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OFFICE OF PERSONNEL MANAGEMENT

48 CFR Parts 1631 and 1699

RIN 3206–AJ10

Federal Employees Health Benefits Program; Revision of Contract Cost Principles and Procedures, and Miscellaneous Changes

AGENCY: U.S. Office of Personnel Management.

ACTION: Final rule.

SUMMARY: The U.S. Office of Personnel Management (OPM) is issuing a final regulation amending the Federal Employees Health Benefits (FEHB) Acquisition Regulation (FEHBAR). This regulation provides additional contract cost principles and procedures for FEHB Program experience-rated contracts and is intended to clarify our requirements and enhance our oversight of FEHB carriers.

DATES: Effective July 1, 2005.

FOR FURTHER INFORMATION CONTACT: Anne Easton, Manager (202) 606–0770, by fax: (202) 606–0633, or e-mail: *aseaston@opm.gov).*

SUPPLEMENTARY INFORMATION: We are enhancing our oversight of experience-rated FEHB contracts by requiring carriers to apply additional cost principles and procedures. We currently contract with thirty-two experience-rated fee-for-service carriers and Health Maintenance Organizations (HMOs). Under the FEHB law, 5 U.S.C. 8902, it is part of OPM's responsibility to ensure that rates charged by health benefits plans reasonably and equitably reflect the cost of the benefits provided. Our interest, from a financial standpoint, is to pay a reasonable price for the health care coverage we purchase from private contractors on behalf of FEHB enrollees. OPM's independent Inspector General regularly audits experience-rated carriers to determine if they are in compliance with the Cost Principles in part 31 of title 48, Code of Federal Regulations (the Federal Acquisition Regulation (FAR)) and chapter 16 of title 48, Code of Federal Regulations (FEHBAR)). In addition, we have other requirements and practices in place to provide assurance to FEHB Program administrators that carriers' financial reporting and contractual requirements are met.

The FEHBAR and part 31 of the FAR are the sole sources of cost accounting principles and practices for FEHB contracts. The basic cost accounting principles in the FAR Part 31 have been in place for over 40 years. During this time period, significant improvements in cost accounting principles and practices have been made. Advances in information technology have enabled FEHB contractors to implement cost accounting practices more complex than those generally used when we adopted the FAR cost principles. Also, we have observed some differences in interpretation regarding the allocation of costs to carriers' contracts. Therefore, we are updating the FEHBAR to allow carriers to use more current contract cost accounting principles and practices and to provide for consistent interpretation of our requirements across the Program. These final regulations may apply to contractors that also allocate costs to other federal contracts subject to CAS-coverage or FAR provisions related to cost-based contracts. OPM plans to contact other federal agencies that contract with the FEHB contractors to discuss how cost accounting practices are applied to business units that may have other cost-based contracts for federal programs, such as Medicare or Tricare, to determine if a consistent standard is appropriate governmentwide.

FAR Part 31 provides criteria that govern the allocation of indirect costs to contracts. This regulation provides guidance to carriers on allocating certain indirect costs to FEHB experience-rated contracts. For example, we have included a section to supplement FAR 31.203 that describes techniques for accumulating and allocating groupings of indirect costs (FEHBAR 1631.203–70). The new section provides guidance for determining logical cost groupings as required by FAR 31.203(c). It also provides methods for achieving the FAR 31.201–4 requirement that costs are to be allocated on the basis of relative benefits received or other equitable relationship. We have also provided more guidance on the allocation of business unit general and administrative (G&A) expenses (FEHBAR 1631.203–71) and home office expenses to carriers' business segments (FEHBAR 1631.203–72) to supplement FAR 31.203. Our intent is to supplement, but not to supplant FAR. Therefore, we believe that the provisions of FAR 31.203 dealing with the allocation of indirect costs, including G&A expenses and home office expenses, are rendered more useful for our purposes when supplemented by FEHBAR 1631.203 –70, 71, and 72. In addition, we have modified the FEHBAR to specifically recognize that monthly indirect cost rates are a practice of the insurance industry and are therefore permitted by FAR 31.203.

We have added subrogation settlements, prescription drug rebates, and volume discounts to the list of FEHB credits in FEHBAR 1631.201–70. This guidance specifies that the applicable portion of any credit relating to any allowable cost and received by or accruing to the carrier must be credited to the FEHB Program. We have always expected carriers to ensure that the Program actually receives these credits. Identifying them makes it even clearer that they are to be credited to the Program. While the list of credits is not intended to be exhaustive, we have added these examples to demonstrate how all credits should be treated. Other enhancements include modifying FAR 31.205–10 to make facilities cost of money (COM) allowable under certain circumstances, even if it is not specifically identified in a carrier proposal (FEHBAR 1631.205–10). This change is intended to more closely reflect the procedures we follow in our annual negotiation process with carriers.

We have added a provision to establish that compensated personal absence must be assigned to the cost accounting period in which the entitlement was earned (FEHBAR 1631.205–72). This section is included to ensure all carriers are following GAAP requirements applicable to accrual procedures. We also provided a transition rule to permit carriers to recover prior years' allocable liability for compensated personal absence not previously charged to FEHB contracts. We believe that the provisions of this section ensure that there is compatibility between the applicable requirements of GAAP, FAR and FEHBAR. It should also be stressed that the transition rule dealing with the recovery of prior years' costs applies only to costs that have not been previously charged to contracts or other final cost objectives.

Consistent with OPM's waiver of Cost Accounting Standards (CAS) requirements, a new FEHBAR Subpart 1699.70 is added to clarify they do not apply to experience-rated FEHB contracts.

We have worked collaboratively with carriers to develop procedures that are consistent with insurance industry practices and assure an equitable allocation of costs to the FEHB Program. When added to our current financial reporting and disclosure requirements, these new provisions will enhance our oversight of the FEHB Program. Because they have been developed in coordination with the standard practices used by experience-rated carriers, we expect they can be implemented within the FEHB Program promptly and without impediments.

On March 26, 2004, OPM published a proposed rule in the **Federal Register** (69 FR 15774). We received comments from two FEHB Program carriers and one Federal employee union. One carrier commented on the provision in 1631.205–72, which establishes that compensated personal absence must be assigned to the cost accounting period in which the entitlement was earned. The carrier asked that we clarify in the preamble that a contractor subject to this provision be permitted to draw the amount of the allowable compensated personal absence from the Plan's letter of credit (LOC) reserves in the cost accounting period in which the contractor determines that an entitlement had been earned. We agree. Further, if it is later determined that the compensated personal absence entitlement was not earned in the cost accounting period to which it was assigned, the contractor will make an appropriate adjustment and credit the LOC reserves. Another carrier commented that it is important and highly appropriate that section 1699.70 provides that the cost accounting standards do not apply to experience-rated contracts, adding that this will avoid unnecessary and burdensome costs to the Program. The carrier also commented on an anomaly in 1631.203 of the proposed regulation which was created when the FAR Councils published a final rule on April 5, 2004, after the publication date of OPM's proposed regulation. The FAR Councils' rule revised FAR 31.203 regarding base periods for allocating indirect costs, stating ''* * * the base period for allocating indirect costs shall be the contractor's fiscal year used for financial reporting purposes in accordance with generally accepted accounting principles. The fiscal year will normally be 12 months, but a different period may be appropriate (*e.g.* when a change in fiscal year occurs due to a business combination or other circumstances.'' Historically, the practice in the insurance industry has been to base the allocation of indirect costs on monthly rates, unadjusted for annual differences. The FEHBAR allows for continuation of normal business practices when there would be no material gain from asserting a change. The practice of allocating indirect costs on a monthly basis is in accordance with GAAP in the insurance industry. Imposing a change would incur additional costs for the Government which would have to pay for the cost of implementing and maintaining the change in administrative systems. Therefore, this clause remains unchanged except to adopt the new paragraph numbering reflected in the updated FAR 31.203. The Federal employee union stated its objection to OPM's waiver of the CAS and, subsequently to all the provisions in the proposed rule except for one. The FAR 30.201–5(b)(2) permits the head of an agency to waive the CAS for a particular contract or subcontract under exceptional circumstances when necessary to meet the needs of the agency. We determined there were sufficient reasons and granted waivers for certain health plans under the FEHB Program. In October 2002, OPM determined that it was appropriate to grant CAS waivers for certain health plans under the FEHB Program for the reasons outlined below. First, OPM determined that the Program has adequate cost accounting requirements in its Federal Employees Health Benefits Acquisition Regulations (FEHBAR), which supplement the Federal Acquisition Regulation. The FEHBAR requires carriers to file annual financial statements. The carriers, and their third party servicing agents, must also adhere to financial and other related standards, comply with an FEHB Program audit guide, and submit to audits by Independent Public Accountants. Second, because OPM has contracted with carriers for twenty to forty years, it has been able to collect extensive data on each carrier, thus making disclosure statements superfluous. Their existing systems are and have been their benchmarks. Third, the OPM Office of the Inspector General audits health carriers on a regular basis; contract rates, which are negotiated annually, are subject to adjustment for audit findings. Fourth, insurance carriers are subject to State regulatory authorities and must meet State statutory reserve requirements in order to conduct business; in addition, many carriers are required to submit to State rate setting procedures. Accordingly, OPM's statutory oversight and regulatory requirements already in place are sufficient to meet the Government's interests in a much less burdensome way than applying CAS. This new regulation will enhance the financial integrity of the Program and demonstrate to the public and any other interested parties that accounting methods and related financial disclosures by carriers are consistent with sound business practices.

Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities because it is based on requirements already in place in the Federal Acquisition Regulation (FAR).

Executive Order 12866, Regulatory Review

This rule has been reviewed by the Office of Management and Budget in accordance with Executive Order 12866.

List of Subjects in 48 CFR Parts 1631 and 1699

Administrative practice and procedure, Government employees, Government procurement, Health facilities, Health insurance, Health professions, Reporting and record keeping requirements, Retirement.

U.S. Office of Personnel Management.

Dan G. Blair,

Acting Director.

■ Accordingly, we are amending chapter 16 of title 48, Code of Federal Regulations, as follows:

CHAPTER 16—OFFICE OF PERSONNEL MANAGEMENT FEDERAL EMPLOYEES HEALTH BENEFITS ACQUISITION REGULATION

■ 1. The authority citations for 48 CFR part 1631 continues to read as follows:

Authority: 5 U.S.C. 8913; 40 U.S.C. 486(c); 48 CFR 1.301.

PART 1631—CONTRACT COST PRINCIPLES AND PROCEDURES

■ 2. Subpart 1631.1 consisting of section 1631.1 is added to read as follows:

Subpart 1631.1—Definitions

1631.1 Definitions.

The definitions in FAR 31.001 are applicable to this section unless otherwise noted.

Subpart 1631.2—Contracts with Commercial Organizations

■ 3. Section 1631.201–70 is revised to read as follows:

1631.201–70 Credits.

The provisions of FAR 31.201–5 shall apply to income, rebates, allowances, and other credits resulting from benefit payments. Examples of such credits include:

(a) Coordination of benefit refunds, including subrogation settlements;

(b) Hospital year-end settlements and other applicable provider discounts;

(c) Uncashed and returned checks;
(d) Utilization review refunds;
(e) Contract prescription drug rebates;
(f) Volume discounts;
(g) Refunds and other payments or recoveries attributable to litigation with subscribers or providers of health services; and,
(h) Erroneous benefit payment, overpayment, and duplicate payment recoveries.

■ 4. A new section 1631.203 is added to read as follows:

1631.203 Indirect costs.

For the purposes of applying FAR 31.203(g)(2) to FEHB Program contracts, OPM considers the monthly rates used by some carriers to be a general practice in the insurance industry.

■ 5. Section 1631.203–70 is revised to read as follows:

1631.203–70 Allocation techniques.

(a) Carriers shall use the following methods for allocating groupings of business unit indirect costs. Carriers shall consistently apply the methods and techniques established to classify direct and indirect costs, to group indirect costs and to allocate indirect costs to cost objectives.

(1) *Input method.* The preferred allocation technique is one that shows the consumption of resources in performance of the activities (input) for the function(s) represented by the cost grouping. This allocation technique should be used in circumstances where there is a direct and definitive relationship between the function(s) and the benefiting cost objectives. Measures of input ordinarily may be expressed in terms such as labor hours or square footage. This means costs may be allocated by use of a rate, such as a rate per labor hour or cost per square foot.

(2) *Output method.* Where input measures are unavailable or impractical to determine, the basis for allocation may be a measure of the output of the function(s) represented by the cost grouping. The output becomes a substitute measure for the use of resources and is a reasonable alternative when a direct measure of input is impractical. Output may be measured in terms of units of end product produced by the function(s). Examples of output measures include number of claims processed by a claims processing center, number of pages printed in a print shop, number of purchase orders processed by a purchasing department, or number of hires by a personnel office.

(3) *Surrogate method.* Where neither activity (input) nor output of the function(s) can be measured practically, a surrogate must be used to measure the resources utilized. Surrogates used to represent the relationship generally measure the benefit to the cost objectives receiving the service and should vary in proportion to the services received. For example, if a personnel department provides various services that cannot be measured practically on an activity (input) or output basis, number of personnel served might reasonably represent the use of resources of the personnel function for the cost objectives receiving the service, where this base varies in proportion to the services performed.

(4) *Other method.* Some cost groupings cannot readily be allocated on measures of specific beneficial or causal relationships under paragraph (a)(1), (a)(2), or (a)(3) of this section. Such costs do not have a direct and definitive relationship to the benefiting cost objectives. Generally, the cost of overall management activities falls in this category. Overall management costs should be grouped in relation to the activities managed. The base selected to measure the allocation of these indirect costs to cost objectives should be a base representative of the entire activity being managed. For example, the total operating expenses of activities managed might be a reasonable base for allocating the general indirect costs of a business unit. Another reasonable method for allocating general indirect costs might be to base them on a percentage of contracts. These examples are not meant to be exhaustive, but rather are examples of allocation methods that may be acceptable under individual circumstances. See also General and Administrative (G&A) expenses, FEHBAR 1631.203–71.

(b) Carriers that use multiple cost centers to accumulate and allocate costs shall apply the techniques in paragraph (a) of this section at each step of the allocation process. Accordingly, the allocation of costs among cost centers at the initial entry into the cost accounting system shall be made in compliance with paragraph (a) of this section. Likewise, the allocation of the cost of interim cost centers to final cost centers is subject to paragraph (a) of this section. If costs of final cost centers are allocated among final cost objectives, the allocation shall also be made in accordance with paragraph (a) of this section. It is possible that carriers using multiple cost centers to accumulate and allocate costs may not have any direct costs, *i.e.*, costs identified specifically with a final cost objective.

(c) The allocation of business unit general and administrative expenses and the allocation of home office expenses to segments are also subject to FEHBAR 1631.203–71 and FEHBAR 1631.203–72, respectively.

■ 6. Section 1631.203–71 is added to read as follows:

1631.203–71 Business unit General and Administrative (G&A) expenses.

G&A expenses shall be allocated to final cost objectives by a base or method that represents the total activity of the business unit.

■ 7. Section 1631.203–72 is added to read as follows:

1631.203–72 Home office expense.

A carrier's practices for allocating home office expenses to the segments of the carrier will be acceptable for purposes of FAR 31.203 if they are allocated on the basis of the beneficial or causal relationship between the home office activities and the segments to which the expenses are allocated. Expenses that cannot be allocated on the basis of a more specific beneficial or causal relationship should be allocated on a basis representative of the entire activity being managed. The compliance of such allocations with FAR 31.203 shall be determined on the basis of the facts and circumstances of each situation.

■ 8. Section 1631.205–10 is added to read as follows:

1631.205–10 Cost of money.

For the purposes of FAR 31.205–10(b)(3), the estimated facilities capital cost of money is specifically identified if it is identified in the prior year's Annual Accounting Statement or, for new experience-rated carriers, the supplemental information supporting submitted costs (such as the Supplemental Schedule of Administrative Expenses).

■ 9. Section 1631.205–72 is amended by designating the existing paragraph as paragraph (a) and adding a new paragraph (b) to read as follows:

1631.205–72 FEHBP compensation for personal services.

(a) * * *

(b)(1) The costs of compensated personal absence shall be assigned to the cost accounting period or periods in which entitlement was earned. Entitlement means an employee's right, whether conditional or unconditional, to receive a determinable amount of compensated personal absence, or pay in lieu thereof.

(2) If at the beginning of the 1st year a carrier subject to paragraph (b)(1) of this section has a liability for accrued but unpaid expenses for compensated personal absences that would otherwise be allocable to FEHB contracts, the

carrier may include such costs in a suspense account. The suspense account may be amortized and included in government contract costs at a rate not exceeding 20 percent per year.

■ 10. Part 1699 is added consisting of subpart 1699.7, section 1699.70 to read as follows:

PART 1699—COST ACCOUNTING STANDARDS

Subpart 1699.7—Cost Accounting Standards

1699.70 Cost accounting standards.

With respect to all experience-rated contracts currently existing under the FEHB Program, the Cost Accounting Standards, found at 48 CFR part 9904, of the Code of Federal Regulations, do not apply.

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