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

Final Audit Report

Subject:

Audit of the Federal Employees Health Benefits Program Operations at Piedmont Community HealthCare

Report No. 1C-2C-00-13-056

Date: July 9, 2014

-- CAUTION --

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AUDIT REPORT

Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Piedmont Community HealthCare
Contract Number 2858 - Plan Code 2C
Lynchburg, Virginia

Report No. 1C-2C-00-13-056 **Date:** July 9, 2014

Michael R. Esser
Assistant Inspector General
for Audits

-- CAUTION --

EXECUTIVE SUMMARY

Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Piedmont Community HealthCare
Contract Number 2858 - Plan Code 2C
Lynchburg, Virginia

Report No. 1C-2C-00-13-056 **Date:** July 9, 2014

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Piedmont Community HealthCare (Plan). The audit covered contract years 2007 through 2012, and was conducted at the Plan's office in Lynchburg, Virginia.

This report questions $171,996 for inappropriate health benefit charges to the FEHBP in contract years 2009, 2010, and 2012. The questioned amount includes $160,699 for defective pricing and $11,297 for lost investment income. We found that the FEHBP rates were developed in accordance with applicable laws, regulations, and the Office of Personnel Management's Rate Instructions to Community-Rated Carriers in contract years 2007, 2008, and 2011.

In contract years 2009, 2010, and 2012, the Plan did not apply the correct similarly sized subscriber group discount to the FEHBP rates. In addition, in contract years 2009 and 2010 the Plan inappropriately loaded the FEHBP's rates with a vision rider.

Consistent with the FEHBP regulations and contract, the FEHBP is due $11,297 for lost investment income, calculated through May 31, 2014, on the defective pricing findings. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning June 1, 2014, until all defective pricing amounts have been returned to the FEHBP.

CONTENTS

I. INTRODUCTION AND BACKGROUND

Introduction

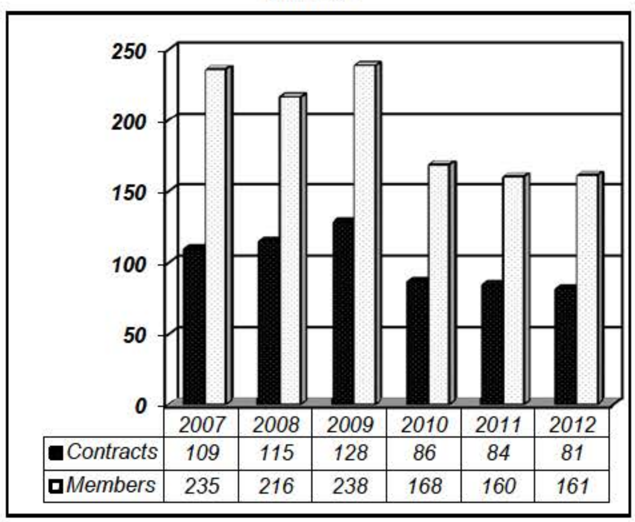
We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Piedmont Community HealthCare (Plan). The audit covered contract years 2007 through 2012, and was conducted at the Plan's office in Lynchburg, Virginia. The audit was conducted pursuant to the provisions of Contract CS 2858; 5 U.S.C. Chapter 89; and 5 Code of Federal Regulations (CFR) Chapter 1, Part 890. The audit was performed by the Office of Personnel Management's (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

Background

The FEHBP was established by the Federal Employees Health Benefits 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. The FEHBP is administered by OPM's Healthcare and Insurance Office. The provisions of the Federal Employees Health Benefits Act are implemented by OPM through regulations codified in Chapter 1, Part 890 of Title 5, CFR. Health insurance coverage is provided through contracts with health insurance carriers who provide service benefits, indemnity benefits, or comprehensive medical services.

Community-rated carriers participating in the FEHBP are subject to various federal, state and local laws, regulations, and ordinances. While most carriers are subject to state jurisdiction, many are further subject to the Health Maintenance Organization Act of 1973 (Public Law 93-222), as amended (i.e., many community-rated carriers are federally qualified). In addition, participation in the FEHBP subjects the carriers to the Federal Employees Health Benefits Act and implementing regulations promulgated by OPM.

FEHBP Contracts/Members
March 31



	2007	2008	2009	2010	2011	2012
Contracts	109	115	128	86	84	81
Members	235	216	238	168	160	161

The chart to the right shows the number of FEHBP contracts and members reported by the Plan as of March 31 for each contract year audited.

The FEHBP should pay a market price rate, which is defined as the best rate offered to either of the two groups closest in size to the FEHBP. In contracting with community-rated carriers, OPM relies on carrier compliance with appropriate laws and regulations and, consequently, does not negotiate base rates. OPM negotiations relate primarily to the level of coverage and other unique features of the FEHBP.

The Plan has participated in the FEHBP since 2000 and provides health benefits to FEHBP members in the Virginia cites of Bedford and Lynchburg, as well as the Virginia counties of Albemarle, Amherst, Appomattox, Bedford, Buckingham, Campbell, Charlotte, Cumberland, Halifax, Lunenburg, Nelson, Nottaway, Pittsylvania, and Prince Edward. There have been no prior audits of this Plan by our office.

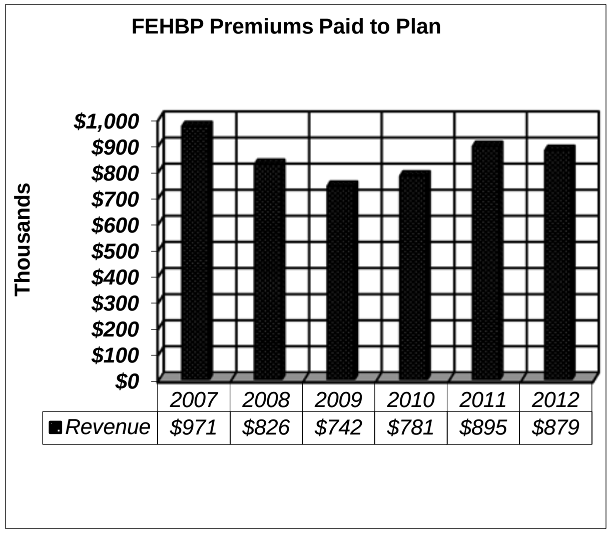
The preliminary results of this audit were discussed with the Plan officials at an exit conference and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan's comments were considered in preparation of this report and included, as appropriate, as the Appendix.

II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The primary objective of this performance audit was to determine if the Plan offered the FEHBP market price rates based on the rates given to the Similarly Sized Subscriber Groups (SSSGs). We also verified that the loadings to the FEHBP rates were reasonable and equitable. Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and regulations governing the FEHBP.

Scope



We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This performance audit covered contract years 2007 through 2012. For these years, the FEHBP paid approximately $5.1 million in premiums to the Plan. The premiums paid for each contract year audited are shown on the chart above.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM Rate Instructions to Community-Rated Carriers (rate instructions). These audits are also designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts.

We obtained an understanding of the Plan's internal control structure, but we did not use this information to determine the nature, timing, and extent of our audit procedures. However, the audit included such tests of the Plan's rating system and such other auditing procedures considered necessary under the circumstances. Our review of internal controls was limited to the procedures the Plan has in place to ensure that:

- The appropriate SSSGs were selected;
- the rates charged to the FEHBP were the market price rates (i.e., equivalent to the best rate offered to the SSSGs); and
- the loadings to the FEHBP rates were reasonable and equitable.

In conducting the audit, we relied to varying degrees on computer-generated billing, enrollment, and claims data provided by the Plan. We did not verify the reliability of the data generated by the various information systems involved. However, nothing came to our attention during our audit testing utilizing the computer-generated data to cause us to doubt its reliability. We believe that the available data was sufficient to achieve our audit objectives. Except as noted above, the audit was conducted in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States.

The audit fieldwork was performed at the Plan's office in Lynchburg, Virginia during September 2013. Additional audit work was completed at our offices in Jacksonville, Florida and Cranberry Township, Pennsylvania.

Methodology

We examined the Plan's federal rate submissions and related documents as a basis for validating the market price rates. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the market price was actually charged to the FEHBP. Finally, we used the contract, the Federal Employees Health Benefits Acquisition Regulations, and OPM's Rate Instructions to Community-Rated Carriers to determine the propriety of the FEHBP premiums and the reasonableness and acceptability of the Plan's rating system.

To gain an understanding of the internal controls in the Plan's rating system, we reviewed the Plan's rating system policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rate Review

1. Defective Pricing $160,699

The Certificates of Accurate Pricing the Plan signed for contract years 2009, 2010, and 2012 were defective. In accordance with federal regulations, the FEHBP is therefore due a rate reduction for these years. Application of the defective pricing remedy shows that the FEHBP is due a premium adjustment totaling $160,699 (see Exhibit A). We found that the FEHBP rates were developed in accordance with applicable laws, regulations, and the rate instructions in contract years 2007, 2008, and 2011.

Carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an SSSG. SSSGs are the Plan's two employer groups closest in subscriber size to the FEHBP. If it is found that the FEHBP was charged higher than the market price rate (i.e., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price rate.

2009

We disagree with the Plan's selection of [redacted] and [redacted] as SSSGs for contract year 2009. We selected [redacted] and [redacted] because they were closer in subscriber size to the FEHBP. The FEHBP did not receive a discount. Our analysis shows that [redacted] received a [redacted] percent discount and [redacted] received a [redacted] percent discount. Since the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG, we applied the [redacted] percent discount to the FEHBP's rates.

In reviewing the FEHBP's rates, we also noted that the Plan included a vision loading to the FEHBP's experience rating calculation. Both SSSGs and the FEHBP received similar vision benefits; however, this loading was not applied to either of the SSSGs experience rating calculations. The inclusion of this loading inappropriately increased the FEHBP premium rates. As a result, we removed the loading from our audited FEHBP rate development.

We calculated the audited FEHBP rates by applying the [redacted] percent discount received by [redacted] and removing the vision loading. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates show the FEHBP was overcharged $43,772 in contract year 2009 (see Exhibit B).

Plan's Comments (see Appendix):

The Plan states [redacted] did not receive a [redacted] percent discount but instead received a [redacted] percent discount, and therefore believes the overcharge to the FEHBP was only $9,843. The Plan did not address the vision loading applied to the FEHBP's rates.

The Plan asserts the auditors used incorrect rates in the discount calculation. Specifically, the rates used in the audited discount calculation for [redacted] are the group's "sold" rates and not the group's renewal rates. The Plan believes the group's renewal rates should be used in the discount calculation.

The Plan also asserts that the auditors did not correctly blend the experience/demographic (manual) rates for [redacted] The Plan states that under their rating methodology for a triple option group such as [redacted] the Plan first blends the experience/demographic rates for each option using each option's individual membership. Then the Plan blends the rates using the entire group population membership.

Lastly, the Plan states they changed the FEHBP's experience/demographic rate blend from 50/50 to 60/40.

OIG's Response to the Plan's Comments:

We disagree with the Plan's position regarding the use of the renewal rates in the discount calculation. The renewal rates are the first step in the group renewal process. They are developed based on the group's current benefit level and tier structure. However, from the initial renewal rate quote to the final rates sold there can be changes to the groups benefit package. The sold, or billed rates, are the rates the group agrees to pay after all changes and negotiations have occurred.

Our audited rates were developed using the Plan's established rating tool and incorporated all changes from the current period to the renewal period. Our audited rates utilized rating tables provided by the Plan, and we confirmed any benefit changes to the groups benefit brochures. Since our audited rates incorporate the impact of any changes from the current period to the renewal period, the appropriate rates to compare our audited rates to would be the sold or billed rates.

In regards to the blending of the experience/demographic rates, we disagree with the Plan's statement that total group membership should be used to determine the blending percentages. The Plan did not provide any written rating polices or rating methodology procedures to support their position. Our audited rates followed the Plan's standard rating tool and the blending percentages used in our audited rates reflect the percentages shown in the blending demographics table provided by the Plan. We found no indication in any of the rating documents provided during our audit that total group membership should be used when a group has more than one option.

Lastly, we agree that the FEHBP experience/demographic rate blend should be 60/40. This is the blend percentages we used in our audited FEHBP rates.

The Plan did not address the questioned vision loading in its response to the draft report. We continue to believe the inclusion of this loading is inappropriate and removed the loading from our audited FEHBP rate development.

2010

We disagree with the Plan's selection of [redacted] and [redacted] as SSSGs for contract year 2010. We selected [redacted] and [redacted] because they were closest in subscriber size to the FEHBP. Our analysis shows that [redacted] received a [redacted] percent discount and [redacted] received a [redacted] percent discount. The FEHBP did not receive a discount. Since the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG, we applied the [redacted] percent discount received by [redacted] to the FEHBP's rates.

[redacted] discount is in part due to the Plan's removal of a member's claims totaling $103,144 from the group's rate calculation. The Plan could not provide any consistent or verifiable criteria used to support the removal of the claim amounts. As a result, we did not accept the removal of the claims, and included the claim amounts in our audited [redacted] rate development. The Plan also did not correctly apply a commission loading to its manual rate calculation.

In reviewing the FEHBP's rates, we noted that the Plan included a vision loading to the FEHBP's experience rating calculation. [redacted] and the FEHBP received similar vision benefits; however, no vision loading was applied to [redacted] experience rating calculation. The inclusion of this loading inappropriately increased the FEHBP premium rates. As a result, we removed the loading from our audited FEHBP rate development.

We calculated the audited FEHBP rates by applying the [redacted] percent discount received by [redacted] and removing the vision loading. A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates shows the FEHBP was overcharged $34,939 in contract year 2010 (see Exhibit B).

Plan's Comments (see Appendix):

The Plan states [redacted] did not receive a [redacted] percent discount but instead received an [redacted] percent discount, and therefore believes that instead of being overcharged, the FEHBP was undercharged by $24,696. The Plan did not address the vision loading applied to the FEHBP's rates.

The Plan asserts the auditors used incorrect rates in the discount calculation. Specifically, the rates used in the audited discount calculation for [redacted] are the group's "sold" rates and not the group's renewal rates. The Plan believes the group's renewal rates should be used in the discount calculation.

In addition, the Plan asserts it does not aggregate and pool large claims for its book of business, nor does the Plan charge pooling fees when underwriting groups. Therefore, when any group has a large non-recurring claim, the Plan's policies and procedures allow for such claims to be excluded from the group's rate development. Typically, these are claims in excess of $100,000. The Plan states this procedure is standard industry practice, when the plan is at risk. During the timeframe [redacted] was underwritten for 2010, there was a COBRA member with claims in the amount of $103,144. Since this member's coverage would be terminating during the 2009-2010 renewal period, Piedmont determined that this would not be an ongoing high dollar member and removed one-half of the claim in the amount of $65,050.

OIG's Response to the Plan's Comments:

We disagree with the Plan's position regarding the use of the renewal rates in the discount calculation. The renewal rates are the first step in the group renewal process. They are developed based on the group's current benefit level and tier structure. However, from the initial renewal rate quote to the final rates sold there can be changes to the groups benefit package or tier structure. The sold, or billed rates, are the rates the group agrees to pay after all changes and negotiations have occurred.

Our audited rates were developed using the Plan's established rating tool and incorporated all changes from the current period to the renewal period. Our audited rates utilized rating tables provided by the Plan and we confirmed any benefit changes to the groups benefit brochures. Since our audited rates incorporate the impact of any changes from the current period to the renewal period, the appropriate rates to compare our audited rates to would be the sold or billed rates.

In regards to the Plan's exclusion of non-recurring large claims, we continue to maintain our position that the Plan does not have sufficient policies in place to support the exclusion of these claims. As detailed in the Plan's response, the decision to exclude claims is on a case-by-case basis and is a management decision. There are no detailed criteria, guidelines or dollar levels set for the exclusion of these claims. Accordingly, we have no verifiable basis to accept the Plan's claims exclusion. Our audited rates for all groups, including the FEHBP, did not exclude any non-recurring large claims.

The Plan did not address the questioned vision loading in its response to the draft report. We continue to believe the inclusion of this loading is inappropriate and removed the loading from our audited FEHBP rate development.

2012

We disagree with the Plan's selection of [redacted] and [redacted] as SSSGs for contract year 2012. We selected [redacted] and [redacted] because they were closest in subscriber size to the FEHBP. Our analysis shows that [redacted] received a [redacted] percent discount and [redacted] received a [redacted] percent discount. The FEHBP did not receive a discount. Since the FEHBP is entitled to a discount equivalent to the largest discount given to an SSSG, we applied the [redacted] percent discount to the FEHBP's rates.

[redacted] discount is due to the Plan's removal of a member's claims totaling $236,544 from the group's rate calculation. The Plan could not provide any consistent or verifiable criteria used to support the removal of the claim amounts. As a result, we did not accept the Plan's removal of the claims, and included the claim amounts in our audited [redacted] rate development.

We calculated the audited FEHBP rates by applying the [redacted] percent discount received by [redacted] A comparison of our audited line 5 rates to the Plan's reconciled line 5 rates show the FEHBP was overcharged $81,988 in contract year 2012 (see Exhibit B).

<u>Plan's Comments (see Appendix):</u>

The Plan asserts that it does not aggregate and pool large claims for its book of business, nor does the Plan charge pooling fees when underwriting groups. Therefore, when any group has a large non-recurring claim, the Plan's policies and procedures allow for such claims to be excluded from the group's rate development. Typically these are claims in excess of $100,000. During the timeframe [redacted] was underwritten for 2012, there was a member with neonatal claims totaling $236,544. After consulting with the Plan's Medical Management team, the underwriter determined that there would be no ongoing high dollar claims associated with this child and the high dollar claims were removed. According to the Plan, this changes the calculated overcharge to an undercharge of $31,779.

<u>OIG's Response to the Plan's Comments:</u>

We continue to maintain our position that the Plan does not have sufficient policies in place to support the exclusion of claims. As detailed in the Plan's response, the decision to exclude claims is on a case-by-case basis and is a management decision. There are no detailed criteria, guidelines or dollar levels set for the exclusion of these claims. Accordingly, we have no verifiable basis to accept the Plan's non-recurring large claims exclusion. Our audited rates for all groups, including the FEHBP, did not exclude any non-recurring large claims.

<u>Recommendation 1</u>

We recommend that the contracting officer require the Plan to return $160,699 to the FEHBP for defective pricing in contract years 2009, 2010, and 2012.

2. <u>Lost Investment Income</u> <u>$11,297</u>

In accordance with the FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing findings in contract years 2009, 2010, and 2012. We determined that the FEHBP is due $11,297 for lost investment income, calculated through May 31, 2014 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning June 1, 2014, until all defective pricing finding amounts have been returned to the FEHBP.

FEHBAR 1652.215-70 provides that, if any rate established in connection with the FEHBP contract was increased because the carrier furnished cost or pricing data that was not complete, accurate, or current as certified in its Certificate of Accurate Pricing, the rate shall be reduced by the amount of the overcharge caused by the defective data. In addition, when the rates are reduced due to defective pricing, the regulation states that the government is entitled to a refund and simple interest on the amount of the overcharge from the date the overcharge was paid to the carrier until the overcharge is liquidated.

Our calculation of lost investment income is based on the United States Department of the Treasury's semiannual cost of capital rates.

Plan's Comments (see Appendix):

The Plan did not address lost investment income in its response to the draft report.

Recommendation 2

We recommend that the contracting officer require the Plan to return $11,297 to the FEHBP for lost investment income, calculated through May 31, 2014. We also recommend that the contracting officer recover lost investment income on amounts due for the period beginning June 1, 2014, until all defective pricing finding amounts have been returned to the FEHBP.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

[redacted]-in-Charge

[redacted], Auditor

[redacted] Auditor

[redacted] Chief

[redacted] Senior Team Leader

Exhibit A

Piedmont Community HealthCare
Summary of Questioned Costs

Defective Pricing Questioned Costs:

Contract Year 2009	$43,772	
Contract Year 2010	$34,939	
Contract Year 2012	$81,988	
Total Defective Pricing Questioned Costs:		$160,699
Lost Investment Income:		$11,297
Total Questioned Costs:		**$171,996**

Piedmont Community HealthCare
Defective Pricing Questioned Costs

2009

High Option	Self	Family		
FEHBP Line 5 - Reconciled Rate	[redacted]	[redacted]		
FEHBP Line 5 - Audited Rate	[redacted]	[redacted]		
Biweekly Overcharge	[redacted]	[redacted]		
To Annualize Overcharge:				
3/31/09 enrollment	[redacted]	[redacted]		
Pay Periods	26	26		
	[redacted]	[redacted]		
Subtotal			**$43,772**	
Total 2009 Questioned Costs				**$43,772**

2010

High Option	Self	Family		
FEHBP Line 5 - Reconciled Rate	[redacted]	[redacted]		
FEHBP Line 5 - Audited Rate	[redacted]	[redacted]		
Biweekly Overcharge	[redacted]	[redacted]		
To Annualize Overcharge:				
3/31/10 enrollment	[redacted]	[redacted]		
Pay Periods	26	26		
	[redacted]	[redacted]		
Subtotal			**$34,939**	
Total 2010 Questioned Costs				**$34,939**

Piedmont Community Healthcare
Defective Pricing Questioned Costs

2012

High Option	Self	Family		
FEHBP Line 5 - Reconciled Rate	[redacted]	[redacted]		
FEHBP Line 5 - Audited Rate				
Biweekly Overcharge	[redacted]	[redacted]		
To Annualize Overcharge:				
3/31/12 enrollment	[redacted]	[redacted]		
Pay Periods	26	26		
Subtotal	[redacted]	[redacted]	**$81,988**	
Total 2012 Questioned Costs				**$81,988**
Total Defective Pricing Questioned Costs:				**$160,699**

Exhibit C

Piedmont Community HealthCare
Lost Investment Income

Year / **Audit Findings:**	2009	2010	2011	2012	2013	2014	Total
1. Defective Pricing	$43,772	$34,939	$0	$81,988	$0	$0	$160,699
Totals (per year):	$43,772	$34,939	$0	$81,988	$0	$0	$160,699
Cumulative Totals:	$43,772	$78,711	$78,711	$160,699	$160,699	$160,699	$160,699
Avg. Interest Rate (per year):	5.250%	3.188%	2.563%	1.875%	1.563%	0.885%	
Interest on Prior Years Findings:	$0	$1,395	$2,017	$1,476	$2,511	$1,423	$8,822
Current Years Interest:	$1,149	$557	$0	$769	$0	$0	$2,475
Total Cumulative Interest Calculated Through May 31, 2014:	$1,149	$1,952	$2,017	$2,245	$2,511	$1,423	**$11,297**

March 17, 2014

[redacted]
Chief, Community-Rated Audits Group
U.S. Office of Personnel Management
Office of the Inspector General
800 Cranberry Woods Drive
Suite 270
Cranberry Township, Pennsylvania 16066

Dear [redacted]

Re: Draft Audit Report No. 1C-2C-00-13-056
Piedmont Community HealthCare

We are in receipt of your letter dated January 23, 2014 enclosing the draft audit report ("Draft Report") on Piedmont Community HealthCare ("Piedmont" or the "Plan") for contract years 2007 through 2012. Piedmont disagrees with the Draft Report's findings and recommendations and submits the following comments and additional information.

I. Contract Year 2009

The Draft Report contains a preliminary finding that [redacted] received a ([redacted] discount that was not applied to the FEHBP's rates. We have reviewed this group's 2009 rating, as well as the audit work papers and have determined that [redacted] actual discount was ([redacted] The support is as follows:

1. [redacted] Updated by PCHP.xlsx 'Summary' tab – The rates reflected in cells G29 through G33 of the auditor's worksheet that were used in the audit's discount calculation for [redacted] 2009-2010 Rate Summary are the "sold" rates for [redacted] <u>not</u> the group's 2009-2010 renewal rates for Option 3 [redacted] The group purchased a less rich Option 3 for 2009-2010 than it had the prior year. The renewal rates for Option 3 are as follows (See Exhibit 2009 Rates [redacted] pdf):

[redacted]

In addition, the calculated renewal rates in cells E29 through E33 reflect the sold product not the renewal product. Replacing the audited rates with the actual renewal rates for the renewal product for the period under review, reduces the discount calculation from ([redacted] to [redacted]

2. [redacted] Updated by PCHP.xlsx [redacted] – [redacted] offers its employees three benefit plan options. The Federal Employee group has one option. Piedmont's rating methodology blends experience rates and demographic rates. Under the Plan's rating methodology for a triple option group, each option is first rated per the Plan's blended methodology described in the preceding sentence to the point of determining blended PEPM experience rates and PEPM demographic rates. The Plan then blends the experience rates and demographic rates for each option based on the total number of members in the entire group population. In the [redacted] tab cells L40 and L41 the blend used was 30% for experience and 70% for demographics. In the [redacted] tab, cells L40 and L41 the blend used was 20% for experience and 80% for demographics. In the [redacted] tab, cells L40 and L41 the blend used was 20% for experience and 80% for demographics. Piedmont's rating model calls for a blend of 40% experience and 60% demographics for groups with 100 to 299 members. [redacted] has [redacted] members. See Exhibit 2009 Membership The Orthopaedic [redacted] xlsx.

   Changing the actual experience/demographic blend to 40/60, reduces the discount calculation from the ([redacted] in item #1 above to ([redacted]

3. For the 2009 FEHBP renewal, Piedmont changed the experience/demographic blend for the FEHBP from 50/50 to 60/40 – resulting in more favorable renewal rates for the FEHBP.

   Changing the experience/demographic blend from 50/50 to 60/40 resulted in the FEHBP renewal rates being discounted by [redacted] as compared to the [redacted] increase per the Plan's rating methodology. The overall impact was a [redacted] discount for FEHBP.

Summary of 2009 [redacted] Rating

Piedmont calculates the SSSG Discount for 2009 as follows:

OIG SSSG Discount Calculation	-[redacted]
Less:	
2009/2010 Actual Rates Option 3	[redacted]%
Blending of Experience and Demographics	[redacted]
[redacted] Discount	-[redacted]

With the above corrections and taking into account the FEHBP's discount, the actual Total Audit Variance changes from a negative ($43,772) to a negative ($9,843).

II. Contract Year 2010

The Draft Report contains preliminary findings that [redacted] received a ([redacted] discount in 2010 that was not applied to the FEHBP's rates. While reviewing the Audited 2010 [redacted] Rate Model spreadsheet, we determined the following:

1. [redacted] Updated by PCHP.xlsx, 'Summary' tab – The rates reflected in G14 through G25 of the auditor's worksheet that were used in the audit's discount calculation for [redacted] 2009 – 2010 are the "sold" rates <u>not</u> the group's 2009 – 2010 renewal rates. The group only had one option at renewal. They chose a dual option when they renewed. The single option renewal rates are as follows (See Exhibit 2010 Rates [redacted] pdf):

   [redacted]

   Replacing the rates with the actual renewal rates for the period under review, reduces the discount calculation from ([redacted] to [redacted]

2. [redacted] Updated by PCHP.xlsx, [redacted] tab – Piedmont does not aggregate and pool large claims for its book of business, nor does the Plan charge pooling fees when underwriting groups. Therefore, when any group has a large non-recurring claim, the Plan's policies and procedures allow for such claims to be excluded from the group's rate development. This is generally described under "Large Group Underwriting" in Piedmont's Underwriting Procedures Manual. Please see Exhibit UwManual Updated 4-07.doc. Typically, these are claims in excess of $100,000. The procedure described above is standard industry practice, when the plan is at risk. During the time frame [redacted] was underwritten for 2010, there was a COBRA member with claims in the amount of $103,144. Since this member's coverage would be terminating during the 2009-2010 renewal period, Piedmont determined that this would not be an ongoing high dollar member and we removed one half of the claim in the amount of $65,050. (Had the member left before the group's renewal, we would have removed the entire claim amount.) Piedmont did exclude high dollar claims from the FEHBP's rate development pursuant to the above-described policies and procedures in a number of years including 2007 when Piedmont removed $419,564 from the FEHBP claims.

   Changing the dollar amount in cell L20 to $65,050 reduces the calculated discount from [redacted] calculated in #1 above to ([redacted]

   Summary of 2010 [redacted] Rating

   Piedmont calculates the SSSG Discount for 2010 as follows:

OIG SSSG Discount Calculation [redacted]

Less:

2009/2010 Actual Renewal Rates [redacted]

Large Claim Exclusion [redacted]

Piedmont SSSG Discount [redacted]

With the above corrections made and adjusting for the difference between the audited FEHBP rates and the rates charged the FEHBP, the Total Audit variance changes from a negative ($34,939) to a positive $24,696. The Plan's calculated rates for the FEHBP group were less than the audited FEHBP rates. Therefore no adjustment is due the FEHBP for 2010.

III. Contract Year 2012

The Draft Report contains a preliminary finding that [redacted] received a [redacted] discount in 2012 that was not applied to the FEHBP's rates. While reviewing the Audited 2012 [redacted] Rate Model spreadsheet we determined the following:

[redacted] Updated by PCHP.xlsx, 'Experience Rate Model' tab – Piedmont does not aggregate and pool large claims for its book of business, nor does the Plan charge pooling fees when underwriting groups. Therefore when a large non-recurring claim occurs on any group, the Plan's policies and procedures allow for such claims to be excluded from the rate development. This is generally described under Large Group Underwriting in Piedmont's Underwriting Procedures Manual referenced above. Typically these are claims in excess of $100,000. During the time frame [redacted] was underwritten for 2012, there was a neonatal claims in the amount of $236,544. After consulting with Piedmont's Medical Management, underwriting determined that there would be no ongoing high dollar claims associated with this child and the high dollar claims were removed.

Changing the dollar amount in H24 to $236,544.26 reduces the calculated discount from a negative [redacted] to a negative [redacted]

Summary of 2012 [redacted] Rating

Piedmont calculates the SSSG Discount for 2012 as follows:

OIG SSSG Discount Calculation [redacted]

Less:

Large Claim Exclusion [redacted]

Piedmont SSSG Discount [redacted]

After making the above corrections and adjusting for the difference between the audited FEHBP rates and the rates charged the FEHBP, the Total Audit Variance changes from a negative ($81.998) to a positive $31,779. The Company's calculated rates for the FEHBP group were less than the audited FEHBP rates. Therefore no adjustment is due the FEHBP for 2012.

In conclusion, Piedmont believes that the Total Questioned Costs, as shown in Exhibit A of the 'Defective Pricing Questioned Costs Updated by PCHP' worksheet tab 'Exhibit A' should be $11,007.

Please let me know if you have questions regarding the above.

Sincerely,

[redacted]
Director of Finance