



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 Physicians Health Plan**

**Report No. 1C-9U-00-14-034**

**Date: December 23, 2014**

-- 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.



Office of the  
Inspector General

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

**AUDIT REPORT**

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Physicians Health Plan  
Contract Number 2915 - Plan Code 9U  
Lansing, Michigan**

Report No. 1C-9U-00-14-034

Date: 12/23/14

A handwritten signature in black ink, appearing to read "Michael R. Esser", written over a horizontal line.

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

-- 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.



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

Office of the  
Inspector General

---

## EXECUTIVE SUMMARY

---

**Federal Employees Health Benefits Program  
Community-Rated Health Maintenance Organization  
Physicians Health Plan  
Contract Number 2915 - Plan Code 9U  
Lansing, Michigan**

**Report No. 1C-9U-00-14-034**

**Date: 12/23/14**

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Physicians Health Plan (Plan). The audit covered contract years 2010 and 2011, and was conducted at the Plan's office in Lansing, Michigan.

This report questions \$90,226 for inappropriate health benefit charges to the FEHBP in contract year 2010. The questioned amount includes \$82,281 for defective pricing and \$7,945 due the FEHBP for lost investment income, calculated through December 31, 2014. We found that the FEHBP premium rates were developed in accordance with the Office of Personnel Management's Rate Instructions to Community-Rated Carriers for contract year 2011.

In contract year 2010, we determined that the FEHBP rates were overstated by \$82,281 due to defective pricing. Specifically, the Plan did not apply an SSSG discount to the FEHBP rates. Also, the Plan inappropriately charged the FEHBP for mental health parity which was not charged to any other group that we reviewed. Finally, the Plan developed the FEHBP's rates using higher medical and prescription drug trend factors than what the Plan filed with the state insurance commission.

Consistent with the regulations and contract, the FEHBP is due \$7,945 for lost investment income, calculated through December 31, 2014 on the defective pricing finding. In addition, we

recommend that the contracting officer recover lost investment income starting January 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

# CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY .....	i
I. INTRODUCTION AND BACKGROUND .....	1
II. OBJECTIVES, SCOPE, AND METHODOLOGY .....	3
III. AUDIT FINDINGS AND RECOMMENDATIONS .....	5
1. Premium Rate Review .....	5
2. Lost Investment Income .....	7
IV. MAJOR CONTRIBUTORS TO THIS REPORT.....	8
Exhibit A (Summary of Questioned Costs)	
Exhibit B (Defective Pricing Questioned Costs)	
Exhibit C (Lost Investment Income)	
Appendix (Physicians Health Plan’s July 16, 2014 response to the draft report)	

# **I. INTRODUCTION AND BACKGROUND**

## **Introduction**

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Physicians Health Plan (Plan). The audit covered contract years 2010 and 2011, and was conducted at the Plan's office in Lansing, Michigan. The audit was conducted pursuant to the provisions of Contract CS 2915; 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.

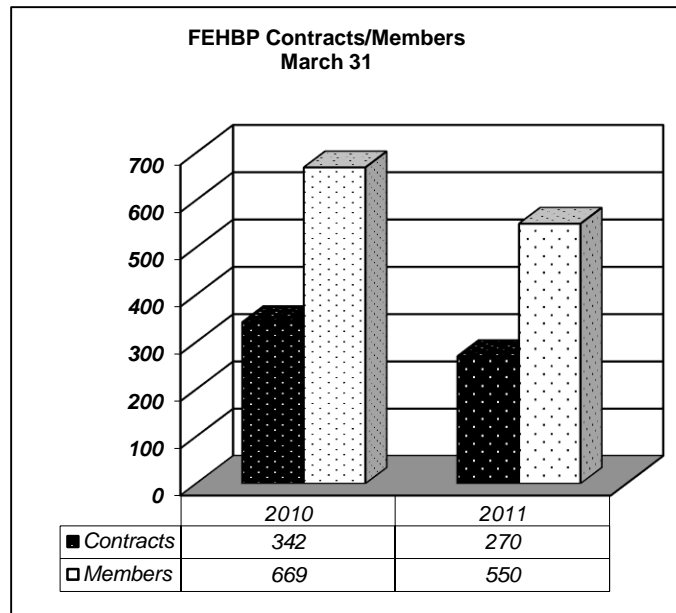
## **Background**

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 the contract years audited.



The Plan has participated in the FEHBP since 2008 and provides health benefits to FEHBP members in the Mid-Michigan area. There are no prior audits conducted by our office. The preliminary results of this audit were discussed with Plan officials at an exit conference and in subsequent correspondence.

## II. OBJECTIVES, SCOPE, AND METHODOLOGY

### Objectives

The primary objectives of the audit were to determine if the Plan offered the FEHBP market price rates and 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.

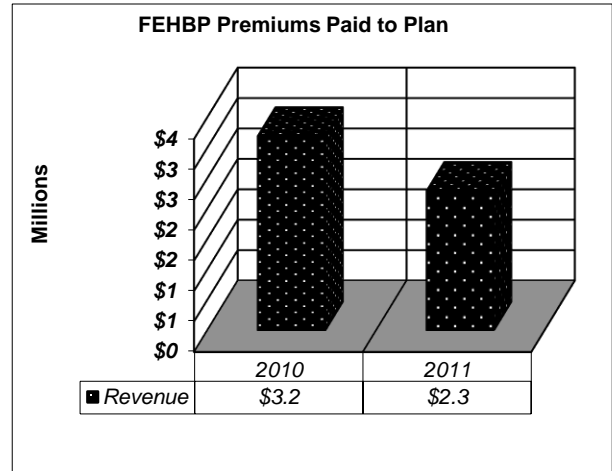
This performance audit covered contract years 2010 and 2011. For these years, the FEHBP paid approximately \$5.5 million in premiums to the Plan.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and the Rate Instructions to Community-Rated Carriers (rate instructions). These audits are also designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts.

We obtained an understanding of the Plan's internal control structure, but we did not use this information to determine the nature, timing, and extent of our audit procedures. However, the audit included such tests of the Plan's rating system and such other auditing procedures considered necessary under the circumstances. Our review of internal controls was limited to the procedures the Plan has in place to ensure that:

- The appropriate Similarly Sized Subscriber Groups (SSSG) were selected;
- the rates charged to the FEHBP were the market price rates (i.e., equivalent to the best rate offered to the SSSGs); and
- the loadings to the FEHBP rates were reasonable and equitable.

In conducting the audit, we relied to varying degrees on computer-generated billing, enrollment, and claims data provided by the Plan. We did not verify the reliability of the data generated by





the various information systems involved. However, nothing came to our attention during our audit testing utilizing the computer-generated data to cause us to doubt its reliability. We believe that the available data was sufficient to achieve our audit objectives. Except as noted above, the audit was conducted in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States.

The audit fieldwork was performed at the Plan's office in Lansing, Michigan during February 2014. Additional audit work was completed at our office in Cranberry Township, Pennsylvania.

### **Methodology**

We examined the Plan's federal rate submission 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 the rate instructions to determine the propriety of the FEHBP premiums and the reasonableness and acceptability of the Plan's rating system.

To gain an understanding of the internal controls in the Plan's rating system, we reviewed the Plan's rating system policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

### **III. AUDIT FINDINGS AND RECOMMENDATION**

#### **Premium Rate Review**

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

**\$82,281**

The Certificate of Accurate Pricing the Plan signed for contract year 2010 was defective. In accordance with federal regulations, the FEHBP is therefore due a rate reduction for this year. Application of the defective pricing remedy shows that the FEHBP is due a premium adjustment of \$82,281 (see Exhibit A). We found that the FEHBP rates were developed in accordance with applicable laws, regulations, and the OPM rate instructions in contract year 2011.

Federal Employees Health Benefits Acquisition Regulations (FEHBAR) 1652.215-70 provides that carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to a SSSG. SSSGs are the Plan's two employer groups closest in subscriber size to the FEHBP. If it is found that the FEHBP was charged higher than the market price rate (i.e., 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.

#### **2010**

We agree with the Plan's selection of **REDACTED** and **REDACTED** as SSSGs for contract year 2010. The SSSGs and FEHBP were rated using a blended Adjusted Community Rating and Community Rating by Class methodologies. The Plan applied "other" discounts of **REDACTED** and **REDACTED** to the FEHBP high and standard options, respectively. The Plan did not apply an "SSSG" discount to the FEHBP rates. Our analysis of the rates charged to the SSSGs shows that **REDACTED** received a **REDACTED** discount and **REDACTED** received a **REDACTED** discount.

Our review of the SSSG rates found that the Plan removed large medical claims and prescription drug claims of terminated members from the **REDACTED** rate development. We found the Plan did not have policies or procedures in place for the removal of large medical claims or prescription drug claims for terminated members. Therefore, we included all large medical claims and prescription drug claims for terminated members in accordance with the Plan's pooling methodology.

Furthermore, the Plan developed the **REDACTED** rates using two years of claims experience, but only applied a one-year pooling point of **REDACTED**. The Plan should have applied the two-year pooling point of **REDACTED**. We applied the correct two-year pooling point of **REDACTED**, which reduced the pooled claims from **REDACTED** to **REDACTED**. These conditions contributed to the **REDACTED** discount.

Our review of the FEHBP rates found that the Plan applied a mental health parity loading of **REDACTED**. This loading was not applied to the other groups reviewed with mental health benefits. Therefore, we removed this loading from our audited rates. We also found the Plan applied a **REDACTED** medical trend factor and a **REDACTED** prescription drug trend factor. Based on the Plan's state insurance commission rate filings, both the medical and prescription drug trend factors should have been **REDACTED**. We corrected these trend factors in our audited rates.

We recalculated the FEHBP rates based on the exceptions noted above and applied the **REDACTED** discount of **REDACTED** to our audited rates. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP was overcharged \$82,281 (see Exhibit B).

**Plan's Comments (See Appendix):**

**REDACTED** Large Claims

The Plan states they removed large medical claims for a single terminated member and disagrees that they have no procedures in place to remove claims for terminated members. The Plan states that in the course of developing experience rates on a prospective basis, it is standard procedure to consider significant changes in risk driven by enrollment changes. The Plan does not think this adjustment should be classified as a discount.

**REDACTED** Pooling Point

The Plan did not comment on this issue.

Medical and Prescription Drug Trends

The Plan states the trends of **REDACTED** and **REDACTED** were filed and the support was provided.

Mental Health Parity

The Plan did not comment on this issue.

**OIG's Response to the Plan's Comments:**

**REDACTED** Large Claims

The Plan is unable to provide written procedures that state they remove claims for terminated members.

Medical and Prescription Drug Trends

The support the Plan provided in its response shows a trend of **REDACTED** for both medical and prescription drug.

The Plan was unable to provide any further evidence which would dismiss our findings in the draft report.

## **Recommendation 1**

We recommend that the contracting officer require the Plan to return \$82,281 to the FEHBP for defective pricing in contract year 2010.

## **2. Lost Investment Income**

**\$7,945**

In accordance with FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing finding in contract year 2010. We determined the FEHBP is due \$7,945 for lost investment income, calculated through December 31, 2014 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning January 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

FEHBAR 1652.215-70 provides that, if any rate established in connection with the FEHBP contract was increased because the carrier furnished cost or pricing data that was 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 did not address lost investment income in its response to the draft report.

## **Recommendation 2**

We recommend that the contracting officer require the Plan to return \$7,945 to the FEHBP for lost investment income, calculated through December 31, 2014. We also recommend that the contracting officer recover lost investment income on amounts due for the period beginning January 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

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

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

**REDACTED**, Auditor-in-Charge

**REDACTED**, Auditor

---

**REDACTED**, Chief

**REDACTED**, Senior Team Leader

**Exhibit A**

**Physicians Health Plan  
Summary of Questioned Costs**

Defective Pricing Questioned Costs

Contract Year 2010	<u>\$82,281</u>	
Total Defective Pricing Questioned Costs		\$82,281
Lost Investment Income		<u>\$7,945</u>
Total Questioned Costs		<u>\$90,226</u>

**Physicians Health Plan  
Defective Pricing Questioned Costs**

**Contract Year 2010 - High Option**

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	<b>REDACTED</b>	<b>REDACTED</b>	
FEHBP Line 5 - Audited Rate	<b>REDACTED</b>	<b>REDACTED</b>	
Bi-weekly Overcharge	<b>REDACTED</b>	<b>REDACTED</b>	
To Annualize Overcharge:			
March 31, 2010 enrollment	<b>REDACTED</b>	<b>REDACTED</b>	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	<b>REDACTED</b>	<b>REDACTED</b>	<b>\$91,974</b>

**Contract Year 2010 - Standard Option**

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	<b>REDACTED</b>	<b>REDACTED</b>	
FEHBP Line 5 - Audited Rate	<b>REDACTED</b>	<b>REDACTED</b>	
Bi-weekly Overcharge	<b>REDACTED</b>	<b>REDACTED</b>	
To Annualize Overcharge:			
March 31, 2010 enrollment	<b>REDACTED</b>	<b>REDACTED</b>	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	<b>REDACTED</b>	<b>REDACTED</b>	<b>(\$9,693)</b>

Total 2010 Defective Pricing Questioned Costs **\$82,281**

July 16, 2014

**REDACTED**

U.S. Office of Personnel Management  
Office of Inspector General  
800 Cranberry Woods Drive  
Suite 270  
Cranberry Township Pennsylvania 16066

Re: Physicians Health Plan (PHP) Draft Report

Dear **REDACTED**

PHP reviewed audit findings and recommendations from the June 17, 2014 draft audit report. The following comments are in response to certain audit findings:

1. Regarding the FEHB 2010 medical and prescription drug trends. The trends of the **REDACTED** and **REDACTED** trends were filed. The 2009 large group rate methodology trends for experience rating were used in the 2010 proposal due on May 31, 2009. The supporting document file is Vis20 - Addendum - Cert for PHPMM Grp Plan Rating Methodology. This was provided with the initial supporting documentation submission under request item #2.
2. Regarding 2010 **REDACTED**. PHP removed large claims for a single terminated member. We respectfully disagree there are no procedures in place to remove claims for terminated members. In the course of developing experience rates on a prospective basis, it is standard procedure to consider significant changes in risk driven by enrollment changes. We do not think this adjustment should be classified as a discount.

PHP requests these comments are considered prior issuing a final report.

Sincerely,

**REDACTED**

**REDACTED**

Controller

Enclosure