



**DEFENSE CONTRACT AUDIT AGENCY**  
**DEPARTMENT OF DEFENSE**  
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IN REPLY REFER TO

PSP 850.1.C

August 4, 2009  
09-PSP-016(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA  
DIRECTOR, FIELD DETACHMENT, DCAA  
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Guidance on Review of Dependent Health Benefit Costs

**SUMMARY**

It has come to our attention that some large defense contractors are inappropriately charging the Government for health benefit costs for dependents that are no longer eligible for such benefits under the contractors' plans. Auditors should ensure that the contractor's forecasted costs and incurred cost submissions do not contain health benefit costs for ineligible dependents. The cost of health insurance premiums and claims for ineligible dependents and ineligible spousal coverage are unallowable in accordance with FAR 31.205-6(m)(1), *Compensation for Personal Services, Fringe Benefits*. Since purchased insurance premiums or self insurance claims associated with ineligible dependents do not meet the expressed requirements of the referenced FAR provision (i.e., in accordance with established contractor policy), penalties should be recommended on any questioned amounts as part of incurred cost audits.

In addition, auditors should verify that contractors have adequate procedures to ensure payment of insurance premiums or claims are only being made related to employees and their eligible dependents. Failure to have adequate control procedures over employee benefit costs should be reported as an internal control deficiency in the contractor's accounting system and a CAS 405 noncompliance, if applicable. The Administrative Contracting Officer (ACO) should be notified of any potential risk related to ineligible dependent health care costs in prior fiscal years to ensure that any active negotiations of open incurred cost years are put on hold until any necessary adjustments are made.

**BACKGROUND**

Current audits have disclosed that contractors have paid a significant number of dependent medical cost claims for family members who did not qualify as dependents under the contractor's medical/health care plan. The reasons for dependent/spousal ineligibility include: (1) dependents reached the age where they no longer qualified as a dependent, (2) spouses were either divorced or deceased, or (3) dependents were covered under another plan as well as the contractor's plan, and the employee failed to notify the contractor of the double coverage as the contractor's plan required an adjusted premium for double coverage. As a result of the failure to remove the ineligible dependents from the plan coverage, increased insurance costs were claimed by the contractor. The increased/unallowable costs resulted from the contractor and its insurer not having adequate procedures in place to ensure that the dependent's health plan eligibility

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information was current, accurate, and periodically verified. In some cases, contractors have hired third party consultants to assess the impact of ineligible dependents on its insurance costs. Some of our audits have shown that third party service provider reviews have not been adequate in assessing the total impact. Contractor's that fail to implement sufficient procedures to identify and exclude health benefit costs associated with ineligible dependents are in noncompliance with FAR 31.201-6 and CAS 405, if applicable.

## **GUIDANCE**

### **Allowability of Dependent Health Benefit Costs**

As part of forward pricing, incurred cost, or other related audits, auditors should verify that the contractor has included only costs for health insurance premiums and claims for eligible dependents. Costs of health insurance premiums and claims for ineligible dependents are unallowable in accordance with FAR 31.205-6(m)(1), *Compensation for Personal Services, Fringe Benefits*, which states in relevant part:

...the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement or an established policy of the contractor.

As this is an express requirement of FAR 31.205, auditors should recommend penalties be applied to any questioned costs during incurred cost audits. Auditors should verify that contractors have adequate procedures to ensure payment of insurance premiums or that claims are only being made that relate to employees and their eligible dependents. Contractor's that fail to implement sufficient procedures should be cited for a CAS 405 noncompliance, when applicable. Auditors that believe there is a risk of potential unallowable cost related to ineligible dependent health care costs in prior fiscal years should notify the ACO to ensure that any active negotiations of open incurred cost years are put on hold until any necessary adjustments are made.

### **Purchased and Self Insurance Plans**

The risk of contractor payments being made related to ineligible dependents applies to both purchased and self insurance plans. Contractors may have self insurance or purchased insurance plans or a combination of both. Under self insurance the contractor maintains a fund based on employee and contractor contributions to pay the claims of the employees. The insurance expense charged to contracts is based in part on actual claims of the employees. The payment of claims related to ineligible dependents is unallowable. Under purchased insurance, premiums are based on the number of employees within each coverage category, and costs significantly increase when an employee moves from self to self/spouse or self/family coverage. The payment of insurance premiums related to ineligible dependents is unallowable. Ineligible dependents can have a significant impact on both types of insurance plans.

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### **Contractor Internal Controls**

Failure to have adequate control procedures over employee benefits costs should be reported as an internal control deficiency in the contractor's accounting system. In addition, there may be inadequacies in the contractor's estimating system if estimated health costs are based on costs related to ineligible dependents. Auditors should perform steps to ensure the contractor has implemented adequate procedures to ensure that dependent and spousal health claims qualify for payment under the contractor's health plan requirements. Contractor procedures should include employee certification attesting to dependent/spousal status and periodic internal or third party audits.

### **Contractor Use of Third Party Consultants**

Some contractors use a third party service provider to administer their medical plan. In addition, some contractors have engaged third party service providers to perform reviews for ineligible dependents. When reviewing the contractor's procedures for ensuring health benefits are paid only to eligible dependents, the auditor must be provided the same level of access to the third party service provider records that he or she would receive from contractor maintained records. If access is denied, denial of access procedures as outlined in MRD 08-PAS-042, dated December 19, 2008, and CAM 1-504.3 should be followed.

### **Contractor Grace Periods**

It has come to our attention that in some cases, contractors have allowed for a "grace period" to permit employees to self disclose ineligible dependents. In these cases, contractors have agreed to not seek reimbursement from their employees for the costs resulting from ineligibility. Regardless of these types of agreements, costs associated with ineligible dependents are unallowable and should not be reimbursed by the Government. Auditors should request that the contractor develop a cost impact of these costs and then audit the contractor's developed cost impact even when the contractor will not seek restitution from the employees. If the contractor refuses to calculate a cost impact, auditors should develop a reasonable estimate of the costs related to ineligible dependents and suspend the costs until the contractor provides a cost impact and/or an audit is complete.

If FAO personnel have any questions, they should contact regional personnel. Regional personnel with any questions should contact Pricing and Special Projects Division, at (703) 767-3290 or by e-mail: [DCAA-PSP@dcaa.mil](mailto:DCAA-PSP@dcaa.mil).

/s/ David E. Johnson  
/for/ Kenneth J. Saccoccia  
Assistant Director  
Policy and Plans

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