



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 PacifiCare of Arizona

Report No. 1C-A3-00-10-001

Date: May 21, 2010

-- CAUTION --

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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
Community-Rated Health Maintenance Organization
PacifiCare of Arizona
Contract Number 2884 - Plan Code A3
Cypress, California**

Report No. 1C-A3-00-10-001

Date: May 21, 2010

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



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

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Inspector General

EXECUTIVE SUMMARY

**Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
PacifiCare of Arizona
Contract Number 2884 - Plan Code A3
Cypress, California**

Report No. 1C-A3-00-10-001

Date: May 21, 2010

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at PacifiCare of Arizona (Plan). The audit covered contract years 2007 through 2009 and was conducted at the Plan's office in Cypress, California. We found that the FEHBP rates were developed in accordance with the applicable laws, regulations, and the Office of Personnel Management's rating instructions for the years audited.

During our claims review, we noted a small number of FEHBP claims that were not adjudicated properly. However, these claims did not have a material impact on the scope of our audit and, furthermore, the Plan no longer participates in the FEHBP. As a result, no corrective action is necessary.

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I. INTRODUCTION AND BACKGROUND

Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at PacifiCare of Arizona (Plan). The audit covered contract years 2007 through 2009 and was conducted at the Plan's office in Cypress, California. The audit was conducted pursuant to the provisions of Contract CS 2884; 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.

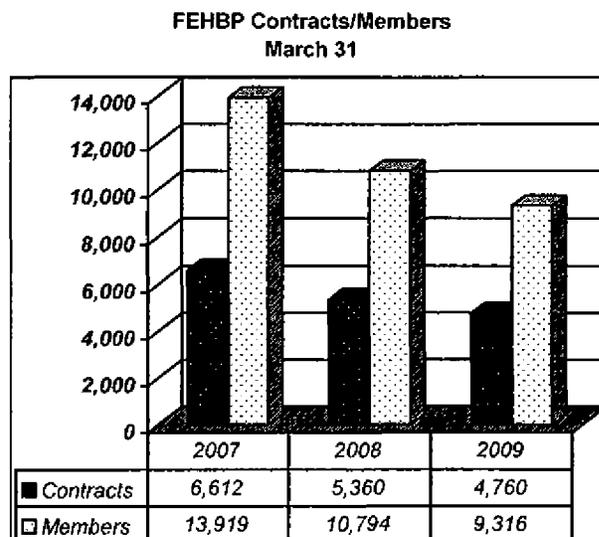
Background

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 Retirement and Benefits 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 various 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 for each contract year audited.



The Plan participated in the FEHBP from 1983 through 2009, and provided health benefits to FEHBP members throughout Maricopa and Pima Counties and a portion of Apache Junction. The last full-scope audit of the Plan covered contract years 2003 through 2006. All issues related to that audit have been resolved.

The preliminary results of this audit were discussed with Plan officials at an exit conference and through subsequent correspondence. Since the audit showed that the Plan's rating of the FEHBP was in accordance with the applicable laws, regulations, and instructions, we did not issue a draft report.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

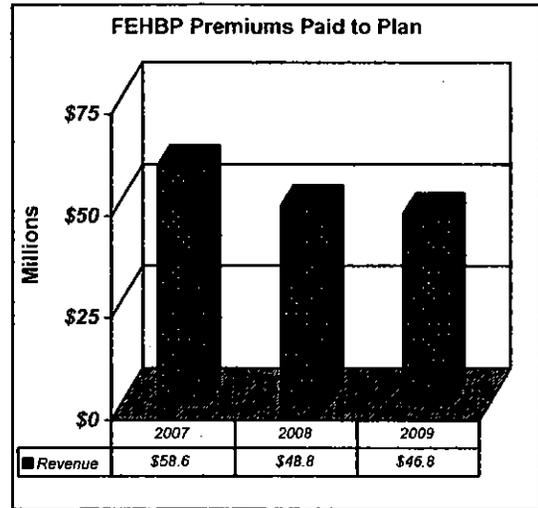
The primary objectives of the audit were to verify that the Plan offered market price rates to the FEHBP and to verify that the loadings to the FEHBP rates were reasonable and equitable. Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and 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 2007 through 2009. For these years, the FEHBP paid approximately \$154.2 million in premiums to the Plan.

The premiums paid for each contract year audited are shown on the chart to the right.



OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM 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 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 performed 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 Cypress, California, during November 2009. Additional audit work was completed at our office in Cranberry Township, Pennsylvania.

Methodology

We examined the Plan's federal rate submissions and related documents as a basis for validating the market price rates. Further, we examined claim payments to verify that the cost data used to develop the FEHBP rates was accurate, complete and valid. 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 OPM's Rate Instructions to Community-Rated Carriers 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's policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. RESULTS OF AUDIT

During our claims review, we noted a small number of FEHBP claims that were not adjudicated properly. However, these claims did not have a material impact on the scope of our audit. Since the Plan no longer participates in the FEHBP, no corrective action is necessary. Our audit showed that the Plan's rating of the FEHBP was in accordance with the applicable laws, regulations, and OPM's rating instructions to carriers for contract years 2007 through 2009. Consequently, the audit did not identify any questioned costs and no corrective action is necessary.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

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