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Federal Employees Health Benefits Program

Statement of  
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Before the  
Subcommittee on Compensation and Employee Benefits  
Committee on Post Office and Civil Service  
House of Representatives



ISSUES RELATED TO THE FEDERAL  
EMPLOYEES HEALTH BENEFITS PROGRAM

SUMMARY OF STATEMENT BY  
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In response to a request from the Chairman, House Subcommittee on Compensation and Employee Benefits, GAO provided preliminary findings of its work associated with the Federal Employees Health Benefits Program. The program, which covers about 8 million federal employees, annuitants and dependents, provides benefits through 375 health plans and will cost the government an estimated \$8.2 billion in 1989. Employees and annuitants will pay an additional \$3.4 billion.

At the Subcommittee's request GAO has been reviewing certain aspects of the program including administrative cost trends, controls to prevent fraud and abuse, and oversight by the Office of Personnel Management (OPM). Administrative expenses grew by 75 percent over the 5-year period ending 1987 while plan service charges (profits) were rising even faster. OPM's cost control efforts through expense ceilings have not been effective because plans seldom reached the ceilings, which in some instances were set at twice the plans' actual costs. OPM is negotiating with the plans to set new ceilings that will be adjusted in future years for changes in enrollment and inflation.

The health benefits program also appears to be vulnerable to fraud and abuse. The primary internal control to prevent fraud and abuse are OPM's periodic plan audits. During the past several years, fraud and abuse including embezzlements, commingling of funds, and inappropriate program charges have been identified in at least six of the largest plans. In addition, despite the potential for significant losses, GAO found that OPM has not required plans to monitor claims to detect provider and enrollee fraud and abuse, did not consider the program funds to be particularly vulnerable to loss, and did not identify the program as having material internal control weaknesses in its annual Federal Managers' Financial Integrity Act reports to Congress. OPM is planning to incorporate provisions in its 1990 contracts requiring the plans to establish procedures for detecting fraud and abuse.

GAO plans additional work to identify further actions OPM and the plans could take to control administrative costs and prevent instances of fraud and abuse.

Mr. Chairman and Members of the Subcommittee:

I am pleased to participate today in this hearing on the Federal Employees Health Benefits Program. The program is a major component of the government's compensation package and, as such, is an important factor in attracting and retaining a quality workforce. At the Subcommittee's request, we have been reviewing certain aspects of the program, including administrative cost trends, controls to prevent fraud and abuse, and oversight by the Office of Personnel Management (OPM). While we have much work yet to do, I would like to present our preliminary findings in these areas.

About 8 million federal employees, annuitants, and their dependents receive health benefits from the program, which in 1989 is estimated to cost \$11.6 billion in premiums. The government will pay \$8.2 billion, or 71 percent of this cost, with enrollees contributing the remainder. Health benefits are provided through 42 experience-rated plans which base their premiums on past claims experience and 333 community-rated plans, primarily health maintenance organizations (HMOs). Experience-rated plans account for about 90 percent of all program expenditures and are the focus of our work.

## ADMINISTRATIVE COSTS

The cost data that I will discuss were obtained from financial reports for 1982 through 1987 filed with OPM by experience-rated plans. The reports are subject to adjustment and to audit by OPM. Reports for 1988 were not filed in time for our review. Administrative expenses incurred by experience-rated plans are reimbursed subject to an OPM-imposed ceiling. Premium taxes imposed by states and other governmental entities on plan insurance underwriters are also reimbursed.

In 1987, the experience-rated plans spent about \$7 billion, or 89 percent of all program funds. About 90 percent of this amount was paid to enrollees or their health care providers for benefit claims. The remainder was for administrative expenses (\$448 million), premium taxes (\$44 million), plus service charges (\$42 million), which are the plans' profits. While small in relation to benefit payments, these three items have escalated rapidly and, at \$534 million, are a significant program cost.

As the graph we brought with us today shows (see attachment), the plans' administrative expenses increased by 75 percent over the 5-year period, or about 1.4 times the increase in benefits paid. The magnitude of this increase cannot be attributed to growth in enrollment, which increased by less than 2 percent. However, as the graph shows, these costs would have been affected to some

extent by wage and price inflation as the Employment Cost Index<sup>1</sup> went up by 21 percent and the Consumer Price Index grew by 18 percent. We will be seeking further explanations for this increase as part of our ongoing review.

The graph also shows that service charges increased at a much faster rate than administrative expenses through 1984. Although they have since leveled off, the plans' profits increased by 77 percent over the 5-year period.

OPM used administrative expense ceilings annually negotiated with the plans as its primary cost control measure but the ceilings have not been an effective control. Seldom during the six years we reviewed did the larger plans' expenses reach their ceilings and, in several instances, their ceilings were set at twice the amounts actually spent. OPM also audits the plans periodically to assure that expenses charged to the program were proper.

OPM is now in the process of changing the way administrative expense ceilings are set. For 1988, the ceiling negotiated with the program's largest plan established a base-year expense level to be adjusted in subsequent years for changes in enrollment and inflation. OPM is also negotiating administrative expense ceilings based on this formula with other plans. As an

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<sup>1</sup>The Employment Cost Index is a principal federal economic indicator that measures changes in compensation levels for all occupations in the non-farm economy.

illustration of the significance of this change, if the ceilings had been based on the new formula, administrative expenses for the period would have increased less than 25 percent and would have been \$132 million less in 1987. This amounts to about two percent of plan costs and premiums could have been reduced accordingly. As the Subcommittee requested, we will be further exploring the causes for the rapid increases in administrative expenses and service charges and evaluating the reasonableness of these costs by gathering data from large state and private sector plans.

Additionally, in 1987, 22 of the experience-rated plans charged the program \$44 million for premium taxes imposed on the plans' insurance underwriters by all 50 states and other governmental entities. Some plans pay no premium taxes because they are self insured and do not use insurance underwriters. In 1980, Congress exempted the federal employees life insurance program premiums from similar premium-based taxes because it considered the program to be self insured. Because any plan losses in one year are recovered through higher premiums in the following years, the health benefits program is operated as if it were self insured. We are currently studying the desirability of exempting the health benefits program from these taxes and will issue a separate report to you on this matter.

## FRAUD AND ABUSE

Another area which appears to lack effective oversight and control concerns the vulnerability of the health benefits program to fraud and abuse. During the past several years, instances of fraud and abuse have been identified in at least six of the largest plans. In 1984, over one million dollars was embezzled by officials of one plan (American Postal Workers Union) and in 1982 about \$35,000 was embezzled by an official of another plan (National League of Postmasters). Officials from both plans were subsequently prosecuted, found guilty, and the monies were returned to the program. OPM's plan audits which serve as the primary internal control to prevent fraud and abuse, identified two plans (American Federation of Government Employees and National Alliance of Federal Employees) which used commingled health benefit program and union funds to finance union operations during the 7-year period ending in 1985. The unions subsequently repaid the monies and OPM has issued regulations prohibiting the commingling of program funds. OPM's audits also identified that another plan (Mail Handlers) improperly charged the program about \$1 million in 1984 for facilities rented to other parties. The plan settled the matter by repaying the funds along with civil penalties after the matter was referred to the Justice Department for prosecution.

We found a serious abuse of program funds by one plan (Aetna), which improperly charged the health benefits program over \$7 million for federal income taxes it paid on plan profits for six years ending in 1987. Federal procurement regulations expressly prohibit the charging of federal income taxes to government contracts. OPM officials had not caught these improper charges when they reviewed the plan's accounting statements. Last December we reported<sup>2</sup> our findings to OPM's program administrator and recommended that the funds be recovered. OPM has since recovered the \$7 million.

We also found that despite the potential for significant losses, OPM had not required plans to monitor claims to detect provider and enrollee fraud and abuse. Although OPM intends to insert a clause in its 1990 contracts requiring procedures for detecting fraud and abuse, the nature and extent of the monitoring will be the prerogative of the plans. Officials at several of the largest plans said their current practice for dealing with suspected fraudulent providers is to closely monitor future claims but referral for prosecution is usually not considered.

The Federal Employees Health Benefits Amendments Act of 1988 permits OPM to exclude from the program health care providers who are found guilty of criminal fraud or unethical practices, but

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<sup>2</sup>Federal Compensation: Recovery of Improper Health Benefits Charges Needed (GAO/GGD-89-27, Dec. 13, 1988).



OPM has not as yet developed regulations to implement this authority. Also, it has not set a date for issuing these regulations.

The Federal Managers' Financial Integrity Act (FIA) of 1982 requires executive agencies to establish and maintain systems of internal control. Internal control systems are to reasonably ensure that among other things, all assets are safeguarded against waste, loss, unauthorized use, and misappropriation. The act requires the heads of executive agencies to make annual evaluations of their internal controls and provide annual reports to the President and Congress on whether agency systems of internal control comply with the objectives set forth in the act.

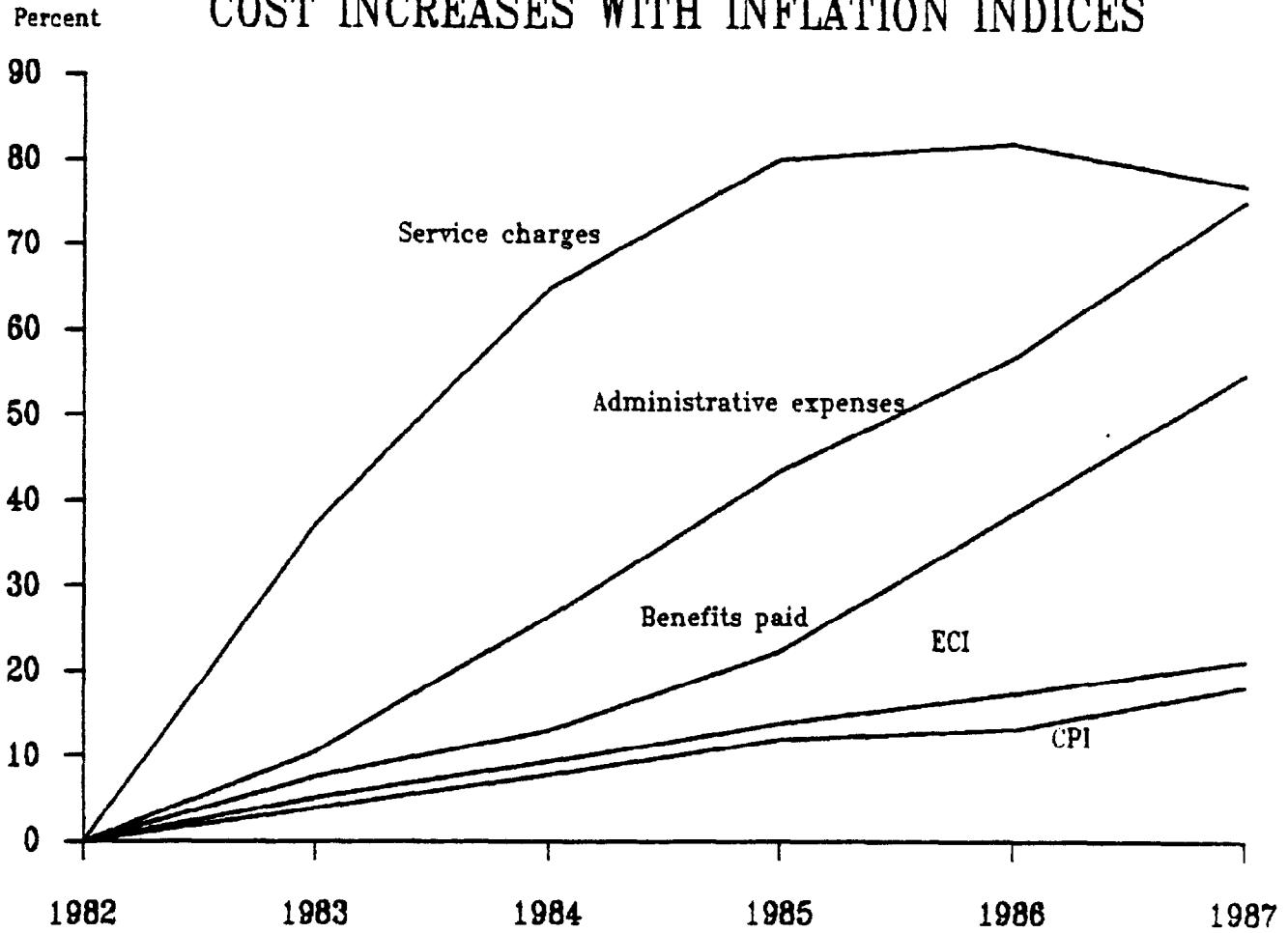
Notwithstanding the reported instances of fraud and abuse, OPM officials responsible for the health program did not consider the program funds to be particularly vulnerable to loss. These officials were operating under the mistaken belief that FIA vulnerability assessment requirements did not extend to the activities of the health benefit plans. Also, the internal control coordinator, who prepared OPM's annual FIA reports to Congress covering insurance programs, said he was unaware that any fraud or abuse involving program funds had occurred. OPM lacks a systematic mechanism to inform him of such instances and he did not ask the program manager. Hence, OPM neither regarded the program to be highly vulnerable to fraud and abuse nor

identified the program as having any material internal control weaknesses in its annual FIA reports.

More effective vulnerability assessments and oversight over the program could help OPM to identify weaknesses in its systems of internal control that have allowed instances of fraud and abuse to occur. In addition, controls to prevent fraud and abuse could be improved by expediting the implementation of regulations to exclude payments to providers found guilty of fraud or unethical practices. We plan more work to identify further actions OPM and the plans could take to prevent fraud and abuse.

In closing, Mr. Chairman, I would like to emphasize that effective cost containment incentives for and oversight and control over administrative expenses and the vulnerability of program funds to fraud and abuse should be of continuing concern to the program's administrator. This concludes my statement. I would be pleased to respond to questions.

### COMPARISON OF HEALTH BENEFITS PROGRAM COST INCREASES WITH INFLATION INDICES



ECI = Employment cost index

CPI = Consumer price index