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

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# Final Audit Report

**Subject:**

**AUDIT OF UNICARE LIFE AND  
INSURANCE COMPANY'S  
PHARMACY OPERATIONS  
AS ADMINISTERED BY  
WELLPOINT HEALTH NETWORKS, INC.  
2004 - 2007**

**Report No. 1C-17-00-09-018**

**Date: September 30, 2009**

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UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Office of the  
Inspector General

**AUDIT REPORT**

Federal Employees Health Benefits Program  
Pharmacy Drug Operations  
Contract CS 2877  
UNICARE Life and Insurance Company  
Plan Codes 17 and 72

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WellPoint Health Networks, Inc.  
Mason, Ohio

REPORT NO. 1C-17-00-09-018

DATE: September 30, 2009

A handwritten signature in black ink, appearing to read "Michael R. Esser".

Michael R. Esser  
Assistant Inspector General  
for Audits



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT  
Washington, DC 20415

Office of the  
Inspector General

**EXECUTIVE SUMMARY**

Federal Employees Health Benefits Program  
Pharmacy Operations  
Contract CS 2877  
UNICARE Life and Insurance Company  
Plan Codes 17 and 72

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WellPoint Health Networks, Inc.  
Mason, Ohio

REPORT NO. 1C-17-00-09-018

DATE: September 30, 2009

The Office of the Inspector General has completed a performance audit of the 2004 through 2007 UNICARE Life and Insurance Company's (UNICARE) pharmacy operations as administered by WellPoint Health Networks, Inc. (WellPoint). The primary objective of the audit was to determine whether WellPoint complied with the regulations and requirements contained within its service agreement with UNICARE and Contract CS 2877 (between UNICARE and the Office of Personnel Management). The audit was conducted in Mason, Ohio, from November 3 through November 21, 2008. Our audit results are summarized below.

**ADMINISTRATIVE EXPENSES**

**Unallowable Administrative Expenses**

**\$9,330**

WellPoint charged the FEHBP \$9,330 for unallowable administrative expenses in contract years 2005 through 2007.

## **LOST INVESTMENT INCOME**

### **Lost Investment Income on Administrative Expense Overcharges**

**\$1,298**

The FEHBP is due \$1,298 for lost investment income on the 2005 through 2007 administrative expense overcharges calculated through August 31, 2009. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning September 1, 2009 until all questioned costs have been returned to the FEHBP.

## **DRUG MANUFACTURER REBATES**

We determined that WellPoint returned all manufacturer drug rebates and the associated administrative fees to the FEHBP in compliance with the terms of the service agreement between WellPoint and UNICARE, as well as Contract CS 2877 between UNICARE and OPM.

## **ANNUAL ACCOUNTING STATEMENT RECONCILIATION**

We reconciled the pharmacy cost reported on UNICARE's Annual Accounting Statements to the supporting documentation provided by WellPoint and did not identify any material variances.

## **MAIL ORDER DRUG PROFIT REMOVAL**

We determined that WellPoint removed all profit from its mail order drug costs charged to the FEHBP in compliance with the terms of the service agreement between WellPoint and UNICARE, as well as Contract CS 2877 between UNICARE and OPM.

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# **I. INTRODUCTION AND BACKGROUND**

## **INTRODUCTION**

As authorized by the Inspector General Act of 1978, as amended, we conducted an audit of the 2004 through 2007 UNICARE Life and Insurance Company (UNICARE) pharmacy operations as administered by WellPoint Health Networks, Inc. (WellPoint). The audit field work was conducted at WellPoint's offices in Mason, Ohio, from November 3 through November 21, 2008. Additional audit work was completed in our Washington, D.C. office.

## **BACKGROUND**

The Federal Employees Health Benefits Program (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. The Office of Personnel Management's (OPM) Center for Retirement and Insurance Services 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 that provide service benefits, indemnity benefits, or comprehensive medical services.

WellPoint Health Networks, Inc. is one of the largest publicly traded health care insurers in the United States. UNICARE, one of its primary subsidiaries, entered into a government-wide contract (CS 2877) with OPM to provide a health benefit plan authorized by the FEHB Act. Consequently, since in this instance the health carrier (UNICARE) and the Pharmacy Benefit Manager (WellPoint) are part of the same entity, UNICARE has a service agreement instead of a contract with WellPoint to manage the delivery and financing of prescription drug benefits for UNICARE health benefit purchasers. As a result of this relationship, the Pharmacy Benefit Manager (PBM) agreement was fully transparent where actual prices were passed through to the FEHBP.

On April 13, 2009, it was announced that Express Scripts (a large national PBM) had acquired WellPoint's PBM business. As a result of this acquisition, the favorable conditions resulting from WellPoint's subsidiary relationship with its PBM that benefited the FEHBP in this case no longer exist.

This was our first audit of the UNICARE pharmacy benefit operations as administered by WellPoint.

## **II. OBJECTIVES, SCOPE, AND METHODOLOGY**

### **OBJECTIVES**

The objectives of the audit were to determine whether WellPoint's charges to the FEHBP and services provided to FEHBP members were in accordance with the terms of the service agreement between WellPoint and UNICARE as well as Contract CS 2877 between UNICARE and OPM. Our specific objectives were as follows:

#### **Administrative Expenses**

- To determine whether the administrative expenses charged to the FEHBP were allowable, reasonable and allocable.

#### **Drug Manufacturer Rebates**

- To determine if the correct rebate percentages were used to calculate FEHBP drug manufacturer rebates;
- To determine whether the FEHBP was credited the appropriate amount of drug manufacturer rebates in a timely manner; and
- To determine if the FEHBP was credited for any administrative fees earned by WellPoint as a result of FEHBP rebates.

#### **Annual Accounting Statement (AAS) Reconciliation**

- To determine whether the costs charged to the FEHBP by WellPoint reconciled to those reported to OPM on the AAS.

#### **Mail Order Profit Removal**

- To determine whether WellPoint properly removed profit included in the Mail Order pharmacy charges to 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 audit 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.

We reviewed UNICARE's Annual Accounting Statements for contract years 2004 through 2007. During this period, UNICARE paid \$40,530,410 in prescription drug charges (see Schedule A).

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

In conducting our audit, we relied to varying degrees on computer-generated data provided by WellPoint. 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 audit testing, nothing came to our attention to cause us to doubt its reliability. We believe that the data was sufficient to achieve the audit objectives.

We also conducted tests to determine whether WellPoint had complied with the contract and service agreement, the applicable procurement regulations (i.e., Federal Acquisition Regulations, and Federal Employees Health Benefits Acquisition Regulations, as appropriate), and the laws and regulations governing the FEHBP. 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 items not tested, nothing came to our attention that caused us to believe that WellPoint has not complied, in all material respects, with those provisions.

## **METHODOLOGY**

To test WellPoint's compliance with the contracts we reviewed the following areas:

### Administrative Expenses

- We judgmentally selected 6 cost centers with the highest amounts charged to the FEHBP in 2007, totaling \$38,024 (from a universe of 23 cost centers totaling \$73,178). We then reviewed the costs charged to the FEHBP in the months of January, July, and December of 2007 to determine if the amounts charged were necessary, reasonable, and allowable.

### Drug Manufacturer Rebates

- From the largest FEHBP carrier administered by WellPoint, we judgmentally selected 10 drug manufacturers (from a universe of 80 drug manufacturers), with the highest FEHBP rebates earned from 2004 through 2007. From this sample:
  - a. We randomly selected and reviewed two drug products from each manufacturer and compared the contract rebate terms with WellPoint's billing for the second quarter of 2007 to verify that the correct rebate percentages were being applied.
  - b. To determine if administrative fees earned by WellPoint as a result of FEHBP drug utilization were properly returned to the FEHBP, we reviewed all 2006 and

2007 administrative fee credits, totaling \$7,633 and \$6,078, respectively, and verified the amount was returned to the FEHBP.

- c. To determine if the FEHBP was properly credited for rebates received, we reviewed all FEHBP rebates for 2004 through 2007 and traced them from WellPoint's general ledger to the AAS and the drawdown reports.

#### AAS Reconciliation

- To determine if the amounts reported by UNICARE on the AAS were accurate, we reconciled WellPoint's general ledger totals for 2004 through 2007 to the AAS.

#### Mail Order Profit Removal

- To determine if the FEHBP was properly credited for any profit included in the mail order pharmacy benefits, we judgmentally selected the latest three months of mail order pharmacy claims data that was readily available from 2007 (the most current year included in our audit scope). Specifically, we reviewed the claims for the months of September through November 2007 and we verified WellPoint's profit calculation and the return of monies to the FEHBP.

The samples above that were selected and reviewed were not statistically based. Consequently, the results could not be projected to the universe since it is unlikely that the results are representative of the universe as a whole. We used Contract CS 2877 and the service agreement between UNICARE and WellPoint to determine if processing and administrative fees charged to the FEHBP were in compliance with the terms of the contract and service agreement.

The results of the audit were provided to WellPoint in written inquiries and were discussed with WellPoint officials throughout the audit and at the exit conference. In addition, a draft report, dated May 14, 2009, was provided to WellPoint for review and comment. WellPoint's comments on the draft report were considered in preparing the final report and are included as an Appendix to this report.

### **III. AUDIT FINDINGS AND RECOMMENDATIONS**

#### **A. ADMINISTRATIVE EXPENSES**

##### **1. Unallowable Administrative Expenses** **\$9,330**

WellPoint charged the FEHBP \$9,330 in unallowable administrative expenses in contract years 2005 through 2007.

The Contract CS 2877, Section 3.2 (2)(ii) states that "Administrative expenses consists of all actual, allowable, allocable and reasonable expenses incurred in the adjudication of subscriber claims or incurred in the Carrier's overall operation of the business."

As administrator of UNICARE's FEHBP pharmacy operations, WellPoint is paid for its actual administrative expenses. WellPoint's administrative expenses are captured on a corporate level and designated to the various pharmacy and pharmacy-related cost centers. WellPoint then allocates expenses captured by cost center to the health carriers included in its corporate network based primarily on the Carriers' membership or weighted membership compared to the total corporate membership.

To determine whether the administrative expenses WellPoint charged to the FEHBP were reasonable, allocable and allowable, we reviewed WellPoint's procedures for allocating pharmacy-related expenses and reviewed the administrative cost centers to identify any unallowable expenses.

Our review found that WellPoint's allocation methods were reasonable and complied with the contract. However, we identified one unallowable cost center that was charged to the FEHBP in contract years 2005 through 2007. The unallowable expenses included in this cost center pertained to pharmacy marketing and product development activities and were not expenses related to FEHBP pharmacy claims.

As a result of including an unallowable cost center in the costs charged to the FEHBP, WellPoint overcharged the FEHBP \$9,330.

#### **WellPoint Comments:**

WellPoint agreed with the finding and stated that it would be returning \$9,330 to the FEHBP. Additionally, WellPoint developed new procedures to ensure that the FEHBP is charged only for the appropriate administrative expenses.

#### **Recommendation 1**

We recommend that the contracting officer ensure that WellPoint returns \$9,330 to the FEHBP for unallowable administrative expenses charged to UNICARE in contract years 2005 through 2007.

## **Recommendation 2**

We recommend that the contracting officer ensure that WellPoint has instituted the new procedures referred to in its response to the draft report.

## **B. LOST INVESTMENT INCOME**

### **1. Lost Investment Income on Administrative Expense Overcharges** **\$1,298**

In accordance with FEHBP regulations and Contract CS 2877 between OPM and UNICARE, the FEHBP is entitled to recover lost investment income (LII) on the untimely return of drug manufacturer rebates to the FEHBP, which totaled \$9,330 relating to contract years 2006 and 2007. The LII on these untimely returned rebates amounts to \$1,298, through August 31, 2009.

Contract CS 2877, Sections 3.4 (e) and (f), states that investment income lost as a result of failure to credit income due to the contract is due to the government based on a simple interest formula from the date the funds should have been credited to the date the funds are returned.

We determined that the FEHBP is due \$1,298 in LII, calculated through August 31, 2009 (See Schedule B). In addition, the FEHBP is entitled to recover LII on amounts due beginning on September 1, 2009, until all questioned costs have been returned to the FEHBP.

Our calculation of LII was based on the United States Department of Treasury's semiannual cost of capital rates.

### **WellPoint Comment:**

The draft report did not include a section covering lost investment income on the audit findings. Therefore, WellPoint did not address lost investment income in its response to the draft report.

## **Recommendation 3**

We recommend that the contracting officer require WellPoint to refund the FEHBP \$1,298 for lost investment income calculated through August 31, 2009, on the 2005 through 2007 administrative expense overcharges.

## **Recommendation 4**

We recommend that the contracting officer recover lost investment income on amounts due beginning September 1, 2009, until all questioned costs have been returned to the FEHBP.

**C. DRUG MANUFACTURER REBATES**

We determined that WellPoint returned to the FEHBP all drug rebates and the associated administrative fees that were received from the drug manufacturers due to FEHBP subscriber drug utilization in compliance with the terms of the service agreement between WellPoint and UNICARE, as well as Contract CS 2877 between UNICARE and OPM.

**D. ANNUAL ACCOUNTING STATEMENT RECONCILIATION**

We reconciled the pharmacy cost reported on UNICARE's Annual Accounting Statements to the supporting documentation provided by WellPoint and did not identify any material variances.

**E. MAIL ORDER DRUG PROFIT REMOVAL**

We determined that WellPoint removed all profit from its mail order drug costs charged to the FEHBP in compliance with the terms of the service agreement between WellPoint and UNICARE, as well as Contract CS 2877 between UNICARE and OPM.

## IV. MAJOR CONTRIBUTORS TO THIS REPORT

### Special Audits Group

██████████ Auditor-In-Charge

██████████ Auditor

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██████████ Group Chief ██████████

██████████ Senior Team Leader

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM  
 PHARMACY OPERATIONS  
 UNICARE LIFE AND INSURANCE COMPANY

CONTRACT CHARGES AND QUESTIONED COSTS  
 REPORT NUMBER: 1C-17-00-09-018

CONTRACT CHARGES	2004	2005	2006	2007	2008	2009	TOTAL
A. PHARMACY BENEFIT CHARGES	\$7,167,677	\$7,653,493	\$8,388,366	\$8,825,557	\$0	\$0	\$32,035,093
B. ADMINISTRATIVE EXPENSES	2,252,998	2,122,173	2,113,534	2,006,613	0	0	8,495,318
	\$9,420,675	\$9,775,666	\$10,501,900	\$10,832,170	\$0	\$0	\$40,530,411
QUESTIONED COSTS	2004	2005	2006	2007	2008	2009	TOTAL
A. ADMINISTRATIVE EXPENSES							
1. UNALLOWABLE ADMINISTRATIVE EXPENSES	\$0	\$698	\$3,315	\$5,317	\$0	\$0	\$9,330
B. LOST INVESTMENT INCOME (LII)							
1. LII ON ADMINISTRATIVE EXPENSE OVERCHARGES	0	15	128	367	461	327	1,298
TOTAL QUESTIONED COSTS	\$0	\$713	\$3,443	\$5,684	\$461	\$327	\$10,628

FEDERAL EMPLOYEES HEALTH BENEFIT PROGRAM  
 PHARMACY OPERATIONS  
 UNICARE LIFE AND INSURANCE COMPANY

LOST INVESTMENT INCOME  
 REPORT NUMBER 1C-17-00-09-018

Year	2004	2005	2006	2007	2008	2009	Total
Audit Finding:							
UNALLOWABLE ADMINISTRATIVE EXPENSES	\$0	\$698	\$3,315	\$5,317	\$0	\$0	\$9,330
Totals (per year):	\$0	\$698	\$3,315	\$5,317	\$0	\$0	\$9,330
Cumulative Totals:	\$0	\$698	\$4,013	\$9,330	\$9,330	\$9,330	\$9,330
Avg. Interest Rate (per year):	4.2500%	4.3750%	5.4375%	5.5000%	4.9375%	5.2500%	
Interest on Prior Years Findings:	\$0	\$0	\$38	\$221	\$461	\$327	\$1,047
Current Years Interest:	\$0	\$15	\$90	\$146	\$0	\$0	\$251
Total Cumulative Interest Calculated Through August 31, 2009:	\$0	\$15	\$128	\$367	\$461	\$327	\$1,298



**Response to OPM Audit Report No. 1C-17-00-09-018**

**Date: May 28, 2009**

Prepared by: [REDACTED]

Office of Personnel Management  
Office of the Inspector General  
Attention: [REDACTED]  
1900 E Street NW, Room 6400  
Washington, DC 20415-1100

Response to OPM Draft Audit Report No. 1C-17-00-09-018

Dear [REDACTED]

Attached is WellPoint's to draft audit report No. 1C-17-00-09-018. If you have any questions please feel free to contact me.

Sincerely,

[REDACTED]

**A. ADMINISTRATIVE EXPENSES**

**1. Unallowable Administrative Expenses Charged to the FEHBP** **\$9,330**

**UNICARE Response**

The plan agrees with this finding.

**UNICARE Draft Response**

The plan agrees with the finding. Please note, the plan will be returning \$9,330 to the Program. Attached are procedures to ensure the FEHBP is charged only for the appropriate administrative expenses.