



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

Final Audit Report

Subject:

**AUDIT OF THE FEDERAL FLEXIBLE
SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS, INC.
FOR 2008 THROUGH 2010**

Report No. 4A-RI-00-11-060

Date: _____

--CAUTION--

This audit report has been distributed to Federal officials who are responsible for the administration of the audited program. This audit report may contain proprietary data which is protected by Federal law (18 U.S.C. 1905). Therefore, while this audit report is available under the Freedom of Information Act and made available to the public on the OIG webpage, caution needs to be exercised before releasing the report to the general public as it may contain proprietary information that was redacted from the publicly distributed copy.

AUDIT REPORT

**AUDIT OF THE FEDERAL FLEXIBLE
SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS, INC.
FOR 2008 THROUGH 2010**

Report No. 4A-RI-00-11-060

Date: _____



Michael R. Esser
Assistant Inspector General
for Audits

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EXECUTIVE SUMMARY

**AUDIT OF THE FEDERAL FLEXIBLE
SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS, INC.
FOR 2008 THROUGH 2010**

Report No. 4A-RI-00-11-060

Date: _____

The enclosed audit report details the results of our audit of the Federal Flexible Spending Account (FSAFEDS) Program as administered by SHPS, Inc. The primary objective of our audit was to determine if SHPS complied with the regulations and requirements contained within Contract OPM030300009 for program years 2008 through 2010. The audit was performed at the SHPS office in Louisville, Kentucky, from October 3 through October 14, 2011.

This report identified two findings and questions \$1,307,040 for investment income that was not returned to the FSAFEDS Program. Additionally, the audit calculated \$163,206 in lost investment income on the audit findings. The results of our audit have been summarized below.

HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT

- **Temporary Employees with Criminal Convictions** **Procedural**

Five temporary employees with prior criminal convictions were improperly placed at SHPS to assist with the 2010 FSAFEDS open season.

CASH MANAGEMENT ACTIVITIES

- **Investment Income not Credited to the FSAFEDS Program** **\$1,307,040**

SHPS did not credit \$1,307,040 of investment income earned on FSAFEDS funds to the Program.

FRAUD AND ABUSE

The results of our review showed that SHPS had policies and procedures in place to help prevent and detect fraudulent activity.

CLAIM BENEFIT PAYMENTS

The results of our review showed that SHPS had proper controls in place to ensure that claims were paid in accordance with the contract.

RISK RESERVE TRANSFERS

The results of our review showed that SHPS followed the contract requirements for requesting and returning borrowed funds to the Risk Reserve account.

SUBCONTRACTS

The results of our review showed that SHPS complied with OPM's contract provisions when awarding subcontracts.

LOST INVESTMENT INCOME

As a result of the audit findings presented in this report, the FSAFEDS Program is due lost investment income of **\$163,206**.

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I. INTRODUCTION AND BACKGROUND

INTRODUCTION

This report details the results of our audit of the Federal Flexible Spending Account (FSAFEDS) Program as administered by SHPS, Inc. 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. The audit fieldwork took place at the SHPS office in Louisville, Kentucky, from October 3 through October 14, 2011. Additional audit work was completed in our Washington D.C. and Cranberry Township, Pennsylvania offices.

BACKGROUND

At the direction of the President, OPM implemented a health insurance premium conversion plan in October 2000 for approximately 1.6 million executive branch employees who participate in the Federal Employees Health Benefits Program. OPM also conducted a study of design and pricing options for medical and dependent care flexible spending accounts (FSAs) across the executive branch. Features and operation of the premium conversion plan and the FSAs are described in the Federal Flexible Benefits Plan under Title 5, Code of Federal Regulations (CFR), Part 892. These reimbursement accounts provide tax advantages authorized under Section 125 of the Internal Revenue Code and are widely used by both private and public employers in the United States. In the years since their development, FSA programs have become an expected benefit that is popular among employees.

OPM has the overall responsibility to maintain the FSAFEDS website, act as a liaison for federal agencies, facilitate the promotion of the FSAFEDS Program in the Federal Government, and respond in a timely manner to a contractor's request for information and assistance. In 2002, OPM issued a request for proposal (RFP) to solicit third party administrators who could provide FSA services to federal employees. In March 2003, SHPS was awarded Contract OMP0303000009 (the Contract), which includes provisions in section I.11 for audits and inspections of the FSAFEDS program operations.

SHPS is one of the country's largest independent providers of employee benefit programs and administration. Its clients include Fortune 100, 500 and 1000 companies, state governments, federal agencies, hospitals, universities, employee trusts, and health plans. SHPS was formed by a joint venture between Sykes Enterprises and Health Plan Services in 1997 and is headquartered in Louisville, Kentucky, with multiple locations throughout the United States.

All findings from our previous audit of the FSAFEDS Program as administered by SHPS (Report Number 4A-RI-00-08-015, dated April 8, 2009) have been satisfactorily resolved.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES

The primary purpose of this audit was to determine if SHPS complied with the regulations and requirements contained within the Contract for program years 2008 through 2010. Our specific audit objectives were as follows:

Health Insurance Portability and Accountability Act

- To determine if SHPS complied with the Contract's provisions related to the Health Insurance Portability and Accountability Act (HIPAA).

Cash Management Activities

- To determine if program funds were held in an interest bearing account separate from SHPS's other lines of business, and if these funds were properly recorded and accurately transferred to the FSAFEDS dedicated investment account.
- To reconcile payroll deductions, investment income, disbursements, claims, and other expenses to the financial statements.
- To determine if SHPS has procedures in place to match expected allotments to actual allotments.
- To determine if SHPS properly calculated and returned forfeitures, and the interest earned on forfeitures, to the Risk Reserve account.
- To determine if the interest earned and/or charged to the FSA Program was calculated correctly, was properly allocated and appeared reasonable, and was properly credited to the Risk Reserve account.

Fraud and Abuse

- To determine if SHPS has policies and procedures in place to help prevent and detect fraud and abuse.
- To determine if SHPS has a system in place to train its personnel in how to prevent and detect fraud and abuse.

Claim Benefit Payments

- To obtain an understanding of SHPS's claims processing system from the time a claim is received through when it's paid.
- To ensure that the system has edits and checks in place to prevent the payment of unallowable claims or duplicate claims, and to ensure claims are paid in accordance with the Contract.
- To reconcile the claim payments schedule to the SHPS audited financial statements.
- To determine if SHPS's procedures for un-cashed checks are in accordance with the terms of the Contract, and if un-cashed checks were properly returned to the Risk Reserve account.
- To determine SHPS's compliance with the Contract's Performance Standards, and whether appropriate penalties were assessed where these performance metrics were not met.

Risk Reserve Transfers

- To obtain an understanding of SHPS's procedures for requesting program funds from the Risk Reserve account to pay unfunded claims.
- To determine if SHPS's protocol for requesting program funds from the Risk Reserve account was in accordance with the terms of the Contract and the Federal regulations.
- To verify that all money borrowed by SHPS to pay unfunded claims was returned to the Risk Reserve account.

Subcontracts

- To determine if SHPS obtained approval from OPM for any subcontracts that are chargeable to the program in excess of \$200,000 and more than 25 percent of the subcontract cost is charged to the Contract.
- To determine if OPM's contracting office approved any significant changes to the original subcontract, including changes to labor rates and final cost.

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 and appropriate evidence to provide a reasonable basis for our 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 the audit objectives.

This performance audit covered SHPS's administration of the FSAFEDS Program, including compliance with the HIPAA and testing the overall effectiveness of its cash management activities, fraud and abuse policies and procedures, claim benefit payments, risk reserve transfers, and handling of subcontracts for program years 2008 through 2010.

In planning and conducting our audit, we obtained an understanding of SHPS'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 SHPS'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 SHPS's system of internal controls taken as a whole.

In conducting our audit, we relied to varying degrees on computer-generated data provided by SHPS. Due to the 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 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.

We also conducted tests to determine whether SHPS had complied with the Contract, the applicable procurement regulations (i.e., Federal Acquisition Regulations), and the laws and regulations governing the FSAFEDS Program. Exceptions noted in the areas reviewed are set

forth in the “Audit Findings and Recommendations” section of this report. With respect to the items not tested, nothing came to our attention that caused us to believe that SHPS had not complied, in all material respects, with those provisions.

METHODOLOGY

To determine if SHPS complied with the regulations and requirements contained within the Contract for program years 2008 through 2010, we performed the following audit steps:

Health Insurance Portability and Accountability Act

- We reviewed SHPS’s response to our HIPAA questionnaire, and its corresponding policies and procedures, to ensure that SHPS had complied with the Contract’s requirements related to the HIPAA and the protection of individually identifiable health information.
- We requested the background investigations on 34 of the 313 temporary employees who were placed at SHPS by 4 temporary employment agencies that were providing 2010 Open Season services. We selected the 34 temporary employees based on the first name of each billing invoice from November 21, 2010, and every 9th name thereafter. It was during this billing period that SHPS received the greatest number of temporary employees. Due to concerns identified in our initial review, we expanded our sample to 107 of the 313 temporary employees to ensure that the required background investigations were performed according to the Contract’s requirements.

Cash Management Activities

- We judgmentally selected a sample of 30 payroll office deductions, totaling \$41,396,900 from a universe of 447 payroll office deductions totaling \$188,445,585, to determine if the FSA funds were held in an interest bearing account separate from SHPS’s other lines of business, if these funds were properly recorded and accurately transferred to the FSA-dedicated investment account for program years 2008 through 2010, and if SHPS followed its process for receiving payroll deductions. Specifically, we selected the following:
 1. The 10 payroll offices with the highest payroll deductions, totaling \$14,810,498, from May 2008, which was the month with the highest payroll deductions collected in program year 2008;
 2. The first 10 payroll deductions received in December 2009, totaling \$9,877,989, since payroll deductions during this month covered 2 program years; and
 3. The 10 payroll offices with the highest payroll deductions, totaling \$16,708,413, from the 26th payroll period of December 2010, since this was the last payroll period covered under the audit scope.
- We reconciled SHPS’s payroll deduction and deposit schedules to the allotments reported in the financial statements for program years 2008 through 2010 to determine if there were any variances in the amounts.

- Using SHPS’s procedures, we compared expected allotments/deposits from the payroll offices to the actual allotments/deposits for December 2010 to determine whether SHPS’s records accurately reflected the amount received from the payroll office. This time period was selected for review because it was the most recent month in the audit scope and was, therefore, the month with most readily available data.
- We reviewed the forfeitures schedule for program year 2010 and reconciled this schedule to the amounts reported on the 2010 financial statement to determine if SHPS properly calculated and returned forfeitures to the Risk Reserve account. This program year was selected for review because it was the most recent year in the audit scope and was, therefore, the year with the most readily available data.
- Using the investment income schedules, we selected the quarter with the highest net investment income earned from each program year (1st quarter 2008, 1st quarter 2009, and 3rd quarter 2010) to determine whether interest earned and/or charged to the FSA Program was calculated correctly, was properly allocated and/or appeared reasonable, and was credited to the FSAFEDS Program (Risk Reserve account). Specifically, we selected the following:
 1. The highest net earnings per quarter during 2008, totaling \$745,877, from a universe totaling \$2,044,996;
 2. The highest net earnings per quarter during 2009, totaling \$132,027, from a universe totaling \$179,172; and
 3. The highest net earnings per quarter during 2010, totaling (\$32,427), from a universe totaling (\$231,224).

Fraud and Abuse

- We reviewed SHPS’s response to the anti-fraud questionnaire to determine if SHPS has policies and procedures to prevent and detect fraud and abuse, and if SHPS has a system in place to train its personnel in how to prevent and detect fraud and abuse.

Claim Benefit Payments

- We performed a walk-through of the claims processing system, and obtained and reviewed the claim system’s procedures and flowcharts, to gain an understanding of the claims flow from the time a claim is received by SHPS until the claim is paid.
- We selected a judgmental sample of 25 FSA enrollee accounts (5 FSA enrollees with Dependent Care accounts, 15 FSA enrollees with Health Care accounts, and 5 FSA enrollees with Limited Care accounts) with total claims paid of \$57,114, out of a universe of 359,139 FSA enrollee accounts with claims paid totaling \$786,406,213 for program year 2010. This year was selected due to the large volume of claims in the audit universe and the availability of the data for review. Accounts were selected based on the type of account, and with various amounts paid within \$0 to \$5,000. Specifically, we determined the following:
 1. Whether SHPS had edits/checks in place to prevent the payment of unallowable or duplicate claims, and to ensure claims were paid in accordance with the Contract.

2. Whether SHPS only reimbursed the subscriber up to the amount elected in their FSA account.

- We reconciled the 2010 claims payment schedule to the financial statements to determine if there was any variance to the amounts reported in the financial statements. This program year was selected for review due to the availability of the data and the large volume of claims in the audit universe.
- We reviewed SHPS's procedures for returning un-cashed FSA benefit checks to the FSAFEDS Program to determine if these procedures are in accordance with the terms of the Contract. We also reviewed a list of FSA un-cashed checks issued during program years 2008 through 2010 to determine if un-cashed checks were properly returned to the Risk Reserve account. Our review consisted of a universe of 4,146 un-cashed checks totaling \$600,718.
- We judgmentally selected the month of December 2010 to determine if SHPS complied with the performance standards defined in the Contract, and to ensure that penalties were assessed where the standards were not met. The month of December 2010 was selected because the "at risk" percentage of abandoned calls appeared to not meet the Contract's required performance standards for this metric.

Risk Reserve Transfers

- We reviewed SHPS's policies and procedures for requesting funds from OPM to pay unfunded claims to determine if these procedures are in accordance with the Contract.
- We reviewed the wire transfers from SHPS to OPM to verify that all money borrowed by SHPS to pay unfunded claims was returned to the Risk Reserve account according to the Contract.

Subcontracts

- We reviewed the list of subcontracts and their approvals during program years 2008 through 2010 to determine if there were any subcontracts where SHPS costs exceeded the Federal regulation threshold, and if these costs were allowable, allocable, and reasonable.

The samples mentioned above, which were selected and reviewed in performing the audit, were not statistically based. Consequently, the results could not be projected to the universe since it was unlikely that the results were representative of the universe taken as a whole.

We used the Contract, the Federal Acquisition Regulations, and the FSAFEDS regulations (5 CFR Part 892) to determine whether SHPS's policies and procedures related to the HIPAA, cash management activities, claim benefit payments, risk reserve transfers, and policies and procedures related to subcontracts were in compliance with the terms of the Contract and the applicable regulations. We also determined whether SHPS had policies and procedures in place to detect and prevent instances of fraud and abuse related to its administration of the FSAFEDS Program.

The results of the audit were discussed with SHPS during fieldwork and at the exit conference. In addition, a draft report, dated May 2, 2012, was provided to SHPS for review and comment. SHPS's comments on the draft report were considered in preparing this final report and are included as Appendices to this report.

III. AUDIT FINDINGS AND RECOMMENDATIONS

A. HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT

1. Temporary Employees with Criminal Convictions

Procedural

Five temporary employees with prior criminal convictions were placed at SHPS by the vendor ██████████ to assist with the 2010 FSAFEDS open season. Three of these employees had a history of theft, one employee had a prior conviction of illegal drug possession, and one employee had a history of both theft and illegal drug possession.

SHPS Standards Regarding Background Checks require vendors to conduct a background investigation on temporary employees prior to placement. The standards also state that temporary employees should not be placed with SHPS if they were convicted of theft or illegal drug possession.

Additionally, the Health Insurance Portability and Accountability Act's (HIPAA) Security Rule for workforce clearance, section 164.308(a)(3)(ii)(B), requires SHPS to address whether all members of the workforce with authorized access to electronic protected health information receive appropriate clearances.

SHPS receives temporary employee services from four vendors to help staff the FSAFEDS open season. As part of our HIPAA review, we sampled 107 of the 313 temporary employees placed at SHPS in 2010, to determine if these individuals had background checks prior to placement. From our review of the 107 background investigations, we identified five employees with criminal convictions that should not have been placed with SHPS. All five individuals were placed by the vendor ██████████ and may have had access to protected health information and personally identifiable information belonging to Federal employees. This mistake placed all Federal employees who participate in the FSAFEDS Program at risk for identity theft and may be considered a HIPAA violation. Fortunately, SHPS and ██████████ identified the mistake within eight days of placement and removed the employees. In all five incidents, ██████████ indicated to SHPS that the temporary employees had cleared the background investigation prior to placement.

SHPS's Response:

SHPS agrees with this finding and has initiated corrective action to meet each of our recommendations.

Recommendation 1

We recommend that the contracting office require SHPS to verify and review each temporary employee's background investigation prior to placement with SHPS.

Recommendation 2

We recommend that the contracting office require SHPS to perform a risk analysis to assess the vulnerability of its protected health information and implement the appropriate safeguards pursuant to the HIPAA Security Rule 164.308(a)(3)(ii)(B) – Workforce Clearance.

Recommendation 3

We recommend that the contracting office require SHPS to stop using vendor services from [REDACTED] if it continues to provide temporary employees in violation of SHPS Standards Regarding Background Checks.

B. CASH MANAGEMENT ACTIVITIES

1. Investment Income not Credited to the FSAFEDS Program **\$1,307,040**

SHPS did not credit \$1,307,040 of investment income earned on FSA funds to the FSAFEDS Program.

We reviewed the investment income earned on FSA funds to determine if all investment income was returned to the FSAFEDS Program. During our review, we found that SHPS earned \$2,129,571 in investment income from 2008 through 2010. From this amount, \$722,168 was used to pay banking fees, and another \$1,307,040 was used to pay for the following unauthorized deductions:

- \$614,922 was used to pay the 2008 and 2009 management fees (1 percent of the FSA funds invested),
- \$607,388 was used to pay the 2008 income tax (38.9 percent of the investment income earned), and
- \$84,730 was retained by SHPS as profit in 2008 (50 percent of the net investment income).

The remaining balance of \$100,363 was returned to the FSAFEDS Program.

SHPS should not have used the interest earned on FSA funds to pay management fees and income tax. Additionally, SHPS should not keep 50 percent of the net investment income. When we asked SHPS why it did not credit the program for the full amount of investment income, net of banking fees, SHPS reported that there was an agreement with OPM authorizing the use of investment income to pay management fees and for SHPS to keep 50 percent of the net investment income. We requested a copy of this agreement between OPM and SHPS, but neither party could provide documentation to show that the agreement existed.

Section I.29(b) of the contract between SHPS and OPM states that all investment income earned on FSA funds must be credited to the FSAFEDS Program. The only exception to this requirement is listed in OPM Contract Modification 003, Exhibit B, Part (3), which allows SHPS to use the interest earned on allotments to pay for claims reimbursement and banking fees. Additionally, section I.15(a) states, “No oral statement of any person shall modify or otherwise affect the terms, conditions, or specifications stated in this contract. The duly authorized Contracting Officer must make all modifications to the contract in writing.” Finally, Section C, Part XI, page C-41 of the contract defines a Contracting Officer as “The OPM employee who has the authority to bind the Government under the resulting contract with the Contractor.”

As a result of SHPS not crediting the FSAFEDS Program for all of the investment income earned on FSA funds, the FSAFEDS Program lost \$1,307,040.

SHPS’s Response:

SHPS disagrees with the finding and provided excerpts of a presentation given in March 2006 between SHPS and OPM’s Contracting Office to support its position. It contends that Page 14 of the presentation describes the “50/50” split of net income and then claims that the recommendations included in the presentation were adopted by OPM and integrated as part of normal operations. SHPS also argues that because of the fall in interest rates that started in 2008, and continues through today, interest has been insufficient to cover its expenses. However, it has chosen not to invoice the shortfall to the Program Office, which has resulted in a substantial savings to the program.

While no documentation exists to support OPM’s agreement with the recommendations that were part of the March 2006 presentation, SHPS did provide a series of emails between OPM’s Program Office staff during March 2009 that confirm SHPS was retaining the interest as income, that SHPS had the income tax liability, and that the income was created from bank accounts used by FSAFEDS. SHPS claims that there were no challenges from OPM regarding SHPS’s response to these e-mails, as the responses were consistent with the March 2006 meeting and Modification 003 to the Contract.

Finally, SHPS cites Modification 003, Exhibit D for why it retained a portion of the interest income. It states that the exhibit is an agreed upon list of additional services and the estimated incremental service fee that may be payable to SHPS if those services are provided. One of the services included on this exhibit is “Banking and Interest”, which OPM and SHPS understood entailed the payment to SHPS for banking and interest services from the interest income itself rather than as a separate fee. Transfer records confirm that, both before and after the execution of Modification 003, payment for these services was based on the split of income and this split was consistent with the terms described in the March 2006 presentation mentioned above.

SHPS does agree that policies and procedures regarding the treatment of investment income should be developed and implemented, and recommend that this be addressed in the next contract modification.

OIG Comments:

We do not concur with SHPS's response, on the basis that the Government was never obligated to pay SHPS \$1,307,040 out of the investment income earned on FSA funds for the following reasons. Modification 003's Exhibit D, which did provide for the payment of these services out of investment income, was no longer in effect during the scope of this audit. Modification 005, effective January 1, 2008, removed paragraphs ii and iii from Exhibit B, which eliminated the true up and incremental service fees shown in Exhibit D, and increased the health care flexible spending account fee from \$4.00 to \$4.35 to account for these services. We would also argue that the "50/50" split of net income, although presented to OPM in a March 2006 meeting, never became enforceable under the Contract because it was never formally agreed to by the Contracting Officer. As mentioned above and included in the contract document, the Contracting Officer is the only employee who has the authority to bind the Government under the Contract. Therefore, we continue to maintain that the \$1,307,040 paid to SHPS out of the investment income earned from 2008 through 2009 should be credited back to the Program.

Recommendation 4

We recommend that the contracting office require SHPS to credit the FSAFEDS Program \$1,307,040 for investment income earned during years 2008 through 2009.

Recommendation 5

We recommend that the contracting office require SHPS to implement policies and procedures to ensure that all investment income earned on FSA funds, less any amount used for claims reimbursement and banking fees, is credited to the FSAFEDS Program.

C. FRAUD AND ABUSE

The results of our review showed that SHPS has policies and procedures in place to help prevent and detect fraudulent activity.

D. CLAIM BENEFIT PAYMENTS

The results of our review showed that SHPS has proper controls in place to ensure that claims were paid in accordance with the contract.

E. RISK RESERVE TRANSFERS

The results of our review showed that SHPS followed the Contract requirements for requesting and returning borrowed funds to the Risk Reserve account.

F. SUBCONTRACTS

The results of our review showed that SHPS complied with OPM's contract provision when awarding subcontracts.

G. LOST INVESTMENT INCOME **\$163,206**

The FSAFEDS Program is due \$163,206 for lost investment income (LII) calculated on the Investment Income not Credited to the FSAFEDS Program finding in this report (calculated through August 31, 2012).

Section I.29(e) and (f) of the contract between SHPS and OPM requires, among other things, that the contractor pay the FSAFEDS Program investment income that was lost as a result of failure to credit income due under the contract. The LII will be paid from the date the income was not credited and will end on the earlier of: (1) the date the amounts are returned to the FSAFEDS Program; (2) the date specified by the Contracting Officer; or (3) the date of the Contracting Officer's final decision. All amounts payable will bear LII compounded semiannually at the rate established by the Secretary of the Treasury.

We computed LII that would have been earned using the semiannual rates specified by the Secretary of the Treasury. Our computations show that the FSAFEDS Program is due LII of \$163,206 for the period January 1, 2009 through August 31, 2012, on questioned amounts from the period January 1, 2008 through December 31, 2010. The Program is also due any additional LII accumulated after August 31, 2012 until all funds have been returned to the Program.

SHPS's Comments

The draft report did not include LII on audit findings. Therefore, SHPS did not address this item in its replies.

Recommendation 6

We recommend that the contracting officer require SHPS to credit the FSAFEDS Program \$163,206 for LII on the audit findings calculated through August 31, 2012, plus any additional LII accumulating after that date until all questioned costs have been returned to the Program.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Special Audits Group

██████████, Auditor-In-Charge

██████████, Auditor

██████████ Group Chief, ██████████

██████████, Senior Team Leader

SCHEDULE A**AUDIT OF THE
FEDERAL FLEXIBLE SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS****SUMMARY OF CONTRACT CHARGES**

	2008	2009	2010	Total
A. Allotments Received	\$596,995,436	\$706,568,189	\$794,001,064	\$2,097,564,689
B. Claim Payments	\$593,789,283	\$702,076,236	\$786,512,741	\$2,082,378,260
C. Service Fees Received	\$14,478,877	\$16,154,506	\$17,967,278	\$48,600,661
D. Total Expenses	(\$14,265,967)	(\$14,331,606)	(\$16,471,123)	(\$45,068,696)

**AUDIT OF THE
FEDERAL FLEXIBLE SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS**

SUMMARY OF QUESTIONED COSTS

AUDIT FINDINGS	2008	2009	2010	2011	2012	Total
A. HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT						
1. Temporary Employees with Criminal Convictions	\$0	\$0	\$0	\$0	\$0	Procedural
B. CASH MANAGEMENT						
1. Investment Income not Credited to the FSAFEDS Program	\$1,201,063	\$105,977	\$0	\$0	\$0	\$1,307,040
C. LOST INVESTMENT INCOME (From Schedule C)	\$0	\$63,879	\$44,046	\$36,490	\$18,791	\$163,206
TOTAL QUESTIONED COSTS	\$1,201,063	\$169,856	\$44,046	\$36,490	\$18,791	\$1,470,246

**AUDIT OF THE
FEDERAL FLEXIBLE SPENDING ACCOUNT PROGRAM
AS ADMINISTERED BY SHPS**

LOST INVESTMENT INCOME CALCULATION

Year	2008	2009	2010	2011	2012	Total
A. Questioned Charges (Subject to Lost Investment Income)						
Investment Income not Credited to the FSAFEDS Program	\$1,201,063	\$105,977	\$0	\$0	\$0	\$1,307,040
B. Lost Investment Income Calculation - Compound Interest Method						
a. Prior Period Total Questioned Costs	\$0	\$1,201,063	\$1,307,040	\$1,307,040	\$1,307,040	
b. Prior Period(s) Interest	\$0	\$0	\$63,879	\$107,925	\$144,415	
c. Cumulative Total	\$0	\$1,201,063	\$1,370,919	\$1,414,965	\$1,451,455	
d. Treasury Rate: January 1 - June 30	4.750%	5.625%	3.250%	2.625%	2.000%	
e. Interest: January 1- June 30	\$0	\$33,780	\$22,277	\$18,571	\$14,515	
f. Prior Period Cumulative Questioned Costs	\$0	\$1,234,843	\$1,393,196	\$1,433,536	\$1,465,970	
g. Interest Rate: July 1 - December 31	5.125%	4.875%	3.125%	2.500%	1.750%	
h. Interest: July 1 - December 31	\$0	\$30,099	\$21,769	\$17,919	\$4,276	
Total Lost Investment Income	\$0	\$63,879	\$44,046	\$36,490	\$18,791	\$163,206

2012 JUN -1 PM 2:0

June 1, 2012

U.S. Office of Personnel Management
Office of the Inspector General
Attn: [REDACTED]
1900 E Street, NW, Rm. 6400
Washington, DC 20415-1100

RE: Report No. 4A-RI-00-01-060

Dear [REDACTED]

ADP Benefit Services KY, Inc. (formerly known as SHPS Human Resource Solutions, Inc. (SHPS HRS)) is pleased to provide you with our response to the recommendations that were presented as a result of the recent audit of the FSAFEDS program by the Office of the Inspector General (OIG). For your convenience, we have provided a separate response for each item outlined in the OIG's report.

If you have any questions after reviewing our feedback, please do not hesitate to contact us for clarification.

Sincerely,

[REDACTED]
Vice President of Finance
9200 Shelbyville Road, 2nd Floor
Louisville, KY 40222
[REDACTED]

Temporary Employees with Criminal Convictions

Recommendation 1: Contracting Office requires SHPS to verify and review each temporary employee's background investigation prior to placement.

SHPS HRS Response:

We agree with this recommendation. Following the identification of this issue, changes were immediately implemented. As identified in your report, we acted decisively to dismiss workers and prevent the recurrence of this problem. This has been remediated by independently screening workers prior to placement. We are no longer relying on the background checks completed by providers of temporary workers.

Recommendation 2: Perform a risk analysis to assess the vulnerability of protected health information and implement appropriate safeguards.

SHPS HRS Response:

We agree with the recommendation.

Task	Status
Risk Analysis	Complete
Risk Management	Complete
Sanction Policy	Complete
Information System Activity Review	Complete. No exceptions.

Recommendation 3: Stop using vendor services from [REDACTED] if they continue to provide workers in violation of standards.

SHPS HRS Response:

We agree with this recommendation.

Cash Management

Recommendation 4: Recommend the Contracting Office require SHPS to credit the FSAFEDS Program \$1,259,230 for the investment income earned during the years 2008-2010.

SHPS HRS Response:

We disagree with this recommendation. Following the OIG visit, additional documentation was identified that provides more detail regarding investment income procedures. The documents (attached) are excerpts from a presentation given at a March 2006 meeting between SHPS HRS leadership and the Contracting Office. The recommendations in the presentation were adopted by OPM and integrated as part of normal operations. The presentation materials were kept by OPM in the 'contract file'.

Page 14 of the presentation describes the "50/50" split of net income. The spreadsheet shows details regarding the split of interest income that were provided to, and audited by, the OIG during their visit. No irregularities were found.

Please note that the agreed upon procedure for handling investment income also entitled SHPS HRS to "*invoice OPM each quarter when interest is insufficient to meet the plan's expenses*". Because of the fall in interest rates that started in 2008, and continues through today, interest has been insufficient to cover expenses. The shortfall through 2010 was \$1,217,842 and totals \$2,048,475 through February 2012 (see attached schedule). SHPS HRS chose not to invoice the shortfall to the Program Office, which has resulted in a substantial savings to the program.

Through the parties' sharing of interest income and SHPS HRS's decision to forgo invoicing the program for the financial shortfall, SHPS HRS has complied with the parties' agreement reached in the March 2006 meeting, which also reflects the spirit of the original contract (section I.29 Investment Income) wherein the program is to benefit from investment practices.

Recommendation 5: Contract Office require SHPS to implement policies and procedures regarding the treatment of investment income.

SHPS HRS Response:

We agree with this recommendation. We recommend the treatment of investment income be part of the next contract modification.



SHPS Follow-up Response to OPM Contract and Scope Discussion

March 28, 2006



Contents

- **Organization chart containing OPM Team FTEs**
- **Sample Ticket**
- **Invoices and Billing Detail**
 - **Server and Installation**
 - **Portal Development and Implementation**
 - **Bank Fees and Interest**
 - **Grace Period**
 - **Open Season Marketing**
 - **Agency Billing**
 - **Reports**
 - **System Enhancements**

Contents

- **Invoices and Billing Detail** (Continued)
 - **Web Management**
 - **Web Response**
- **Missed Billing File**
- **Next Steps**

Bank Fees and Interest

From our discussions in Washington, SHPS is seeking to recover bank fees, income tax obligations, investment management fees. Our model contemplates a split of remaining amounts (after expenses) with OPM. The resulting amount would be credited to the risk reserve quarterly. This model will not yield any payback to OPM for 2004 or 2005 generated.

██████████ will schedule a separate meeting with OPM this week to review the model and address any questions or ideas.

Bank Fees and Interest

- SHPS will split '50/50' the net income (interest earned that exceeds the obligation to pay actual bank fees, actual postage to mail participant checks, tax obligation, and investment management fee) with OPM. This amount will be credited to the risk reserve each quarter. SHPS will invoice OPM each quarter when interest is insufficient to meet the plan's expenses.

Results

- This methodology did not yield any 'pay-back' for OPM for 2004 or 2005. SHPS is invoicing OPM for those amounts.
- This methodology generated a \$35,000 credit to FSAFEDS in January 2006 and should yield a similar amount for February.
- Under this methodology, both OPM and SHPS meet its obligation under the standing contract, as described in the Inspector General's 2004 audit. Our obligation are to:
 - "Invest FSA funds on hand"
 - "Within the constraints of safety and liquidity – seek to maximize investment income"
 - "Income earned in FSA funds must be credited to the Federal FSA Program"

	2008											
	January	February	March	April	May	June	July	August	September	October	November	December
Total Interest Income	\$ 360,207.79	\$ 232,201.10	\$ 147,591.15	\$ 72,357.31	\$ 44,594.12	\$ 44,097.41	\$ 50,261.00	\$ 61,384.74	\$ 106,043.40	\$ 151,787.72	\$ 148,856.62	\$ 142,024.41
Mgt Fee+Bank Fees+Income Tax Liab.	\$ 235,012.99	\$ 174,442.11	\$ 129,820.44	\$ 81,865.67	\$ 63,832.43	\$ 58,016.37	\$ 59,605.12	\$ 71,000.34	\$ 99,575.35	\$ 125,940.79	\$ 135,861.37	\$ 141,340.81
Amount to be Split	\$ 125,194.80	\$ 57,758.99	\$ 17,770.71	\$ (9,508.36)	\$ (19,238.31)	\$ (13,918.96)	\$ (9,344.12)	\$ (9,615.60)	\$ 6,468.05	\$ 25,846.93	\$ 12,995.25	\$ 683.60
SHPS Share	\$ 62,597.40	\$ 28,879.50	\$ 8,885.36	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,234.02	\$ 12,923.47	\$ 6,497.63	\$ 341.80
OPM Share	\$ 62,597.40	\$ 28,879.50	\$ 8,885.36	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,234.02	\$ 12,923.47	\$ 6,497.63	\$ 341.80

	2009											
Total Interest Income	\$ 121,380.59	\$ 59,573.51	\$ 28,243.05	\$ 10,547.36	\$ 15,065.27	\$ 16,974.85	\$ 14,481.39	\$ 11,750.43	\$ 15,428.08	\$ 19,861.80	\$ 20,509.03	\$ 24,384.62
Mgt Fee+Bank Fees+Income Tax Liab.	\$ 143,333.00	\$ 106,046.77	\$ 74,610.09	\$ 46,563.36	\$ 52,726.43	\$ 49,385.40	\$ 50,051.58	\$ 49,089.15	\$ 53,725.09	\$ 74,203.63	\$ 87,982.55	\$ 103,744.49
Amount to be Split	\$ (21,952.41)	\$ (46,473.26)	\$ (46,367.04)	\$ (36,016.00)	\$ (37,661.16)	\$ (32,410.55)	\$ (35,570.19)	\$ (37,338.72)	\$ (38,297.01)	\$ (54,341.83)	\$ (67,473.52)	\$ (79,359.87)
SHPS Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
OPM Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

	2010											
Total Interest Income	\$ 40,483.64	\$ 32,220.77	\$ 26,011.34	\$ 20,307.57	\$ 22,225.86	\$ 22,021.02	\$ 21,047.17	\$ 25,510.25	\$ 28,992.65	\$ 40,468.50	\$ 44,826.64	\$ 46,357.34
Mgt Fee+Bank Fees+Income Tax Liab.	\$ 123,385.42	\$ 100,104.19	\$ 97,322.00	\$ 66,545.49	\$ 67,852.46	\$ 57,013.76	\$ 49,165.28	\$ 63,254.33	\$ 68,738.63	\$ 87,071.39	\$ 99,611.55	\$ 113,363.95
Amount to be Split	\$ (82,901.78)	\$ (67,883.42)	\$ (71,310.66)	\$ (46,237.92)	\$ (45,626.60)	\$ (34,992.74)	\$ (28,118.11)	\$ (37,744.08)	\$ (39,746.98)	\$ (46,602.89)	\$ (54,784.91)	\$ (67,008.61)
SHPS Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
OPM Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

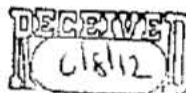
	2011											
Total Interest Income	\$ 39,863.55	\$ 28,277.35	\$ 19,739.01	\$ 13,379.44	\$ 10,698.30	\$ 10,517.89	\$ 9,906.58	\$ 11,457.97	\$ 15,378.99	\$ 12,264.36	\$ 15,661.34	\$ 17,982.57
Mgt Fee+Bank Fees+Income Tax Liab.	\$ 127,346.43	\$ 98,088.02	\$ 77,762.59	\$ 63,563.96	\$ 51,838.59	\$ 47,996.75	\$ 44,735.82	\$ 47,613.78	\$ 58,455.98	\$ 76,563.78	\$ 92,612.38	\$ 69,366.51
Amount to be Split	\$ (87,682.88)	\$ (69,810.67)	\$ (58,023.58)	\$ (50,184.52)	\$ (41,140.29)	\$ (37,478.86)	\$ (34,829.24)	\$ (36,155.81)	\$ (43,076.99)	\$ (64,299.42)	\$ (76,951.04)	\$ (51,383.94)
SHPS Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
OPM Share	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

	2012	
Total Interest Income	\$ 20,661.10	\$ 14,897.17
Mgt Fee+Bank Fees+Income Tax Liab.	\$ 119,443.26	\$ 95,730.65
Amount to be Split	\$ (98,782.16)	\$ (80,833.48)
SHPS Share	\$ -	\$ -
OPM Share	\$ -	\$ -

ShortFall

2008	\$ (61,625.35)
2009	\$ (533,261.56)
2010	\$ (622,955.70)
Sub-total	\$ (1,217,842.61)

2011	\$ (651,017.24)
2012, thru Feb	\$ (179,615.64)
Total	\$ (2,048,475.49)



June 8, 2012

██████████ Senior Team Leader
Office of the Inspector General
U. S. Office of Personnel Management
800 Cranberry Woods Drive, Suite 130
Cranberry Township, PA 16066

RE: Report No. 4A-RI-00-01-060

Dear ██████████

ADP Benefit Services KY, Inc. (formerly known as SHPS Human Resources Solutions Inc. (SHPS HRS)) is pleased to provide you with follow-up responses to your 6/1/2012 email. For your convenience, we have provided a separate response for each item outlined in your email to us.

If you have any questions after reviewing our feedback, please do not hesitate to contact us for clarification.

Sincerely,

██████████
Vice President of Finance
11405 Bluegrass Parkway
Louisville, KY 40299
(502) 263-5622
kevin.scarborough@shps.com

**Deleted by the OIG
Not Relevant to the Final Report**

Question: SHPS states that the information in the presentation was adopted by OPM. Does SHPS have any documentation showing that OPM accepted the investment income procedures? This can be an email, memo, or any form of a written agreement/acceptance.

Response: SHPS does not have documentation of acceptance from OPM. However, in a series of emails between [REDACTED] and various individuals at SHPS during March 4-5, 2009, it was confirmed SHPS was retaining the interest as income, SHPS had the income tax liability and the income was created from bank accounts used by FSAFEDS. See attached. There were no challenges by SHPS to the inquiry or from OPM regarding our response, as it was consistent with the March 2006 meeting and Mod 3.

**Deleted by the OIG
Not Relevant to the Final Report**

**Deleted by the OIG
Not Relevant to the Final Report**

As it relates to SHPS' actions in retaining a portion of interest income, please see Mod 3, Exhibit D: *'Additional Services / Incremental Service Fee Adjustments.'* The Exhibit is an "agreed upon list of additional services and the estimated incremental service fee PHPM that may be payable to SHPS". If SHPS provides a service included on the list, SHPS is due a fee as described. If a service included on the list wasn't rendered, the corresponding fee wasn't payable.

One of the services included in Exhibit D is "Banking and Interest, Actual fees plus management fee vs. Interest Income" with the "Fee Basis" listed as "Interest income." Both OPM and SHPS understood this line item to mean that SHPS was to be paid for the "Banking and Interest" services relative to investment of idle funds, and that this payment was to be taken from the interest income itself rather than paid as a separate fee. Transfer records confirm that, both before and after the execution of Mod 3, the parties accomplished this payment based on the split of income, and that the details of that split were defined in the March 2006 meeting, based on the terms described in the SHPS presentation made at that meeting. Although SHPS acknowledges that there could have been more written documentation of the specific payment terms, this agreed-to split is consistent with the payment structure set forth in Exhibit D.

Question: SHPS states that it has complied with the agreement reached by both parties in the March 2006 meeting. **Again, the OIG would like for SHPS to present some form of evidence of this agreement. OPM Contracting has no record of this agreement and we have no support showing that OPM agreed to any information presented in a meeting.**

Response: We agree there is insufficient written evidence of this agreed upon procedure. In our response to the draft, we agreed with recommendation # 5 calling for the establishment of policies and procedures.

**Deleted by the OIG
Not Relevant to the Final Report**

[REDACTED]

From: [REDACTED]
Sent: Monday, March 05, 2012 9:35 AM
To: [REDACTED]
Subject: OPM - interest income

Per our discussion

From: [REDACTED]@opm.gov]
Sent: Thursday, March 05, 2009 10:12 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

Does the "total current month avg daily balance" represent 100% FSAFEDS allotments?

-----Original Message-----

From: [REDACTED]@shps.com]
Sent: Thursday, March 05, 2009 10:08 AM
To: Darby, [REDACTED]
Cc: Mosley, [REDACTED]
Subject: RE: Money & Tax

[REDACTED]

I did confirm with [REDACTED] that the items listed as "OPM" on the PDF were for just OPM. So, you can reference line 2 of the top and middle sections; the bottom section (labeled OPM Summary) is all OPM.

[REDACTED]

Can you answer [REDACTED] question below, please?

Thanks!

[REDACTED]

From: [REDACTED]@opm.gov]
Sent: Thursday, March 05, 2009 9:57 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

Another question related to this topic. How is SHPS booking the allotment flow - as a liability or revenue?

-----Original Message-----

From: [REDACTED]@shps.com]
Sent: Thursday, March 05, 2009 9:35 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

Yes, actually, I did glance at it and saw that OPM was specifically listed. This is what [REDACTED] provided the IG. I'll confirm with [REDACTED] (just left him a VM) just to make sure.

From: [REDACTED]@opm.gov]
Sent: Thursday, March 05, 2009 9:30 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

By chance.....and be honest.....did you look at the attachment? ☺

This appears to be a comingled report - I don't want to risk extracting answers to my questions and my conclusions being incorrect cause I'm dealing with a non-FSAFEDS specific report.

Please bounce my questions back for answers and if there is more info that's needed to paint a complete picture - go ahead and have them include it.

Thanks...

-----Original Message-----

From: [REDACTED]@shps.com]
Sent: Wednesday, March 04, 2009 3:14 PM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

See if this helps!

From: [REDACTED]@opm.gov]
Sent: Wednesday, March 04, 2009 2:27 PM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

Well..just a bit more before we can close this one.....

Please pick a year - 08 if you have all the data, otherwise 07 - and let me know what....

- 1) the total "income" was
- 2) the income tax charge
- 3) the total interest income
- 4) the other banking fees that bounce against the interest earned

When you can.....thanks!

-----Original Message-----

From: [REDACTED]@shps.com]
Sent: Wednesday, March 04, 2009 10:44 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: Money & Tax

One down!

- 1) Is the allotment stream considered income to SHPS? **yes**
- 2) Are income taxes assessed/paid on the allotment stream? **yes**
- 3) If so, who is paying those taxes.....non-fsafeds SHPS or FSAFEDS-SHPS. **The tax ID belongs to SHPS, Inc.**
- 4) If FSAFEDS-SHPS, where are the funds coming from....interest earned on the checking accounts that house the allotment stream or somewhere else? **in interest earned from the OPM checking accounts.**

From: [REDACTED]@opm.gov]
Sent: Wednesday, March 04, 2009 8:46 AM
To: [REDACTED]
Cc: [REDACTED]
Subject: Money & Tax

We heard from the OPM audit team that the allotment stream into SHPS may be taking on the form of income.....from a tax perspective.

We need to know.....

- 1) Is the allotment stream considered income to SHPS?
- 2) Are income taxes assessed/paid on the allotment stream?
- 3) If so, who is paying those taxes.....non-fsafeds SHPS or FSAFEDS-SHPS.
- 4) If FSAFEDS-SHPS, where are the funds coming from....interest earned on the checking accounts that house the allotment stream or somewhere else?

No rush as I am aware that both of you are recovering from an overdose of glue fumes.....

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