



A Report  
to the  
Board of  
Supervisors

*Maricopa County  
Internal Audit  
Department*

**Ross L. Tate**  
County Auditor

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# Employee Health Initiatives

*Medical premium rate and reserve  
setting processes are adequate*

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June ■ 2009

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**The mission of Maricopa County** is to provide regional leadership and fiscally responsible, necessary public services so that residents can enjoy living in a healthy and safe community.

**The mission of the Internal Audit Department** is to provide assistance to the Board of Supervisors so they can ensure Maricopa County government is accountable to its citizens.

The County Auditor reports directly to the Maricopa County Board of Supervisors, with an advisory reporting relationship to the Citizen's Audit Advisory Committee.

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***"Do the Right Things Right!"***



# Maricopa County

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June 10, 2009

Max W. Wilson, Chairman, Board of Supervisors  
Fulton Brock, Supervisor, District I  
Don Stapley, Supervisor, District II  
Andrew Kunasek, Supervisor, District III  
Mary Rose Wilcox, Supervisor, District V

We have completed our Fiscal Year (FY) 2008-09 review of the Employee Health Initiatives Department (EHI). This audit was performed in accordance with the annual audit plan approved by the Board of Supervisors. The specific areas reviewed were selected through a formal risk-assessment process.

Highlights of this report include the following:

- Employee Health Initiatives (EHI) has adequate processes to establish premium rates and self-insured trust fund reserve levels
- EHI could reduce benefit costs by verifying dependent eligibility at open enrollment and during new employee hiring
- EHI should continue to periodically review stop-loss coverage for catastrophic medical claims to identify savings

This report contains an executive summary, specific information on the department reviewed, and the department's response to our recommendations. We have reviewed this information with department leadership and appreciate the excellent cooperation provided by management and staff. If you have any questions, or wish to discuss the information presented in this report, please contact Eve Murillo at 506-7245.

Sincerely,

A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate  
County Auditor

# Executive Summary

## **Self-Insurance Process (Page 5)**

Employee Health Initiatives has adequate processes to establish premium rates and reserve levels for the self-insured trust fund. County management continues to monitor reserves and take action as needed.

## **Dependent Eligibility Verification (Page 7)**

Employee Health Initiatives could reduce benefit costs by verifying dependent eligibility at open enrollment and during new employee hiring. Research shows the County could save between \$1.6 and \$3.3 million in the first year of verifying dependent eligibility. Employee Health Initiatives should consider initiating dependent eligibility verification at initial enrollment.

## **Stop-Loss Insurance Coverage (Page 9)**

Internal Audit's independent actuarial consultant found that the County's specific stop-loss insurance coverage for catastrophic medical claims could be more costly than alternative forms of coverage. Employee Health Initiatives should continue to review stop-loss coverage to identify savings.

# Introduction

## Background

The Employee Health Initiatives Department (EHI) was established in FY 2002 and reports through the Deputy County Manager to the County Manager. EHI procures and manages County health benefit plans, numerous vendors, premium rates, fund reserves, and employee wellness programs.

The FY 2008 Risk Management and Employee Benefits Trust Funds audited financial statements show that County and employee medical premiums were approximately \$123 million (nearly seven percent of the County budget) to provide medical insurance benefits for nearly 29,000 employees, dependents, and retirees.

Employers either purchase health insurance from an insurance company (fully insured), or finance health benefits directly for employees (self-insured). A large majority of U.S. workers in firms with 5,000 or more employees are in self-insured plans.<sup>1</sup> Prior to FY 2008, the County was self-insured for pharmacy, short-term disability, one dental plan and the balance of the health benefits were purchased from commercial insurance companies on a fully insured basis. In FY 2008, the County began self-insuring the medical, behavioral health, and vision plans. The County continues to purchase life insurance and two dental plans on a fully-insured basis.

According to EHI, Maricopa County's premiums for employees and families have increased an average of 7.5% per year since 1999. Nationwide, health care premiums for employees with families have increased 119 percent nationwide<sup>2</sup>—an average of nine percent per year. The County chose to self-insure to reduce overhead costs and increase control over benefit offerings and plan design features.

EHI retained Buck Consultants, a nationally recognized benefits and actuarial consulting firm, to help determine benefit offerings, premium rates, and other actuarial components for the self-funded health benefit plans. The County accounts for premiums collected and claims paid in the Employee Benefit Trust Fund (EBT). The EBT is overseen by a Board of Trustees appointed by the County Board of Supervisors. State law requires annual audited financial statements for all self-insurance activities.

The following are considered when establishing medical premiums:

- Claims payment history, population demographics, and administrative fees
- Stop-loss premiums (to provide protection against catastrophic or unpredictable losses)
- Estimated liability of future claims based on projections (Claims that have occurred but not been received and recorded are referred to as "IBNR" or Incurred but not Reported)

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<sup>1</sup> Employee Benefit Research Institute, Fast Facts, February 11, 2009 #114  
<http://www.ebri.org/pdf/FFE114.11Feb09.Final.pdf>

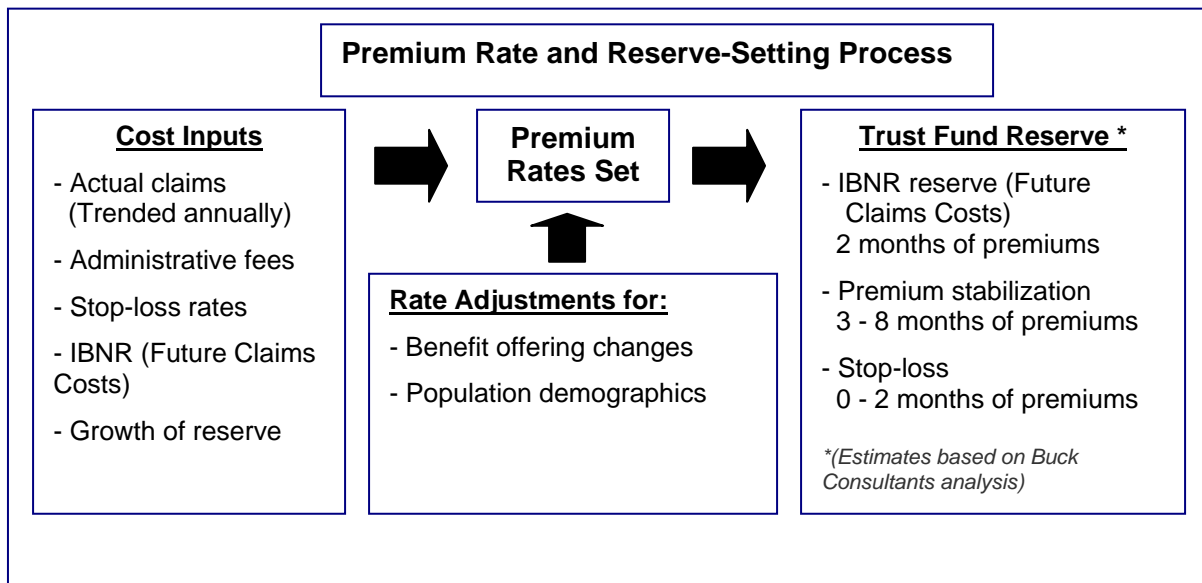
<sup>2</sup> Kaiser Family Foundation and Health Research & Educational Trust 2008 Annual Employer Health Benefits Survey  
<http://ehbs.kff.org/>

- Management decisions concerning trust fund reserve threshold amounts

EBT reserves are monies that management sets aside in the event medical benefit costs exceed estimates. Reserves come from:

- Net premium revenue (premium revenue collected less claims and other expenses paid)
- General Fund contributions

EHI’s actuary, Buck Consultants, periodically recommends EBT reserve levels. The chart below shows how each cost input impacts the premium rate and reserve-setting process.



Source: IA analysis of EHI documents

## Scope and Methodology

### Audit Objectives

The audit objectives were to:

- Perform a risk assessment of EHI’s self-insurance program, rate setting, reserve balances, and use of stop-loss insurance. An independent health plan consultant with broad actuarial expertise and experience assisted with the assessment.
- Examine EHI’s controls over determining medical benefit plan dependent eligibility

### Audit Standards

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 that supports 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.

# Department Reported Accomplishments

**Employee Health Initiatives has provided the Internal Audit Department with the following information for inclusion in this report.**

## ***Achievements & Innovations since FY 2002***

- Achieved negative trend rates in medical and pharmaceutical and avoided approximately **\$25.8 million** in medical and prescription drug costs since FY 2002. Since FY 2002, on a national level medical and pharmacy rates have increased by 10% per year while the County rates have increased by 7.5% per year.
- Increased employee satisfaction with health care program from 77% to 98%.
- Encouraged employees to achieve a national best generic drug dispensing rate of 74% while the government employer generic dispensing rate is 66%, and achieved a quit tobacco rate of 54% while community quit rates are 40%.
- Achieved and maintained ZERO GASB 45 liability
- Implemented several worksite employee health care innovations, including but not limited to:
  - Onsite Pharmacy, Clinic and Employee Worksite Wellness Programs
  - Mobile onsite prostate exams, dental and mammography services
  - Onsite employee biometric screening and health assessment programs
- Received numerous state and national awards for innovation and achievement:
  - Best National Generic Drug Utilization Award
  - Best National Pharmacy Trend Award
  - 3 National Association of County Awards for Innovation and Achievement
  - Arizona Quality Alliance Award for Excellence
  - Wellness Council of Arizona Award for Leadership in Worksite Health Promotion

# Issue 1 Self-Insurance Process

## Summary

Employee Health Initiatives (EHI) has adequate processes to establish premium rates and reserve levels for the self-insured trust fund. County management continues to monitor reserves and take action as needed.

## Criteria

The Government Accounting Standards Board (GASB 10) states that actuarial methods should be used to provide a reasonable estimate of self-insured claim expenses and liabilities.

## Condition

Internal Audit commissioned an experienced healthcare consulting actuary to assist with assessing the risks associated with EHI's health plan management.

### *Self-Insured Decision*

The consulting actuary assessed the County's process for setting premium rates and reserve levels for the self-insured trust fund. The actuary reviewed the FY 2007 and the unaudited FY 2008 self-insured trust fund financial statements. He also reviewed contracts, interview notes, and trends of premium expenses and revenues provided by Internal Audit. The actuary concluded that the County had adequately researched the decision to become self-insured.

As noted previously, the County's decision to self-insure is consistent with other large employers. The County has an adequate membership pool size (29,000 members) to "smooth out" claim loss trends over time. Based on the pool size and EHI's estimate of cost savings, the actuarial consultant concluded that the County was a good candidate for self-insurance.

The consultant also noted that the County vendors for actuarial services, stop-loss, and health benefit administrative services are well respected and highly rated within their industries.

### *Reserve Analysis*

Health plan reserves are the monies earmarked to cover imminent, but "as yet un-received" claims. EHI retained an actuary, Buck Consultants, to help set premium rates and general fund contributions to cover medical claims and fund the Employee Benefit Trust (EBT) reserve. Buck estimated reserve levels based on:

- Incurred But not Reported Claim (IBNR) reserves (covers the estimated cost for claims in process)
- Premium stabilization reserves (flattens premium rate fluctuations or unexpected claim activity)
- Stop-loss insurance reserves (covers very costly claims)

Buck Consultants recommended three thresholds for the EBT reserve level, minimum, target, or maximum. Each threshold includes two months' future claim expenses (IBNR) plus twelve months' administrative expenses. Above this baseline, each shows increasing amounts for claim costs and stop-loss premiums:

- Minimum (three months claim costs and no stop loss premiums)
- Target (five months claim costs and one month stop loss premiums). EHI has renamed this level "Prudent"
- Maximum (eight months claim costs and two months stop loss premiums)

Internal Audit's (IA) consulting actuary calculated that the County's IBNR (future claims) estimates are appropriate and close to expected ranges. The consulting actuary's and EHI's FY 2008 IBNR estimates (unaudited) are shown below.

<b>FY 2008 IBNR (Future Claim Payment Estimates) EHI Estimates Compared with IA* Actuary Estimates</b>			
<b>Medical Plan</b>	<b>EHI's Estimates for Future Claim Payments</b>	<b>IA Actuary: Estimated Future Claim Payment Ranges</b>	
		<b>Low</b>	<b>High</b>
Medical	\$7,957,000	\$7,551,600	\$11,327,401
Prescription Drugs	1,545,000	534,065	1,068,130
Behavioral Health	259,000	107,240	123,739
Dental	247,000	208,209	246,066
Vision	100,000	99,504	119,405
<b>Total</b>	<b>\$10,108,000</b>	<b>\$8,500,618</b>	<b>\$12,884,741</b>

*Source: Unaudited 2008 EBT Financial Statement and IA\*(Internal Audit) Commissioned Actuary Report*

The consulting actuary's review of the unaudited Medical Benefit Trust Fund balance sheet showed that the County's \$10.1 million estimate at the end of FY 2008 for future claim costs (IBNR) appeared reasonable.<sup>3</sup>

### **Recommendation**

None, for information only.

<sup>3</sup> *Estimates did not include an independent recalculation of the County's medical plan liabilities. Claim cost estimates are inherently uncertain due to the unpredictable nature of insurance claim settlements. Contingent events, claim reserving procedures, settlement philosophy, current and perceived social and economic inflation, current and future court and jury attitudes, improvement in medical technology, and many other economic, legal, political and social factors all can have significant effects on ultimate claim costs. No warranty is expressed or implied that the actual cost of settling claims over time will not differ from those implicit in the consulting actuary's analysis. Such differences could be material.*

# Issue 2 Dependent Eligibility Verification

## Summary

Employee Health Initiatives could reduce benefit costs by verifying dependent eligibility at open enrollment and during new employee hiring. Research shows the County could save between \$1.6 and \$3.3 million in the first year of verifying dependent eligibility. Employee Health Initiatives should consider initiating dependent eligibility verification at initial enrollment.

## Criteria

### *County Eligibility Standards*

The County Employee Benefit Plan restricts health coverage eligibility to employees and their dependents. The plan defines “dependent” as:

- A legal spouse
- An unmarried natural child, stepchild, legally adopted child, child placed with an employee for adoption, or a child for whom an employee is the legal guardian

### *Eligibility Verification Practices*

Other entities conduct dependent eligibility audits, including the County of Richmond, Virginia; Riverside, California; and the State of Arizona and private companies. Several fee-based eligibility audit vendors state that they can find ineligibility in 5 to 15 percent of employee-listed dependents.

## Condition

In FY 2008, the County and employees paid approximately \$123 million (nearly seven percent of the FY 2008 County budget) in medical benefit premiums. These benefits cover approximately 12,000 employees and 17,000 dependents. Employee and dependent medical coverage enrollment is shown on the next page.

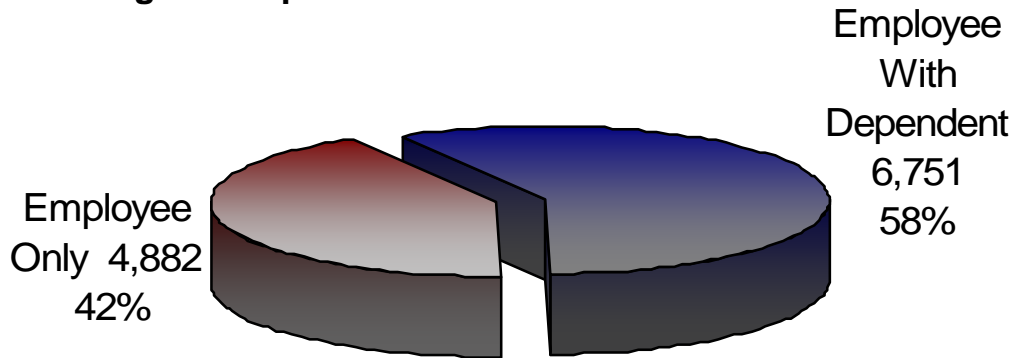
Currently EHI only requires dependent eligibility documentation from employees who report mid-year changes (birth, adoption, etc.) or who have a student dependent age 19 or older. EHI does not verify dependent eligibility when employees are hired or during open enrollment.

## Effect

The lack of dependent eligibility verification at initial enrollment, plus low-cost premiums, makes enrollment error easy and abuse attractive. A recent Mercer National Survey of Employer-Sponsored Health Plans shows that three to six percent of covered family members do not produce valid eligibility documentation when requested. Mercer’s data indicates the County could save between \$1.6 and \$3.3 million in ineligible dependent claim costs in the first year of expanded dependent verification.

## FY08 Medical Plan Enrollment

Over 58% of medical plan enrollees have chosen coverage for dependents



*Source: IA analysis of EHI County medical benefit enrollment*

### Cause

EHI does not verify employee dependent eligibility when employees are hired or at open enrollment because:

- EHI considers current dependent eligibility verification procedures to be consistent with standard industry practice
- Extensive dependent eligibility verification is resource intensive and may discourage employees from requesting appropriate health care coverage
- EHI believes a feasibility study would be needed to obtain County leadership direction
- EHI is concerned that expanded dependent eligibility verification would adversely affect relations with County employees and the public

### Recommendation

EHI should consider auditing dependent eligibility.

# Issue 3 Stop-Loss Insurance Coverage

## Summary

Internal Audit's independent actuarial consultant found that the County's specific stop-loss insurance coverage for catastrophic medical claims could be more costly than alternative forms of coverage. Employee Health Initiatives should continue to review stop-loss coverage to identify savings.

## Criteria

The American Academy of Actuaries and the Self-Insurance Institute of America recommend that most large organizations purchase stop-loss coverage and protect their self-funded plans with both aggregate and specific types of coverage.

## Condition

Stop-loss insurance limits an employer's claim liability exposure for catastrophic level illness/injury. Stop-loss coverage starts when a claim reaches a pre-determined threshold amount. After the threshold is reached, the stop-loss policy pays claims up to the lifetime limit per employee. In FY 2008, the County expended more than \$1.8 million for stop-loss coverage. The County uses a stand-alone, specific stop-loss policy that covers claims over \$200,000 for a 12-month period. The lifetime maximum benefit is \$2,000,000 per member.

Internal Audit's consulting actuary considered three catastrophic coverage types when reviewing the County's coverage:

- Stand-alone specific (currently used by the County) protects the employer against high claims on any one individual
- Stand-alone aggregate places a ceiling on the total eligible expenses an employer pays during a contract period. The employer is reimbursed after the contract period ends.
- A combination of stand-alone specific and aggregate coverage

The County's initial stop-loss claims have been small; however, the consultant suggested periodically reviewing alternative stop-loss coverage strategies in case changes occur.

## Effect

The County's use of specific stop-loss coverage may cost more than other types of coverage.

## Cause

EHI has not pursued alternatives to the current stop-loss coverage because previous EHI analysis did not show a positive cost benefit outcome in doing so.

## Recommendation

EHI should continue to periodically review stop-loss coverage to identify savings.

# Department Response

**AUDIT RESPONSE**  
**Employee Health Initiatives May 26, 2009**

**Issue #1:**

For information only; no response required.

**Issue #2:**

Employee Health Initiatives could reduce benefit costs by verifying dependent eligibility at open enrollment and during new employee hiring. Research shows the County could save between \$1.6 and \$3.3 million in the first year of verifying dependent eligibility. Employee Health Initiatives should initiate dependent eligibility verification at initial enrollment.

**Recommendation:** Employee Health Initiatives should consider auditing dependent eligibility.

**Response:** Concur—subsequent to a thorough feasibility study and direction from senior County management and the Board of Supervisors. In accordance with standard industry practices and limited staffing resources, EHI does not currently verify dependent eligibility during open enrollment or new employee hiring. The pursuit of expanded eligibility verification should consider the adverse impact on labor relations, employee relations, public relations, and the loss of dependent health care coverage.

**Target Completion Date:** 6/30/10

**Benefits/Costs:** Potential cost savings.

**Issue #3:**

Internal Audit's independent actuarial consultant found that the County's specific stop-loss insurance coverage for catastrophic medical claims could be more costly than alternative forms of coverage. Employee Health Initiatives should continue to review stop-loss coverage to identify savings.

**Recommendation :** Employee Health Initiatives should continue to review stop-loss coverage to identify savings.

**Response:** Concur--in process. EHI periodically reviews stop-loss coverage needs to provide an appropriate balance between premium cost and risk mitigation.

**Target Completion Date:** 6/30/09

**Benefits/Costs:** Potential cost savings and increased protection against catastrophic claims.

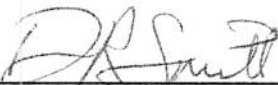
Approved By :

  
\_\_\_\_\_  
Department Head

6/8/09  
Date

  
\_\_\_\_\_  
Deputy County Manager

6-9-09  
Date

  
\_\_\_\_\_  
County Manager

6/9/09  
Date