REPORT BY THE

OFFICE OF THE CITY AUDITOR

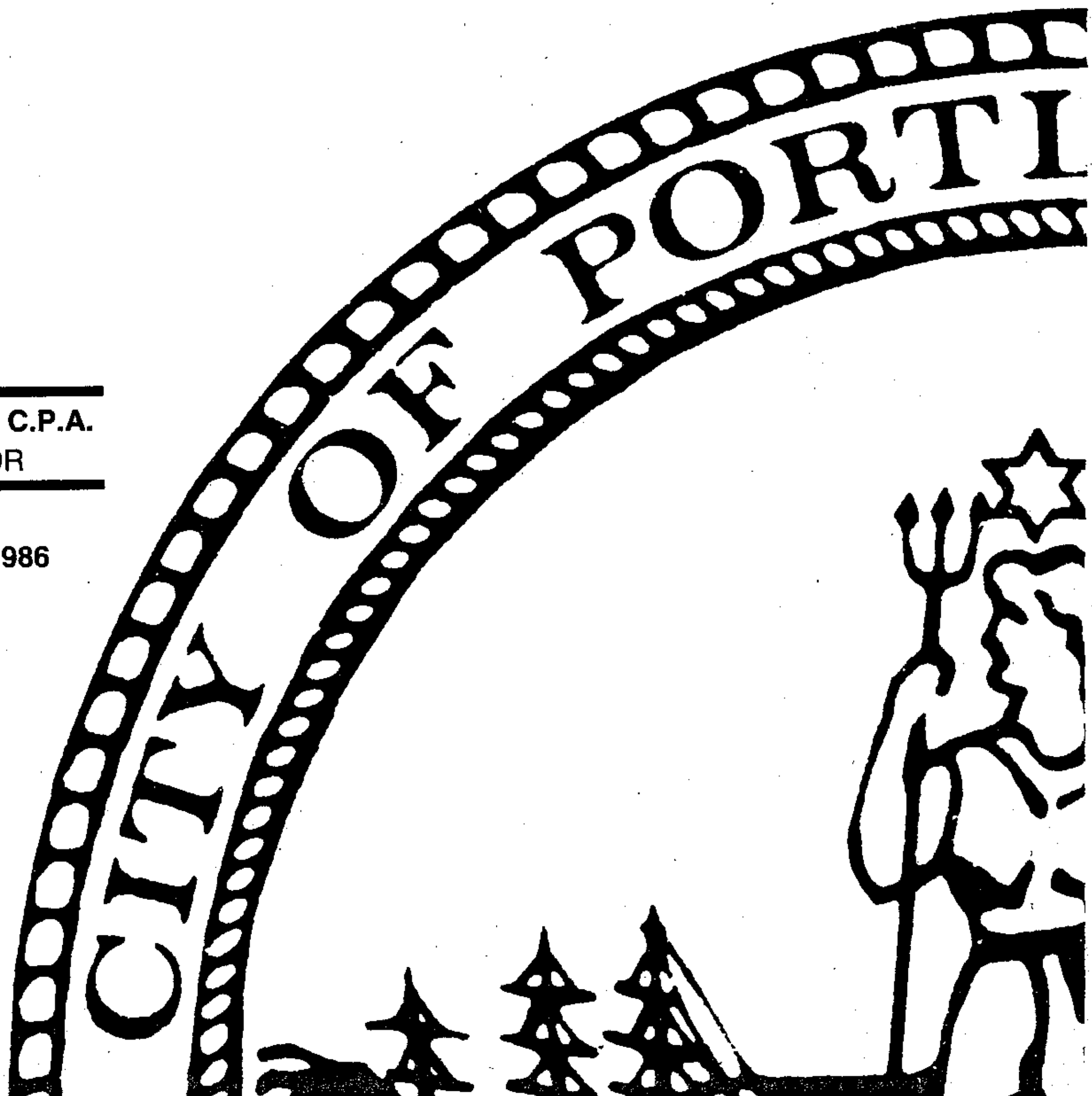
CITY OF PORTLAND, OREGON

CONTAINING THE COST OF CITY HEALTH CARE PROGRAMS

JEWEL LANSING, C.P.A.
CITY AUDITOR

SEPTEMBER 1986

IAR 2-86



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INTERNAL AUDIT DIVISION
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#2-86

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PORTLAND, OREGON
OFFICE OF CITY AUDITOR

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September 23, 1986

TO: J.E. Bud Clark, Mayor
Dick Bogle, Commissioner
Mike Lindberg, Commissioner
Mildred Schwab, Commissioner
Margaret Strachan, Commissioner
John Woods, Director, Bureau of Personnel Services

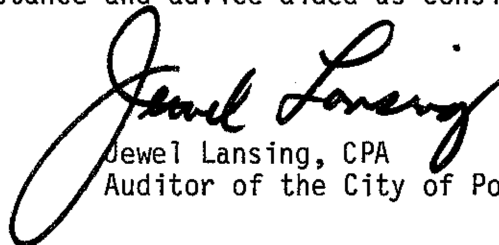
SUBJECT: Audit on Containing the Cost of City Health Care Programs (IAR #2-86)

Attached is our Internal Audit Report #2-86 concerning our review of the City's health care programs. The audit was added to our FY 1985-86 Internal Audit Schedule. A summary is contained in the beginning of the report.

We have discussed the report with Bureau of Personnel Services Director John Woods and with Commissioner Bogle. They are in general agreement with the conclusions and findings of the report. Their written responses are included at the end of this report.

We would appreciate receiving a written status report from Bureau of Personnel Services' management in six months indicating what further progress has been made on findings identified in this report. This response should be circulated to the Mayor, the City Commissioners, and the City Auditor.

We appreciate the cooperation and assistance we received from City bureaus and staff. Their assistance and advice aided us considerably in preparing this report.



Jewel Lansing, CPA
Auditor of the City of Portland

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Attachment

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SUMMARY

The City of Portland provides its employees a variety of health care benefits. The cost of these benefits has increased significantly over the last nine years, rising from $3.6 million in Fiscal Year (FY) 1976-77 to $10.8 million in FY 1985-86, a 200 percent increase.

This report explains why health costs have risen, compares the costs of our major plan to other government health plans, and describes various ways to reduce future cost increases.

Reasons for High and Increasing Costs

While inflation accounts for over 50 percent of all increases in health care expenditures, changes in federal government funding of Medicare and Medicaid programs and the introduction of expensive new medical technologies in hospitals are two additional factors. We also found that the City's major health care program, the First Farwest (FFW) plan, is more generous than other health plans.

The City's First Farwest health plan provides a higher level of benefits than 90 percent of the other government health plans surveyed nationwide by our consultant, Hay/Huggins Company Inc. Our plan is more costly primarily because employees do not participate in the plan's cost and some services are covered very liberally.

Steps Taken to Control Costs

The City has taken a number of steps to stem the rise in health insurance costs. These include self-insuring the FFW health plan, competitively bidding claims processing services, and reducing claims

administration and insurance broker fees. However, because City labor contracts stipulate that health benefits will be provided to represented employees at no cost, other significant cost-containment actions can only be achieved by changing existing labor contracts.

One of the major actions taken to control costs has been the implementation of a "cafeteria style" flexible benefits program for non-represented employees called Beneflex. While Beneflex allows employees to select the type of benefits they need, the program has not achieved cost savings as envisioned by the Bureau of Personnel Services. Although the program provides some opportunities for future savings, cost-containment may not be the most appropriate goal of the program.

Additional Opportunities for Cost Savings

Opportunities are available to the City to introduce more effective cost control measures for health expenditures. For example, shifting more of the costs of the City's major plan to employees by introducing co-payments and premium sharing provisions could save the City approximately $700,000 annually. In addition, limits on special coverages such as chiropractic, vision, and prescriptions could save an additional $481,000 annually. According to our consultant, cost-sharing methods are the most effective and commonly used techniques to reduce employer health costs. Involving employees in the cost of their health care also provides a financial incentive to use medical services more carefully, resulting in lower plan costs.

In addition, introducing less costly alternative services such as outpatient surgery and preauthorization of hospitalization also have potential to reduce expenditures. Our research showed that other jurisdictions claim cost savings by negotiating hospital rates, better managing catastrophic claims, and introducing employee wellness programs.

INTRODUCTION

This report covers our review of the City's health care programs. The audit was approved by the City Auditor and included in the Internal Audit Division's Fiscal Year (FY) 1985-86 audit schedule as amended in November 1985. We conducted this audit in accordance with generally accepted governmental auditing standards and limited our work to those areas specified in the Audit Scope and Methodology section of this report.

BACKGROUND

The City of Portland provides its employees a variety of benefits in addition to salary and wages. City benefits include life insurance, a retirement program, a deferred compensation plan, and school tuition reimbursement. One of the major benefits provided employees is health care. Health care benefits cover the costs of general medical services, hospitalization and surgery, and dental and vision care.

During recent years, the City has offered employees a choice between a self-insured health care plan administered by the First Farwest Corporation (FFW) and one offered by the Kaiser Foundation Health Plan of Oregon. In July 1985, the City introduced a new "cafeteria style" program called Beneflex for its 650 non-represented employees, approximately 14 percent of all City employees. This program provides five health plan choices for these employees, including the Kaiser and First Farwest plans. The City pays the entire premium cost for employee health plans and all plans cover both the employee and the employee's dependents.

The FFW plan is a standard "fee for service" plan and includes a base plan which pays 100 percent of all covered services and a major medical plan that contains some deductible provisions and co-payment by the employee.

The FFW plan allows free choice of doctors and facilities. The Kaiser plan involves little or no charge to the employee in the form of deductibles or co-payments but normally restricts the employee to using the services of the Kaiser hospitals and the Kaiser Permanente group of medical professionals.

The Beneflex program allocates a set dollar amount to each employee and allows the employee to select the type of benefits he or she desires. The Beneflex plan offers both FFW and Kaiser coverage, and also two additional health plans - the Health Promotion Plan administered by First Farwest and the Good Health Plan of Sisters of Providence. Also, employees can select other benefits not previously available. For example, employees may use their Beneflex allocation to "purchase" more life insurance, obtain disability coverage, establish a child care reimbursement fund, or to set up a medical expense reimbursement account to pay for deductible, co-payment, or other medical costs not covered by their selected health plan. Employees may also opt for no health care benefits coverage (if they are covered by an outside health insurance plan) and take 50 percent of their allocation in cash.

The City provides dental care programs through the Oregon Dental Service Plan and the Kaiser Foundation Dental Plan,[1] and vision care under the Vision Service Plan and the Kaiser health plan. The Oregon Dental Service plan allows the employee and family to select any licensed dentist and involves co-payment by the employee in the early years. The Kaiser dental plan provides the services of a group of dentists at Kaiser Permanente dental facilities, and requires no co-payment. The Vision Service Plan provided with the First Farwest program features a panel of selected vision care professionals and the Kaiser vision care program is provided at Kaiser health facilities.

[1] A Blue Cross/Blue Shield Dentacare plan is provided as an additional option for Beneflex enrollees.

Cost of Employee Health Benefits

The total cost of health benefit programs for the City was $10.8 million in FY 1985-86. Cost for each program and the number of enrollees in each program is shown in Table 1 below.

TABLE 1

CITY OF PORTLAND
HEALTH PROGRAM COSTS AND ENROLLEES*
FY 1985-86

Program	Cost 1985-86	Number of Enrollees	Percent of Enrollees
HEALTH			
First Farwest Health Plans and Vision Service Plan	$ 5.8 million	2,468	62
Kaiser Health and Vision Plans	2.9 million	1,528	38
Subtotal	$ 8.7 million	3,996	100
DENTAL			
Oregon Dental Service	$ 1.8 million	3,299	83
Kaiser Dental Plan	0.3 million	659	17
Subtotal	$ 2.1 million	3,958	100
TOTAL	$10.8 million	N/A	N/A

*The Good Health Plan and the Blue Cross/Blue Shield Dentacare program are new and presently have too few enrollees to be a significant factor in total employee health care costs.

AUDIT SCOPE AND METHODOLOGY

The primary objective of our review was to determine the costs of City health benefits and evaluate the effectiveness of actions taken to control costs. We also compared our City costs to other governments and reviewed techniques used by others to reduce health care expenditures. We did not evaluate the other benefits provided to City employees or the impact of retiree health costs.

We examined the City Code, insurance program information, and Beneflex pamphlets. We interviewed City managers and staff, as well as insurance experts in private industry. We reviewed professional literature to obtain cost-containment techniques used by other employers. We analyzed claims information from the City's self-insured health program to determine the effects of various cost-containment techniques.

We also obtained the services of Hay/Huggins Company Inc., a Philadelphia, Pennsylvania, based consulting firm specializing in employee benefits. Based on a detailed questionnaire that was completed by the Bureau of Personnel Services, the Hay/Huggins Company provided various analyses of our health program in comparison to other employers in the nation.

AUDIT RESULTS

OPPORTUNITIES EXIST TO REDUCE THE COSTS OF HEALTH CARE BENEFITS

Summary

Total City costs for employee health programs have tripled during the nine years between FY 1976-77 and FY 1985-86, rising from $3.6 million to $10.8 million. Although the City has taken a number of steps to control the continued rise in costs, more effective cost control methods are needed to reduce expenditures.

A major factor in the high cost of City health care is the liberal features of the City's major health program, the First Farwest plan (FFW). Our consultant found that this plan provided a higher dollar value of benefits than 90 percent of the other cities and states they surveyed nationwide. Moreover, the City also provides a higher level of total employer-paid benefits than most other jurisdictions they reviewed throughout the nation.

The most effective and widely used method to contain health cost increases is to shift some portion of the costs to employees. Over 50 percent of the 360 employers surveyed by our consultant instituted cost sharing to lower health costs. We estimate that the City could save approximately $150,000 to $1.2 million annually by implementing various plan redesign alternatives. Other methods such as preauthorization for hospitalization and surgery, and wellness programs also have potential for cost savings.

Health Care Costs are High and Increasing

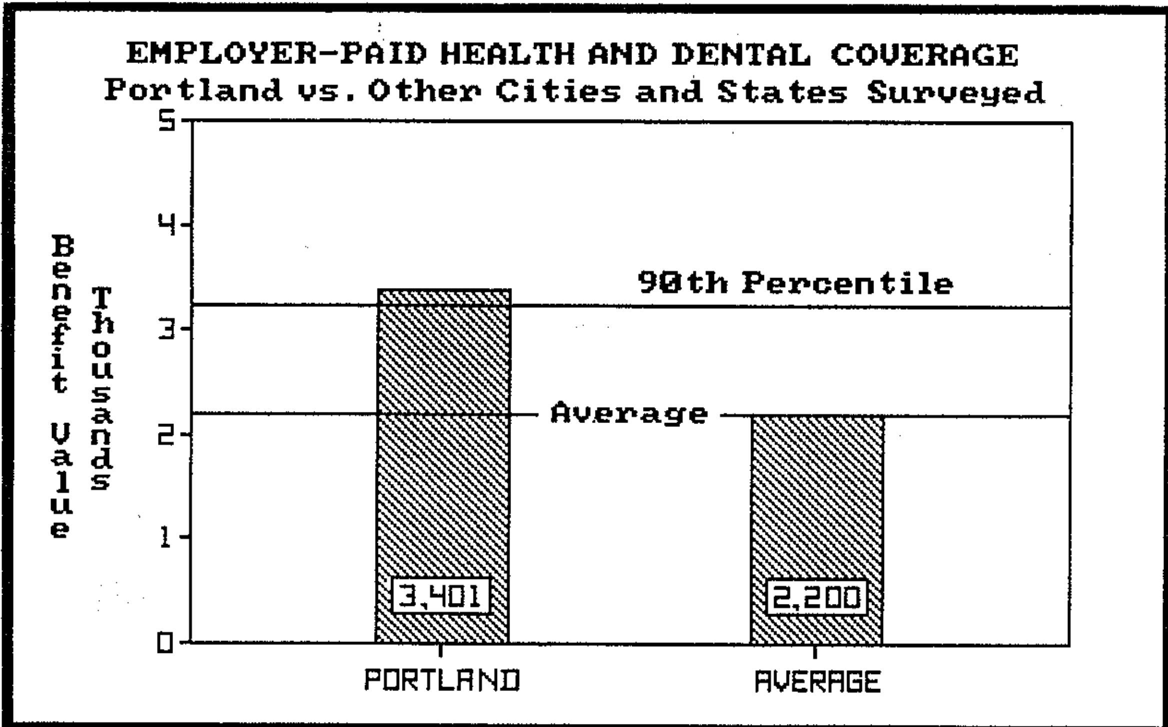
The City of Portland provides a higher level of health care benefits than most other cities and states surveyed by our consultant, Hay/Huggins Company Inc. Compared to 22 other government health plans, Portland ranks in the top 10 percent in terms of the dollar value provided under its major health program. In addition, the average annual percent increase in employee health care costs exceeds the annual percentage increase in both gross pay and total personal services over the last nine years. Health and vision costs per employee have increased by 14.1 percent a year while gross pay and total personal service costs have increased 6.1 percent and 6.9 percent, respectively. Total health care expenditures have doubled during the last five years.

In order to compare Portland's health care benefits to other governments, we contracted with the Hay/Huggins Company Inc., an international benefits consulting firm. At our request, the Bureau of Personnel Services completed an extensive benefits questionnaire provided by Hay/Huggins. The City's benefits were compared by Hay/Huggins to 155 other service organizations and specifically to 22 city and state government health plans.[2]

[2] See Appendix for a discussion of Hay/Huggins Benefit Value Comparison methodology and a listing of 22 comparison health plans.

Table 2 below compares the relative dollar value of the City's major health plan (First Farwest and Oregon Dental Service plans) to health plans offered by the other cities and states in the survey. As shown, using the common cost approach, the dollar value of the City of Portland's health program is $3,401, while the average plan value for all of the 22 plans in the survey was $2,200. Portland's plan value is above the 90th percentile for all plans. This means that 90 percent of all other government plans surveyed provided a lower valued health program to its employees than Portland.

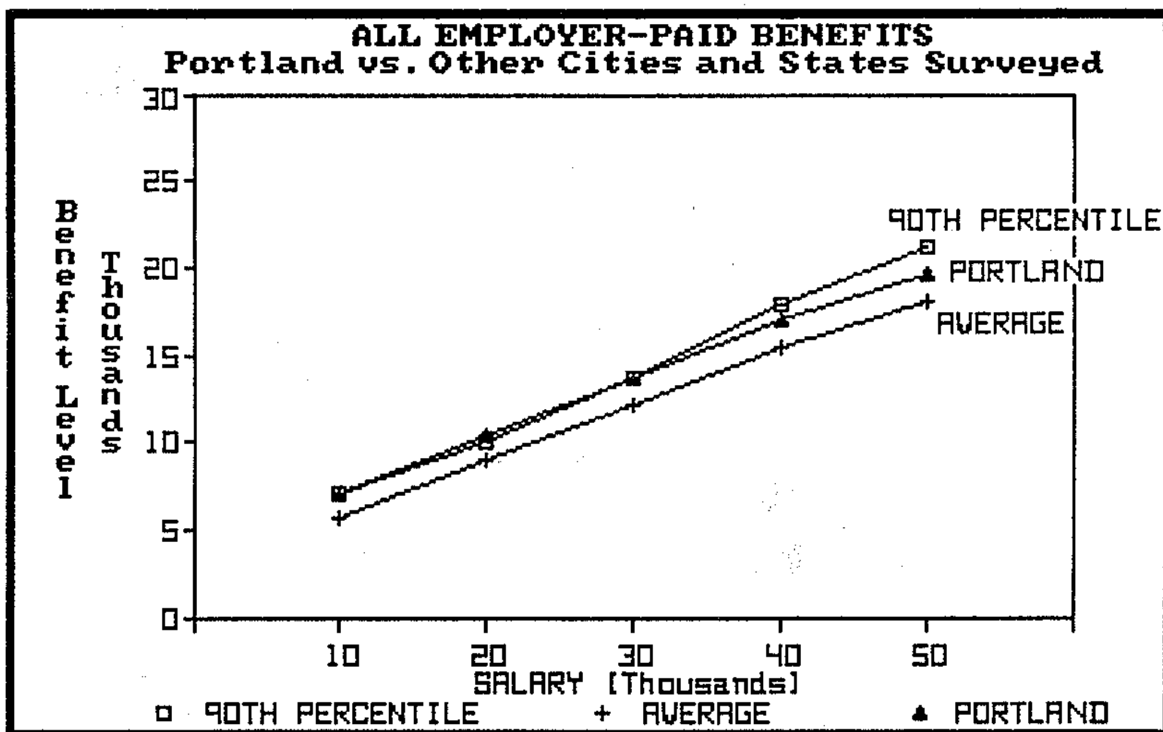
TABLE 2



Source: Hay/Huggins Benefit Value Analysis

Table 3 below shows that Portland also ranks well above average in terms of the value of the total benefits package (retirement, insurance, sick leave, etc.) paid to employees. The value of benefits paid by the City is at the 90th percentile for employees making up to $30,000 per year. Employees making more than $30,000 are about midway between the average and the 90th percentile.

TABLE 3



Source: Hay/Huggins Benefit Value Analysis

From 1977 to 1986, the cost of providing health care benefits to employees increased from $3.6 million to $10.8 million and grew two and one-half times faster than did employees' gross pay. Table 4 below shows that gross pay per employee has increased at an average 6.1 percent per year since 1977, while health and vision plan costs have grown at an average annual rate of 14.1 percent. Over the last five years, total health and vision costs have more than doubled.

TABLE 4

AVERAGE PERSONAL SERVICES COST PER EMPLOYEE*
FY 1976-77 Through FY 1985-86

Fiscal Year	Gross Pay	Health and Vision	Dental	Other Benefit Programs**	Total Personal Services
1976-77	$15,945	$ 560	$241	$1,549	$18,295
1977-78	$16,766	$ 684	$277	$1,689	$19,416
1978-79	$17,881	$ 779	$295	$1,502	$20,457
1979-80	$19,520	$ 775	$272	$1,792	$22,359
1980-81	$20,428	$ 859	$288	$2,674	$24,249
1981-82	$22,108	$1,059	$352	$2,962	$26,481
1982-83	$23,801	$1,348	$408	$3,360	$28,917
1983-84	$23,979	$1,498	$409	$3,326	$29,212
1984-85	$25,663	$1,617	$406	$3,655	$31,341
1985-86	$27,152	$1,831	$442	$3,823	$33,248
Increase in Nine Years	70%	227%	84%	147%	82%
Average Annual Increase	6.1%	14.1%	7.0%	10.6%	6.9%

*Costs were calculated based on total number of employees, including temporary and probationary employees who do not receive employer-paid health and dental benefits. As a result, actual average health and dental costs per employee were slightly higher than indicated in the table.
**Other Benefit Programs include pension, employer's FICA, and life insurance.

The Office of Fiscal Administration (OFA) has also recognized the rapidly increasing health costs and identified the need to contain rising costs. OFA projected in 1983 that if fringe benefits continued to increase at the existing rate, they would consume a larger percentage of the City's total personnel expenditure until very little would be left for increases in take-home pay. According to OFA, the second largest employee benefit that can be controlled is health insurance. OFA also stated that health insurance costs for the City were rising faster than other sectors of our economy and recommended that action be taken to control costs.

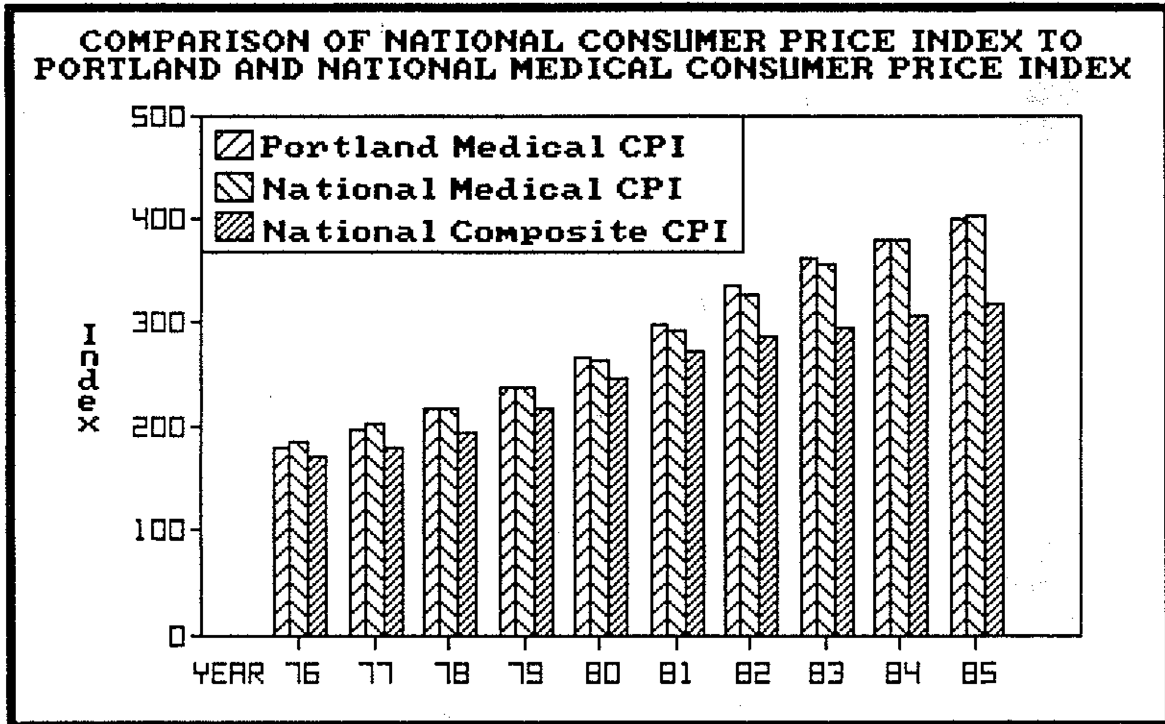
Factors Causing High Health Care Costs

High and increasing health costs are caused by a variety of factors. Some of these factors are not controllable by the City, while others can be affected by City management. Our review of other studies and reports prepared by federal and state governments, universities, and the medical industry shows that the major causes for high and increasing health costs are: inflation, federal government actions, hospital cost increases, and the type of benefits provided by organizations.

Inflation

Inflation is the major cause of rising medical care costs. One study we reviewed concluded that inflation accounts for 50 to 58 percent of all health cost increases. In order to illustrate the effects of inflation on medical costs, we compared the national composite consumer price index (CPI) to the consumer price index for medical services nationwide and in Portland. Table 5 shows that medical expenses in Portland are rising more rapidly than the composite inflation rate. Medical inflation appears to be approximately 28 percent higher than the general rate. Portland's medical CPI is similar to the nation as a whole.

TABLE 5



Source: Bureau of Labor Statistics

Federal Government Actions

Cost shifting from the major federal government-sponsored medical programs, Medicare and Medicaid, has also increased medical costs for employers. Reports from the Portland Business Group on Health (BGH), a committee of the Portland Chamber of Commerce, and the American Enterprise Institute for Public Policy Research show that federal government cutbacks

in payment schedules under these programs cause hospitals to absorb or redistribute costs no longer paid by the government. Hospitals have responded by passing the costs on to other patients, many of whom are covered by employer-paid insurance programs. The result is higher costs to employers whenever employees use hospital facilities. According to the BGH, cost shifting in Portland grew at a rate of 105 percent from 1980 through 1982 (more recent data not yet available).

Increased Hospital Costs

Hospital costs are the single largest expenditure in the national health bill, over 40 percent in 1981, the latest year for which we have information. Several factors drive hospital charges upward: improved technology, incomplete utilization, and hospital ownership.

Improved technology has increased the ability of medical practitioners to diagnose and treat diseases and injuries; however, the cost of this equipment is passed on to consumers as more hospitals obtain sophisticated and expensive equipment. For example, relatively few hospitals had electroencephalograph machines several years ago. Today, all but the smallest hospitals have them. Also, one of the newest and most expensive techniques used by hospitals is Magnetic Resonance Imaging (MRI). MRI examines tissues, organs, and cross sections of the human body without having to conduct exploratory surgery. The installed cost of this equipment ranges from $2 million to $3 million. Portland already has 3 or 4 of these machines, and 10 have been approved for use in City hospitals.

Studies show that hospital utilization is another important factor in hospital charges. Utilization is important because every hospital has fixed costs which must be paid whether or not anyone uses the facility. Since all costs are allocated among paying patients, fixed costs are spread over fewer paying patients. When utilization drops, patients and insurers pay a larger portion of the fixed costs. In addition, research has shown that whenever excess capacity exists - excess surgeons and/or hospital beds - the number of elective surgeries increases. Individuals have surgery which they may not have had otherwise thereby increasing expenses to the insured and the insurer. According to the BGH, the Portland area had 13 percent excess hospital capacity in 1982, the latest year for which we have data.

Hospital ownership is another factor in the rising cost of health care service. Our studies show that approximately one-third of all hospitals belong to a multi-hospital system - an organization which owns or controls two or more hospitals. According to the National Center for Health Services Research, these hospitals generally charge more than other hospitals, particularly during the years following acquisition. In addition to charging more for services rendered, these hospitals usually provide a greater range of ancillary services which further increase costs.

Level of Benefits Provided by the City

The final major factor influencing the high and increasing costs of health care is the management of the City's health care program. Over the last six years, the City has made no adjustments in the deductibles or maximum out-of-pocket expenses in order to respond to inflation increases. Consequently, the City has absorbed all of the inflationary cost increases during the last several years.

Additionally, the City provides very liberal health plan coverages. As shown by our consultants, Hay/Huggins, the City's major health plans (First Farwest and Oregon Dental Service) provide a higher level of coverage than

90 percent of the other governments in their survey. Officials from Hay/Huggins told us that the FFW plan was very generous primarily because it pays 100 percent ("first dollar coverage") of all basic services and covers services not included in most other plans they review. For example, the FFW plan pays for unlimited chiropractic services, includes dependents up to the age of 26, and provides vision coverage. Additionally, the basic FFW plan has no co-payment provisions that are commonly employed in most other health plans.

Representatives from First Farwest Group, Inc., our local medical claims processor, indicate that City claims are about the easiest claims to process, in terms of determining coverage, of all the plans they administer because the City plan essentially pays for all services. They also told us that our plan is more generous than 95 percent of the plans they currently administer. The most liberal features of our plan according to FFW officials are 100 percent payment of nearly all services, unlimited chiropractic coverages, and no deductible on the basic plan.

Efforts to Control Health Care Costs

The Bureau of Personnel Services and other City organizations have made numerous attempts to control or reduce the cost of the employee health care program. These efforts include competitively bidding the FFW claims processing, self-insuring health coverage, establishing an employee assistance program, and initiating wellness programs. The major cost-containment strategy employed by the Bureau of Personnel Services since December 1983, was the development and implementation of the Beneflex program.

We estimate that competitively bidding claims processing, purchasing stop-loss insurance, and negotiating administrative fees has resulted in a savings of over $462,000 since 1981. Although we did not quantify the effect of the Employee Assistance Program or the bureaus' wellness programs, other studies we reviewed reported declines in sick days, fewer health

claims, and improved employee productivity. The Bureau of Personnel Services has also taken a variety of actions in response to recent Internal Audit Reports to Management (RTM #A-86 and RTM #B-86) that have improved controls over claims processing, recovered dollars due the City, and clarified health plan coverages.

According to the Bureau of Personnel Services, a significant constraint in containing costs is the current City labor contracts. The labor contracts call for the City to fully pay for health and welfare programs. The contracts stipulate that the City will maintain the existing health care programs or their substantial equivalents for the life of the contract agreement and continue to fully pay the premium costs. Because over 86 percent of City employees are covered by labor agreements, cost savings through changing benefit levels can only be achieved through labor contract negotiations. The Bureau indicates that labor agreements have been a major obstacle in achieving health cost savings.

Beneflex Savings Not Realized

Although the Beneflex program offers significant advantages to City employees, it did not achieve savings during its first year. We found that the total costs of the program were $120,000 while savings totalled $35,000, for a net loss of $85,000. According to the Bureau's Benefits Manager, the Beneflex program provides an opportunity to save costs if the annual Beneflex allowance is capped and recent Employee Benefits Advisory Committee recommendations are adopted. However, we believe that cost-containment may not be the most appropriate goal of a flexible benefits program and little savings will be achieved from the Advisory Committee recommendations.

We found that the operating costs of Beneflex were about $94,000 during FY 1985-86. In addition, there were $26,000 in costs associated with an error in the premium level for the FFW plan (see RTM #B-86) and the extra allocation when spouses both work for the City. Savings of $35,000 were generated by Beneflex during the first year as a result of limiting the

benefit allocation provided to new enrollees and retaining some cash that was forfeited by employees. The Bureau indicates that actual operating costs in the first year of the program are higher than they will be in future years due to one-time-only start-up costs.

Opportunities for cost savings may exist if the Council limits the annual increase in each employee's Beneflex allowance as initially recommended by the Bureau in 1985. Additionally, the Employee Benefits Advisory Committee recently recommended that the Beneflex allowance growth be limited by the medical consumer price index. According to the City's Benefits Manager, this approach would allow the medical purchasing power of City employees to keep pace with medical inflation but protect the City from other cost factors such as over-utilization of health services. We have not thoroughly evaluated the advantages and disadvantages of this approach and cannot reliably predict that this action will reduce City health care expenditures.

More importantly, cost-containment may not be the most important or appropriate goal for flexible benefit plans like Beneflex. Our research shows that the primary objectives of flexible benefit plans appear to be related more to improving employee morale and satisfaction through providing a greater choice of benefits without increasing employer costs. Under traditional health programs, employers are forced to pay for health benefits that some employees do not want - a wasted expenditure. In addition, traditional programs deny employees access to alternative benefits such as child care and disability insurance because they are not equally attractive to all employees. According to the Employers Council on Flexible Compensation, a national association of employers that provide cafeteria or flexible plans, allowing employees to choose benefits "guarantees that each benefit dollar maximizes employee satisfaction and morale." Rather than as a tool to control cost expenditures, flexible benefits may more appropriately facilitate and soften the impact of plan design changes that

require more employee participation in health costs, such as premium-sharing, higher deductibles, and co-payments. These and other methods are discussed below and have been used more frequently and effectively by employers to control health costs.

Additional Opportunities for Cost Savings

The City of Portland can take additional steps to lower its health care expenditures and to reduce rising health costs. According to our consultant, the most widely used and effective method involves changing the plan design in ways such as changing the application of deductible and co-payments and limiting the types and amounts of services covered. Other cost-containment techniques involve encouraging alternative services such as outpatient surgery and preadmission testing, and utilization reviews that require approval by a peer review group before non-emergency hospital admissions. Expanded wellness programs and negotiated hospital rates also have potential to reduce costs in the long-term.

The following sections describe how these methods could be employed to reduce City health care expenditures.

Plan Redesign

Plan redesign involves sharing more costs with employees and limiting the types or amounts of medical services covered by the plan. According to Hay/Huggins, plan redesign has been the most common approach taken by employers to reduce costs. Over the last two years, 52 percent of the employers surveyed have made reductions in health care outlays. Of the 330 public and private sector employers surveyed nationwide, 45 percent have raised plan deductibles, 44 percent have made hospital expenses subject to

deductibles, and 31 percent have increased the employee share of the insurance premium. By shifting more of the cost burden to employees, Hay/Huggins found that expenses are reduced and employee awareness of health care cost increases. For example, if an employee has to pay an out-of-pocket portion of the cost for each doctor visit, unnecessary doctor visits could be reduced.

In order to identify which elements of our plan could be subject to plan redesign, we asked Hay/Huggins and our local claims processor, First Farwest Group, Inc., to identify which elements of our health plan were unique and liberal compared to other national and local plans. We also compared our major plan to the City's other plan, Kaiser, and to the plans of two major employers in the region, the Port of Portland and the federal government. We identified the following unique features of our major plan, FFW.

- "First dollar coverage". The FFW plan pays 100 percent of all employee costs under the base plan. Base plan includes doctor visits, hospital room and board, surgeon and specialist fees, and hospital room fees. While most employers in the Hay/Huggins survey and those surveyed locally require co-payment, the FFW base plan is not subject to a co-payment or a deductible by the employee. Only the major medical portion of the plan requires employee participation in costs. The major medical supplements the base plan and protects employees from catastrophic loss. There is a $100 deductible for each family member (family maximum of $200) and a 20 percent employee co-payment on the first $2,500 of major medical for each family member.

- No employee participation in premium payment. Sixty-four percent of all employers surveyed by Hay/Huggins require employees to pay for a portion of the insurance cost. Generally, employees contribute to premium charges to cover dependent and family members. No City plans include any employee participation in premium payment for either employees or dependents.

- Unique covered services. The FFW plan covers some services that are unique from the plans surveyed by Hay/Huggins, other local health plans, and with the City's other major health plan, Kaiser. The FFW plan covers all chiropractic charges without limit, 80 percent of prescription charges (after meeting the $100 major medical deductible), and employee dependents up to 26 years of age. Also, only 15 percent of the employers surveyed by Hay/Huggins cover vision care, a provision which is available to both FFW and Kaiser plan enrollees.

To identify the potential dollar savings to be gained if changes were made in only the unique features identified above, we obtained computer data on a year of claims paid by FFW under the current plan and developed a model to estimate the cost of the plan under various alternative changes. We made no change in the maximum out-of-pocket cost an employee would be subject to and retained the major medical deductible at $100.

As shown in Table 6, the City can potentially save significant health care expenditure by making various changes in its health care plan without increasing an employee's maximum out-of-pocket expense. For example, eliminating chiropractic coverage (Alternative #4) would save the City $165,000 annually. Similarly, requiring employees to pay 10 percent on all base plan charges (Alternative #1) would save $244,000. Alternative #2, 20 percent co-payment on all base plan charges, would save $408,000. Combining various alternatives would achieve additional savings. Combining Alternatives #3, #6, and #8, for example, would result in approximately $812,000 in annual savings.

TABLE 6

ESTIMATED SAVINGS FOR
SELECTED PLAN DESIGN ALTERNATIVES

REDESIGN ALTERNATIVES	Total Potential Savings Annually
#1 10% Co-Payment on All Services	$244,000
#2 20% Co-Payment on All Services	$408,000
#3 Eliminate Prescription Coverage	$164,000
#4 Eliminate Chiropractic Coverage	$165,000
#5 Limit Dependent Care to Age 23	N/A*
#6 10% Co-Payment with Limited Chiropractic Coverage	$367,000
#7 20% Co-Payment with Limited Chiropractic Coverage	$535,000
#8 Employee Pay 5% of Premium	$281,000
#9 Eliminate Vision Care	$152,000

*Our sample of claims for 200 families revealed only one claim from a dependent over age 23 for $5.

It should be noted, that these plan design changes would result in shifting the cost of services to employees but could also result in lower overall costs as employees reduce unnecessary hospital and doctor utilization. It is also possible to change a variety of other elements of our plan including raising deductible amounts and maximum out-of-pocket expenses, and changing covered charges from our current "reasonable and customary charges" to a defined schedule of benefit charges. However, for purposes of illustration and clarity, our analysis retains our basic program but modifies only those elements that are generally unique and cause our plan to be costly compared to others.

Alternative Services

Using less costly alternative services has also helped other employers combat escalating hospital and surgery costs. Many employers have changed their plans to allow 100 percent payment for lower cost alternatives. For example, while over 50 percent of the employers surveyed by Hay/Huggins pay less than 100 percent of hospitalization charges, 48 percent pay 100 percent of charges if the employee uses outpatient surgery. Studies have shown that when a patient is otherwise healthy, at least 20 percent of all surgical procedures can be safely undertaken on an outpatient basis. Outpatient surgery is typically far less expensive than the same operations in a hospital. Cost savings related to outpatient surgeries need to be monitored, however. Some evidence suggests that hospitals raise the cost of outpatient surgeries when inpatient utilization drops. If this occurs, the cost savings associated with outpatient surgeries may shrink.

Preadmission testing is another less costly alternative service that is used by 46 percent of the employers surveyed by Mercer-Meidinger, an international consulting firm. This practice consists of performing lab tests in the doctor's office prior to being admitted to the hospital. Costs are lowered because the tests are less expensive when performed by the doctor than in the hospital. Preadmission testing, according to some researchers, can save employers between 1 percent and 2 percent of total claim costs per year. This would represent a potential savings of between $50,000 and $100,000 per year to the City of Portland.

The Beneflex program includes one health plan option, the Health Promotion Plan, that includes many of the alternative service options discussed here. For example, the "Promo" program includes outpatient surgery and preauthorization requirements, and preadmission testing. However, this program is only available to non-represented employees and few employees have enrolled in this option. As of April 1986, only 73 out of 3,996 City enrollees participated in the Health Promotion Plan.

Wellness Programs

Wellness programs may also provide a long-term solution to rising health care costs. Wellness programs involve employees in maintaining their own health. Wellness programs can include personalized health assessments (screening and prevention), educating employees to avoid risks, and encouraging life-style changes that improve overall well-being. Although some employers have reported cost savings, it may take several years of research to determine if the savings are actual and can be maintained.

Screening/prevention programs are intended to save money through the avoidance of large claims. Most of the dollar savings claimed for wellness programs have been in this area. For example, screening for high blood pressure can help employees avoid strokes by early detection and treatment, and also save other employer costs due to high absenteeism and low productivity.

Wellness programs also involve health education and life-style changes. A research report we reviewed estimated that smoking cessation programs save $21 for every $1 invested. Exercise, nutrition, and weight loss counselling can also improve employee health although the economic implications of these programs have not yet been demonstrated. Several City bureaus have initiated wellness programs and each bureau reports that both employees and the organization have benefited.

Negotiating for Lower Hospital Rates

There may be opportunities to reduce health costs through negotiations with health care providers to obtain lower rates. This technique has been used by many large employers and is currently being explored by the Portland Business Group on Health. BGH goals are to define the causes of high health care costs and identify ways to reduce them, such as working to reduce excess capacity in hospitals, developing a data base of claims histories

from participating employers, and negotiating with health care providers for lower rates. The Group is still in the initial stages of developing a data base, and it will probably be several years before useful information is available. One City union leader also suggested to us that a City management team, together with union leaders, could negotiate directly with health care providers to obtain lower costs.

Develop and Use Health Program Data

The Bureau of Personnel Services needs to develop and make better use of health program data to better manage the City's health program. Better information on health plans can assist management to make more informed decisions on ways to address rising health costs. Our review found that the Bureau of Personnel Services has limited data and has performed few analyses on the costs and effectiveness of its health care plans. The Employee Benefits Manager lacks summarized information on the total costs of the City's health care program, the number of individuals enrolled in the Beneflex program by plan and family category, and the performance of the Beneflex program in achieving cost savings. Additionally, available FFW data has not been used to evaluate utilization patterns by employees and providers or to monitor the most expensive features of the program to justify plan changes. One of the consultants involved in the inception of Beneflex had recommended that more complete data be obtained and used; however, we found that while much information about individual enrollees is being collected and used for day-to-day administration, summary management information has not been developed or used.

RECOMMENDATIONS

In order to reduce and contain the costs of the City's health care program, we recommend that the Bureau of Personnel Services:

- Seek City Council approval to negotiate changes in existing City labor contracts and to redesign the standard FFW plan.

  - Labor negotiations should seek flexibility in the contract provisions regarding health and welfare benefits in order to achieve plan design changes and other cost-containment measures.

  - FFW plan design should require employee participation in the plan cost. Changes could include requiring co-payments and higher deductible amounts, limiting coverages such as chiropractic and vision care, and requiring employees to share a portion of premium costs.

- Implement various alternative services such as preauthorization and peer review of hospitalization and surgery charges, outpatient surgery, and preadmission testing. Other techniques, such as wellness programs and negotiating for lower hospital rates, should also be reviewed.

- Develop and use management information from the City health plans to monitor and track health expenditures. Data can be used to monitor high-use providers and employees, to evaluate effectiveness of cost-containment efforts, and to modify plan design.

APPENDIX

HAY/HUGGINS BENEFIT VALUE COMPARISON METHODOLOGY AND LOCATION OF COMPARISON PLANS

Hay/Huggins uses an analysis method called the "common cost" approach. This method allows valid comparisons to be made taking into account differences in geographic environments, financing techniques, accounting methods, and employee mixes. All plans in the study are, in effect, "purchased" for the same group of employees, from the same source, using the same financing source. The "provider" is a hypothetical firm that "sells" coverage based on each jurisdiction's current actuarial assumptions, plan coverage, and experience. The result is an actuarially derived "common cost" for each plan expressed as a dollar value. This method also controls for differences in plan actual costs due to local cost of living indexes.

In accordance with Hay/Huggins instructions, the questionnaire was completed based on data from the City's major health care and dental program, the FFW health plan (62 percent of City employees) and the Oregon Dental Service plan (83 percent of City employees).

Portland's health plan benefits were compared to 22 other plans administered in the following cities and states:

City of Colorado Springs
City of Hampton
City of Los Angeles (Fire and Police)
City of Los Angeles (General)
City of Los Angeles (Water and Power)
City of Norfolk
City of Rapid City (General)
City of Rapid City (Fire and Police)
City of Richmond
City of Suffolk
State of Arizona
State of Connecticut
State of Florida

State of Georgia
State of Maryland
State of Michigan
State of Nebraska
State of New Jersey
State of North Carolina
State of Oregon
State of South Dakota
State of Texas

CITY OF

PORTLAND, OREGON

OFFICE OF PUBLIC WORKS

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INTERNAL AUDIT
SEP 18 1986

September 18, 1986

TO: Jewel Lansing, City Auditor

FROM: Dick Bogle, Commissioner of Public Works

SUBJECT: INTERNAL AUDIT ON CONTAINING THE COSTS OF THE CITY OF PORTLAND'S HEALTH CARE PROGRAMS

I'd like to thank both you and your staff for reviewing the City's cost containment efforts in its health care programs. As you know, I requested last year that such an audit be done. Your report is timely as we continue to scrutinize our benefits programs to assure cost-effectiveness, equity, quality and quantity.

The report elaborates well on the current status of the program and what needs to be done to improve it. I feel it important, however, that everyone understand how the program got to where it is and what the major obstacles are that remain in the way.

Your recommendations point to some areas of concern echoed for some time now by our Personnel Director, those of benefit design and cost participation by employees. One major obstacle not directly dealt with, however, is the existing benefit provisions in the City's labor contracts. The Bureau will elaborate further in this area.

With Beneflex, we took some bold strides to move in a direction that would make it possible for the City's health care programs to not only be innovative and creative, but cost-effective. In my opinion, the start-up costs for the program have been well worth the gains to be derived from it.

I feel strongly that the Beneflex Program is a good program. It has the potential to become a great program. The audit, I believe, confirms that and provides clear direction for the Bureau. It also provides direction for Council, since change in a major program such as this is not easy without its unanimous support.

Accordingly, it is my desire to have the Personnel Bureau develop recommendations to be submitted for review and approval by Council within the very near future.

Again, I thank you and commend your staff for its time and effort spent to produce this report.

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CITY OF
PORTLAND, OREGON
BUREAU OF PERSONNEL SERVICES

John E. Woods
Personnel Director
1220 S.W. Fifth Ave.
Portland, Oregon 97204
(503) 248-4157

September 18, 1986

INTERNAL AUDIT
SEP 18 1986

TO: Dick Tracy
Audit Manager

FROM: John E. Woods
Personnel Director

SUBJECT: Response to Audit Report on Containing the Costs of the City's Health Care Programs (IAR #2-86)

The following comments are submitted for inclusion in your final report:

How We Got to the 90th Percentile Level

The City gave generous benefit guarantees to its employees many years ago. Employee-paid health coverage for employees and their dependents was granted in 1970 as part of the City's first collective bargaining agreement. This plan included significant first dollars coverage and many of the unique covered services found in the City's First Farwest Standard Health Plan today. Employer-paid family dental coverage was added in 1973, followed by employer-paid family vision coverage in 1978. Minor enhancements were added to the health plan in 1980 when the City changed health insurance carriers from the former carrier to First Farwest; however, the benefit plans that City employees have today are the substantial equivalents of the plans granted to employees in the early days of the City's collective bargaining history.

Current Barriers to Cost Containment

The labor contracts currently limit the City's ability to implement the cost-containment recommendations made in the audit report (i.e., employee premium contributions, plan redesign). These contractual barriers include:

1. Limitation on Employee Co-Payments - The contracts guarantee that the entire cost will be borne by the City.

2. Limitation on Plan Redesign - The contracts guarantee that the City will continue to offer the existing plans or their "substantial equivalents." (In practice, the phrase

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"substantial equivalents" is defined as plans which do not reduce the number or type of covered benefits, maintain the current reimbursement levels, and do not limit the freedom of employees to such care from the provider of their choice.)

Due to the significant limitations imposed by the labor contracts, modification of existing health and welfare provisions was identified by the Bureau of Personnel as a necessary first step in order to realize the major opportunities for cost savings identified in the audit report.

The Beneflex Strategy for Cost Containment

The Beneflex program was identified by the Bureau of Personnel in 1984 as a negotiating tool that could be used to obtain future collective bargaining concessions in the health and welfare area. As indicated in the audit report, cafeteria plans can soften the impact of plan design changes that require more employee participation in health costs, such as premium sharing and co-payments. Cafeteria plans minimize the financial impact to employees by allowing these expenses to be paid on a before-tax rather than an after-tax basis. As stated in the audit report, cafeteria plans also "guarantee that each dollar maximizes employee satisfaction and morale" by allowing the individual employee to decide how each dollar is spent. Finally, cafeteria benefit plans educate employees regarding benefit plan costs by providing financial incentives to choose cost-effective health care coverage, i.e., dollars that are not spent in benefits are used to increase take-home pay.

Beneflex Implementation

The Beneflex program was implemented with non-represented employees first, in order to fine-tune the program before bringing it to the collective bargaining table. Negotiation of benefit cost containment with represented employees was delayed due to a number of equity issues that arose when the Beneflex program was implemented with non-represented employees in July, 1985. The issues include:

1. Whether the City should continue to contribute a larger amount for employees enrolled in the First Farwest Plan than it does for employees enrolled in the Kaiser Plan.

2. Whether the City should continue to subsidize health care for dependents by contributing more for families than it does for single employees and married employees without children.

These equity issues were referred by the Council to a newly created Benefits Advisory Committee in December 1985. As a

result of the Committee's work, the Bureau of Personnel will be making recommendations to Council for addressing these issues in the 1987 Beneflex plan design.

Beneflex Administrative Costs

The audit report cites operating costs of $94,000 during FY 1985-86. These costs include $54,000 in personnel services, $36,000 in data processing services and $4,000 in other miscellaneous office expenses. In order to obtain a realistic view of on-going operating expenses for the administration of the Beneflex program, it is important to note that:

1. No new positions were created to staff the Beneflex program. The $54,000 expended in FY 1985-86 represent a pro-rata allocation of three existing positions lent to the program on a part-time basis during its initial year of operation. Expenses for personnel allocated to the program for FY 1986-87 are estimated at $21,000.

2. The $36,000 for data processing services expended in FY 1985-86 was for the development and fine-tuning of the new data processing system. Data processing costs for this fiscal year are budgeted at $40,000 in order to develop the summarized management information reporting recommended by the audit and to expand the capacity of the system to include all represented employees. After the third year of operation, data processing costs should stabilize at less than $5,000 per year.

3. The $4,000 in miscellaneous office expenses included expenses for both Beneflex and non-Beneflex programs.

These start-up and ongoing administrative expenses are minimal when compared to the potential cost reductions in the City's $10.8 million benefit program.

Other Steps Taken By the Bureau of Personnel to Contain Costs

The audit report recommends a number of actions to redesign the City's First Farwest health plan to contain costs. These audit recommendations include implementing:

- a 20% employee co-payment
- hospital and surgical pre-authorization requirements
- outpatient surgery
- pre-admission testing
- utilization review
- employee wellness programs

It should be noted that the Bureau of Personnel has redesigned the First Farwest Plan to incorporate the cost containment features cited above. The redesigned plan was implemented in July 1985 as a new health plan option under Beneflex, called the City of Portland Health Promotion Plan. (Since union employees are still eligible to enroll in the old First Farwest Plan, the Health Promotion Plan is presently offered to non-represented employees as an additional health option, rather than as a replacement for the First Farwest Standard Plan.)

Response to Audit Recommendations

Recommendation #1: Seek City Council approval to negotiate changes in existing City labor contracts and to redesign the standard FFW plan.

- Labor negotiations should seek flexibility in the contract provisions regarding health and welfare benefits in order to achieve plan design changes and other cost-containment measures.

- FFW plan design should require employee participation in the plan cost. Changes could include requiring co-payments and higher deductible amounts, limiting coverages such as chiropractic and vision care, and requiring employees to share a portion of premium costs.

Response to Recommendation #1: The Bureau of Personnel will develop, and seek Council endorsement for , a number of collective bargaining proposals that incorporate the audit report's recommendations for employee premium contribution/plan redesign. The Bureau of Personnel will use the Hay-Higgins analysis and the work done by the audit staff to support its request for benefit concessions.

In addition, the Bureau of Personnel will endorse the Benefits Advisory Committee's recommendations to redesign the First Farwest Standard Plan to be offered to non-represented employees in 1987. These changes include specific limits on chiropractic care, as well as peer review of hospitalization, inpatient and outpatient surgery and pre-admission testing.

Recommendation #2: Implement various alternative services such as pre-authorization and peer review of hospitalization and surgery charges, outpatient surgery, and pre-admission testing. Other techniques such as wellness programs, catastrophic claims management, and negotiating for lower hospital rates should also be reviewed.

Response to Recommendation #2: Changes such as pre-authorization and peer review of hospitalization and surgery charges, outpatient surgery, and pre-admission testing are mandatory subjects of bargaining because they limit reimbursement under certain circumstances. The Bureau of Personnel will include these recommendations in future collective bargaining proposals for represented employees. As noted in the response to Recommendation #1, the Bureau of Personnel will endorse the Benefits Advisory Committee's recommendation to implement these changes for non-represented employees effective 1/1/87.

Wellness Programs - The Bureau of Personnel will coordinate with the Bureau of Risk Management in the development of a comprehensive employee wellness program that addresses City worker's compensation, sick leave, and medical insurance costs.

Catastrophic Claims Management - The Bureau of Personnel has reviewed proposals for the development of a catastrophic claims case management program. A memorandum of understanding is required with all labor unions before a catastrophic claims management program can be implemented. The Bureau of Personnel will meet with the City's Labor-Management Insurance Committee in 1987 to explain the features of the program and to obtain the unions' endorsement. If the unions endorse the proposal, the Bureau of Personnel will bring an ordinance to Council to amend the First Farwest contract and to obtain the necessary funding for the requisite medical intervention services.

Negotiated Hospital Rates - The Bureau of Personnel has been active since 1984 in the Greater Portland Business Group on Health's (BGH) efforts to contain employer health care costs. The BGH strategy is that a data project should be undertaken before rates are negotiated. This is necessary because no data base exists in Portland at this time to identify those hospitals which are cost-effective. Without this advance knowledge, the City could inadvertently direct City employees to inefficient providers who manipulate other cost factors (i.e., number of admissions, length of stay) in order to compensate for the lower per diem rates. Due to the risks involved in proceeding without the prerequisite data, the Bureau of Personnel recommends that this opportunity for potential cost savings be deferred until the BGH analysis is completed (1-2 years).

Recommendation #3: Develop and use management information from the City health programs to monitor and track health expenditures. Data can be used to monitor high-use providers and employees to evaluate effectiveness of cost containment efforts, and to modify plan design.

Response to Recommendation #3: The Bureau of Personnel will undertake the following health care data-related activities in 1987:

1. Develop summarized management information reports for the Beneflex program and expand the capacity of the system to include all represented employees.

2. Direct First Farwest to improve the usefulness of their cost containment reports, including documentation of the cost effectiveness of the First Farwest pre-authorization and peer review program.

   Note: Due to labor concerns, the Bureau of Personnel recommends that the problem of the "high use" employee be addressed through plan redesign rather than the identification of individual employees who "over utilize" City benefit plans.

3. Recommend participation in the BGH data project to identify cost-effective providers as a prerequisite for negotiating hospital rates. (Note: Additional funding may be required to pursue this objective.)

4. Request utilization data from Kaiser as a prerequisite for developing a comprehensive employee wellness program.

Finally, the Bureau of Personnel would like to thank the audit staff for the work you have done in summarizing the City's health care cost problem, presenting a variety of options for health care cost containment, and making suggestions for improvements in the administration of employee benefit plans. We have gained further insight through the audit process and are grateful for your assistance.

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cc: Susy Wagner

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