



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

Final Audit Report

**AUDIT OF THE FEDERAL EMPLOYEES HEALTH
BENEFITS PROGRAM OPERATIONS AT HEALTH NET
OF CALIFORNIA – NORTHERN REGION**

Report Number 1C-LB-00-14-043

March 23, 2015

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EXECUTIVE SUMMARY

Audit of the Federal Employees Health Benefits Program Operations at Health Net of California – Northern Region

Report No. 1C-LB-00-14-043

March 23, 2015

Why Did We Conduct the Audit?

The objectives of this performance audit were to determine if Health Net of California – Northern Region (Plan) offered the Federal Employees Health Benefits Program (FEHBP) market price rates and whether 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.

What Did We Audit?

Under contract CS 2002, the Office of the Inspector General completed a performance audit of the FEHBP rates offered for contract year 2011. Our audit fieldwork was conducted from May 5, 2014 through May 9, 2014 at the Plan's office in Woodland Hills, California. Additional audit work was completed at our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania.

What Did We Find?

This report questions \$207,321 for inappropriate health benefit charges to the FEHBP in contract year 2011. The questioned amount includes \$193,514 for defective pricing and \$13,807 due to the FEHBP for lost investment income, calculated through February 28, 2015.

The Plan had high and standard options for the FEHBP in contract year 2011. We determined that the Plan's high and standard option rates were overstated by \$183,587 and \$9,927, respectively, due to defective pricing. For both options, the Plan did not apply the correct SSSG discount to the FEHBP rates.

Consistent with the regulations and contract, the FEHBP is due \$13,807 for lost investment income, calculated through February 28, 2015 on the defective pricing finding. In addition, we recommend that the contracting officer recover lost investment income starting March 1, 2015, until all defective pricing amounts have been returned to the FEHBP.



Michael R. Esser
*Assistant Inspector General
for Audits*

ABBREVIATIONS

CFR	Code of Federal Regulations
FEHBP	Federal Employees Health Benefits Program
FEHBAR	Federal Employees Health Benefits Acquisition Regulations
OA	Office of the Actuaries
OIG	Office of the Inspector General
OPM	U.S. Office of Personnel Management
PLAN	Health Net of California – Northern Region
SSSG	Similarly Sized Subscriber Group
U.S.C.	United States Code

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I. BACKGROUND

This final report details the findings, conclusions, and recommendations resulting from the audit of the Federal Employees Health Benefits Program (FEHBP) operations at Health Net of California – Northern Region (Plan).

The audit covered contract year 2011, and was conducted at the Plan’s office in Woodland Hills, California. The audit was conducted pursuant to the provisions of Contract CS 2002; 5 U.S.C. Chapter 89; and 5 Code of Federal Regulations (CFR) Chapter 1, Part 890. The audit was performed by the U.S. Office of Personnel Management’s (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

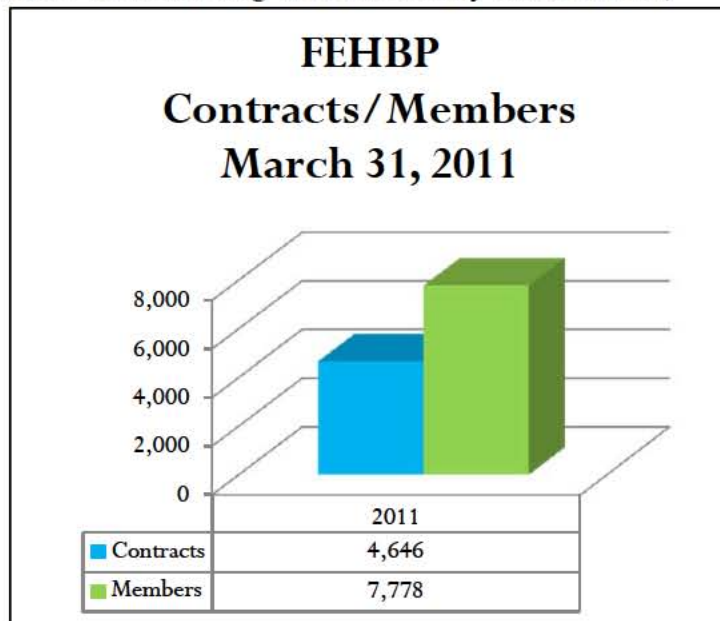
The FEHBP was established by the Federal Employees Health Benefits Act (Public Law 86-382), enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for Federal employees, annuitants, and dependents. The FEHBP is administered by OPM’s Healthcare and Insurance Office. Health insurance coverage is provided through contracts with health insurance carriers that 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, 2011.

The Plan has participated in the FEHBP since 1980 and provides health benefits to FEHBP members in Northern California. The Plan’s prior audit covered contract years



2008 through 2010. All findings associated with that audit have been resolved.

The preliminary results of this audit were discussed with the Plan officials at an exit conference and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan's comments were considered in the preparation of this report and are included, as appropriate, as the Appendix.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objective

The primary objectives of this performance 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 year 2011. For this year, the FEHBP paid approximately \$64.7 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 OPM 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 (SSSGs) 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 from May 4, 2014 through May 9, 2014 at the Plan's office in Woodland Hills, California. Additional audit work was completed at our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania.

Methodology

We examined the Plan's Federal rate submissions and related documents as a basis for validating the market price rates. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the market price was actually charged to the FEHBP. Finally, we used the contract, the Federal Employees Health Benefits Acquisition Regulations, and 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.

To test the Plan's compliance with the FEHBP health benefit provisions related to coordination of benefits with Medicare, we selected a judgmental sample of potential uncoordinated claim lines. To select our sample, we queried the Plan's FEHBP claims data for any members over the age of 65, resulting in a universe of 1,214 claim lines. We then sorted by the Insurance Amount Paid and judgmentally selected all claim lines over \$20,000. This resulted in a sample of 17 claim lines. We sent the 17 claim lines to the Plan for review to determine if the claims were properly coordinated with Medicare. The results of this sample were not projected to the universe.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rate Review

1. Defective Pricing

\$193,514

The Certificate of Accurate Pricing the Plan signed for contract year 2011 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 \$193,514 (see Exhibit A).

Carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an 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., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price rate.

2011

We agree with the Plan's selection of [REDACTED] and [REDACTED] as SSSGs for contract year 2011. The SSSGs and FEHBP were rated using an Adjusted Community Rating methodology. The Plan applied a [REDACTED] percent SSSG discount to the FEHBP high and standard options. An additional [REDACTED] percent underwriting discount was applied to the FEHBP standard option. Our analysis of the rates charged to the SSSGs shows that [REDACTED] received a [REDACTED] percent discount, and [REDACTED] received a [REDACTED] percent discount.

We determined that the FEHBP high and standard option rates were overstated by \$183,587 and \$9,927, respectively, due to defective pricing. Specifically, the Plan did not apply the correct SSSG discount to the FEHBP high and standard option rates. The Plan incorrectly used 65,135 shared risk member exposures in the calculation of [REDACTED]'s pooling point charge. We applied 78,038 shared risk member exposures based on the supporting documents provided by the Plan. The adjustment increased the pooling charge from [REDACTED] to [REDACTED]. This error in the rate development contributed to [REDACTED]'s [REDACTED] percent audited discount.

We recalculated the FEHBP high and standard option rates and applied the SSSG discount of [REDACTED] percent to our audited rates. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows that the FEHBP rates were overcharged \$193,514, for both the high and standard options in contract year 2011 (see Exhibit B).

Plan's Comments (see Appendix):

The Plan agrees with our finding.

Recommendation 1

We recommend that the contracting officer require the Plan to return \$193,514 to the FEHBP for defective pricing in contract year 2011.

2. Lost Investment Income \$13,807

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 2011. We determined the FEHBP is due \$13,807 for lost investment income, calculated through February 28, 2015. In addition, the FEHBP is entitled to lost investment income for the period beginning March 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 provide any comment on lost investment income.

Recommendation 2

We recommend that the contracting officer require the Plan to return \$13,807 to the FEHBP for lost investment income, calculated through February 28, 2015. We also recommend that the contracting officer recover lost investment income on amounts due for the period beginning March 1, 2015, until all defective pricing amounts have been returned to the FEHBP.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

COMMUNITY-RATED AUDITS GROUP

██████████, Auditor-in-Charge

██████████, Auditor

██████████, Senior Team Leader

██████████, Group Chief

EXHIBIT A

Health Net of California - Northern Region Summary of Questioned Costs

Defective Pricing Questioned Costs

Contract Year 2011	<u>\$193,514</u>
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Total Defective Pricing Questioned Costs	\$193,514
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Lost Investment Income	<u>\$13,807</u>
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Total Questioned Costs	<u>\$207,321</u>
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EXHIBIT B

Health Net of California - Northern Region Defective Pricing Questioned Costs

Contract Year 2011 - High Option

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	████████	████████	
FEHBP Line 5 - Audited Rate	████████	████████	
Bi-weekly Overcharge	████	████	
To Annualize Overcharge:			
March 31, 2011 enrollment	████	████	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	████████	████████	\$183,587

Contract Year 2011 - Standard Option

	<u>Self</u>	<u>Family</u>	
FEHBP Line 5 - Reconciled Rate	████████	████████	
FEHBP Line 5 - Audited Rate	████████	████████	
Bi-weekly Overcharge	████	████	
To Annualize Overcharge:			
March 31, 2011 enrollment	████	████	
Pay Periods	<u>26</u>	<u>26</u>	
Subtotal	████████	████████	<u>\$9,927</u>

Total 2011 Defective Pricing Questioned Costs **\$193,514**

EXHIBIT C

Health Net of California - Northern Region Lost Investment Income

Year	2011	2012	2013	2014	28-Feb-15	Total
Audit Findings:						
1. Defective Pricing	\$193,514	\$0	\$0	\$0	\$0	\$193,514
Totals (per year):	\$193,514	\$0	\$0	\$0	\$0	\$193,514
Cumulative Totals:	\$193,514	\$193,514	\$193,514	\$193,514	\$193,514	\$193,514
Avg. Interest Rate (per year):	2.563%	1.875%	1.563%	2.063%	2.125%	
Interest on Prior Years Findings:	\$0	\$3,628	\$3,024	\$3,991	\$685	\$11,328
Current Years Interest:	\$2,479	\$0	\$0	\$0	\$0	\$2,479
Total Cumulative Interest Calculated Through February 28, 2015:	\$2,479	\$3,628	\$3,024	\$3,991	\$685	\$13,807



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