FEHBP and has corrected the calculation for Contract Year 2012 and beyond.

The Plan has requested the auditors' work papers that support their calculation of the impact of removing the 1.17 percent attributable to the THIP. The Plan has not yet received those work papers. The Plan is reserving its rights to challenge the auditors' calculation based on information the Plan receives from the auditors.

Coordination of Benefits (COB)

The Draft Report contains the following statement by OIG auditors:

“During our COB review, we found two FEHBP claims not properly coordinated with Medicare that inappropriately increased the 2011 FEHBP rates. The paid amounts were \$77,400 and \$48,450. Medicare should have paid as primary instead of the Plan.

The Plan states there was no COB information available at the time of the claim payment and once the COB information was available, it was beyond the 180-day Medicare recovery window. It is the Plan's responsibility to keep its COB information up-to-date.

We adjusted the FEHBP claims experience used in our audited rate development to account for the two COB claims. As a result, the FEHBP was overcharged \$224,313 in contract year 2011.”

The Plan acknowledges that the two claims in question were not coordinated with Medicare. However, the Plan relied on information from the member as to any other coverage that they were entitled to. This information is requested on a routine basis and the Plan's systems are updated accordingly. The Plan feels strongly that the information utilized at the time of claim adjudication was correct and therefore the claims in question were processed appropriately according to the information provided by the respective members.

Lost Investment Income

OPM/OIG has asserted that it is entitled to recover lost investment income on the defective pricing for contract years 2009 – 2011. It has calculated that amount to be \$17,486 through April 30, 2012. The Plan agrees that the FEHBP is entitled to lost investment income on any overpayments actually due to FEHBP. However, the Plan has calculated a different amount of overpayment by the FEHBP and therefore the FEHBP is due lost investment income only for that amount of overpayment.

August 17, 2012

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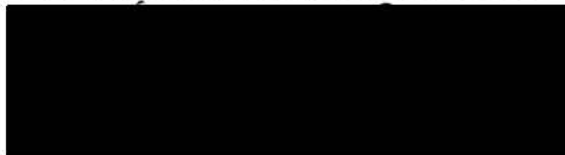
CONCLUSION

In conclusion, PacifiCare has reviewed OPM/OIG's findings for CY 2009 – 2011, presented in the Draft Report 1C-GF-00-12-030. Based on our review of the information, PacifiCare has determined that, although there was an overpayment by FEHBP, the amount is less than that calculated by OPM/OIG.


Once you have had an opportunity to review our response, please contact me at the address, phone number or e-mail on this letterhead if you have any questions or require additional information. Thank you for your ongoing cooperation.

Very truly yours,

LOCKE, LORD, BISSELL & LIDDELL LLP



cc:


Director, Underwriting
UnitedHealthcare