FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM: IMPROVED BENEFITS FOR CIVIL SERVANTS—A MODEL FOR OTHERS

The Federal Employees Health Benefits Program began in 1960 and is a key component of the employee compensation package that enables the Federal Government to compete with other employers in attracting and retaining a well-qualified workforce. Administrative responsibility lies with the Office of Personnel Management and it is America's largest employer-sponsored health benefit program, providing over $18 billion a year in health care benefits, through contracts with over 250 private insurers, for approximately nine million Federal workers, retirees, and eligible dependents. Moreover, since the early 1990s, the White House, Congress, and others increasingly have promoted the program as a model for advancing the quality of health care nationally.

IMPLEMENTATION OF A PATIENTS' BILL OF RIGHTS

In November 1997, President Clinton endorsed recommendations of the President's Advisory Commission on Consumer Protection and Quality in the Health Care Industry in its Consumer Bill of Rights and Responsibilities (Patients' Bill of Rights) and asked agencies to assess the extent to which Federal health care programs were in compliance. The Patients' Bill of Rights urged consumer protections in the health care industry through assuring open communication between patients and providers, requiring greater disclosure of health plan and provider information, and increasing access to specialists and emergency room services. In February of 1998, the Office of Personnel Management forwarded its assessment indicating there were no statutory impediments to full implementation of the PBR in the Federal Employees Health Benefits (FEHB) Program.

The President then directed Executive agencies to use their regulatory and administrative authorities to bring Federal health programs into full compliance with the PBR. Subsequent to the President's directive, OPM worked with health plans in the FEHB Program throughout 1998 and 1999 to achieve full compliance with the PBR by the year 2000. The successful implementation of these important protections resulted from a strategy of focusing on outcomes, not process, to allow health plans the flexibility to implement the protections in ways best suited to the capabilities of their business settings. The Administration's example demonstrated that important consumer protections can be implemented cost effectively across all health care delivery systems on a national basis. This successful experience influenced Congress to consider extending similar consumer protections to the nation's private health care system.

MENTAL HEALTH AND SUBSTANCE ABUSE PARITY IN THE FEDERAL EMPLOYEES HEALTH BENEFITS (FEHB) PROGRAM

In June of 1999, President Clinton directed the Office of Personnel Management to achieve mental health and substance abuse parity in the Federal Employees Health Benefits Program by the 2001 contract year. Achieving parity means that benefits for mental health, substance abuse, and physical conditions are the same with respect to patient deductibles, coinsurance, copayments, and day/visit limitations. OPM identified essential components of parity for Federal employee health plans and invited insurers to propose various benefit design approaches consistent with their business settings to meet these standards. This allowed full implementation of mental health and substance abuse parity for the nations' largest employer at a minimal premium increase of 1.3%.

President Clinton's directive to achieve full parity culminated earlier efforts by the Administration to progressively improve mental health and substance abuse benefits for Federal employees and retirees. For example, in 1995, prior to the Federal Mental Health Parity Act, the Clinton Administration abolished lifetime benefit maximums on mental health services under its employee health program. Later negotiations with insurers eliminated annual benefit maximums and encouraged health plans to remove contractual day and visit limitations and lower patient out-of-pocket costs. In 1999, the Office of Personnel Management required that pharmacotherapy, and medical visits and tests to monitor drug treatment for mental health conditions, be covered to the same extent as physical disease management. The agency also encouraged the use of preferred provider organizations and utilization management to improve mental health and substance abuse benefits cost effectively. At health plan conferences held in 1998 and 1999, the Office of Personnel Management featured presentations by panels of experts who discussed the desirability and feasibility of offering expanded and affordable mental health and substance abuse benefits.

In developing mental health and substance abuse benefits strategies, the Office of Personnel Management reviewed research by the National Advisory Mental Health Council, the National Alliance for the Mentally Ill, the Substance Abuse and Mental Health Services Administration, the Washington Business Group on Health, the National Institutes of Mental Health (NIMH) and others. These organizations indicate a growing consensus on the effectiveness of treatment and the efficiency of managed delivery systems in providing mental health and substance abuse care. The NIMH informed OPM that most diagnoses have well-established biological bases, diagnoses are reliable, and treatment is both effective and available. This research convinced the Clinton Administration that mental health and substance abuse benefits could be expanded cost effectively to be at parity with benefits for physical illness or disease. Adequate mental health and substance abuse benefits coverage will improve patient health outcomes, provide patients with greater financial protection, and will reduce work place absences and disabilities.

NEW GOVERNMENT CONTRIBUTION FORMULA

A new Government contribution formula, known as "Fair Share," became effective under the Federal Employees Health Benefits Program in January 1999 under a provision of the Balanced Budget Act of 1997 (Public Law 105-33, sec. 7002, approved on August 5, 1997). As a result, health plan enrollees eligible for a Government contribution receive an amount equal to 72 percent of the Program-wide weighted average of subscription charges, for self-only and self-and-family types of enrollment, respectively, not to exceed 75 percent of the premium for any particular plan.

The Fair Share formula replaced the "Big-6" formula that evolved in the early 1970's and set Government contributions as a percent of the average of premium charges for six large health plans described by applicable law. One distinct component of the Big-6 formula ceased Program participation at the end of 1989 and to continue using the formula with the five remaining plans would have substantially reduced Government cost sharing and shifted costs to enrollees. To stabilize the program, Congress authorized use of a phantom premium rate representing the lapsed plan through the end of 1998, while the Clinton Administration and Congress considered a variety of proposed permanent solutions to the problem and reached consensus on the Fair Share approach. The intent of the new, formula is to maintain the level of Government contributions at a consistent percent of total program costs, regardless of the configuration of available health plans or enrollment patterns.

PREMIUM CONVERSION FOR FEDERAL EMPLOYEES

In October 2000, Federal employees started to use pre-tax dollars to pay health insurance premiums to the Federal Employees Health Benefits Program under an arrangement called "Premium Conversion." Premium conversion is standard practice in private sector employer health insurance programs and uses Federal tax rules to let employees deduct their share of health insurance premiums from their taxable income, thereby reducing their taxes and making health coverage more affordable. This was one of a number of initiatives in President Clinton's Fiscal Year 2001 Budget to enhance Federal employee compensation in order to improve the Government's ability to attract and retain a high-quality work force.

PROMOTING INFORMED CONSUMER CHOICE WITH PLAIN LANGUAGE

The President and Vice President made plain language a top priority for Federal agencies. In February 1999, health plan representatives and OPM staff began a collaborative effort to rewrite all health plan brochures in "Plain Language" to make the brochures easier for everyone to read and understand and to assist enrollees with health plan comparisons.

As the work group realized the enormity of the task facing them, they decided to limit this effort to rewriting the standard, Program-wide language that appears in all FEHBP plan brochures. These portions of the 2000 brochures were rewritten using common, everyday words, except for necessary technical terms; "you" and other personal pronouns; active voice; and short sentences.

In December 1999, a second workgroup reorganized the brochures and devised standard structure for the benefits sections. These changes were incorporated into the 2001 brochures. It was further decided to make the structure and language used in fee-for-service and HMO brochures parallel. Enrollees would then be able to easily compare the benefits available under the two types of plans and make an informed choice.

Meanwhile, the Office of Personnel Management greatly enhanced comparison materials it makes available during the annual open enrollment period to include information on health plan accreditation, performance, and customer satisfaction, in plain language consumers can easily understand and compare.

IMPROVING WOMEN'S HEALTH AND FAMILY-FRIENDLY SERVICES

As administrator of the Federal Employees Health Benefits Program under President Clinton, the Office of Personnel Management adopted several important benefits policies to improve access to women's health services. These policies support the Federal Government's employer interest in ensuring that appropriate basic health services are available to all employees, retirees, and their dependents, and give broad exposure to national health care concerns as addressed by advisory committees and recent Federal laws.

Between 1993 and 1999, the Office adopted contracting policies that require all health plans to:

- include benefits for the diagnosis and treatment of infertility problems (although coverage for artificial reproductive technology or experimental infertility treatments is not mandated);
- provide benefits for mammography screening consistent with National Cancer Advisory Board recommendations;
- cover high dose chemotherapy in conjunction with allogeneic and autologous bone marrow transplants for breast cancer, multiple myeloma, and ovarian epithelial cell tumors;
- provide guaranteed hospital stays for mastectomy, as well as for maternity conditions subject to the Newborns' and Mothers' Health Protection Act of 1996;
- provide direct access to obstetricians and gynecologists consistent with the President's Patients' Bill of Rights; and
- provide the full range of contraceptive drugs and devices approved by the Food and Drug Administration (unless the plan obtains a waiver based on religious beliefs.

Vice President Gore's 7th Annual Family Reunion in the Fall of 1998 focused on Families and Health. It promoted the idea that the family has significant influence over individual health and well-being and therefore families must be respected and supported in their role as care givers and decision-makers. The Office of Personnel Management subsequently initiated discussions with health insurers and plan member focus groups to examine ways to enhance family-focused services. These discussions led to new guidance in the 1999 annual Call Letter on: benefits for childhood immunizations; offering supplemental dental and vision coverage; benefits for routine screening and diagnostic testing for colorectal cancer and other diseases; making health plan pre-authorization and referral procedures customer friendly; and other customer service enhancements.

MAJOR LEGISLATION AFFECTING THE FEGLI PROGRAM ENACTED DURING THE CLINTON ADMINISTRATION

The administration initiated the following legislation affecting the Federal Employees' Group Life Insurance (FEGLI) Program:

IMPROVEMENTS - Pub. L. 105-311 - enacted 10/30/98
Interim regulations published 12/28/99

- Removed the maximums on Basic insurance and Option B.
- Allows foster children to be covered under Option C.
- Allows erroneous coverage to become valid if it's been in effect for at least 2 years and the insured individual has paid the appropriate premiums during that time.
- Allows employees, annuitants, and compensationers, whose pay (or annuity or compensation) is too low for premium withholdings, to make direct premium payments, rather than have their life insurance terminate.
- Allows retiring employees and employees becoming insured as compensationers to elect not to have their Option B and/or Option C coverage reduce when they reach age 65.
- Allows employees whose Option B coverage is terminating because of separation or completion of 12 months in nonpay status to port their coverage.
- Increases the amount of coverage available under Option C from $5,000 for a spouse and $2,500 for each eligible child to up to 5 multiples of those amounts.

The President also approved the following legislation affecting the FEGLI Program:

ASSIGNMENT - Pub. L. 103-336 - enacted 10/3/94
Interim regulations published 10/4/95; final regulations published 9/17/97

- Allows all Federal employees, annuitants, and compensationers to make an irrevocable assignment of their life insurance.

LIVING BENEFITS - Pub. L. 103-409 - enacted 10/25/94
Interim regulations published 6/15/95; final regulations published 9/17/97

- Allows terminally ill employees, annuitants, and compensationers with a life expectancy of 9 months or less to receive their Basic insurance benefits while they are still living.

COURT ORDERS - Pub. L. 105-205 - enacted 7/22/98
Interim regulations published 4/6/99; final regulations published 10/8/99

- Requires life insurance benefits to be paid according to the terms of a court order if the appropriate office receives the court order before the insured individual dies. Previous designations of beneficiary are invalid, and the insured cannot make a new designation that goes against the court order unless the person named in the court order agrees or the court order is modified.

LONG-TERM CARE SECURITY ACT

President Clinton signed "The Long-Term Care Security Act," Public Law 106-265 (H.R. 4040), on September 19, 2000. The legislation evolved from a proposal the Administration submitted to Congress in January 1999 (H.R. 110, S. 57) to authorize the Office of Personnel Management to offer group long-term care insurance to Federal employees, retirees and certain qualified relatives. Enrollees would pay the full cost at group rates expected to be 15 to 20 percent lower than rates for private individual policies. Succeeding Congressional proposals expanded the eligible population to include United States Postal Service employees, active duty military personnel, respective retirees, and qualified relatives, bringing those potentially eligible to 13 million. The final consensus bill had strong bipartisan support as the result of input from many stakeholders, including Members of Congress, employee unions, civilian and military retiree associations, the insurance industry, and caregivers' groups.

Long-term care insurance for Federal workers was part of the President's initiative, launched at a White House event on January 4, 1999, to focus national attention on the growing need for planning and financing future long-term care needs as Americans are living longer and increasing numbers need help with daily living activities. The availability of long-term care insurance significantly impacts those needing care and those providing care. Over 50% of caregivers make work-related adjustments to care for a loved one.

The Long-Term Care Security Act positions the Federal Government, as the largest employer in the nation, to influence public policy by its example and encourage other employers to act responsibly to assist employees with meeting long-term care insurance needs. OPM will coordinate its educational efforts with the Department of Health and Human Services which is responsible for conducting a national campaign to educate Medicare beneficiaries as to the limited long-term care coverage under Medicare and how to best evaluate long-term care alternatives.

MAJOR PROVISIONS OF THE ACT

- Authorizes the Office of Personnel Management to contract for group long-term care insurance covering an array of long-term care services to meet the needs of a potential population of 13 million.
- Requires each participant to pay full cost of coverage based on age upon enrollment.
- Requires the insurance product to meet all requirements and consumer protections mandated by the Internal Revenue Code for qualified long-term care insurance.
- Requires consumer protections such as guaranteed renewability, portability of benefits, and nonforfeiture provisions.
- Provides for minimal underwriting (health status screening) for active Federal and military employees and for spousal parity to the extent practicable.
- Requires initial enrollment season no later than October 2002.
- Requires the General Accounting Office to evaluate the program and report to the President, Congress, and OPM.

IMPROVEMENT IN FINANCIAL ADMINISTRATION AND ENHANCED FINANCIAL INTEGRITY IN FEDERAL EMPLOYEES' EARNED BENEFIT PROGRAMS

OPM administers the Federal Employees Earned Benefits Programs – the Retirement, Health Benefits and Life Insurance Programs – through the Retirement and Insurance Service. OPM also has a fiduciary responsibility to manage the trust funds that account for the financial activities of each of the Programs. The trust funds are primarily funded through employee and Federal agency contributions and investments in Government securities. At September 30, 1999, the aggregate activity of the Funds consisted of: over $519 billion in assets; over $34 billion in annual receipts from employee and agency contributions, in excess of $34 billion in annual earnings on investments, and over $64 billion in annual disbursements.

Prior to 1997, annual audits of the Trust Funds resulted in a disclaimer of opinion on the financial statements representing the activity of the Federal Employees Health Benefits Fund. The auditors' opinions on the financial statements representing the activity of the Retirement Fund had also been modified to express a qualification or a concern about the reasonableness of certain information contained in the statements. On the other hand, auditors had previously expressed an "unqualified" or clean opinion on the financial statements representing the activity of the Life Insurance Fund.

During 1996 OPM engaged, for the first time, an Independent Public Accounting Firm, KPMG Peat Marwick, LLP (KPMG), to conduct the audit of the financial statements representing the activity of the Funds. At the conclusion of its fieldwork and internal control testing, KPMG articulated two major issues that significantly impacted the auditor's ability to opine on the financial statements representing the activity of the Retirement and Health Benefits Funds. With respect to the Retirement Fund, KPMG concluded that OPM had not established adequate controls to determine whether benefit payments to annuitants were accurate. As for the Health Benefits Fund, KPMG disclaimed an opinion on these financial statements because they were unable to satisfy themselves as to the accuracy of information reporting experienced rated carrier activity, including claim payments and the balances reported in the financial statements and the premiums paid to insurers. Another concern expressed by KPMG and by auditors in prior years was that OPM did not have a basis for relying on other Federal agency's systems of internal control over employee withholdings and agency contributions activity associated with all of the Earned Benefit Funds.

OPM took the following steps to improve the financial administration of the Federal Employees Earned Benefits Funds and to enhance the integrity of the financial information reported:

- During 1997, to determine the accuracy of claim payments in the Retirement Program, OPM engaged KPMG to work in tandem with its own Quality Assurance staff to re-adjudicate more than 2,500 claims paid at September 30, 1997. Based on the results of this review, KPMG concluded that the frequency and dollar value of the errors found were immaterial and had little impact on the presentation of the financial statements for the Retirement Fund. Accordingly, KPMG removed the qualification and the scope limitation previously cited by them during the 1996 audit. Consequently, KPMG issued an "unqualified" audit opinion on the financial statements representing the activity of the Retirement Fund for the fiscal year ending September 30, 1997.

- OPM management had long been concerned about the integrity of the financial activity and account balances reported in the financial statements prepared by experienced rated carriers and subsequently reported in the financial statements representing the activity of the Health Benefits Fund. Beginning in 1995, the Office tasked a Quality Improvement Team with developing auditing requirements for experienced rated carriers. After developing the requirements and working collaboratively with our auditor, the carriers, and their respective Independent Public Accountants, OPM issued an official "Audit Guide" with audit requirements for experienced rated carriers during 1998. The Guide requires each carrier to: engage an Independent Public Accounting Firm to annually audit Health Benefits Fund activity and account balances, make an assessment and report on the carrier's systems of internal control, and to perform certain agreed upon procedures designed to ensure program integrity. Experienced rated carriers applied the requirements of the Guide to their financial activity during 1998. After evaluating the results of the experienced rated carrier audits and other supplemental information, KPMG issued an "unqualified" audit opinion on the financial statements representing the financial activity of the Health Benefits Fund for the fiscal year ending September 30, 1998.

- Although KPMG visited a selective group of Federal agency payroll offices to perform audit tests to confirm whether or not agencies' systems of internal controls over activities associated with employee withholdings and agency contributions were sufficient, we realized that this decentralized activity had Government-wide implications from an audit perspective. Consequently, OPM officials collaborated with the Office of Management and Budget (OMB) in an effort to subject agencies to additional audit requirements for activities associated with the Earned Benefit Programs. During 1998, OMB revised its audit requirements to include provisions for Federal agencies to engage an Independent Public Accounting Firm or their Inspector General to perform certain agreed upon procedures on transactions and activities associated with the employee withholdings and agency contributions that are accounted for and remitted to OPM. The initial OMB guidance was effective during fiscal year 1998. The results of the agency activity provided KPMG with the assurance that the controls over contributions are sufficient.

- During the audits of the Earned Benefits Funds during 1998 and 1999, KPMG issued "unqualified" or clean audit opinions on the financial statements representing the activity of the Retirement, Health Benefits and Life Insurance Funds. In addition, in 1999, the auditor reported no material weaknesses in controls over the Funds.

CUSTOMER SERVICE IN THE RETIREMENT AND INSURANCE SERVICE

The Retirement and Insurance Service focused its energy and resources on becoming a premier customer service organization. To achieve this goal we worked to change the organizational culture from the old mindset of simply protecting the interests of the retirement system, to add an intense focus on customer service. We also increased the resources we allocated to providing employees with the training, equipment and work environment they needed to attain our goal.

We took significant actions to bring about these changes. Our frontline positions were reengineered to focus on providing customer service. We provided employees with training and with modern tools, including the latest technology in computer networks and Internet access. We also implemented new technologies for the millions of customers we serve. Those included a nation-wide toll free telephone number, an interactive voice technology permitting self-service on numerous kinds of retiree transactions, and an internet site that allows annuitants to access information about retirement benefits and make many of their own account changes "on-line."

We provided personalized statements of benefits in plain language, provided for immediate interim payments, improved exit counseling at Federal agencies, increased electronic fund transfer for the security and convenience of our customers, and expanded the use of allotment choices for our customers. Customers can now direct their funds in a variety of ways including checking and saving account allotments, purchasing savings bonds, and contributions to charity.

Levels of service improved in many areas. From 1995 to 1999, the percentage of customers receiving their first payment either before or when they expected increased from 73% to 80%. The first annuity payment was authorized in an average of 7 days in 1995 and 4 days in 1999. Processing times for retirement claims were reduced from 70 days in 1995 to 30 days in 1999. Processing times for survivor benefits were reduced from 38 days in 1995 to 10 days in 1999. Overall customer satisfaction with telephone services improved from 78% in 1995 to 90% in 1999.

In 1999, results from the American Customer Satisfaction Index showed that our service to retirees exceeded the national average for both public and private sector organizations that provide comparable services. We received an index of 75 (on a scale of 1 to 100), 3 points above the national average for private sector companies. It was also 6.4 points above the national average for public sector organizations.

In addition, we made significant strides in improving the level of service in our insurance functions. Backlogs in disputed health claims were eliminated, surveys were begun to provide our customers with better information regarding health insurance provider performance and we, along with the health plans, provided all new materials in plain language to better enable informed decision making.

RETIREMENT SYSTEMS MODERNIZATION

Retirement Systems Modernization is OPM's strategic initiative to reengineer the various processes that support and provide services to Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) participants and to acquire the necessary technology to support the redesigned processes. In 1997, we recognized that four important factors threatened OPM's continued ability to provide quality retirement services and meet customer expectations in the 21st century—a fourfold growth in the FERS caseload that is significantly more complex and time-consuming to handle without the tools that technology offers; the high error rate associated with benefit calculations that results in about $20 million in overpayments and $4 million in underpayments each year; OPM's outdated, three-decade old legacy computer systems that can no longer be improved to increase operational efficiency; and a paper environment that does not allow OPM to meet the legislative mandates of the Government Paperwork Reduction Act and the Government Paperwork Elimination Act to reduce the paper burden and conduct business electronically. We also recognized that current and future budget allocations would not provide the funding to meet customer service needs in the future through additional staffing.

OPM faces several challenges in modernizing the retirement system. First, the paper record-keeping system in place since the inception of the retirement system in 1920 must be converted to an electronic one. Not only must we begin receiving participant data from Federal agencies in electronic format, but we must also convert millions of historical paper records at agencies and at OPM into electronic data. Second, we must develop a set of universal tools for determining accurate retirement coverage and eligibility, for calculating and modeling retirement benefits, and for controlling the workflow of the electronic claim processing. The data and tools must be available to OPM and Federal agency staff for benefits counseling and calculation of benefits and to participants for account information and financial planning. It is critical that the data and tools are accessible by agency staff working in organizations with a variety of information technology infrastructures, and that the participant's individual data be safeguarded and kept secure by the modernized systems.

Retirement Systems Modernization is being implemented in phases, bringing benefits to each customer segment as the modernization progresses. Most of the business process design has been completed, as well as the balanced scorecard performance measurement system that will be used to gauge success as we modernize. We have also completed much of the technical architecture, including technical requirements and some data modeling. At the same time we have implemented improvements that bring early benefits, including a prototype calculator and an improved benefits information booklet for new retirees. OPM's modernization will continue over the upcoming years, until the redesigned system is fully implemented and OPM can continue to offer the quality retirement services that Federal employees have earned and deserve to receive.

ERRONEOUS RETIREMENT COVERAGE CORRECTION

Prior to the mid 1980s, most Federal employees were excluded from Social Security coverage because they were covered by the Civil Service Retirement System (CSRS), which had been created long before there was a Social Security System. During the 1980s, a national policy decision was made that new Federal employees would be covered by Social Security, and that these new employees would also come under a separate new retirement system for Federal employees, later enacted as the Federal Employees Retirement System (FERS). However, adding complexity were provisions "grandfathering" certain employees under CSRS if specified technical requirements were met.

This major change was largely accomplished in an exemplary manner, but it is impossible to make any change of this magnitude without some errors creeping in. Some employees ended up contributing under the wrong retirement plan for years. This results in substantial harm to the employee's long-term retirement planning when the error is discovered and corrected.

The older CSRS is a defined benefit system, with benefits primarily based upon average salary and years of service. The new FERS includes a smaller defined benefit tier based upon service and salary, but also relies upon Social Security coverage and a Thrift Savings Plan (TSP) in which employer and voluntary employee contributions are invested in a manner chosen by the employee. These differences made errors difficult or impossible to equitably correct when discovered after a period of time. This was especially true in the case of individuals who should have been in FERS, because they lost the opportunity for full TSP participation on a timely basis.

The Administration set upon the task of creating a fair and equitable remedy. After careful consideration, it established the following objectives—

- The remedy should demonstrate that the Government cares about its employees who were disadvantaged by an error in their retirement coverage.
- The remedy should provide the employee with a choice between corrected retirement coverage and the benefit the employee expected to receive, without disturbing Social Security coverage law.
- The options provided the employee should be easy to understand.
- The administrative burden and cost of the remedy should be kept to a minimum.

Keeping these principles in mind, the Administration created a legislative proposal that would fully accomplished all of these objectives. Under the Administration's proposal, individuals who had been in the wrong retirement system for three or more years would be given an election. These employees, retirees, and survivors would be provided with full information as to their options, and given time to make an informed election.

As a result of these efforts, the "Federal Erroneous Retirement Coverage Corrections Act," Public Law 106-265, was approved on September 19, 2000. Thanks to the concerted efforts of the Administration, equity was provided for the employees who had been erroneously placed in the wrong retirement system, and for their families.

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Appointed as Associate Director for Retirement and Insurance in 1994, Mr. Flynn directs the Federal retirement systems, the Federal Employees Health Benefits Program, and the Federal Employees Group Life Insurance Program. From 1992 to 1994, he was Assistant Director for Financial Control and Management, where he managed the Service's financial management and related programs. Annually, more than $60 billion is paid to, or on behalf of, Federal participants in the employer-sponsored benefit programs administered by OPM. In 1999, President Clinton recognized Mr. Flynn with the Distinguished Senior Executive Award.

From 1989 to 1992, Mr. Flynn was partner and Executive Vice President of Schroeder, Flynn & Co. Based in Atlanta with seven offices throughout the Southeast, the firm provided retained outplacement services to corporate clients undergoing executive transition or a major downsizing. Prior to that, Mr. Flynn worked for OPM in several executive positions as Regional Director and Deputy Regional Director in the Atlanta and Chicago regions, and as Assistant to the Director for Regional Operations in Washington, DC. Mr. Flynn's early experience with the agency included budget, accounting and administrative management positions in both headquarters and field locations.

Mr. Flynn holds a Bachelor of Arts degree from George Mason University, where he graduated with honors. He pursued graduate studies in public administration at Virginia Polytechnic Institute and State University. He is a graduate of the Executive Education Program offered by the Federal Executive Institute.

A decorated Vietnam veteran, Mr. Flynn and his wife, Judy, have been active in community affairs, participating in fund-raising events and serving as foster parents. The Flynns reside in Arlington, Virginia.

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INFORMATION ABOUT THE EMPLOYEE BENEFIT PROGRAMS

Retirement Program

The Retirement Program is comprised of two defined benefit programs: the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The basic benefits of both systems are paid by the Civil Service Retirement and Disability Fund (CSRDF). By law, CSRDF funds may be used to pay all disbursements and operating expenses of both programs.

CSRS

The CSRS was created by the Civil Service Retirement Act (P.L. 66-215), enacted May 22, 1920, to provide retirement benefits for Federal employees. The CSRS is a stand-alone pension system - its defined annuity benefits are not intended to be a supplement to or be supplemented by other retirement benefits. The CSRS covers most Federal employees hired before 1984 and provides benefits to the survivors of deceased CSRS annuitants and employees. For all practical purposes, the system was closed to new entrants in 1984.

Annuity and Disability Benefits

The CSRS provides normal retirement with a full annuity at age 55 with 30 years of service, age 60 with 20 years of service, or age 62 with 5 or more years of service. Disability retirement is permitted at any age with a minimum of 5 years of service, and involuntary retirement at any age after 25 years of service or at age 50 with 20 years of service. Deferred annuities are payable at age 62 with 5 years of service. There is no general mandatory retirement provision. The annuity formula provides 1.5 percent of average salary for the first five years of service, 1.75 percent for the next five years, and 2 percent for any remaining service, up to a maximum of 80 percent of average salary (based on the highest three years of salary). Disability annuitants receive the greater of the preceding computation or a guaranteed minimum of the lesser of 40 percent of average salary or the regular formula using service projected to age 60.

Death Benefits

Widows and widowers of employees who die in service receive 55 percent of the annuity the employee would have received had the employee retired on disability. Widows and widowers of deceased annuitants receive 55 percent of the annuity unless the employee annuitant and spouse waived provisions of a survivor benefit, or elected to provide less than a full survivor benefit. Children of deceased annuitants and employees receive a flat monthly amount.

FERS

The FERS was established on June 6, 1986, by the Federal Employees' Retirement System Act of 1986 (P.L. 99-335). FERS is a three-part pension program, using Social Security as a base and providing a defined benefit component and a thrift savings plan. The Service administers the defined benefit component of FERS. The Federal Retirement Thrift Investment Board, an independent agency, administers the thrift savings plan. The FERS covers most employees first hired after December 31, 1983 and provides benefits to the survivors of deceased FERS annuitants and employees.

Annuity and Disability Benefits

The FERS provides for full immediate or deferred retirement benefits at the Minimum Retirement Age (MRA) with 30 years of service, age 60 with 20 years of service, or age 62 with 5 or more years of service. The MRA is 55 for those born before 1948, and incrementally increases to 57 for those born during or after 1970. Deferred retirement benefits are also available at or after the MRA with 10 years of service at reduced benefit levels. Disability retirement may occur at any age with at least 18 months of service. Full immediate benefits are payable at age 50 with 20 years of service or at any age with 25 years of service in certain cases of involuntary separation or separation during a major reorganization or reduction in force.

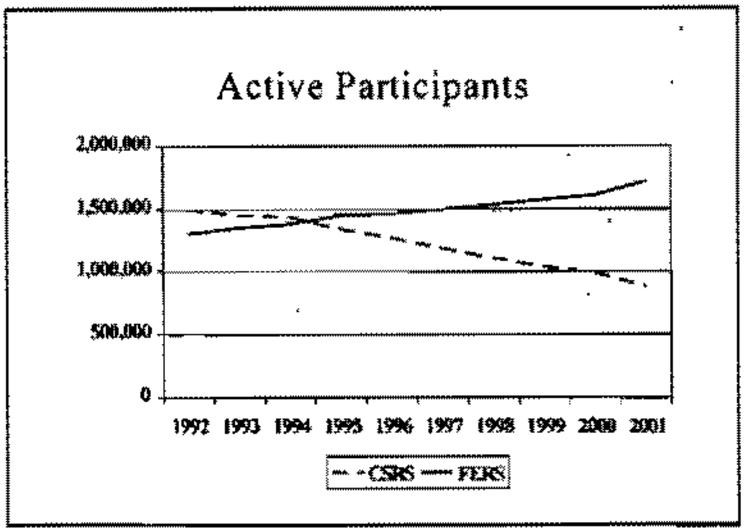
The annuity formula generally provides one percent of the employee's average salary (based on the highest three years of salary) times the number of years of creditable service. If retirement is at age 62 or later, with at least 20 years of service, a factor of 1.1 percent is used rather than 1 percent. In the first year of retirement, disability annuitants generally receive 60 percent of their high-three average salary, minus their Social Security disability benefit. Subsequently, they receive 40 percent of their high-three average salary, minus 60 percent of their Social Security disability benefit, until recomputation at age 62. The FERS non-disability benefits for those who transfer from the CSRS to the FERS may include a portion computed under the CSRS formula. The law also contains special eligibility and computation requirements for certain law enforcement officers, fire fighters, air traffic controllers, congressional employees, Members of Congress, and military reserve technicians.

Death Benefits

Widows and widowers of employees who die in service after at least 18 months of service receive a lump-sum payment of $15,000 (indexed to the CSRS COLAs) plus one-half of the annual rate of pay at death, or one-half of the highest three years average pay as of the date of death, whichever is higher. If the employee had at least 10 years of service, the surviving spouse also receives an annuity equaling 50 percent of the accrued basic retirement benefit. Widows and widowers of deceased annuitants receive 50 percent of the annuity, unless the employee annuitant and spouse waived provision of a survivor benefit or elected a benefit of 25 percent. Children of deceased annuitants and employees receive a flat monthly amount, minus the amount of Social Security benefits payable to them.

Program Participation - Active Employees

FERS membership among active employees overtook CSRS membership in 1995 and by the end of 1999 represents 60% of all Federal employees. The Service expects the CSRS population to decline significantly over the next decade, as CSRS employees retire or leave Federal service for other reasons.



Program Participation - Annuitants

As the FERS employee population has grown, so too has the FERS annuitant population. Though still quite small, at the end of 1999, FERS annuitants represented 4% of the total annuitant population.

Distribution of Participant Retiree/Survivor Annuitants

Type	1995	1996	1996	1998	1999
CSRS	2,255,211	2,265,275	2,269,074	2,271,188	2,360,071
FERS	55,500	67,875	83,203	98,162	109,360
Total	2,310,711	2,333,150	2,352,277	2,369,350	2,469,431

Health Benefits Program

The Health Benefits Program is comprised of two separate programs, one large and the other quite small. The Federal Employees Health Benefits Program (FEHBP) was established by the Federal Employees Health Benefits Act of 1959 (P.L. 86-382). The law made basic hospital and major medical protection available to active Federal employees, annuitants, and their families. The law also allows OPM to contract with qualified carriers and establish program-wide eligibility requirements.

Types of Plans

In 1999, 362 health benefits plans participated in the Program. These plans generally are grouped into two types: Fee-for-Service (comprised of the Federal employees plan offered by Blue Cross/Blue Shield and employee organization plans) and health maintenance organizations (HMOs).

A Fee-for-Service (FFS) plan is traditional type of insurance that lets the participant use any doctor or hospital. These plans are called FFS because doctors and other providers are paid for each service, such as an office visit, or test. The Government-wide plan, offered by Blue Cross/Blue Shield, and the various employee organization plans, are FFS.

A Health Maintenance Organization (HMO) is a health plan that provides care through a network of physicians and hospitals located in particular geographic or service areas. Eligibility to enroll in an HMO is determined by where the participant lives or, in some plans, where they work.

Health Benefit Program Enrollment Levels

Type of Plan	1995	1996	1997	1998	1999
Government-wide	1,763,695	1,754,553	1,785,679	1,849,961	1,905,245
Employee organization	1,178,735	1,167,898	1,134,352	1,038,866	987,436
HMO	1,208,537	1,219,240	1,212,985	1,230,354	1,229,969
Total	4,150,967	4,141,691	4,133,016	4,119,181	4,122,650

Currently, there are 2.3 million Federal civilian employees and 1.8 million annuitants participating in the Program, representing about 78% of the eligible population. In all, approximately nine million individuals are covered.

The Program has several features that make it one of the Nation's leading health benefits plan:

- Participants have an unparalleled choice in the variety of available health plans.
- Participants are not required to pass a medical exam in order to enroll in the program and there are no coverage exclusions for pre-existing conditions or waiting periods.
- There is a comprehensive minimum benefit level for all HMOs and similar levels exist for fee-for-service plans.
- Participants are given an opportunity to change their coverage every year during the annual Open Season.

The Retired Federal Employees Health Benefits Program (RFEHBP) is a very small program and has no material effect on the financial statements of the FEHB Program. It provides health benefits to employees and survivors who were already retired on the effective date of the FEHB Program and were therefore ineligible to participate in the FEHB Program. Initially, 236,000 annuitants elected to participate in the RFEHBP; as of September 30, 1999, only 5,500 enrollees remain.

Life Insurance Program

The Life Insurance Program was created in 1954 by the Federal Employees Group Life Insurance Act (P.L. 83-598) and covers 90% of eligible employees and annuitants, as well as many of their family members. It is administered through a contract with Metropolitan Life Insurance Company (MetLife). It is the largest group life insurance program in the world, covering over 4 million Federal employees and retirees, as well as many of their family members.

Types of Coverage

The Program provides group term life insurance. As such, it does not build up any cash value or paid-up value. It consists of Basic life insurance coverage and three options:

- *Basic life insurance* is determined by the amount of an employee's annual rate of basic pay, rounded to the next highest thousand, plus two thousand dollars. All eligible, or most Federal employees are automatically covered by Basic insurance unless they decline.

- *Standard Optional* insurance is $10,000 of coverage an employee can elect in addition to Basic insurance.

- *Additional Optional* insurance is coverage an employee can elect based on multiples of his or her basic pay.

- *Family Optional* insurance is coverage an employee can elect to insure a spouse in multiples of $5,000 up to a maximum of $25,000 and children in multiples of $2,500 up to a maximum of $12,500 for each eligible child.

Before the current Program was created, life insurance coverage was offered to groups of Federal employees by beneficial associations. By 1954, there were 27 such associations. With the creation of the current Program in 1954, membership in these associations was closed, and the administration of beneficial association insurance was contracted for with the Shenandoah Life Insurance Company. This is a very small program with few enrollees and has no material effect on the financial statements of the Life Insurance Program.

Program Participation

Coverage	1995	1996	1997	1998	1999*
Basic	4,060,000	4,024,000	3,982,000	3,973,000	3,953,000
Standard Optional	1,418,000	1,394,000	1,379,000	1,356,000	1,352,000
Additional Optional	1,340,000	1,304,000	1,288,000	1,277,000	1,294,000
Family Optional	1,380,000	1,355,000	1,226,000	1,220,000	1,299,000

**Estimate*

July 2000

Dear Carrier:

To improve our management of the Federal Employees Health Benefit Program (FEHBP), we have published the enclosed "FEHBP Experienced-Rated Carrier and Service Organization Audit Guide" (Guide). The Guide provides authoritative guidance for the audit of the Annual Accounting Statement (AAS) submitted by all experienced-rated carriers (ERCs). It requires all ERCs to engage a certified independent public accounting (IPA) firm to obtain a standard audit engagement and to perform specified procedures on the AAS and the general control environment.

Engagement Reporting Options

All carriers must submit an AAS for the accounting periods ending September 30 and December 31. However, carriers may choose to obtain an audit of the AAS for either accounting period.

> *Primary coverage.* Carriers with FEHBP claims expense of $40 million or more in the previous contract (calendar) year are required to submit an audited AAS as of either September 30 or December 31. In addition, these carriers must provide a report on compliance with laws, regulations and internal controls, in accordance with either attestation standards or generally accepted government auditing standards, and agreed-upon-procedures.
>
> *Secondary coverage.* Carriers with FEHBP claims expense of less than $40 million in the previous contract (calendar) year are required to submit an AAS as of either September 30 or December 31. It is important to note that the AAS submitted by carriers, ordinarily subject to secondary coverage will, at the contracting officer's discretion, be made subject to primary coverage on a rotational basis at a frequency not less than every five (5) years.

Primary Coverage Engagement Options

For maximum flexibility, the Guide provides four options for meeting the primary coverage requirements. If this is the carrier's first year of primary coverage under the Guide, then the carrier should submit their selected option in writing to its contracting officer by **August 14, 2000**. The options are outlined in Chapter 1 of the audit guide. Carriers may not switch among options from year to year without advance approval from OPM.

Effective Date

These requirements are effective beginning for the year ended either December 31, 1999 or September 30, 2000, depending on the reporting option period chosen by the carrier. Related reports are due by March 31 for the period ending December 31 or December 15 for the period ending September 30.

We are willing to discuss modifications to the required delivery dates of the AAS and related audit reports. Requests for extensions must be submitted to your contract officer in writing and they must provide a complete description of the reasons for the extension.

Submit 4 copies of all reports to:

> U.S. Office of Personnel Management
> Retirement and Insurance Service
> 1900 E Street NW., Room 3H19
> Washington, DC 20415-0001
>
> Attn: Financial Management Division

Questions and requests for the guide may be faxed to the Office of the Inspector General at (202) 606-4823, emailed to dlfletch@opm.gov, or mailed to:

> U.S. Office of Personnel Management
> Office of the Inspector General
> 1900 E Street NW., Room 6400
> Washington, DC 20415-1100
>
> Attn: Audits

We look forward to working with you on this important initiative.

Harvey D. Thorp
Assistant Inspector General for Audits

Frank D. Titus
Assistant Director for Insurance Programs

U.S. Office of Personnel Management
Office of the Inspector General and Retirement and Insurance Service

July 2000

FEHBP EXPERIENCED-RATED CARRIER AND SERVICE ORGANIZATION AUDIT GUIDE

TOPICS

Financial Statement Audits

Reporting on Internal Controls and Compliance with Laws and Regulations

Attestation Reports

Agreed-Upon Procedures

Reporting on Internal Controls of Third Party Servicing Organizations

CONTENTS

APPENDICES

Appendix A

Appendix B

Appendix C

Appendix D

Appendix E

CHAPTER I

REPORTING REQUIREMENTS AND OTHER CONSIDERATIONS

PURPOSE OF THE AUDIT GUIDE

Objectives

Overall objectives of OPM in implementing these financial audit, internal control and compliance review and agreed-upon procedure (AUP) requirements are to gain the following assurances:

A. Carrier's calendar or fiscal year Federal Health Benefits Program (FEHBP) Annual Accounting Statements (AAS) are fairly stated in all material respects in accordance with the Office of Personnel Management's (OPM) prescribed accounting practices.

B. Carrier management's assertions, supported by an independent public accountant's (IPA) report, on the effectiveness of the entity's internal controls over compliance with the FEHBP contract is fairly stated.

C. Carrier reported fiscal year activity is reasonably complete and accurate, and processed in accordance with the FEHBP contract requirements.

D. Service organization(s) has suitably designed and effectively operating internal control systems over FEHBP processed activity.

USE OF THIS GUIDE

This guide must be used by experienced-rated carriers (ERCs) participating in the FEHBP.

This guide is divided into five sections.

Chapter I provides general information about engagement requirements and addresses the purpose of the Guide, the scope of required engagements, management and practitioner responsibilities, reporting, effective dates, examination periods and due dates.

Chapter II describes assertions to be made by management regarding the effectiveness of internal controls over, and management's compliance with, the FEHBP contract, and provides suggested examination procedures for selected assertions.

Chapter III provides FEHBP program-related procedures and FEHBP financial information roll forward procedures and related reporting requirements and other matters.

Chapter IV provides guidance over reviews of internal controls at service organizations.

AUTHORIZATION

The FEHBP contracts, as amended, require each participating ERC to prepare an AAS and supplemental information at specified times, and subject this information to audit and other audit related procedures.

These contracts also require that the audits and audit related procedures be performed by a qualified, independent certified public accountant.

Accounting Requirements - See Appendix A.

ERC REPORTING REQUIREMENTS

The Guide requires, depending upon the reporting option chosen by the carrier, that:

A. Carriers with claims greater than $40 million select from the following options:

	September 30			December 31		
	Option 1	Option 2		Option 3	Option 4	
	GAAS	GAGAS	DUE DATES	GAAS	GAGAS	DUE DATES
Reports Prepared by IPA:						
1. Financial audit of AAS	X	X	December 15	X	X	March 31
2. SSAE 3	X	-	December 15	X	-	March 31
3. Agreed-upon procedures:						
a. Program	X	X	December 15	X	X	December 15
b. Roll forward	-	-		X	X	December 15
4. Unaudited AAS for:						
a. Fiscal year ending 9/30	-	-	-	X	X	December 15
b. Fiscal year ending 12/31	X	X	March 31	-	-	-
5. Third party service organization control test	For guidance SAS No.70 is referenced			For guidance SAS No.70 is referenced		
Reports Prepared by Carrier:						
6. Corrective action plan	X	X	March 31	X	X	June 30

B. **Carriers with claims less than $40 million must only do lines No. 1 above for FEHBP activity and No. 4 unless otherwise notified by OPM.**

Generally, in addition to performing the engagement at either September 30 or December 31, the engagements may be performed in conformity with either Generally Accepted Auditing Standards (GAAS), including Attestation Standards where applicable, or Generally Accepted Government Auditing Standards (GAGAS).

Option 1

This engagement would be performed on the September 30 AAS in accordance with GAAS. The AAS and all audit reports must be received by OPM no later than **December 15.** Additionally, this engagement requires:

A. Statements on Standards for Attestation Engagements (SSAE) No. 3 (attestation engagement) related to specified management assertions about the carrier's compliance with the FEHBP contract for the period ending September 30.

B. The application of specified agreed-upon procedures as of September 30.

C. The procedures necessary to assess service organization controls related to FEHBP activity, if applicable. The IPA may consider the use of a service organization auditor's report.

D. Unaudited AAS as of December 31.

Option 2

This engagement would be performed at September 30 in accordance with GAGAS. The AAS and all audit reports must be received by OPM no later than **December 15.** Additionally, this engagement requires:

A. The application of specified agreed-upon procedures as of September 30.

B. The procedures necessary to assess service organization controls related to the FEHBP if applicable. The IPA may consider the use of a service organization auditor's report.

C. A report on compliance with laws, regulations and internal controls.

D. Unaudited AAS as of December 31.

Option 3

This engagement would be performed at December 31 in accordance with GAAS. The AAS and all audit reports must be received by OPM no later than **March 31**. Additionally, this engagement requires:

A. An attestation engagement related to specified management assertions about the carrier's compliance with the FEHBP contract for the period ending December 31.

B. The application of two sets of specified agreed-upon procedures; one, as of September 30, and the second, as of December 31.

C. The procedures necessary to assess service organization controls related to health benefits program activity, if applicable. The IPA may consider the use of a service organization auditor's report.

D. Unaudited AAS as of September 30.

Option 4

This engagement would be performed at December 31 in accordance with GAGAS. The AAS and all reports must be received by OPM no later than **March 31**. Additionally, this engagement requires:

A. The application of two sets of specified agreed-upon procedures; one, as of September 30, and the second, as of December 31.

B. The procedures necessary to assess service organization controls related to FEHBP activity, if applicable. The IPA may consider the use of a service organization auditor's report.

C. A report on compliance with laws, regulations and internal controls.

D. Unaudited AAS as of September 30.

Where applicable, we encourage the performance of any of the work described in the options above to be performed throughout the year or at interim periods. In addition, the carrier should consider having their internal auditors to perform some of the AUP work. The role of the internal auditors should be coordinated with the IPA responsible for the overall Guide testwork and should be in accordance with SAS No. 65, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements, and with this Guide.

CORRECTIVE ACTION PLAN

Management Reporting Responsibilities Defined

Management Assertions (if GAGAS is not applied). Carrier management is required to make written assertions about the carrier's compliance with specified FEHBP contract requirements and the effectiveness of the carrier's internal control over compliance with those requirements.

Corrective Action Plan. To assist OPM to resolve deficiencies in financial statements, internal controls and contract compliance, a carrier or service organization must develop and submit a corrective action plan directly to OPM within 90 days of report issuance. The corrective action plan, an essential part of the report requirement for the FEHBP, is prepared by the carrier or service organization management, and is presented on the entity's letterhead and includes the name, title, and telephone number of the responsible carrier or service organization official. In the plan, management:

A. Describes the corrective action taken or planned in response to findings identified in the practitioner's report.

B. Comments on the status of corrective action taken on the findings included in the practitioner's two prior reports.

See Appendix B, Example 6, for a suggested plan format.

Practitioner Reporting Responsibilities For Other Than Financial Statement Audits

Attestation Reports. SSAE No. 3[1] provides overall guidance on reports. See Appendix B for pro forma reports.

Agreed-Upon Procedures Reports. SAS No. 75 provides overall guidance on reports. See Appendix B for pro forma reports.

Deficiencies in Carrier's Internal Controls

For carriers: For carriers electing reporting Options 1 and 3, paragraphs 58 and 59 of SSAE No. 3 describe the practitioner's responsibility to communicate internal control structure deficiencies identified during the attestation engagement. In addition, paragraphs 33-37 provide the practitioner with guidance regarding reportable conditions and material weaknesses. For carriers electing reporting Options 2 or 4 (GAGAS options), refer to the GAO's Government Auditing Standards, as amended July 1999 (Yellow Book).

For service organizations: Service organization management is encouraged to engage a practitioner to perform a SAS No. 70 (Report on the Processing of Transactions by Service Organizations) review that reports on the internal control policies and procedures placed in operation and tests of operating effectiveness, or the carrier's IPA may perform procedures to determine the effectiveness of the service organization's controls. Practitioners should consider the testing and reporting requirements contained in the Codification of Statements on Auditing Standards, AU sec. 324, Reporting on an Entity's Internal Control Structure over Financial Reporting.

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[1]SSAE No. 3 was amended by SSAE No. 9 in 1999. We have revised all references to SSAE No. 3 to reflect the amendments. However, IPAs should be aware of and consider the amendments when performing their work.

Follow-up on Audit Resolution Matters: Paragraph 4.10 of Government Auditing Standards require practitioners to:

A. Follow up on known material findings and recommendations from previous audits to determine whether timely and appropriate corrective action has been taken.

B. Report the status of uncorrected material findings and recommendations from prior audits.

Practitioners must report on the status of material findings and related recommendations contained in prior reports by the practitioner or by other practitioners that are related to the carrier's or service organization's participation in the FEHBP.

Practitioners do not have to report on the specific status of findings or recommendations from OPM program reviews or other engagements, which were not OPM required examinations or audits (opinion-level engagements). An illustrative report is shown in Appendix B, Example 1, of this guide.

We anticipate requirements of this guide will serve as the basis for establishing certain performance measures, which will be used to evaluate carriers and service organizations.

MANAGEMENT RESPONSIBILITIES AND ASSERTIONS

Among other management responsibilities discussed in this guide, carrier management is responsible for:

A. Preparing the Annual Accounting Statements as of and for the period ending September 30 and December 31.

B. Complying with FEHBP contract requirements.

C. Establishing and maintaining effective internal controls.

D. Evaluating and monitoring the effectiveness of internal controls.

E. Providing the audit practitioner with their written representations (See Chapter II), in a separate report, about all matters in paragraph 67 of SSAE No. 3 (not required if audit is performed in accordance with GAGAS).

F. Maintaining accounting records for 5 years after contract year-end.

Management must comply with the above requirements to avoid being in default of its FEHBP contract.

PRACTITIONER QUALIFICATIONS AND RESPONSIBILITIES

Following is a discussion of the standards audit practitioners must follow and guidance on applying those standards in the engagements required by this guide.

Qualifications and General Standards. The FEHBP contract requires a combination of annual financial audits, reports on internal controls and compliance with laws and regulations, attestation reports, reports on agreed-upon procedures and reviews of service organization activities to be conducted by a qualified, independent public accountant in accordance with GAGAS or GAAS. Therefore the engagements must be performed by a licensed certified public accountant ("practitioner") who meets the general standards of qualification, independence, due professional care and quality control. For GAGAS audits, refer to Chapter 3 of the Yellow Book for continuing professional education requirements. In part, those standards require practitioners and audit firms to comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the engagement is being conducted. If the carrier or service organization is located in a state outside the home state of the practitioner, and the practitioner performs substantial field work in the carrier's or service organization's state, the practitioner must document his or her compliance with the licensing requirements of the public accountancy laws of that state. This guide does not impose additional licensing requirements beyond those established by the individual State Boards of Accountancy.

Internal auditors of a carrier or service organization are not independent of the entity while auditing within it and, therefore, their work and reports cannot directly satisfy the reporting requirements of this guide. However, where audit standards allow, internal auditors and their work should be considered by the practitioner. For example, while performing the examination of internal controls discussed in Chapter II of this guide, a practitioner should consider the guidance in SAS No. 65 for use of internal auditors.

Field work and Reporting Standards. The practitioner must follow the fieldwork and reporting standards for financially related audits in accordance with those standards contained in GAAS or Chapters 4 and 5, respectively, of GAGAS. If the audit is performed in accordance with GAAS, the practitioner must perform a review of and report on the carrier's internal controls and compliance with laws and regulations in accordance with SSAE No. 3.

Engagement Scope. The nature of the carrier or service organization management's written assertions and the scope of the practitioner's engagement may vary depending on whether the carrier contracts with service organizations. All applicable assertions required of management by this guide must be addressed by the practitioner's report.

Engagement Letter. The practitioner must prepare a letter of engagement to communicate to the carrier or service organization the nature of the engagement. The letter must include, at a minimum, the following:

A. A statement that the engagement is to be performed in accordance with GAGAS, GAAS and AICPA Attestation Standards as applicable.

B. A statement that both parties understand that the U.S. Office of Personnel Management intends to use the practitioner's report to help carry out its responsibilities for oversight of the FEHBP.

C. A statement that the practitioner is required to provide OPM's contracting officer and Inspector General, as well as the U.S. General Accounting Office (GAO), or their representatives, access to working papers or related documents to review the engagement. Access to working papers includes making necessary photocopies. Practitioners can refer to Interpretation No. 1 of SAS No. 41, titled "Providing Access to or Photocopies of Working Papers to a Regulator," or attestation standards AT 9100 paragraphs 56 to 59, for guidance. Information regarding confidential commercial information that may be contained in working papers and Freedom of Information Act (FOIA) disclosure is provided in the "Working Papers" subsection on page I-10 of this guide.

Obtaining Management Representations. Management representations are required for essentially all of the engagements in this Guide. Specifically, Paragraph 9c of SSAE No. 3 states, in part, a practitioner may perform an examination engagement if management makes written assertions about the entity's compliance with specified requirements or about the effectiveness of the entity's internal control over compliance. Management's written assertions are the basis for the practitioner's testing and, therefore, are an integral part of the engagement. In addition to the specific assertions identified in the Guide, management must also provide written representations about the matters in paragraph 12 of SSAE No. 3 to the practitioner. Management must provide all written assertions and representations required by the Guide to the IPA. If management omits any of the required assertions or representations, the practitioner should consider the guidance of paragraph 68 of SSAE No. 3 about restrictions on the scope of the engagement.

Matters Requiring Immediate Action. Practitioners must plan and perform the audit to obtain reasonable assurance about whether financial statements are free of material misstatements, whether caused by error, illegal acts or fraud, in accordance with AICPA SAS No. 82.

As described in paragraph 2, Appendix B of SAS No. 82, the practitioner is required to plan and perform his or her work with due professional care. Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards on fieldwork and reporting.

As described in Paragraph 38 of SAS 82, whenever the auditor has determined that there is evidence that fraud may exist, that matter must be brought to the attention of an appropriate level of management. This is generally appropriate even if the matter might be considered inconsequential; such as a minor defalcation by an employee at a low level in the entity's organization. Fraud or illegal acts involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the AAS should be reported to the audit committee. Further, consistent with paragraph 40 (a) and (d) of SAS 82, the auditor must disclose possible fraud and illegal acts and management's response to the OPM Inspector General within 30 days from the time disclosure is made to management or the audit committee as appropriate. The practitioner shall submit these reports to the Assistant

Inspector General for Audits at the address shown at the end of this section.

For supplemental guidance, consult SAS No. 82, Consideration of Fraud in a Financial Statement Audit, and SAS No. 54, Illegal Acts by Clients.

Due Care and Professional Skepticism. Paragraph 3.26 of GAGAS states due professional care should be used in conducting the audit and in preparing related reports. Practitioners are cautioned against ignoring basic weaknesses in internal controls, performing audit steps mechanically (auditing form over substance), and accepting explanation for audit exceptions without question.

Obtaining an Understanding of Internal Control Structure. SAS No. 78, SSAE No. 3, and Chapter 5 of the Government Auditing Standards provide guidance on understanding, evaluating and testing internal control policies and procedures.

Obtaining Sufficient Evidence and Sampling. The examination procedures suggested in this guide are not intended to be all inclusive. The practitioner is responsible for determining the procedures necessary to form an opinion regarding the financial statements and whether management's assertion regarding the effectiveness of internal controls is fairly stated. The procedures are not intended to supplant the practitioner's judgment of the work required. Suggested procedures described may not cover all circumstances or conditions encountered. Practitioners should consider Evidential Matter, Codification of Statements on Auditing Standards, AU sec. 326.

The Guide requires samples to be selected in such a way to be representative of the population and period under audit (in the case of service organizations, representative of the carrier clients serviced) and have certain confidence levels and tolerable error rates. Practitioners are encouraged to use guidance contained in the AICPA's Professional Standards, Vol. 1, AU sec. 350, Audit Sampling, and the GAO Financial Audit Manual.

Working Papers. SAS No. 41 and Paragraphs 4.34 through 4.38 of GAGAS address working papers. SAS No. 41, paragraph 5 states working papers ordinarily should include documentation showing (a) the work was adequately planned and supervised; (b) sufficient understanding of the internal control structure was obtained to plan the audit and determine nature, timing and extent of audit tests; and (c) the audit evidence obtained, the auditing procedures applied, and the testing performed have provided sufficient competent evidential matter to afford a reasonable basis for an opinion.

Further, Paragraph 4.35 of GAGAS states the practitioner's working papers should "contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditor's significant conclusions and judgments."

Carriers, service organizations or practitioners who deem any of the working paper information to be "confidential commercial information" should take appropriate steps to so designate each working paper containing confidential commercial information.

Such designation may protect its confidentiality if, at a future point of time, a request is made for disclosure of this information under the Freedom of Information Act. "Confidential commercial information" means records that may contain material exempt from release under Exemption 4 of the FOIA (pertaining to trade secrets and commercial or financial information that is privileged or confidential) because disclosure could reasonably be expected to cause substantial competitive harm. Further information regarding the designation of such documents and OPM's Office of Inspector General (OIG) procedures upon receipt of a FOIA request are contained in Appendix E.

Engagement Quality. The OPM OIG has implemented procedures for evaluating work performed by non-federal practitioners. As part of this evaluation, the practitioner shall make working papers available upon request to the Assistant Inspector General for Audits or other representatives of the OIG. To facilitate these requests, management's reporting package should include an information sheet identifying the name, address, and telephone number of the partner on the engagement (see Appendix A). Working paper reviews will normally take place at the carrier's office.

Whenever an evaluation of a report or working papers discloses inadequacies, the practitioner may be asked to take corrective action. If OPM determines the report and working papers are substandard or contain significant inadequacies, referral to the AICPA and the cognizant State Board of Accountancy will be considered. OPM may also initiate action to debar the practitioner from further participation in federal programs.

FUTURE REVISIONS

It is the practitioner's responsibility to ensure he/she is using the most current version of this guide. OPM periodically revises the FEBHP reporting requirements and the OPM OIG plans to issue revisions to this Guide to reflect these changes. Until the Guide is revised, inconsistencies may exist between the Guide and FEBHP laws or regulations. Practitioners should follow the FEBHP laws or regulations in effect for the period being examined and modify their procedures to test the FEBHP compliance requirements accordingly.

The practitioner is also responsible for monitoring relevant changes in GAGAS and GAAS, including AICPA SASs and SSAEs, and for considering the implications of changes on the engagement.

Technical questions about applying the Guide and suggestions for improving future guides should be sent to:

Assistant IG for Audits
Office of the Inspector General
U.S. Office of Personnel Management
1900 E Street NW., Room 6400
Washington, D.C. 20415-1100

Fax: (202) 606-4823
Email: dlfletch@opm.gov

CHAPTER II

SSAE NO. 3 CARRIER REPORTING

MANAGEMENT ASSERTIONS FOR COMPLIANCE ATTESTATION IN ACCORDANCE WITH SSAE NO. 3

These assertions are made by the management of each experienced-rated carrier participating in the Federal Employees Health Benefits Program (FEHBP). They relate to the effectiveness of the carrier's internal controls over compliance with specified laws and regulations and with the carrier's contract with the Office of Personnel Management (OPM) (See Appendix D). The independent public accountant (IPA), engaged by that carrier, will perform the procedures necessary to express an opinion about whether the assertions are fairly stated in all material respects.

Preamble: The Federal Employees Health Benefits Program is authorized and operates under statute (Title 5, U.S. Code, Chapter 89) and regulation (Title 5, Code of Federal Regulations, Part 890). Carriers participate under the terms of a contract with OPM; the contracts conform with the Federal Acquisition Regulation (FAR), 48 CFR Ch. 1, and the Federal Employees Health Benefits Acquisition Regulations (FEHBAR), 48 CFR Ch. 16.

Assertion 1: **Management asserts that controls were in place during the current federal fiscal year to ensure compliance with the contractual requirements for accurate and timely claim payments and coordination of benefits as described in the contract.**

Examination considerations: Using the sample test results from the agreed upon procedures for "Accuracy of Claim Payments" and "Timeliness of Claim Payments" from Chapter III, evaluate the errors and determine whether the controls over the accuracy and timeliness of claims payments are adequate.

Assertion 2: **Management asserts that controls were in place during the current fiscal year to ensure compliance with the requirements for investing FEHBP funds as specified in section 3.4 of the contract.**

Assertion 3: **Management asserts that controls were in place during the current fiscal year to ensure that FEHBP funds were not commingled with funds obtained from other sources in accordance with the requirements in Section 3.5 of the contract.**

Assertion 4: **Management asserts that controls were in place during the current federal fiscal year to ensure compliance with the requirements at 48 CFR 1632.170 (2) and (3) for withdrawing funds from the letter of credit account maintained by OPM for the plan.**

Examination considerations: Using the sample test results from the agreed upon procedures for "Letter of Credit (LOC) authorizations" in Chapter III, evaluate the findings reported and determine whether the controls over LOC withdrawals are adequate.

Assertion 5: **Management asserts that controls were in place during the current federal fiscal year to ensure that uncashed checks issued to pay for or reimburse the payment of benefits, services or supplies are credited and handled in accordance with Section 3.6 of the contract.**

Examination considerations: Using the sample test results from the agreed upon procedures for "Cash and Equivalents" in Chapter III, evaluate the reported findings and determine whether controls over uncashed checks are adequate.

Assertion 6: **Management asserts that controls were in place during the current fiscal year to ensure that the requirements for diligent collection of overpaid claims in section 2.3 (g) of the contract are adhered to.**

Assertion 7: **Management asserts that controls were in place during the current federal fiscal year to ensure that costs charged to the contract were allowable, actual, necessary, and reasonable and were properly justified and supported in accordance with section 3.2 of the contract.**

Examination considerations: Using the sample test results from the agreed upon procedures for "Administrative Expenses" in Chapter III, evaluate the reported findings and determine whether controls over administrative expenses are adequate.

Assertion 8: **Management asserts that controls were in place during the current federal fiscal year to ensure that enrollment was reconciled with information provided by employers in the form of a quarterly health benefits reconciliation report.**

Examination considerations: Using the results of the inspection performed from the agreed upon procedures for "Revenue" in Chapter III, evaluate the reported findings and determine whether controls over subscriber enrollment reconciliations are adequate.

Assertion 9: **Management asserts that controls were in place during the current federal fiscal year to ensure that, in accordance with FAR 31.201-5, the applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by or accruing to the carrier was credited to the FEHBP either as a cost reduction or by refund. FEHBP credits/refunds result from benefit payments that include, but are not limited to, coordination of benefits, hospital year-end settlements, uncashed and returued checks, utilization reviews, litigation with subscribers or providers of services, and erroneous benefit payments.**

Examination considerations: Using the sample test results from the agreed upon procedures for "Refunds" in Chapter III, evaluate the reported findings and determine whether controls over refunds are adequate.

Assertion 10: Management asserts that controls were in place during the current federal fiscal year to ensure that, in accordance with 5 U.S.C. 8909(f)(1), no taxes, fees, or other monetary payment, directly or indirectly, were imposed on FEHBP premiums by any state, the District of Columbia, the Commonwealth of Puerto Rico, or any other political subdivision [48 CFR 1631.205-41].

Assertion 11: Management asserts that controls were in place during the current fiscal year to ensure that, in accordance with FEHBAR 1631.205-73, no interest costs incurred in the administration of the contract were charged to the contract.

Assertion 12: Management asserts that controls were in place during the current fiscal year to ensure that, in accordance with FEHBAR 1631.205-73, no selling costs related to sales promotion or paid to outside entities for enrolling federal subscribers in the plan were charged to the contract.

Assertion 13: Management asserts that controls were in place to ensure that known material findings and recommendations from prior audits were incorporated into a corrective action plan and subsequently forwarded to the Office of Personnel Management.

CHAPTER III

AGREED-UPON PROCEDURES FOR SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF THE FINANCIAL STATEMENT FOR PROGRAM REPORTING (SAS 75)

PROGRAM PROCEDURES

This section of Chapter III contains specific procedures for seven requisite elements to be followed during the audit. Should the carrier's system of accounts and records make the use of these specific procedures inappropriate, the carrier may request OPM to consider alternative procedures designed to produce similar results. The seven requisite elements include the following:

Health Benefits Charges
Letter of Credit (LOC) Authorizations
Cash and Equivalents
Administrative Expenses
Revenue
Refunds
Provider Charges

Health Benefits Charges

Accuracy of Claim Payments. Stratify the claims-paid universe into five payee subgroups: (1) physician, (2) hospital, (3) pharmacy/prescriptions, (4) subscriber under age 65, and (5) subscriber age 65 or over. Select a judgmental sample of each claim population. The compliance test sample size for Groups 1, 2, 3 and 5 is 157; for Group 4 the test sample size is 93.

Sample sizes may be reduced under the following circumstances:

- o Items that meet multiple subgroup criteria can be used as a sample item for several categories; e.g. if a claim was selected as a physician claim, but also was for a subscriber under age 65, then this item could be counted as one sample item for both subgroups. Or

- o If a carrier can assert that all claims are processed through the same processing system at the same location by the same employees and are subject to the same control procedures then stratify the claims-paid universe into two payee subgroups, (1) subscriber age 65 and over and (2) all other claims. The sample size for each subgroup would consist of 157 claims.

For each claim selected, perform the following:

A. Compare the claimant's name and other identifying information to the carrier's subscriber eligibility files and determine eligibility.

B. Inspect documentation evidencing accuracy of claim amount.

C. Inspect documentation evidencing allowability of claim and compare with the terms of the contract.

D. Compare evidence of claim amount with claim amount recorded in the general ledger or claim amount to check register and then to the general ledger.

E. Inspect documentation supporting proper application of coinsurance.

F. Inspect documentation supporting proper application of coordination of benefits (COB).

For claim population of subscriber age 65 or over, also perform the following:

G. Obtain the subscriber history file (for up to 6 months) of subsequent information.

H. Inspect documentation that identifies other insurance coverages (Medicare B, etc.) impacting COB.

I. Recalculate COB amounts due OPM for retroactive application of coverage.

J. Determine whether the amount of the claim and the amount charged to the FEHBP agrees with the amount on the remittance advice to provider, or amount of the check.

K. Select judgmental sample of COB refunds and determine that they were properly applied to the contract.

Evaluation: Compile the number of errors including monetary amounts found for each subgroup sample and report the claim amounts and error rate as a finding.

Timeliness of Claim Payments. Using the sample derived above, calculate the average number of working days from the date a claim was received to the date it is adjudicated (paid, denied, or a request for further information is sent out), for the given time period, expressed as a cumulative percentage.

Evaluation: If the cumulative percentage of average days for all 5 subgroups exceed the standards expressed in Section 1.9(a)(2)(I), of the standard contract, report the results as a finding.

Letter of Credit Authorizations

Select a sample of 25 withdrawals from the carrier's FEHBP LOC account and using the sample:

A. Examine the withdrawals and confirm that the amounts withdrawn are supported by claims invoices, administrative expense vouchers or other documentation, and compare the total dollar value of the supporting documentation with the amounts withdrawn.

B. Inspect withdrawals. Compare the date the checks issued for FEHBP disbursements were actually presented to the carrier's bank with the date of the withdrawals.

Evaluation: Compile the number of times that the dollar value of the LOC withdrawal exceeds the dollar value of the supporting documentation. In each case identified, report the amount of the excess. In addition, compile the number of times that LOC withdrawals occur before checks issued for FEHBP Program disbursements are presented to the carrier's bank.

Cash and Equivalents

A. Inspect a sample of uncashed FEHBP checks. Identify and tally all checks outstanding for two years. Compare the amounts represented by these checks with the corresponding amounts credited to the FEHBP, and identify those checks that were credited later than the 25th month after issuance or not credited at all.

B. Inspect a sample of uncashed checks where the FEHBP is a related party. Identify and tally all checks outstanding for two years. Compare the date that amounts representing the FEHBP's allocable share of these checks were credited to the FEHBP with the date of the uncashed checks. Identify those amounts representing FEHBP's allocable share of the checks credited later than the 25th month after issuance or not credited at all.

Evaluation: Compile the number of instances that the FEHBP or FEHBP-related uncashed checks outstanding for two years have not been credited to the FEHBP later than the 25th month after issuance and report the results as a finding.

Administrative Expenses

A. Stratify the administrative expenses into five subgroups: (1) salaries, (2) fringe benefits, (3) pension costs, (4) post retirement benefits, and (5) all other. Select a judgmental sample of each expense population. The compliance test sample size is 42, sample unit is general ledger transactions, for each subgroup.

For each sample item:

1. Inspect documentation evidencing that each transaction was supported by invoices or other documentation.

2. Compare charges to the criteria prescribed for allowability of charges as defined in the contract cost principles procedures found in 48 CFR, Part 31 and 1631.

3. Inspect documentation evidencing the charges were allocable to the contract, as defined in 48 CFR 31-201-4.

4. Compare charges to the definition of reasonable charges as described in 48 CFR 31.201-3.

Evaluation: Report as a finding all instances where administrative charges made to the FEHBP were not in accordance with the contractual terms or the charges were not supported by appropriate documentation.

B. Inspect all manual adjustments to administrative expenses made after period-end closing and compare the adjustments with the corresponding supporting documentation.

C. Inspect all manual adjustments to administrative expenses made after period-end closing and compare the adjusted administrative costs with the charges allowable by 48 CFR, Part 31 and 1631.

Evaluation: Report as a finding all instances where supporting documentation did not exist for manual adjustments and instances where adjusted administrative costs were not allowable charges under the terms 48 CFR, Part 31 and 1631.

D. Review any nonrecurring items such as gain or loss on sale of assets to insure that the FEHBP was allocated according to 48 CFR 31.205-16.

E. Review rental charges for five transactions (involving five different properties) according to 48 CFR 31.205-36. Note any items with rental costs; treatment under a sale and leaseback agreement; and charges for rent between any divisions, subsidiaries, or organization under common control.

Evaluation: Report as a finding all instances where amount charged exceeds allowable amounts by more than 3 percent.

Revenue

The carrier is required to maintain records of subscriber enrollment reconciliations with federal payroll offices and to make the information available for inspection by OPM's Inspector General and by the U.S. General Accounting Office.

The federal payroll offices initiate the enrollment reconciliation cycle by producing and sending to the carriers the quarterly reports of enrollment. These reports are sent on 4/1, 7/1, 10/1 and 1/1 of a given year. Within 60 days after receiving the enrollment reports, the carriers must reconcile these reports to their enrollment information and report to the federal payroll offices any discrepancies. In return, the payroll offices must respond within 31 days to the discrepancies reported by the carriers. The reconciliation is complete when all enrollees have been confirmed.

Inspect the records of subscriber enrollment reconciliations with federal payroll offices and affirm that: (1) all reconciliations were completed quarterly, and (2) all actions were taken to reconcile identified differences within 91 days of the end of the quarter.

> ***Evaluation:*** Report all instances where enrollment reconciliations are not completed quarterly. Also, report all instances where action to reconcile differences have not occurred within 91 days of the end of the quarter. Identify instances where federal payroll offices fail to respond to carrier efforts to reconcile, including the identification of the payroll offices.

Refunds

A. Inspect the carrier's accounting policies and procedures used to account for solicited and unsolicited refunds and determine whether the policies and procedures are in accordance with the contract.

B. Compare the outstanding refunds report to the total refunds reported in the general ledger.

C. Select a sample of 25 refund transactions (resulting from direct and indirect charges) and perform the following:

   1. Compare refunds allocable to the FEHBP with requirement that refunds be credited to it within 60 days of receipt.

   2. For refunds that were indirectly charged to the FEHBP, but where the proportionate share of the charge or associated refund cannot be identified, compare the FEHBP refund with an amount derived from the application of a percentage (FEHBP's share of the carrier's business proportionate to the carrier's total business) to the total refund amount.

> ***Evaluation:*** Report as a finding all instances where: the carrier lacks policies and procedures to account for refunds, the outstanding refunds report does not agree with the general ledger; and refunds directly or indirectly associated with the FEHBP are not credited to the program within 60 days of receipt.

Provider Charges

Obtain agreements detailing arrangements the carrier has established with its providers for discounts and settlements.

A. Inspect payment/pricing methodology and determine if the methodology allows for retroactive settlements to occur.

B. Inspect a sample of 25 carrier settlements and document and determine whether they are in compliance with provider agreements. Compare the settlement received by the FEHBP with the terms of the agreements.

C. Tally the number of transactions where amounts resulting from provider discounts/settlements were returned to the FEHBP after 60 days of receipt by the carrier.

Evaluation: Compile the number of instances where the carrier: (1) cannot identify discounts and settlements. (2) does not comply with provider agreements, (3) does not credit the FEHBP in accordance with the terms of the agreements, and (4) does not return funds benefited from the discounts/settlement arrangements within 60 days of receipt by the carrier. Report the results as a finding.

ROLL FORWARD PROCEDURES

Roll forward procedures are to be completed when a carrier chooses either option 3 or 4. These procedures are performed on the September 30 unaudited AAS supporting documentation.

Obtain reconciliations and supporting detailed schedules for all amounts reported in the financial statements.

Review the carrier's financial records for the following:

A. Review the carrier's general ledger record of cash (LOC) receipts to verify that the carrier received OPM premium payments and that they are recording the receipts properly. Reconcile any differences.

B. Payments from the carrier to providers. Review the carrier's general ledger records of claim payments to verify that the carrier reimbursed providers and subscribers for the amounts received from OPM. Reconcile any differences.

C. Charges for administrative expenses. Determine that the administrative expenses reported in the FEHBP financial statements reconcile to the carrier's general ledger.

For all schedules (i.e., cash reconciliations or property, plant, and equipment listings) with amounts representing 10 percent or more of the total assets for the balance sheet or 10 percent or more of the total claims on the statement, verify that they agree with the general ledger balances or can be reconciled to the general ledger. The auditor should agree the detailed information contained in the schedules and reconciliations to supporting documentation. Tests should also analyze the next month's transactions for activity relating to the prior period as is done with standard cut-off testing.

STATUS OF PRIOR YEAR FINDINGS

If the carrier was subject to the Guide in the prior year, update the status of prior year findings. Obtain the carrier's corrective action plan from the prior year. Obtain an update on the status of each finding from the prior year. Verify that the actions indicated were completed by the plan by viewing evidence from the plan. See Appendix B, number 6 for an illustrative corrective action plan.

CHAPTER IV

SAS No. 70 REVIEWS FOR SERVICE ORGANIZATIONS

This chapter sets forth the suggested federal fiscal year reporting for carriers who use service organization entities to process FEHBP-related transactions. It also provides guidance on the general approach the practitioner should consider in designing and carrying out procedures necessary to report on the controls placed in operation and tests of operating effectiveness.

SERVICE ORGANIZATION REQUIREMENTS

The service organization is encouraged to provide a written representation, which includes all elements of AICPA Professional Standards, Vol. 1, AU sec. 324, paragraph 57. Service organizations have responsibility for designing and implementing sufficient internal controls to ensure FEHBP claims are accurately processed in accordance with the terms of the service contract.

If a service organization does not perform for its carrier client all of the functions addressed by a single assertion, that assertion may be modified, but must clearly distinguish responsibilities of the carrier and the service organization, so that their respective written assertions address only the functions each performs.

PRACTITIONER (SERVICE AUDITOR) ENGAGEMENT REQUIREMENTS

The service auditor is responsible for performing the procedures necessary to provide reasonable assurance that during the current federal fiscal year service organization management has:

A. Designed controls to ensure FEHBP claims are accurately processed in accordance with the terms of the service contract; and

B. Controls are operating with sufficient effectiveness to provide reasonable assurance FEHBP claims are accurately processed in accordance with the terms of the service contract.

Responsibilities of the service auditors are contained in AICPA Professional Standards, Vol. 1, AU sec. 324, paragraphs 22-24. In addition service auditors should consult paragraphs 41-56 for information on reports on controls placed in operation and tests of operating effectiveness.

CHAPTER V

CONTRIBUTORS TO THIS GUIDE

The Office of Inspector General wishes to express our appreciation for the contributions of time, effort and expertise so generously given by the members of the following government and private entities.

OPM Retirement and Insurance Service
KPMG Peat Marwick, LLP
Baird, Kurtz and Dobson, LLP
Government Employees Hospital Association (GEHA)
Blue Cross and Blue Shield National Capital Area
American Postal Workers Union, Health Plan Department

OPM and the Office of the Inspector General also gratefully acknowledge the assistance provided by all other FEHBP carriers and the public accounting community.

APPENDIX A

CARRIER ANNUAL ACCOUNTING STATEMENT FORMAT

Carrier financial statements should be presented in conformity with the following OPM prescribed statements, which are representative of Generally Accepted Accounting Principles (GAAP) for Health and Welfare Plans (SOP 92-06). The following statements presentation and are for information purposes only. We acknowledge changes may be necessary for each carrier's individual situation and it is the carrier's responsibility to prepare full disclosure financial statements. All supplemental schedules must be completed as detailed.

This guide requires federal fiscal year-end and calendar year-end carrier financial statements and disclosures. However, the following illustrative financial statements and disclosures (pages A-2 through A-12) are calendar year only.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM
ANNUAL ACCOUNTING STATEMENTS
FOR
CALENDAR YEAR 19XX

Carrier Name:____________________________ **Code**_____

TABLE OF CONTENTS

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** _____

BALANCE SHEET
DECEMBER 31, 19XX AND 19XX

	19XX	19XX
ASSETS		
Cash and Cash Equivalents	$	$
Balance in Letter of Credit (LOC) Account		
Interest Income Receivable		
Program Income Receivable		
Prepaid Expenses		
TOTAL ASSETS	$	$
LIABILITIES		
Health Benefits Accrued but Unpaid	$	$
Accrued Administrative Expenses and Retentions		
Special Reserve		
TOTAL LIABILITIES WITH SPECIAL RESERVE	$	$

See accompanying notes to financial statements.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** ______

STATEMENT OF OPERATIONS
FOR THE
YEAR ENDED DECEMBER 31, 19XX

	19XX	19XX
REVENUE:	$	$
Letter of Credit (LOC) Authorizations		
Net Investment Income		
Total Revenue		
BENEFITS AND EXPENSES		
Health Benefit Charges		
Administrative Expenses		
State Statutory Reserve		
Reinsurance Expenses		
Service Charges		
Other		
Total Benefits and Expenses		
GAIN (LOSS) FROM OPERATIONS	$	$ ________
Special Reserve Beginning of Year	$	$
Gain (Loss) from Operations		
Return of Excess Reserves		
Contingency Reserve Payments		
Other		
Special Reserve at End of Year	$	$ ________

See accompanying notes to financial statements.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** ______

STATEMENT OF CASH FLOWS
FOR THE
YEARS ENDED DECEMBER 31, 19XX AND 19XX

	19XX	19XX
CASH FLOWS FROM OPERATIONS ACTIVITIES	$	$
Net Gain		
Adjustments to Reconcile Net Gain to Net Cash Provided by (used in) Operating Activities:		
(Increase) Decrease in Assets:		
Benefits Receivable		
Accrued Investment Income		
xxx		
xxx		
Other Assets		
Increase (Decrease) in Liabilities:		
Accrued Benefits Payable		
Special Reserve		
xxx		
xxx		
xxx		
Other Liabilities		
TOTAL ADJUSTMENTS		
Net cash provided by operating activities	$	$ ________

(Continued Next Page)

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** ______

STATEMENT OF CASH FLOW (Continued from previous page)

CASH FLOWS FROM INVESTMENT ACTIVITIES

Proceeds from Sale of Investments xxx	$	$
Net Cash Provided by Investing Activities	$	$ ________

NET INCREASE IN CASH AND CASH EQUIVALENTS

Cash and Cash Equivalents at the Beginning of Year		
Cash and Cash Equivalents at the End of Year	$	$ ________

See accompanying notes to financial statements.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** _____

NOTES TO FINANCIAL STATEMENTS
FOR THE
YEARS ENDED DECEMBER 31, 19XX AND 19XX

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ Code ______

SUPPLEMENTAL SCHEDULE OF ADMINISTRATIVE EXPENSES
FOR THE
YEARS ENDED DECEMBER 31, 19XX AND 19XX

	19XX	19XX
ADMINISTRATIVE EXPENSES		
Rent	$	$
Salaries		
Employee Benefits		
Furniture and Equipment		
Maintenance		
Equipment Rental		
Printing, Stationery and Supplies		
Travel		
Postage		
Telephone & Telegraph		
Private Wire System		
Auditing Services		
Legal Services		
Consulting & Professional		
Payroll Taxes		
Utilities		
Insurance		
LOC Bank Charges		
Cost Containment		
Other		
TOTAL	$	$

See accompanying independent auditors' report.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** _____

SUPPLEMENTAL SCHEDULE OF STATUS OF RESERVES
AS OF DECEMBER 31, 19XX

1. **Reserves Held by Carrier**

a. Ending Special Reserve Balance	$ ________
b. Ending Accrued but Unpaid Health Benefits Charges	________
c. Total. *(line 1.a. plus line 1.b.)*	$ ________

2. **One Month's Average Expenses**

a. One Month's Average Claims Paid:

Claims paid-last six months of 19XX:

July	$________		
August	________		
September	________		
October	________		
November	________		
December	________		
Total	$________	x 1/6	$ ________

b. One Month's Average Administrative Expenses and Retentions (Statement of Operations x 1/12)	$ ________
c. Total One Month's Average Expenses. *(line 2.a. plus line 2.b.)*	$ ________

3. **Target Level of Carrier-Held Reserves.** *(line 2.c. x 3.5)*	$ ________

4. **Status of Reserves:**

a. Excess Reserve *(If the amount on line 1.c. is greater than the amount in line 3., enter the difference here.)*	$ ________
b. Deficiency of Reserves *(If the amount on line 3. is greater than line 1.c., enter the difference here.)*	$ ________

See accompanying independent auditors' report.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** _____

High Option _______
Low Option _______

SUPPLEMENTAL SCHEDULE OF HEALTH BENEFIT CHARGES PAID FOR THE YEAR ENDED DECEMBER 31, 19XX

PART A - Monthly Claims Paid

MONTH	AMOUNT PAID	YEAR INCURRED		
		1998	1997	1996 - PRIOR
January	$	$	$	$
February				
March				
April				
May				
June				
July				
August				
September				
October				
November				
December				
Total	$	$	$	$

Prior year's accrual from line *Summary Statement* $________

Difference $________

PART B - Number of Claims Paid

TOTAL	YEAR INCURRED		
	1998	1997	1996 - PRIOR

(Continued Next Page)

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ **Code** ______

SUPPLEMENTAL SCHEDULE OF HEALTH BENEFIT CHARGES PAID FOR THE YEAR ENDED DECEMBER 31, 19XX (Continued from previous page)

PART C - Types of Claim Paid

TOTAL	HOSPITALIZATION	PHYSICIANS	OTHER

PART D - Reconciliation of Health Benefit Charges Paid

Total Claims Paid from Part A *(above)*	$ ________
Less: Reinsurance Recovery	________
Other Adjustments *(explain)*	________
TOTAL (Summary Statement)	$ ________

See accompanying independent auditors' report.

FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Carrier Name: ______________________________ Code _____

SUPPLEMENTAL SCHEDULE OF AUDIT FINDINGS
FOR THE
YEAR ENDED DECEMBER 31, 19XX

AUDIT NUMBER AND ASSOCIATED YEAR:

XXXX	$ _______
XXXX	_______
TOTAL	$ _______

APPENDIX B

SAMPLE PRACTITIONER REPORTS - For Selected Requirements

1. ILLUSTRATIVE REPORT ON CARRIER MANAGEMENT'S ASSERTIONS ABOUT EFFECTIVENESS OF CONTROLS OVER COMPLIANCE WITH FEHBP CONTRACT REQUIREMENTS

Independent Accountants' Report

Office of Personnel Management
Carrier Audit Committee
Carrier X
City, State ZIP Code

We have examined management's assertions about the requirements listed in Chapter II of the Audit Guide about [*name of carrier*]'s compliance with its contract with the Office of Personnel Management and the effectiveness of the internal controls over compliance with those requirements during the year ended [*September 30 or December 31*]. Management is responsible for [*name of carrier*]'s compliance with those requirements. Our responsibility is to express an opinion on management's assertions about the carrier's compliance based on our examination.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and, accordingly, included examining, on a test basis, evidence about [*name of carrier*]'s compliance with these requirements and performing other such procedures we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on [*name of carrier*]'s compliance with specified requirements.

[Unqualified]

In our opinion, management's assertions that the [*name of carrier*] complied with the aforementioned requirements for the year ended [*September 30 or December 31*] is fairly stated, in all material respects.

[Qualified]

Our examination disclosed the following material noncompliance *with [compliance requirement*] applicable to [*name of carrier*] during the year ended [*September 30 or December*

31]. [*Describe noncompliance*].

In our opinion, except for the material noncompliance described in the third paragraph, management's assertions that the [*name of carrier*] complied with the aforementioned requirements for the year ended [*September 30 or December 31*] is fairly stated, in all material respects.

[Adverse]

Our examination disclosed the following material noncompliance *with [compliance requirement*] applicable to [*name of carrier*] during the year ended [*September 30 or December 31*]. [*Describe noncompliance*].

In our opinion, because of the material noncompliance described in the third paragraph, management's assertions that the [*name of carrier*] complied with the aforementioned requirements for the year ended [*September 30 or December 31*] is not fairly stated.

(Date)

2. ILLUSTRATIVE REPORT ON AGREED-UPON PROCEDURES (AU Section 622.34)

Office of Personnel Management

We have performed the procedures enumerated below, which were agreed to by the audit committees and management of OPM and carrier x, solely to assist you in evaluating the accompanying Annual Accounting Statement for the period ending September 30, 19xx. This agreed-upon procedure engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed are enumerated in the listing of engagement procedures accompanying this report. Findings obtained from performing these procedures are presented in the accompanying schedule of findings and questioned amounts.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the accompanying Annual Accounting Statement of carrier X. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of OPM and the audit committee and management of carrier X, and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

3. ILLUSTRATIVE SCHEDULE OF FINDINGS AND QUESTIONED AMOUNTS

Schedule of Findings for Agreed-Upon Procedures			
Area	Description of Findings	$ Questioned	Status of Finding
Claims Enrollment Records	Describe in detail the noted finding	$10,000 Unknown	1. Amount Reimbursed to FEHBP, or 2. Amount Not Reimbursed to FEHBP, or 3. Resolved – No Money Due the FEHBP 4. Unresolved – No Money Due the FEHBP

4. ILLUSTRATIVE COMMENTS ON RESOLUTION OF PRIOR YEAR'S EXAMINATION FINDINGS

Finding No 1: In an examination performed by the [name of audit entity] dated [mm/dd/yy] and titled [name of report], in tests of claims paid, the carrier did not properly coordinate payment of benefits. The FEHBP was overcharged by $xx.

Status: As of [mm/dd/yy] the carrier has not reimbursed the FEHBP for these claims or recorded proper accounting entries to record payable to the FEHBP.

NOTE: The chart in No.3 could be modified to incorporate these two items, and thereby minimize duplication of efforts.

5. ILLUSTRATIVE SAS No. 70 REPORT REGARDING SERVICE ORGANIZATION MANAGEMENT'S ASSERTIONS (AU 324.39)

We have examined the accompanying description of controls related to the claims processing and payment applications of ABC service organization. Our examination included procedures to obtain reasonable assurance about whether: (1) the accompanying description presents fairly, in all respects, the aspects of ABC service organization's controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements, (2) the controls included in the description were suitably designed to achieve the control objectives specified in the description, if those controls were complied with satisfactorily, and (3) such controls had been placed in operation as of September 30, 19xx. The control objectives were specified by ABC service organization.

In our opinion, the accompanying description of the aforementioned application presents fairly, in all respects, the relevant aspects of ABC service organization's controls that had been placed in operation as of September 30, 19xx. Also, in our opinion, the controls, as described are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily.

In addition to the procedures we considered necessary to render our opinion as expressed in the previous paragraph, we applied tests to specific controls, listed in Schedule X, to obtain evidence about their effectiveness in meeting the control objectives, described in Schedule X, during the period from October 1, 19x1 to September 30, 19x2. The specific controls and the nature, timing, extent, and results of the tests are listed in Schedule X. This information has been pro-vided to user organizations of ABC service organization and to their auditors to be taken into consideration, along with information about the internal control at user organizations, when making assessments of control risk for user organizations. In our opinion the controls that were tested, as described in Schedule X, were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectiveness specified in Schedule X were achieved during the period from October 1, 19x1 to September 30, 19x2.

The relative effectiveness and significance of specific controls at ABC service organization and their effect on assessments of control risk at user organizations are dependent on their interaction with the controls and other factors present at individual user organizations. We have performed no procedures to evaluate the effectiveness of controls at individual user organizations.

The description of controls at ABC service organization as of September 30, 19xx, and information about tests of the operating effectiveness of specified controls covers the period from October 1, 19x1 to September 30, 19x2. A projection of such information to the future is subject to the risk that, because of change, the description may no longer portray the system in existence. The potential effectiveness of specified controls at the service organization is subject to inherent limitations and, accordingly, errors or irregularities may occur and not be detected. Furthermore, the projection of any conclusions, based on our findings, to future periods is subject to the risk that changes may alter the validity of such conclusions.

This report is intended solely for use by the management of the ABC service organization, its customers, and the independent auditors of its customers.

6. ILLUSTRATIVE CORRECTIVE ACTION PLAN FOR MATERIAL WEAKNESSES OR FINDINGS

Corrective Action Plan
(Prepared by carrier or service organization)

Name of carrier or service organization and plan code:

Official responsible for plan:

Phone number:

Audit Period:

Practitioner/Audit firm:

A. Comments on findings and recommendations

The carrier should provide a statement of concurrence or nonconcurrence with each finding and recommendation. For instances of nonconcurrence, the carrier should provide documentation to support their position.

B. Actions taken or planned

The carrier should develop a detail action plan to correct or resolve all practitioner findings. The plan should include expected correction date(s) and name of official responsible for corrective actions.

C. Status of corrective actions for prior year findings

The carrier, should document status of all prior year findings and the related corrective actions including changes in corrective action, and expected dates of completion.

APPENDIX C

DEFINITIONS AND ACRONYMS

Carrier:	a voluntary association, corporation, partnership, or other non-governmental organization which is lawfully engaged in providing, paying for, or reimbursing the cost of health services under group insurance polices or contracts, medical or hospital services agreements, membership or subscription contracts, or similar group arrangements, in consideration of premiums or other periodic charges payable to the carrier, including a health benefits plan duly sponsored or underwritten by an employee organization.
Service organization:	any organization that provides claims processing or claims related service(s) to a FEBHP carrier as defined above.

AICPA	American Institute of Certified Public Accountants
AIGA	Assistant Inspector General for Audits
BCBS	Blue Cross Blue Shield
CFR	Code of Federal Regulations
CFO Act	Chief Financial Officers Act of 1990
CPA	Certified Public Accountant
ERC	Experienced-rated Carriers
FOIA	Freedom of Information Act
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	U.S. General Accounting Office
GLS	General Ledger System
IC	Internal Control
LOC	Letter of Credit
MOU	Memorandum of Understanding
OFCM	Office of Financial Control and Management
OIG	Office of the Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
QIT	Quality Improvement Team
SAS	AICPA's Statement on Auditing Standards
SSAE	AICPA's Statements on Standards for Attestation Engagements

AUTHORITATIVE REFERENCES

Generally Accepted Accounting Principles (GAAP)
GAO's Government Auditing Standards (Yellow Book)/Generally

Accepted Government Auditing Standards (GAGAS)
Generally Accepted Auditing Standards (GAAS)
SAS No. 41, Working Papers
Interpretation No. 2 of SAS No. 41, Providing Access to or Photocopies of Working Papers to a Regulator
SAS No. 54, Illegal Acts by Clients
SAS No. 65, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements
SAS No. 70, Reports on the Processing of Transactions by Service Agents
SAS No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55
SAS No. 82, Consideration of Fraud in a Financial Statement Audit
SSAE No. 3, Compliance Attestation, as amended by SSAE No. 9
SSAE No. 4, Agreed-Upon Procedures Engagements

APPENDIX D

LAWS AND REGULATIONS, AND CONTRACT TERMS TO BE TESTED FOR COMPLIANCE

1. *Enrollment reconciliations.*

2. *Claims benefit payments.*

3. *Coordination of benefits.* OPM expects all Federal Health Benefits Program plans to coordinate benefits. (48 CFR- 1604.70.)

4. *Carrier investment of FEHBP funds.* The carrier is required to invest and reinvest all funds on hand, including any attributable to the special reserve or the reserve for incurred but unpaid claims, exceeding the funds needed to discharge promptly the obligations incurred under the contract. Also, the carrier is required to credit income earned from its investment of FEHBP funds to the special reserve on behalf of the FEHBP. If a carrier fails to invest excess FEHBP funds or to credit any income due the contract, for whatever reason, it shall return or credit any investment income lost to OPM or the special reserve. Investment income is the net amount earned by the carrier after deducting investment expenses. (48 CFR - 1615.805-70b, c and d).

5. *FEHBP credits.* FAR 31.201-5 provides that the applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the government either as a cost reduction or by cash refund. FEHBP credits result from benefit payments that include, but are not limited to:

    a. Coordination of benefit refunds
    b. Hospital year-end settlements
    c. Uncashed and returned checks
    d. Utilization review refunds
    e. Refunds attributable to litigation with subscribers or providers of health services
    f. Erroneous benefit payment, overpayment, and duplicate payment recoveries. (48 CFR - 1631.201-70).

6. *Taxes.* 5 U.S.C. 8909(f)(1) prohibits the imposition of taxes, fees, or other monetary payment, directly or indirectly, on FEHBP premiums by any state, the District of Columbia, or the Commonwealth of Puerto Rico or by any political subdivision or other governmental authority of those entities. (48 CFR - 1631.205-41).

7. *Interest expense.* Interest charges incurred in the administration of FEHBP contracts are not allowable in accordance with FAR 31.205.20. However, interest charges that are associated with the carrier's investment of FEHBP account funds are not considered

administrative costs and may be allowable under very limited circumstances [See criteria (1) through (5)]. (48 CFR - 1631.205-73).

8. *Selling costs*. FAR 31.205-38 is modified to eliminate from allowable costs those costs related to sales promotion and the payment of sales commissions fees or salaries to employees or outside commercial or selling agencies for enrolling Federal subscribers in a particular FEHBP plan. Selling costs are allowable costs to FEHBP contacts to the extent that they are necessary for conducting annual contract negotiations with the government and for liaison activities necessary for ongoing contract administration. (48 CFR 1631.205-75).

9. *Non-commingling of FEHBP funds*. Carrier or underwriter commingling of FEHBP funds with those from other sources makes it difficult to precisely determine FEHBP cash balances at any given time or to precisely determine investment income attributable to FEHBP invested assets. FEHBP funds shall be maintained separately from other cash and investments of the carrier or underwriter. (48 CFR 1632.771).

10. Carriers must comply with the provisions negotiated and as reported in the contract and any addendums thereto between the carrier and the Office of Personnel Management.

11. *Exclusion of unallowable costs per FAR.*

APPENDIX E

FREEDOM OF INFORMATION REQUESTS

NOTIFICATION TO SUBMITTERS OF CONFIDENTIAL COMMERCIAL INFORMATION

You have been or may be asked to submit to the Office of Inspector General, U.S. Office of Personnel Management, information in connection with these procedures, audit, inspection or other inquiry pursuant to the Inspector General Act of 978, as amended, 5 U.S.C. app. 3, sec. 1 et seq. This is to notify you that if you deem any of this information to be "confidential commercial information," you may take steps to so designate that information to protect its confidentiality if at a future point in time a request is made for disclosure of this information under the Freedom of Information Act (FOIA).

"Confidential commercial information" means records that may contain material exempt from release under Exemption 4 of FOIA (pertaining to trade secrets and commercial or financial information that is privileged or confidential), because disclosure could reasonably be expected to cause substantial competitive harm.

You may use any reasonable method you believe appropriate and which is acceptable to the OIG to indicate which documents and information you deem to fall into the category of "confidential commercial information." Please be as specific as possible in segregating the information that you consider to be "confidential commercial information" from any other information you are providing to the OIG. This may be done before such information is provided to the OIG if feasible, but only if it will not delay or interfere with production of the information or delay or interfere with the OIG's investigation, audit, inspection or other inquiry. Otherwise, you may so designate this information within a reasonable period of time after the information is provided to the OIG.

If a FOIA request is received by the OIG for information you have designated as "confidential commercial information," the OIG is nevertheless required by law to make its own independent determination of whether the FOIA requires disclosure of the information or whether it should be withheld pursuant to Exemption (b)(4) or any other exemption of FOIA. If the OIG determines that it may be required to disclose pursuant to FOIA that information you have designated or other information that the OIG has reason to believe could be expected to cause substantial competitive harm, to the extent permitted by law, we will make a good faith effort to notify you and provide you with a reasonable opportunity to object to such disclosure and to state all grounds upon which you oppose disclosure. We will give careful consideration to all specified grounds for nondisclosure prior to making our final decision.

If we nonetheless believe that disclosure is required, we will provide you with a statement explaining why your objections were not sustained and specifying a disclosure date. To the extent permitted by law, this statement will be provided to you in a reasonable number of days prior to the specified disclosure date. Furthermore, if disclosure of the designated information is denied pursuant to an exemption under FOIA and an administrative or judicial appeal is taken by the FOIA requester, we will make a good faith effort to notify you promptly.

The procedures outlined in this notice are intended only to improve the internal management of the OIG and are not intended to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States, its agencies, officers, or any person.

kpmg

2001 M Street, NW
Washington, DC 200036-3389

INDEPENDENT AUDITORS' REPORT

Director, U.S. Office of Personnel Management:

We have audited the accompanying balance sheet of the Retirement Program (RP), administered by the U.S. Office of Personnel Management (OPM) Retirement and Insurance Service (RIS), as of September 30, 1999, and the related statements of net cost, changes in net position, budgetary resources, and financing (hereinafter collectively referred to as "financial statements") for the year then ended. The objective of our audit was to express an opinion on the fair presentation of these financial statements. In connection with our audit, we also considered OPM's internal control over financial reporting related to the RP and tested OPM's compliance with certain provisions of applicable laws and regulations related to the RP that could have a direct and material effect on its financial statements.

In our opinion, RP's financial statements as of and for the year ended September 30, 1999, are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

Regarding our consideration of internal control over financial reporting, we noted reportable conditions in the following areas:

1. EDP general control environment;
2. Budgetary accounting structure, and
3. Actuarial census data

Regarding our tests of compliance with certain provisions of applicable laws and regulations, with the exception of the Federal Financial Managers' Integrity Act (FFMIA), we noted no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

Our conclusions and the scope of our work are discussed in more detail below.

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying balance sheet of the RP as of September 30, 1999 and the related statements of net cost, changes in net position, budgetary resources, and financing for the year then ended.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the RP as of September 30, 1999, and its net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary obligations for the year then ended, in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on RP's financial statements taken as a whole. The information included in the section entitled *Management Discussion and Analysis of the Retirement, Health Benefits and Life Insurance Programs (MD&A)* and the required supplementary information in the schedule entitled *Retirement Program – Required Supplementary Information* is not a required part of the financial statements but is supplementary information required by Office of Management and Budget (OMB) Bulletin 97-01, *Form and Content of Agency Financial Statements*, as amended. Regarding the MD&A, we have considered whether this information is materially inconsistent with the financial statements. Regarding the required supplementary information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information in the MD&A section of the RP or the required supplementary information and accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The objectives of internal control over financial reporting are to provide management with reasonable, but not absolute, assurance that:

- transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles;

- assets are safeguarded against loss from unauthorized acquisition, use, or disposition;

- transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements and certain other laws, regulations and government-wide policies identified by OMB, as applicable to OPM, and

- transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit preparation of performance information in accordance with criteria stated by management.

Because of inherent limitations in internal controls, misstatements, losses, and noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of internal control over financial reporting to future periods is subject to the risk that the internal control procedures may become inadequate because of changes in conditions, or that the effectiveness of the design or operations of the policies and procedures may deteriorate.

We noted certain matters, described in items 1 through 3 below, involving the internal control over financial reporting and its operation that we consider to be reportable conditions under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 98-08, as amended. Reportable conditions are matters coming to our attention that represent significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the RP's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we do not consider the reportable conditions described below to be material weaknesses.

The status of prior year findings is presented in Exhibit 1. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of OPM in a separate letter dated February 11, 2000.

1. EDP General Control Environment

(a) Entity-Wide Security Program

Certain areas in OPM's entity-wide security program could be strengthened. As noted in our prior year report:

- OPM does not have an integrated enterprise-wide security program, and has distributed security functions and responsibilities throughout the organization for data security, general support systems, application systems, and network operations. While different parts of the organization perform different functions, they share common hardware, software, and network platforms, and from a security perspective may be exposed to similar or interrelated vulnerabilities. The current distribution of security functions and responsibilities does not adequately ensure coordinated procedures, risk assessments, and monitoring and response capabilities. In contrast, the opportunity to leverage resources and realize opportunities may not be fully realized with the current decentralized security model.

- OPM has not performed a security risk assessment within the last three years. However, during that period OPM upgraded the mainframe and networking platforms and implemented a new core financial management system. While OPM plans to perform assessments, they have not been scheduled.

- OPM's draft *Information Technology Security Policy* addresses the need for a certification and accreditation process, but there is not one currently in place. OMB Circular A-130 requires "*that agencies consider risk when determining the need for and selecting computer-*

related control techniques. This risk assessment approach should include a consideration of the major factors in risk management: the value of the system or application, threats, vulnerabilities, and the effectiveness of current or proposed safeguards." Compliance with OMB Circular A-130 is a critical compliance indicator for the Federal Financial Management Integrity Act, and performance of periodic risk assessments is a critical component of achieving compliance with OMB Circular A-130.

- OPM does not have a formally established, integrated, and robust monitoring and response capability to ensure adequate network and systems security. A limited penetration study found vulnerabilities that were not properly mitigated. OPM immediately responded to these particular vulnerabilities, but does not have a mechanism to identify new risks or to verify that implemented changes were adequate or operating as intended.
- There is no official method of tracking employees that are terminated and/or separated from OPM to ensure that systems security and physical access privileges were appropriately revoked.

An entity-wide security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

(b) Access Control

OPM's EDP access controls require modification. Access controls include physical controls and logical controls. Adequately controlling physical access to computer equipment is an example of a physical control. OPM's physical access control system for the mainframe did not record all security events.

Logical controls include security software programs designed to prevent or detect unauthorized access to sensitive files. We noted certain user account groups with excessive privileges to mainframe resources, which could potentially undermine proper segregation of duties.

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of limiting access are to ensure that (1) users only have the access necessary to perform their duties; (2) access to very sensitive resources, such as security software programs, is limited to very few individuals; and (3) employees are restricted from performing incompatible functions or functions beyond their responsibilities.

(c) Application Change Control/Systems Development

Certain controls over the modification of application software programs are deficient. Establishing controls over the modification of application software programs helps to ensure only authorized programs and authorized modifications are implemented. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off" or that processing irregularities or malicious code could be introduced.

As noted in our prior year report, OPM has not developed a systems development methodology for application software, and the current "RSOD Retirement ADP Standards and Procedures" is missing critical chapters, including data set design and allocation, system development procedures, testing and acceptance, and system software installation and maintenance.

(d) Service Continuity

Losing the capability to process, retrieve, and protect information maintained electronically can significantly impact OPM's ability to accomplish its mission. For this reason, OPM should have procedures in place to protect information resources and minimize the risk of unplanned interruptions, as well as a plan to recover critical operations should interruptions occur. To mitigate service interruptions, it is essential that the related controls be understood and supported by management and staff throughout the organization. OPM has several separate ongoing service continuity-related initiatives and draft plans that need to be finalized, formalized, and properly coordinated so OPM can ensure that critical functions will still be available in the event of a disruption.

Recommendation

We recommend that OPM develop a formal action plan to review and revise its EDP general controls. This plan should address each of the four areas discussed above as well as other areas that impact the general EDP control environment. The plan should also set forth appropriate corrective action steps, assign responsibilities to employees, and establish target completion dates for each action. This plan should be reviewed by the Office of the Inspector General, adopted by executive management of OPM, and provide for periodic review of progress towards achievement of corrective actions.

2. Budgetary Accounting Structure

RIS continues to find it cumbersome to produce accurate and timely year end financial statements for the benefit plans. In fiscal year 1999, RIS implemented a new core financial management system for benefit plan accounting, but did not implement the budgetary accounting structure in its general ledgers. As a result, RIS manually calculated the budget figures in its statements of budgetary resources and financing, and several recalculations were necessary to produce accurate statements. In addition, RIS did not perform reconciliations between the budgetary amounts reported in the financial statements and the corresponding amounts reported on the SF-133 and SF-2108 forms. Without a set of self-balancing accounts to summarize budgetary activity, the risk of reporting inaccurate budgetary figures exists. The lack of a formal budgetary accounting structure resulted in our conclusion that the RP did not substantially conform with the requirements of FFMIA, in accordance with the guidelines contained in OMB Bulletin No 98-08, as amended.

Recommendation

We recommend RIS implement the budgetary accounting structure in the RP general ledger and begin recording budgetary accounting activity consistent with their policy statements. This action will assist RIS in preparing accurate year end financial statements.

3. Actuarial Census Data

The Postal Data File (PDF) contains census data for United States Post Office (USPS) retirees, and is used by OPM in the calculation of RP actuarial liabilities at September 30th. Audit procedures performed on the PDF determined that the PDF had not been updated since September 11, 1998, the last submission by USPS before year end. However, a salary increase had occurred on September 12, 1998 and was not reflected in the PDF. While this salary increase was not large enough to materially affect the estimate of the actuarial liability for September 30, 1999, similar timing differences, should they continue to occur, may affect future years' estimations.

Recommendation

We understand USPS normally submits its year end data approximately two to three weeks prior to year end. We recommend OPM perform year end procedures to inquire whether systemic changes are made to the PDF database after the USPS submission, and to request an update to the PDF data if systemic changes have occurred. OPM should also consider whether other agencies may have similar procedures that could affect data in other databases used by OPM to calculate year end actuarial liabilities.

* * * * *

OMB Bulletin No. 98-08, as amended, requires us to compare material weaknesses disclosed during the RP audit with the material weaknesses reported by OPM in its Federal Managers' Financial Integrity Act (FMFIA) report for the audit period. As a result of this comparison, we noted that the substantial nonconformance with FFMIA reported in the *Compliance with Laws and Regulations* section of our report was not included in OPM's fiscal year 1999 FMFIA report.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with laws and regulations, exclusive of FFMIA, performed as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, disclosed no instances of noncompliance required to be reported herein under *Government Auditing Standards* and OMB Bulletin 98-08, as amended.

Under FFMIA, RP's financial management systems are required to be in substantial conformance with (1) Federal financial management system requirements, (2) Federal accounting standards, and (3) the United States Standard General Ledger (SGL) at the transaction level.

The results of our tests of compliance with FFMIA disclosed instances, described below, where RP's financial management systems did not substantially conform with the requirements discussed in the preceding paragraph:

1. **Federal Financial Management System Requirements**. In accordance with OMB Bulletin No. 98-08, as amended, an agency must meet the following requirements to substantially conform with FFMIA: Federal financial management system requirements; OMB Circular A-127 requirements; requirements published in JFMIP's Federal Financial System Requirements series; and OMB Circular A-130 security requirements. The systems supporting the RP do not meet the following requirements:

   a. *Support the budget execution function and comply with external reporting requirements* – The budgetary account structure for the Federal Financial System (FFS), the core financial management system for the benefit plans, was not implemented as of September 30, 1999. This finding resulted in noncompliance with OMB Circular A-127 and JFMIP's Federal Financial Management Systems Requirements for "Comparability and Consistency," "Application of the SGL at the Transaction Level," "Financial Reporting," and "Support for Budgeting and Performance Reporting."

   b. *Provide adequate system security* – OPM has not performed a security risk assessment within the last three years. However, during that period OPM upgraded the mainframe and networking platforms and implemented a new core financial management system. While OPM plans to perform assessments, they have not been scheduled. In addition, OPM's draft *Information Technology Security Policy* addresses the need for a certification and accreditation process, but there is not one currently in place. Compliance with OMB Circular A-130 is a critical compliance indicator for the FFMIA, and performance of periodic risk assessments is a critical component of achieving compliance with OMB circular A-130.

2. **Federal Accounting Standards**. OMB Bulletin No. 98-08, as amended, states that FFMIA requires financial information used in the preparation of financial statements to be adequately supported by detailed financial records. Detailed financial records exist for all proprietary accounting information; however, the RP has not yet implemented an accounting structure to

support budgetary amounts reported in the RP statements of budgetary resources and financing. The lack of a formal budgetary structure compromises RIS's ability to accurately summarize budgetary data in the RP financial statements.

3. **SGL at the Transaction Level.** OMB Bulletin No. 98-08, as amended, states that FFMIA requires detailed information to be *"captured and summarized so that it follows the SGL descriptions and posting rules and is captured at the level necessary to meet OMB or Treasury reporting requirements and for preparing financial statements."* While detailed records exist for all proprietary accounts, the RP has not implemented an accounting structure to support budgetary amounts reported in the RP financial statements.

Recommendation

To achieve substantial conformance with FFMIA, RIS should implement the budgetary accounting structure of FFS, its core financial management system. RIS should also take actions to address the findings related to systems security required by OMB Circular A-127 and OMB Circular A-130. The resolution of these findings should be a priority for fiscal year 2000.

RESPONSIBILITIES

Management's Responsibility. The Chief Financial Officers (CFO) Act of 1990 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the ageneies' financial position and results of operations. To assist OPM in meeting its CFO Act reporting requirements, annual financial statements are prepared for the RP. Management is responsible for:

- preparing the finaneial statements in conformity with generally accepted accounting principles;
- establishing and maintaining internal control over financial reporting; and
- complying with laws and regulations applicable to the RP, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures.

Auditors' Responsibility. Our responsibility is to express an opinion on the RP financial statements as of and for the year ended September 30, 1999 based on our audit. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 98-08, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

To fulfill these responsibilities, we performed procedures such as the following:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

- assessed the accounting principles used and significant estimates made by management; and

- evaluated the overall financial statement presentation.

We are also responsible for considering OPM's internal control over financial reporting related to the RP and testing OPM's compliance with certain provisions of applicable laws and regulations related to the RP that could have a direct and material effect on its 1999 RP financial statements.

In planning and performing our audit, we considered OPM's internal control over financial reporting related to the RP by obtaining an understanding of the agency's significant internal controls, determined whether these internal controls have been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 98-08, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions under standards issued by the AICPA and OMB Bulletin 98-08, as amended, and, accordingly, would not necessarily disclose all reportable conditions that are material weaknesses.

In addition, we considered the RP's internal control over the information contained in the required supplementary information schedule entitled *Retirement Program – Required Supplementary Information* by obtaining an understanding of the agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over the required supplementary information, and, accordingly, we do not provide an opinion on such controls.

With respect to internal controls related to performance measures determined by management to be key and reported in the MD&A to the financial statements, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether RP's financial statements are free of material misstatement, we performed tests of RP's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We also performed tests of RP's compliance with certain other laws, regulations and government-wide policies identified by OMB, as applicable to OPM, including the requirements set forth in FFMIA. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to the RP. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit. Accordingly, we do not express such an opinion.

Additionally, under FFMIA, we are required to report whether RP's financial management systems substantially conform with (1) Federal financial management system requirements, (2) Federal accounting standards, and (3) the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 98-08, as amended.

DISTRIBUTION

This report is intended solely for the information and use of OPM's management, OPM's Office of the Inspector General, OMB and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 11, 2000
Washington, D.C.

kpmg

2001 M Street, NW
Washington, DC 20036-3389

INDEPENDENT AUDITORS' REPORT

Director, U.S. Office of Personnel Management:

We have audited the accompanying balance sheet of the Health Benefits Program (HBP), administered by the U.S. Office of Personnel Management (OPM) Retirement and Insurance Service (RIS), as of September 30, 1999, and the related statements of net cost, changes in net position, budgetary resources, and financing (hereinafter collectively referred to as "financial statements") for the year then ended. The objective of our audit was to express an opinion on the fair presentation of these financial statements. In connection with our audit, we also considered OPM's internal control over financial reporting related to the HBP and tested OPM's compliance with certain provisions of applicable laws and regulations related to the HBP that could have a direct and material effect on its financial statements.

In our opinion, based on our audit and the reports of other auditors, HBP's financial statements as of and for the year ended September 30, 1999, are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

Regarding our consideration of internal control over financial reporting, we noted reportable conditions in the following areas:

1. EDP general control environment;
2. Budgetary accounting structure;
3. Reconciliation of inter-program transactions, and
4. Controls over program administration for the community-rated health carriers.

Regarding our tests of compliance with certain provisions of applicable laws and regulations, with the exception of the Federal Financial Managers' Integrity Act (FFMIA), we noted no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended.

Our conclusions and the scope of our work are discussed in more detail below.

OPINION ON FINANCIAL STATEMENTS

We have audited the accompanying balance sheet of the HBP as of September 30, 1999 and the related statements of net cost, changes in net position, budgetary resources, and financing for the year then ended. We did not audit the financial statements of the experience-rated health carriers, which statements comprise 1% of total assets reflected in the HBP balance sheet and substantially all post-retirement benefits and current benefits reflected in the HBP statement of net cost. The experience-rated carrier financial statements were audited by other auditors, whose report thereon has been provided to us, and our opinion, insofar as it relates to the amounts included for the experience-rated carriers, is based solely on the report of the other auditors.

In our opinion, based on our audit and the report of the other auditors, the financial statements present fairly, in all material respects, the financial position of the HBP as of September 30, 1999, and its net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary obligations for the year then ended, in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on HBP's financial statements taken as a whole. The information included in the section entitled *Management Discussion and Analysis of the Retirement, Health Benefits, and Life Insurance Programs (MD&A)* and the required supplementary information in the schedule entitled *Health Benefits Program – Required Supplementary Information* is not a required part of the financial statements but is supplementary information required by Office of Management and Budget (OMB) Bulletin 97-01, *Form and Content of Agency Financial Statements,* as amended. Regarding the MD&A, we have considered whether this information is materially inconsistent with the financial statements. Regarding the required supplementary information, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information in the MD&A section of the HBP or the required supplementary information and accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The objectives of internal control over financial reporting are to provide management with reasonable, but not absolute, assurance that:

- transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles;

- assets are safeguarded against loss from unauthorized acquisition, use, or disposition;

- transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements, and certain other laws, regulations and government-wide policies identified by OMB, as applicable to OPM, and

- transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit preparation of performance information in accordance with criteria stated by management.

Because of inherent limitations in internal controls, misstatements, losses, and noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of internal control over financial reporting to future periods is subject to the risk that the internal control procedures may become inadequate because of changes in conditions, or that the effectiveness of the design or operations of the policies and procedures may deteriorate.

We noted certain matters, described in items 1 through 4 below, involving the internal control over financial reporting and its operation that we consider to be reportable conditions under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 98-08, as amended. Reportable conditions are matters coming to our attention that represent significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the HBP's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we do not consider the reportable conditions described below to be material weaknesses.

The status of prior year findings is presented in Exhibit 1. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of OPM in a separate letter dated February 11, 2000.

1. EDP General Control Environment

(a) Entity-Wide Security Program

Certain areas in OPM's entity-wide security program could be strengthened. As noted in our prior year report:

- OPM does not have an integrated enterprise-wide security program, and has distributed security functions and responsibilities throughout the organization for data security, general support systems, application systems, and network operations. While different parts of the organization perform different functions, they share common hardware, software, and network platforms, and from a security perspective may be exposed to similar or interrelated vulnerabilities. The current distribution of security functions and responsibilities does not adequately ensure coordinated procedures, risk assessments, and monitoring and response capabilities. In contrast, the opportunity to leverage resources and realize opportunities may not be fully realized with the current decentralized security model.

- OPM has not performed a security risk assessment within the last three years. However, during that period OPM upgraded the mainframe and networking platforms and implemented a new core financial management system. While OPM plans to perform assessments, they have not been scheduled.
- OPM's draft *Information Technology Security Policy* addresses the need for a certification and accreditation process, but there is not one currently in place. OMB Circular A-130 requires "*that agencies consider risk when determining the need for and selecting computer-related control techniques. This risk assessment approach should include a consideration of the major factors in risk management: the value of the system or application, threats, vulnerabilities, and the effectiveness of current or proposed safeguards.*" Compliance with OMB Circular A-130 is a critical compliance indicator for the Federal Financial Management Integrity Act, and performance of periodic risk assessments is a critical component of achieving compliance with OMB Circular A-130.
- OPM does not have a formally established, integrated, and robust monitoring and response capability to ensure adequate network and systems security. A limited penetration study found vulnerabilities that were not properly mitigated. OPM immediately responded to these particular vulnerabilities, but does not have a mechanism to identify new risks or to verify that implemented changes were adequate or operating as intended.
- There is no official method of tracking employees that are terminated and/or separated from OPM to ensure that systems security and physical access privileges were appropriately revoked.

An entity-wide security program, including security policies and a related implementation plan, is the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. Without a well-designed program, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. Such conditions may lead to insufficient protection of sensitive or critical resources and disproportionately high expenditures for controls over low-risk resources.

(b) Access Control

OPM's EDP access controls require modification. Access controls include physical controls and logical controls. Adequately controlling physical access to computer equipment is an example of a physical control. OPM's physical access control system for the mainframe did not record all security events.

Logical controls include security software programs designed to prevent or detect unauthorized access to sensitive files. We noted certain user account groups with excessive privileges to mainframe resources, which could potentially undermine proper segregation of duties.

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. The objectives of limiting access are to ensure that (1) users only have the access necessary to perform their duties; (2) access to very sensitive resources, such as security software programs, is limited to very few individuals; and (3) employees are restricted from performing incompatible functions or functions beyond their responsibilities.

(c) Application Change Control/Systems Development

Certain controls over the modification of application software programs are deficient. Establishing controls over the modification of application software programs helps to ensure only authorized programs and authorized modifications are implemented. Without proper controls, there is a risk that security features could be inadvertently or deliberately omitted or "turned off" or that processing irregularities or malicious code could be introduced.

As noted in our prior year report, OPM has not developed a systems development methodology for application software, and the current "RSOD Retirement ADP Standards and Procedures" is missing critical chapters, including data set design and allocation, system development procedures, testing and acceptance, and system software installation and maintenance.

(d) Service Continuity

Losing the capability to process, retrieve, and protect information maintained electronically can significantly impact OPM's ability to accomplish its mission. For this reason, OPM should have procedures in place to protect information resources and minimize the risk of unplanned interruptions, as well as a plan to recover critical operations should interruptions occur. To mitigate service interruptions, it is essential that the related controls be understood and supported by management and staff throughout the organization. OPM has several separate ongoing service continuity-related initiatives and draft plans that need to be finalized, formalized, and properly coordinated so OPM can ensure that critical functions will still be available in the event of a disruption.

<u>Recommendation</u>

We recommend that OPM develop a formal action plan to review and revise its EDP general controls. This plan should address each of the four areas discussed above as well as other areas that impact the general EDP control environment. The plan should also set forth appropriate corrective action steps, assign responsibilities to employees, and establish target completion dates for each action. This plan should be reviewed by the Office of the Inspector General, adopted by executive management of OPM, and provide for periodic review of progress towards achievement of corrective actions.

2. Budgetary Accounting Structure

RIS continues to find it cumbersome to produce accurate and timely year end financial statements for the benefit plans. In fiscal year 1999, RIS implemented a new core financial management system for benefit plan accounting, but did not implement the budgetary accounting structure in its general ledgers. As a result, RIS manually calculated the budget figures in its statements of budgetary resources and financing, and several recalculations were necessary to produce accurate statements. In addition, RIS did not perform reconciliations between the budgetary amounts reported in the financial statements and the corresponding amounts reported on the SF-133 and SF-2108 forms. Without a set of self-balancing accounts to summarize budgetary activity, the risk of reporting inaccurate budgetary figures exists. The lack of a formal budgetary accounting structure resulted in our conclusion that the HBP did not substantially conform with the requirements of FFMIA, in accordance with the guidelines contained in OMB Bulletin No 98-08, as amended.

Recommendation

We recommend RIS implement the budgetary accounting structure in the HBP general ledger and begin recording budgetary accounting activity consistent with their policy statements. This action will assist RIS in preparing accurate year end financial statements.

3. Reconciliation of Inter-Program Transactions

Health insurance premiums are withheld from payments made by annuitants to the Retirement Program (RP). The RP is responsible for transferring these amounts to the HBP. RIS records amounts for annuitant withholdings using data from an Annuity Roll Processing System (ARPS) report and records the offsetting payment using information from the Monthly Income Recap report. The reports originate from two different sources and do not reconcile. RIS has recognized this, but because of resource constraints, they have not taken appropriate action to reconcile these transactions.

Recommendation

As noted in our fiscal year 1997 and 1998 reports, we continue to recommend that RIS (1) request ADP services to gain extract data from the annuity roll system; (2) compare these transactions to the manual vouchers to determine what is causing the differences; and (3) reconcile the existing differences between the RP and HBP. In addition, RIS should implement procedures to prevent future out-of-balance situations.

4. Controls Over Program Administration For The Community-Rated Health Carriers

OPM remits premiums it receives from federal agencies to Community-Rated Carriers (CRCs) twice a month. As in prior years, OPM's existing systems were not designed to centrally associate the monies paid as premiums to participating carriers with the enrollees for which they are being paid. Consequently, the potential exists for carriers to provide benefits to employees who are not covered by their plan at the time the services are rendered. To reinforce the need for effective enrollment reconciliations, in 1998 OPM issued a payroll letter requiring agency payroll offices to provide carriers with the names of enrollees and the amounts withheld from pay for health benefits, by carrier, on a quarterly basis. However, OPM does not have adequate controls in place to determine whether payroll offices are complying with these requirements and whether carriers are reconciling their enrollment records regularly.

Recommendation

OPM has future plans to implement a centralized enrollment system to resolve this internal control weakness. Until the system can be developed, we recommend OPM OIG make CRC enrollment reconciliation reviews a priority in their annual audit planning.

* * * * *

OMB Bulletin No. 98-08, as amended, requires us to compare material weaknesses disclosed during the HBP audit with the material weaknesses reported by OPM in its Federal Managers' Financial Integrity Act (FMFIA) report for the audit period. As a result of this comparison, we noted that the substantial nonconformance with FFMIA reported in the *Compliance with Laws and Regulations* section of our report was not included in OPM's fiscal year 1999 FMFIA report.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with laws and regulations, exclusive of FFMIA, performed as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, disclosed no instances of noncompliance required to be reported herein under *Government Auditing Standards* and OMB Bulletin 98-08, as amended.

Under FFMIA, HBP's financial management systems are required to be in substantial conformance with (1) Federal financial management system requirements, (2) Federal accounting standards, and (3) the United States Standard General Ledger (SGL) at the transaction level.

The results of our tests of compliance with FFMIA disclosed instances, described below, where HBP's financial management systems did not substantially conform with the requirements discussed in the preceding paragraph:

1. **Federal Financial Management System Requirements**. In accordance with OMB Bulletin No. 98-08, as amended, an agency must meet the following requirements to substantially conform with FFMIA: Federal financial management system requirements; OMB Circular A-127 requirements; requirements published in JFMIP's Federal Financial System Requirements series; and OMB Circular A-130 security requirements. The systems supporting the HBP do not meet the following requirements:

   a. *Support the budget execution function and comply with external reporting requirements* – The budgetary account structure for the Federal Financial System (FFS), the core financial management system for the benefit plans, was not implemented as of September 30, 1999. This finding resulted in noncompliance with OMB Circular A-127 and JFMIP's Federal Financial Management Systems Requirements for "Comparability and Consistency," "Application of the SGL at the Transaction Level," "Financial Reporting," and "Support for Budgeting and Performance Reporting."

   b. *Provide adequate system security* – OPM has not performed a security risk assessment within the last three years. However, during that period OPM upgraded the mainframe and networking platforms and implemented a new core financial management system. While OPM plans to perform assessments, they have not been scheduled. In addition, OPM's draft *Information Technology Security Policy* addresses the need for a certification and accreditation process, but there is not one currently in place. Compliance with OMB Circular A-130 is a critical compliance indicator for the FFMIA, and performance of periodic risk assessments is a critical component of achieving compliance with OMB Circular A-130.

2. **Federal Accounting Standards**. OMB Bulletin No. 98-08, as amended, states that FFMIA requires financial information used in the preparation of financial statements to be adequately supported by detailed financial records. Detailed financial records exist for all proprietary accounting information; however, the HBP has not yet implemented an accounting structure to support budgetary amounts reported in the HBP statements of budgetary resources and financing. The lack of a formal budgetary structure compromises RIS's ability to accurately summarize budgetary data in the HBP financial statements.

3. **SGL at the Transaction Level.** OMB Bulletin No. 98-08, as amended, states that FFMIA requires detailed information to be "*captured and summarized so that it follows the SGL descriptions and posting rules and is captured at the level necessary to meet OMB or Treasury reporting requirements and for preparing financial statements.*" While detailed records exist for all proprietary accounts, the HBP has not implemented an accounting structure to support budgetary amounts reported in the HBP financial statements.

Recommendation

To achieve substantial conformance with FFMIA, RIS should implement the budgetary accounting structure of FFS, its core financial management system. RIS should also take actions to address the findings related to systems security required by OMB Circular A-127 and OMB Circular A-130. The resolution of these findings should be a priority for fiscal year 2000.

RESPONSIBILITIES

Management's Responsibility. The Chief Financial Officers (CFO) Act of 1990 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To assist OPM in meeting its CFO Act reporting requirements, annual financial statements are prepared for the HBP. Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing and maintaining internal control over financial reporting; and
- complying with laws and regulations applicable to the HBP, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures.

Auditors' Responsibility. Our responsibility is to express an opinion on the HBP financial statements as of and for the year ended September 30, 1999 based on our audit. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 98-08, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

To fulfill these responsibilities, we performed procedures such as the following:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management; and
- evaluated the overall financial statement presentation.

We are also responsible for considering OPM's internal control over financial reporting related to the HBP and testing OPM's compliance with certain provisions of applicable laws and regulations related to the HBP that could have a direct and material effect on the 1999 HBP financial statements.

In planning and performing our audit, we considered OPM's internal control over financial reporting related to the HBP by obtaining an understanding of the agency's significant internal controls, determined whether these internal controls have been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 98-08, as amended. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion on internal control.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions under standards issued by the AICPA and OMB Bulletin 98-08, as amended, and, accordingly, would not necessarily disclose all reportable conditions that are material weaknesses.

In addition, we considered the HBP's internal control over the information contained in the required supplementary information schedule entitled *The Health Benefits Program – Required Supplementary Information*, by obtaining an understanding of the agency's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over the required supplementary information, and, accordingly, we do not provide an opinion on such controls.

With respect to internal controls related to performance measures determined by management to be key and reported in the MD&A to the financial statements, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin 98-08, as amended. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether HBP's financial statements are free of material misstatement, we performed tests of HBP's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We also performed tests of HBP's compliance with certain other laws, regulations and government-wide policies identified by OMB, as applicable to OPM, including the requirements set forth in FFMIA. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to the HBP. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit. Accordingly, we do not express such an opinion.

Additionally, under FFMIA, we are required to report whether HBP's financial management systems substantially conform with (1) Federal financial management system requirements, (2) Federal accounting standards, and (3) the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 98-08, as amended.

DISTRIBUTION

This report is intended solely for the information and use of OPM's management, OPM's Office of the Inspector General, OMB and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 11, 2000
Washington, D.C.