May 9, 2005

DEWITT O. HARRIS
VICE PRESIDENT, EMPLOYEE RESOURCE MANAGEMENT

SUBJECT: Audit Report - Verification of the Anticipated and Realized Medical Cost Savings Resulting From the Postal Service's Contracts With First Health Group Corporation (Report Number HM-AR-05-005)

This report presents the results of our self-initiated audit of the Postal Service's contracts with First Health Group (FHG) Corporation to provide injury compensation medical bill review services (Project Number 04YG030HM000). The objectives of our audit were to:

- Verify the anticipated and realized savings to the Postal Service derived from the FHG contracts.

- Determine whether the recommendations agreed to in the previous Office of Inspector General (OIG) report[1] were implemented and whether modifications should be made to the current FHG contract.

The Postal Service was successful and realized $2.2 million in cost savings over a four-year period. Although this was not the $30 million annual savings the Postal Service anticipated, it is working with the Department of Labor (DOL) and FHG to improve their savings.

We also determined that four of the five recommendations in the previous OIG report were implemented and, although recommendation 2 was not fully implemented, there was no effect on the current contract. Further, we determined the current FHG contract needed no modifications.

[1]Postal Service OIG Audit Report Postal Service's Arrangement with a Preferred Provider Organization (Report Number HK-AR-03-001, dated March 31, 2003).

Background

Office of Workers' Compensation Programs

The DOL's Office of Workers' Compensation Programs (OWCP) is responsible for adjudicating bills and paying compensation, medical, and death benefits for injured federal workers, including Postal Service employees. The Federal Employees' Compensation Act (FECA) covers all medical care that an employee needs to recover from the effects of a work-related injury, including hospitalization, nursing services, prosthetic appliances, and the services of an attendant when required for severe injuries. Payments for medical services are subject to a schedule of maximum allowable amounts. These benefits are paid from the OWCP's Employees' Compensation Fund, which is later reimbursed by federal agencies through the chargeback[2] billing process.

Postal Service Workers' Compensation Costs

The Postal Service was the largest participant in the DOL's OWCP in chargeback year (CBY) 2004, representing about 30 percent of the total federal workforce that participated. It was also the largest payee to the OWCP, with approximately $830 million in payments for the same year–more than 35 percent of the $2.3 billion in total federal workers' compensation payments. In addition to the $830 million, the Postal Service also paid chargeback billing costs of $22.9 million for the old Post Office Department and an administrative fee[3] of $44.5 million. This brings the total CBY 2004 costs to $897.4 million as shown in Table 1.

Table 1. Postal Service Total Workers' Compensation and Medical Costs for CBY 2004

Type of Cost	CBY 2004 (in millions)
Postal Service Workers' Compensation and Medical Costs	$830.0
Post Office Department Workers' Compensation and Medical Costs	22.9
Administrative Fee	44.5
Total	$897.4

Source: DOL OWCP Chargeback Billing Summary

[2]OWCP's Chargeback System is the mechanism by which the costs of compensation for work-related injuries and death are billed annually by DOL to employing agencies. The chargeback billing period is from July 1 in one year, to June 30 the following year.
[3]The Postal Service's administrative fees increased 35.3 percent, from $32.9 million in CBY 2000 to $44.5 million in CBY 2004.

History

FHG is a preferred provider organization with a network of doctors and hospitals that totaled 4,342 hospitals and 333,108 doctors and allied health care professionals as of April 2004. It has 5,500 employees at 35 locations nationwide and a client base that includes nearly 1,200 clients in the group health and workers' compensation marketplaces. FHG manages an estimated $20.3 billion in medical bills on behalf of its clients.

Prior to the first contract with FHG, the 811,000 physicians and 6,000 medical centers that provided medical services to injured Postal Service employees nationwide submitted bills directly to the 12 separate OWCP paying offices. The intent of the FHG contract was for one medical contract to provide bill review services that would help standardize[4] bill processing procedures and decrease the cost of medical services through negotiated fee schedules.

On March 1, 2001, the Postal Service entered into a two-year contract with FHG to test a program to provide bill review services[5] through FHG's network to the Postal Service. The purpose of the test program was to substantially slow the rapidly increasing medical costs incurred by the Postal Service. FHG anticipated that taking advantage of its network discounts,[6] which were negotiated by FHG with its providers,[7] would result in medical cost savings. These discounts were presumed to be lower than fee schedule[8] amounts paid by the OWCP.

The medical costs savings were to be achieved from providers submitting all medical bills to FHG rather than the OWCP for payment. FHG would identify providers who belonged to its network based on these submissions and then send them to the OWCP for processing. The OWCP would then issue checks to FHG who, upon receipt, would:

- Apply its network discount.
- Issue checks to its network providers.
- Retain its fee (60 percent of the difference after the provider was paid).
- Remit net savings (40 percent) to the Postal Service monthly.

FHG estimated the Postal Service portion of medical cost savings would be $30 million annually when the test program was fully implemented. Appendix B is a flowchart that shows how each bill is processed from the time the employee is injured until the Postal Service receives its savings check from FHG.

[4]"Standardization" is defined as FHG's billing process of using the same form every time and submitting all bills to the 12 OWCP paying offices.
[5]Bill review services are the repricing of bills to the FHG network contracted rate.
[6]The discounts are based on contractual arrangements between FHG and providers who agree to accept a reduced payment.
[7]According to a Postal Service official, FHG providers are willing to accept a reduced payment from FHG because they expect an increase in business volume, a reduction in billing expenses, and a faster turnaround in payments.
[8]The FECA fee schedule, Title 20, Code of Federal Regulations, Part 10, is a list of medical codes, service descriptions, and the corresponding maximum allowable amounts used by the OWCP to reimburse providers for medical services.

On March 12, 2001, the Postal Service, FHG, and the DOL signed a Memorandum of Understanding (MOU) to allow the Postal Service to evaluate the concept of using the FHG to reprice its medical bills and submit them to the OWCP. On June 21, 2002, the contract was modified to expand the program nationwide and on December 26, 2002, the new contract was awarded with four one-year options.

According to the Postal Service's November 2004 Transformation Plan Progress Report, the Postal Service's contract with FHG continues to be effective. The report states the Postal Service has received more than $2.3 million[9] in cost savings through its association with FHG and its hospital and physician network.

Objectives, Scope, and Methodology

We reviewed the current signed FHG contract, including the statement of work/solicitation proposal with the Postal Service, representing the period October 1, 2003, through September 30, 2004, and, subsequently, extended for one year.[10] We also reviewed the prior contract representing the period March 1, 2001, through February 28, 2003,[11] and determined whether the prior audit report's recommendations, as they related to the current contract, were implemented.

We reviewed FHG's Business Summary Reports[12] for savings for the period March 19, 2001, through July 31, 2004. We also compared the Postal Service's savings on those reports to the FHG check payments made to the Postal Service to ensure they matched the receipts.

We interviewed Postal Service Headquarters' Health and Resource Management and FHG officials to gain an understanding of the savings derived from the contracts with FHG and we determined whether the Postal Service had adequate internal controls for the oversight of the reported savings.

Through interviews with Postal Service and FHG officials and a review of the current FHG contract, we documented and evaluated the policies, procedures, and requirements used to identify and address billing errors.

This audit was conducted from September 2004 through May 2005 in accordance with generally accepted government auditing standards and included such tests of internal controls as were considered necessary under the circumstances. We discussed our observations and conclusions with appropriate management officials and included their

[9]Although the Postal Service reported $2.3 million, we validated $2.2 million.
[10]The current contract was effective October 1, 2003, and contains four one-year options. The total period of contract performance may not exceed five years (September 30, 2008). The Postal Service has already exercised the first option, extending the current period of performance through September 30, 2005.
[11]Although a signed agreement was not in effect from March 1, 2003, through September 30, 2003, FHG continued to provide medical bill review services to the Postal Service, since contract negotiations were already underway for a follow-on contract.
[12]Business Summary Reports are Microsoft Excel spreadsheets prepared by FHG containing medical bill data.

comments where appropriate. We relied on computer-processed data from the FHG Bill Review System. We did not establish the data's reliability. In our opinion, use of this data was not significant to our finding.

Results

Anticipated and Realized Savings

The Postal Service was successful and realized $2.2 million[13] in cost savings over a four-year period. This was not the anticipated annual $30 million savings because FHG did not receive the volume of medical bills they expected. According to FHG and Postal Service officials, the savings did not reach the anticipated level because many providers are billing the OWCP directly and not sending their bills to FHG as planned. This occurred because there was no provision in the MOU with the OWCP that medical bills only be forwarded to FHG.

Postal Service management told us they are currently working with DOL and FHG to facilitate a process whereby all provider bills will be sent to FHG. Postal Service management anticipates this will substantially increase the realized savings.

Prior Audit Coverage

Four of the five recommendations agreed to in the previous OIG report[14] were implemented and a fifth recommendation was not fully implemented. Specifically, the Postal Service:

- Developed and obtained written approval for the noncompetitive purchase request submitted to Supply Management, resulting in the current contract with FHG (recommendation 1).

- Obtained prior written approval for the noncompetitive purchase request prior to executing the current contract with FHG. In addition, the noncompetitive purchase request was approved at the appropriate level within Supply Management (recommendation 3).

- Negotiated to include appropriate standard contract clauses and eliminated restrictive clauses in the current contract with FHG (recommendation 4).

- Renegotiated the percentage of medical cost savings split in the current contract with FHG (recommendation 5).

[13]We reviewed FHG's Business Summary Reports and verified checks paid to the Postal Service for the period March 19, 2001, through July 31, 2004. Our review disclosed a $1,295 shortage that FHG reimbursed the Postal Service for as soon as it was discovered.
[14]Postal Service OIG Audit Report, Postal Service's Arrangement with a Preferred Provider Organization (Report Number HK-AR-03-001, dated March 31, 2003).

However, the Postal Service did not prepare contract documentation to include the rationale for the best value determination as required by the Purchasing Manual, Issue 2, paragraph 4.2.5.d, dated January 31, 2002 (recommendation 2). Although this recommendation was not fully implemented, we determined it had no effect on the current contract.

We also determined that no modifications to the current FHG contract were needed.

Other Issues

We noted the following contract administration control weaknesses and, although we did not consider them significant, we brought them to the attention of the contracting officer (CO) in charge of the FHG contract at the Travel, Retail, and Temporary Services Category Management Center in Denver, Colorado:

- The CO relied on the program manager to monitor and accept contractor performance without delegating such authority in writing. This condition was corrected prior to the issuance of this report.

- The Postal Service did not have a contract with FHG from March 1, 2003, to October 14, 2003.

We have no recommendations for Postal Service officials regarding the issues in this report.

Management's Comments

Management's only disagreement with the report was the actual amount of gain share the Postal Service planned to achieve. They agreed the original estimate was $30 million; however, they said this was based on the Postal Service paying a fee for the program. They said the Postal Service never formally changed the anticipated savings when the program was changed to a gain share. They also stated they based their planned gain share of 40 percent–or $12 million–on the FHG's original estimate that the Postal Service could save $30 million.

Management further stated that in several presentations it has given regarding the contract with FHG, it has anticipated the Postal Service's savings to be between $10-15 million annually. Management agreed the OIG correctly identified the reasons the savings had not approached this amount.

Management also stated if the planned process changes are implemented the Postal Service should see a gain share in the $8-12 million range, depending on the gain share percentage. Management also stated this program does not cost the Postal Service anything, yet currently produces about $1 million in gain share per year. Management's comments, in their entirety, are included in Appendix C of this report.

Evaluation of Management's Comments

Management's actions taken or planned are responsive to the findings identified in the report.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information please contact Chris Nicoloff, Director, Human Capital, or me at (703) 248-2300.

/s/ Mary W. Demory

Mary W. Demory
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Attachments

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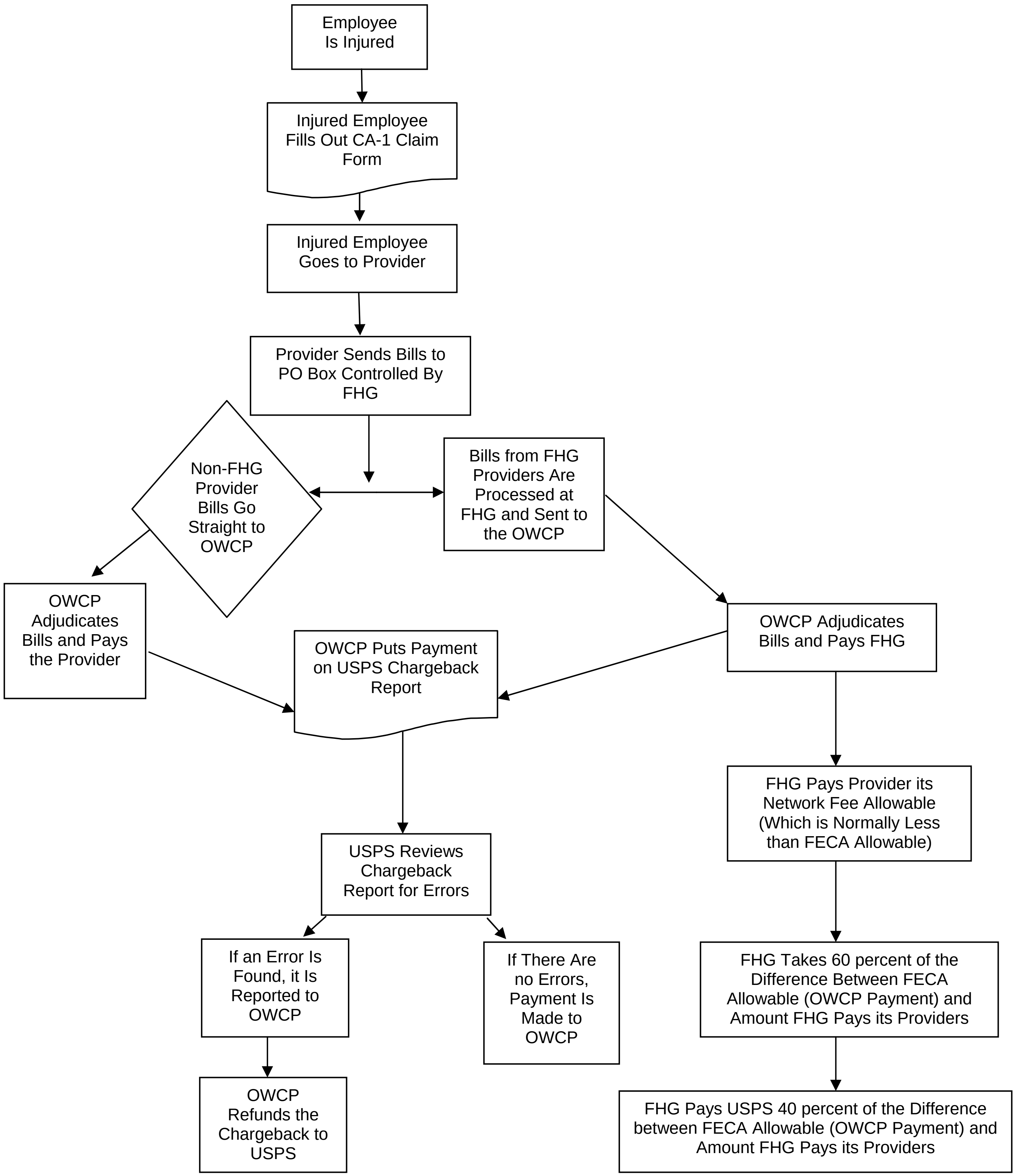
APPENDIX A. ABBREVIATIONS

CBY	Chargeback Year
CO	Contracting Officer
DOL	Department of Labor
FECA	Federal Employees' Compensation Act
FHG	First Health Group
MOU	Memorandum of Understanding
OIG	Office of Inspector General
OWCP	Office of Workers' Compensation Programs

APPENDIX B. FHG BILL PROCESS FLOWCHART



APPENDIX C. MANAGEMENT'S COMMENTS

DEWITT O. HARRIS
VICE PRESIDENT
EMPLOYEE RESOURCE MANAGEMENT

UNITED STATES POSTAL SERVICE

April 27, 2005

KIM H. STROUD

SUBJECT: First Health Group Contract

This memorandum is in response to the audit conducted by the Office of Inspector General (OIG) on the medical cost savings resulting from the Postal Service contract with the First Health Group Corporation (First Health).

Our only disagreement with the report, which was extremely thorough and well-written, is the actual amount of gain share the postal service planned to achieve. The original estimate was $30 million, which was partly based on the Postal Service paying a fee for the program. When the program was changed to a gain share, there was never a formal change in the anticipated savings to the Postal Service. Given that First Health originally believed that the Postal Service could save $30 million, then 40% (the postal gain share) would be about $12 million. In several presentations it was noted that the Postal Service anticipated a savings of between $10-15 million annually. The OIG correctly identified the reasons that the savings has not approached that amount. If the process changes are implemented as planned, the Postal Service should see a gain share in the $8-12 million range, depending on the gain share percentage.

It should be noted that this program does not cost the postal service anything, yet currently produces about $1 million in gain share per year of full implementation.

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