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UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Office of the
Inspector General

July 22, 2020

FOIA Request # 2020-03859

This is in response to your Freedom of Information Act (FOIA) request made on March 22, 2020, to the U.S. Office of Personnel Management (OPM) Office of the Inspector General (OIG). In this request you sought (1) copies of Management Advisories, Management Advisory Memoranda, and Management Advisory Reports issued by the OPM OIG after January 1, 2017 as well as (2) a printout of the listing of Management Advisories, Management Advisory Memoranda, and Management Advisory Reports issued by the OPM OIG after January 1, 2010.

The OPM OIG conducted a thorough search for records and located 110 pages responsive to Item 1 of your request. Ninety-nine pages are being released in full and 11 pages are being released in part. Certain information has been redacted to withhold confidential financial information submitted to the government by healthcare carriers, *see* 5 U.S.C. § 552(b)(4); to withhold information which is predecisional and deliberative, the release of which would prevent the frank and open consideration of agency policies, *see* 5 U.S.C. § 552(b)(5); and to avoid the unwarranted invasion of personal privacy, *see* 5 U.S.C. § 552(b)(6).

No responsive record was located for Item 2 of your request, which requested a printout of a single listing of all Management Advisories, Management Advisory Memoranda, and Management Advisory Reports issued by the OPM OIG after January 1, 2010.

For your information, Congress excluded three discrete categories of law enforcement and national security records from the requirements of FOIA. *See* 5 U.S.C. § 552(c). This response is limited to those records that are subject to the requirements of FOIA. This is a standard notification that is given to all our requesters and should not be taken as an indication that excluded records do, or do not, exist.

I trust that this information fully satisfies your request. If you need any further assistance or would like to discuss any aspect of your request, please do not hesitate to contact me at opmoigfoia@opm.gov or (202)-606-1200.

Additionally, you may contact the Office of Government Information Services (OGIS) to inquire about the FOIA mediation services they offer. The contact information for OGIS is as follows:

Office of Government Information Services
National Archives and Records Administration
8601 Adelphi Road-OGIS
College Park, Maryland 20740
Email: ogis@nara.gov
Telephone: 202-741-5770
Toll-free: 1-877-684-6448
Facsimile: 202-741-5769

If you are not satisfied with the response to this request, you may administratively appeal by emailing opmoigfoia@opm.gov.

Please include a copy of your initial request, a copy of this letter, and a statement explaining why you disagree with our decision. You should write "Freedom of Information Act Appeal" in the subject line of the email. Your appeal must be electronically transmitted within 90 days of the date of the response to your request.

Due to COVID-19, the OIG is not accepting Freedom of Information/Privacy Act appeals via standard mail. We apologize for this inconvenience and appreciate your understanding.

Regards,

A handwritten signature in black ink, appearing to read "A. Kirby", written over a horizontal line.

Andrew P. Kirby
Attorney-Advisor

Enclosure



UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

Office of the
Inspector General

February 16, 2017

Report No. 4A-CF-00-16-038

MEMORANDUM FOR KATHLEEN M. McGETTIGAN

Acting Director

FROM:

NORBERT E. VINT
Acting Inspector General

A handwritten signature in black ink, reading "Norbert E. Vint", is positioned to the right of the name and title.

SUBJECT:

Management Advisory Report – Digital Accountability and
Transparency Act Readiness Review

The Office of the Inspector General (OIG) conducted a readiness review of the U.S. Office of Personnel Management's (OPM) efforts to be in compliance with the Digital Accountability and Transparency Act (hereafter referred to as the DATA Act). The objective of our review was to gain an understanding of the processes, systems and controls which OPM has implemented, or plans to implement, to report financial and payment data in accordance with the requirements of the DATA Act.

We issued our draft review memorandum to Dennis D. Coleman, Chief Financial Officer (CFO), on September 30, 2016. The CFO's October 17, 2016, comments on the draft review were considered in preparing this final memorandum and are included as appendices. For specific details on the review results, please refer to the "Results" section of the memorandum.

This final memorandum has been issued by the OIG to OPM officials to improve the likelihood of compliance with the requirements of the DATA Act prior to full implementation. As part of this process, OPM may release the report to authorized representatives of the reviewed party. Further release outside of OPM requires the advance approval of the OIG. Under section 8M of the Inspector General Act, the OIG makes redacted versions of its final reports available to the public on its webpage. We interpret these reporting requirements to be applicable to this memorandum.

Please contact me, at (202) 606-1200, if you have any questions, or someone from your staff may wish to contact Michael R. Esser, Assistant Inspector General for Audits, at (b)(6)

Attachment

cc: Dennis D. Coleman
Chief Financial Officer and Acting Chief Management Officer

Daniel K. Marella
Deputy Chief Financial Officer

Rochelle S. Bayard
Associate CFO, Center for Financial Systems Management

David L. DeVries
Chief Information Officer

Mark W. Lambert
Associate Director, Merit System Accountability and Compliance

Janet L. Barnes
Director, Internal Oversight and Compliance

(b)(6)
Chief, Policy and Internal Controls



**U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS**

Management Advisory Report

**THE U.S. OFFICE OF PERSONNEL MANAGEMENT'S
DIGITAL ACCOUNTABILITY AND TRANSPARENCY ACT READINESS REVIEW**

**Report No. 4A-CF-00-16-038
February 16, 2017**

-- CAUTION --

This report has been distributed to Federal officials who are responsible for the administration of the subject program. This non-public version may contain confidential and/or proprietary information, including information protected by the Trade Secrets Act, 18 U.S.C. § 1905, and the Privacy Act, 5 U.S.C. § 552a. Therefore, while a redacted version of this report is available under the Freedom of Information Act and made publicly available on the OIG webpage (<http://www.opm.gov/our-inspector-general>), this non-public version should not be further released unless authorized by the OIG.

BACKGROUND

The DATA Act, enacted on May 9, 2014, requires that Federal agencies report financial and payment data in accordance with data standards established by the U.S. Department of Treasury (Treasury) and the U.S. Office of Management and Budget (OMB). The data reported will be displayed on a website available to taxpayers and policy makers. In addition, the DATA Act requires that agency Inspectors General (IG) review statistical samples of the data submitted by the agency under the DATA Act and report on the completeness, timeliness, quality and accuracy of the data sampled and the use of the data standards by the agency.

The DATA Act provides for this oversight by way of the IGs and the Comptroller General of the United States. The DATA Act requires a series of oversight reports to include, among other things, an assessment of the completeness, timeliness, quality, and accuracy of data submitted. Specifically, the first set of IG reports were originally due to Congress in November 2016; however, agencies are not required to submit spending data in compliance with the DATA Act until May 2017. As a result, the IGs could not report on the spending data submitted under the DATA Act by the statutory deadline, as this data would not exist until the following year.

To this end, the Council of the Inspectors General on Integrity and Efficiency (CIGIE) issued a letter, dated December 22, 2015, to Congress addressing the timing anomaly and informing them that the IGs plan to provide Congress with their first required reports in November 2017, a one-year delay from the due date in the statute, with subsequent reports following on a two-year cycle, in November 2019 and November 2021. CIGIE believes that moving the due dates back one year will enable IGs to meet the intent of the oversight provisions in the DATA Act and provide useful reports for the public, the Congress, the Executive Branch, and others.

Although CIGIE determined the best course of action was to delay the IG reports, CIGIE is encouraging IGs to undertake DATA Act “Readiness Reviews” at their respective agencies well in advance of the first November 2017 report. The IG community, through the Federal Audit Executive Council (FAEC) stood up the FAEC DATA Act Working Group. The working group issued the DATA Act Readiness Review Guide to assist agencies in their readiness reviews. This readiness review, in addition to the requirements of the DATA Act, will assist all parties in helping to ensure the success of the DATA Act implementation efforts and with future audits required by the DATA Act. The primary criteria for this review were OMB’s M-15-12¹ and Treasury’s *DATA Act Implementation Playbook*² (version 1.0).

¹ M-15-12 “Increasing Transparency of Federal Spending by Making Federal Spending Data Accessible, Searchable, and Reliable” provides guidance for agencies to carry out current transparency reporting requirements pursuant to the Federal Funding Accountability and Transparency Act and new reporting requirements pursuant to the DATA Act.

² The DATA Act Implementation Playbook describes eight key steps that, if followed together, should help agencies leverage existing capabilities to drive implementation of the DATA Act.

SCOPE AND METHODOLOGY

We performed our review from May 12 through August 31, 2016, at OPM's headquarters in Washington, D.C. The scope of our review concentrated on the following four steps of the "Agency 8-Step Plan" as described in the *DATA Act Implementation Playbook* (version 1.0):

1. Organize team: Create an agency DATA Act work group including impacted communities (e.g., Chief Information Officer, Budget, Accounting, etc.) and identify the Senior Accountable Officer.
2. Review elements: Review list of DATA Act elements and participate in data definitions standardization.
3. Inventory data: Perform inventory of Agency data and associated business processes.
4. Design and strategize:
 - a. Plan changes (e.g., adding award identification numbers (Award ID) to financial systems) to systems and business processes to capture data that are complete multi-level (e.g., summary and award detail) fully-linked data.
 - b. Prepare cost estimates for fiscal year (FY) 2017 budget projections.

To accomplish the review, we:

- Obtained an understanding of the laws, legislation, directives, and any other regulatory criteria (and guidance) related to OPM's responsibilities to report financial and payment information under the DATA Act.
- Conducted interviews with OPM's DATA Act working group responsible for the implementation of the DATA Act at the agency-level.
- Identified the major reporting components within OPM responsible for implementation of the DATA Act.
- Assessed OPM's efforts and formal implementation plans (at the agency and component levels) to report financial and payment information under the DATA Act.

RESULTS

Based on our analysis, we determined that OPM's implementation process is on track for meeting the requirements of the DATA Act.

OPM's DATA Act Implementation Narrative

We found OPM's DATA Act Implementation Narrative, which addresses new requirements that agencies must employ pursuant to the DATA Act and was submitted to OMB in September 2015, to be adequate. OPM's plan includes an implementation timeline, estimates for resource requirements, and a target for identification of foreseeable challenges to implementation of the DATA Act by May 2017.

DATA Act Subject Matter Experts

OPM has aligned knowledgeable personnel within OPM's DATA Act Implementation Workgroup (DAIW) to provide a vision for a successful implementation of the DATA Act and its requirements. The DAIW has an effective management structure with clearly defined roles and responsibilities, which include, but are not limited to:

- the Senior Accountable Official, who for the DATA Act implementation is also OPM's Chief Financial Officer, and who assumes responsibility for coordinating and collaborating OPM's efforts pursuant to the development and implementation of the DATA Act and data quality framework for reporting OPM Federal spending information;
- the Chief Acquisition Officer, who leads policy development, establishment of acquisition goals, evaluation and monitoring of bureau organizations, strategic sourcing, governance of Federal-wide and Treasury procurement systems, and continuous improvement of the acquisition environment; and
- the Chief Information Officer, who is responsible for endorsing and providing input on the DATA Act implementation.

Information Technology Systems under the DATA Act

OPM has two separate financial systems affected by the implementation of the DATA Act: (1) the Consolidated Business Information System (CBIS), an Oracle application, for its Salaries & Expenses and Revolving Fund business operations, and (2) the Federal Financial System (FFS), a long running Consultants to Government and Industries - American Management System mainframe solution of over 20 years, for its Trust Funds processing.

Data mapping ensures an agency has identified and linked all 57 required data elements in its source systems. In addition, data mapping is necessary so agencies can successfully extract data in the required DATA Act format. Specifically, data mapping ensures OPM is able to extract the required data from its procurement and grant systems to the broker³ to extract the data. The data mapping for OPM's systems involves several files containing various payment data elements.

³ The broker is a virtual data layer at the agency that maps, ingests, transforms, validates, and submits agency data into a format consistent with the DATA Act Schema.

OPM is currently excluding File C⁴ for FFS and is using Governmentwide Treasury Account Symbol/Standard Form 133 (GTAS/SF133) information for the File A⁵ extract for CBIS. CBIS received a technical patch on October 10, 2016, that introduced reporting form updates to File B⁶. Furthermore, OPM is performing custom extracts for File C for CBIS until Oracle releases the DATA Act patch. Once Oracle releases its DATA Act patch in FY 2017, OPM will use the delivered software extracts for testing all CBIS related files in the DATA Act broker to ensure all agency data is consistent with the DATA Act Schema⁷ for File C. OPM is using GTAS/SF133 information for FFS to generate the File A extract and OPM's Office of the Chief Information Office and Office of the Chief Financial Officer (OCFO) departments are in the process of assessing File B for FFS.

OPM has established an Award ID link for CBIS between Oracle and CompuSearch PRISM⁸; however, they do not maintain any award data in FFS. The DAIW stated that Treasury verbally acknowledges the fact that OPM's File C, of FFS, cannot be generated; however, without supporting documentation, we are unable to verify that an official waiver has been granted to exclude File C from OPM's FFS DATA Act reporting requirements. OPM submitted and validated both CBIS and FFS Files A, B, and C in the DATA Act broker to which all files were validated.

Areas of Concern

In spite of the fact that we believe OPM is on track for meeting the requirements of the DATA Act, we have identified two areas of concern that should be immediately addressed by OPM to improve the implementation process moving forward. Specifically:

(1) Oversight of the Implementation Process

OPM's DATA Act narrative states, "The goal for the DAIW risk management process is to manage risks, issues and related action items in a timely manner and execute mitigation strategies and adhere to related due dates. At a minimum, high priority risks and new risks will be reviewed at the bi-weekly DAIW status meetings."

We were unable to determine that OPM's DAIW functioned in the capacity stated by OPM's DATA Act narrative above, in regards to coordinating and collaborating OPM's implementation efforts across multiple offices within OPM. Our determination was based on the following factors:

- The DAIW provided Power Point presentations from two of their DAIW status meetings held on May 26 and June 7, 2016. However, the DAIW did not provide actions taken

⁴ File C reports obligations at the award and object class level.

⁵ File A contains appropriation summary level data that is aligned to the SF133 reporting.

⁶ File B includes obligation and outlay information at the program activity and object class level.

⁷ A data standard that contains both a human-readable and a machine-readable version of the standard.

⁸ PRISM is a powerful, web-based application that provides federal and defense acquisition communities with the tools needed to effectively support the complete acquisition management lifecycle.

during the status meetings, such as; documenting the roles and responsibilities for each DATA Act team member, recording key decisions and actions from team meetings, and formalizing the review and approval of deliverables submitted to OMB and the Treasury. Meeting minutes are a valuable project management tool that is vital to any successful implementation plan to discuss the project's goals, assigned tasks, and progress or deviation towards intended outcomes. OPM should strengthen documentation of the DAIW regularly scheduled status meetings held to exchange information about the project. This will allow key managers to track the progress of work results, change requests, corrective actions, and lessons learned of the DAIW implementation endeavors.

- The DAIW denied OIG's request to attend their August 2, 2016, meeting, the purpose of which was to allow the OIG to observe the DAIW's risk management process first hand.
- The DAIW missed a milestone date, which stated a completion timeframe of the first quarter of FY 2016. During our review, we were unable to validate the completion of the requested FFS data element inventory, in "Step 3: Define Inventory of Data Elements", outlined in the OPM DATA Act Implementation narrative provided to OMB, dated September 11, 2015. OPM should strengthen project management over the DATA Act's implementation effort by ensuring that they complete the tasks and meet the milestones projected in the eight step *DATA Act Implementation Playbook*.

CFO's Response:

OPM will track the progress of the project as they work toward the May 2017 implementation date. In regard to the missed milestone, "Treasury and OMB did not release the DATA Act Information Model Schema Version ... until April [29, 2016; therefore,] the original milestone date of Quarter 1, 2016 [first quarter of FY 2016] was no longer feasible. OPM completed this step in June. ... OPM will continue our efforts toward the successful implementation of the DATA Act by ensuring tasks are completed timely and milestone dates are met in accordance with the eight step DATA ACT Implementation Playbook."

OIG's Reply:

The OIG acknowledges the fact that Treasury and OMB did not release the DATA Act Information Model Schema until April 29, 2016; however, OPM's DATA Act implementation narrative stated that an initial inventory, which identified OPM's source systems data extractions, was to be completed by the first quarter in FY 2016, during which time a 90 beta version of the DATA Act Information Model Schema existed.

(2) Inventory Data

Program activity is not automatically stored and produced in CBIS or FFS; therefore, OPM is relying on manual calculations to bridge this gap⁹. As a result, during our review we did not

⁹ Data that is not captured or data that is hard to extract.

conduct a formal, adequate, and complete data inventory of the DATA Act elements for each major reporting component, and therefore could not confirm that OPM is properly reporting complete, reliable or accurate data. An upcoming Oracle patch for OPM's CBIS is expected to be released in FY 2017, which will update the Reporting Code form to accommodate mapping for program activities.

During our review we were also unable to validate the completion of the FFS data inventory, as the inventory had not yet been completed by the Office of the Chief Information Officer and the OCFO. In response to our draft memorandum, the OCFO provided the OIG with a copy of the completed FFS inventory. While we acknowledge that the FFS inventory has since been completed, we did not review the inventory for content and the requirements of the DATA Act, due to reporting time constraints. We will complete a detailed review of the FFS inventory as part of our FY 2017 DATA Act audit.

CFO's Response:

OPM acknowledges this area of concern. "Regarding FFS, OPM is in the final stages of development of a new reporting program that will extract File B balances from the financial system. Within this program is a crosswalk that will derive program activity codes and object class information aligned with FFS accounting Entry Identifications. User Acceptance Testing (UAT) is expected to begin in late October."

CONCLUSION

We found that OPM is in position to report financial and payment data in accordance with the requirements of the DATA Act. Nonetheless, we have identified two areas of concern that if not addressed may impact our FY 2017 DATA Act audit.

- Our review of OPM's coordination and collaboration of DAIW efforts between the program offices concluded that OPM's oversight was inefficient.
- In addition, our review of the CBIS and FFS data element inventory concluded that OPM requires manual calculations to extract data vital to reporting complete, reliable, and accurate data as mandated by the DATA Act. While the OCFO understands this process is not ideal, it was a necessary progression to allow inclusion of a functional inventory in the timeframe outlined by the DAIW to complete the implementation process. Plans are currently in place to upgrade the system and begin the implementation of automated calculations for any element that previously required a manual effort. OPM is working with Treasury and OMB to rectify all material gaps identified during the implementation process and satisfy all requirements set forth by the DATA Act.




UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

OCT 17 2016

Chief Financial
Officer

MEMORANDUM FOR (b)(6)
Chief, Internal Audits Group

FROM: DENNIS D. COLEMAN 
Chief Financial Officer

SUBJECT: Response to Draft- Results of the Digital Accountability and Transparency Act
Readiness Review (DATA Act)

In response to the "Draft - Results of the Digital Accountability and Transparency Act Readiness Review dated September 20, 2016 issued by the Office of the Inspector General (OIG), the Office of Personnel Management (OPM) has reviewed the draft. OPM acknowledges that OIG has determined that the implementation process is on track for meeting the requirements of the DATA Act.

OPM also acknowledges the two areas of concern identified by the OIG in which they are recommending be addressed immediately by OPM to improve the implementation process moving forward. The two areas of concern are (1) oversight of the implementation process and (2) inventory data.

In the oversight of the implementation process concern OIG indicates that the DATA Act Implementation Workgroup (DAIW) did not provide documentation of meeting minutes from bi-weekly status meetings. OPM agrees that meeting minutes are a valuable project management tool that is vital to a successful implementation. To that end, OPM documents activity for all bi-weekly meetings in addition to maintaining attendance to record team members' participation in these meetings. OPM provided supporting documentation to OIG in response to this concern also referenced in their Information Request #02 on June 23, 2016.

Included in the oversight concern, OIG referenced that OPM denied their request to attend DAIW bi-weekly meetings. The bi-weekly meetings are intended to be working sessions where members report progress on their assigned responsibilities and each member has a specific role. This structure enhances the productivity of these meetings. OIG's participation as a member of the DAIW with a specific role will be considered, in addition to OIG attendance at future DAIW bi-weekly meetings.

OIG also indicated that OPM's DAIW missed milestones dates that were outlined in the September 2015 Implementation Plan narrative provided to the Office of Management and Budget (OMB), as part of their oversight of the implementation process concern. OPM is unable to address this concern, as we are not aware of the specific missed milestone date that OIG references.

The second area of concern identified by OIG is associated with inventory data. OIG indicated that the Program Activity is not automatically stored and produced in the Consolidated Business Information

Systems (CBIS) or the Federal Financial System (FFS), and that OPM is relying on manual calculations to bridge this gap. OPM addressed this concern in the OIG Information Request #03 dated August 18, 2016, where it was stated that "viable solutions were identified for all material gaps." A CBIS GAP Analysis and Alternatives was also included in OPM's response detailing plans for utilizing the Oracle patch to configure the CBIS program code information for File C (Award Financial). The use of manual calculations is a short term solution to allow OPM to take advantage of the immediate opportunity of using the DATA Act Broker. The patch enhancement provided by Oracle will configure all data elements and automate the calculated balances as the long term solution. Additionally, CBIS was recently updated with a technical patch on October 10, 2016 that introduced reporting form updates to the Federal Administrator to facilitate Object Class and Program Activity mapping configurations for File B requirements. These new code types will allow mapping configurations to be defined against the current Accounting Code Structure flexfield ranges to extract data accordingly for the File B process.

Regarding FFS, OPM is in the final stages of development of a new reporting program that will extract File B balances from the financial system. Within this program is a crosswalk that will derive program activity codes and object class information aligned with FFS accounting Entry Identifications. User Acceptance Testing (UAT) is expected to begin in late October.

OIG also indicated that they were unable to validate that the FFS data inventory was complete and that all material gaps have been identified. OPM provided the CBIS data inventory in response to the OIG Information Request #02. However, we are unable to identify a specific request for the FFS data inventory. The FFS data inventory will be provided, if needed. The gaps identified for FFS focused on object class/program activity not being defined or stored in the system. OPM is currently developing a reporting program for FFS to support the File B (Object Class/Program Activity) DATA Act requirements.

OPM will continue our efforts toward the successful implementation of the DATA Act by ensuring tasks are completed timely and milestone dates are met in accordance with the eight step DATA Act Implementation Playbook. OPM will also continue to track the progress of the project as we work toward the May 2017 implementation date.

If you have any questions or concerns, please contact (b)(6) on (b)(6) or (b)(6) (b)(6) on (b)(6).

From: (b)(6)
To: (b)(6)
Cc: [Coleman, Dennis D](#); (b)(6); (b)(6)
Subject: FW: Emailing - Draft DATA Act Readiness Review.pdf Date: Thursday, November 03, 2016 4:03:32 PM Attachments: FW DATA Act Request for Status Update.msg RSS - FFS Data Act Elements Inventory v2.xlsx
Importance: High

Good afternoon (b)(6),

Thank you for the opportunity to provide a response to the OIG assessment of the missed milestone. Please find below the OPM response. Additionally, as requested, attached is the completed FAA data inventory for OIG review.

If additional information is required, please let us know.

OPM RESPONSE: OIG indicated that OPM's DAIW missed milestones dates that were outlined in the September 2015 Implementation Plan narrative provided to the Office of Management and Budget (OMB), as part of their oversight of the implementation process concern. However, Treasury and OMB did not release the DATA Act Information Model Schema Version 1.0 (DAIMS v 1.0) until April 29th, 2016. Therefore, the original milestone date of Quarter 1 - 2016 was no longer feasible. OPM completed Step 3 in June, 2016.

Thank you, (b)(6)

Chief, Projects & Initiatives

Office of Personnel Management Office of the Chief Financial Officer (OCFO) E-mail: (b)(6) [@opm.gov](#) Phone: (b)(6)

Begin forwarded message:

From: "(b)(6)" <(b)(6) [@opm.gov](#)>
Date: November 1, 2016 at 4:11:11 PM EDT
To: "Coleman, Dennis D" <(b)(6) [@opm.gov](#)>
Cc: "(b)(6)" <(b)(6) [@opm.gov](#)>, "(b)(6)" <(b)(6) [@opm.gov](#)>
Subject: RE: Emailing - Draft DATA Act Readiness Review.pdf

Good afternoon Dennis,

Thank you for your response to our DATA Act Readiness Review draft report. In an effort to keep our promise of reporting a complete, accurate and fair final memorandum, I would like to further clarify our comments in the draft with supporting documentation provided within this email. On your response, dated October 17, 2016, it was stated that:

“OIG also indicated that OPM's DAIW missed milestones dates that were outlined in the September 2015 Implementation Plan narrative provided to the Office of Management and Budget (OMB), as part of their oversight of the implementation process concern. OPM is unable to address this concern, as we are not aware of the specific missed milestone date that OIG references.”

OIG cited “Step 3: Define Inventory of Data Elements”, of the OPM DATA Act Implementation narrative dated September 11, 2015, which stated that this task was estimated to be completed by the first quarter of fiscal year 2016. *(Please see attachment - OPM DATA Act Implementation narrative, page 7, section 3.2.3)*

In addition, we reviewed the following documentation which identified the status of “Step 3: Define Inventory of Data Elements” as still “in progress” (see attachments for the bulleted three items below):

- Data Act - Status Update - 05262016 FINAL v3 *(see slide 9 of 15, step 3 and 3.5)*
- DATA_Act_PMO_OPM_Meeting Deck_Final_20160523 *(see slide 6 of 6, items for discussion and timeline provided)*
- 2016 0607 DATA Act Status Bi-Weekly *(See page 3 of 7, status update chart for step 3)*

OPM RESPONSE: OIG also indicated that OPM's DAIW missed milestones dates that were outlined in the September 2015 Implementation Plan narrative provided to the Office of Management and Budget (OMB), as part of their oversight of the implementation process concern.

Treasury and OMB did not release the DATA Act Information Model Schema Version 1.0 (DAIMS v 1.0) until April 29th, 2016. Therefore, the original milestone date of Quarter 1, 2016 was no longer feasible. OPM completed this step in June.

Please provide a response, by 11/3/16, notifying us whether you agree or disagree with our assessment of a missed milestone date for the completion estimate for “Step 3: Define Inventory of Data Elements”, located within OPM DATA Act Implementation narrative.

Respectfully,

(b)(6)
Auditor, Internal Audits Group Office of Inspector General
U.S. Office of Personnel Management 1900 E. Street, NW, Room 6400 Washington, DC
20415
Direct: (b)(6) / Fax: (b)(6)
(b)(6) [@opm.gov](mailto:(b)(6)@opm.gov)

All labor that uplifts humanity has dignity and importance

From: (b)(6)
Sent: Monday, October 17, 2016 4:42 PM
To: (b)(6) <(b)(6)@opm.gov>
Cc: Coleman, Dennis D <(b)(6)@opm.gov>; Barnes, Janet L
<(b)(6)@opm.gov>; (b)(6) <(b)(6)@opm.gov>
Subject: Emailing - Draft DATA Act Readiness Review.pdf Please see attached CFO
response.

Thanks

(b)(6)
Program Analyst - Administrative Operations Resource Management Office
Office of the Chief Financial Officer Room 7512A
1900 E. Street, N.W.
Washington, DC 20415
(b)(6)



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Washington Metro Area: (202) 606-2423

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

-- CAUTION --

This report has been distributed to Federal officials who are responsible for the administration of the subject program. This non-public version may contain confidential and/or proprietary information, including information protected by the Trade Secrets Act, 18 U.S.C. § 1905, and the Privacy Act, 5 U.S.C. § 552a. Therefore, while a redacted version of this report is available under the Freedom of Information Act and made publicly available on the OIG webpage (<http://www.opm.gov/our-inspector-general>), this non-public version should not be further released unless authorized by the OIG.

Report No. 4A-CF-00-16-038



**U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF LEGAL & LEGISLATIVE AFFAIRS**

Management Advisory

**Review of the U.S. Office of Personnel Management's
Non-Public Decision to Prospectively and
Retroactively Re-Appportion Annuity Supplements**

**Report Number L-2018-1
February 5, 2018**

EXECUTIVE SUMMARY

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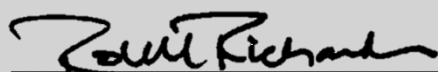
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Why Did We Conduct the Review?

On September 16, 2016, FLEOA wrote to then-Acting Director Beth Cobert raising concerns about an apparent change in OPM policy regarding the calculation of the Annuity Supplement received by certain LEOs who are subject to a state divorce decree. Specifically, FLEOA stated that OPM had recently concluded that if a former spouse is entitled to a portion of a retired LEO's Basic Annuity, that former spouse is also entitled to a portion of the former LEO's Annuity Supplement, even if the divorce decree is silent on the issue. FLEOA noted that this policy change was implemented without public notice. Further, OPM had applied this policy retroactively, resulting in the creation of a new debt that the retired LEOs now owed their former spouses. The Acting Inspector General was cc'd on this letter and subsequently contacted by FLEOA. We determined the issue warranted examination.

What Did We Review?

We examined OPM's policy regarding the treatment of the division of an Annuity Supplement in the context of divorce decrees and recent changes in that policy.



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What Did We Find?

This final Management Advisory details the findings, conclusions, and recommendations resulting from the U.S. Office of Personnel Management (OPM) Office of the Inspector General's (OIG) review of OPM's recent decision that reverses the way OPM apportions a retirement annuity based on a state court-ordered former spouse's marital share. The OIG initiated its review after receiving a complaint from the Federal Law Enforcement Officers Association (FLEOA). FLEOA raised concerns that OPM's non-public change was made without prior notice and is contrary to established law and practice.

For almost 30 years, OPM applied the state court-ordered marital share to the Basic Annuity (also known as the gross monthly annuity) only and not also to the Annuity Supplement. The Annuity Supplement is a supplemental annuity received by Law Enforcement Officers (LEOs) and certain other persons (such as Members of Congress) who retire earlier than when eligible for Social Security benefits. OPM previously considered the Annuity Supplement to be a Social Security-type benefit and thus not allocable as between former spouses. As a result, OPM did not include the Annuity Supplement in the calculation of annuity benefits to be paid to a former spouse, except under certain circumstances where the state court order expressly addressed the Annuity Supplement.

In July 2016, OPM started applying the state court-ordered marital share to both the Basic Annuity and the Annuity Supplement, even in cases where the state court order did not address the Annuity Supplement. However, OPM did not provide any public notice that it now considers the Annuity Supplement to be allocable and that, as a result, OPM will now apply the state court-ordered marital share to the Annuity Supplement, even when the state court order refers to the Basic Annuity only. Instead, retirees and the former spouses learned of OPM's decision only when their annuity amounts changed – many years after the parties had divorced, after a state court had ordered a former spouse's marital share, and after OPM had accepted the state court order for processing. In addition, OPM applied this new interpretation retroactively to the date when the retiree started receiving an Annuity Supplement, resulting in a debt due from the retiree to the former spouse. OPM's new policy has been causing immediate financial disruption to annuitants. Moreover, OPM's new policy improperly changes previously litigated final state court orders without notice to annuitants.

This report sets forth the specific findings and recommendations for the agency. We have considered the agency's response to these recommendations, which is included in the Appendix.

ABBREVIATIONS

FERS	Federal Employees Retirement System
FLEOA	Federal Law Enforcement Officers Association
LEO	Law Enforcement Officer
MSPB	Merit Systems Protection Board
OIG	Office of the Inspector General
OPM	U.S. Office of Personnel Management
RS	Retirement Services

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I. BACKGROUND

On September 16, 2016, the Federal Law Enforcement Officers Association (FLEOA) sent a letter to the U.S. Office of Personnel Management's (OPM) then-Acting Director Beth F. Cobert, objecting to OPM's recent decision to start applying state court-ordered marital shares to the Annuity Supplements of retired Law Enforcement Officers (LEOs), even though the underlying state court orders referred to the Basic Annuity only and did not refer to the Annuity Supplements.¹ FLEOA requested OPM rescind this new policy immediately.

In response, OPM asserted that "the law requires [OPM] to include any payable [Federal Employees Retirement System (FERS)] Annuity Supplement when dividing a FERS annuity under the terms of a state court order."² OPM conceded that "some FERS annuities subject to division under a court order were originally processed without consideration of the FERS Annuity Supplement," and that, "OPM's guidance has been updated to reflect that a FERS annuity includes the FERS Annuity Supplement."³ OPM also stated, "[t]o date, OPM has identified 595 of our 2.6 million annuitants and survivors who are currently receiving the FERS Annuity Supplement and are subject to the terms of a state court order."⁴

¹ Letter from Nathan R. Catura, National President, FLEOA, to Beth F. Cobert, Acting Director, OPM (Sept. 16, 2016). Mr. Catura also contacted OPM's Acting Inspector General, Norbert E. Vint.

² Letter from Kenneth J. Zawodny, Jr., Associate Director, OPM, to Nathan R. Catura, National President, FLEOA, (OPM Ltr.), at 1 (undated but emailed on or about Nov. 17, 2016).

³ We are not aware of any publicly provided guidance. *See* OPM's Memorandum (Mar. 28, 2017) at 23 *infra* ("OPM does not believe it is obligated to post, as a matter of course, materials in the nature of work instructions to claims adjudicators when management observes a problem with consistent application of the law and the regulations").

⁴ OPM Ltr. at 3. Thus it would appear that an increasing number of annuitants will be subject to this new non-public interpretation.

II. CASE EXAMPLES

The Office of the Inspector General (OIG) obtained the following examples as to how OPM's new policy affects current retirees:

- In 2013, former LEO M.T. retired, and OPM applied the standard formula: court-ordered marital share (19.89% x Gross Monthly Annuity = Former Spouse's benefit \$495.85/month).⁵ In 2016, OPM sent a letter stating, "[b]y court order, your former spouse's marital share of your retirement benefit is [] 19.89% of your retirement benefit. By law, [your former spouse] is also due 19.89% of your FERS annuity supplement." OPM included a new formula: "[marital share] x (Gross Monthly Annuity + Annuity Supplement) = Former Spouse's benefit."⁶ The former spouse's new monthly payment going forward would be \$712.85. OPM also retroactively apportioned the Annuity Supplement, stating M.T. now owed the former spouse a debt of \$7,269.54.
- In 2016, OPM sent a letter to E.S., who had retired in 2014, stating that "[b]y court order, your former spouse's marital share of your retirement benefit is 14.16% of your retirement benefit [or \$336.44/month]. By law, [your former spouse] is also due 14.16% of your FERS annuity supplement."⁷ OPM included a new formula: "14.16% x (Gross Monthly Annuity + Annuity Supplement) = Former Spouse's benefit."⁸ The former spouse's new monthly payment going forward would be \$504.66. OPM also retroactively apportioned the Annuity Supplement, stating E.S. now owed the former spouse a debt of \$4,878.38. In contrast, E.S.'s state court order stated, the "[a]lternate payee is entitled to a pro-rata share of participant's gross monthly annuity under [FERS]."⁹ The state court order further provided, "[t]hi agreement does not require the payment of more than fifty percent (50.00%) of the participant's gross annuity."¹⁰
- Federal agent K.O. retired in 2013 and, per state court order, the former spouse received 21.08% of K.O.'s gross monthly annuity.¹¹ In 2016, OPM sent K.O. a letter stating that "the amount we are paying you has changed," and that OPM is now multiplying the 21.08% marital share by the Annuity Supplement as well.¹² The former spouse's new

⁵ Letter from OPM to M.T. (Nov. 16, 2013).

⁶ Letter from OPM to M.T. (July 21, 2016) (emphasis added). ("[T]he amount that you receive under the FERS annuity supplement provisions must be included in the calculation of the benefit paid to your former spouse.").

⁷ Letter from OPM to E.S. (Aug. 6, 2016) (emphasis added).

⁸ *Id.* "OPM is required to divide a FERS annuity supplement regardless of whether it is expressly provided for in a court order." OPM Decision on Reconsideration to E.S. (Feb. 2, 2017).

⁹ *S. v. S. [redacted], Court of Common Pleas, [redacted], Court Order Acceptable for Processing* (Feb. 28, 2013), ¶¶ E, H (emphasis added).

¹⁰ *Id.* at ¶ H.

¹¹ Letter from OPM to K.O. (Aug. 1, 2013).

¹² Letter from OPM to K.O. (July 28, 2016).

monthly payment going forward would be \$1,311.17, up from \$1,052.94. Further, OPM retroactively apportioned the Annuity Supplement, stating K.O. now owed the former spouse a debt of \$10,329.20.

- In January 2017, OPM sent a letter entitled, “Explanation of Inclusion of the FERS Annuity Supplement,” to former LEO L.N., stating that per a court order, the former spouse received 37.19% of the gross monthly annuity, and that “[b]y Law, we must collect any amount of benefits [] retroactively” for the last eight years to December 1, 2008, the date on which L.N. started receiving annuity supplements.¹³ As a result, OPM stated that L.N. owed the former spouse a debt of \$28,389.96.

¹³ Letter from OPM to L.N. (Jan. 9, 2017).

III. STATUTORY AND REGULATORY FRAMEWORK

A. Treatment of LEOs Under FERS

FERS generally covers Federal employees hired after 1983.¹⁴ FERS is “a three-tiered plan consisting of Social Security, a basic FERS annuity, and the Thrift Savings Plan.”¹⁵ Under FERS, Federal employees are entitled to a retirement annuity after reaching their minimum retirement age (ages 55–57) and completing 30 years of service, or at age 60 after completing 20 years of service.¹⁶

FERS treats LEOs differently from other Federal employees. FERS defines a LEO as “an employee, the duties of whose position are primarily--the investigation, apprehension, or detention of individuals suspected or convicted of offenses against the criminal laws of the United States or [] the protection of officials of the United States against threats to personal safety” and whose duties “are sufficiently rigorous that employment opportunities should be limited to young and physically vigorous individuals, as determined by the [OPM] Director considering the recommendations of the employing agency.”¹⁷ As recognized by the Federal Circuit, “Congress passed the preferential retirement provisions to make the federal law enforcement corps a career service composed of young men and women capable of meeting the stringent physical requirements of law enforcement and performing at peak efficiency.”¹⁸ As a result, LEOs are entitled to retire earlier than other Federal employees, at age 50 after completing 20 years of service or, at any age, after completing 25 years of service.¹⁹ LEOs are also subject to mandatory retirement by age 57.²⁰

¹⁴ Congress created FERS when it enacted the Federal Employees’ Retirement System Act of 1986 (FERSA), codified at chapter 84 of Title 5 of the U.S. Code.

¹⁵ OPM, *Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) Handbook for Personnel and Payroll Offices* (April 1998), Section 1A1.1-3 at 4 & Section 1A1.1-1 at 1 (“The Handbook contains the instructions agency personnel and payroll offices need to carry out their responsibilities for basic benefits under the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). This Chapter also describes the responsibilities of the Office of Personnel Management (OPM) and employing agencies in retirement matters.”) <https://www.opm.gov/retirement-services/publications-forms/csrsfers-handbook/c001.pdf>.

¹⁶ 5 U.S.C. § 8412(a), (b) & (h).

¹⁷ 5 U.S.C. § 8401(17)(A).

¹⁸ *Pitsker v. OPM*, 234 F.3d 1378, 1382 (Fed. Cir. 2000).

¹⁹ 5 U.S.C. § 8412(d)(1)-(2).

²⁰ 5 U.S.C. § 8425(b)(1) provides, “A law enforcement officer, firefighter, nuclear materials courier, or customs and border protection officer who is otherwise eligible for immediate retirement under section 8412(d) shall be separated from the service on the last day of the month in which that law enforcement officer, firefighter, nuclear materials courier, or customs and border protection officer as the case may be, becomes 57 years of age or completes 20 years of service if then over that age.”

B. The FERS Annuity Supplement

Because LEOs retire before they are eligible for Social Security benefits, they are entitled to receive an Annuity Supplement in addition to their Basic Annuity.²¹ The Annuity Supplement is also payable to certain other individuals who retire early: Members of Congress; members of the Senior Executive Service retiring under 5 U.S.C. § 8414(a); involuntary retirees (except those removed for cause); and employees who separate voluntarily when their agency is undergoing a major reduction in force, reorganization, or transfer of function. However, non-LEO retirees may not begin to receive the Annuity Supplement until they attain the minimum retirement age.²² The Annuity Supplement “approximates the value of FERS service in a Social Security benefit. The general purpose [] is to provide a level of income before age 62 similar to what the retiree will receive at age 62.”²³ The Annuity Supplement terminates when annuitants become entitled to Social Security old-age insurance benefits, but no later than age 62.²⁴

C. State Court Orders

As for court orders that may affect an employee annuity, FERS provides that:

[p]ayments under this chapter which would otherwise be made to an [] annuitant . . . based on service of that individual shall be paid (in whole or in part) . . . to another person if and to the extent expressly provided for in the terms of [] any court decree of divorce, annulment, or legal separation, or the terms of any court order or court-approved property settlement agreement incident to any court decree of divorce, annulment, or legal separation.²⁵

D. OPM Implementing Regulations And Publicly Available Guidance

In accordance with the statute, OPM promulgated regulations that implement the statutory standards under FERS.²⁶ On February 11, 1987, OPM issued an interim rule, stating that:

[t]hese rules implement a provision of FERS which requires payment of an annuity supplement to certain eligible retirees. Section 8421 of FERS provides for a supplement equal to a portion of a hypothetical social security retirement benefit based on the employee’s pay during FERS-covered civilian employment and

²¹ 5 U.S.C. § 8421(a).

²² 5 U.S.C. § 8412(f) and 5 U.S.C. § 8414(a) and (b).

²³ OPM, *Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS) Handbook for Personnel and Payroll Offices*, Chapter 51 (“Retiree Annuity Supplement”), at p.1 (April 1998), <https://www.opm.gov/retirement-services/publications-forms/csrsfers-handbook/c051.pdf>.

²⁴ 5 U.S.C. § 8421(a)(3)(B).

²⁵ 5 U.S.C. § 8467(a).

²⁶ The statute authorizes OPM to prescribe regulations to carry out the provisions of chapter 84. 5 U.S.C. § 8461(g).

deemed earnings during years before FERS service. Payment of the supplement is subject to an earnings test similar to the test under the Social Security Act applicable to social security recipients.²⁷

Under the regulations, the “Annuity Supplement” is specifically defined as “an amount equal to the old-age insurance benefit payable under title II of the Social Security Act, multiplied by a fraction”²⁸

OPM has also promulgated regulations that address court orders affecting retirement benefits, such as divorce settlement agreements or court orders:

In executing court orders under this part, OPM must honor the clear instructions of the court. Instructions must be specific and unambiguous. OPM will not supply missing provisions, interpret ambiguous language, or clarify the court’s intent by researching individual State laws. In carrying out the court’s instructions, OPM performs purely ministerial actions in accordance with these regulations. Disagreement between the parties concerning the validity or the provisions of any court order must be resolved by the court.²⁹

The regulations define the terms “Basic Annuity,” “Gross Annuity,” and “Net Annuity,”³⁰ and require, *inter alia*, that the court order must comply with the enumerated provisions to be processed, including specifying the type of annuity to be apportioned.³¹ As to this latter requirement, the applicable regulation states:

The standard types of annuity to which OPM can apply the formula, percentage, or fraction are phased retirement annuity of a phased retiree, or net annuity, gross annuity, or self-only annuity of a retiree. Unless the court order otherwise directs, OPM will apply to gross annuity the formula, percentage, or fraction directed at annuity payable to either a retiree or a phased retiree.

The regulations further state, “[a]ll court orders that do not specify net annuity or self-only annuity apply *to gross annuity*.”³²

²⁷ Federal Employees Retirement System -- Basic Annuity; Annuity Supplement, 52 Fed. Reg. 4,478 (1987) (codified at 5 C.F.R. pt. 842, subpt. E). The annuity supplement of LEOs is exempt from the earnings test until the retiree reaches the minimum retirement age for regular FERS employees.

²⁸ 5 C.F.R. § 842.504.

²⁹ 5 C.F.R. § 838.101(a)(2).

³⁰ OPM uses the terms “basic annuity,” “gross monthly annuity,” and “gross annuity” interchangeably to refer to the amount of the monthly annuity computed under 5 U.S.C. § 8415, entitled, “Computation of basic annuity.” *See, e.g.*, 5 C.F.R. § 838.103 (“Gross annuity means the amount of monthly annuity payable to a retiree or phased retiree after reducing the self-only annuity to provide survivor annuity benefits, if any, but before any other deduction.”).

³¹ 5 C.F.R. § 838.306(b).

³² 5 C.F.R. § 838.625(c) (emphasis added).

In addition to the implementing regulations, OPM has issued detailed guidance documents that address FERS, as well as the processing of state court orders on FERS retirement benefits.³³ OPM's guidance documents include a 1997 attorney handbook that provides step-by-step instructions for processing a court order.³⁴ *None* of these publications -- which have been available for almost two decades -- suggest that the Basic Annuity is to be considered synonymous with the Annuity Supplement or that the Annuity Supplement may be apportioned.

E. OPM's Non-Public "Internal" Guidance

During the course of our review, the OIG learned of the existence of the following two documents that squarely address this issue:

1. Memorandum, "OS Clearinghouse 359 and Unnumbered Request; Division of FERS Annuity Supplement" (undated but apparently October 23, 2014).
2. Retirement and Insurance Letter, RIL 2016-12, "Processing Court Ordered Benefits Affecting the Federal Employees Retirement System (FERS) Basic Annuity and the FERS Annuity Supplement" (June 28, 2016).

These two documents state that questions arose as to whether the Annuity Supplement may be apportioned by a state court order *in cases where the court order expressly identified the marital share* in addressing the Annuity Supplement. Neither OS Clearinghouse 359 nor RIL 2016-12 are available publicly, and these documents have not been provided to annuitants or to employees planning for retirement. As the Retirement and Insurance Letter acknowledged, "[s]ince the inception of FERS, OPM has not applied 5 U.S.C. § 8421(c) to include the FERS annuity supplement with the FERS basic annuity in the calculation of the benefits paid to a former spouse."³⁵ OPM also changed its computer system processing:

[b]efore modifications were made in our current programming, the system automatically applied the apportionment calculation only to the basic annuity (life rate/reduced rate). Now our system has been updated to account for the inclusion of the FERS annuity supplement as part of the amount used in the court order benefit calculation.³⁶

³³ OPM, *CSRS and FERS Handbook for Personnel and Payroll Offices*, <https://www.opm.gov/retirement-services/publications-forms/csrsfers-handbook/> (April 1998).

³⁴ OPM, *A Handbook for Attorneys on Court-ordered Retirement, Health Benefits and Life Insurance Under the Civil Service Retirement Benefits, Federal Employees Retirement Benefits, Federal Employees Health Benefits, Federal Employees Group Life Insurance Program*, <https://www.opm.gov/retirement-services/publications-forms/pamphlets/ri38-116.pdf> (rev. July 1997); *see also* OPM's FERS pamphlet, <https://www.opm.gov/retirement-services/publications-forms/pamphlets/ri90-1.pdf> (rev. April 1998).

³⁵ RIL 2016-12 at 1.

³⁶ Email from (b)(6), Legal Admin Specialist, OPM to R.M. (Aug. 24, 2016); *see also* RIL 2016-12 at 2.

IV. ANALYSIS

A. OPM Has Long Interpreted The Annuity Supplement To Be Non-Allocable By State Court Order

The Annuity Supplement is specifically addressed in 5 U.S.C. § 8421(c), which provides:

[a]n amount under this section shall, for purposes of section 8467 [court orders], be treated in the same way as an amount computed under section 8415 [Basic Annuity].

For approximately 30 years, OPM viewed this provision as one dealing with a Social Security benefit and thus presumptively *not* allocable as between an employee and a former spouse.³⁷ Previously, OPM had advised employees and annuitants that “the apportionment to a former spouse does not include the FERS Supplement.”³⁸ OPM’s regulations and longstanding guidance documents referencing court orders do not contain any references to the Annuity Supplement. In certain circumstances, however, where an underlying state court order had expressly addressed the allocation of the Annuity Supplement, OPM’s Retirement Services would consider apportioning it.³⁹ However, Retirement Services did not do so uniformly and this was the basis of OPM’s recently issued, but not publicly available, internal guidance memoranda.

In any event, this Management Advisory addresses OPM’s new policy whereby the Annuity Supplement is included in the apportionment payment to a former spouse in those instances *where the state court order is silent as to the Annuity Supplement*.⁴⁰

B. Section 8421 Does Not Mandate OPM’s Reinterpretation

In its internal guidance, OPM reversed its interpretation of Section 8421(c), concluding that “[u]nder this provision, OPM is not only required to divide a FERS Annuity Supplement when a court order provides a separate and express provision dividing this specific benefit, OPM *is also required to include a division of a FERS Annuity Supplement* in cases where the court order *merely* expressly divides a FERS benefit.”⁴¹ As more fully discussed below, OPM’s acknowledged change in policy or re-interpretation effectively constitutes a new rule as OPM has resolved the meaning of Section 8421(c) in a new and significantly different way.

OPM’s assertion that it is required “by law” to effect this change is incorrect. The language of the statute simply does not mandate the conclusion that the Basic Annuity and the Annuity

³⁷ See OS Clearinghouse 359 Mem. at 2-3; *accord* RIL 2016-12.

³⁸ See, e.g., Email from (b)(6), Legal Admin Specialist, OPM, to C.K. (May 21, 2013).

³⁹ OS Clearinghouse 359 Mem. at 2 (“some of the experienced paralegals [] stat[ed] that as long as we can honor the provisions of the court order, including a provisions to divide the Social Security supplement, we should honor it.”).

⁴⁰ Email from (b)(6), Legal Admin Specialist, OPM to R.M. (July 30, 2016).

⁴¹ OS Clearinghouse 359 Mem. at 3 (emphasis added).

Supplement should be deemed to be one and the same. While this is one possible interpretation of the statute, the language of the statute also supports another interpretation. Section 8421(c) states that the “amount” of the Annuity Supplement is to be “treated” the same way as the “amount” calculated for the Basic Annuity. The term “treated” is not defined. Therefore, this term may be reasonably construed to mean that the Annuity Supplement is subject to division by a state court order in divorce proceedings “in the same way” that the Basic Annuity may be subject to division by a state court order in those proceedings. In other words, a state court may order allocations of each annuity.

The latter interpretation comports with basic principles of family law, under which parties are generally free to divide marital assets by agreement, and state court order incorporates the final division of marital assets allocated in any such agreement. The parties are thus free, by agreement, to allocate respective shares of the Basic Annuity, the Annuity Supplement, or any other marital asset subject to the divorce court’s jurisdiction. A spouse may thus bargain away his or her share of an Annuity Supplement or the Basic Annuity in exchange for other valuable consideration. As further discussed below, this interpretation is consistent with OPM’s new internal guidance that the Annuity Supplement may be separately allocated if the court order does so expressly.

C. OPM’s Regulations Require That the Agency Perform Ministerial Actions Only

It is undisputed that OPM, by statute, regulation and practice, is bound to follow the terms of a court order and not allocate retirement benefits except in strict accordance with the express terms of a court order. The regulations provide that “[i]n executing court orders under this part, OPM must honor the clear instructions of the court” and “[i]n carrying out the court’s instructions, OPM performs purely ministerial actions”⁴² As the Federal Circuit has stated, “OPM is neither qualified nor obligated to resolve disputes about the import of state divorce decrees OPM’s task is ‘purely ministerial’ with respect to court-ordered property settlements.”⁴³

Importantly, “neither we nor the [Merit Systems Protection Board (MSPB)] is permitted by the terms of 5 U.S.C. § 8341(h) to rewrite or equitably reform state court divorce decrees or settlement agreements that do not unambiguously provide for a[n] annuity.”⁴⁴ Thus, “the intent to award a [] survivor annuity must be clear.”⁴⁵

As recognized by the MSPB, OPM is not free to disregard its own published guidance regarding retirement matters, over which it has statutory and regulatory responsibility.⁴⁶ If OPM believes

⁴² 5 C.F.R. § 838.101(a)(2).

⁴³ *Perry v. OPM*, 243 F.3d 1337, 1341 (Fed. Cir. 2001) (quoting *Snyder v. OPM*, 136 F.3d 1474, 1477 (Fed. Cir. 1998)).

⁴⁴ *Fox v. OPM*, 100 F.3d 141, 145 (Fed. Cir. 1996).

⁴⁵ *Hayward v. OPM*, 578 F.3d 1337, 1345 (Fed. Cir. 2009).

⁴⁶ *De Laet v. OPM*, 70 M.S.P.R. 390, 394 (1996) (“OPM is not free to disregard the provisions of the [Federal Personnel Manual] and the Handbook, which constitute its own interpretation of statutes and regulations, and which

that the order is vague, OPM's responsibility is to return the order to the parties so that the state court may address the vague aspect.⁴⁷ Therefore, at most, the omission of any reference to the Annuity Supplement creates an ambiguity as to whether the court intended to address the Annuity Supplement. OPM is neither equipped nor empowered to resolve any such ambiguity.

Since the relevant court order may, or may not, provide for division of the Annuity Supplement, it is not a "ministerial" function to create a division of payment that the court order does not expressly contain. Rather, in effect, OPM is creating a new rule that allocates the Annuity Supplement regardless of whether the court has elected to omit any such allocation. That is a rulemaking function, and that function must be carried out in accordance with the provisions of the Administrative Procedure Act.

D. OPM's New Interpretation Requires Notice and Comment Rulemaking

OPM's acknowledged change in practice effectively constitutes a new rule within the meaning of the Administrative Procedures Act as it resolves the meaning of Section 8421(c) in a new way. As explained below, the OIG concludes that OPM may not adopt or apply this change without undergoing notice and comment rulemaking.

A rule is defined as "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency"⁴⁸ "Interpretive rules do not require notice and comment" but "do not have the force and effect of law and are not accorded that weight in the adjudicatory process."⁴⁹ A legislative rule has the force and effect of law but must be authorized by Congress and promulgated using notice and comment rulemaking.⁵⁰

The Eighth Circuit has stated that the critical distinction between legislative and interpretative rules is that whereas interpretative rules "simply state what the administrative agency thinks the

are entitled to deference, particularly where, as here, OPM has statutory and regulatory responsibility over retirement matters"); *accord Nichol v. OPM*, 2007 M.S.P.B. 82 (2007).

⁴⁷ See 5 C.F.R. pt. 838.

⁴⁸ 5 U.S.C. § 551(4).

⁴⁹ *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 99 (1995). See 5 U.S.C. § 553(b)(3)(A).

⁵⁰ "[T]he critical feature of interpretive rules is that they are 'issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers.'" *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1204 (2015) (citation omitted). On the other hand, a legislative rule, authorized by Congress and issued through notice and comment, has the "force and effect of law." *Perez*, 135 S. Ct. at 1203, quoting *Chrysler Corp. v. Brown*, 441 U.S. 281, 302–303 (1979). Such a rule generally receives full *Chevron* deference. See, e.g., *United States v. Mead Corp.*, 533 U.S. 218, 229–30 (2001); *Christensen v. Harris Cty.*, 529 U.S. 576, 587 (2000). An interpretative rule does not. *Christensen*, 529 U.S. at 587. *Perez* squarely holds that an agency need not engage in notice and comment rulemaking in order to issue or change an interpretative rule or practice. *Perez*, 135 S. Ct. at 1206. A change in a legislative rule would require the same procedural proceedings as the original rule, viz., notice and comment. *Id.*

statute means, and only ‘remind’ affected parties of existing duties,” a legislative rule “imposes new rights or duties.”⁵¹ Similarly, the D.C. Circuit stated recently in *National Mining Ass’n v. McCarthy*:

An agency action that purports to impose legally binding obligations or prohibitions on regulated parties -- and that would be the basis for an enforcement action for violations of those obligations or requirements -- is a legislative rule (As to interpretive rules, an agency action that merely interprets a prior statute or regulation, and does not itself purport to impose new obligations or prohibitions or requirements on regulated parties, is an interpretive rule.) An agency action that merely explains how the agency will enforce a statute or regulation -- in other words, how it will exercise its broad enforcement discretion or permitting discretion under some extant statute or rule -- is a general statement of policy.⁵²

As the D.C. Circuit stated in *McCarthy*, the “most important factor” is the “actual legal effect (or lack thereof) of the agency action in question on regulated parties.”⁵³ Here, the agency’s change goes beyond merely advising the public of the agency’s interpretation of Section 8421(c). It not only creates a new rule or practice, it also imposes real financial consequences, *viz.*, a prospective and retroactive change in how the retiree’s Annuity Supplement amount is allocated between the retiree and the ex-spouse. By any measure, that change imposes “new duties or rights.”⁵⁴

Another factor, according to *McCarthy*, is the agency’s characterization of the rule, *viz.*, whether it is intended to impose a legally binding requirement. That factor also suggests that the rule is legislative, as the agency is stating that its new position is a binding interpretation of Section 8421(c) that controls the amount paid in Annuity Supplement benefits. The agency is then applying its interpretation to reduce the amount paid to the retiree. It is simply not just guidance to future conduct, as it changes the effect of an *existing* court order in a way that is legally binding on the retiree.⁵⁵ In sum, if OPM wishes to reinterpret the meaning of Section 8421(c), the OIG concludes that OPM must do so in formal rulemaking, using notice and comment procedures.

⁵¹ *Nw. Nat’l Bank v. U.S. Dep’t of the Treasury*, 917 F.2d 1111, 1117 (8th Cir. 1990) (quoting *Jerri’s Ceramic Arts, Inc. v. Consumer Prod. Safety Comm’n*, 874 F.2d 205, 207 (4th Cir. 1989)).

⁵² 758 F.3d 243, 251-52 (D.C. Cir. 2014).

⁵³ 758 F.3d at 252.

⁵⁴ See *Nw. Nat’l Bank*, 917 F.2d at 1117. Under these principles, it is highly likely that OPM’s change in its interpretation of Section 8421(c) would be deemed to be a legislative rule that requires notice and comment rulemaking.

⁵⁵ See *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1023 (D.C. Cir. 2000) (holding that a guidance document was a legislative rule where it contained mandatory language and commands and was applied as if it were binding on regulated parties).

E. OPM May Not Give Its New Interpretation Retroactive Effect

Even assuming *arguendo* that OPM's new interpretation is merely an interpretative policy, OPM may not apply such a policy retroactively by re-apportioning prior payments of Annuity Supplement benefits or applying the new interpretation to court orders that preexisted the adoption of the new interpretation.

The rule against retroactive rulemaking was stated by the Supreme Court in *Bowen v. Georgetown University Hospital*, where the Court held that "congressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result."⁵⁶ As the Court explained, "an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress" and "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms."⁵⁷

Here, OPM's decision to apply its new interpretation to pre-existing court orders creates a prohibited retroactive effect. We are aware of no statutory authorization for such retroactive rulemaking.⁵⁸ Applying OPM's new rule to prior court orders necessarily affects the substantive rights, liabilities and duties of the parties to that prior court order as it would change how OPM reads and applies the court's order in a way that alters the allocation of Annuity Supplement benefits under that court order. As such, OPM's re-interpretation affects the "substantive rights" and "liabilities" of the parties set forth in that pre-existing court order.⁵⁹

In summary, OPM may not apply its re-interpretation of Section 8421(c) to prior court orders, much less retroactively change the apportionment of benefits for those prior years. If OPM wishes to apply this new interpretation of Section 8421(c) to future court orders, then the Administrative Procedures Act and simple fairness to all concerned demand that OPM publish its new interpretation, so that the parties are on notice in negotiating post-marital property allocation agreements that are expressly reflected in the court orders.⁶⁰ As outlined above, that publication must take the form of full notice and comment rulemaking, just as the existing rules and

⁵⁶ 488 U.S. 204, 208 (1988).

⁵⁷ *Id.* "Even where some substantial justification for retroactive rulemaking is presented, courts should be reluctant to find such authority absent an express statutory grant." *Id.* at 208-09.

⁵⁸ As the Court explained in *Fernandez-Vargas v. Gonzales*, 548 U.S. 30, 37 (2006), in assessing whether a rule has retroactive effect "we ask whether applying the statute to the person objecting would have a retroactive consequence in the disfavored sense of 'affecting substantive rights, liabilities, or duties [on the basis of] conduct arising before [its] enactment.'" *Id.* (quoting *Landgraf v. USI Film Products*, 511 U.S. 244, 278 (1994)).

⁵⁹ See also *Travenol Laboratories, Inc. v. United States*, 118 F.3d 749, 752 (Fed. Cir. 1997) ("The determination of whether a statute's application in a particular situation is prospective or retroactive depends upon whether the conduct that allegedly triggers the statute's application occurs before or after the law's effective date.") (quoting *McAndrews v. Fleet Bank of Mass., N.A.*, 989 F.2d 13, 16 (1st Cir. 1993)).

⁶⁰ Courts likewise must be put on notice in allocating marital property.

regulations were published in notice and comment rulemaking. OPM lacks the authority to apply its new interpretation retroactively, either to reallocate the years of benefits as seen in the examples provided above or to apply its new interpretation to court orders that were entered before the adoption of this new interpretation.

V. RECOMMENDATIONS

Recommendation 1: We recommend that OPM cease implementing the RIL 2016-12 and OS Clearinghouse 359 memoranda to apply the state court-ordered marital share to Annuity Supplements unless those court orders expressly and unequivocally identify the Annuity Supplement to be apportioned.

OPM Response:

OPM does not concur with this recommendation. OPM adheres to its conclusion that the language of section 8421(c) requires OPM to treat the supplemental annuity in the same fashion that it treats the basic annuity for the purposes of court orders dividing employee annuities. Section 8421(c) of title 5 of the United States Code, the section addressing annuity supplements, states that “[a]n amount under this section,” *i.e.*, an amount reflecting an annuity supplement, “*shall*, for the purposes of section 8467,” a section expressly addressed to court orders, “be treated in the same way as an amount computed under section 8415” (emphasis added). This language leaves no room for alternative interpretations. It requires OPM to treat annuity supplements in the same fashion that it treats the basic annuity “for the purposes of court orders. “If the intent of Congress is clear, that is the end of the matter; for . . . the agency, must give effect to the unambiguously expressed intent of Congress.” *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984).

But even if there is room for interpretation, OPM’s duly promulgated regulations in 5 C.F.R. part 838 also make clear that, unless the court specifies otherwise, a court order divides the monthly “recurring payments” of “[e]mployee annuity,” 5 C.F.R. § 838.103, not sums of money within those payments attributable to various provisions of chapter 84. Significantly, Congress has entrusted the great responsibility of interpreting chapter 84 to the Director of OPM. *See* 5 U.S.C. § 1103(a)(5)(A) (“executing, administering, and enforcing. . . the laws governing the civil service” is “vested in the Director”); *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 55-56 (2011) (“[t]he power of an administrative agency to administer a congressionally created. . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress” (emphasis supplied; internal quotations omitted)).

OIG Comment:

The OIG disagrees with OPM’s position. OPM’s response is contradicted by its nearly three decades of acknowledged practice of interpreting the Basic Annuity to *not* include the Annuity Supplement.

Likewise problematic is OPM’s stated reliance on *Chevron* deference for its new interpretation. *Chevron* deference refers to an important principle of administrative law that the Supreme Court established in *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*⁶¹ In *Chevron*, the Supreme

⁶¹ 467 U.S. 837 (1984).

Court held that courts should defer to agency interpretations of such statutes where Congress has expressly delegated formal rulemaking authority to the agency and the interpretation is embodied in the resulting rule. Any such interpretation cannot override express language of the statute (“step one”) and, if the statute is silent or ambiguous, the interpretation must be otherwise a permissible or reasonable construction of the statutory language (“step two”).⁶² We note that with few exceptions,⁶³ such deference is generally accorded only where an agency has employed full notice and comment rulemaking procedures.⁶⁴ OPM has not employed such procedures here in adopting its new policy.

Given the significance of the issue, and the far-reaching consequences of this new policy on retirees and their ex-spouses, it is difficult to see how *Chevron* deference would be appropriate in the absence of formal procedures.⁶⁵ OPM’s response is likewise contradicted by OPM’s new policy that recognized that if the order expressly divides the Annuity Supplement, then OPM will follow those terms, regardless of how the Basic Annuity is divided. OPM thus recognized that the Annuity Supplement is not the same as the Basic Annuity and may be subject to a different marital allocation.

OPM’s response failed to address the retroactive aspect of the agency’s new policy change. OPM’s policy is causing significant and immediate financial hardship for annuitants and is disturbing previously litigated state court orders that effected a division of marital property.

Recommendation 2: We recommend that OPM take all appropriate steps to make whole those retired LEOs and any other annuitants affected by this re-interpretation. This would include reversing any annuities that were decreased either prospectively or retroactively that involved a state court order that did not expressly address the Annuity Supplement.

OPM Response:

OPM does not concur with this recommendation insofar as it characterizes OPM as having reinterpreted the statutory and regulatory provisions governing annuity supplements.

⁶² *Id.* at 842-43.

⁶³ See *United States v. Mead Corp.*, 533 U.S. 218, 230-31 (2001) (“we have sometimes found reasons for *Chevron* deference even when no such administrative formality was required and none was afforded”); *Barnhart v. Walton*, 535 U.S. 212, 222 (2002) (“whether a court should give such deference depends in significant part upon the interpretive method used and the nature of the question at issue”).

⁶⁴ See *Mead*, 533 U.S. 218, 230-31 (2001).

⁶⁵ *Id.* at 230 (“It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force.”).

OIG Comment:

The OIG disagrees with OPM's response that appears to deny that OPM has "reinterpreted the statutory and regulatory provisions governing annuity supplements." As discussed above, OPM has changed its interpretation after almost three decades of interpreting the Basic Annuity to *not* include the Annuity Supplement.

Recommendation 3: We recommend that OPM determine whether it has a legal requirement to make its updated guidance, including Retirement and Insurance Letters, publicly available.

OPM Response:

OPM does not concur with this recommendation insofar as the recommendation applies to the documents in question here. OPM does not believe it is obligated to post, as a matter of course, materials in the nature of work instructions issued to claims adjudicators when management observes a problem with consistent application of the law and the regulations. Should the question arise, [Retirement Services] will consult with the Office of the General Counsel as to the circumstances under which such claims processing guidance should be made available for public inspection and copying under the Freedom of Information Act (FOIA), as described in 5 U.S.C. § 552(a)(2), subject to applicable FOIA exemptions under 5 U.S.C. § 552(b).

OIG Comment:

The OIG disagrees. As discussed above, OPM has a legal obligation to provide public notice of a new policy that significantly affects how OPM processes state court orders – and that has resulted in the imposition of new and wholly unexpected substantive obligations. Although OPM has not so construed the Basic Annuity to be congruent with the Annuity Supplement for the past 30 years, OPM has decided to issue a new policy that now equates the Basic Annuity with the Annuity Supplement in the absence of any court order provision that addresses the Annuity Supplement separately. Employees, annuitants, spouses, and courts rely heavily on OPM's guidance and are entitled to notice of OPM policies that directly affect them. In this context, OPM's continuing failure to provide public notice of this new policy is troubling.

Finally, OPM formally requested that the OIG keep this memorandum non-public, stating in relevant part:

OPM requests that the Inspector General forego such publication here, where the very essence of the alert is legal argument. As noted below, litigation before the MSPB concerning the subject matter of the alert has now commenced, and court order appeals call for special sensitivity because they affect two private parties whose interests are in conflict with one another. The Inspector General's alert essentially lays out arguments that could be used by annuitants in appeals from the agency's decisions, but these annuitants' interests are in conflict with other private individuals, i.e., the annuitants' spouses. At this point, it would be prudent to let

the MSPB, and, as appropriate, its reviewing courts, sort out the legal issues as Congress contemplated in the Civil Service Reform Act; otherwise, the Inspector General might place itself in the position of tipping the scales in favor of one group of affected individuals over another.

OIG Comment:

The OIG declines to accept OPM's request that the OIG forego publication, as it would be inconsistent with the Inspector General Act of 1978, as amended (IG Act).⁶⁶ Congress established the OIG "to provide a means for keeping the head of the establishment and the Congress fully and currently informed about problems and deficiencies relating to the administration of such programs and operations and the necessity for and progress of corrective action."⁶⁷ OPM's unpublished decision that re-interpreted Section 8421(c) is a highly significant change pertaining to OPM's administration of the Retirement Services Program, a program that has particular significance for thousands of Federal law enforcement personnel.

OPM's concern that "these annuitants' interests are in conflict with other private individuals" is not an appropriate reason for the OIG to decline to publicly post these recommendations in the usual manner. Section 4(e)(1)(A) of the IG Act requires that the OIG post documents making recommendations for corrective action to the OIG's website within three days of submitting the document to the Director.⁶⁸ In any event, we are advised that the previously pending MSPB appeals have been dismissed as a result of OPM's issuing of a "rescindment" of OPM's decisions on reconsideration.⁶⁹

⁶⁶ 5 U.S.C. app.

⁶⁷ *Id.* § 2(3). "An IG works as the agency's watchdog. The amount IGs can save the taxpayer in identifying and recovering improper payments, ferreting out abusive or wasteful practices, and identifying troubled programs is well-documented." S. Rep. No. 114-36, at 2 (2015).

⁶⁸ *See* 5 U.S.C. app. § 4(e).

⁶⁹ In at least one of these prior appeals, the affected annuitant continues to have his monthly annuity decreased based on OPM's new policy notwithstanding the "rescindment." Accordingly, it is difficult to understand how that final agency action was completely rescinded.

APPENDIX

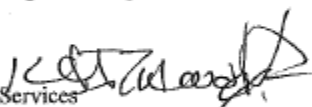


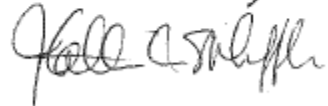
Retirement Services

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

MAR 28 2017

FOR: J. DAVID COPE
Assistant Inspector General for Legal and Legislative
Affairs

FROM: KENNETH J. ZAWODNY, JR. 
Associate Director, Retirement Services

KATHIE ANN WHIPPLE 
Acting General Counsel

SUBJECT: MANAGEMENT ADVISORY, OPM's Non-Public
Decision to Prospectively and Retroactively Re-Appportion
Annuity Supplements Notwithstanding Silence of the State
Court Orders

Thank you for providing us the opportunity to respond to the Office of the Inspector General (OIG) draft management advisory, "OPM's Non-Public Decision to Prospectively and Retroactively Re-Appportion Annuity Supplements Notwithstanding Silence of the State Court Orders." Our responses to your recommendations are provided below.

OPM understands that the Office of Inspector General usually publishes management alerts such as the one to which OPM now responds. OPM requests that the Inspector General forego such publication here, where the very essence of the alert is legal argument. As noted below, litigation before the MSPB concerning the subject matter of the alert has now commenced, and court order appeals call for special sensitivity because they affect two private parties whose interests are in conflict with one another. The Inspector General's alert essentially lays out arguments that could be used by annuitants in appeals from the agency's decisions, but these annuitants' interests are in conflict with other private individuals, i.e., the annuitants' spouses. At this point, it would be prudent to let the MSPB, and, as appropriate, its reviewing courts, sort out the legal issues as Congress contemplated in the Civil Service Reform Act; otherwise, the Inspector General might place itself in the position of tipping the scales in favor of one group of affected individuals over another.

Background:

Section 8421 of title 5 of the U.S. Code provides for an "annuity supplement" for certain individuals whose annuities commence prior to age 62, in addition to the basic annuity payable under 5 U.S.C. § 8415. The annuity supplement is analogous to insurance benefits payable under title II of the Social Security Act. Section 8467(a) of title 5, addressing court-ordered

benefits for the former spouses of annuitants, further provides that “[p]ayments under this chapter [*i.e.*, chapter 84, the Federal Employees Retirement System (“FERS”)] which would otherwise be made to an . . . annuitant . . . based on the service of that individual shall be paid (in whole or in part) by the Office . . . to another person if and to the extent expressly provided for in the terms of . . . any court decree of divorce, annulment, or legal separation;” and under a corresponding provision in 5 U.S.C. § 8421(c), “[a]n amount under this section [related to annuity supplements] shall, for purposes of section 8467, be treated in the same way as an amount computed under section 8415 [related to the basic annuity].”

OPM has issued implementing regulations in 5 C.F.R. part 838, which cover both FERS and the Civil Service Retirement System (“CSRS”). OPM’s regulations govern the effect of a qualifying court order on the “Employee annuity,” defined as those “recurring payments . . . made to a retiree” that “are payable on the first business day of the month following the month in which the benefit accrues.” 5 C.F.R. §§ 838.103, 838.132(a); *see also id.* § 838.211(a)(1). Thus the regulation speaks in terms of the effect of court orders on recurring monthly annuity payments. Consistent with the statute, the regulation does not distinguish between the sources of money making up the monthly annuity payments under applicable provisions of chapter 84.

The regulations provide that “OPM *must comply* with qualifying court orders, decrees, or court-approved property settlements in connection with divorces, annulments of marriages, or legal separations . . . that award *a portion of an employee annuity* [*i.e.*, a portion of the recurring monthly payments] to a former spouse.” 5 C.F.R. 838.201(a) (emphasis supplied). The regulations then focus on when a court order is “acceptable for processing,” *i.e.*, when it “expressly divides the employee annuity,” “provides for OPM to pay the former spouse a portion of the employee annuity,” and “provides sufficient instructions and information that OPM can compute the amount of the former spouse’s monthly benefit using only the express language of the court order” as well as OPM’s own regulations and records. 5 C.F.R. §§ 838.303(a), 838.304(a), 838.305(a).

On October 23, 2014, the Retirement Policy group in Retirement Services (“RS”) issued a memorandum to the Operations Support group (“OS Clearinghouse 359”), addressing questions on how to divide a FERS annuity pursuant to court order when the monthly employee annuity payments include both basic annuity monies and supplemental annuity monies. Operations Support noted, in its request, that there had been inconsistencies among the staff processing such court orders. *Id.* at 2.

Retirement Policy concluded that under the express and unambiguous language of 5 U.S.C. § 8421(c) -- and consistent with OPM’s regulation in 5 C.F.R. § 838.103, which requires division of the “employee annuity” without any words of limitation permitting only certain components thereof are to be divided -- both the basic and supplemental components are to be divided, when a court orders the division of the employee annuity. *Id.* at 3-4.

Operations Support then issued Retirement and Insurance Letter (“RIL”) 2016-12 on June 28, 2016. The RIL detailed corrections that had been made to OPM rate computation software and set forth some procedures for calculating and correcting overpayments. It concluded that “[i]f an annuitant is entitled to a FERS annuity supplement under 5 U.S.C. § 8421, OPM must include

the FERS annuity supplement in the calculation of a former spouse's benefit unless the court order expressly excludes it." *Id.* at 4.

The Federal Law Enforcement Officers' Association objected to these conclusions in a September 16, 2016 letter, and OPM Retirement Services responded that "[b]ecause . . . the FERS Annuity Supplement [is] considered part of the annuity divisible by court order under the authority of 5 U.S.C. § 8467, OPM's claims processing guidance to Retirement Services' staff has been updated to reflect that a FERS annuity includes the FERS Annuity Supplement. . . . when the FERS annuity is divided under the terms of a court order." Letter at 2.

After a period of consultation with OPM management, OIG's review and draft Management Advisory and Recommendations followed on March 9, 2017. OPM management submits the following response to the draft recommendations.

Recommendation #1: We recommend that OPM cease implementing RIL 2016-12 and OS Clearinghouse 359 Memorandum to apply the state court-ordered marital share to the Annuity Supplement unless those court orders expressly and unequivocally identify the Annuity Supplement to be so apportioned.

Management Response:

OPM does not concur with this recommendation. OPM adheres to its conclusion that the language of section 8421(c) requires OPM to treat the supplemental annuity in the same fashion that it treats the basic annuity for the purposes of court orders dividing employee annuities. Section 8421(c) of title 5 of the United States Code, the section addressing annuity supplements, states that "[a]n amount under this section," *i.e.*, an amount reflecting an annuity supplement, "shall, for the purposes of section 8467," a section expressly addressed to court orders, "be treated in the same way as an amount computed under section 8415" (emphasis added). This language leaves no room for alternative interpretations. It requires OPM to treat annuity supplements in the same fashion that it treats the basic annuity "for the purposes of" court orders. "If the intent of Congress is clear, that is the end of the matter; for . . . the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984).

But even if there is room for interpretation, OPM's duly promulgated regulations in 5 C.F.R. part 838 also make clear that, unless the court specifies otherwise, a court order divides the monthly "recurring payments" of "[e]mployee annuity," 5 C.F.R. § 838.103, not sums of money within those payments attributable to various provisions of chapter 84. Significantly, Congress has entrusted the great responsibility of interpreting chapter 84 to the Director of OPM. See 5 U.S.C. § 1103(a)(5)(A) ("executing, administering, and enforcing . . . the laws governing the civil service" is "vested in the Director"); *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 55-56 (2011) ("[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress" (emphasis supplied; internal quotations omitted)).

Recommendation #2 (first part): We recommend that OPM immediately take appropriate steps to make whole those retired LEOs and any other annuitants affected by this re-interpretation. This includes reversing any annuities that were decreased either prospectively or retroactively that involved a state court order that did not expressly address the Annuity Supplement.

Management Response:

OPM does not concur with this recommendation. As an initial matter, OPM does not accept the premise that there was any "re-interpretation" of the statutory or regulatory provisions governing annuity supplements, as Congress has left no interpretive gap for OPM to fill, and accordingly, OPM's regulation merely conforms to the statute. Even if there is room for interpretation, however, as noted above, OPM has done nothing more than to correct inconsistencies to bring the practices in line with OPM's duly promulgated regulations in 5 C.F.R. part 838.

With respect to the OIG's specific "make whole" recommendation, however, OPM cannot pay higher amounts to annuitants than the statute allows -- or correspondingly reduce the amounts to which annuitants' former spouses are statutorily entitled -- based on "individual favor" toward particular claimants. See *Office of Pers. Mgmt. v. Richmond*, 496 U.S. 414, 424-28 (1990). Nevertheless, under 5 U.S.C. § 8470(b), OPM shall waive collection of an individual's annuity overpayment "when, in the judgment of the Office, the individual is without fault and recovery would be against equity and good conscience." OPM's implementing regulations in 5 C.F.R. part 845, set forth the applicable standard for individual adjudications, and explain each annuitant's right to advanced notice and opportunity to seek reconsideration, waiver, or compromise. If an individual is dissatisfied with OPM's decision, he or she has a right to appeal the decisions to the Merit Systems Protection Board ("MSPB" or "Board") under 5 U.S.C. § 8461(e)(1).

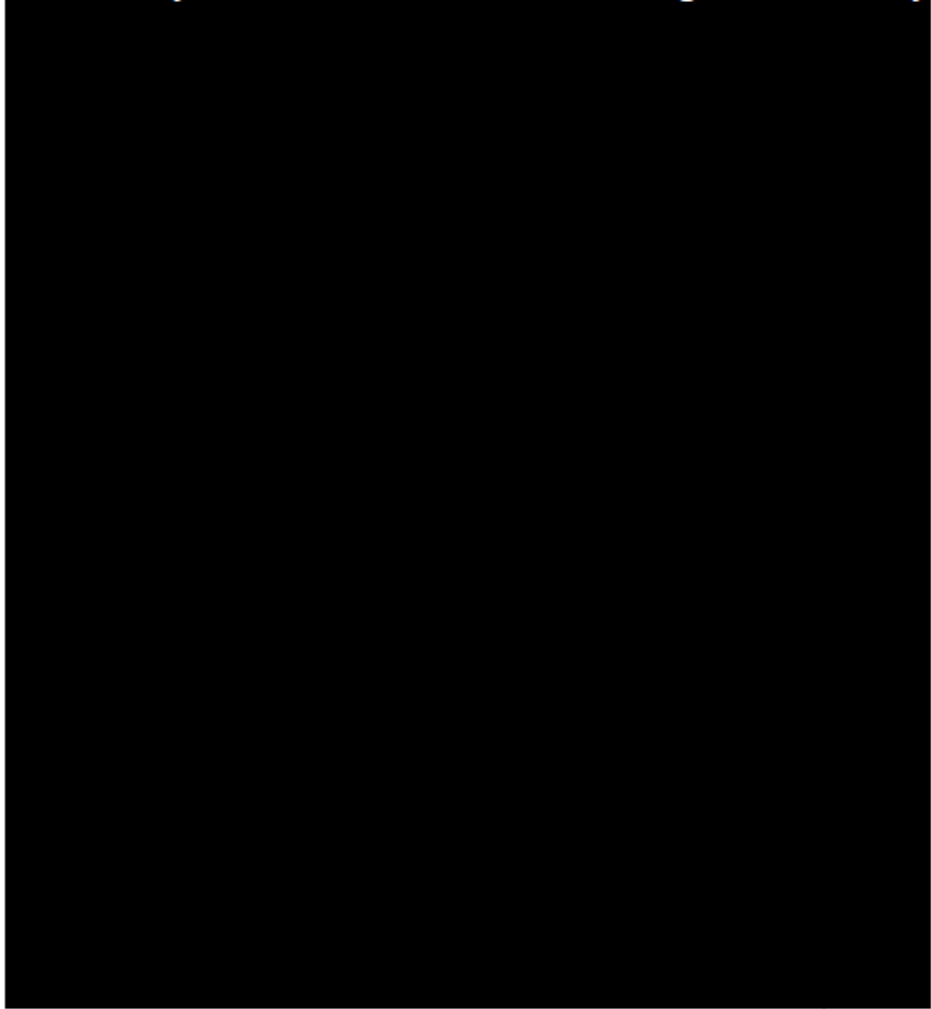
Each annuitant whose former spouse's annuity was adjusted received a Retirement & Insurance ("RI") form 38-47, "Information and Instructions on Your Reconsideration Rights" notice. This gave each affected annuitant the opportunity to challenge the existence and amount of the overpayment, with a right of appeal to the MSPB. Following the transmissions of those forms, OPM also issued each of the affected annuitants an RI form 34-3, "Notice of Amount Due Because of Annuity Overpayment," with a new 30-day period to request reconsideration, and with collection of the overpayment suspended, pending a final decision. This gave each affected annuitant the opportunity to request reconsideration, waiver, or compromise of OPM's collection of the overpayment, with additional MSPB appeal rights. Accordingly, OPM has furnished the procedural redress that the law requires.

Further, OPM has met with representatives of the Federal Law Enforcement Officers Association ("FLEOA") to directly explain its position and to invite a continued dialogue with FLEOA and its members; OPM has also met with staff from the House Oversight and Government Reform Committee about this matter. But, litigation before the MSPB has now commenced and it would be imprudent to comment, in this forum, on the Agency's litigation position. Court order appeals call for special sensitivity because they are in essence a form of private party litigation, even though they are litigated in an administrative tribunal; the former spouses may (and frequently do) intervene to litigate against the annuitants, either in favor of or against OPM's position. See 5 C.F.R. § 1201.34(a). Although OPM will defend its legal position before the MSPB, as it

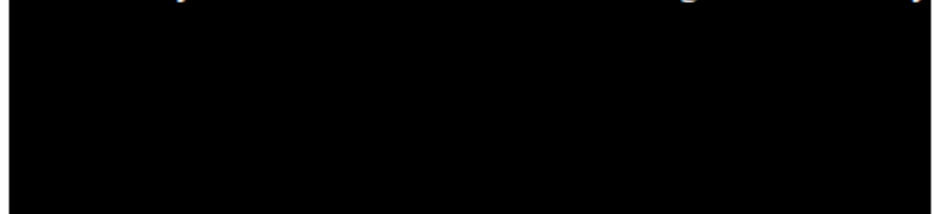
must, OPM -- including its Inspector General -- must scrupulously avoid any appearance that it favors one category of private claimant over the other. The MSPB and its reviewing courts are now the best place in which to achieve a resolution of the legal questions at hand.

In the event the Board disagrees with OPM's actions -- and the Board's decision, or the decision of the appellate courts in any appeal from the Board's decision becomes final -- OPM will of course take any necessary steps to comply with an appropriate order.

Removed by OIG - Not relevant to final Management Advisory



Removed by OIG - Not relevant to final Management Advisory



Recommendation #4: We recommend that OPM determine whether it has a legal requirement to make its updated guidance, including Retirement and Insurance Letters, publicly available.

Management Response:

OPM does not concur with this recommendation insofar as the recommendation applies to the documents in question here. OPM does not believe it is obligated to post, as a matter of course, materials in the nature of work instructions issued to claims adjudicators when management observes a problem with consistent application of the law and the regulations. Should the question arise, RS will consult with the Office of the General Counsel as to the circumstances under which such claims processing guidance should be made available for public inspection and copying under the Freedom of Information Act (FOIA), as described in 5 U.S.C. § 552(a)(2), subject to applicable FOIA exemptions under 5 U.S.C. § 552(b).



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**U.S. OFFICE OF PERSONNEL MANAGEMENT
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OFFICE OF AUDITS**

Management Advisory

**U.S. Office of Personnel Management's
Fiscal Year 2017 IT Modernization Expenditure
Plan**

**Report Number 4A-CI-00-18-022
February 15, 2018**

ABBREVIATIONS

Appropriations Act	Fiscal Year 2017 Consolidated Appropriations Act
CIO	Chief Information Officer
CPIC	Capital Planning and Investment Control
FITARA	Federal Information Technology Reform Act
FY	Fiscal Year
IT	Information Technology
MaaS	Mainframe as a Service
OCIO	Office of the Chief Information Officer
OMB	U.S. Office of Management and Budget
OPM	U.S. Office of Personnel Management
Plan	IT Modernization Expenditure Plan

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I. SUMMARY

The Consolidated Appropriations Act of 2017 (P.L. 115-31) (Appropriations Act), made available \$11 million to the U.S. Office of Personnel Management (OPM) “specifically for the operation and strengthening of the security of OPM legacy and Shell ... [information technology (IT)] systems and the modernization, migration and testing of such systems.” The Appropriations Act further requires that “the amount ... may not be obligated until the Director of the Office of Personnel Management submits ... a plan for expenditure of such amount ... that –

- 1) identifies the full scope and cost of the IT systems remediation and stabilization project;
- 2) meets the capital planning and investment control review requirements established by the Office of Management and Budget, including Circular A-11, part 7;
- 3) includes a Major IT Business Case under the requirements established by the Office of Management and Budget Exhibit 300;
- 4) complies with the acquisition rules, requirements, guidelines, and systems acquisition management practices of the Government;
- 5) complies with all Office of Management and Budget, Department of Homeland Security and National Institute of Standards and Technology requirements related to securing the agency’s information system as described in 44 U.S.C. 3554; and
- 6) is reviewed and commented upon within 90 days of plan development by the Inspector General of the Office of Personnel Management”

On December 4, 2017, the OPM Office of the Chief Information Officer (OCIO) provided its IT Modernization Expenditure Plan (Plan) for our review. While we believe that the Plan is a step in the right direction toward modernizing OPM’s IT environment, it falls short of the requirements outlined in the Appropriations Act. The Plan identifies several modernization-related initiatives and allocates the \$11 million amongst these areas, but the Plan does not identify the full scope of OPM’s modernization effort or contain cost estimates for the individual initiatives or the effort as a whole. All of the other capital budgeting, project planning, and IT security requirements are similarly missing.

On the surface, OPM is continuing to make the same mistakes that plagued its recent unsuccessful “*Shell*” initiative (see Background section). Rather than developing a modernization strategy, evaluating alternatives, estimating the costs, and following established capital budgeting processes, OPM is doing it backwards. The starting point for the Plan is a modernization budget not supported by strategy or cost analysis, which was then followed by a determination of how to spend the money.

In our discussion with OCIO officials on this point, we were told that OPM lacks the IT governance and enterprise architecture to complete a comprehensive modernization strategy or to be able to estimate the costs of implementing it. The current plan is that the bulk of the \$11 million will be devoted to improving the environment that would enable the proper planning and strategy to evolve.

It is concerning that almost three years after the data breach of 2015 and the unsuccessful *Shell* project that followed, OPM has still not clearly identified a comprehensive modernization strategy or established the required planning and budgeting mechanisms that would accompany such a project. While some progress has been made, it remains to be seen whether OPM can effectively manage the modernization of its aging technical infrastructure and implement the security improvements that are only possible with current technology.

II. BACKGROUND

In 2015 OPM initiated a large-scale IT modernization project referred to as the “*Shell*.” The goal of the *Shell* project was to consolidate OPM’s outdated and decentralized technical infrastructure into two new and modern data centers, and to then modernize the agency’s legacy information systems and migrate them into this new infrastructure. While we generally agreed with the strategy of modernizing the infrastructure, we identified at that time a number of concerns regarding OPM’s capital planning procedures and the project management activities surrounding this project. We issued a series of audit reports expressing our concerns, the most notable of which were:

- OPM did not identify the full scope or cost of the project. The agency did not have a comprehensive inventory of information systems that needed to be upgraded and migrated to the *Shell*, much less any realistic cost estimates or timelines of doing so.
- OPM did not follow the Capital Planning and Investment Control (CPIC) processes required by U.S. Office of Management and Budget (OMB) Circular A-11. OPM initiated its modernization project without preparing a Major IT Business Case (a critical CPIC artifact) to seek approval and secure funding. The process of developing a Business Case should have involved a variety of disciplined project management activities that would have allowed OPM to fully evaluate the costs, benefits, and risks associated with its project, and to present the project to OMB to seek approval and dedicated funding.
- OPM never performed an Analysis of Alternatives to evaluate whether the *Shell* project was the best solution to address the agency’s needs. The agency should have conducted market research to identify as many alternatives as possible and used a benefit-cost approach to selecting the best available alternative within the budget.

Our reports predicted that the *Shell* project would fail to meet its stated objectives, and unfortunately this was the ultimate result. The contractor supporting the development of the *Shell* project suddenly went out of business in May 2016, leaving OPM with an incomplete project. The two new data centers that were set up to host the *Shell* have been subsequently shut down, and OPM is no longer pursuing this modernization project.

It is apparent that OPM’s lack of disciplined project management and capital budgeting processes surrounding the *Shell* project influenced the decision-making process of the Appropriations committees in Congress that drafted the Appropriations Act. This is clear from our prior reporting on the matter, our interactions with the committees during the drafting process, and the committees’ report which amplifies the intent of the language. Congress

appears willing to fund OPM's modernization efforts provided that OPM has developed a clear strategy for the total effort, has identified the technical level of effort involved, and has reasonably estimated the total costs of the project.

III. PROGRESS AFTER SHELL

In the time since the *Shell* project was abandoned in 2016, OPM has made incremental progress in stabilizing its technical environment. The agency has improved its information system inventory and has implemented a risk assessment process designed to identify critical and high-risk assets. In addition, many of the technical security tools that were procured for the *Shell* environment were successfully incorporated into the legacy technical environment.

The agency has also made significant progress in consolidating its historically decentralized data centers. OPM designated two primary data centers and reconfigured and updated these facilities to absorb systems previously housed at secondary data centers. Several secondary data centers have been closed since 2016.

IV. CURRENT STRATEGY AND FY 2017 EXPENDITURE PLAN

We reached out to current and former OCIO officials as early as May 2017, shortly after the Appropriations Act was enacted, and many months after the Appropriations committees proposed draft language that would make modernization funding available pending OPM's compliance with certain requirements. Our intention was to establish a common understanding of the requirements, and to communicate our expectations of the OCIO spending plan, based on the language in the Appropriations Act and our discussions with Appropriations committee staff during the legislative drafting process.

While the language in the Appropriations Act describing the requirements and timelines is clear and unequivocal, it was apparent to us that the OCIO's vision for the OPM Plan did not match ours or the Appropriations Act's. It was also obvious that the OCIO had not done the work necessary to support a well-developed, comprehensive IT capital budgeting modernization plan, as our previous audit reports discussed in 2015. The final Plan provided to our office in December 2017, while incorporating some positive elements, does not meet any of the requirements outlined in the Appropriations Act. It also made clear that OPM still does not have a fully developed modernization strategy.

For example, although the Appropriations Act required OPM to "identify the full scope and cost ... of the project," OPM's Plan is essentially a description of how it would spend the \$11 million appropriated for Fiscal Year (FY) 2017 (two-year appropriation), rather than a comprehensive modernization project plan. The Plan allocates the \$11 million to a variety of initiatives, but there is no evidence that an analysis has been done to estimate the total cost of completing each initiative.

The Plan also does not meet the capital planning and investment control requirements in OMB Circular A-11, part 7, which lays out the principles of acquisition and management of capital IT investments. The basic concept when considering a capital IT project is that agencies should take the following steps:

- Conduct an analysis of alternative options, including maintaining the status quo;
- Select the lowest cost option, based on a discounted net present valuation;
- Prepare a lifecycle cost estimate, showing a future breakeven point, and estimated savings; and

- Submit a Major IT Business Case to OMB, to present a benefit/cost-based request for funding for the investment.

The OCIO provided our office new or updated Major IT Business case documentation to support some of the initiatives in the Plan. However, none of these documents showed any evidence of compliance with basic CPIC guidelines. As an example, OPM's Infrastructure Investment included an updated section for modernizing the agency's mainframe computing environment which hosts many mission-critical applications. OCIO officials have discussed with us their strategy to "get out of the mainframe business" by moving these applications to a mainframe shared-service provider (also known as Mainframe as a Service or MaaS), and ultimately refactoring the applications to be compatible with a more modern distributed computing environment. We were told that such a move could save the agency up to \$10 million annually and significantly reduce operational and security risk.

Indeed, the updated section of the Infrastructure Major IT Business Case document states that the goal of the investment is to "re-host mainframe applications to a commercial provider to significantly reduce operational risks to core applications and provide the foundation to migrate applications to a more modern infrastructure." However, the lifecycle cost section of this document shows estimated development costs of only \$2 million with completion in FY 2018. We know that the actual lifecycle costs of such a project (not including modernizing applications) could potentially exceed \$50 million over several years, based on the OCIO's market research with a mainframe shared service provider.

This example seems to demonstrate that the OCIO may not understand the CPIC process, especially considering that this is the one area in which it has done much of the work that would be required to support this investment. The OCIO has conducted significant market research regarding MaaS over the past year. It is our understanding that OPM is working on an analysis of alternative options and has enough information to establish a total cost estimate for this effort. Since OPM has defined its strategy and can develop a reasonable lifecycle cost estimate, it would seem appropriate for the agency to prepare a fully-developed Major IT Business case for the investment as part of its capital budgeting process to secure adequate funding from OMB for its MaaS initiative.

However, none of this information is included in OPM's Plan. As stated before, the Plan is simply an allocation of how the agency would spend \$11 million. The current version of the Plan allocates \$2 million to mainframe modernization – an amount that OPM already knows is only a small fraction of the total cost estimate.

An additional concern in this area stems from our recommendation in audit Report No. 4A-CI-00-15-055 (“Flash Audit Alert – OPM’s Infrastructure Improvement Project”) that OPM create a comprehensive Major IT Business Case for its modernization effort as a whole. That recommendation was specific to the *Shell* project, which was designed as a consolidated effort that, in our opinion, merited a stand-alone funding and tracking mechanism.

The current modernization effort will be far more decentralized – as a result a different approach is needed. With that said, we do not agree that it is appropriate to link every element of the agency-wide IT modernization effort solely to existing investments. Burrowing a major initiative into existing portfolio elements can give the impression that the agency is not being transparent regarding the scope and scale of its modernization efforts.

We continue to believe that a project of this scale warrants dedicated and centralized tracking. As a specific example of our concern, the Plan currently has “Legacy Application Modernization” associated with the Retirement Benefits Services Investment. However, OPM has many legacy applications that do not relate to Retirement Services – or any of the other existing major investments. OPM could consider tracking “Application Modernization” as a separate investment with a dedicated Major IT Business Case.

In addition to our concerns regarding the lack of strategic focus and CPIC processes, the OCIO’s Plan does not comply with the Appropriations Act provisions regarding acquisition and security requirements. We cannot assess or comment specifically on these areas because the Plan does not include adequate detail to make a determination. However, as noted below, we have significant concerns regarding OPM’s overall adherence to the Federal Information Technology Reform Act (FITARA) requirements regarding the role of an agency’s Chief Information Officer (CIO) in the acquisition of Federal IT systems.

Although OPM’s Plan is lacking in all of the required aspects, it at least appears to outline the basic elements of a full-scope modernization strategy. It describes three broad areas in need of improvement: governance, environment modernization, and business modernization, and subdivides these areas into a total of seven specific initiatives each with its own broad milestones and timelines.

But in our discussions about the Plan with OCIO officials from May through December 2017, it seemed obvious that a comprehensive, post-*Shell* IT modernization strategy is still a work in progress. For example, the draft version of the Plan was strictly focused on operational priorities with no strategic vision at all. Further discussions between the OIG and the OCIO helped lead to the improved final Plan; however, the strategic focus of the Appropriations Act provisions is still missing from the Plan.

As this understanding continued to evolve, the timeline of the appropriations process influenced the quality of the Plan. It was clearly started too late and hastily prepared in view of the September 30, 2018, deadline to obligate the \$11 million appropriated in the Appropriations Act. In addition, there only appeared to be one or two individuals working on the Plan under the direction of the Deputy CIO. We would expect to see an Integrated Project Team, as required by OMB Circular A-11, Part 7, made up of subject matter experts from all of the relevant disciplines intimately involved in such a critical initiative.

With that said, this document could be the starting point of a modernization strategy. However, OCIO officials stressed that they were unable to fully define a modernization strategy because of an overall lack of governance and consistent enterprise architecture in the agency. Their focus in spending the \$11 million will be to establish the structures that will be the necessary baseline from which to evolve a fully mature modernization strategy.

There are at least two significant barriers to good IT governance and enterprise architecture at OPM. First, continuous turnover of the CIO position has prevented the agency from focusing on a single modernization strategy. There have been six different individuals in the CIO role since June 2015, when we first raised our concerns about the IT modernization efforts at OPM. Although each CIO has recognized the need to modernize OPM's outdated IT infrastructure, none has been in place long enough to establish a tangible strategy. This is why it is particularly critical for the current CIO to document a centralized and consolidated strategy complete with the appropriate CPIC artifacts to support a well-managed project. Once this is in place, it will be easier for future CIOs to continue the efforts of his or her predecessor, instead of starting with a clean slate as the last six CIOs have.

Second, OPM continues to be plagued by a decades-old, decentralized IT organizational structure. Major IT investments (up to and including the mainframe) were procured, managed, and owned by OPM's various business units. There was a time when OPM had no CIO. Starting in the mid-2000s, incumbents in the CIO role have struggled to consolidate control over technology management. Information security was also the responsibility of the business units, and while the CIO could develop policies, procedures, and guidelines – it was up to the business owners to enforce them.

Although there has been improvement in recent years in centralizing all technology management under the CIO, the historical decentralization continues to hinder OPM's technology modernization efforts. There are still many examples of patchwork systems with different platforms, operating systems, vendors, and applications that support program office activities. The OCIO does not have full control of these resources and cannot effectively manage them. In addition, there are several application development initiatives underway by program offices

within OPM, in particular the Office of the Chief Financial Officer and the Healthcare and Insurance Office, with limited or no OCIO involvement. This is, in our view, a major impediment to a truly effective enterprise architecture and IT security program.

Budgetary resources are also a significant problem, as funding for technology procurement and operation is still routed through OPM's business units, and the OCIO is reimbursed through an antiquated "common services" methodology. The scope and scale of the CIO's technology expenditures rarely align with the funding it receives from the business units. This is another reason why it is critical that the agency's modernization efforts be tracked in a centralized and transparent investment that outlines the entire scope and cost of modernization – to help ensure that the OCIO can receive the dedicated funding that it needs for such efforts.

FITARA requires that the "Chief Information Officer of the agency has a significant role in ... the management, governance, and oversight process related to information technology." Although we are not explicitly reporting that OPM is operating in violation of FITARA regulations, we do believe that OPM's business units continue to have an improper level of influence over IT management, and that the CIO's office does not directly receive the dedicated funding needed to fulfill its mission.

V. RECOMMENDATIONS

Recommendations:

1. We recommend that OPM establish baseline governance and enterprise architecture improvements that can facilitate the planning and execution of a successful IT modernization strategy.
2. We recommend that OPM's OCIO focus its spending priorities on establishing the necessary governance and enterprise architecture improvements, including an enterprise IT program management office and an enterprise architecture program management office.
3. We recommend that OPM develop a comprehensive IT modernization strategy with input from the appropriate stakeholders and convene an Integrated Project Team, as required by OMB Circular A-11, Part 7, to manage the overall modernization program and ensure that proper CPIC processes are followed.
4. We recommend that the OPM Director ensure that the CIO has the appropriate level of control over the IT acquisition and budgeting process across all of OPM.

OCIO Response:

We provided the OCIO with a draft copy of this Management Advisory and our recommendations for its review and comment. The OCIO concurred with all four recommendations and stated its commitment to improving the necessary elements that will serve as the starting point for a comprehensive IT improvement strategy. We will continue to work closely with the OCIO and monitor its progress in implementing these recommendations. The OCIO's complete response to the draft Management Advisory is attached as an appendix.

VI. CONCLUSION

Even though OPM's IT Modernization Expenditure Plan does not comply with the provisions in the Appropriations Act, it does outline critical modernization elements and could serve as a starting point for a comprehensive IT improvement strategy. We understand that OPM intends to use much of the \$11 million made available for improving IT governance and enterprise architecture, a necessary prerequisite to developing and executing a modernization strategy. OCIO officials seem to understand the need for a strategy and have committed to us that their focus will be on strengthening these areas.

Modernization of OPM's aging infrastructure is needed to promote better services to its customers – for example, automating retirement claims processing and improving the background investigations process – but it is also, and primarily, a critical element of improved IT security and preventing future data breaches. The legacy environment is simply too complicated and antiquated to adequately secure, even though significant improvements have already been put in place. A strategy that will lead to a modern, secure environment for the agency's mission-critical applications is crucial to prevent another major security incident.

Therefore, it is our opinion that the Congressional Appropriations committees should approve OPM to obligate \$11 million pursuant to the FY 2017 Consolidated Appropriations Act, with the understanding that OPM will adhere to the recommendations in this report. We will continue to very closely monitor OPM's progress in this respect.

APPENDIX



Chief Information
Officer

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

MEMORANDUM FOR MICHAEL ESSER

ASSISTANT INSPECTOR GENERAL FOR AUDITS
OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL

FROM:

DAVID A. GARCIA
CHIEF INFORMATION OFFICER
OFFICE OF PERSONNEL MANAGEMENT

FEB 07 2018

Subject:

Response to the Draft Management Advisory Letter –
Comments on IT Modernization Expenditure Plan

Thank you for providing the Office of Personnel Management (OPM) the opportunity to respond to the Office of the Inspector General (OIG) Draft Management Advisory Letter – Comments on IT Modernization Expenditure Plan.

We appreciate that your “opinion is that the Congressional Appropriations committees should approve OPM to obligate the \$11M” in FY17 IT modernization funds. We also appreciate the critical nature of much of your review and are committed to improving the necessary elements that will serve as the starting point for a comprehensive IT improvement strategy. Specifically focusing on improving IT governance and enterprise architecture as “a necessary prerequisite to developing and executing a modernization strategy” that will improve OPM’s capabilities to develop and execute IT improvements and modernization. We look forward to continuing to closely work with you on our progress.

Responses to your recommendations are provided below.

Recommendation #1: We recommend that OPM establish baseline governance and enterprise architecture improvements that can facilitate the planning and execution of a successful IT modernization strategy.

Management Response: We concur.

Recommendation #2: We recommend that OPM’s OCIO focus its spending priorities on establishing the necessary governance and enterprise architecture improvements, including an enterprise IT program management office and an enterprise architecture program management office.

Management Response: We concur.

Subject: Response to the Draft Management Advisory Letter –
Comments on IT Modernization Expenditure Plan

Recommendation #3: We recommend that OPM develop a comprehensive IT modernization strategy with input from the appropriate stakeholders and convene an Integrated Project Team, as required by OMB Circular A-11, Part 7, to manage the overall modernization program and ensure that proper CPIC processes are followed.

Management Response: We concur.

Recommendation #4: We recommend that the OPM Director ensure that the CIO has the appropriate level of control over the IT acquisition and budgeting process.

Management Response: We concur and will continue to ensure the CIO has the appropriate level of control over the IT acquisition and budgeting process.

I appreciate the opportunity to respond to this draft report. If you have any questions regarding our response, please contact me or Robert Leahy, Deputy CIO.



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**U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS**

Final Management Advisory

**U.S. Office of Personnel Management's
Fiscal Year 2018 IT Modernization Expenditure Plan**

**Report Number 4A-CI-00-18-044
June 20, 2018**

ABBREVIATIONS

Appropriations Act	Fiscal Year 2018 Consolidated Appropriations Act
CPIC	Capital Planning and Investment Control
FEHBP	Federal Employees Health Benefits Program
FY	Fiscal Year
FY 2018 Plan or Plan	FY 2018 IT Modernization Expenditure Plan
IT	Information Technology
OCIO	Office of the Chief Information Officer
OMB	U.S. Office of Management and Budget
OPM	U.S. Office of Personnel Management
PMA	President’s Management Agenda

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I. SUMMARY

The Consolidated Appropriations Act of 2018 (P.L. 115-141) (Appropriations Act), made available \$21 million to the U.S. Office of Personnel Management (OPM) “for information technology infrastructure modernization and Trust Fund Federal Financial System migration or modernization” The Appropriations Act further requires that “the amount ... may not be obligated until the Director of the Office of Personnel Management submits ... a plan for expenditure of such amount ... that –

- 1) identifies the full scope and cost of the [information technology (IT)] systems remediation and stabilization project;
- 2) meets the capital planning and investment control review requirements established by the [U.S. Office of Management and Budget (OMB)], including Circular A-11, part 7;
- 3) includes a Major IT Business Case under the requirements established by the Office of Management and Budget Exhibit 300;
- 4) complies with the acquisition rules, requirements, guidelines, and systems acquisition management practices of the Government;
- 5) complies with all Office of Management and Budget, Department of Homeland Security and National Institute of Standards and Technology requirements related to securing the agency’s information system as described in 44 U.S.C. 3554; and
- 6) is reviewed and commented upon within 60 days of plan development by the Inspector General of the Office of Personnel Management”

This is very similar to language in the fiscal year (FY) 2017 Consolidated Appropriations Act. The conditions that prompted Congress to enact these requirements stem from the OPM data breaches of 2015 and the failed Shell project that followed. Our audits at the time demonstrated that OPM did not follow appropriate project management and capital budgeting processes. Based in part on our work and on OPM’s history of failed IT projects, Congress determined that OPM’s IT modernization program should be funded, but only if it were clearly shown to be following these strict guidelines.

Our report on OPM’s FY 2017 IT Modernization Expenditure Plan (See Report No. 4A-CI-00-18-022 (<https://www.opm.gov/our-inspector-general/management-advisory-reports/management-advisory-report-us-office-of-personnel-management%E2%80%99s-fiscal-year-2017-it-modernization-expenditure-plan.pdf>.) discussed in detail the shortcomings of OPM’s IT modernization program. To summarize, OPM has not followed OMB capital

budgeting guidance, which is an established process for well-developed, thoroughly-researched, and fully funded large scale investments. In FY 2017, OPM officials informed us that the agency lacked the governance and IT enterprise architecture that would set the stage for such processes to occur. Our recommendations were focused on these structural reforms, and we expressed the opinion that, even though OPM had not met the funding requirements, Congress should allow it to obligate appropriations with a view toward moving these fundamental improvements forward.

OPM was authorized to obligate \$11 million in FY 2017 funding, and most of those funds were used to start the process of making the required reforms. On April 23, 2018, the Office of the Chief Information Officer (OCIO) provided its FY 2018 IT Modernization Expenditure Plan (FY 2018 Plan or Plan), and based on our review it appears that OPM is generally continuing in the right direction toward modernizing OPM's IT environment.

While this is an encouraging development, we still have several concerns with the Plan, and OPM's overall approach to IT modernization.

- Like the FY 2017 spending plan, this Plan does not meet the explicit requirements of the Appropriations Act. To be fair, OPM has not had enough time to establish the baseline requirements that OCIO officials told us would be required to develop adequate planning and budgeting processes. Despite OPM's long history of failed commitments, changing priorities, and turnover in critical leadership positions, we are cautiously optimistic that this effort may be successful, but we will very closely monitor and report on the agency's progress.
- The allocation of the \$21 million appropriated in the FY 2018 Consolidated Appropriations Act is not primarily based on an objective analysis of IT modernization needs. It appears that some of the money is targeted toward satisfying deferred business process automation needs based on considerations related to the President's Management Agenda (PMA), and not enough is being spent on true infrastructure improvements as required.

II. OIG REVIEW AND COMMENTS

In December 2017, as OPM was preparing its FY 2017 spending plan for our review, OCIO officials informed us that the agency's IT environment was so fractured and decentralized, and so lacking in overall governance, that they were not able to even begin the process of designing an overall IT modernization plan. The capital planning and investment control (CPIC) process that is described in OMB Circular A-11, and which forms the basis of the FY 2017 and 2018 Appropriations Act requirements, could not be implemented. We were told that technical analysis, and cost and schedule estimates, were impossible.

To begin the process of developing proper governance and an enterprise architecture, OPM recently awarded a contract to a vendor to establish an enterprise project management office. The objectives of this project are to define an agency-wide IT governance structure to more effectively manage IT infrastructure, systems, and development projects under the centralized authority of the OCIO.

In addition, the contractors are supposed to help OPM design a technical architecture at the enterprise level. One of the many problems at OPM is uncontrolled and decentralized IT development using a variety of different operating systems, database vendors, and other related systems leading to an environment that is very difficult to maintain. A standardized technical environment enforced across the agency would promote analysis, design, and planning at the strategic enterprise level.

As this process and capability matures we would expect to see OPM take a more rigorous approach to its IT modernization program, fully incorporating the correct CPIC and project management processes. However, as it stands now, OPM's FY 2018 spending plan does not meet the requirements of the FY 2018 Consolidated Appropriations Act.

For example, the Plan does not identify the full scope of OPM's modernization effort or contain cost estimates for the individual initiatives or the effort as a whole. In fact, OPM has expressed that with the change in OCIO leadership, the fundamental approach to modernizing the IT environment has changed and they do not view this effort as a single, all-encompassing project, and thus do not intend to manage a single project plan or determine a full-scope cost estimate. As such, they do not have, nor intend to, produce an overarching capital budget, project plan, or defined IT security requirements.

In general, we agree with this approach providing that the individual modernization projects do follow CPIC, including an assessment of technical effort required, analysis of alternative options, estimates of lifecycle costs, and proper business case development and maintenance. OPM does maintain Major IT Business case documentation to support some of the initiatives in the Plan.

However, the majority of these documents do not show evidence of compliance with basic CPIC guidelines.

For example, and as discussed in our previous report (referenced above), OPM's Infrastructure Investment included an updated section for modernizing the agency's mainframe computing environment, which hosts many mission-critical applications. This is one area where the agency has a fairly advanced strategy and enough information to do proper CPIC, but the investment is still inadequate. Our concern is that the agency does not fully understand or value the CPIC process and may not be able to properly manage it in the future.

An important element of CPIC is to derive budget requirements based on an assessment of needs, and that a project team made up of subject matter experts should manage each investment. We addressed this concern at length in our previous report, but it appears that OPM is still struggling in this area.

Even though the OCIO cannot derive enterprise-level cost estimates and budget requests, one would expect that a plan to spend a given amount would be based on an assessment of targeted requirements. However, it is our understanding that the allocation of the \$21 million appropriated in FY 2018 was top down, and driven at least in part by the PMA. Further, the overall modernization effort continues to be managed by a small group of OCIO staff rather than an integrated project team made up of subject matter experts representing the relevant disciplines – although we were told that this will be the focus of the new enterprise project management office currently being stood up.

In addition to evaluating overall compliance with the conditions that must be met prior to obligating funds, we reviewed the funding priorities and proposed investments in the Plan. Congress directed that the funds appropriated in FY 2018 be used for “information technology infrastructure modernization and Trust Fund Federal Financial System migration or modernization”

The FY 2018 spending plan distributes the \$21 million appropriated for this purpose between governance, environment modernization, and business modernization. The governance initiative consists of risk management, enterprise architecture and enterprise project management. Modernizing the IT environment covers upgrading the critical infrastructure, completing a system inventory, researching a cloud-based network solution, and re-hosting mainframe applications to a commercial provider.

Business modernization includes the mandatory trust fund system migration and upgrades to legacy mainframe applications, but also incorporates several projects that seem unrelated to the intent of Congressional appropriators. For example, the OCIO proposes to spend modernization

funds on an employee digital record system, migration of the non-trust fund financial system to a shared service provider, and the development of a central enrollment database system for the Federal Employees Health Benefits Program (FEHBP). While these are probably worthy initiatives, it is important to remember that the funding provided by Congress is rooted in the 2015 OPM data breaches and predicated on the concept that they will be used to modernize OPM's IT environment to improve security, reduce risk, and prevent future data breaches.

We understand that these investments were added to the FY 2018 spending plan because of a desire by senior OPM officials to fund them outside of the normal budget process. For example, nearly \$1 million is set aside for the FEHBP central enrollment database, even though a separate budget request for the system was denied by OMB in FY 2018. Another \$500,000 is earmarked for the Consolidated Business Information System (OPM's non-trust fund financial management system) migration to a shared service provider even though this project is funded through a separate investment outside of the OCIO.

While we can acknowledge that these are worthwhile initiatives, they do not appear to be an appropriate use of the IT modernization funding. The funding is intended for strengthening OPM's legacy IT environment, not the improvement of business processes through new IT solutions.

Another concern is that the investment in infrastructure is not sufficient to sustain the improvements in progress. OCIO officials informed us that the strategy to modernize OPM's IT infrastructure (i.e., the hardware, software, and network components that support IT services) is focused on commercial solutions, such as Network as a Service and Mainframe as a Service. The concept is to reduce cost and risk through shared service providers.

Again, while this appears to be a commendable strategy, it is probably going to be a very complicated and time-consuming process. In fact, we have heard the same or similar ideas from the OCIO going back to the Shell project, and even before that. Although there has been significant progress made in data center consolidation, OPM is not close to meeting the overall objectives of OMB's Data Center Optimization Initiative, which promotes the transition to a more efficient and secure infrastructure. Also, it will be a highly complex and expensive process to migrate OPM's mission-critical mainframe applications to a commercial service provider.

III. CONCLUSION

OPM has not met the explicit requirements of the FY 2018 Consolidated Appropriations Act, but it has made progress in its IT modernization program. OPM has engaged a contractor to begin the process of establishing an enterprise program management office to strengthen IT governance and enterprise architecture.

OPM's FY 2018 spending plan mostly supports initiatives that comport with the intent of Congress to modernize IT infrastructure to strengthen security and prevent data breaches. However, some of the targeted projects are not strictly necessary and should not be included in the funding. The funds should be re-allocated to directly support infrastructure modernization.

It is our opinion that OPM should obligate funds pursuant to the FY 2018 Consolidated Appropriations Act that are in direct support of infrastructure modernization and the migration of the trust fund financial system, with the understanding that OPM will implement current and outstanding recommendations related to this issue. We will very closely monitor OPM's progress in this respect.

IV. RECOMMENDATIONS

Recommendations

1. We recommend that the OPM Director ensure that the distribution of FY 2018 IT modernization funds is consistent with strengthening OPM's legacy IT environment, as expressed in the FY 2018 Consolidated Appropriations Act.
2. We recommend that funding for the FEHBP Central Enrollment Database, the Employee Digital Record, and the Consolidated Business Information System migration be obtained using the normal budget process (or other potential sources, such as the Modernizing Government Technology fund), and not from the FY 2018 IT modernization funds.

OPM Response:

1. *"We concur with your recommendation and will ensure the FY 2018 IT modernization funds are used to strengthen OPM's legacy IT environment. With the recent confirmation of the Director and Deputy Director of OPM, we will continue to reassess our IT Modernization plan moving forward, as needed, and maintain an open dialogue with you regarding any changes."*
2. *"We partially concur with your recommendation. We understand the rationale for your recommendation, i.e., that distribution of the FY 2018 IT modernization funds be used to strengthen OPM's legacy IT environment, as expressed in the FY 2018 Consolidated Appropriations Act. However, we would like to use this opportunity [to] provide more information to better explain the ways in which each of the items mentioned in your recommendation as being more appropriately funded through normal budget processes actually operate to directly strengthen OPM's legacy IT environment while mitigating possible risks. We ask you to further consider this additional information. We would also note these projects have been fully briefed to the Appropriations Committees ahead of Congressional passage of FY18 funding."*

Although we recognize that the items in our modernization plan support the [PMA], they are also important to strengthening OPM's legacy IT environment.

The FEHBP Central Enrollment Database planning team, including [Healthcare] and Insurance and CIO leadership, has agreed to a plan that will enhance the legacy OPM FEHB Data Hub so that it will be capable of receiving and transmitting daily enrollment transactions (currently weekly) from agencies government-wide to carriers and enhance data validations to improve the quality of enrollment data. This will be accomplished in six months, by the end of CY 2018. The results of utilizing the legacy FEHB platform will include reducing risks related to operations and finances, reducing government and enrollee costs through identification of dual enrollments, and enhancing service and accountability for the entire FEHB program. Mitigation of these risks directly impacts OPM's ability to implement additional IT Modernization efforts.

OPM has also facilitated development of a conceptual plan that will deliver the initial EDR operational capability in September 2019 and position EDR to fully replace eOPF and EHRI. The legacy eOPF and EHRI are both older and poorly architecture systems that contain vast amounts of employee information. Replacing both of these legacy systems with the EDR will result in reduced cyber and operational risks, as well as improved data availability and analytics. In addition, EDR was initially funded in the FY 2017 IT modernization appropriation, was identified in the FYs 2017, 2018, and 2019 budget requests, and the funding carries forward the work started in FY 2017.

The Consolidated Business Information System is currently operating on a legacy platform that [is] almost ten (10) years old. In May 2017, OPM transitioned the operations and maintenance of CBIS environments to a Federal Shared Service Provider (FSSP). While it is fully supported under an FSSP agreement, it has significant operational risks. The plan to migrate CBIS from its current legacy environment to a fully modernized, supported shared service platform will significantly reduce operational risks.

We are currently in the process of finalizing the detailed project schedule of all activities supporting the FY 2017 and 2018 IT modernization funding, and we are happy to share the schedule with you and your team.

In summary, using IT modernization funding for these projects directly upgrades our IT infrastructure, mitigating possible risks, and has an impact of allowing existing efforts and resources to be utilized on additional IT modernization efforts. However, your concerns are understood, and OPM will work with OMB to include funding for these and other projects in future budget requests. Neither our intent, nor our current plan, is meant to use IT Modernization funding for activities or projects that will not further our Agency's goal of updating critical IT infrastructure to enhance the security of our systems and data."

OIG Comment:

The OIG does not dispute the benefit that OPM would derive from the development of the Central Enrollment Database and the EDR or from migrating CBIS to a new FSSP implementation of the software. We do however feel that these worthwhile projects should be funded through the normal budgetary request process, as they do not appear to meet the intent of the FY 2018 IT modernization appropriations. Furthermore, as we noted in the report above, OPM has still not complied with any of the capital budgeting and project management requirements in the Appropriations Act, which would make investment in these initiatives using IT modernization funding a high-risk proposition. In addition, these systems are not considered high risk, high value assets that would merit prioritization for modernization. There are other systems, such as the antiquated applications supporting Retirement Services, which pose a much higher risk of compromise.

The largest distinction between the intended use of the modernization funding in FY 2017 and FY 2018 comes directly from the Appropriations Committee. From FY 2017 to FY 2018, very little guidance changed regarding their requirements for OPM to receive the IT modernization

funding, with the exception of the language specifically used to explain how the funds should be allocated.

In FY 2017, the Appropriations Act provided a wide range of intended allocation for the \$11 million, citing specifically “the operation and strengthening of the security of OPM legacy and Shell . . . IT systems and the modernization, migration and testing of such systems”

However, in FY 2018 this broad guidance was very distinctly narrowed to two specific uses for the \$21 million: “information technology infrastructure modernization and Trust Fund Federal Financial System migration or modernization” With the development of its FY 2018 spending plan, OPM appears to be continuing its FY 2017 efforts rather than following the guidance provided in the FY 2018 Act. We believe it is clear that instead of general IT modernization initiatives, “the Committee expects OPM to continue with IT upgrades to secure its networks against future attacks.”

For further discussion of the initiatives highlighted in our recommendation, please see below:

1) Central Enrollment Portal and Database

The FY 2018 Plan sets aside \$0.9 million for the creation of a Central Enrollment Portal and Database. This initiative has been an OPM goal for many years, and would automate an inefficient business process. While the FEHBP data hub is a legacy system, the overall project is largely a business process modernization effort rather than an effort intended to address the cybersecurity risks faced by the agency. While we acknowledge that this is a worthy initiative that could reduce operational risk and represent cost savings, it still does not appear to be an appropriate use of the FY 2018 IT modernization funding specifically intended for the strengthening of OPM’s “information technology infrastructure,” not the improvement of business processes through IT solutions.

2) Employee Digital Record

Similarly, OPM has set aside \$2.1 million for the creation of the Employee Digital Record. This effort also has been an OPM goal for many years, supports the PMA, and could represent a reduction in operational risk while improving data availability and analytics. We do not dispute these potential benefits, and do believe generally this is a key initiative for OPM.

Additionally, OPM has indicated that once created, the EDR may be able to replace two legacy systems: eOPF and EHRI. We acknowledge these legacy systems do represent a cybersecurity risk to the Agency as they both are old, poorly architected, and contain substantial PII. If the EDR successfully replaced these legacy systems, this would be a notable improvement in OPM’s legacy IT security posture. However, OPM’s history of

project development gives us great concern that even if EDR were eventually implemented, incorporating these systems may not in fact be possible.

OPM's most recent failed enterprise-wide case management system, e-Case, is a perfect example. Intended to replace a substantial number of legacy systems, the e-Case system was procured and configured but ultimately fell short of expectations as a result of inadequate requirements gathering and project management. Ultimately, e-Case has not replaced any of the legacy systems that were originally intended, and is the latest expensive IT project failure at OPM.

Regarding EDR, OPM has not completed the necessary project planning to ensure a successful implementation, which could eventually include eOPF and EHRI. The conceptual plan is still in its infancy. As such, funding decisions to implement EDR should be made cautiously with regard to the potential benefits of EDR also replacing eOPF and EHRI.

Despite EDR's inclusion in the FY 2017 spending plan, our ultimate concern parallels what we expressed above for the Central Enrollment Portal and Database. The inclusion of these initiatives in the FY 2018 spending plan does not appear to meet the revised guidance the Appropriation Committee provided for the distribution of the \$21 million.

3) Consolidated Business Information System

\$0.5 million of the FY 2018 spending plan is devoted to migration of the Consolidated Business Information System. As OPM pointed out, CBIS is approaching ten years old; however, it is currently supported, more secure and functionally stable, and represents a substantially lower security risk to the agency than many other OPM legacy systems. Devoting funding to this initiative does not align with an agency-wide risk-based approach to modernizing legacy systems. This type of agency-wide risk-based assessment is something we would like to see incorporated into the overall IT modernization strategy.

Additionally, the spending plan highlights that the CBIS migration is purported to produce "cost savings needed to sustain operations while also improving financial performance and reporting." While the CBIS migration is beneficial for OPM and further supports the Federal initiative to use shared service providers, allocating a portion of the IT modernization funding, which is intended to address security weaknesses in the legacy environment, towards system enhancements does not comport with the intent of this separate Appropriation.

Furthermore, the migration of CBIS from its current state to the shared service provider's Delphi instance is a significant initiative with projected costs of tens of millions of dollars

over a two-year period. OPM should seek support for a capital investment like this through separate submissions to OMB for evaluation and funding isolated from OPM's larger IT modernization efforts. It is not prudent for OPM to devote \$.5 million to initiating a much larger effort without first receiving the necessary support to follow through with implementation.

In conclusion, we continue to believe that OPM would be better served by revising its Plan to focus the \$21 million distribution more substantially on the improvement of OPM's legacy infrastructure as highlighted in the FY 2018 Appropriations Act. With OPM's agreement to address the recommendations outlined in both the FY 2017 and FY 2018 Management Advisories, we are still supportive of OPM obligating funds pursuant to the FY 2018 Consolidated Appropriations Act.

APPENDIX

JUN 13, 2018

MEMORANDUM FOR LEWIS F. PARKER JR.

DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITS
OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL

FROM: DAVID A. GARCIA
CHIEF INFORMATION OFFICER
OFFICE OF PERSONNEL MANAGEMENT

Subject: Response to the Draft Management Advisory Letter –
Comments on IT ... Modernization Expenditure Plan

Thank you for providing the Office of Personnel Management (OPM) the opportunity to respond to the Office of the Inspector General (OIG) Draft Management Advisory Letter – Comments on IT Modernization Expenditure Plan.

We appreciate your guidance, and conclusion that based on your review of our Fiscal Year 2018 Expenditure Plan the Appropriations Committees should approve OPM to obligate funds pursuant to the FY 2018 Consolidated Appropriations Act. We also recognize that your draft report highlighted areas for improvement and we are committed to ongoing improvements to the IT modernization program and continued collaborative engagement with your office. OPM continues to similarly engage our Appropriations Committee's to create a fully transparent process with the Committees as we implement the IT Modernization plan. We look forward to continuing to closely work with both you, and the Committees, on our progress.

Responses to your recommendations are provided below.

Recommendation #1: We recommend that the OPM Director ensure that the distribution of FY 2018 IT modernization funds are used to strengthen OPM's legacy IT environment as expressed in the FY 2018 Consolidated Appropriations Act.

Management Response: We concur with your recommendation and will ensure the FY 2018 IT modernization funds are used to strengthen OPM's legacy IT environment. With the recent confirmation of the Director and Deputy Director of OPM, we will continue to reassess our IT Modernization plan moving forward, as needed, and maintain an open dialogue with you regarding any changes.

Recommendation #2: We recommend that funding for the FEHBP Central Enrollment Database, the Employee Digital Record, and the Consolidated Business Information System migration be obtained using the normal budget process (or other potential sources, such as the Modernizing Government Technology fund), and not from the FY 2018 IT modernization funds.

Management Response: We partially concur with your recommendation. We understand the rationale for your recommendation, i.e., that distribution of the FY 2018 IT modernization funds be used to strengthen OPM's legacy IT environment, as expressed in the FY 2018 Consolidated Appropriations Act. However, we would like to use this opportunity [to] provide more information to better explain the ways in which each of the items mentioned in your recommendation as being more appropriately funded through normal budget processes actually operate to directly strengthen OPM's legacy IT environment while mitigating possible risks. We ask you to further consider this additional information. We would also note these projects have been fully briefed to the Appropriations Committees ahead of Congressional passage of FY18 funding.

Although we recognize that the items in our modernization plan support the President's Management Agenda (PMA), they are also important to strengthening OPM's legacy IT environment.

The FEHBP Central Enrollment Database planning team, including [Healthcare] and Insurance and CIO leadership, has agreed to a plan that will enhance the legacy OPM FEHB Data Hub so that it will be capable of receiving and transmitting daily enrollment transactions (currently weekly) from agencies government-wide to carriers and enhance data validations to improve the quality of enrollment data. This will be accomplished in six months, by the end of CY 2018. The results of utilizing the legacy FEHB platform will include reducing risks related to operations and finances, reducing government and enrollee costs through identification of dual enrollments, and enhancing service and accountability for the entire FEHB program. Mitigation of these risks directly impacts OPM's ability to implement additional IT Modernization efforts.

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The Consolidated Business Information System is currently operating on a legacy platform that [is] almost ten (10) years old. In May 2017, OPM transitioned the operations and maintenance of CBIS environments to a Federal Shared Service Provider (FSSP). While it is fully supported under an FSSP agreement, it has significant operational risks. The plan to migrate CBIS from its current legacy environment to a fully modernized, supported shared service platform will significantly reduce operational risks.

We are currently in the process of finalizing the detailed project schedule of all activities supporting the FY 2017 and 2018 IT modernization funding, and we are happy to share the schedule with you and your team.

In summary, using IT modernization funding for these projects directly upgrades our IT infrastructure, mitigating possible risks, and has an impact of allowing existing efforts and resources to be utilized on additional IT modernization efforts. However, your concerns are understood, and OPM will work with OMB to include funding for these and other projects in future budget requests. Neither our intent, nor our current plan, is meant to use IT Modernization funding for activities or projects that will not further our Agency's goal of updating critical IT infrastructure to enhance the security of our systems and data.

We appreciate the opportunity to respond to this draft report and hope that this additional information and explanation will allow you to continue your support [of] our entire request. As stated, we look forward to continuing an open engagement on our IT Modernization and if following a reassessment of any planned [projects] OPM determines a need for change we would engage with you on that decision. If you have any questions regarding our response, please contact me or Robert Leahy, Deputy CIO.



Report Fraud, Waste, and Mismanagement

Fraud, waste, and mismanagement in Government concerns everyone: Office of the Inspector General staff, agency employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and mismanagement related to OPM programs and operations. You can report allegations to us in several ways:

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



**U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS**

Final Management Advisory Report

**Federal Employees Health Benefits Program
Prescription Drug Benefit Costs**

Report Number 1H-01-00-18-039

Original Report Issue Date: February 27, 2020

Corrected Report Issue Date: March 31, 2020

Errata Page
Federal Employees Health Benefits Program
Prescription Drug Benefit Costs

Our original statements made on page 15 referenced premium increases being offset by benefit reductions in the form of higher member cost shares. We have revised this language to more accurately reflect the intent of our comments to OPM's response related to the effect that increasing member copays and/or coinsurance has had on premiums.

Our original text on page 15 is as follows: "We also recognize that OPM has been able to maintain a reasonable premium increase (4 percent increase in 2020 – up from 1.3 percent the prior year), but at what cost? Premium increases have undoubtedly been offset by the actuarial values of benefit reductions that causes the members' out of pocket cost shares (i.e., copays, coinsurance, deductibles, etc.) to increase, which certainly plays a significant part in keeping FEHBP premium increases to a minimum. While reducing benefit levels can help offset premium increase, it is not a solid long-term strategy to mitigate the risks of future increases."

The page 15 text was changed to read: "We also recognize that OPM has been able to maintain reasonable premium increases in recent years. However, increases in member cost sharing (i.e., higher copays, coinsurance, deductibles, etc.) over the years have had a lowering effect on premiums, which have played a role in controlling premium costs. OPM acknowledges these increases in member cost share, as referenced in the 2020 FEHB Call Letter, which states:

‘Over the years, several Carriers have moved away from drug copayments to coinsurance, in which the member pays a percentage of the negotiated cost of the drug. As the cost of prescription drugs continues to rise, there is concern that some FEHB members may not be able to afford their medication costs and that the amount of their cost share is less transparent. This is especially true for FEHB members in plans that do not have a maximum limit on coinsurance for prescription drugs. Research has indicated that as member out-of-pocket costs grow, the rate of prescription abandonment or delays in filling prescriptions increases, which in turn has implications for downstream health care costs’.

OPM indicates that recent premium increases are the lowest in 23 years due to initiatives they have implemented. However, the increases in member cost share over time have also had an impact on premium increases and should be factored in as a method the FEHBP has capitalized on to control costs."

The clarification made to the two paragraphs on page 15 does not alter the conclusions or recommendations made in the final report.

EXECUTIVE SUMMARY

Federal Employees Health Benefits Program Prescription Drug Benefit Costs

Report No. 1H-01-00-18-039

March 31, 2020

What is a Management Advisory Report?

The primary purpose of this Management Advisory Report (MAR) is to inform the U.S. Office of Personnel Management (OPM) of concerns that the Office of the Inspector General (OIG) has regarding the escalating cost of the prescription drug benefit in the Federal Employees Health Benefits Program (FEHBP).

Why Issue a Management Advisory Report?

It is vital that OPM ensure that all possible methods to lower the cost of the prescription drug benefits in the FEHBP are explored. The OIG has identified the rising costs of prescription drugs in its “Top Management Challenges” reports issued to OPM annually. Since the inception of the FEHBP, pharmacy benefits have been provided via participating FEHBP carriers by administering pharmacy benefits internally, or by carriers contracting with Pharmacy Benefit Managers (PBM) on behalf of their enrolled population. Instead of capitalizing on the purchasing power of over 8 million FEHBP members to generate greater savings, each of the hundreds of FEHBP participating carriers separately contracts with a PBM, with sometimes less negotiating leverage, resulting in FEHBP pharmacy costs that vary greatly.



Michael R. Esser
Assistant Inspector General for Audits

What Is Our Concern?

Our concern remains that OPM may not be obtaining the most cost effective pharmacy benefit arrangements under the FEHBP.

We believe that OPM should consider all possible options, starting by conducting another independent study, to gain additional savings and maximize cost containment efforts, as discussed in this MAR.

ABBREVIATIONS

Act	Federal Employees Health Benefits Act
ADC	Automated Data Collection
AWP	Average Wholesale Price
FEHBP	Federal Employees Health Benefits Program
HIO	Healthcare and Insurance Office
MAR	Management Advisory Report
OIG	Office of the Inspector General
OPM	U.S. Office of Personnel Management
PBM	Pharmacy Benefits Manager
PDP	Prescription Drug Plan
RFI	Request for Information
VA	U.S. Department of Veterans Affairs

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APPENDIX (OPM’s Response to the Draft Management Advisory Report, dated May 13, 2019)

REPORT FRAUD, WASTE, AND MISMANAGEMENT

I. SUMMARY

The primary purpose of this Management Advisory Report (MAR) is to highlight and expand on a mission-critical challenge we identified several years ago and continue to address in our “Top Management Challenges” reports issued to the U.S. Office of Personnel Management (OPM) annually. Our concern remains that OPM may not be obtaining the most cost effective pharmacy benefit arrangements under the Federal Employees Health Benefits Program (FEHBP). We believe that OPM should study all options to gain additional savings and maximize cost containment efforts, as discussed in this MAR.

Prescription drug benefits are a major component of the cost for the FEHBP, currently representing over 27 percent of total premiums spent on drugs, net of member cost share. Considering that prescription drug spending in the United States is about 17 percent¹ of overall personal healthcare expenditures, there may be an opportunity to reduce the drug spend in the FEHB Program. Most FEHBP carriers report an increase in drug costs per member each year. Greater utilization of existing drugs and the expanding costs of specialty drugs² contribute significantly to FEHBP premiums. Prescription drug utilization and costs are expected to increase for the foreseeable future, as new pharmaceutical advancements are developed and the rapid growth of the specialty drug market continues. In fact, 2017 data reported to OPM by one large FEHBP carrier indicates that while specialty drug claims represent only a small portion (0.6 percent) of their total number of drug claims, its associated cost accounts for over one-third (37 percent) of total drug spend. That means a small-to-moderate increase in specialty drug utilization could result in extreme increases in total drug costs. This is an alarming statistic knowing that specialty drug trends are not expected to slow down anytime soon. Since prescription drugs make up over a quarter of the total FEHBP spending, OPM needs to do all it can to ensure that Federal employees and the American taxpayers are getting the best value for their dollar.

The need for impartial and extensive analysis of the FEHBP drug program and potential cost-saving options is long overdue. The last time that OPM formally studied this issue was approximately seven years ago. The PBM and prescription drug landscape has significantly changed since 2012 and as such, warrants the need to evaluate the benefits, delivery, and pricing of FEHBP prescription drugs; specifically, whether carriers’ PBM contracts provide the best value to the Federal Government and FEHBP enrollees in today’s pharmacy benefits environment. Moving forward, OPM will need to develop an effective, long-term strategy to

¹ U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, “Observations on Trends in Prescription Drug Spending” (2016), <https://aspe.hhs.gov/pdf-report/observations-trends-prescription-drug-spending>.

² Specialty drugs are a recent designation of pharmaceuticals that are classified as high-cost, high complexity and/or requiring increased human intervention. Specialty drugs are often biologics—drugs derived from living cells that are injectable or infused.

mitigate and manage future FEHBP prescription drug costs, while maintaining overall program value and effectiveness.

II. BACKGROUND

The FEHBP was established by the Federal Employees Health Benefits Act (Act), Public Law 86-382, enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for Federal employees, annuitants, and dependents. OPM's Healthcare and Insurance Office (HIO) has overall responsibility for administration of the FEHBP, including the publication of program regulations and agency guidance. As part of its administrative responsibilities, the HIO contracts with various health insurance carriers that provide service benefits, indemnity benefits, and/or comprehensive medical services, which all include some level of prescription drug coverage. The provisions of the Act are implemented by OPM through regulations codified in 5 CFR 890.

Currently, the FEHBP covers approximately 8.2 million Federal employees, retirees, and their dependents by contracting with over 200 health insurance plans on a fee-for-service, experience-rated, or community-rated funding arrangement. The FEHBP offers a wide variety of plan types and coverage options to help meet the health care needs of its enrollees. The FEHBP is the largest employer-sponsored health insurance program in the country, providing more than \$53 billion in health care benefits annually, of which approximately 72 percent is paid by the Federal government and 28 percent is paid by subscribers. Many organizations and policy makers look to the FEHBP as a model for providing health care, which reinforces the need for the program to provide the best quality in health care benefits at the best possible price.

OPM requires participating health insurance plans to offer prescription drug coverage as part of its overall FEHBP health benefits package. This is known as a pharmacy "carve-in" model, where prescription drug coverage is bundled into the medical benefits. It is the traditional delivery system of pharmacy benefits for most small and mid-sized employer groups. FEHBP member cost share (i.e., copays, coinsurance, deductibles) and a health plan's drug formulary³ vary greatly among the available options, however the vast majority of participating plans use what is known in the industry as a Pharmacy Benefit Manager, or PBM, to administer prescription drug benefits. FEHBP carriers contract with PBMs to provide benefits as well as manage drug costs and utilization for their enrolled population. The FEHBP does not contract directly for prescription drug benefits.

PBMs are primarily responsible for processing and paying prescription drug claims on behalf of many large employers and health plans. The services provided typically include retail pharmacy, mail order, and specialty drug coverage. For retail drugs, the PBM contracts directly with pharmacies located throughout the United States and many of its territories. For maintenance prescriptions that do not need to be filled immediately, PBMs typically offer the option of mail

³ A drug formulary is a list of preferred drugs that the member may obtain at a lower cost share than other similar drugs in its class.

order pharmacies (usually for up to a 90-day supply of medications). PBMs also provide specialty pharmacy services for members with rare and/or chronic medical conditions. PBMs are used to develop, allocate, and control costs related to the pharmacy claims program it serves. PBMs negotiate terms with each individual FEHBP health plan for the services, networks, prices, rebates, guarantees, and other pricing and financial terms based on multiple market factors. In contrast with other Federal programs, the FEHBP does not regulate or negotiate drug pricing for its members. Instead, it relies solely on competition among the various participating health plans using multiple PBMs to attempt to keep prices low. OPM has no direct involvement in PBM contract negotiations. In fact, Title 5, Section 8903 prevents OPM from directly contracting with PBMs for pharmacy benefits.

III. INITIATIVES AND OTHER GOVERNMENT EXAMPLES

Over the years, OPM has taken several FEHBP prescription drug program initiatives that emphasize the need for better cost controls and improved administration of the drug benefit. The following are some of the actions OPM has taken that supports this effort.

A. OPM Call Letter Directives

Each spring, OPM issues a call letter soliciting benefits and rate proposals from FEHBP carriers for the following year. This call letter outlines specific policy goals and initiatives that are at the forefront of OPM's mission to provide high quality, cost effective health care to its enrollees. As part of this call letter, OPM typically calls on participating health plans to focus on innovative ways to optimize pharmacy benefits to ensure the safe and effective use of prescription medications while managing costs. To accomplish this objective, OPM directed participating health plans over the years to consider initiatives that seek to achieve this goal, such as the following:

- Add and expand drug management programs that control costs, and improve quality and patient outcomes;
- Expand efforts to use a common four-tiered benefit structure to improve members' understanding of their prescription drug benefits and maximize cost savings;
- Implement a prescription drug cost calculator that will allow current and prospective enrollees to compare the cost of the prescription drugs they use to verify coverage prior to enrollment;
- Establish better formulary management techniques and selective pharmacy network contracting based on costs and quality criteria, as well as a formulary exception process;
- Optimize the use of high value medication distribution channels by aligning member incentives with the most cost effective options;
- Implement, operate, and reinforce drug utilization management strategies;
- Take action to improve medication adherence, drug utilization management, and the alignment of formularies to established clinical guidelines;
- Optimize the benefit channel through which certain specialty drugs are delivered (e.g., medical or pharmacy benefit);
- Implement a cost comparison tool that gives current and prospective enrollees access to user friendly information about the formulary tier and member cost-share for prescription drugs; and,
- Strengthen efforts to prevent opioid misuse and implement effective addiction treatment programs.

Based on the above efforts, it is clear that OPM's goal for the FEHBP is to pursue ways to restrain rising health care costs while providing opportunities for members to live healthier lives. OPM is focused on ways to provide affordable, quality health plans for Federal employees, annuitants, and their families.

We commend OPM for these efforts to maximize quality drug benefits while attempting to minimize drug cost increases in a program comprised of hundreds of different drug benefit options. However, most, if not all, of the above initiatives have been delegated to the individual health plans to administer, and OPM has little to no direct control over how these efforts are implemented and the outcomes are difficult to quantify. Moreover, several of the initiatives have room for interpretation among carriers and the methods employed to meet these cost saving initiatives may vary greatly, diminishing their ability to affect the FEHBP as a whole. Nonetheless, the above efforts have undoubtedly had a positive impact on the FEHBP's prescription drug program and should continue to be a part of any comprehensive drug management program going forward.

B. Prior PBM Studies by OPM

In 2010, OPM contracted with an outside consulting firm to provide a detailed quantitative analysis of multiple alternative pharmacy benefit purchasing scenarios in order to mitigate the increasing costs of offering prescription drugs and create greater cost transparency.

The study focused on the following three cost saving strategies:

- To reduce the utilization of multi-source brand drugs through higher generic utilization;
- To negotiate a single contract with one PBM for all FEHBP pharmacy operations; and
- To reduce the size and variation of FEHBP formularies by using a single supply schedule.

The study concluded that to reduce the utilization of multi-source brand drugs from mail and retail, OPM would have to force carriers to increase generic utilization. The study found that brand and retail drug costs could be reduced by about 2.1 percent (specialty drugs showed no cost savings at the time). OPM acted on this strategy and issued call letters to the carriers requiring an 80 percent generic utilization rate by contract year 2014.

To negotiate a single contract with one PBM for pharmacy operations, OPM would have to issue a request for proposal and set up an administrative group to oversee the bid and implementation process. OPM would also have to consider the necessary changes to current law. Finally, OPM would have to compare any cost savings against the loss of

benefits to FEHBP members. The study showed that a projected cost savings of 0.8 percent could be achieved by moving the entire FEHBP into the PBM with the best discounts (at the time); however, the savings projection was based on implicit discounts derived from historical FEHBP claims and other market data. The projected savings were not based on single source bids from prospective PBMs competing for the entire FEHBP book of business, which theoretically could result in greater savings. Nonetheless, since the cost savings appeared minor compared to any loss of benefits and disruptions to the FEHBP, OPM did not implement this strategy.

To reduce the size and variation of FEHBP formularies, the study found that OPM would have to set strict formulary requirements for FEHBP carriers to follow or implement a single supply schedule. The formulary requirements could include closed formularies, program wide exclusions, and a narrower preferred list that must be used by all carriers. The study showed that the savings resulting from a reduced formulary or single supply schedule would be greater than 30 percent, with the majority of the cost shifted to the member since half of the FEHBP drugs would no longer be on the preferred formulary list. While this option showed the greatest savings potential based on the 2010 study, OPM did not implement this strategy.

In 2012, OPM conducted additional analysis by issuing a request for information (RFI) to obtain price, delivery, and other market information from prospective respondents for preferred PBM services in the FEHBP. The purpose of the RFI was to potentially make available to FEHBP carriers an arrangement with which an FEHBP carrier could contract with a preferred PBM to obtain better financial terms than their current PBM contract for FEHBP business. However, this preferred PBM strategy never came to fruition, and the idea languished.

Although these studies were beneficial in providing ways to reduce costs, OPM only implemented one strategy - requiring FEHBP carriers to increase generic utilization. The other cost saving strategies identified were not implemented for various reasons, such as the potential harm to enrollee benefits. Additionally, because these studies were performed several years ago, most of the information is outdated and no longer reliable. Consequently, we believe it is in OPM's best interest to perform a new market study on ways to reduce prescription drug costs in the current environment.

C. **PBM Transparency Standards**

In 2005, and then updated in 2011, PBM transparency standards were incorporated into the FEHBP fee-for-service and experience-rated carrier contracts. These terms articulated the following transparency principles:

- Pass-through transparent pricing is an arrangement based on the PBM's cost for drugs in which the carrier receives the value of the PBM's negotiated discounts, rebates, or other credits.
- The PBM's profit under the contract comes from clearly identifiable sources.
- The PBM's administrative fees, such as dispensing fees, are clearly identified on retail claims, mail claims, and clinical programs, if applicable.
- All contracts and other documentation that support amounts charged to the carrier contract are fully disclosed to and auditable by the carrier, or its agent, and the OPM Office of the Inspector General (OIG).

PBM transparency requirements improved the means by which the FEHBP carriers' PBM (large provider) agreement is audited and may have even forced PBMs to reevaluate their business models. The transparency standards defined the pass-through pricing model and was a good "first step" towards ensuring the FEHBP receives a transparent price for prescription drugs. However, while transparency standards were necessary and long overdue, they do not guarantee the best possible price for the FEHBP.

With the incorporation of pharmacy transparency standards into FEHBP contracts, we are now able to contractually request and review the detailed pricing and financial arrangements each fee-for-service and experience-rated carrier has agreed to on behalf of the Federal Government with their individual PBMs. Unfortunately, pharmacy transparency standards do not apply to community-rated carriers (Health Maintenance Organizations) and information related to those plans is still unavailable. Nonetheless, we recently reviewed the most current (at the time of this report) PBM contracts of FEHBP fee-for-service and experience-rated carriers and found that the drug pricing and financial arrangements varied greatly. Our research showed that the size of the carrier's FEHBP membership in some cases had no direct correlation to the level of discount the carrier was able to negotiate on behalf of OPM. The following is a chart showing the range of certain PBM pricing and other financial terms for fee-for-service and experience-rated carriers:

**PBM Pricing and other Financial Terms
Fee-for-Service and Experience-Rated Carriers
2018**

Drug Expense Category	Least Advantageous Arrangement	Most Advantageous Arrangement
Discount Rate (Retail – Generic)	(b) (4)	
Discount Rate (Retail – Brand)		
Discount Rate (Mail – Generic)		
Discount Rate (Mail – Brand)		
Discount Rate (Specialty – Retail/Mail)		
Dispensing Fee (Retail – Generic/Brand)		
Dispensing Fee (Mail – Generic/Brand)		
Administration Fee (Retail – Generic/Brand)		
Administration Fee (Mail – Generic/Brand)		
Administration Fee (Specialty – Retail)		
Administration Fee (Specialty – Mail)		
Brand Rebate Guarantee (Retail)		
Brand Rebate Guarantee (Mail)		
Brand Rebate Guarantee (Specialty at Retail)		
Brand Rebate Guarantee (Specialty at Mail)		
<p><i>Disclaimer: The financial arrangements shown above are from all of the PBM agreements reviewed and do not represent one agreement for all categories. These arrangements are for illustration purposes only and should not be considered independent of further in-depth study and evaluation.</i></p> <p><i>AWP - Average Wholesale Price.</i></p>		

Based on the information above, it is evident that there is a wide range of complex financial arrangements among the PBM agreements reviewed. Consequently, potential prescription drug savings may exist for the FEHBP population. The need for expert consultation in the review of the FEHBP's value proposition for pharmacy benefits is both timely and warranted.

D. Presidential Plan for Economic Growth and Deficit Reduction

In 2011, "The President's Plan for Economic Growth and Deficit Reduction" called for streamlining FEHBP pharmacy benefit contracting and allowing OPM to contract directly for pharmacy benefit management services on behalf of all FEHBP enrollees and their dependents. The study showed \$1.6 billion as potential pharmacy savings over a 10-year period. Because current FEHBP law precludes OPM from contracting directly with PBMs, OPM previously proposed statutory authority language changes, seeking to amend the current FEHBP law to permit OPM to contract directly with PBMs. However, this

proposal has become stagnant, and there have been no recent efforts by OPM to push this initiative to Congress for approval.

Allowing OPM to have direct contracting authority with PBMs may provide the FEHBP stronger purchasing power, help to ensure that the benefits and fees negotiated are in the best interests of the FEHBP, and will strengthen the controls and oversight of the FEHBP pharmacy program.

E. Other Government Plans

One vital aspect to studying cost saving options is to determine how other government payers are administering prescription drug programs. Here are just a few government prescription drug program examples that OPM should research when looking for cost saving solutions.

TRICARE

TRICARE is the health care program for uniformed service members and their eligible family members, covering approximately 9.4 million members worldwide. Depending on eligibility, there are four plans from which to choose: TRICARE Prime, TRICARE Select, TRICARE for Life, or certain optional premium-based plans. TRICARE offers nine plan options under four separate regional programs depending on where eligible beneficiaries are located. Each regional program is administered by a commercial health insurance plan. TRICARE health plan options include a comprehensive pharmacy benefit, administered by one PBM. TRICARE's pharmacy benefits are available to all eligible uniformed service members, retirees, and family members. The TRICARE pharmacy program provides outpatient prescription drugs through home delivery, retail, and specialty pharmacy services. Its exclusive PBM handles millions of prescriptions each year through a mail order option and retail network pharmacies. The TRICARE pharmacy program is designed to provide the medications needed, in a safe, convenient, and cost-effective manner.

Veterans Health Administration

The Veterans Health Administration is a large integrated health care system operated by the U.S. Department of Veterans Affairs (VA) and offered to members of the military once they leave active duty. The VA does not merely pay prescription drug claims submitted by providers. Unlike the FEHBP and its carriers, the VA self-administers its own prescription drug benefits through the Pharmacy Benefits Management Services. By law, prescription drugs are purchased by the VA directly from the manufacturer at discounted prices. In

addition, the VA also negotiates an even deeper discount on its national formulary. Due to its ability to purchase drugs at deep discounts, the VA prescription drug program is often used as an example for other large purchasers to follow in obtaining favorable drug pricing.

Medicare

The Medicare Part D prescription drug program was based on the FEHBP model. The Medicare Prescription Drug, Improvement, and Modernization Act, also called the Medicare Modernization Act, is a Federal law, enacted in 2003, to provide prescription drug benefits to seniors and beneficiaries covered under Medicare Part A and B. Medicare contracted with PBMs as a stand-alone insurer to provide a drug benefit or in conjunction with a preferred provider organization or other managed care insurer, which would provide the standard Medicare health benefit. Thus, PBMs operate within Medicare as a Prescription Drug Plan (PDP), or they may contract with health insurers to provide PBM services. If a PBM serves as a PDP, it must comply with Medicare regulations regarding enrollment, benefits, and premiums, and it must implement a mandatory compliance plan. If a PBM only contracts with health insurers, the insurers are required to bear those compliance responsibilities. However, insurers are required to exercise proper monitoring, oversight, and auditing to ensure Medicare program compliance.

Large Employer/State Government Plans

Nearly two-thirds of all large employers in the United States contract directly with a PBM to handle their drug benefits and costs. In addition, many state governments have found that pharmacy carve out arrangements through a direct PBM contract provide greater flexibility in plan design and realize significant savings over traditional carve in programs. Many health care payers are using the additional prescription drug rebates gained through a direct PBM contract to assist their employees in offsetting copays or even premium increases. In fact, the State of West Virginia recently performed a study of its Medicaid prescription drug costs and found that bringing the program in house (which they did effective July 1, 2018) would realize significant savings (up to \$70 million annually) over the carve in option that had been in place with its contracted managed care organizations. OPM has an opportunity to learn from other large employers' and states' progress in addressing prescription drug costs.

IV. CONCLUSION

As of 2019, the FEHBP and its enrollees spent over \$13 billion annually on prescription drugs, comprising over 27 percent of the total cost of the program. The OIG feels strongly that OPM should take a more proactive approach to finding ways to curtail the prescription drug cost increases in the FEHBP. While the efforts made to date have undoubtedly helped control drug costs, we feel additional measures are needed to find more cost saving solutions to the problem of the growing costs of prescription drugs in the FEHBP.

As previously mentioned, the latest study conducted on FEHBP prescription drugs was in 2012. Several of the initiatives identified from this study that were projected to achieve little or no cost savings could now provide higher cost savings to the program. Changes in the industry may have borne new cost savings concepts or techniques not thought of or available nearly a decade ago. Any study undertaken should incorporate, at a minimum, all of the examples discussed in this report. OPM should evaluate each cost saving option developed from such a study to determine if it is feasible and is in the best interests of the FEHBP, its members, and the Federal Government.

The FEHBP was established nearly 60 years ago and remains the single largest employer sponsored healthcare program in the United States. During this period of time, the FEHBP has not changed the fundamental way in which it conducts business. Allowing contracted carriers to sometimes set and interpret the rules can result in a lack of controls and the stagnation of any program modernization. Since OPM's prior research in 2012, there have been dramatic changes in the way pharmacy benefits are managed that warrant a new study. OPM should research whether taking control and condensing FEHBP prescription drug benefit components would produce an overall strategy that reduces benefit costs.

V. RECOMMENDATIONS AND OPM'S RESPONSE

Recommendation 1

We recommend that OPM conduct a new, comprehensive study by seeking independent expert consultation on ways to lower prescription drug costs in the FEHBP, including but not limited to the possible cost saving options discussed in this report.

OPM's Response:

Healthcare and Insurance partially agrees with our recommendation and while it appears they are not opposed to an independent study, they state they have neither the funding nor the resources to conduct such an engagement in the near future. (b) (5)

PM goes on to adamantly disagree with one of our Management Advisory's suggestions that a prescription drug carve-out program be considered, listing a multitude of reasons why such a fundamental change in the FEHBP would be detrimental to the integrity and operations of the program. Some of the challenges that OPM puts forth as reasons for not carving out prescription drugs include:

- *It would do away with a market-based competition model that has worked well since its inception of the program;*
- *The requirements of having to establish a large administrative structure to handle separate funding and premiums, causing the Federal government to be the underwriter for the benefit (e.g., a self-funded arrangement), fundamentally changes the risk arrangement of the program;*
- *Contracting issues and possible non-winning bidder protests;*
- *Detrimental strategic implications;*
- *Limited member choices;*
- *Carriers departing the FEHBP;*
- *Ineffective coordination of medical and pharmacy claims; and,*
- *Other administratively burdensome activities, all of which OPM opposes.*

Furthermore, OPM highlights that a prescription drug carve-out program would fall outside the current policy and legislative framework for which OPM's Healthcare and Insurance office is responsible. OPM goes on to add that the FEHB Act required the development of a market-based Program. It did not allow for direct contracting specifically to provide

pharmacy benefits. Similarly, it did not allow for direct contracting with physicians or hospitals or for a single “one size fits all” health plan like the fee-for-service Medicare program.

OPM states that FEHB Program actions to control prescription drug policies are aligned with the Administration’s American Patient’s First Blueprint across the key strategies to Improve Negotiation, Lower List Prices, Reduce Out-of-Pocket Spending, and Create Incentives to Lower List Prices. They state that they continue to monitor FEHB Program prescription drug spending, PBMs, and pharmaceutical trends and controls within plan designs (e.g., formulary management, step therapy, etc.), related to the pharmacy benefit, at either the health plan level or through the PBM, seeking opportunities to derive greater value for FEHBP members.

OPM states they have done significant work to study prescription drug spending in the FEHB Program to control future cost increases. This includes:

- Identifying and outlining long-range administrative and quality goals and objectives for pharmacy benefits.*
- Assessing trends, new developments, and best practices (including medication management, specialty drug utilization, pharmacy benefits management, and formulary management) in the pharmaceutical industry by holding annual meetings with the major pharmaceutical benefit managers – PBMs such as CVS, Optum and Express Scripts.*
- Staying abreast of industry trends by attending conferences or participating in meetings sponsored by organizations such as the American Society of Health-System Pharmacists - ASHP, the Academy of Managed Care Pharmacists - AMCP, and the American Pharmacists Association - APhA. In addition, by subscribing to professional journals, accessing continuing pharmacy education resources, industry publications, and bulletins and reviewing and examining technical, scientific, and medical data in support of agency policy development and program management.*
- Evaluating methods to improve health outcomes related to the use of pharmaceuticals (e.g., step therapy and collaborative practice agreements between physicians and pharmacists for disease state management).*
- Administering the pharmacy-related automated data collection (ADC) to guide future Call Letter topics and to monitor Carrier implementation of prior guidance.*
- Evaluating quality and utilization measures that pertain to medication management, the use of preventive medications, and the attainment of health outcomes via medication therapy.*

OPM states that 2019’s 1.3 percent FEHB Program premium increase, the lowest in 23 years, exemplifies the effective management OPM exercises over the 200+ plans in the program. They state they are committed to cost-effective prescription drug management as evidenced by the list of actions the MAR acknowledges and others that OPM has taken. These include incorporating step therapy and prior authorization in prescription benefit structures, encouraging benefits that increase the generic dispensing rate, mandating the expansion of tiers and managed formularies, narrower networks, tighter controls on opioid prescriptions

and more. Per the ADC, the total drug expenditures under the prescription benefit for the FEHB Program increased 4.7 percent from 2016 to 2017. In line with industry trends, this was a slower growth than from 2015 to 2016, which was 12.53 percent. U.S. spending on prescription medicines in 2016 increased at a slower rate in comparison to 2015 and 2014 due to fewer high-cost specialty drugs coming into the market and manufacturers facing increasing pressure on pricing and competition.

OIG's Comments:

We recognize that OPM has implemented measures to control future drug spending in the FEHBP and our goal is not to discredit these efforts. We also understand that OPM is limited with regards to funding a study. (b) (5)

[REDACTED], we recommend that a funding request be included in the next budget formulation cycle and each year thereafter, until such time a study is funded. In addition, we do not argue for one solution to the rising costs of prescription drugs in the FEHBP. While entertaining a prescription drug carve-out program is one of the many possible solutions, it should not be excluded as an option before giving due consideration to its merits. Many of the points that OPM argues against the idea of carving out prescription drugs should be evaluated as part of the recommended study. They are valid points but lack the quantitative support needed to make an informed decision about carving out prescription drugs.

We also recognize that OPM has been able to maintain reasonable premium increases in recent years. However, increases in member cost sharing (i.e., higher copays, coinsurance, deductibles, etc.) over the years have had a lowering effect on premiums, which have played a role in controlling premium costs. OPM acknowledges these increases in member cost share, as referenced in the 2020 FEHB Call Letter, which states:

“Over the years, several Carriers have moved away from drug copayments to coinsurance, in which the member pays a percentage of the negotiated cost of the drug. As the cost of prescription drugs continues to rise, there is concern that some FEHB members may not be able to afford their medication costs and that the amount of their cost share is less transparent. This is especially true for FEHB members in plans that do not have a maximum limit on coinsurance for prescription drugs. Research has indicated that as member out-of-pocket costs grow, the rate of prescription abandonment or delays in filling prescriptions increases, which in turn has implications for downstream health care costs”.

OPM indicates that recent premium increases are the lowest in 23 years due to initiatives they have implemented. However, the increases in member cost share over time have also had an impact on premium increases and should be factored in as a method the FEHBP has capitalized on to control costs.

Also, OPM referenced studies and initiatives in its response to the report that were based on outdated information, and many influential factors have changed since then. We feel that a study is long overdue and that OPM should be open to exploring different ways to reduce prescription drug costs and modernizing the FEHBP and the way the prescription drug program has been operated since the inception of the program in 1960. OPM has a fiduciary responsibility to periodically reevaluate the effectiveness of cost containment and drug reimbursement program efforts in an over \$13 billion annual pharmacy benefits operation. That fiduciary responsibility should include performing studies and analysis to identify improved ways to administer and control the costs of prescription drugs in the FEHBP. Lastly, any program or legislative changes needed to produce a more effective and efficient pharmacy benefits program should not be the reason for maintaining the status quo.

Recommendation 2

We recommend that OPM evaluate any study conducted pursuant to Recommendation 1 and, with due diligence, formulate recommendations and a plan for agency action based on the best interests of the government, the FEHBP, and its enrollees.

OPM's Response:

OPM agrees with this recommendation.

APPENDIX



Healthcare and
Insurance

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

Washington, DC 20415

May 13, 2019

MEMORANDUM FOR: Michael R. Esser
Assistant Inspector General for Audits

FROM: Laurie E. Bodenheimer
Acting Director, Healthcare and Insurance

SUBJECT: Response to the Draft Management Advisory Report, FEHB
Program Prescription Drug Costs 1H-01-00-18-039

OPM appreciates the opportunity to respond to the Office of the Inspector General (OIG) Draft Management Advisory Report (MAR) on the Federal Employees Health Benefits (FEHB) Program's pharmacy costs, 1H-01-00-18-039. Our strategic goal is to increase the quality and affordability of FEHB Program health plans and we value your input.

We note that the draft "Management Advisory Report" is not focused primarily on OPM's management of prescription drug costs in the FEHB Program that Congress created in long-standing law, but on alternative models of a federal health insurance benefit program design that would require fundamental policy and legislative change. In fact, significant elements of the MAR fall outside of the current legislative framework that Healthcare and Insurance (HI) is charged to implement. The MAR indicates: "Instead of capitalizing on the purchasing power of over 8 million FEHB Program members to generate greater savings, each of the hundreds of FEHB Program participating carriers separately contract with a PBM, with sometimes less negotiating leverage, resulting in FEHB Program pharmacy costs that vary greatly." The FEHB Act required the development of a market-based Program. It did not allow for direct contracting specifically to provide pharmacy benefits. Similarly, it did not allow for direct contracting with physicians or hospitals or for a single "one size fits all" health plan like the fee-for-service Medicare program.

In accordance with the Act, each FEHB plan offers comprehensive medical services, including services provided by physicians and other health care professionals, hospital services, surgical services, prescription medications, medical supplies and devices, and mental health services. A proposal to carve out any of these services or the other services covered under the contract, and administer the benefit as a separate contract or program would significantly change the fundamental market-based nature of the Program. FEHB plans compete to offer all of the aforementioned benefits in a high quality manner at the most competitive price possible. HI has previously indicated our position that we do not support legislative change to carve out

Report No. 1H-01-00-18-039

pharmacy benefits. In the Top Management Challenge: Fiscal Year 2018⁴, the OIG includes prescription drug benefits and costs as a challenge and states that OPM should consider contracting with one PBM to gain additional savings and maximize cost containment efforts. In answer to this challenge, HI provided the response below in 2018 and a very similar response in 2017:

OPM does not concur with OIG's suggestion that OPM continue to pursue efforts towards a prescription carve-out program. The Federal Employees Health Benefits (FEHB) Program is a market-based program that provides complete health benefits within each FEHB plan. The FEHB Program is not a self-funded plan and its statutory framework does not contemplate it to be the direct payer of benefits. Each FEHB Program plan offers comprehensive medical services including services provided by physicians and other health care professionals, hospital services, surgical services, prescription medications, medical supplies and devices, and mental health services. FEHB Program plans compete to offer all of these benefits in a high quality manner at the most competitive price possible.

Carving out pharmacy benefits or any of the other services normally covered under an FEHB Program contract and administering the benefit as a separate contract or program, could undermine the fundamental market-based nature of the FEHB Program. It would be disruptive and could lead to a reduction in plan participation, and limit the ability of FEHB carriers to focus on comprehensively improving the health of the population. There would likely be less effective coordination of medical and pharmacy claims, and potentially less effective, one-size-fits-all pharmacy utilization and disease management programs. OPM is now assessing carrier performance on the basis of clinical quality measures that require tight coordination between medical and pharmacy benefits. A carved out pharmacy benefit is not consistent with or supportive of plan performance assessment, and may impair achievement of OPM's long-term population health goals. As an example, carriers being held accountable for controlling diabetes and hypertension in the population they serve cannot do so readily if they do not have control over pharmacy benefit design and real time access to adherence data.

To control the cost of prescription drugs, OPM works with carriers to better manage pharmacy networks, focus on drug utilization techniques, coordinate coverage of specialty drugs between the medical and pharmacy benefit, optimize the prescription drug benefit via formulary design, and implement effective cost comparison tools for members and prospective enrollees. Additionally, OPM notes that the most recent drug trend reported by FEHB carriers showed a significantly slower rate of growth compared with previous years, in line with industry trends.

In addition, in the 2019 Congressional Budget Justification HI indicated:

The FEHB Program is market-based. Each FEHB Program plan offers comprehensive medical services, including services provided by physicians and other health care professionals, hospital services, surgical services, prescription medications, medical supplies and devices, and mental health services. At present, HI is not pursuing carving out pharmacy benefits. A proposal to carve out any of these services or the other services covered under the contract, and administer

⁴ <https://www.opm.gov/about-us/budget-performance/performance/2018-agency-financial-report.pdf>

the benefit as a separate contract or program could undermine the fundamental market-based nature of the FEHB Program. OPM's research in this area has not proven that cost savings could be achieved that may offset the substantial risk of pursuing such a proposal. FEHB Program plans compete to offer all of the aforementioned benefits in a high quality manner at the most competitive price possible. In order to manage the cost of prescription drugs, OPM works with carriers to better manage pharmacy networks, focus on drug utilization techniques, coordinate coverage of specialty drugs between the medical and pharmacy benefit, optimize the prescription drug benefit via formulary design, implement effective cost comparison tools for members and prospective enrollees, and encourage sharing of best practices between the health plans.

Actions Taken

FEHB Program actions to control prescription drug policies are aligned with the Administration's American Patient's First Blueprint across the key strategies to Improve Negotiation, Lower List Prices, Reduce Out-of-Pocket Spending and Create Incentives to Lower List Prices⁵, see Attachment I. We continue to monitor FEHB Program prescription drug spending, PBMs, and pharmaceutical trends and controls within plan designs (e.g., formulary management, step therapy, etc.) related to pharmacy at either the health plan level or through the PBM, seeking opportunities to derive greater value for our members.

OPM has done significant work to study prescription drug spending in the FEHB Program to control future cost increases. This includes:

- Identifying and outlining long-range administrative and quality goals and objectives for pharmacy benefits.
- Assessing trends, new developments and best practices (including medication management, specialty drug utilization, pharmacy benefits management, and formulary management) in the pharmaceutical industry by holding annual meetings with the major pharmaceutical benefit managers – PBMs such as CVS, Optum and Express Scripts.
- The Chief Pharmacy Officer stays abreast of industry trends by attending conferences or participating in meetings sponsored by organizations such as: American Society of Health-System Pharmacists - ASHP, Academy of Managed Care Pharmacists - AMCP, American Pharmacists Association - APhA, subscribing to professional journals accessing continuing pharmacy education resources, industry publications, and bulletins and reviewing and examining technical, scientific and medical data in support of agency policy development and program management.
- Evaluating methods to improve health outcomes related to the use of pharmaceuticals (e.g., step therapy, collaborative practice agreements between physicians and pharmacists for disease state management).
- Administering the pharmacy-related automated data collection (ADC) to guide future Call Letter topics and to monitor Carrier implementation of prior guidance.

⁵ <https://www.hhs.gov/sites/default/files/AmericanPatientsFirst.pdf>

- Evaluating quality and utilization measures that pertain to medication management, the use of preventive medications, and the attainment of health outcomes via medication therapy.

In addition, this year's 1.3 percent FEHB Program premium increase, the lowest in 23 years, exemplifies the effective management OPM exercises over the 200+ plans in the program. We are committed to cost-effective prescription drug management as evidenced by the list of actions the MAR acknowledges and others that OPM has taken. These include incorporating step therapy and prior authorization in prescription benefit structures, encouraging benefits that increase the generic dispensing rate, mandating the expansion of tiers and managed formularies, narrower networks, tighter controls on opioid prescriptions and more. Per the ADC, the total drug expenditures under the prescription benefit for the FEHB Program increased 4.7% from 2016 to 2017. In line with industry trends, this was a slower growth than from 2015 to 2016 (12.53%). U.S. spending on prescription medicines in 2016 increased at a slower rate in comparison to 2015 and 2014 due to fewer high-cost specialty drugs coming into the market and manufacturers facing increasing pressure on pricing and competition.

In 2013, HI employed the services of a Registered Pharmacist as the Chief Pharmacy Officer. This first Chief Pharmacy Officer had deep knowledge and experience in Pharmacy Benefit Management, having negotiated PBM contracts for one of the largest health insurers. In 2016, OPM hired as our next Chief Pharmacy Officer a person who holds both a PharmD, and an MBA. The Chief Pharmacy Officer's primary responsibilities include monitoring of the pharmacy industry; benchmarking the FEHB Program with the private sector; developing and analyzing ADC questions, responses and trends; assisting in the negotiation of prescription drug benefits; strengthening controls surrounding PBMs; and tailoring guidance to carriers to continuously improve prescription drug benefits, services, and costs. This position has enabled OPM to feature prescription drug initiatives in the annual FEHB Program Call Letters for each of the last several years, resulting in benefit enhancements and cost savings. HI has also devoted additional staffing resources with legal, economics and public health expertise to support pharmacy initiatives.

Federal Supply Schedule

The Federal Supply Schedule (FSS) is a multiple award, multi-year federal contract that is available for use by any Federal Government agency. Section 603(a)(1) of the Veterans Healthcare Act of 1992 (Act), 38 U.S.C. §8126(a)(1), requires drug manufacturers to make their "covered drugs" available for procurement on the FSS. If an entity manufactures or sells drugs covered under Public Law 102-585 § 603, offering those drugs to the FSS is mandatory in order to receive any revenue from the Federal Government for covered drugs, including through Medicaid or Medicare. Legislative action would be required to enable FEHB Program plans to take advantage of discounts extended in the Federal Supply Schedule.

For those drugs covered under Public Law 102-585, Veterans Health Care Act of 1992, pricing is either negotiated based on vendor's most favored commercial customer pricing or statutorily-required pricing calculations. Vendors have an opportunity to establish FSS Big 4 prices and FSS dual prices. Big 4 prices are only available to the Department of Veterans Affairs (VA), the

Department of Defense (DoD), the Public Health Service (Indian Health Service), and U.S. Coast Guard customers, and are based on pricing calculations outlined under the Public Law. Dual prices are negotiated for Other Government Agencies (OGAs) that comprise the remaining authorized users of the FSS program. Dual prices are based on most favored commercial customer pricing negotiations held with the vendors.

A study conducted by the Congressional Budget Office in 2005⁶ compared multiple Federal purchaser prices to Average Wholesale Price costs of drugs including the FSS, Federal Ceiling Price and Medicaid Best Pricing. On average, the report found that FSS prices were 53 percent of AWP, Medicaid net manufacturer prices were 51 percent of AWP and Federal Ceiling Price were 50 percent of AWP. For some sense of private sector prices, the report also included comparison to “best price” used in Medicaid pricing calculations, which is the lowest price paid by any private-sector purchaser for the drug product, including discounts, rebates, chargebacks, and other pricing adjustments. Best price was 63 percent of AWP.

While it might appear that allowing FEHB plans to purchase drugs from the FSS or at the Medicaid best price has the potential to save the government money in prescription drug costs, this would require legislation. The VA and pharmaceutical manufacturers raised strong concerns when OPM proposed a pilot purchase program with an FEHB carrier in 1999. VA was concerned that if FEHB plans were allowed to purchase drugs from the FSS, the prices negotiated for VA and others under the FSS would be at risk. In other words, drug manufacturers would not negotiate equally favorable pricing if the group purchasing off the schedule included private sector entities and reduced manufacturer revenue by charging lower prices to a larger group. Pharmaceutical manufacturers maintained that they were not required to sell to non-Federal entities and that drugs potentially could be diverted to unauthorized users. There was no Congressional interest in this proposal.

Potential OPM Actions

There are several actions OPM is currently taking and/or considering. These include:

1. The 2019 Call Letter⁷ initiatives:

Addressing the opioid epidemic

- Encourage implementation or review of processes for detecting, treating, and coordinating care for opioid use disorder in pregnant women and affected babies.
- Proposals should include how to identify and refer members at risk, evidence-based pain management through non-opioid and non-pharmacological interventions, telehealth for opioid use and other substance use disorders, access to treatment programs including for certain high-risk populations like youth and pregnant women, develop or update policies for extending addiction treatment, identify improvements from retrospective review of care

⁶Congressional Budget Office, Prices for Brand Name Drugs Under Selected Federal Programs, June 2005 <https://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/64xx/doc6481/06-16-prescriptdrug.pdf>

⁷ <https://www.opm.gov/healthcare-insurance/healthcare/carriers/2019/2019-01.pdf>

for pregnant women with opioid use disorder, and promote comprehensive and coordinated care approach.

Affordability through transparency, prescription drug management, and controlling fraud, waste, and abuse

- Carriers should continue to improve the drug cost transparency tool for current and prospective members and promote the use of available provider tools at the point of prescribing.
 - Carriers are expected to have a robust specialty drug management program that coordinates medical and pharmacy benefit. Carriers should also propose a site-of-care management program.
 - Carriers may deliver rebate value at the point of sale and are encouraged to submit innovative proposals to do so. Point-of-sale rebates and all drug price components should be identifiable.
 - Carriers should describe policies and programs to incentivize generic drug use, especially where there is a demonstrable mechanism for addressing multi-source brand couponing without undue burden on the member.
 - OPM will gather through the ADC additional data on utilization and trends.
 - Carriers should have processes to monitor pharmacy claims to identify possible evidence of fraud, waste, and abuse, such as recent schemes involving compounding pharmacies.
2. HI is drafting a Carrier Letter that consolidates and expands upon guidance related to the management of pharmacy benefits for the FEHB Program.
 3. The 2019 Plan Performance Assessment measures for the Clinical Quality Performance⁸ area shows OPM's focus on prescription drug benefits, including measures for Asthma Medication Ratio, Avoidance of Antibiotics in Adults with Acute Bronchitis, Statin Therapy for Patients with Cardiovascular Disease (Adherence), Controlling High Blood Pressure, and Comprehensive Diabetes Care HbA1C < 8%.

In conclusion, OPM is taking several actions to mitigate pharmacy cost concerns and believes the information provided fully supports our strategic goal to increase the quality and affordability of FEHB health plans.

Responses to your recommendations are provided below.

Recommendation #1: We recommend that OPM conduct a new, comprehensive study by seeking independent expert consultation on ways to lower prescription drug costs in the FEHB Program, including but not limited to the possible cost saving options discussed in this MAR.

Management Response: Partially Concur

While the MAR recommends a new study be undertaken to identify cost-saving measures, it is grounded in the suggestion that the FEHB Program carve-out its prescription drug benefits from

⁸ <https://www.opm.gov/healthcare-insurance/healthcare/carriers/2017/2017-11a1.pdf>

the medical services, which would fundamentally undermine one of the bedrocks of the program's structure—competition. There are myriad additional implications in such a concept including that it would require separate premium and funding to administer, and the creation of a large administrative structure that does not currently exist. Key issues include:

1. Aligning Financial Accountability and Benefits Management Responsibility – This issue can also be thought of as “Who ‘owns’ the drug spend?” In the typical private sector employer pharmacy carve-out arrangement, the self-funded employer is responsible for financing the pharmacy benefit. However, the FEHB Program is not self-funded. Such an approach would require the establishment of new financing requirements including the creation of a new reserve fund and the payment of premiums directly to OPM. This would put the federal government in the role of a direct underwriter of this benefit.

OPM could potentially seek to attach the drug spend for carrier's enrollees to that carrier's premium. However, under the FEHB Program, both experience-rated and community-rated carriers carry underwriting risk. Attributing claims costs to a carrier for a benefit it does not manage would create an untenable situation where the carrier would be asked to assume risk but would have no ability to manage that risk. This would create additional administrative problems and a distortion in the market dynamics of the FEHB Program. To mitigate this problem, carriers could be provided with some degree of control over plan design, formulary and drug utilization and other clinical management programs. This might be done by establishing a limited set of standard plan designs, formularies and clinical programs that carriers could choose. The more carrier-to-carrier variation allowed the less group purchasing economies could be gained through drug manufacturer rebates.

2. Administrative Challenges – Developing a pharmacy carve-out program, including plan design, formulary and clinical programs, procuring a PBM, managing the transition and ongoing management of the program would require new funding for OPM, expansion of staff, and developing new capabilities. In addition, carriers would incur the costs of making system changes to accommodate the new OPM-managed PBM vendor, as well as to manage the transition, and integrate the new vendor's pharmacy claims data feeds into their medical management processes. While these costs might not exceed those generally expected in implementing a PBM transition, they could pose an unexpected burden on carriers not otherwise planning to change PBMs. Some Carriers are their own PBM and closely integrate with the medical benefits. Other Carriers contract with a PBM and could be locked into a contract for a period of approximately 3 years.

Some key points to consider in this area are:

- Unlike large self-funded employers in the private sector or TRICARE, OPM does not have a central enrollment file for PBMs to use.
- Even if pharmacy claims costs could be attributed to the enrollee's medical carrier of record, it is not clear how OPM administrative costs would be funded.
- The limitations and uncertainty of federal government funding (e.g. sequester, furloughs, etc.) create a significant risk that incremental staffing to administer this program would not be approved or once approved and in place could later be

reduced or eliminated, compromising the ongoing administration of the new program.

3. Contracting – A “winner take all” (or, for that matter, a “winner take most” or “2-3 winners take all”) procurement may result in formal bid protests by the losing bidders. This has been the experience of TRICARE since its inception and there is no reason to believe that an OPM pharmacy benefit carve-out PBM procurement would be any different.

Another dimension of contracting would be the relationship between the carrier and the OPM PBM vendor. Currently, FEHB carriers hold the contracts with their selected PBMs, who are then accountable to that carrier for their performance on everything from claims and customer service to reporting timely and accurate prescription drug claims data feeds into the carrier’s data systems. To assure effective coordination between carriers and the OPM PBM vendor, some kind of operating agreement or other arrangement would need to be executed between the carrier and the vendor. One way of doing this would be to envision OPM as holding the “master agreement” with the vendor, like a group purchasing contract, but then requiring all (or most) FEHB carriers to contract with this vendor under a standard set of terms. However, since the PBM vendor would not be accountable to the carrier, but to OPM, there may be disputes by carriers if they experience performance issues that affect their members or their operations.

4. Strategic Implications – Going down the path of a pharmacy benefit carve out has significant strategic implications for OPM as an agency and for the FEHB Program. It would fundamentally change the role of the agency from its “managed competition” role of establishing ground rules, encouraging innovation and benefit enhancements, overseeing contractual performance and managing FEHB Program trust funds to a direct benefits management role.

Another strategic implication is that a pharmacy carve out, with a uniform program design (or highly limited variations) administered by a single vendor runs contrary to promotion of consumer choice of both plan design and benefits provider, which has been a fundamental underpinning of the FEHB Program since its inception in 1960. A carve-out arrangement would have significant effects on the competitive market of FEHB carriers and could lead to the departure of many plans.

Finally, the premise that OPM is not capitalizing on the purchasing power of over 8 million FEHB members is a false premise. For any FEHB carrier that also offers health benefits in the commercial market, the FEHB Program enrollment is but a small portion of the Carrier’s business. Even for the largest FEHB Carrier, FEHB enrollment may represent 5 percent or less of the overall Carrier population. However, for most of the FEHB plans, the Carrier uses the same PBM for which it contracts across its larger commercial book of business. This purchasing power may represent far more than 8 million covered lives and there is no guarantee that the FEHB Program could negotiate a better deal with a PBM or for that matter as a direct purchaser of prescription drugs.

OPM is not opposed to an additional unbiased study of the FEHB Program's prescription drug costs. However, neither the current FY2019 funding level for HI, nor the Administration's proposed funding levels for FY2020 would enable us to fund such a study. The earliest opportunity for OPM to request funding for a study would be in FY2021.

Healthcare and Insurance (HI) will request funding in the next budget formulation cycle (for FY2021) to conduct an independent study that will include administrative, regulatory, and legislative options.

**Deleted by the OIG
Not relevant to the final report**

We appreciate the opportunity to respond to this draft report and request a meeting to discuss the findings and our responses. If you have any questions regarding our response, please contact Angela Calarco, Branch Chief, Audit Resolution and Compliance, FEIO.



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