



## Internal Audit Report

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Third-Party Administration of Self-Insured Medical and Dental

January 1, 2011 – June 30, 2012

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Third-Party Administration of Self-Insured Medical and Dental  
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## Transmittal Letter

Audit Committee  
Port of Seattle  
Seattle, Washington

We have completed a limited operational audit of Third-Party Administration of Self-Insured Medical and Dental.

We examined information related to the period January 1, 2011, through June 30, 2012.

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.

We extend our appreciation to the management and staff of the Human Resources and Development Department for their assistance and cooperation during the audit. We also thank the management and staff of Premera Blue Cross and Washington Dental Services for their assistance during the audit.



Joyce Kirangi, CPA  
Director, Internal Audit

## Executive Summary

**Audit Scope and Objectives** We examined Third-Party Administration of the Self-Insured Medical and Dental Program for the period January 1, 2011, through June 30, 2012.

The purpose of the audit was to determine whether:

1. Port management controls are adequate to ensure:
  - a. Proper processing and verification of claims billings
  - b. Proper processing and verification of administrative fee billings
  - c. Claims paid are valid and for eligible parties
  - d. Proper validation of dependents receiving medical and dental benefits
  - e. Compliance with legal requirements
  
2. Port management has complied with legal requirements related to annual reporting to the state

**Background** The self-insured medical and dental program began January 1, 2011, at which time the Port transitioned from a fully insured medical and dental program to a self-insured medical and dental program. Prior to this transition, consultants completed a feasibility study in March 2009. On May 11, 2010, the Commission adopted Resolution 3636, which authorized the self-insured medical and dental program. On November 5, 2010, the Port submitted its application to the state of Washington to become a self-insured public employer, which was approved.

This program is managed by the Port's Human Resources and Development Department and administered under agreements with third-party administrators: Premera Blue Cross (Premera) and Washington Dental Services (WDS). The program has resulted in savings of \$1 million from 2010, when the Port was fully insured for medical and dental coverage, to 2011, when the Port transitioned to self-insured medical and dental coverage. These savings do not include payments associated with Group Health or union employees.

For the 18-month period under audit, the medical claims payments were \$15M; the dental claims payments were \$2M. These payments do not include other related payments (e.g., stop-loss insurance premiums and consulting/broker fees).

**Audit Result Summary** We did not identify any processed claims that were inaccurate or invalid; however, there are opportunities to improve management controls and oversight of the self-insured medical and dental programs. Although annual reporting to the state is timely and accurate, the review process can be improved. These issues are discussed in Finding 1. Although we did not become aware of any ineligible dependents, there are opportunities to strengthen controls over ensuring dependent eligibility, which are discussed in Finding 2.

## Background

The Port's self-insured medical and dental program began January 1, 2011, at which time the Port transitioned from a fully insured medical and dental program to a self-insured medical and dental program.

The following describes the distinctions between fully insured and self-insured programs:

- In a traditional **fully insured** health plan, a company pays a premium. The insurer collects the premiums and pays the health care claims.
- In a **self-insured** plan, a company pays the claims instead of a premium, and the company may purchase stop-loss insurance to cover claims that exceed specified levels.

On May 11, 2010, the Commission adopted Resolution 3636, which authorized the self-insured medical and dental program. On November 5, 2010, the Port submitted its application to the state of Washington to become a self-insured public employer, which was approved.

The Port's self-insured program was administered in 2011 and 2012, by Premera Blue Cross (medical) and Washington Dental Services (dental). In 2012, the Port conducted a competitive process for third-party administration of the medical and dental self-insured programs for 2013, awarding the administration to:

- Medical – Cigna
- Dental – WDS

The self-insurance program does not include health coverage for union employees or employees covered under Group Health.

As with other third-party management agreements, to which the Port is a party, the Port retains full responsibility for the program's transactions and legal compliance. The third party is responsible for administering the program, but the Port is responsible for ensuring transactions processed are complete and accurate and the program complies with legal requirements. The overarching concept is that the Port may delegate its responsibilities to a third-party administrator, but it may not abdicate its responsibilities. Additionally, under state law, the Port must conduct a claims audit every three years. A claims audit ensures that providers' billing codes are proper in relation to the services provided, fees charged by providers are based on negotiated rates, procedures billed are within the parameters of the Port's plan, etc.

**Financial Highlights**

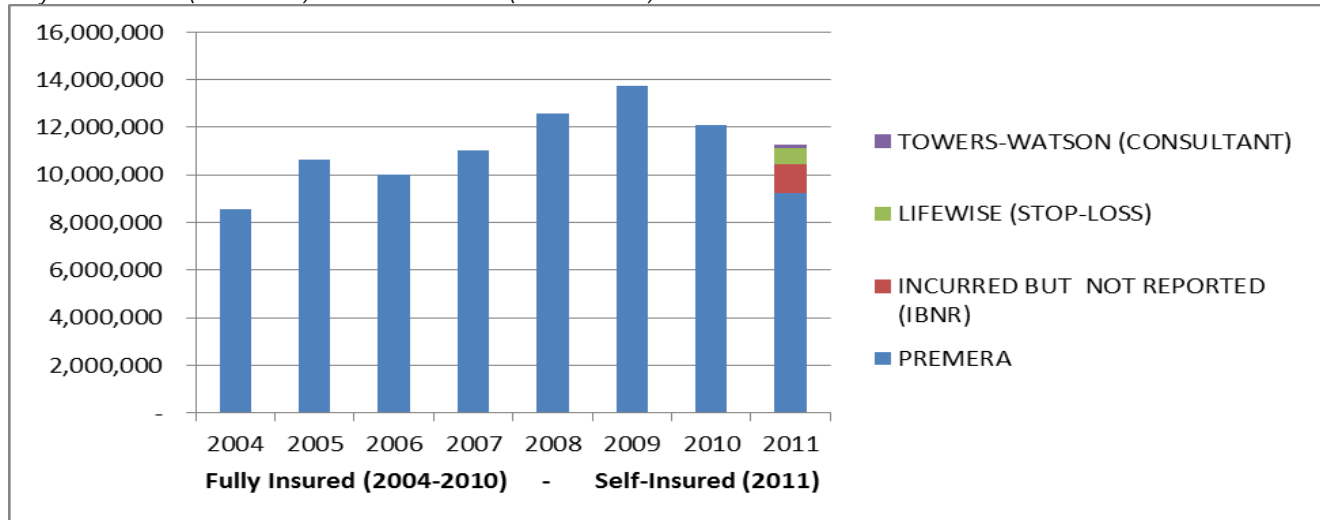
For the 18-month period under audit, the medical claims payments were \$15M; the dental claims payments were \$2M. These payments do not include other related payments (e.g., stop-loss insurance and consulting/broker fees).

Chart 1, below, compares medical payments during the time the Port was fully insured to the first year of self-insurance in 2011. The Port purchases stop-loss insurance to minimize the risk of large medical claims payments. State law requires aggregate stop-loss insurance for claims in excess of 125% of annual expected claims. The Port also elected to purchase individual stop loss insurance for claims that exceed \$150,000 per individual per year. For 2011, stop-loss coverage premiums were \$702k, and the stop-loss carrier covered a total of \$407k in medical claims payments that exceeded the stop-loss limit. For 2012, stop-loss premiums are projected to be \$1M. Through June, the stop-loss carrier covered \$595k in total medical payments that exceeded the stop-loss limit.

Other related payments include consultant/broker fees and claims incurred in 2011, but not reported and paid until 2012.

**Chart 1: Port of Seattle Medical Payments**

*Fully Insured Period (2004 – 2010) & Self-Insured Period (2011 – Present)*

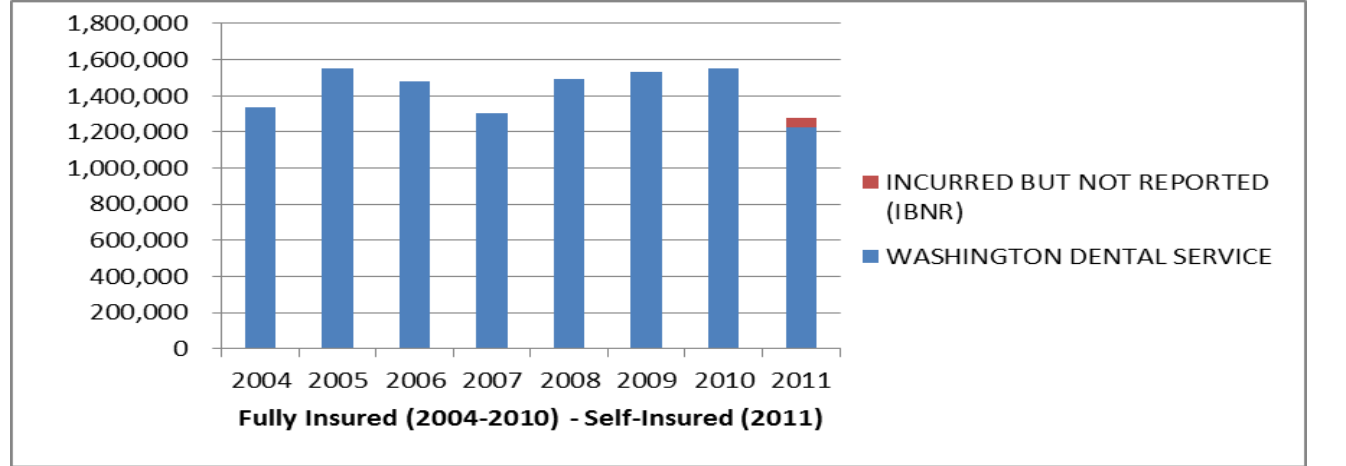


Data Source: POS PeopleSoft Records

Chart 2 compares dental payments during the time the Port was fully insured to the first year of self-insurance in 2011. Dental payments do not include stop-loss. Also, no consulting fees were charged to the dental program in 2011.

**Chart 2: Port of Seattle Dental Payments**

*Fully Insured Period (2004 – 2010) & Self-Insured Period (2011 – Present)*



Data Source: POS PeopleSoft Records

### Highlights and Accomplishments

- The self-insured medical and dental programs have resulted in decreased health care payments (claims and other related payments) by \$1 million (from 2010 to 2011).
- In 2012, the Port competitively bid third-party administration, which is projected to result in savings of \$750,000 in 2013.
- The self-insured medical and dental programs have allowed the Port greater flexibility in plan design and the coverage it provides to employees, and which also will facilitate compliance with federal health care reforms enacted in 2010.
- Through self-insurance, the Port has greater access to aggregated claims data that may be used to more effectively manage the program and support employee health. <sup>1</sup>
- Starting in 2013, self-insurance will allow the program to more fully integrate elements of the Port's own wellness program with the health-care program to contain health-care payments.
- The first claims audit is expected to be conducted during 2013.

### Audit Scope and Methodology

The scope of the audit covered the period January 1, 2011, through June 30, 2012. We utilized a risk-based audit approach. We gathered information through interviews with management and staff in order to obtain a complete understanding of the self-insured medical and dental program and its administration. We analyzed claims activity and associated expenditures. We conducted the following procedures to address our audit objectives:

<sup>1</sup> Personal health information is protected under the Health Insurance Portability and Accountability Act (HIPAA).

1. Management controls are adequate:

- a. Verify that weekly claims invoicing is supported by the detailed claims payments.

We traced and agreed a limited number of weekly claims invoices to the detailed database of activity provided by the third-party administrators.

- b. Verify that stop-loss is properly applied.

We identified claims that exceeded the \$150k threshold and determined whether stop-loss had been applied against these claims.

- c. Verify that monthly administrative fee invoicing based on:

- i. Per-person fees cited in the agreements with the third-party administrators
- ii. Accurate number of covered employees/dependents

We developed an expectation for the total administrative fees and compared our projection to the total administrative fees paid by the Port to determine whether the fees were reasonable.

- d. Verify claims billings against administrators' accounting records.

We determined whether the third-party administrators process all claims through systems that are separately audited. We reviewed the audit reports to determine whether the external auditors had provided assurance that the system controls were working as designed and whether the auditors had brought forward any significant issues. We selected targeted and random samples of claims transactions and determined whether the transactions were properly supported in the third-party administrators' accounting records. We further determined whether processed claims were for valid Port employees.<sup>2</sup>

#### Dental - WDS

From the database of the two dental plans provided by WDS, we selected two separate sample sets:

- From Plan 00201, with total claims payments of \$1,109,449, we selected 96 separate transactions that totaled \$30,747 (3%).
- From Plan 09201, with total claims payments of \$744,141, we selected 68 separate transactions that totaled \$17,147 (2%).

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<sup>2</sup> Our audit of claims did not constitute a "claims" audit, as mandated under state law to be performed every three years and which requires the expertise of claims auditors.



Medical – Premera

From the database provided by Premera, with total claims payments of \$15,177,952, we selected 97 separate transactions that totaled \$1,278,883 (8.5%).

- e. Verify dependent eligibility.

We selected a sample of employees of the Port with active dependents and confirmed by signed affidavit whether the dependents cited in the affidavit agreed to the dependents in the Port's system.

2. Annual reporting to the state

We reviewed the following reports and determined whether they had been submitted timely and accurately:

- Schedule 21 to the Washington State Auditor
- Forms A and B to the Local Government Self-Insurance Program
- GASB 10 note disclosures

**Conclusion**

We did not identify any processed claims that were inaccurate or invalid; however, there are opportunities to improve management controls and oversight of the self-insured medical and dental programs. Although annual reporting to the state is timely and accurate, the review process can be improved. These issues are discussed in Finding 1. Although we did not become aware of any ineligible dependents, there are opportunities to strengthen controls over ensuring dependent eligibility, which are discussed in Finding 2.

## Schedule of Findings (Improvement Opportunities) and Recommendations

### 1. The Port's Oversight Of The Self-Insured Medical And Dental Program Can Be Improved.

The Human Resources and Development (HRD) managers and staff that oversee the work of the third-party administrators have not implemented certain controls, which could improve oversight of the third-party administration of the self-insured medical and dental programs and the annual reporting process. We identified the following areas that could be improved:

- HRD staff processes claims invoices (medical and dental) of well over \$200,000 weekly, but staff does not reconcile the weekly detailed listing of individual claims to the weekly invoice totals. Thus, there could be discrepancies between the detailed listing of individual claims paid by the third-party administrators and the invoice summary total.
- Although management uses various criteria to select the third-party administrators, HRD staff does not obtain audit reports (referred to as an SSAE 16 Report) from the third-party administrators prior to contracting with them. Such reports provide an independent assessment by independent auditors of the adequacy of the third-party administrators' controls and processing systems. Such audit reports are intended for user entities (like the Port), so that they can be aware of any issues.
- Accounting and Financial Reporting (AFR) prepares the financial sections (Form B) of the Annual Report to the State Risk Manager (Individual Health & Welfare Self-Insurance Programs). HRD reviews the financial sections, completes the remainder of the report, signs the report, and submits it to the state. HRD management discusses the financial information with AFR to ensure HRD management understands how AFR derives the amounts. However, HRD does not reconcile the amounts against its own tracking documents. HRD relies on AFR, which is responsible for the Port's central accounting, to ensure the accuracy and appropriate presentation of the financial amounts on Form B.

HRD management has not fully assessed its current processes to determine whether they are adequate to ensure strong controls over third-party administration of the self-insured medical and dental programs. When management does not design internal controls to provide reasonable assurance of achieving its objectives, it cannot be assured of the effectiveness and efficiency of its operations. For example, when reconciliations are not performed, errors could occur and not be detected timely. Additionally, if audit reports are not obtained from third parties, management may not become aware of potential control issues.

Further, HRD management and AFR have not developed a process that ensures the financial information presented in the reports to the state depicts the true results of the self-insured program. The current presentation of the report to the state indicates that the program is underfunded, when, in fact, it is not.

*Committee of Sponsoring Organizations (COSO)*<sup>3</sup> cites five interrelated components of effective internal control:

1. Control environment – The tone set by management that influences the control consciousness of staff.
2. Risk assessment – Management’s identification and analysis of relevant risks to achievement of its objectives.
3. Information and communication – Systems to support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
4. Control activities – specific policies or procedures that directly address risks related to the achievement of objectives.
5. Monitoring – Management’s review of the operation of internal controls over time.

The *2011 SSAE 16 Report* (for Premera and WDS) provides a listing of “complementary user entity controls,” which states, in part:

This section describes controls that should be in operation at user entities [Port of Seattle] to complement the controls at [Premera and WDS] ... to provide reasonable assurance that:  
*(Abridged – The SSAE 16 Report lists 14 controls. We have captured four of the listed controls.)*

- Transaction activity is authorized, complete and accurate.
- Erroneous and/or incomplete data is [sic] corrected and resubmitted in a timely manner.
- [Premera and WDS]-generated output is reviewed for completeness and accuracy.
- Claims activity and reporting is monitored and reviewed, and suspicious/erroneous activity is followed up on.

## **Recommendations**

1. Ensure staff reconciles weekly the claims invoice to the claims detail from Premera and WDS and researches and resolves discrepancies timely.
2. Ensure the SSAE 16 Report is obtained from each of the third-party administrators of the self-insured medical and dental programs.
3. Review the SSAE 16 Report for third-party administrators, to ensure the Port’s complementary controls are adequate.
4. Coordinate with AFR and establish a process to more clearly document HRD’s review of the accuracy and presentation of the annual reports submitted to the state.

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<sup>3</sup> COSO was formed in 1985. Its goal is to provide management guidance in three interrelated subjects: enterprise risk management (ERM), internal control, and fraud deterrence.

5. Consider whether the establishment of a restricted cash (reserve) account for the self-insured medical and dental program would assist in the presentation of the information in the annual reports.

### Management Response

- *Staff is now reconciling the weekly claims invoice to the claims detail from Premera. Staff is working with WDS to obtain the weekly claims detail, so that staff can reconcile the WDS claims detail to the weekly invoices.*
- *The most recent SSAE 16 reports from Premera, WDS, and Cigna have been obtained and are under review. The reports indicate that the controls in place at these entities are adequate to achieve their control objectives.*
- *Regarding the Annual Report to the state:*
  - *The state Office of Financial Management (“OFM”) requires reporting on a form (“Form B”) that assumes the reporting entity has a separate cash account for their self-funded medical and dental programs. Because the Port does not maintain such an account, and because the directions for the new state form did not provide clear directions, HRD staff consulted with AFR staff on appropriate completion of the state form. As a result of this consultation, the 2011 claims payments we anticipated paying in 2012 were reported as a negative balance. HRD management consulted with OFM and was advised that this type of reporting was acceptable, given the Port’s ability to pay any such payments from the Port’s general fund.*
  - *HRD management intends to re-state its 2011 report to indicate a zero cash balance/reserve, and include a note that the initial report showed a negative amount that represented 2011 plan payments anticipated to be paid in 2012.*
  - *Going forward, HRD management will use an approach that creates a zero balance, while also considering the possibility of a separate account.*
  - *HRD and AFR will work together to develop a process that more clearly documents how the financial amounts provided by AFR reconcile to amounts tracked by HRD throughout the year.*

## 2. The Port's Process For Determining Eligibility Of Dependents To Be Covered By The Port's Insurance Benefit Plans Can Be Improved

Employees may add spouses, domestic partners, children, and other dependents to their medical and dental insurance plans when they are hired, during open enrollment, or within a certain number of days after events (e.g., marriage, execution of a domestic partnership agreement, birth/adoption, or other legal arrangements). The Port requires that employees submit signed affidavits in support of dependent eligibility to the Human Resources and Development Department. The claims payment breakout between employees and dependents is as follows:

- As of January 1, 2012, the self-insured **medical** plan provided benefits to 941 employees and 1206 dependents. The claims payments for the period January 1, 2011, through June 30, 2012, were \$7,429,932 (employees) and \$7,748,021 (dependents).
- As of January 1, 2012, the self-insured **dental** plan provided benefits to 986 employees and 855 dependents. The claims payments for the period January 1, 2011, through June 30, 2012, were \$906,216 (employees) and \$947,374 (dependents).

HRD management has not fully assessed its current processes, which include periodic dependent eligibility audits, to determine whether they are adequate to ensure eligibility of persons receiving medical and dental insurance coverage as dependents. By requiring only signed affidavits from employees of dependent eligibility, the Port is not ensuring that individuals receiving medical and/or dental benefits as a spouse, domestic partner, child, or other qualified dependent are eligible. Thus, the Port may be providing medical and/or dental benefits to ineligible persons.

*Generally Accepted Government Auditing Standards (2011 Revision), Section 6.20, states, in part:*

Controls over the safeguarding of assets and resources include policies and procedures that ... reasonably prevent or promptly detect unauthorized acquisition, use, or disposition of assets and resources.

### Recommendations

1. When hiring new employees, require sufficient documented evidence to support eligibility for medical and dental insurance coverage of spouses, domestic partners, children, and other qualified dependents. Examples of adequate documentation include marriage certificates and/or recent tax returns, legal documents granting a domestic partnership, birth certificates, or other legal support for dependent status.
2. For current employees, initiate a process to obtain documented proof of dependent eligibility. Continue this process until documents have been obtained from all employees for their dependents receiving medical and dental insurance benefits.

### Management Response

*HRD management will review options and their implications for requiring more documentation to support dependent eligibility.*