



U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS

Final Audit Report

Subject:

AUDIT OF CAPITAL BLUECROSS HARRISBURG, PENNSYLVANIA

Report No. 1A-10-36-12-003

Date: August 23, 2012

--CAUTION--

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AUDIT REPORT

Federal Employees Health Benefits Program
Service Benefit Plan Contract CS 1039
BlueCross BlueShield Association
Plan Code 10

Capital BlueCross
Plan Code 361
Harrisburg, Pennsylvania

REPORT NO. 1A-10-36-12-003

DATE: August 23, 2012



Michael R. Esser
Assistant Inspector General
for Audits

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EXECUTIVE SUMMARY

Federal Employees Health Benefits Program
Service Benefit Plan Contract CS 1039
BlueCross BlueShield Association
Plan Code 10

Capital BlueCross
Plan Code 361
Harrisburg, Pennsylvania

REPORT NO. 1A-10-36-12-003 DATE: August 23, 2012

This final audit report on the Federal Employees Health Benefits Program (FEHBP) operations at Capital BlueCross (Plan), in Harrisburg, Pennsylvania, questions \$143,406 in administrative expenses and lost investment income (LII). The BlueCross BlueShield Association agreed (**A**) with this questioned amount.

Our limited scope audit was conducted in accordance with Government Auditing Standards. The audit covered miscellaneous health benefit payments and credits from 2006 through June 30, 2011, as well as administrative expenses from 2006 through 2010 as reported in the Annual Accounting Statements. In addition, we reviewed the Plan's cash management practices related to FEHBP funds from 2006 through June 30, 2011.

The audit results are summarized as follows:

MISCELLANEOUS HEALTH BENEFIT PAYMENTS AND CREDITS

The audit disclosed no findings pertaining to miscellaneous health benefit payments and credits. Overall, we concluded that health benefit refunds and recoveries were promptly returned to the FEHBP and miscellaneous payments were properly charged to the FEHBP.

ADMINISTRATIVE EXPENSES

- **Pension Costs (A)** **\$143,406**

The Plan overcharged the FEHBP \$24,097 in 2006, \$85,843 in 2007, and \$13,668 in 2010 for pension costs. We determined that the Plan allocated these pension costs to the Federal Employee Program based on the Financial Accounting Standards Board 87 valuation instead of the required valuation under Cost Accounting Standards 412 and 413. As a result of this finding, the Plan returned \$143,406 to the FEHBP, consisting of \$123,608 for the pension cost overcharges and \$19,798 for LII on these overcharges.

CASH MANAGEMENT

The audit disclosed no findings pertaining to cash management. Overall, we concluded that the Plan handled FEHBP funds in accordance with Contract CS 1039 and applicable laws and regulations.

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I. INTRODUCTION AND BACKGROUND

INTRODUCTION

This final audit report details the findings, conclusions, and recommendations resulting from our limited scope audit of the Federal Employees Health Benefits Program (FEHBP) operations at Capital BlueCross (Plan). The Plan is located in Harrisburg, Pennsylvania.

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 (FEHB) 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. OPM's Healthcare and Insurance Office has overall responsibility for administration of the FEHBP. The provisions of the FEHB Act are implemented by OPM through regulations, which are codified in Title 5, Chapter 1, Part 890 of the Code of Federal Regulations (CFR). Health insurance coverage is made available through contracts with various health insurance carriers.

The BlueCross BlueShield Association (Association), on behalf of participating BlueCross and BlueShield plans, has entered into a Government-wide Service Benefit Plan contract (CS 1039) with OPM to provide a health benefit plan authorized by the FEHB Act. The Association delegates authority to participating local BlueCross and BlueShield plans throughout the United States to process the health benefit claims of its federal subscribers. The Plan is one of approximately 63 local BlueCross and BlueShield plans participating in the FEHBP.

The Association has established a Federal Employee Program (FEP¹) Director's Office in Washington, D.C. to provide centralized management for the Service Benefit Plan. The FEP Director's Office coordinates the administration of the contract with the Association, member BlueCross and BlueShield plans, and OPM.

The Association has also established an FEP Operations Center. The activities of the FEP Operations Center are performed by CareFirst BlueCross BlueShield, located in Washington, D.C. These activities include acting as fiscal intermediary between the Association and member plans, verifying subscriber eligibility, approving or disapproving the reimbursement of local plan payments of FEHBP claims (using computerized system edits), maintaining a history file of all FEHBP claims, and maintaining an accounting of all program funds.

Compliance with laws and regulations applicable to the FEHBP is the responsibility of the Association and Plan management. Also, management of the Plan is responsible for establishing and maintaining a system of internal controls.

¹ Throughout this report, when we refer to "FEP", we are referring to the Service Benefit Plan lines of business at the Plan. When we refer to the "FEHBP", we are referring to the program that provides health benefits to federal employees.

All findings from our previous audit of the Plan (Report No. 1A-10-36-08-043, dated February 5, 2009) for contract years 2005 through 2007 have been satisfactorily resolved.

The results of this audit were provided to the Plan in written audit inquiries; were discussed with Plan and/or Association officials throughout the audit and at an exit conference; and were presented in detail in a draft report, dated February 2, 2012. The Association's comments offered in response to the draft report were considered in preparing our final report and are included as an Appendix to this report. Also, additional documentation provided by the Association and Plan on various dates through June 11, 2012 was considered in preparing our final report.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES

The objectives of our audit were to determine whether the Plan charged costs to the FEHBP and provided services to FEHBP members in accordance with the terms of the contract. Specifically, our objectives were as follows:

Miscellaneous Health Benefit Payments and Credits

- To determine whether miscellaneous payments charged to the FEHBP were in compliance with the terms of the contract.
- To determine whether credits and miscellaneous income relating to FEHBP benefit payments were returned promptly to the FEHBP.

Administrative Expenses

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

Cash Management

- To determine whether the Plan handled FEHBP funds in accordance with applicable laws and regulations concerning cash management in the FEHBP.

SCOPE

We conducted our limited scope performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and 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.

We reviewed the BlueCross and BlueShield FEHBP Annual Accounting Statements as they pertain to Plan code 361 for contract years 2006 through 2010. During this period, the Plan paid approximately \$559 million in health benefit charges and \$32 million in administrative expenses (See Figure 1 and Schedule A).

Specifically, we reviewed miscellaneous health benefit payments and credits (e.g., refunds, subrogation recoveries, hospital settlements, and fraud recoveries) and cash management activities for 2006 through June 30, 2011. We also reviewed administrative expenses for 2006 through 2010.

In planning and conducting our audit, we obtained an understanding of the Plan'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 the Plan's internal control structure and its operations. However, since our audit would not necessarily disclose all significant matters in the internal control structure, we do not express an opinion on the Plan's system of internal controls taken as a whole.

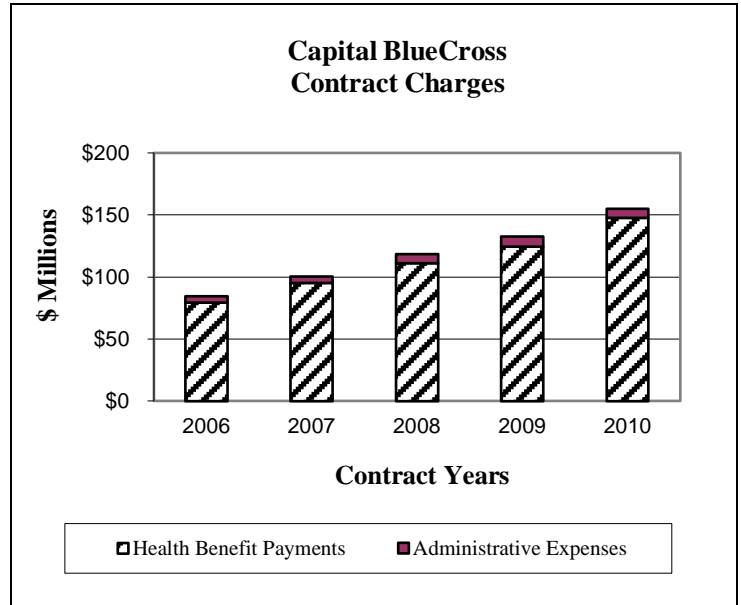


Figure 1 - Contract Charges

We also conducted tests to determine whether the Plan had complied with the contract, the applicable procurement regulations (i.e., Federal Acquisition Regulations (FAR) and Federal Employees Health Benefits Acquisition Regulations (FEHBAR), as appropriate), and the laws and regulations governing the FEHBP. The results of our tests indicate that, with respect to the items tested, the Plan did not comply with all provisions of the contract and federal procurement regulations. 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 the Plan 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 the FEP Director's Office and the Plan. Due to time constraints, we did not verify the reliability of the data generated by the various information systems involved. However, while utilizing the computer-generated data during our audit testing, nothing came to our attention to cause us to doubt its reliability. We believe that the data was sufficient to achieve our audit objectives.

The audit was performed at the Plan's office in Harrisburg, Pennsylvania on various dates from October 17, 2011 through December 16, 2011. Audit fieldwork was also performed at our offices in Washington, D.C. and Cranberry Township, Pennsylvania.

METHODOLOGY

We obtained an understanding of the internal controls over the Plan's financial, cost accounting, and cash management systems by inquiry of Plan officials.

We interviewed Plan personnel and reviewed the Plan's policies, procedures, and accounting records during our audit of miscellaneous health benefit payments and credits. We also

judgmentally selected and reviewed 30 high dollar provider off-sets and claim adjustments, totaling \$2,981,234 (from a universe of 250,643 off-sets/adjustments, totaling \$81,420,266); 7 high dollar provider advance adjustments, totaling \$2,272,791 (from a universe of 40 advance adjustments, totaling \$3,435,474); 59 high dollar health benefit refunds, totaling \$1,122,708 (from a universe of 1,631 refunds, totaling \$1,564,311); 25 high dollar subrogation recoveries, totaling \$635,005 (from a universe of 215 recoveries, totaling \$907,867); 20 high dollar hospital settlements, totaling \$431,298 in net FEP payments (from a universe of 119 settlements, totaling \$275,216 in net FEP payments); 19 high dollar provider audit recoveries, totaling \$247,614 (from a universe of 495 recoveries, totaling \$455,026); 6 high dollar fraud recoveries, totaling \$194,534 (from a universe of 34 recoveries, totaling \$273,805); and 30 high dollar special plan invoices (SPI), totaling \$433 in net FEP payments (from a universe of 261 SPI's, totaling \$3,048,737 in net FEP payments), to determine if refunds and recoveries were promptly returned to the FEHBP and if miscellaneous payments were properly charged to the FEHBP.² The results of these samples were not projected to the universe of miscellaneous health benefit payments and credits.

We judgmentally reviewed administrative expenses charged to the FEHBP for contract years 2006 through 2010. Specifically, we reviewed administrative expenses relating to cost centers, natural accounts, out-of-system adjustments, prior period adjustments, pension, post-retirement, employee benefits, executive compensation, non-recurring projects, Association dues, subcontracts, gains and losses, lobbying, and Health Insurance Portability and Accountability Act of 1996 compliance. We used the FEHBP contract, the FAR, and the FEHBPBAR to determine the allowability, allocability, and reasonableness of the administrative expense charges.

We also reviewed the Plan's cash management to determine whether the Plan handled FEHBP funds in accordance with Contract CS 1039 and applicable laws and regulations.

² The sample of provider off-sets and claim adjustments included the 10 highest dollar off-sets/adjustments from 2006 and 2007 and the 5 highest dollar off-sets/adjustments from each year for 2008 through June 30, 2011. The sample of provider advance adjustments included all adjustments greater than \$200,000. For health benefit refunds, the sample consisted of all refunds greater than \$4,500. For subrogation, the sample consisted of the five highest dollar recoveries from each year, unless the recoveries were less than \$2,800. For hospital settlements, the sample consisted of the two highest dollar credits and the two highest dollar payments from each year for 2006 through 2009, the highest dollar credit and the two highest dollar payments from 2010, and the highest dollar credit from the period January 1, 2011 through June 30, 2011. For provider audit recoveries, the sample consisted of all recoveries greater than \$5,000. The sample of fraud recoveries included the three highest dollar recoveries from each year for 2009 and 2010. (Note: For the audit scope, the Plan only reported fraud recoveries in 2009 and 2010.) For the SPI sample, we selected three SPI's with the highest credit totals and three SPI's with the highest payment totals from each year for 2006 through 2010.

III. AUDIT FINDINGS AND RECOMMENDATIONS

A. MISCELLANEOUS HEALTH BENEFIT PAYMENTS AND CREDITS

The audit disclosed no findings pertaining to miscellaneous health benefit payments and credits. Overall, we concluded that health benefit refunds and recoveries were promptly returned to the FEHBP and miscellaneous payments were properly charged to the FEHBP.

B. ADMINSTRATIVE EXPENSES

1. Pension Costs **\$143,406**

The Plan overcharged the FEHBP \$123,608 for pension costs in 2006, 2007, and 2010. As a result of this finding, the Plan returned \$143,406 to the FEHBP, consisting of \$123,608 for the pension cost overcharges and \$19,798 for LII on these overcharges.

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 904.412, 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 in paragraphs (j) (3) through (8) of this subsection.”

The FAR limits the amount of pension cost that may be charged to a government contract. Only the following may be charged:

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

FAR 52.232-17(a) states, “all amounts that become payable by the Contractor . . . shall bear simple interest from the date due . . . The interest rate shall be the interest rate established by the Secretary of the Treasury as provided in Section 611 of the Contract Disputes Act of 1978 (Public Law 95-563), which is applicable to the period in which the amount becomes due, as provided in paragraph (e) of this clause, and then at the rate applicable for each six-month period as fixed by the Secretary until the amount is paid.”

For the period 2006 through 2010, the Plan allocated \$540,607 to the FEP for pension costs. We reviewed all of the FEP pension costs to determine if the amounts were properly charged to the FEHBP in accordance with the federal regulations. Based on our review, we determined that the Plan allocated pension costs to the FEP based on the Financial Accounting Standards Board (FASB) 87 valuation instead of the required valuation under CAS 412 and 413. Therefore, the Plan did not charge the correct amounts to the FEHBP.

The Association conducted a “Control and Performance Review” (CPR) of this Plan in 2010 and questioned pension cost charges in 2008 and 2009 for the same reason as noted in the previous paragraph. In the CPR report (dated May 6, 2011), the Association specifically questioned \$61,492 and \$175,774 in pension costs that were allocated to the FEP for 2008 and 2009, respectively. As a result, the Plan submitted prior period adjustments (PPA) on May 11, 2011 to adjust \$237,266 in pension costs that were charged to the FEHBP for 2008 and 2009.

However, since no additional adjustments were made for the remaining years in our audit scope, we determined that the Plan incorrectly charged \$123,608 to the FEHBP for pension costs in 2006, 2007, and 2010. Specifically, the Plan overcharged the FEHBP \$24,097 in 2006, \$85,843 in 2007, and \$13,668 in 2010 for pension costs. Again, these overcharges occurred because the Plan charged pension costs to the FEHBP based on the FASB 87 valuation, instead of the required valuation under CAS 412 and 413. As a result of this finding, the Plan returned \$143,406 to the FEHBP, consisting of \$123,608 for the pension cost overcharges and \$19,798 for LII on these overcharges. We reviewed and accepted the Plan’s LII calculation for this finding.

Association’s Response:

The Association agrees with the questioned pension costs. The Association states that the Plan will prepare and submit PPA’s for the 2006, 2007, and 2010 pension cost overcharges.

OIG Comments:

After submitting the draft report response, the Association provided documentation supporting that the Plan wire transferred the pension cost overcharges of \$123,608 and LII of \$19,798 to the Association’s FEP joint operating account on April 9, 2012. The Association then wire transferred these funds to OPM on April 26, 2012.

Recommendation 1

Since we verified that the Plan returned \$123,608 to the FEHBP for the pension cost overcharges, no further action is required for this questioned amount.

Recommendation 2

Since we verified that the Plan returned \$19,798 to the FEHBP for LII on the questioned pension cost overcharges, no further action is required for this LII amount.

C. CASH MANAGEMENT

The audit disclosed no findings pertaining to cash management. Overall, we concluded that the Plan handled FEHBP funds in accordance with Contract CS 1039 and applicable laws and regulations.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Experience-Rated Audits Group

██████████, Auditor-In-Charge

██████████, Auditor

██████████, Auditor

██████████, Chief, ██████████

██████████, Senior Team Leader

V. SCHEDULE A

CAPITAL BLUECROSS
HARRISBURG, PENNSYLVANIA

CONTRACT CHARGES AND AMOUNTS QUESTIONED

CONTRACT CHARGES*	2006	2007	2008	2009	2010	2011	2012	TOTAL
A. HEALTH BENEFIT CHARGES								
PLAN CODE 361	\$79,344,737	\$94,285,626	\$109,654,820	\$125,022,646	\$147,300,577			\$555,608,406
MISCELLANEOUS HEALTH BENEFIT PAYMENTS AND CREDITS	194,440	1,105,537	1,658,056	(353,303)	444,008			3,048,738
TOTAL HEALTH BENEFIT CHARGES	\$79,539,177	\$95,391,163	\$111,312,876	\$124,669,343	\$147,744,585			\$558,657,144
B. ADMINISTRATIVE EXPENSES								
PLAN CODE 361	\$4,929,349	\$4,887,356	\$7,160,084	\$7,929,680	\$8,123,442			\$33,029,911
PRIOR PERIOD ADJUSTMENTS	0	0	0	(13,937)	0			(13,937)
BUDGET SETTLEMENT REDUCTION	0	0	0	0	(628,312)			(628,312)
TOTAL ADMINISTRATIVE EXPENSES	\$4,929,349	\$4,887,356	\$7,160,084	\$7,915,743	\$7,495,130			\$32,387,662
TOTAL CONTRACT CHARGES	\$84,468,526	\$100,278,519	\$118,472,960	\$132,585,086	\$155,239,715			\$591,044,806
AMOUNTS QUESTIONED	2006	2007	2008	2009	2010	2011	2012	TOTAL
A. MISCELLANEOUS HEALTH BENEFIT PAYMENTS AND CREDITS	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
B. ADMINISTRATIVE EXPENSES								
1. Pension Costs**	24,097	87,168	5,428	5,772	17,172	3,168	601	143,406
C. CASH MANAGEMENT	0	0	0	0	0	0	0	0
TOTAL AMOUNTS QUESTIONED	\$24,097	\$87,168	\$5,428	\$5,772	\$17,172	\$3,168	\$601	\$143,406

* This audit covered miscellaneous health benefit payments and credits and cash management from January 1, 2006 through June 30, 2011 and administrative expenses from 2006 through 2010.

** We included lost investment income of \$19,798 within this audit finding.

March 19, 2012

██████████, Group Chief
Experience-Rated Audits Group
Office of the Inspector General
U.S. Office of Personnel Management
1900 E Street, Room 6400
Washington, DC 20415-11000



**BlueCross BlueShield
Association**

An Association of Independent
Blue Cross and Blue Shield Plans

Federal Employee Program
1310 G Street, N.W.
Washington, D.C. 20005
202.942.1000
Fax 202.942.1125

**Reference: OPM DRAFT AUDIT REPORT
Capital Blue Cross
Audit Report Number 1A-10-36-12-003
(Dated February 2, 2012 and Received February 2, 2012)**

Dear ██████████:

This is the Capital Blue Cross Plan's response to the above referenced U.S. Office of Personnel Management (OPM) Draft Audit Report covering the Federal Employees' Health Benefits Program (FEHBP) concerning the

Our comments concerning the finding in the report are as follows:

A. ADMINISTRATIVE EXPENSES

1. Pension \$123,608

OPM questioned \$303,314 in pension costs because the Plan used the Financial Accounting Standards Board (FASB) 87 instead of the required valuation under CAS 412 and 413. Since the issuance of the Draft Audit Report, the Plan obtained an outside Actuary's valuation of its pension costs for 2006 and 2007 as required by Federal Acquisition Regulations. As a result of the valuation, the Plan agrees that \$109,940 in pension costs were overcharged to the Program for 2006 and 2007 (\$24,097 and \$85,843 respectively) and \$13,668 for 2010 but disagrees that \$179,733 (\$162,750, \$16,983 respectively) was overcharged in 2006 and 2007. The pension re-evaluation (attached) was provided to the OIG audit team for their review.

[REDACTED]
March 19, 2012

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The Plan will prepare and submit Prior Period Adjustments for 2006, 2007 and 2010 by March 26, 2012.

We appreciate the opportunity to provide our response to this Draft Audit Report and request that our comments be included in their entirety as an amendment to the Final Audit Report.

Sincerely,

[REDACTED]
[REDACTED]
Director, Program Integrity

[REDACTED]