# State of Colorado

**John W. Hickenlooper**
*Governor*

**Kathy Nesbitt**
*Executive Director*

**Jennifer Okes**
*Deputy Executive Director*

**DPA**

**Department of Personnel & Administration**

**Executive Office**
633 17th Street, Suite 1600
Denver, Colorado 80202
(303) 866-3000
Fax (303) 866-2102
www.colorado.gov/dpa

August 5, 2011

Diane E. Ray, State Auditor
Colorado Office of the State Auditor
200 E. 14th Ave.
Denver, CO 80203

Dear Ms. Ray:

The Department submits the following status of recommendations for the DPA Employee Benefits Program, audit #2073. I will be in attendance as well as my Deputy Director Jennifer Okes on August 22, 2011 to present the status report to the Legislative Audit Committee.

If you have any additional questions, please do not hesitate to contact me or my Deputy Director Jennifer Okes.

Regards,

Kathy Nesbitt
Executive Director

# AUDIT RECOMMENDATION STATUS REPORT

**AUDIT NAME: Employee Benefits Program**
**AUDIT NUMBER: 2073**
**DEPARTMENT/AGENCY/ENTITY: Department of Personnel & Administration**
**DATE: July 7, 2011**

## SUMMARY INFORMATION

*Please complete the table below with summary information for all audit recommendations.* ***For multi-part recommendations, list each part of the recommendation SEPARATELY.*** *(For example, if Recommendation 1 has three parts, list each part separately in the table.)*

| **Recommendation Number** *(e.g., 1a, 1b, 2, etc.)* | **Agency's Response** *(i.e., agree, partially agree, disagree)* | **Original Implementation Date** *(as listed in the audit report)* | **Implementation Status** *(Implemented, Implemented and Ongoing, Partially Implemented, Not Implemented, or No Longer Applicable)*<br><br>Please refer to the attached sheet for definitions of each implementation status option. | **Revised Implementation Date** *(Complete only if agency is revising the original implementation date.)* |
|---|---|---|---|---|
| 1 | Agree | July 1, 2011 | Implemented and Ongoing | |
| 2a | Agree | Ongoing | Implemented and Ongoing | |
| 2b | Agree | Ongoing | Implemented and Ongoing | |
| 3a | Agree | Ongoing | Implemented and Ongoing | |
| 3b | Agree | Ongoing | Implemented and Ongoing | |
| 3c | Agree | Ongoing | Implemented and Ongoing | |
| 4a | Agree | July 1, 2011 | Partially Implemented | July 1, 2012 |
| 4b | Agree | July 1, 2011 | Partially Implemented | July 1, 2012 |
| 5a | Agree | June 30, 2011 | Implemented | |
| 5b | Agree | June 30, 2011 | Partially Implemented | June 30, 2012 |
| 6a | Agree | June 30, 2011 | Partially Implemented and Ongoing | August 31, 2011 |

| **Recommendation Number** *(e.g., 1a, 1b, 2, etc.)* | **Agency's Response** *(i.e., agree, partially agree, disagree)* | **Original Implementation Date** *(as listed in the audit report)* | **Implementation Status** *(Implemented, Implemented and Ongoing, Partially Implemented, Not Implemented, or No Longer Applicable)*<br><br>Please refer to the attached sheet for definitions of each implementation status option. | **Revised Implementation Date** *(Complete only if agency is revising the original implementation date.)* |
|---|---|---|---|---|
| 6b | Agree | June 30, 2011 | Implemented and Ongoing | |
| 7a | Agree | Ongoing | Implemented | |
| 7b | Agree | Ongoing | Implemented and Ongoing | |
| 8a | Agree | January 31, 2011 | Implemented and Ongoing | |
| 8b | Agree | January 31, 2011 | Implemented and Ongoing | |
| 9a | Agree | June 30, 2012 | Partially Implemented | |
| 9b | Agree | January 31, 2011 | Implemented | |
| 10 | Agree | June 30, 2011 | Partially Implemented | June 30, 2012 |

## DETAIL OF IMPLEMENTATION STATUS

**Recommendation #: 1**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**

The Department of Personnel & Administration should mitigate the risk to the State of self-funding by structuring the medical plans in a way to ensure that the State can maintain a sufficiently large risk pool with participants who represent diverse risk levels. To accomplish this, the Department should consider the options available to bring employees who are currently enrolled in a fully-insured Health Maintenance Organization (HMO) into the State's risk pool. These options may include:

- Working with the Kaiser Foundation Health Plan (Kaiser) to determine whether Kaiser would be willing to offer a self-funded HMO plan option in Colorado.
- Risk adjusting Kaiser premiums to minimize adverse selection against the State's PPO plan options and increase the State's risk pool.
- Freezing enrollment in the Kaiser HMO plans to current participants.
- Eliminating the fully-insured HMO plans altogether.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**

The Department is cognizant of the need to manage the self-funded risk pool. Historically, the Department has monitored the risk pool, examined trends, and adjusted plan designs in an effort to mitigate adverse selection with the fully-insured plans to the degree possible. In fact, the evaluation committee for the State's health plans Request for Proposals determined to award both the self-funded third-party administrator contract to UnitedHealthcare and the fully-insured contract to Kaiser "contingent upon the use of strategies, including risk adjustment and plan design within the self-funded plan to mitigate any negative effect on the self-funded plan by co-existing with Kaiser." The option of risk adjusting the fully-insured premiums was considered last year but ultimately not implemented as it was determined to not be necessary given the selected plan designs. The Department will continue to evaluate all options to best manage the self-funded risk pool.

**Agency's Current Comments on Implementation Status of Recommendation: Implemented and Ongoing**

The Department continues to monitor the risk pool, examine trends and adjust plan designs as necessary to mitigate adverse selection against the self-funded options.

**<u>Recommendation #</u>: 2**

**<u>Agency Addressed:</u>** Department of Personnel & Administration

**<u>Recommendation Text in Audit Report</u>:**
The Department of Personnel & Administration should take steps to improve its use of stop loss insurance in conjunction with the premium stabilization reserve to mitigate the risk to the State of self-funding. This should include:

a. Continuing to reevaluate annually whether to purchase specific or aggregate stop loss coverage, or both; whether to increase the attachment point for stop loss insurance as appropriate; and whether to seek competitive proposals for stop loss insurance.

b. Continuing to fund the premium stabilization reserve until the State is able to maintain a sufficient balance of at least 10 percent of projected claims costs over a period of several years.

**<u>Agency's Response</u>** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**<u>Agency's Written Response in Audit Report</u>:**
The Department will continue its annual evaluation of stop loss insurance for the self-funded medical plan options. As an example, the Department has increased the attachment point since initiating self-funding from $50,000 to $200,000 as the premium stabilization reserve has grown. When the State changed to self-funding, specific stop loss coverage was determined to be the most prudent option for initial self-funding. We believe specific stop loss coverage continues to be appropriate at this time. As noted by the auditor, if the decision is made to purchase aggregate stop loss coverage, which should have a lower premium, larger reserves will be required to protect the plan. The Department will continue to evaluate the premium stabilization reserve (PSR) to ensure an adequate reserve is maintained based upon the type and amount of stop loss insurance in place.

**<u>Agency's Current Comments on Implementation Status of Recommendation</u>: Implemented and Ongoing**
The Department evaluates stop-loss coverage as part of the plan design each year. For Fiscal Year 2012, the attachment point remains unchanged at $200,000 based on the actuarial analysis that indicated this is the most cost effective attachment point for the State currently. The Department will continue to evaluate this coverage each year. The minimum premium stabilization reserve (PSR) was 10 percent at the beginning of Fiscal Year 2011 and was increased mid-year to 12 percent and will remain at this level for Fiscal Year 2012. The Department will continue to project and monitor the PSR in order to manage a stable amount from year-to-year.

**<u>Recommendation #</u>: 3**

**<u>Agency Addressed:</u>** Department of Personnel & Administration

**<u>Recommendation Text in Audit Report</u>:**
The Department of Personnel & Administration should continue to evaluate the plan design of the State's Preferred Provider Organization (PPO) and Health Maintenance Organization (HMO) plans to identify opportunities to incrementally reduce employee out-of-pockets costs. Opportunities may include:

a. Increasing some HMO out-of-pocket costs to be more consistent with comparable plans and the State's PPO plans, in conjunction with implementation of Recommendation No. 1.

b. Adjusting PPO copay, coinsurance, and deductible provisions to be more consistent with comparable employer offerings.

c. Decreasing "Choice Plus" PPO plan deductibles and out-of-pocket maximums to a level equal to or lower than the "Choice Plus Definity" PPO plan.

As appropriate, the Department should make recommendations to the General Assembly that cost-savings realized from implementing the recommendations in this report be used to increase the State's contribution to benefits.

**<u>Agency's Response</u>** *(i.e., Agree, Partially Agree, or Disagree)*: Agree

**<u>Agency's Written Response in Audit Report</u>:**
The Department will continue adjusting plan designs in an effort to reduce employee out-of-pocket expenses and to be more consistent with comparable employers. It is important to understand the critical role funding plays in being able to improve plan designs while keeping costs affordable for both the State and employees. In other words, all adjustments in design will cost. Similarly, any reduction in out-of-pocket costs can shift those costs to higher premiums. For a number of years, the Department's total compensation strategy, as well as the annual compensation survey reports, has recognized that the State's medical plan lags the market of comparable employers in both employer contribution and design related to out-of-pocket costs. Both aspects must be addressed, but it is a matter of funding. Historically, the priority was to close the gap in employer contributions before significantly addressing the costs associated with plan designs so affordability would not be negatively impacted. The Department began reporting on cost sharing in the annual compensation report and letter for Fiscal Year 2012. The Department will continue to measure both premium and out-of-pocket costs in developing recommendations for state contributions. We will also continue to pursue value-based designs to ensure a balance in quality and cost that avoids unintended consequences such as overuse of certain services. As noted by the auditor, some increased costs to the State can be offset by applying the

savings from measures such as a dependent eligibility audit and pro-rated state contributions to part-time employees. The Department will evaluate such opportunities and the application of cost-savings to improve state contributions for the consideration of the General Assembly to the extent possible. Finally, it is important to understand that this is an incremental process that occurs over a number of plan years.

**Agency's Current Comments on Implementation Status of Recommendation: Implemented and Ongoing**

The Department continues to evaluate the designs of both the fully-insured and self-funded plans and to look for opportunities to align employee out-of-pocket costs (cost share) to levels comparable with similar employers' plans while keeping costs affordable. The Department continues to benchmark the State's plans against those of comparable employers in the market and now includes cost share metrics in that analysis. For Fiscal Year 2012, the Department concentrated on making the required changes under the Affordable Care Act, which will reduce employee out-of-pocket costs, such as 100 percent coverage of recommended preventive services, and the elimination of lifetime and annual dollar limits for essential services. The Department continues to use value-based designs (e.g., lower co-pays for generic drugs, higher co-pays for emergency room).

**Recommendation #: 4**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**

The Department of Personnel & Administration should continue to evaluate options for revising policies related to the State's contribution to benefits for part-time employees, and work with the General Assembly to pursue any necessary statutory changes. These options should include:

a. Establishing minimum work requirements for determining eligibility for state contributions to benefits for part-time and seasonal employees.

b. Prorating the State's contribution to employee benefits based on the number of hours employees work during a week.

If the changes recommended in part (a) or (b) are implemented, the Department should provide guidance to all state agencies on how to designate part-time and seasonal employees in the agencies' payroll systems.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**<u>Agency's Written Response in Audit Report</u>:**
The Department will work with the General Assembly to evaluate options related to the State's contribution to health (medical and dental) benefits for part-time employees and on any necessary statutory changes. The Department will also provide guidance to state agencies on the consistent designation of part-time and seasonal employees.

**<u>Agency's Current Comments on Implementation Status of Recommendation</u>: Partially Implemented**
The Department worked with the General Assembly and two bills were considered during the 2011 session: House Bill 11-1301 which would have removed the grandfather date in the statute granting the Director authority to prorate state contributions and House Bill 11-1257 which would have specified three levels of prorated contribution based on hours worked per week. Both bills were unsuccessful. The Department is working with the Governor's Office to determine the appropriate course of action for the 2012 legislative session. It should be noted that prorating on hours per week is almost impossible to administer as the State's payroll systems are not programmed to track in such a manner for this purpose, and benefits are provided and paid for on a monthly basis. Thus, if a prorated contribution is implemented, the Department would consider a different basis such as their percentage of a full-time position (for example, an employee who typically works 16 hours per week, would be considered 40% of a full-time position).

**<u>Recommendation #</u>: 5**

**<u>Agency Addressed:</u>** Department of Personnel & Administration

**<u>Recommendation Text in Audit Report</u>:**
The Department of Personnel & Administration should evaluate the State's current leave policies compared with other comparable employers and determine if changes are needed. Specifically, the Department should:

a. Evaluate the State's sick leave accrual rate and determine if 10 days per year is consistent with comparable employers and the cost impact to the State of increasing the number of employee sick days. On the basis of this evaluation, the Department should pursue any necessary statutory changes to employees' sick leave accrual rate.

b. Continue to pursue a pooled "paid time-off" leave system for state employees that combines annual and sick leave into one leave pool, ensures increased flexibility and benefit to employees, and results in reduced compensated absences liability for the State.

**<u>Agency's Response</u>** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**
The Department will continue to evaluate the sick leave accrual rate to determine if statutory change should be pursued as well as the potential implementation of a pooled "paid time-off" leave system.

**Agency's Current Comments on Implementation Status of Recommendation: Partially Implemented**
The Department evaluated the statutory sick leave accrual rate using the latest data from the *2011 Paid Time Off Survey* published by Mountain States Employers Council. We found our sick leave accrual rate of 10 days or 80 hours per year is generally consistent with market practices. The Department is working with the Governor's Office to evaluate the potential implementation of a pooled "paid time-off" leave system.

**Recommendation #: 6**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**
The Department of Personnel & Administration should implement sufficient controls over the benefit enrollment process to ensure that only eligible individuals participate in the State's benefit plans. These controls should include:

a. Conducting an eligibility audit for all individuals currently enrolled in the State's benefit plans. Once the initial audit is completed, the Department should continue to periodically conduct eligibility audits based on a sample of files.

b. Implementing system controls in the Benefits Administration System that require benefit administrators to scan and approve documentation verifying dependent eligibility before an employee's enrollment can be completed.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**
The Department is in the procurement process to contract with a third party to conduct an eligibility audit. The audit is anticipated to be conducted and concluded prior to the beginning of the next plan year, Fiscal Year 2012. In addition, the Department will implement improved controls around document verification, including requiring that proper documentation be approved and scanned into the Benefits Administration System.

**Agency's Current Comments on Implementation Status of Recommendation: Partially Implemented and Ongoing**
The Department contracted with HMS Employer Solutions to conduct the independent dependent eligibility audit. To date, approximately 90 percent of all covered dependents have been verified. The Department is finalizing the eligibility review process for the remaining dependents and unverified dependents will be removed from coverage by August 2011. In April, the Department began requiring verification of dependent status on all open enrollment and new hire transactions when a dependent is added; transactions that include a dependent must be reviewed and approved by the Employee Benefits Unit. Beginning with FY 2012, mid-year qualified events involving dependents will also be reviewed and approved by the Employee Benefits Unit. The Department also plans to conduct periodic audits of sample records moving forward.

**Recommendation #: 7**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**
The Department of Personnel & Administration should ensure that accurate enrollment data are used for payroll purposes and to pay premiums to insurance carriers for fully-insured plans and administrative fees to third-party administrators for self-funded plans by:

a. Routinely reconciling enrollment data in the Benefits Administration System with data in the State's payroll systems.

b. "Self-billing" all insurance carriers and third-party administrators using Benefits Administration System enrollment data. If self-billing is not an option, the Department should routinely reconcile the invoiced enrollment data with Benefits Administration System data.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**
The Department has reinitiated the processes to reconcile enrollment data in the Benefits Administration System and invoiced enrollment data with state payroll systems.

**Agency's Current Comments on Implementation Status of Recommendation: Implemented and Ongoing**
The Department has reconciled the Benefits Administration System enrollment data with the payroll systems for all of Fiscal Year 2011. To date, a total of $178,432 has been identified and billed to agencies, with $131,498 collected to date. The Department will continue to collect

the remaining $46,934 and perform ongoing reconciliations. The insurance carriers and third-party administrators are provided the enrollment data from the Benefits Administration System; this data is the basis for invoiced enrollment data.

**Recommendation #: 8**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**

The Department of Personnel & Administration should improve its ability to adequately monitor insurance carrier, third-party administrator, and pharmacy benefit manager performance by renegotiating its contracts to strengthen provisions by:

a. Requiring that the insurance companies, third-party administrator, and pharmacy benefit manager provide more complete and comprehensive performance reports addressing key areas such as subrogation and cost-recovery efforts, claims appeals processing, and pharmacy benefit management activities, as outlined in this audit report.

b. Requiring that the Department be notified in advance of formulary changes for prescription drugs so that the Department can evaluate and approve such changes.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**

The Department agrees to renegotiate the current contracts to ensure more complete and comprehensive performance reports are obtained from providers. The Department will also incorporate a requirement for advance notice of formulary changes in order to evaluate and approve the changes. The ability to approve formulary changes is already in the contract with the third-party administrator so the Department will ensure it is implemented. We will evaluate if a contract with a Pharmacy Benefit Management specialist who possesses the clinical expertise to evaluate the impact of the proposed change to participants and costs is appropriate.

**Agency's Current Comments on Implementation Status of Recommendation: Implemented and Ongoing**

The Department renegotiated the current contract performance standards for FY 2012 to include quarterly claims appeal reporting. Additionally, subrogation reports are being provided on a monthly basis effective March 2011. The Fiscal Year 2012 contract was also clarified to allow the State of Colorado to either accept or reject formulary changes to more expensive tiers, and additions or deletions to the formulary. Changes to the formulary are made on January 1st and July 1st of each year. Changes involving moving to lower tiers, quantity limitations, and step therapy will be reported monthly. The Department will continue to evaluate if additional performance standards should be included in the contracts.

**Recommendation #: 9**

**Agency Addressed:** Department of Personnel & Administration

**Recommendation Text in Audit Report:**

The Department of Personnel & Administration should strengthen its oversight of claims for self-funded plans to ensure that its third-party administrator is accurately and appropriately processing and paying all medical and pharmacy claims by:

a. Conducting periodic and timely audits of the administrator's claims processing.

b. Renegotiating and strengthening the third-party administrator contract provisions to allow the State more flexibility with claims audits.

**Agency's Response** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**Agency's Written Response in Audit Report:**

a. The Department agrees that a periodic audit of claims processing by the third-party administrators is good practice. In fact, such audits were conducted on a regular basis when the plan was self-funded in the past. The Department will complete the procurement process to contract with an independent auditor to conduct a claims administration audit in Fiscal Year 2012, when one year of data under the new contract is available. Based on the findings, the Department will evaluate the appropriate frequency for future audits.

b. The Department will renegotiate the provisions of the current contract to allow more flexibility, including the ability to have claims administration audits conducted by an independent auditor.

**Agency's Current Comments on Implementation Status of Recommendation: Partially Implemented**

The Fiscal Year 2012 contract has been amended to allow the State to conduct an independent claims audit as often as reasonable. The Department is currently preparing the Request for Proposal to solicit an independent auditor to conduct a claims audit of the first 12 months of claims processing.

**Recommendation #: 10**

**<u>Agency Addressed:</u>** Department of Personnel & Administration

**<u>Recommendation Text in Audit Report</u>:**

The Department of Personnel & Administration should evaluate the cost-benefits of developing and implementing a comprehensive wellness program into the State's group benefit plans. Based on the results of this evaluation, the Department should take appropriate steps to develop and implement a wellness program.

**<u>Agency's Response</u>** *(i.e., Agree, Partially Agree, or Disagree)***:** Agree

**<u>Agency's Written Response in Audit Report</u>:**

The Department will evaluate the cost-benefits of implementing a comprehensive wellness program into the group benefits plans. The State's medical plan options already have wellness plans for enrolled participants. However, financial incentives have not been used so the evaluation will include looking at potential funding strategies for such incentives. Department staff will work with the two providers in performing the evaluation with the goal of completing it by the end of this fiscal year. The Department believes that the ultimate goal should be the trend that is developing in the market—an effective health management program that applies to the entire workforce, not just those enrolled. These programs are standalone and focused on productivity through change in a number of areas, such as health care costs, wellness, and absence management. Thus, the Department will continue to monitor developments in this area with an eye towards this broader goal.

**<u>Agency's Current Comments on Implementation Status of Recommendation</u>: Partially Implemented**

The Department continues to evaluate the cost-benefit of implementing a comprehensive wellness program into the State's group benefit plans. The Department will also continue to monitor trends and developments in the market and look for ways to expand the program to eventually include all employees.