

March 23, 2004

Internal Audit Report 2004-4
Premera Blue Cross Blue Shield of Alaska
Contract Administration
Employee Relations Department

Introduction. On March 1, 2001, the Municipality of Anchorage (Municipality) contracted with Premera Blue Cross Blue Shield of Alaska (BCBS) to provide medical, dental, vision, prescription and audio healthcare coverage for its employees. Prior to March 2001, the Municipality had a “split funded group plan agreement” also known as a minimum premium payment healthcare program, where the Municipality paid actual claims’ costs and a minimum monthly premium to AETNA for administrative fees. According to the Records, Benefits and Payroll Division (Benefits), one of the reasons for the move to a fully insured funding arrangement agreement with BCBS was that BCBS estimated they could save the Municipality 10 percent over what the Municipality would have paid AETNA for the same coverage. According to Account Experience Summary Reports provided by BCBS, in 2003 the Municipality paid approximately \$27,676,424 for healthcare services.

Objective and Scope. The objective of this audit was to determine if the BCBS contract for healthcare coverage was adequately administered and monitored to control healthcare costs. We were unable to audit contractor records and claims payments due to the lack of an audit clause in the contract. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of December 2003 through February 2004. The audit was requested by the Administration.

Overall Evaluation. The administration and monitoring of the BCBS contract need improvement to control healthcare costs. We found that Benefits staff did not appear to monitor the BCBS

contract to ensure the contractor was performing satisfactorily. In addition, we found the contract did not include several important contractual elements, such as performance guarantees and an audit provision. Moreover, a proposed amendment to the BCBS contract was not properly prepared. For example, while the proposed amendment was for \$35,013,562, the Assembly approved a memorandum to provide continuing healthcare coverage in the amount of \$34,878,782. We also found that Fund 735, Employee Benefit Agency, containing revenues and expenditures for the BCBS contract for healthcare coverage, was not monitored or reconciled during the year by Benefits staff. A preliminary reconciliation for the end of 2003 by the Controller Division indicated that there was a shortage of more than \$800,000 in the Fund. Finally, Benefits personnel made six late payments to BCBS since 2002.

FINDINGS AND RECOMMENDATIONS

1. BCBS Contract Not Monitored.

- a. Finding.** Benefits staff did not appear to be monitoring the BCBS contract to ensure the contractor was performing satisfactorily. We found no evidence that any verification of paid claims had been performed to ensure claims paid were only for plan participants. Furthermore, we found no evidence that Benefits staff were involved in analyzing and verifying proposed rates, negotiating contract amendments, and reviewing claims statistics to discover significant trends in healthcare issues/costs. As a result, contractual problems were not identified and resolved.

We found that most contract monitoring and administrative tasks had been delegated to Mercer, the Municipality's benefits consultant. The Benefits staff relied on Mercer to negotiate the contract extensions, set plan rates, review claims reports, and so forth. Using a consultant to assist in working complex and complicated issues is common practice where highly specialized expertise and industry knowledge is

required. However, the Municipality's best interest may not always be served if consultants are allowed to perform all of the monitoring tasks instead of assisting the Municipality in administering contracts.

Contract monitoring is an essential part of the contracting process. Monitoring helps ensure that contractors comply with the terms of the contract, performance expectations are achieved, and any problems are identified and resolved. Without a sound monitoring process, the Municipality does not have adequate assurance it receives what it contracts for or that the services are provided for the least cost.

- b. **Recommendation.** The Employee Relations Director should encourage Benefits staff responsible for the administration of the BCBS contract to more effectively monitor and administer the contract for the Municipality's best interest.

- c. **Management Comments.** Management stated, "Management agrees that it should encourage Benefits staff responsible for the administration of BCBS contract to more effectively monitor and administer the contract for the Municipality's best interest.

"Management asserts that use of the Municipality's benefits consultant to review the rates and review claims reports for reasonableness is appropriate given that actuaries develop the rates and Benefits staff does not have that level of expertise to perform an actuarial evaluation of rates.

"In a 2001 audit of Records and Benefits performed by Internal Audit, IA recommended that they perform a claims audit and Management concurred. Blue Cross Blue Shield agrees to an audit of claims, but would like that function to be done by an external auditor. Management concurs that an audit of claims is appropriate and will work with Blue Cross Blue Shield to reach agreement on who will perform that audit."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **BCBS Contract Missing Important Elements.**

- a. **Finding.** Several important contractual elements were not included in the BCBS contract. Our review of the BCBS contract revealed the following:

- Performance guarantees and penalties were not included in the contract, even though BCBS personnel told us performance guarantees and penalties were normally provided to all of BCBS's large clients. Performance guarantees define performance standards and identify how vendor performance will be evaluated. While the original proposal from BCBS included performance guarantees, Benefits staff inadvertently left them out of the 2001, 2002 and 2003 contracts. As a result, the Municipality had no assurance that BCBS was processing claims timely and in accordance with contract terms.
- No audit provision was included in the contract. As a result, we were not able to audit contract records and claims data to determine if all claims paid were appropriate.
- The contract did not include a requirement for monthly and annual claims experience reporting. This requirement was included in the original BCBS proposal as part of the performance guarantees, which were left out of the contract. Even without a contractual requirement, BCBS has provided claims experience reports on a regular basis.
- The contract did not identify a contract monitor. As a result, there is little assurance that the contractor complied with contract provisions.

- b. Recommendation.** The Employee Relations Director should ensure that performance guarantees and an audit provision are included in the contract, as well as establish a contract monitor.
- c. Management Comments.** Management stated, “Management agrees that the Blue Cross Blue Shield contract should contain provisions for Performance Guarantees and an Audit Provision. With the assistance of the Legal Department, the contract extension amendment was modified to include these provisions.”
- d. Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. Contract Amendment Not Properly Prepared.

- a. Finding.** The proposed amendment to the BCBS contract, extending the contract to 2004, was not properly prepared. For example, our review of the proposed December 16, 2003, amendment revealed the following problems:

 - The proposed amendment stated that the 2004 contract amount was for \$35,013,562. However, the Assembly approved a memorandum for continued healthcare coverage which stated that the 2004 contract amount was for \$34,878,782, a difference of nearly \$135,000.
 - The current rate structure implemented for 2004 was based on a refund eligible contract provision. However, the proposed amendment did not include this wording.
 - The performance guarantees referred to in the amendment were the guarantees originally proposed by BCBS. However, they did not reflect the

performance guarantees agreed upon in the 2003 Police Union grievance settlement.

- Benefits staff stated that the requirement to make monthly payments had been revised by BCBS. Instead of the BCBS payments being due on the 1st of every month, payments would not be required until BCBS sent an invoice on or about the 17th of every month. However, the proposed amendment did not contain this revision.

As of February 1, 2004, the contract amendment had not been finalized and the January payment had not been made.

- Recommendation.** The Employee Relations Director should ensure contract amendments include all required provisions and changes, and are processed in a timely manner to preclude interruption of service.
- Management Comments.** Management stated, “Management agrees that contract amendments should include all required provisions and changes, and should be processed in a timely manner.”
- Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. Payments to BCBS Not Reconciled.

- Finding.** Fund 735, Employee Benefit Agency, which contains revenues and expenditures for the BCBS contract, was not monitored or reconciled during the year by Benefits staff. Fund 735 revenues were received from all Municipal Departments through the payroll system, as well as payments received from Police and Fire

Retiree Medical Trust, and COBRA participants. Expenditures consisted of payments made to BCBS for healthcare services. The Controller Division's preliminary reconciliation of Fund 735 for 2003 indicated a shortage of more than \$800,000. If a monthly reconciliation had been performed, a shortage of funds may have been detected and corrected during 2003. In addition, a periodic reconciliation of revenues and expenditures could provide assurance that the proper amount of revenue was budgeted to cover payments made to BCBS.

- b. **Recommendation.** The Employee Relations Director should ensure that Benefits staff monitor and reconcile Fund 735 on a monthly basis.

- c. **Management Comments.** Management stated, "Management agrees that Benefits staff should monitor and reconcile Fund 735 on a monthly basis."

"Management would like to note that it was only recently informed of this responsibility with the change from Fund 603 to Fund 735."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Late Payments.**

- a. **Finding.** Benefits personnel made three late payments to BCBS in 2002 and two late payments in 2003. In addition, as of February 2004, the BCBS payment for January 2004 had not been made. According to Section III, Payments, of the BCBS contract, the Municipality shall pay on or before the 1st of each month, an amount equal to the total of the monthly contractual rates with a 10-day grace period. If a payment is not received by BCBS by the end of the grace period, the Municipality will pay a daily late charge. The late charge is calculated from the due date, rather than from the end

of the grace period. The late charge is based on the average prime rate during the contract period, plus 2 percent on the amount of the late payments for the number of days late. In addition, according to Section III.B of the BCBS contract, BCBS will not pay benefits for otherwise eligible expenses (claims) for any day that payment has not been made. For example, the Police Union filed a grievance stating that healthcare claims were not being paid timely. BCBS responded by stating that since the Municipality had not made timely payments, BCBS was not obligated to pay employee's claims timely as stated in Section III.B of the contract.

- b. Recommendation.** The Employee Relations Director should ensure that payments to BCBS are made in accordance with contract requirements.
- c. Management Comments.** Management stated, "Management agrees that payments to Blue Cross will be made in accordance with contract requirements."
- d. Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on February 9, 2004.

Audit Staff:
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