Report #
2011-01

Audit of Employee Health and Pension Benefits:

The Administration Of Health Benefits Has Strengthened, But Areas Of Concern Remain

The City's Current Methods For Determining Premium Amounts And Shares Need Improvement

Moderate Changes Could Help Rein In Rising Pension Costs

City Payments Towards Retiree-Health Costs Are Growing And The Way The City Pays For These Benefits Could Result In Overpayments

Rising Benefit Costs Require The City To Evaluate Cost Containment Options Like Those That Other Governments Employ And Best Practices Recommend

Jorge Oseguera
City Auditor

Scott Herbstman
Auditor

Office Of The City Auditor
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CITY OF SACRAMENTO
CALIFORNIA

Office of the City Auditor
Jorge Oseguera, City Auditor

April 6, 2010

Honorable Mayor and
Members of the City Council
915 I Street - Fifth Floor, New City Hall
Sacramento, CA 95814-2604

Enclosed is the *Audit of Employee Health and Pension Benefits*. We conducted this performance audit in accordance with generally accepted government auditing standards and City Code Chapter 2.18.

The report contains 5 findings and makes 28 recommendations for improving Human Resources' operations, controls, and management. The Department's written response to this report is found on page 48. I will present this audit at the April 12, 2011 *Audit Committee* meeting.

We would like to thank the Department of Human Resources, Department of Finance, the City Attorney's Office, and the City Manager's Office for their assistance and cooperation during this audit.

Should you have any questions, please feel free to contact me.

Respectfully submitted,

Jorge Oseguera
City Auditor

CITY HALL – THIRD FLOOR
915 I STREET, SACRAMENTO, CA 95814-2604
PH (916) 808-7270 • FAX (916) 264-7680 • EMAIL joseguera@cityofsacramento.org

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Executive Summary

In accordance with the City Auditor's 2010-11 Audit Plan, we have completed an *Audit of Employee Health and Pension Benefits.* 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.

Finding 1: The Administration Of Health Benefits Has Strengthened, But Areas Of Concern Remain

Human Resources is charged with administering employee benefits. In recent years, Human Resources has improved how it administers benefits. Most notable was the City's transition to the eCaps system, which allows for a more accurate reporting and billing of health benefits. Other changes include the use of this electronic system to allow employees to view and at times change their benefits, and the establishment of a policy related to how the City enters into changes to the terms of labor agreements. While Human Resources has improved its administration of benefits, areas of concern remain.

We found that:

- Prior to July 2009, the City overpaid health providers and still does not have a mechanism to fully confirm accurate billing and medical coverage;
- Past letters of understanding (LOUs) increased the City's contributions towards benefits and lacked a formal approval process and transparency;
- The City-share of payments towards health benefits were not always in line with agreements;
- Information presented to employees during open enrollment for 2011 did not accurately show how much they would contribute;
- Understanding how much employees contribute towards benefits may be confusing;
- Unnecessary complexity related to flex credits has led to over payments to some employees who have left the City; and
- The City has not formalized its agreements to provide out-of-area health coverage.

By addressing these areas of concern, Human Resources will improve its ability to effectively administer the City's benefits program.

RECOMMENDATIONS

We recommend that Human Resources:

1. Continue to work with health providers and the City Attorney's Office to determine if the City can recover overpayments.
2. Develop a system to reconcile self-billed amounts to actual amounts deducted in payroll.

3. Inventory all previous LOUs and present them to Council for incorporation into labor agreements as necessary.
4. Create a formal procedure related to LOUs to ensure the implementation of Resolution No. 2010-700 and that LOUs become part of the labor agreements.
5. Post all active LOUs online along with labor agreements.
6. Establish a written procedure to review labor agreements. Such a procedure should entail a review of key amounts specified in the documents as well as a sign-off form that indicates Human Resources' staff and management review of agreement terms.
7. Establish a written procedure for creating rate sheets to ensure that amounts set in agreements are correctly transferred to eCaps and rate sheets.
8. Modify its current review process for open enrollment to ensure that premium amounts and shares of costs are correct and in compliance with labor agreements.
9. Work with Accounting and Information Technology to change electronic paycheck information to clearly display how much the City and employees contribute towards benefits.
10. Change the practices for crediting employees who leave the City to ensure that they are refunded the correct amounts for health premium payments.
11. Formalize the out-of-area plan and the subsidy methodology in the labor agreements.

Finding 2: The City's Current Methods For Determining Premium Amounts And Shares Need Improvement

As the City's health premiums have increased, it is important to evaluate the reasonableness of the premiums and management of these costs. Health premium rates are generally based on types of coverage offered and the City's experience rating. The City hires a broker to negotiate the cost of health premiums each year. Our review examined premium costs, but focused primarily on the shares that the City and employees pay towards their coverage. The City contribution amounts are negotiated between the City and employee unions and recorded in the labor agreements.

We found that:

- The City's benefit premiums are in line with what other area government employers pay;
- The amount City employees pay towards health premiums varies significantly based on the number of dependents covered;
- The share of premiums many employees pay towards health insurance have fluctuated and has not always moved in line with premium increases;
- City employees' contributions towards health premiums are similar to some area government employees' contributions, but differences exist;
- City contributions towards premiums exceed government and business sector averages for the western states; and
- Changing how the City determines its premium cost sharing could yield improvements.

Although the health benefit premium rates appear to be in line with what other government employers are experiencing, the City's current cost sharing could benefit from some reconsideration.

RECOMMENDATIONS

We recommend that Human Resources:

12. Establish a formal process to periodically compare the costs of the City's health premiums to what other area governments pay.
13. Report to City Council how the City's premium amounts compare with those paid by area governments.
14. Consider employee equity when negotiating with unions the City's contributions to health benefits.
15. Establish a process to obtain and review trends in area governments' contributions towards employees' health premiums.
16. Consider regional trends when negotiating benefit shares.
17. Negotiate terms that require increasing employees' contributions to their benefits.

Finding 3: Moderate Changes Could Help Rein In Rising Pension Costs

Rising pension costs have been a growing concern for many governments. The City, like more than 1,500 local public agencies in California, contracts with the California Public Employees' Retirement System (CalPERS) to provide pension benefits to City employees. Contributions into the system typically consist of an employer contribution and an employee contribution. Pensions pay retirees a defined lifetime benefit with monthly amounts based on an employees' salary prior to retirement, years of service, and the benefits formula employers provide.

CalPERS charges contracting government agencies percentages of employees' salaries to cover the future benefit payments. The designated City contribution towards pensions have increased from $29.1 million in 2004-05 to $44.1 million in 2009-10. This represents an overall increase of 52 percent. The City's pension costs have increased significantly in recent years due to factors like recent investment losses and changes to CalPERS' assumptions that project retirees will live longer than earlier expected. According to CalPERS, investment gains and losses are usually the biggest factor in determining if future employer contributions will change. Given the potential impact of the projected future costs of the current pension program, it is in the City's interest to consider making changes now in order to begin reining in pension costs.

We found that:

- City contribution rates have increased at a greater rate than City revenues and are projected to continue to increase during the next few years;
- Changes to the share of who contributes towards pensions could save the City millions each year; and
- Most employees who work in nearby governments contribute a greater share to their pensions than City employees.

Given the trend of rising pension expenses, the City needs to evaluate how it shares these pension costs with employees.

RECOMMENDATIONS

We recommend that Human Resources:

18. Negotiate a change in contributions to require that all employees pay some share of the employee contribution portion of pensions.
19. Consider the employee contributions required by nearby government employers when negotiating the City's pension share.

Finding 4: City Payments Towards Retiree-Health Costs Are Growing And The Way The City Pays For These Benefits Could Result In Overpayments

The City contributes towards health premiums for about 1,800 retirees. However, not all former Sacramento employees receive health benefits from the City, as these benefits are generally provided only to those with at least 10 years of City service. Retiree health benefits are negotiated and specified in labor agreements. Under most agreements, retirees receive a set amount towards premiums. The amounts paid are based on years of service and the number of dependents covered. Retirees pay the difference between the City contribution and the monthly premium costs.

Contributions for Fire retirees are calculated differently. Amounts are based on the premium amounts of the retiree health and dental coverage. There is no additional City contribution if retirees have dependents. For both general and Fire retirees, City-paid contribution amounts increase with years of service and employees must work at least 20 years to receive the full benefits.

We found that:

- Annual retiree health contributions are projected to nearly double in the next eight years; and
- The City does not have a system in place to ensure it pays correct amounts towards retiree health benefits.

Considering projected retiree-health costs increases, the City should continue its current cost-containment efforts and should apply the lessons learned from transitioning to self billing with active employees to its retiree-health benefits operations.

RECOMMENDATIONS

We recommend that Human Resources:

20. Work towards negotiating a change to the City's contribution for Fire retirees' benefits to bring them more in line with contributions made toward other City retirees.
21. Continue pursuing options to reduce retiree health costs.
22. Continue working with Health Net to pursue overpayments for the out-of-area subsidy.
23. Continue work to implement the self-billing method for retiree health benefits.

Finding 5: Rising Benefit Costs Require The City To Evaluate Cost Containment Options Like Those That Other Governments Employ And Best Practices Recommend

Overall, the costs of providing employee benefits have risen in recent years while City revenues have declined. This trend, when combined with the total amount that the City already pays towards benefits each year, is troubling. While the City engages in a request for proposals (RFP) process for selecting health insurers every five years and Human Resources works with a health insurance broker to remain aware of trends, Sacramento does not have a formal process in place to identify and evaluate potential cost savings measures.

Given the rise in health and pension costs, it is imperative that the City considers cost containment strategies. With that in mind, we considered strategies of other government employers and industry practices.

We found that:

- Changes to the type of benefits offered and share of who covers costs could reduce city spending:
  Changing Plan Design
  Adding a High Deductible Plan
  Purchasing Health Insurance Elsewhere
  Wellness Programs
  Alternative Retiree-Health Benefit Plan
  Reduced Pension Benefits For New Employees

- Best practices in benefit cost containment focus on creating plans and evaluating performance.

By exploring these options, the City may be able to help contain its costs while continuing to provide quality benefit packages at competitive rates.

RECOMMENDATIONS

We recommend that Human Resources:

24. Establish a process to annually review health plans for possible cost savings options.
25. Continue plans to implement a wellness program that includes assessing the program's impact.
26. Consider changes to the retiree health benefits program.
27. Consider changes to pension formulas and final compensation calculations for new employees.
28. Create and manage a strategic health-care plan.

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Introduction

In accordance with the City Auditor's 2010-11 Audit Plan, we have completed an *Audit of Employee Health and Pension Benefits.* 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.

Background

The City's Department of Human Resources is charged with, among other responsibilities, administering and negotiating employee and retiree benefits. The department's 2009-10 approved budget was $29,473,715 and included 65.8 full-time equivalent employees. The Benefits and Retirement division strives to provide a competitive package of employee benefit programs that supports City recruitment and retention objectives. Labor Relations, which is charged with negotiating the City's labor agreements, became a division of Human Resources in 2010.

The City of Sacramento (City) and employees pay about $100 million per year towards employee health and pension benefits. While employees paid toward their health premiums and pension contributions in Fiscal Year 2009-10, the City covered most of these expenses. The following shows how health and pension costs were divided between the City and employees in Fiscal Year 2009-10:

Exhibit 1: Health And Pension Benefits Cost About $100 Million A Year

Benefit Category	City Annual Costs (millions)	Employee Annual Costs (millions)	Total Annual Costs (millions)
Employee Health Premiums	$30.3	$3.7	$34.0
Pension Contributions	$61.4	$4.8	$66.2
Total	$91.7	$8.5	$100.2

Source: Generated from eCaps reports, information provided by Finance Staff, and Auditors' analysis

Career and some part-time employees are eligible to participate in the City-sponsored employee health plan. Health insurance choices include four health maintenance organization (HMO) plans and one preferred provider organization (PPO) for those living out of the coverage area of the HMO plans. HMO services are provided by Kaiser and Health Net, which each offer two plans with different co-pays for medical treatment ($15 or $25 co-pay amounts). Monthly premiums for these plans are significantly lower than the PPO plan and almost all employees who participate in the City-sponsored health plan enroll in one of the HMO options. All plans include options to cover the employee only, employee plus one dependent, and the employee plus two or more dependents. The City's share of the premium cost are negotiated and specified in labor agreements with employees' unions. For unrepresented employees, the City enters into personnel resolutions that specify terms. Eligible employees who decline health plans, because they have benefits elsewhere, receive a payment of $200 per month for waiving coverage.

Most labor agreements specify that the City contribution amount towards monthly premiums for employee-only coverage shall be equal to the total of the least expensive health and dental plan premiums. For the employee with one dependent, and the employee with two or more dependents, the City share amounts have been negotiated with unions. The City contribution amounts are stated in the labor agreements. The following shows the approximate number of active employees enrolled in the City's HMO plans:

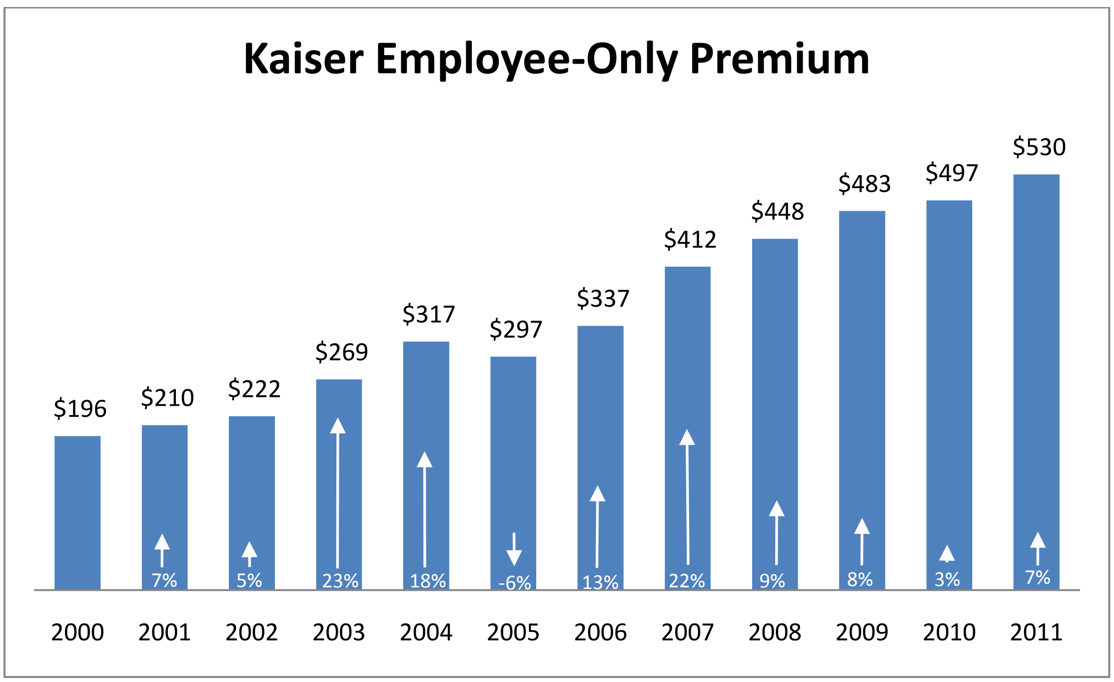
Exhibit 2: Approximate Number of Employees Enrolled In Benefits By Coverage Type[1]

Employee Only	1,141	40%
Employee+1	559	20%
Employee+2+	1,148	40%
Total Covered	2,848	

Source: Generated from eCaps report and Auditors' analysis

Premiums have more than doubled in the past decade. Monthly premiums for employee-only coverage increased from about $196 in 2000 to about $530 in 2011. This represents an overall increase of 170 percent. The following graph shows the monthly premium and year-to-year percent changes embedded in the bars:

Exhibit 3: Health Premiums Have Increased [2]



Source: Generated from information provided by Human Resources Staff

[1] The number of employees enrolled in benefits fluctuates throughout the year. The estimate for Exhibit 2 was based on October 2010 information in the City's electronic Human Resources/Payroll financial management system.

[2] Premiums are based on least expensive Kaiser plan. In 2005, the City began offering two Kaiser plans with different co-pay amounts. Prior to 2005, the City offered only one Kaiser plan.

In addition to health premiums increasing, the City has also seen growth in its pension and retiree health costs. The costs in all three of these areas are expected to continue to grow. The increases during the past several years occurred at a time in which overall City revenues have declined. Such a trend combined with the overall costs of these benefits makes it necessary to consider options to contain employee benefit costs and to operate more efficiently.

In recent years, Human Resources has made significant improvement to how it administers benefits. The following specify Human Resources' recent accomplishments:

- Beginning in 2008, employee benefit information has been available in the City's electronic eCaps system.[3] Employees can log in to this system to view their benefits. For the past three years, employees have been able to make benefit changes in eCaps during open enrollment (the time each year when employees can change their benefits).
- In July 2009, Human Resources began to self bill for health premiums. To self bill, Human Resources uses eCaps' benefit information to determine which employees should be enrolled in their respective Health Net or Kaiser health plans. Using this information, staff determines how much the City should pay towards premiums and pays the two health insurance providers accordingly. The system allows for the City to update this information frequently and no longer relies on the providers to bill the correct amounts for benefits.
- On December 7, 2010, City Council adopted Resolution No. 2010-700: Authorization to Approve Letters of Understanding With Recognized Employee Organizations. Labor Relations, which became a division of Human Resources in 2010, and unions have historically made agreements with Letters of Understanding (LOUs). These documents change terms of the labor agreements for various reasons, and have been used in some cases to increase the City's contributions towards benefits. Resolution No. 2010-700 specifies who has the authority to enter into which types of LOUs and details the threshold of agreements that require City Council approval.
- We reviewed a random sample of 40 employees' health benefit deductions for a pay period in 2010. Our sample did not identify any discrepancies between what employees had enrolled in and the benefits they were receiving.

Audit Objective, Scope, and Methodology

The objective of this audit was to identify ways to reduce the costs and improve the administration of employee benefits. Specifically, we evaluated Human Resources' 1) administration of health benefits; 2) method for determining health premium amounts and shares; and 3) administration of pension benefits. Additionally, we examined 4) trends in retiree-health costs; and 5) benefit cost containment options that other governments use and best practices recommend. This report primarily examines the administration and cost sharing of employee health and pension benefits[4].

Our audit scope drew on historical information and projected possible future costs, but focused primarily on 2009 and 2010. In our review, we compared Sacramento's health and pension benefits to

[3] The eCaps system is the City's electronic Human Resources/Payroll financial management system.
[4] Our analysis did not include a review of the City's dental, vision, or other optional benefits.

those provided by other area governments. Specifically, we compared benefits to those offered by the State of California; cities of Elk Grove, San Francisco, San Jose and West Sacramento; and County of Sacramento. Additionally, we compared the City of Sacramento's health benefit cost sharing to that of other employers in the western United States.

We obtained access to the City's eCaps system, which includes payroll and benefits information. We used this system to understand health benefit and pension costs and to test benefit deductions for accuracy. Besides using this system, we interviewed and obtained information from Human Resources, Finance, and the City Attorney's Office.

We should note that as City employees, the Auditor's Office participates in the benefits program we audited.

Finding 1: The Administration Of Health Benefits Has Strengthened, But Areas Of Concern Remain

Human Resources is charged with administering employee benefits. In recent years, Human Resources has improved how it administers benefits. Most notable was the City's transition to the eCaps system, which allows for a more accurate reporting and billing of health benefits. Other changes include the use of this electronic system to allow employees to view and at times change their benefits, and the establishment of a policy related to how the City enters into changes to the terms of labor agreements. While Human Resources has improved its administration of benefits, areas of concern remain.

We found that:

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- Information presented to employees during open enrollment for 2011 did not accurately show how much they would contribute;
- Understanding how much employees contribute towards benefits may be confusing;
- Unnecessary complexity related to flex credits has led to over payments to some employees who have left the City; and
- The City has not formalized its agreements to provide out-of-area health coverage.

By addressing these areas of concern, Human Resources will improve its ability to effectively administer the City's benefits program.

Prior To July 2009, The City Overpaid Health Providers And Still Does Not Have A Mechanism To Fully Confirm Accurate Billing And Medical Coverage

Overall, the City and employees together contributed about $34 million in Fiscal Year 2009-10 towards employee health premiums. Of that, the City paid about $30.3 million while employees paid $3.7 million. As it is charged with administering benefits, Human Resources is responsible for maintaining accurate employee benefit enrollment information and paying providers the correct amounts for health premiums. However, we found that prior to July 2009, the City failed to accurately identify benefit eligible employees, resulting in the City paying providers to cover employees who were no longer eligible to receive benefits.

When the current Benefits and Retirement Manager started her position in August 2005, benefits staff relied on an unstructured system of tracking and reporting employee benefit information. During this time, benefit employees entered changes to benefits information (including information about which employees' coverage should terminate) in Excel spreadsheets. These spreadsheets, saved on floppy disks, were sent to providers. In some cases, changes to coverage were also faxed to providers. There was not a central place where spreadsheets were shared and different staff members kept their own spreadsheets. Starting in about May of 2006, staff began entering changes in the providers' Web-based interface, but would sometimes also fax information to providers. Based on this information, the insurers would bill the City. The use of the Web-based entries continued until self billing started. According to the Benefits and Retirement Manager, the City did not calculate how much it should pay towards employees' monthly premiums. Instead, she said that the City simply paid the amounts providers billed.

We began questioning Human Resources about benefit payments after researching monthly payments to providers and finding discrepancies between bill amounts and what we would have expected as payments. A review of 2009 indicated a difference between what was collected from employees and the City in paychecks towards benefits and what was billed by providers. We compared the amounts the City paid to Health Net and Kaiser for health premiums to the eCaps payroll deduction information for the corresponding months and found inconsistencies that could indicate overpayments during the year. The eCaps information included the amounts of both the City and employees' share of their respective premiums. The comparisons showed a difference between what was collected in payroll from employees and the City towards health benefits and what was paid to providers of about $480,000 for the year. The following table shows the differences by provider.

Exhibit 4: Differences Existed Between Billed Amounts And Amounts Deducted From Payroll[5]

	2009 Bills and Self Bills		2009 Payroll (eCaps)		Difference	
Month	Kaiser	Health Net	Kaiser	Health Net	Kaiser	Health Net
January	$1,499,203	$1,458,522	$1,469,439	$1,403,919	$29,764	$54,603
February	$1,504,285	$1,431,900	$1,458,646	$1,387,040	$45,639	$44,860
March	$1,523,100	$1,449,505	$1,452,856	$1,391,629	$70,244	$57,876
April	$1,477,846	$1,408,887	$1,446,130	$1,388,133	$31,716	$20,754
May	$1,469,618	$1,414,239	$1,436,741	$1,393,246	$32,877	$20,993
June	$1,474,638	$1,354,606	$1,435,275	$1,395,094	$39,363	(40,488)
July	$1,420,474	$1,384,927	$1,414,107	$1,375,222	$6,367	$9,705
August	$1,396,079	$1,359,455	$1,389,374	$1,349,085	$6,705	$10,370
September	$1,400,796	$1,354,903	$1,393,966	$1,347,985	$6,830	$6,918
October	$1,402,357	$1,354,010	$1,399,900	$1,346,616	$2,457	$7,394
November	$1,408,376	$1,351,041	$1,405,833	$1,345,227	$2,543	$5,814
December	$1,404,944	$1,351,454	$1,404,370	$1,345,271	$574	$6,183
Total	$17,381,714	$16,673,449	$17,106,637	$16,468,467	$275,077	$204,982

Source: Generated from eCaps reports, information provided by Human Resources and Finance Staff, and Auditors' Analysis

As shown above, the discrepancies narrowed significantly in July of 2009 when the City shifted to self billing.[6] This appears to be due in part to the removal of premium payments for those who should not have been covered – as explained below. However, we have not conducted a full reconciliation of these figures. The difference between the providers' bills and the payroll amounts towards health benefits for the months during 2009 before self billing averaged about $68,000 per month (indicating a possible overpayment of as much as this amount). For the months in 2009 after self billing, the difference

[5] Numbers displayed are rounded to the nearest dollar and therefore may not total exactly.

[6] Self billing refers to a fundamental change in how the City calculates benefits cost from one that relies on the providers' bills, to one in which the City self generates bills based on its eligibility and enrollment information.

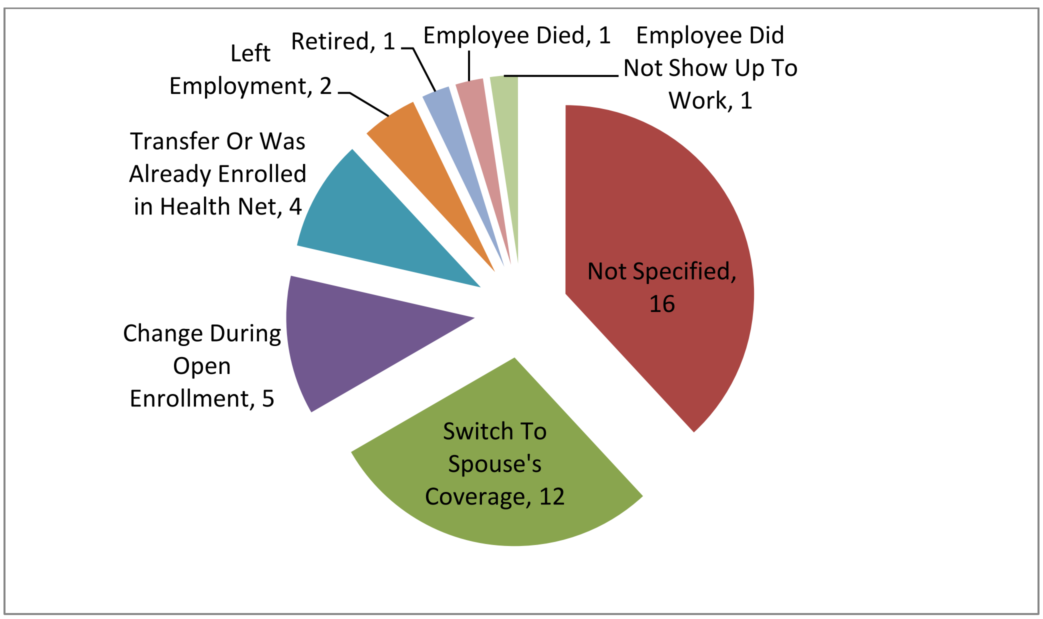
averaged about $12,000 per month. Some variation could be expected in a complex system of administering benefits that involve employees entering and exiting employment at various points.

In July 2009, the City began self billing for health premium costs. To self bill, Human Resources uses eCaps' benefit information to identify all benefit eligible employees and determines the benefit cost based on the employees' benefit elections. When the City changed to self billing in July 2009, Human Resources and providers realized that some employees and former employees, and their dependents were enrolled in health coverage in which they should have no longer been enrolled. In response, Human Resources worked with providers on these discrepancies. While we have obtained evidence of these reconciliation records from both insurers, Kaiser was able to provide more complete records for that period. Human Resources staff researched the employees who should have had their coverage terminated in the past and determined when the coverage should have ended. This information was entered into a spreadsheet and was sent back to Kaiser. After a discussion with Kaiser during audit fieldwork about possible billing discrepancies, Kaiser sent the auditors the spreadsheet that contained Human Resource's prior analysis. Human Resources did not have its record of this spreadsheet.

A review of the spreadsheet found 42 examples that clearly indicated that the City was paying health benefits for those who should not have been enrolled in those benefits. This list included people who had left the city, switched to spouses' plans, changed coverage to another City plan, and one case in which an employee had died. For these 42, the City paid on average about 30 months of benefits that should not have been paid. We estimate that between 2004 and 2009 the City paid about $750,000 in premiums to Kaiser for those who should not have been covered. As Human Resources had no reconciliation process prior to self billing to ensure that it was paying to cover the correct people, it is unlikely that these errors would have been discovered without the switch to the self-billing method.

The City should have terminated coverage for these individuals for a variety of reasons. The following chart shows why coverage should have ended per the spreadsheet prepared by Human Resources in 2009. Some instances did not specify why coverage should have terminated.

Exhibit 5: Reasons Why Coverage Should Have Ended



Source: Generated from information provided by Kaiser and Auditors' analysis

The following table provides examples of some of the City payments on behalf of employees or former employees who should not have been covered:

Exhibit 6: Examples Of Those Who Should Not Have Been Covered

Why Coverage Should Have Ended	Type Covered	Excessive Months Of Coverage	Estimated City Cost
Transferred to Spouse's Coverage	e+2+	56	$ 56,000
Transferred to Health Net	e	64	$ 25,600
Left City Employment[6]	e+1	30	$ 24,000
Member Died[6]	e+2+	19	$ 19,000
Employee Did Not Show Up To Work[7]	e	26	$ 10,400

Source: Generated from information provided by Kaiser and Auditors' analysis

In addition to the payments made to Kaiser on behalf of those who should not have received benefits, we also found evidence that the City was paying premiums to Health Net for those who the City should not have covered. While Human Resources and Health Net searched their records for evidence of a reconciliation spreadsheet created around the time in which the self-billing switch occurred, they could not find a completed record. Health Net was able to provide Excel spreadsheets from around that time that identified possible discrepancies. This information did not include the City's eligibility determinations. However, Health Net did provide an electronic file that showed which employees were enrolled in Health Net benefits during the first quarter of 2009. We compared this data against when coverage should have ended per the eCaps system. We estimate that since the middle of 2008, the City paid Health Net nearly $125,000 in premiums for 24 employees who should not have been covered.

A review of payroll records indicated that people who were erroneously covered by either provider may not have known that the City was paying for the coverage. For example, our review of employees' paycheck records showed that employees who transferred to their spouses' plans were no longer seeing their share of contributions for the plan they had left being deducted from their paychecks. Additionally, those who switched to other City plans had the amounts deducted for their new plan and not for the old coverage.

The Benefits and Retirement Manager recently reviewed some of the personnel files of those who should have had their Kaiser coverage terminated. She said that the files reviewed did not clearly show evidence that Human Resources staff had sent the termination information to Kaiser prior to the discovery during self billing.

We recognize self billing as a major improvement. While the self-billing system includes a method to check eCaps reports for accuracy, it does not reconcile the amounts paid to providers with the employee and City contributions deducted in paychecks towards benefits. In order to better ensure that the City is only paying health premiums for eligible employees, Human Resources should expand on its self-billing method. Specifically, in addition to determining who should be eligible for which type of coverage, Human Resources should also reconcile this information with the payroll amounts deducted from both the City and employees towards health premiums. Such reconciliations, if performed consistently, will

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[7] Human Resources is dependent on the City's departments providing timely Personnel Action Requests (PARs) to ensure that changes to the City's benefit information are entered in a timely manner.

detect problems in a timely manner and prevent the long-term City payments of premiums on behalf of those who should not be covered. Without a reconciliation process, it might still be possible for the City to pay for employees and former employees who should not be eligible for health coverage.

In January, we shared concerns about overpayments with Human Resources and the City Attorney's Office. Currently, Human Resources is working with providers to determine if overpayment amounts could be recovered.

RECOMMENDATIONS

We recommend that Human Resources:

1. Continue to work with health providers and the City Attorney's Office to determine if the City can recover overpayments.
2. Develop a system to reconcile self-billed amounts to actual amounts deducted in payroll.

Past Letters of Understanding (LOUs) Increased The City's Contributions Towards Benefits And Lacked A Formal Approval Process And Transparency

The City enters into labor agreements that detail the terms of employment with employee unions. One of the areas covered in labor agreements are employee benefits. The employee benefits section of the labor agreements details the City's contributions for health benefits. In addition to these agreements, the City enters into Letters of Understanding (LOUs) with unions to modify terms of the labor agreements, if needed.

In the past, Labor Relations relied on the City's Employer-Employee Relations Policy (adopted in 1993 and amended in 1997) to guide it in labor negotiations. The policy designated the authority to negotiate with unions to the City Manager or the manager's authorized representative, which at the time included the Labor Relations staff. It states that for agreements reached between the City and unions for matters subject to approval by City Council, Labor Relations shall present a written agreement to City Council for determination. The policy does not explicitly state what matters are subject to City Council approval and what can be decided under the City Manager's authority. However, we found that LOUs were utilized frequently in the past and it is unclear when and if they were submitted to City Council for formal consideration.

According to the Labor Relations Manager, LOUs were used extensively in the past. Sacramento routinely used LOUs to negotiate various changes – averaging 40 agreements per year from 2005 to 2010. Most agreements, including the ones that increased the City's contributions to health premiums, were not sent to City Council for formal approval in open session. While some LOUs were posted on Labor Relations' website along with the labor agreements, others were not at the time of our review. Our review of recent LOUs found four agreements that increased the City's contributions towards employees' health benefits.[8] Of these, two were publically posted as of the middle of February 2011. According to the Labor Relations Manager, the division is reviewing LOUs and will post those that are still active.

[8] While other LOUs impacted City expenses, our review focused specifically on LOUs related to the cost of employee health benefits.

We found that entering into LOUs in recent years cost the City several hundred thousand dollars in benefit contributions over what unions originally agreed to in labor agreements. A review of LOUs pertaining to health premiums revealed that these agreements increased the City contribution for employees in four unions – increasing City contributions beyond agreed-upon terms for some classifications by $50 or $75 per employee per month.

During our initial audit work, we reviewed City labor agreements and LOUs posted on the Labor Relations' website to confirm that the terms of the agreements were consistent with the City's payments towards benefits. Initially, our review identified some inconsistencies between the terms of the agreements and what had been built into the City's eCaps system. If accurate, these differences would have meant that the City was paying towards benefits in excess of what it agreed to pay for some employees. We shared these concerns with Human Resources and they provided the unposted LOUs that specified the updated amounts of the City contributions. While these documents showed that the discrepancies we identified in testing did not represent City overpayments for benefits, they led us to new concerns. Specifically, a lack of posting the accompanying LOUs resulted in incomplete and arguably misleading information regarding the actual terms agreed upon between the bargaining units and the City. This lack of transparency is a disservice to the public as well as City policymakers. Additionally, Labor Relations did not keep the City Attorney's Office (CAO) apprised of many LOUs even though the CAO is responsible for providing legal counsel to City government.

We estimate that the four LOUs related to employee health benefits cost the City about $750,000 during 2009 and 2010 in payments beyond originally-stated labor agreement terms. According to the Labor Relations Manager, the increases in health benefit contributions established in the LOUs constituted bona-fide agreements that were consistent with the labor relations practices and policies of the City at that time. He said the agreements were based on the best interests of the parties and the unique circumstances evident at the time the agreements were reached. According to Labor Relations staff, these amounts were increased for these four unions because the City had in the past brought all unions' health benefit terms in line with the most favorable health benefit terms negotiated by one union (known as "me too" or "favored nation" clauses). The Labor Relations Manager said that this practice has stopped. He said that in the future, each union's unique interests will be considered and individual labor agreements may establish differences in how salary and benefits are treated when compared to the labor agreement of another union.

The Labor Relations Manager further stated that the use of LOUs will be avoided unless there is a compelling interest for the City to enter into them. He said that in the past - before he became Labor Relations Manager - some LOUs were presented to Council in closed session, but he is not sure how many were presented and how many were not. He said that there was not a formal record kept of what City Council agreed to in closed session relating to LOUs. The Labor Relations Manager said that this was a concern and that a recent resolution defines authority and allows for a process to track the approvals of LOUs.

In December 2010, City Council passed Resolution No. 2010-700, which sets parameters for the use of LOUs. The resolution specifies that the City Manager can agree to LOUs that do not exceed $100,000 over the term of the labor agreements and that the Director of Human Resources can agree to non-monetary LOU terms. Under the resolution, all LOUs must be submitted to the City Attorney's Office for review. Terms that will cost the City more than $100,000 will go to City Council for approval in open session and will be presented with staff reports that specify the costs of agreeing to the terms.

If LOUs are to be legally binding, it is imperative that that they are well-crafted, documented, publicly disclosed and entered into under a grant of authority from the City Council.

RECOMMENDATIONS

We recommend that Human Resources:

3. Inventory all previous LOUs and present them to Council for incorporation into labor agreements as necessary.
4. Create a formal procedure related to LOUs to ensure the implementation of Resolution No. 2010-700 and that LOUs become part of the labor agreements.
5. Post all active LOUs online along with labor agreements.

The City-Share of Payments Towards Health Benefits Were Not Always In Line With Agreements

The City enters into labor agreements with employee unions and adopts personnel resolutions for unrepresented employees. These agreements, which specify benefit contributions, are approved by City Council. Human Resources is charged with correctly administering the City's agreements. Human Resources enters rate information into eCaps each year and creates and distributes rate sheets to employees. These specify the City contribution to health plans. A review of the Personnel Resolution for unrepresented employees and benefit contributions revealed that the City covered a greater share of health premiums than it agreed to pay for some employees in 2010 and the City was slated to pay more than it agreed to as of the beginning of 2011.

According to the Benefits and Retirement Manager, this was due to errors when updating the Personnel Resolution for unrepresented employees. Specifically, she explained that the Personnel Resolution for unrepresented employees should have been updated each year to include greater amounts for benefits. She said that traditionally the Resolution that rules health premium contributions for these unrepresented employee classifications is updated to be in line with what most represented employees receive.

In response to these discrepancies, which we presented to Human Resources during field work, Human Resources worked with the City Attorney's Office to amend the language of the resolution for unrepresented employees to approve the greater benefit amounts (that are in line with what most other employees receive). City Council approved the changes at their January 11, 2011 meeting.

While the Council approval updated the resolution's terms, the fact that errors related to benefits were present in two consecutive years of this resolution is troubling. Specifically, there is no written policy that states the basis for making the recommendations to Council for the benefit amounts for unrepresented employees. Nor is there a written procedure for reviewing the labor agreements. Additionally, there is no written procedure for updating and reviewing the rate sheets that Human Resources creates.

If the identified discrepancy had continued through the end of 2011, the City would have paid about $104,000 in excess of the originally stated amounts in the resolution. This discrepancy was $30 per month per employee for one employee classification in 2010. Payments in excess of the resolution's terms were slated to be $34 for two employee classifications per month and $64 for another classification in 2011. While City Council was able to update language to resolve this discrepancy, the accuracy of labor agreements and personnel resolutions is fundamental since errors related to benefits could increase City costs.

RECOMMENDATIONS

We recommend that Human Resources:

6. Establish a written procedure to review labor agreements. Such a procedure should entail a review of key amounts specified in the documents as well as a sign-off form that indicates Human Resources' staff and management review of agreement terms.
7. Establish a written procedure for creating rate sheets to ensure that amounts set in agreements are correctly transferred to eCaps and rate sheets.

Information Presented To Employees During Open Enrollment For 2011 Did Not Accurately Show How Much They Would Contribute

As part of its administration of benefits, Human Resources is responsible for providing employees accurate information about their health premium costs so they can make informed decisions when selecting coverage. Our review of Human Resources' documents for Open Enrollment showed that the department had prepared an extensive plan and checklist for running the annual process. However, we found that information provided to employees in preparation for and during open enrollment in October 2010 for calendar year 2011 did not accurately reflect the amount that all employees would pay for their benefits. Specifically, the amounts of the City share towards health benefits for some employees were incorrect in the eCaps system (where employees sign up for benefits during open enrollment), on rate sheets that were posted on the City's Intranet site, and in an open enrollment newsletter sent to employees in September. The amount that the City would contribute for most employees enrolled with employee-only coverage indicated that the City would pay $520 towards monthly premiums and the employee would pay the remainder of the premium. Although the system and rate sheets indicated a $520 contribution, the City had agreed in labor agreements to contribute $554 towards premiums to most employees with employee-only coverage.

While this meant that most employees in this category are receiving $34 per month in greater City contributions towards health premiums than expected, the incorrect amount stated during open enrollment could have influenced some employees' overall decisions about which benefits to choose. For example, employees may have chosen different dental plans or opted in or out of vision coverage based on overall benefit costs.

At the start of open enrollment, we identified the difference between the City contribution amounts on the rate sheet that Human Resources provided to employees during open enrollment and the amounts stated in recently-approved labor agreements. Specifically, the rate sheets set the 2011 City contribution at $520 (a freeze at the 2010 level) each month for employees with employee-only coverage, while most of the agreements indicated that the City contribution would be equivalent to the least expensive health and dental premiums ($554). We asked Human Resources about this possible discrepancy on October 6. At that meeting, Human Resources staff stated that while it believed that the City contribution for most employees with employee-only coverage was frozen at the 2010 level, staff would check with the City's labor negotiator about the exact terms. After checking with the negotiator, Human Resources informed us in the middle of October that the freeze of the City contribution for those with employee-only coverage was only for those represented by one union (Local 447). Human Resources said that most other employees in this category would receive the $554 City contribution in 2011 (equivalent to the lowest cost health and dental premiums in 2011).

As the information provided about rates was inconsistent with the labor agreements, Human Resources notified employees. Human Resources, through the City's Public Information Officer, sent an employee-wide e-mail on October 18 with the subject "Reminder: Open Enrollment Ends October 30th" that specified the correct City contributions for both Local 447 and other employees. While auditors notified Human Resources of these discrepancies related to employee-only health premium amounts during the start of the open enrollment month and Human Resources acknowledged the errors, changes to the amounts in eCaps were not made during open enrollment. Additionally, rate sheets also were not updated in the City's Intranet system by the end of open enrollment. However, Human Resources did post updated rate sheets to the City's Intranet Site by the end of December. If the error had not been identified prior to the start of 2011, the City would have been out of compliance with the terms of its labor agreements.

RECOMMENDATIONS

We recommend that Human Resources:

8. Modify its current review process for open enrollment to ensure that premium amounts and shares of costs are correct and in compliance with labor agreements.

Understanding How Much Employees Contribute Towards Benefits May Be Confusing

It is reasonable to expect that information regarding employee's compensation and benefits be clearly detailed on an employee's paycheck. However, we found that the current method of presenting this information has caused much confusion. This confusion results from the current payroll system design, which breaks out the contributions for health benefits into three categories: "earnings," "before-tax deductions," and "employer paid benefits." Specifically, the system is complicated by a $200 per month Flex Credit, which is classified as "earnings" on paychecks. The Flex Credit designation serves a dual purpose. It can in some cases represent the amount the City will pay an employee for waiving health benefits, or it can represent a portion of the City's contribution towards employee health benefit costs. The Flex Credit makes up part of the City's contribution to health benefits for employees who enroll in these benefits and it is shown on paychecks as "earnings." According to the Benefits and Retirement Manager, the Flex Credit amount was set up in the eCaps system and figured into benefit payments since employees who waive health coverage receive this credit if they choose to waive coverage.[9] While it would be expected that the credit would be classified as earnings for these employees, it is unclear why it is considered earnings for those who receive it towards medical benefits.

To understand how much employees actually contributed to their health benefits, employees would have to cross reference paycheck information with Human Resources' benefits rate sheet. The following shows how information about benefits was displayed in a biweekly electronic pay check in 2010 for an

[9] Employees may waive coverage because they are insured elsewhere. For example, they could have coverage through a spouse's plan.

employee enrolled in employee-only coverage for the least expensive Kaiser health plan (letters were added to this graphic for demonstration purposes):

Exhibit 7: Medical Benefits Shown On An Employee's Biweekly Electronic Pay Check

Earnings			
Description	Hours	Rate	Amount
Regular	[redacted]		
FFlxCredit			A 100.00
TechAllowa			[redacted]
Total:	80.00		[redacted]

Taxes	
Description	Amount
Fed Withholdng	[redacted]
Fed MED/EE	
Fed OASDI/EE	
CA Withholdng	
Total:	

Before-Tax Deductions	
Description	Amount
Kaiser Med	B 88.43
Dental	[redacted]
Vision	
401A	
457DefComp	

After Tax Deductions	
Description	Amount
OOASubFee	[redacted]

Employer Paid Benefits	
Description	Amount
Kaiser Med	C 160.00
BasicLife	[redacted]
LTD	
401A	
PERS70002	
ER - 70002	

Source: eCaps payroll information and Auditors' analysis

The above display does not clearly state who pays for what health benefit. Specifically, there are two "Kaiser Med" categories. One is under "Employer Paid Benefits" (marked C) and is paid by the City. The other $88.43 (marked B), shown as "Before-Tax Deductions," may lead an employee to conclude that this is the portion that he/she pays towards the health benefit (since it is not marked as "employer paid)." The area under earnings called Flex Credit (marked A) is a City paid amount that, in addition to the "employer paid benefit," goes towards this employee's health premiums.

To better understand payments, it is necessary to also consult a rate sheet. The following portion of the 2010 rate sheet shows the employee's health plan (least expensive Kaiser plan):

Exhibit 8: 2010 Premium Rate Sheet

CITY OF SACRAMENTO 2010 RATES WITH "OUT OF POCKET" COSTS										
	2009 Monthly Rates		2010 Monthly Rates		2010 Employer Contribution		2010 Employee Cost		2010 Biweekly Employer Contribution	
Flex Credit (Cash)					$ 200.00	$ E 200.00	$520		$ 100.00	$ H 100.00
Co-pay	$ 15.00	$ 25.00	$ 15.00	$ 25.00	$ 15.00	$ 25.00	$ 15.00	$ 25.00	$ 15.00	$ 25.00
Kaiser									Employee Cost	
Single Employee	$ 518.58	$ 493.02	$ 523.10	$ D 496.86	$ 320.00	$ F 320.00	$ 203.10	$ G 176.86	$ 101.55	$ I 88.43
Employee + 1 dependent	$ 1,027.18	$ 976.06	$ 1,046.16	$ 993.68	$ 650.00	$ 650.00	$ 396.16	$ 343.68	$ 198.08	$ 171.84
Employee + 2 or more dep.	$ 1,362.86	$ 1,294.86	$ 1,391.40	$ 1,321.60	$ 1,000.00	$ 1,000.00	$ 391.40	$ 321.60	$ 195.70	$ 160.80

Source: Human Resources' rate sheet and Auditors' analysis

To figure out the employee's contribution and to check for accuracy, an employee could follow these steps:

1. Determine how much the City will contribute per month by adding the Flex Credit (E) to the Single Employee amount (F) from the rate sheet: $200 + $320 = $520.
2. Check the monthly premium amount for this plan. It is shown at "D" on the rate sheet, and is $496.86.
3. To find how much the employee contributes, subtract the City contribution from the premium: $496.86 - $520 = -$23.14. In this case, the employee's contribution is negative. That means that the City pays more than the cost of this premium and the excess can be used by the employee to pay for other benefits like dental coverage.
4. From the paycheck, add the Flex Credit shown at "A" to "Kaiser Med" at "C.": $100 + $160 = $260.
5. Double this amount to find the monthly amount that the City contributes: $260 x 2 = $520. This represents the total City contribution towards health benefits. The amount matches up with the calculation in step 1.
6. Add both (B and C) "Kaiser Med" categories on the paycheck: $88.43 + $160 = $248.43
7. Double this amount to find the monthly premium amount for this plan" $248.43 x 2 = $496.86. This matches with the premium amount "D" on the rate sheet.

While the amount that the City and employee contribute can be calculated, the complexity is problematic. In essence, the amount called "Kaiser Med" (B) in "Before-Tax Deductions" on the paycheck and "Employee Cost" (I) on the rate sheets are placeholder numbers created to account for the application of the Flex Credit. Because of this complexity, the above employee could erroneously conclude that he/she is contributing $88.43 per pay period in which health deductions are taken for a total of $2,122 per year when in reality the employee would be contributing nothing towards the Kaiser premiums.

Unnecessary Complexity Related To Flex Credits Has Led To Over Payments To Some Employees Who Have Left The City

In addition to the confusion related to the flex credit identified above, there have been instances in which this method led to overpayments of as much as $100 to some employees who have left the City. We estimate that the City made overpayments of about $28,000 from January 2009 through September 2010. Specifically, because of timing issues between when an employee pays for benefits and is eligible for benefits, there is the chance that those leaving the City would contribute to benefits that they would not be eligible to receive. Employees' health insurance coverage generally terminates at the end of the month in which they leave the City. To reconcile the end of coverage with the payroll deductions, Accounting uses a payoff checklist to determine if health insurance contributions should be returned to employees in the employees' final checks that are sent a few weeks after the employee leaves (and contain payments for any time that should be paid out).

We determined that when employees are reimbursed for their health insurance contributions, they are credited back the amount of their medical coverage that is specified in pay checks as "Before Tax Deductions," or on rate sheets as "employee contributions." As explained above, these amounts do not represent the actual amounts that employees pay towards their health premiums. This means an overpayment for those who require this reconciliation of as much as $100 per employee who leaves.

For example, an employee who left the City towards the end of September 2010 had deductions made in his October, 5 2010 paycheck to cover health benefits for October 2010. However, that employee was no longer eligible for benefits in October. The check deducted $88.43 as a before tax deduction for his medical plan. As noted above, this amount is a placeholder number that accounts for the application of the flex credit and does not represent what the employee contributed to benefits. In this case, the employee actually paid nothing towards his health benefits. When Accounting performed a reconciliation to pay the former employee's final check in November, the $88.43 was credited to the former employee.

According to the Payroll Principal Accountant, the City credits this amount because of language in some of the City's labor agreements related to the City's contribution towards health premiums. Agreements state, "Eligible employees shall receive a City contribution for each such pay period if the employee is paid for one or more hours of salary." We believe that this language should not apply to those who are no longer eligible to receive benefits. As explained above, the payments currently made are not refunds of employees' actual contribution. Instead, they represent both the City and – in some cases – employees' contributions. While the portion that employees contribute towards benefits that they will not receive should be returned to the employees, the additional amount covered by the City should not be paid to employees.

As this discrepancy represents a relatively small amount, we did not conduct an extensive review of the exact related costs. However, Human Resources and Accounting should update their practices to ensure that they are refunding the correct amounts to employees who leave the City.

RECOMMENDATIONS

We recommend that Human Resources:

9. Work with Accounting and Information Technology to change electronic paycheck information to clearly display how much the City and employees contribute towards benefits.
10. Change the practices for crediting employees who leave the City to ensure that they are refunded the correct amounts for health premium payments.

The City Has Not Formalized Its Agreements To Provide Out-Of-Area Coverage

As previously noted, most employees who participate in City health plans enroll in one of the Health Net HMO plans or one of the Kaiser HMO plans. However, some employees and retirees who live outside of the HMO coverage areas can enroll in the City's Health Net PPO plan. Approximately 125 employees and retirees are enrolled in this out-of-area coverage (most of those enrolled are retirees, as only five active employees are currently enrolled in the plan). Premiums for this plan cost about twice as much as the premiums for Health Net's HMO plans and the City has been collecting subsidy amounts from many employees and retirees who participate in the City health plans to cover part of the premium expenses for those who live outside of the area. Not all employees contribute to the subsidy and those with employee unions that do not pay towards the subsidy cannot receive the benefit. Instead, they pay an unsubsidized amount if they enroll in the out-of-area plan.

The following shows the 2011 employee share[10] for employees enrolled in the out-of-area plan who both receive and do not receive the subsidy:

Exhibit 9: Subsidized And Unsubsidized Amount For Out-Of-Area Coverage

Type	Subsidized	City Share	Employee Share
Emp.	$778	$554	$224
e+1	$1,556	$850	$706
e+2+	$2,077	$1,200	$877

Type	Unsubsidized	City Share	Employee Share
Emp.	$1,136	$554	$582
e+1	$2,281	$850	$1,431
e+2+	$3,023	$1,200	$1,823

Source: Generated from Human Resources' Rate sheet

While Labor Relations has historically issued Insurance Benefit Plan Review memos each year to unions that summarize benefits and specify that the out-of-area plan and the subsidy will continue, the City has not formally documented this understanding within the labor agreements. The Benefits and Retirement Manager explained that the City is bound by policy and labor agreements to provide employees and retirees medical coverage, but that the exact type of coverage is not specified. Our review of the out-of-area plan did not entail an evaluation of the merits of the plan, but instead analyzed the basis for the plan.

In 2010, the City paid on behalf of health-plan-participating employees and retirees about $500,000 in subsidy fees.[11] In 2007, Local 39 members stopped paying into the subsidy and therefore Local 39 employees or retirees who live outside the area and select the coverage do not receive the subsidy. If the City continues to offer the plan and continues to rely on payments from employees and retirees to subsidize the coverage, then the City should formally enter into agreements that specify the terms of the plan and employee subsidy.

RECOMMENDATIONS

We recommend that Human Resources:

11. Formalize the out-of-area plan and the subsidy methodology in the labor agreements.

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[10] The amounts would vary for retirees as the City contribution changes depending on their years of service and position.

[11] Employees and retirees who subsidize out-of-area coverage each contribute $10 per month towards the subsidy.

Finding 2: The City's Current Methods For Determining Premium Amounts And Shares Need Improvement

As the City's health premiums have increased, it is important to evaluate the reasonableness of the premiums and management of these costs. Health premium rates are generally based on types of coverage offered and the City's experience rating.[12] The City hires a broker to negotiate the cost of health premiums each year. Our review examined premium costs, but focused primarily on the shares that the City and employees pay towards their coverage. The City contribution amounts are negotiated between the City and employee unions and recorded in the labor agreements.

We found that:

- The City's benefit premiums are in line with what other area government employers pay;
- The amount City employees pay towards health premiums varies significantly based on the number of dependents covered;
- The share of premiums many employees pay towards health insurance have fluctuated and has not always moved in line with premium increases;
- City employees' contributions towards health premiums are similar to some area government employees' contributions, but differences exist;
- City contributions towards premiums exceed government and business sector averages for the western states; and
- Changing how the City determines its premium cost sharing could yield improvements.

Although the health benefit premium rates appear to be in line with what other government employers are experiencing, the City's current cost sharing could benefit from some reconsideration.

The City's Benefit Premiums Are In Line With What Other Area Government Employers Pay

The City's Benefits division strives to provide desirable employee benefit programs that support City recruitment and retention objectives and are designed to meet the diverse and changing needs of its employees. A key component of such efforts is securing quality benefit packages at competitive rates. We reviewed the City's health insurance premium amounts for the least expensive plan in 2011 and found that they are generally in line with the average paid by other governments in the area. Monthly premiums in 2011 for the City's least expensive Kaiser Plan are $529.86, employee only; $1,059.72, employee with one dependent; and $1,409.46, employee with two or more dependents.

[12] According to the Handbook of Employee Benefits, under an experience-rating arrangement, "the actual previous financial experience of the employer's plan is the basis for determining the future plan year's premium rates…the medical insurance premium charged is based on expected paid claims, inflation/utilization trend, underwriting margin, reserve adjustments, pooling charge and administrative costs…these factors cumulatively determines the experience-rated medical premium charge."

The following table compares the City's premiums with those of other governments. Those that exceed the City's premiums are in bold:

Exhibit 10: A Comparison Of Area Governments' Least Expensive Kaiser Plans

Least Expensive Kaiser Plan (2011)[A]	Employee Only	Employee+1	Employee +2+
City of Sacramento	$529.86	$1059.72	$1409.46
CalPERS Sacramento Region[B]	$524.51	$1049.02	$1363.73
CalPERS State Employees	$522.58	$1045.16	$1358.71
Sacramento County [C]	**$561.54**	None	**$1436.00**
San Francisco[D]	$481.70	$962.34	$1361.28
San Jose [E,C]	$496.04	None	$1235.16
West Sacramento[F]	$466.12	$932.24	$1281.84
Average	$508.75	$997.19	$1339.45

Source: Generated from information provided by respective governments

A. Excludes high deductible health plans. The details of the coverage were not evaluated for this comparison.

B. Davis and Elk Grove, for example, purchase insurance through CalPERS.

C. Employers do not have employee+1 plans. So the cost for employees with one dependent is the same as employees with +2+ dependents. In calculating the average for this category, these two governments were excluded.

D. Based on 7/1/2010 to 6/30/2011 fiscal year, not calendar year 2011.

E. Lowest plan is only available to some employee classifications.

F. This covers non-fire employees. Health insurance for Fire employees is purchased through CalPERS.

As shown above, Sacramento's premiums are more expensive than most of the other governments' premiums. For all compared, only one government (Sacramento County) had more expensive premiums (for the employee-only and employee with two or more dependents). On average, the City of Sacramento's premiums were greater than the other governments' average by 4 percent, employee only; 6 percent, employee and one dependent; and 5 percent, employee and two or more dependents.

According to the Benefits and Retirement Manager, the City's plan terms are generous and the City has an older and sicker population than other governments in the area. She explained that this adds to the utilization of the plan and in turn the premium rates are greater. As benefit costs continue to increase, it is important that the Benefits Division monitors the competitiveness of the premium rates that the City is offered in order to ensure that costs remain reasonable.

RECOMMENDATIONS

We recommend that Human Resources:

12. Establish a formal process to periodically compare the costs of the City's health premiums to what other area governments pay.
13. Report to City Council how the City's premium amounts compare with those paid by area governments.

The Amount City Employees Pay Towards Health Premiums Varies Significantly Based On The Number Of Dependents Covered

Human Resources' Labor Relations division is responsible for negotiating the amounts that the City pays towards employee benefits. These amounts are specified in labor agreements. A review of payments revealed that the amount employees pay towards their health insurance premiums vary significantly based on the number of dependents covered.[13] This factor means that some employees pay nothing towards their premiums while others contribute more than 20 percent of the benefit cost. Additionally, based on the City contribution to premiums, some employees actually pay more to insure fewer dependents.

The City negotiates multi-year agreements with unions that specify how much the City will pay towards health premiums. These agreements are determined before the actual costs of health premiums are known – as premium amounts are adjusted each year. In the past, the City has generally agreed to contribute the equivalent of the cost of the lowest health and dental premiums towards those employees with employee-only coverage. These amounts increase throughout the term of the agreement as health and dental premiums have increased each year.

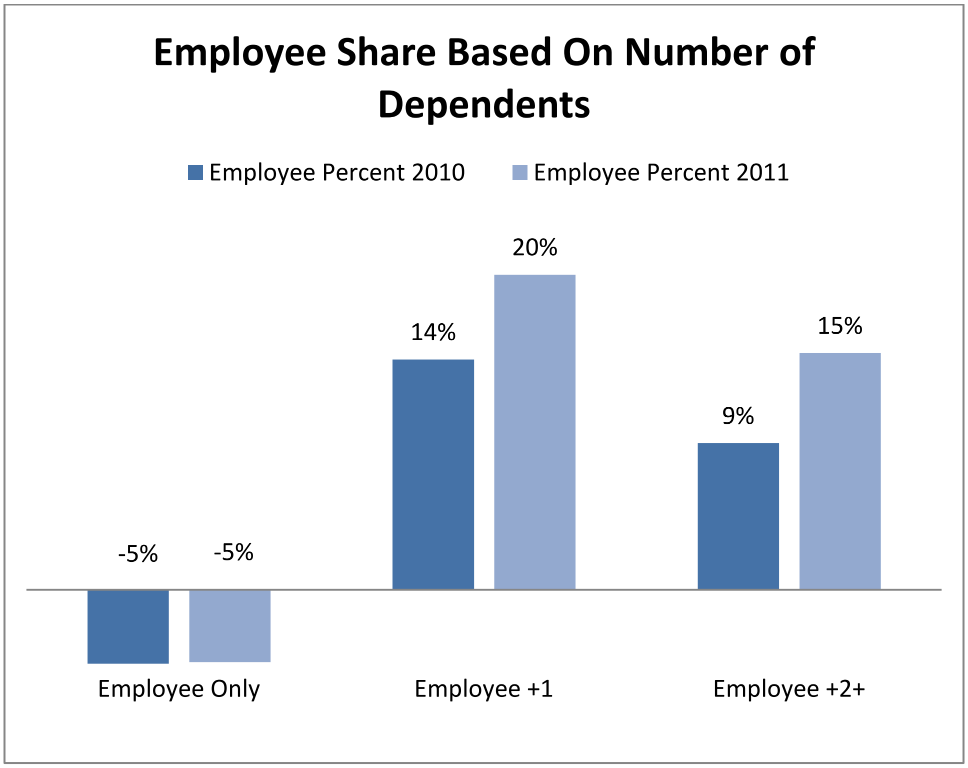
The City contribution amounts for those in the employee with one dependent and the employee with two or more dependents (family plan) are not calculated in a similar manner to those with employee-only coverage. Instead, the City contributions for those with dependents are specified for each year of the agreement. The amounts are based on negotiation, but are not tied to the actual changes in premium rates.

As described above, employees who signed up for employee-only coverage with the least expensive health plan paid nothing towards health premiums in 2010 while others paid 14 percent of premiums (employees with one dependent). The employees who chose the least expensive family plan paid 9 percent of the premium for that year.

In 2011, these differences grew even larger with employees who signed up for employee-only coverage continuing to pay nothing towards premiums and those with dependents paying between 15 and 20 percent. The following tables show the percent of premium shares for employees who chose the least expensive plans and the dollar amounts employees pay for these plans each year.

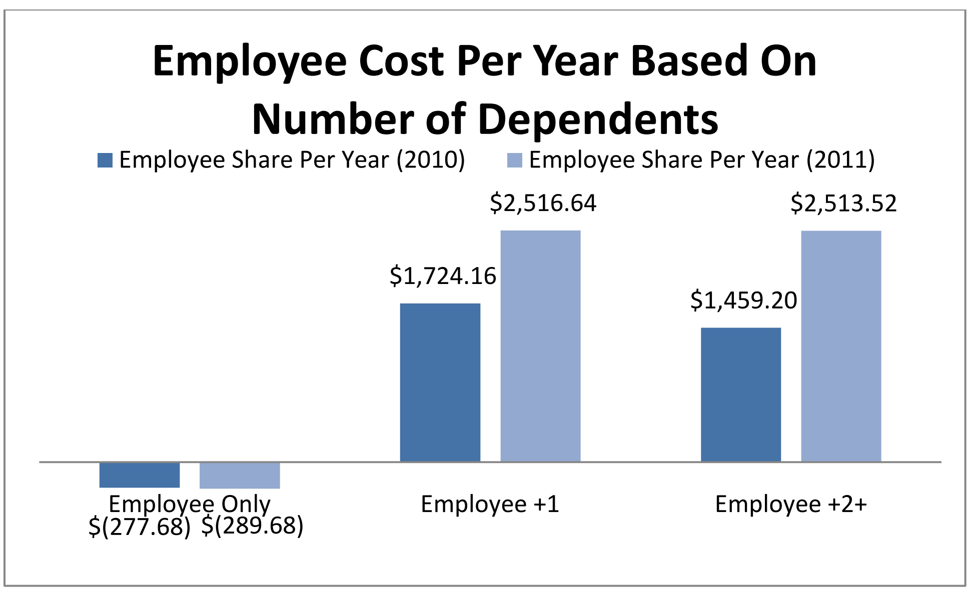
[13] This section focuses on the amount employees contribute towards premiums and not the premium breakdown amounts by the number of dependants. The breakdown of premium amounts for the employee-only, employee +1, and employee+2+ is based on an industry formula and we are not questioning this method.

Exhibit 11: Employee Share Of Premiums



Source: Generated from rate sheets and Auditors' analysis

Exhibit 12: Employee Annual Costs Of Premiums



Source: Generated from rate sheets and Auditors' analysis

Under the current system, employees enrolled in employee-only coverage contribute nothing or small amounts to their premiums (depending on the plans they choose). The negative percents and amounts above for those with employee-only coverage are due to setting the rates for this group based on the equivalent of the lowest health and dental amounts. After covering health insurance premiums, excess amounts are applied towards other premiums. As seen above, some employees are paying nothing towards health premiums during 2011 while others will pay about $2,500 for the year. Additionally, as shown in Exhibit 12, in both 2010 and 2011, employees with only one dependent paid more for medical benefits than employees with two or more dependents. Members of this group paid about $265 more in 2010 than those with family coverage – even though those with one dependent were paying to cover fewer people.

The Share of Premiums Many Employees Pay Towards Health Insurance Have Fluctuated And Has Not Always Moved In Line With Premium Increases

As noted above, the amounts set as City contributions towards health benefits for those with one dependent and those with two or more dependents has been determined through negotiations with employee unions. Amounts have not been tied to specified employee and employer share of premiums. Under this system, the percent of premiums that employees have contributed towards their benefits have fluctuated.

For those enrolled with one dependent, the employee share has ranged from 14 percent to 20 percent in recent years. Employees with two or more dependents have seen more variation. They paid between 9 percent and 21 percent of premiums. The following tables show examples of how much employees have paid toward their benefits for those enrolled in the least expensive Kaiser plan.[14]

Exhibit 13: Fluctuation In Monthly Employee Payments For Those With One Dependent

Year	Premium: Least Expensive Kaiser Plan for Emp+1	City Contribution	Employee Pay	Employee Percent Premium
2008	$875.72	$730.00	$145.72	17%
2009	$966.06	$800.00	$166.06	17%
2010	$993.68	$850.00	$143.68	14%
2011	$1059.72	$850.00	$209.72	20%

Source: Generated from Human Resources' rate sheets and Auditors' Analysis

[14] Employee-only coverage has been excluded from this analysis as the City covers the full cost for employees in this plan.

Exhibit 14: Fluctuation In Employee Payments For Those With Family Plans

Year	Premium: Least Expensive Kaiser Plan for Emp+2+	City Contribution	Employee Pay	Employee Percent Premium
2008	$1164.70	$920.00	$244.70	21%
2009	$1284.86	$1050.00	$234.86	18%
2010	$1321.60	$1200.00	$121.60	9%
2011	$1409.46	$1200.00	$209.46	15%

Source: Generated from Human Resources' rate sheets and Auditors' analysis

The following shows the year-to-year percent changes of employee expenses for those in the least expensive Kaiser plan who have one dependent and those who cover two or more dependents. The table also includes the year-to-year premium percent increases:

Exhibit 15: Year-To-Year Percent Change In Employee Contributions

Year To Year	Emp+1 Employee Pay Change	Emp+2+ Employee Pay Change	Premium Increase
2008 to 2009	14%	-4%	10%
2009 to 2010	-13%	-48%	3%
2010 to 2011	46%	72%	7%

Source: Generated from Human Resources' rate sheets and Auditors' analysis

While health premiums have been increasing, the cost sharing rates have varied significantly from year-to-year. This could make it difficult for employees and the City to plan for how much they will contribute towards the health benefits. Also, the method of negotiating the increases without knowing how much premiums will increase has meant that employees' payments sometimes decrease as premium costs increase.

City Employees' Contributions Towards Health Premiums Are Similar To Some Area Government Employees' Contributions, But Differences Exist

While Sacramento employees' contributions towards health premiums in some categories are near the average contributions of area government employees, significant differences exist. Specifically, most other governments reviewed require those with employee-only coverage to contribute more towards their premiums. Also, City employees enrolled in a plan with one dependent pay nearly double the average.

As various governments figure contributions towards premiums in different ways, an exact comparison of one government employer to another is difficult. The following table compares the lowest Kaiser monthly premiums and the employee shares of the costs. Bold areas indicate employee shares and amounts in excess of what Sacramento City employees pay.

Exhibit 16: Employee Payments For Kaiser Health Coverage[15]

	Employee Only			Employee+1			Employee +2+		
Area Governments	**Premium Cost**	**Employee Share**		**Premium Cost**	**Employee Share**		**Premium Cost**	**Employee Share**	
City of Sacramento	$529.86	($24.14)	-5%	$1,059.72	$209.72	20%	$1,409.46	$209.46	15%
Elk Grove[A]	$524.51	($125.49)	-24%	$1,049.02	($132.98)	-13%	$1,363.73	($192.27)	-14%
CalPERS State Employees[B]	$522.58	**$12.58**	**2%**	$1,045.16	$59.16	6%	$1,358.71	$75.71	6%
Sacramento County[C]	$561.54	**$112.30**	**20%**	$1,436.00	**$287.20**	20%	$1,436.00	**$287.20**	**20%**
San Francisco[D]	$481.70	**$0**	**0%**	$962.34	$9	1%	$1,361.28	**$228.74**	**17%**
San Jose[E]	$496.04	**$74.40**	**15%**	$1,235.16	$185.28	15%	$1,235.16	$185.28	15%
West Sacramento[F]	$466.12	($243.88)	-52%	$932.24	**$222.24**	**24%**	$1,281.84	**$571.84**	**45%**
Average		($28.35)			$104.96			$192.75	

Source: Based on information provided by respective governments and Auditors' analysis.
A. Elk Grove purchases insurance through CalPERS. Depending on hire date, some receive cash payments of excess.
B. Based on the State's "Excluded Employees."
C. Hired after 12/31/2006
D. For most classifications: based on FY 2010-11, not calendar year.
E. The lowest plan is available only to some employee classifications and some employees receive different City contributions.
F. Based on management employees. Excess goes to dental and vision and remainder could be cashed out.

As seen above, the employee costs for employee-only coverage for City employees who chose the least expensive Kaiser plan is -$24.14 (meaning that excess City payments can be applied to other benefits). Of the governments reviewed above, four had greater employee shares towards premiums than Sacramento's employees. The greater share ranged between 0 percent and 20 percent and the employee costs ranged from $0 to $112.30 per month.

Sacramento's employees who are covered with one dependent pay double the cost of what the employees in the average of the above governments pay. City employees pay $209.72 and the average for this category is $104.96. Employees in two governments pay more than Sacramento's employees for employee+1.

For plans that cover the employee and two or more dependents, City employees' contributions are more in line with the averages. Sacramento employees pay $209.46, which is about $17 more than the $192.75 average of the other governments.

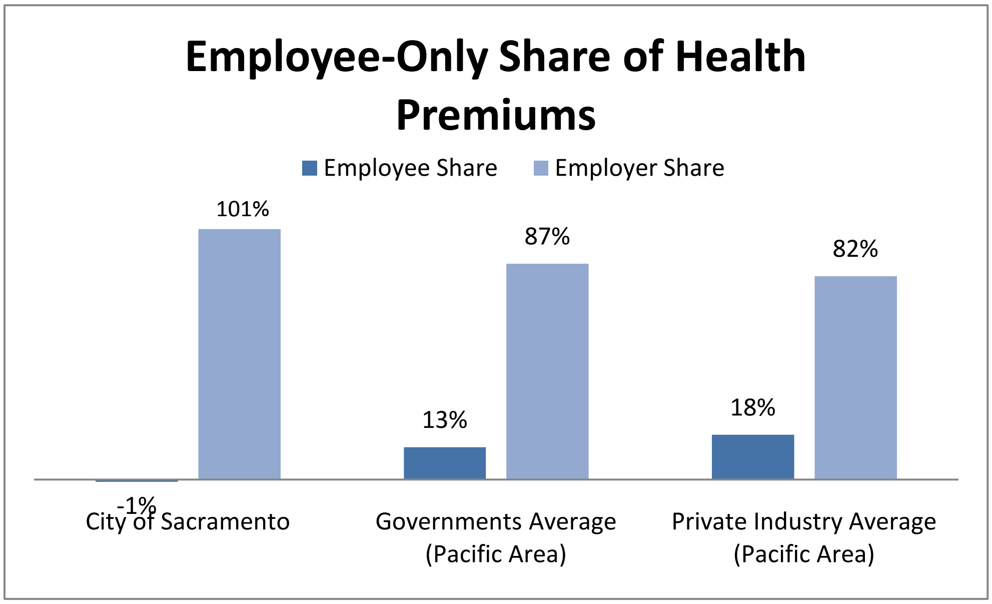
City Contributions Towards Premiums Exceed Government And Business Sector Averages For The Western States

Sacramento paid a greater share of health premiums than the average government and business employers in the western United States. Based on the Bureau of Labor Statistics' Employee Benefits in the United States – March 2010 report, the City paid a greater share of the premiums than other employers. In the study, Sacramento was included in the "Pacific Region." In addition to California, this region included Alaska, Hawaii, Oregon and Washington.

[15] Negative shares indicate that the employer pays in excess of the premium. In these cases, amounts can be applied to other health-related premiums (for example, dental benefits).

In 2010, Sacramento employees enrolled under employee-only coverage in the City's HMO plans paid on average -1 percent of the premiums. This was 14 percent less than the government average for the region and 19 percent less than the private industry average:

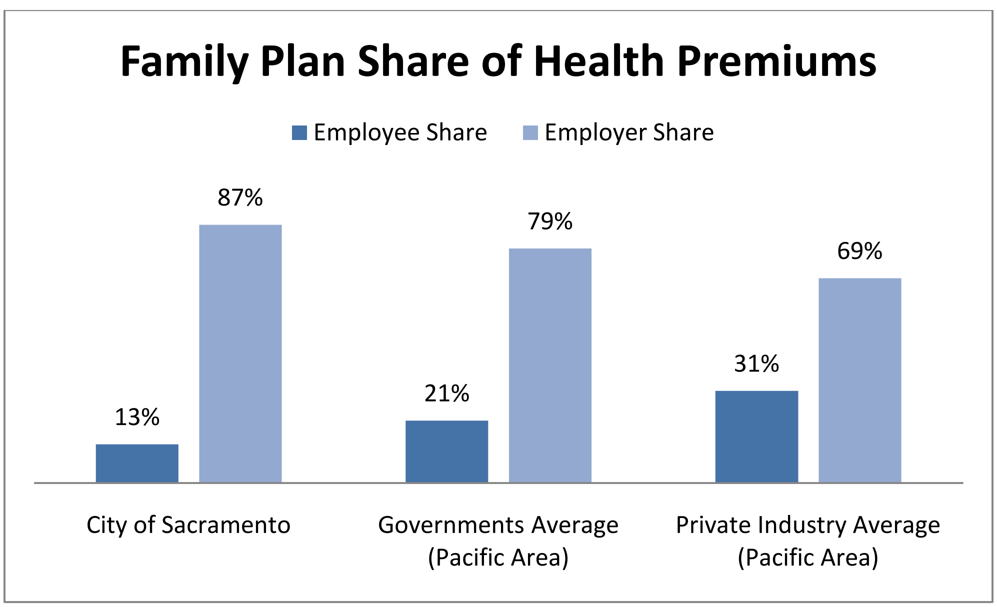
Exhibit 17: Regional Comparison Of Employee-Only Share Of Premiums



Source: Based on Bureau of Labor Statistics information and Auditors' analysis

For the family plan in 2010, Sacramento employees covered 13 percent of the average HMO premiums. This trailed the government average by 8 percent and private industry average by 18 percent:

Exhibit 18: Regional Comparison Of Family Share Of Premiums



Source: Based on Bureau of Labor Statistics information and Auditors' analysis

When negotiating the amounts of the City contribution towards health benefits, the City should consider how much other area governments and employers in the region contribute towards their benefits.

Changing How The City Determines Its Premium Cost Sharing Could Yield Improvements

As noted above, the cost sharing for benefit costs varies significantly depending on whether an employee is enrolled in employee-only coverage or would like to cover one or more dependents. As medical premiums continue to increase, the City will need to explore increasing the employees' share of benefit costs. As the majority of health benefit terms are set in labor agreements, most changes would have to be negotiated.

The group that appears most out of line with regional cost sharing rates is the City's employee-only group. Changes to cost sharing for the employee-only group has the potential to significantly impact the City's contributions to health benefits since approximately 40 percent of employees who participate in the City's health plans are enrolled in employee-only coverage. We estimate that the City will pay about $7.6 million towards employee-only health premiums in 2011. These employees will pay only $51,000 in total towards those premiums.[16] If employees insured with employee-only coverage had similar cost sharing rates as the City's employees with dependents, the city would save between $1.2 million[17] and $1.6 million[18] in the first year.[19]

We estimate that if the City were to negotiate employee-only benefit cost sharing rates for 2012 as explained above, employees enrolled in the least-expensive employee-only plan would pay about $85 to $110[20] per month towards health premiums. The following graph illustrates the City's one-year costs of coverage based on different employee-share scenarios:

[16] Some employees with employee-only coverage contribute towards the cost of their benefits because their premium costs exceed the cost of the least expensive health and dental cost.

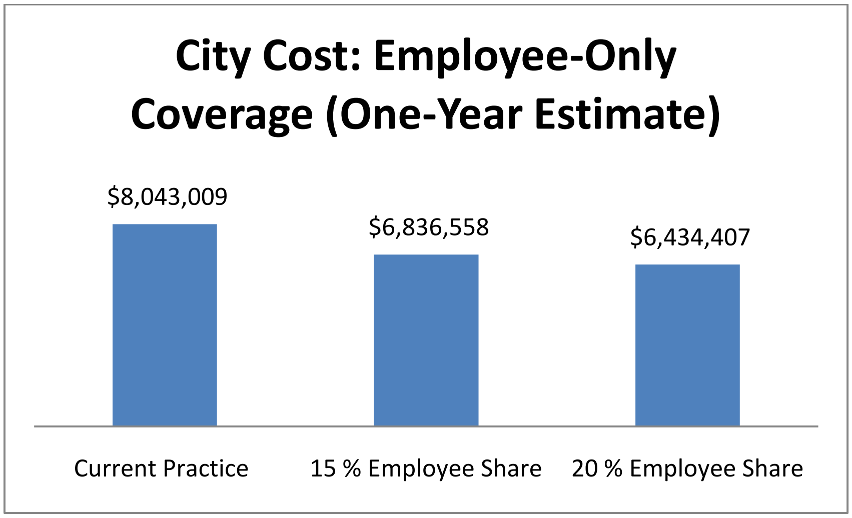
[17] 15 percent employee-only share

[18] 20 percent employee-only share

[19] This assumes that the current cost sharing ratios for employee+1 and employee+2+ remain the same and that premium increase trends hold constant.

[20] Employee contributions towards health premiums are generally pre-tax. Therefore, the employee contribution would have less of an impact on decreasing employees' take-home pay than the $85 or $110 amounts used in the example.

Exhibit 19: Changes In Shares Could Reduce City Expenses



Source: Based on eCaps information and Auditors' analysis

As noted above, if employees insured with employee-only coverage had similar cost sharing rates as the City's employees with dependents, the City could significantly reduce its costs. One union, Local 447, has already agreed to less of a City contribution in 2011 for those in this category. Instead of contributing $554 per month, the City pays $520 (a freeze to the 2010 contribution) for employee-only coverage. This agreement will save the City about $15,500 in 2011.

The following table compares the employee share and percentages of premiums between what most in the employee-only category pay each month in 2011 and what members of Local 447 pay:

Exhibit 20: Differences In What Most Employees And Local 447 Employees Pay Towards Premiums

Plans (Employee-Only Coverage)	Premiums	Most Employees (Employee Share)	Most Employees (Percent of Premium)	Local 447 (Employee Share)	Local 447 (Percent of Premium)
Kaiser $25 Co-pay	$529.86	$(24.14)	-5%	$9.86	2%
Kaiser $15 Co-pay	$557.88	$3.88	1%	$37.88	7%
Health Net $25 Co-pay	$563.96	$9.96	2%	$43.96	8%
Health Net $15 Co-pay	$587.72	$33.72	6%	$67.72	12%

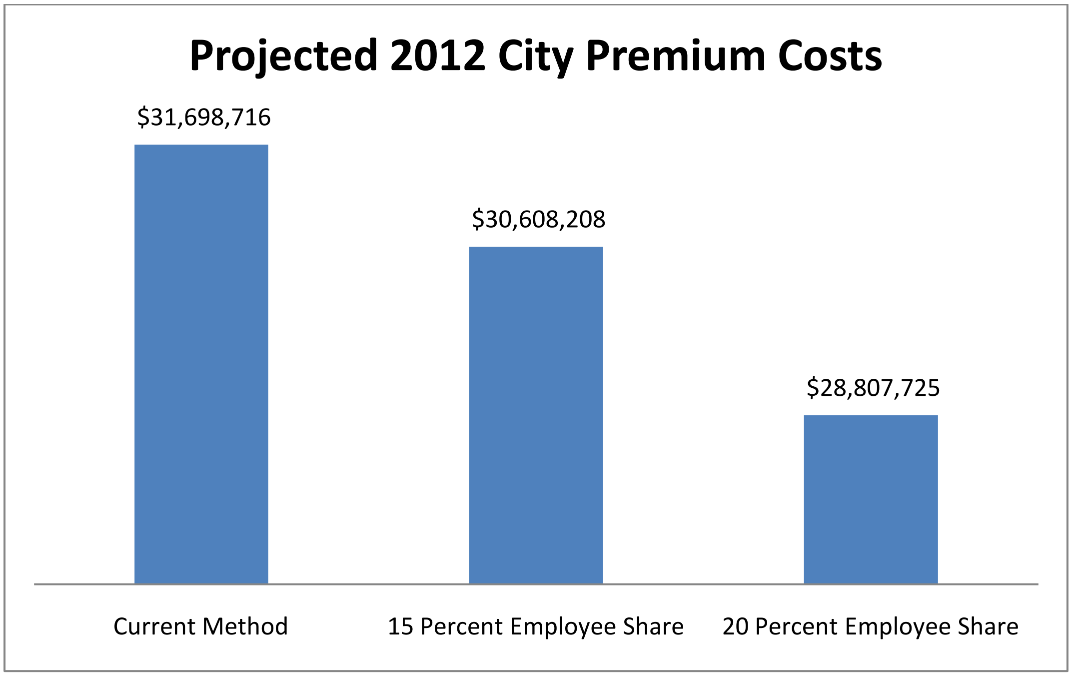
Source: Generated from Human Resources' rate sheets

As seen above, most employees contribute between -$24.14 and $33.72 towards health premiums while those in Local 447 pay between $9.86 and $67.72 per month. Based on their plans remaining the same, Local 447 employees on average will contribute about $39 per month to health premiums (about 7 percent of the premium costs). If the same reduction of the City share was applied in 2011 to all employees enrolled with employee-only coverage, the City savings would have been about $450,000.

Some governments, including the City of San Jose and County of Sacramento, base their benefit payments on a fixed percent of the least expensive premiums. If the City of Sacramento was to negotiate such a practice, the City could significantly reduce its benefit costs.

As noted above, employees with dependents already contribute 15 or 20 percent. If the City were to apply a flat rate based on the cost of the least expensive plan, we estimate the City would save in the first year $1.1 million if 15 percent was applied and $2.9 million at 20 percent. The following shows the projected 2012 City premiums costs based on these scenarios:

Exhibit 21: City Expenses Could Decline If Employees Paid A More Standard Share Of Premiums



Source: Based on eCaps information and Auditors' analysis

Some area governments recently negotiated increases to the employee contributions towards health benefits. For example, the City of San Jose's Fire union reached an agreement to decrease the City's contribution to health premiums. Terms specify that the City will contribute beginning in July 2011 the equivalent of 85 percent of the cost of the lowest cost health premium. Currently, San Jose contributes 90 percent of this cost for Fire employees. The change will bring terms more in line with what the City contributes towards its other employees' benefits. Additionally, the City of Folsom also approved an agreement in February with its largest union (Local 39) to shift more of the health premium costs to employees.

RECOMMENDATIONS

We recommend that Human Resources:

14. Consider employee equity when negotiating with unions the City's contributions to health benefits.
15. Establish a process to obtain and review trends in area governments' contributions towards employees' health premiums.
16. Consider regional trends when negotiating benefit shares.
17. Negotiate terms that require increasing employees' contributions to their benefits.

Finding 3: Moderate Changes Could Help Rein In Rising Pension Costs

Rising pension costs have been a growing concern for many governments. The City, like more than 1,500 local public agencies in California, contracts with the California Public Employees' Retirement System (CalPERS) to provide pension benefits to City employees. Contributions into the system typically consist of an employer contribution and an employee contribution. Pensions pay retirees a defined lifetime benefit with monthly amounts based on an employees' salary prior to retirement, years of service, and the benefits formula employers provide.

CalPERS charges contracting government agencies percentages of employees' salaries to cover the future benefit payments. The designated City contribution towards pensions have increased from $29.1 million in 2004-05 to $44.6 million in 2009-10. This represents an overall increase of 53 percent. The City's pension costs have increased significantly in recent years due to factors like recent investment losses and changes to CalPERS' assumptions that project retirees will live longer than earlier expected. According to CalPERS, investment gains and losses are usually the biggest factor in determining if future employer contributions will change. Given the potential impact of the projected future costs of the current pension program, it is in the City's interest to consider making changes now in order to begin reining in pension costs.

We found that:

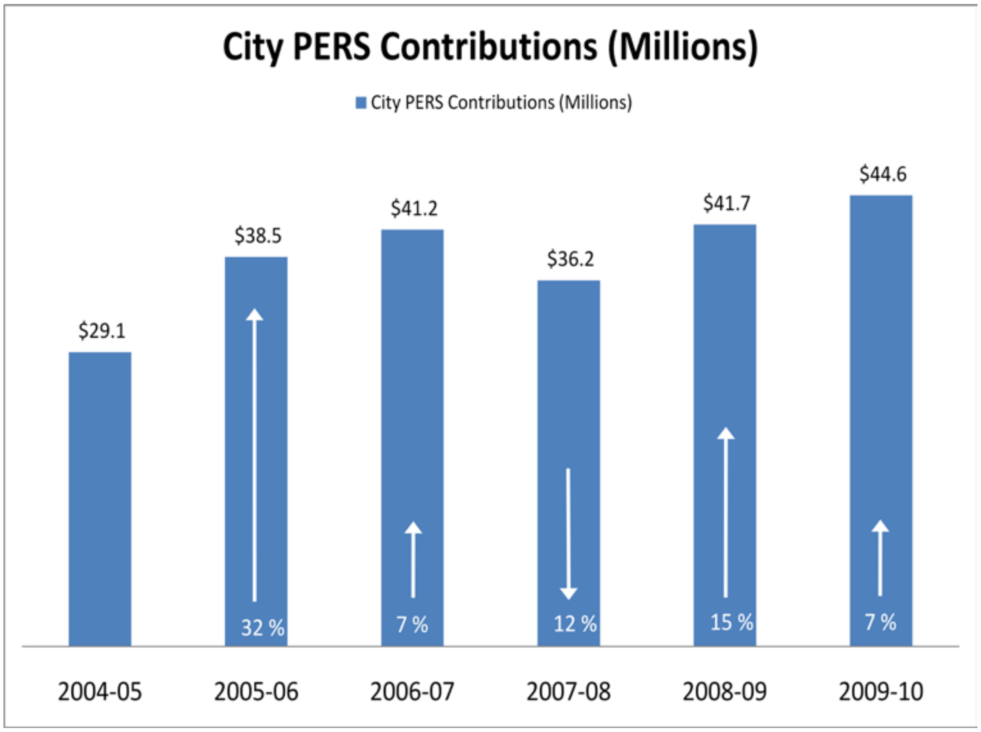
- City contribution rates have increased at a greater rate than City revenues and are projected to continue to increase during the next few years;
- Changes to the share of who contributes towards pensions could save the City millions each year; and
- Most employees who work in nearby governments contribute a greater share to their pensions than City employees.

Given the trend of rising pension expenses, the City needs to evaluate how it shares these pension costs with employees.

City Contribution Rates Have Increased At A Greater Rate Than City Revenues And Are Projected To Continue To Increase During the Next Few Years

As noted above, the City's contributions to CalPERS for the City contribution amounts have increased in recent years. Such increases in pension contributions have grown faster than the City's increase in revenue. While City contributions towards pensions increased on average by 11 percent year-over-year from 2004-05 to 2008-09, total City revenues decreased 3.8 percent on average year-over-year during that period. The amounts shown below represent what is called the "employer contribution," towards pensions:

Exhibit 22: City Pension Contributions Have Increased[21]



Source: Generated from Finance's comprehensive annual financial reports

According to CalPERS' actuarial report for Sacramento (issued in 2010), the City will need to contribute a greater percent of salary costs towards pensions. The following shows the changes in City contributions towards benefits for Miscellaneous and Safety workers. Employees are divided into Safety workers[22] and Miscellaneous workers[23] since these groups have different pension formulas.

Exhibit 23: Pension Contributions Are Increasing

Classification	2009-10	2010-11	2011-12	2012-13[A]	2013-14[A]
Miscellaneous	11.222%	11.727%	12.659%	13.10%	14.60%
Safety	22.584%	23.187%	27.530%	29.30%	33.60%

Source: CalPERS' actuarial reports
A. CalPERS' projections

This growth in City contributions means that the City would pay more towards an employee's pension in the future even if that employee did not receive a pay increase. The following graph assumes that both a Miscellaneous and Safety employee earns $60,000 per year for each of the five years specified. Amounts show what the City has paid and is projected to pay towards the pensions:

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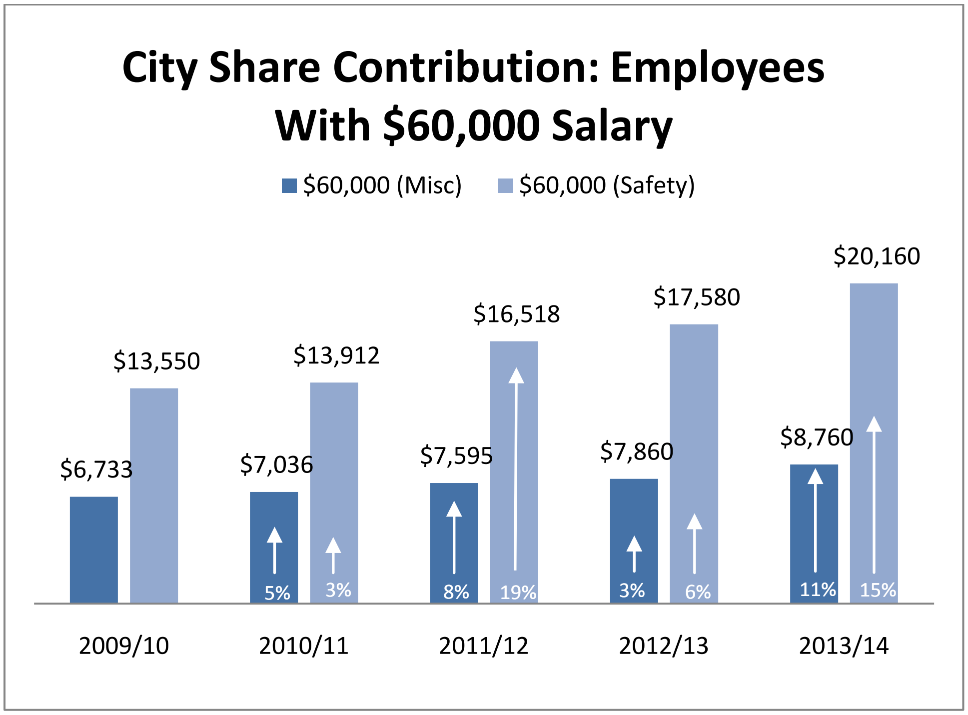
[21] Amounts shown do not include the "employee contributions" even if the "employee contribution" was paid in whole or in part by the City.
[22] This includes most Fire and Police employees.
[23] This includes most non-fire and non-police employees.

Exhibit 24: Payments Towards Pensions Will Increase Even If Salaries Remain The Same[24]



Source: Generated from CalPERS' actuarial reports and Auditors' analysis

Changes To The Share of Who Contributes Towards Pensions Could Save The City Millions Each Year

In addition to the employer contribution, the City has been paying most of what is designated the "employee contribution" of pension contributions. The amount of the employee contribution that is covered by the City is negotiated with labor unions. For those classified as Miscellaneous employees, the designated employee share is 7 percent and the City covers the entire amount or 3 or 5 percent – depending on the terms negotiated in labor agreements. For those classified as Safety employees, the employee share is 9 percent[25], which is paid entirely by the City. The following details the 2009-10 City and Employee contribution rates:

[24] 2012/13 and 2013/14 are based on CalPERS' projections.

[25] The City contributes slightly more than 9 percent on behalf of Fire employees due to how this contribution is classified.

Exhibit 25: Total City Contributions With The City-Paid Portion Of Employees' Shares

Classification	Employer (City) Contribution	Designated Employee Contribution	City Paid Employee Contribution	Actual Employee Contribution[A]	Total City Contribution
Automotive/ Equipment Mechanics	11.222%	7%	3%	4%	14.222%
Building Trades and Construction	11.222%	7%	3%	4%	14.222%
Civilian Police	11.222%	7%	3%	4%	14.222%
Confidential/ Administrative[B]	11.222%	7%	3%	4%	14.222%
Engineering Unit	11.222%	7%	3%	4%	14.222%
Exempt Management[B]	11.222%	7%	7%	0%	18.222%
Exempt Management Support[B]	11.222%	7%	5%	2%	16.222%
Fire	22.584%	9%	9%	0%	31.584%
General Supervisors	11.222%	7%	3%	4%	14.222%
Office and Technical	11.222%	7%	3%	4%	14.222%
Operations and Maintenance	11.222%	7%	3%	4%	14.222%
Plant Operator	11.222%	7%	3%	4%	14.222%
Police Sworn	22.584%	9%	9%	0%	31.584%
Professional Unit (Local 39)	11.222%	7%	3%	4%	14.222%
Safety Management[B]	22.584%	9%	9%	0%	31.584%
Traffic Engineering Unit	11.222%	7%	3%	4%	14.222%
Water and Sewer Unit	11.222%	7%	3%	4%	14.222%

Source: Generated from labor agreements, CalPERS' actuarial reports, and Auditors' analysis
A. Actual Contribution is slightly less than indicated.
B. Terms for these classifications are presented in the Personnel Resolution Covering Unrepresented Officers and Employees

As seen above, the City contributed the equivalent of between about 14.2 and 31.6 percent of salaries towards CalPERS pensions. In 2009-10, the City paid $44.7 million for the employer contribution and about $16.7 million towards the employee contribution. Employees who contributed to the employee portion paid about $4.8 million towards their pensions. Based on CalPERS' projections, and assuming that the City contributes to the employee share in the same way and that this percent remains the same, the City will contribute the equivalent of between 17.6 and 42.6 percent of salaries towards pensions in 2013-14. This is a troubling trend and one that if left unchecked, could significantly impact the City's finances.

Requiring all employees to contribute to the employee share of their pensions would save the City millions over the next few years. Such a change would require negotiations with labor unions, as contribution rates are set in labor agreements. As noted above, some employees already contribute 4 percent of their salaries to the employee contribution. If all employees contributed 4 percent to their pensions, the City would save about $39.7 million over the next five years – or about $7.9 million on average per year. [26] Estimates are based on the payroll amount specified in the most recent CalPERS' actuarial study. The table below estimates potential savings based on all employees making the following contributions:

Exhibit 26: Estimated City Savings If Employees Paid More Of The Employee Share Of Pension Costs[27]

Employee Contribution	One-Year City Savings	Five-Year City Savings	10-Year City Savings
2%	$1,164,806	$6,215,099	$13,507,966
3%	$4,304,727	$22,968,884	$49,920,833
4%	$7,444,648	$39,722,669	$86,333,701
5%	$10,584,568	$56,476,454	$122,746,568

Source: Generated from CalPERS' actuarial reports and Auditors' analysis

Most Employees Who Work In Nearby Governments Contribute A Greater Share To Their Pensions Than City Employees

As specified above, Sacramento's Safety employees do not contribute to their CalPERS pensions and most Miscellaneous employees contribute either nothing or four percent. Other governments reviewed require between 0 and about 8 percent in employee contributions. For example, Miscellaneous workers for the State of California contribute 8 percent[28] and those classified as Administrative employees of Sacramento County pay 4.87 percent.[29]

The table below provides examples of how much some area employees contribute towards their pensions if they earned $60,000 per year. Some employees with this salary pay as much as a few hundred dollars each month towards their pensions. As pension contributions vary for a variety of reasons, the following is not a complete list of available pension scenarios. The first table shows Miscellaneous employees and the second shows Safety employees.

[26] Our analysis projects payroll growing at 3.25 percent and subtracts out what those employees who already pay the 4 percent share would pay in the future to determine the City's savings.

[27] As employee contributions towards pension costs are generally pre-tax, the actual impact on most employees' take-home pay would be less than the contribution amount.

[28] Percent applies to monthly salary over $513.

[29] Percent applies to bi-weekly salaries over $161.

Exhibit 27: Miscellaneous Employees' Pension Contributions For Employees Earning $60,000

Government Employer	Employee Share (Misc.)	Employee Pays Per Month
Sacramento (Misc, No Share)	*0%*	*$0*
Sacramento (Misc, 4% Share)	*4%[D]*	*$194.67*
Elk Grove	0%	$0
Sacramento County Administrative[A]	4.87%[D]	$226.51
San Francisco	7.50%	$375.00
San Jose	4.54%	$227.00
State Of California[B]	8%[D]	$358.96
West Sacramento[C]	1%	$50.00

Source: Generated from respective governments' pension and labor agreement information and Auditors' analysis

A. Assumes Miscellaneous 3rd Tier employees paying Social Security

B. Based on Local 1000 agreements

C. Specialists and Professional Classification

D. Actual employee amounts for the City of Sacramento, 4 percent of salary over $133.33 per month; Sacramento County, 4.87 percent of biweekly salary over $161; State of California, 8 percent of salary over $513 per month.

Exhibit 28 Safety Employees' Pension Contributions For Employees Earning $60,000

	Percent of Salary (Safety)	Employee Pays Per Month
Sacramento	0%	$0
Elk Grove	0%	$0
Sacramento County Safety	5.46%[A]	$253.95
San Francisco	7.50%	$375.00
San Jose	9.81%	$490.50
State of California	9 %[B]	$421.47
West Sacramento	0%	$0

Source: Generated from respective governments' pension and labor agreement information and Auditors' analysis

A. Actual employee amounts for Sacramento County are 5.46 percent of biweekly salary over $161

B. Actual employee amount is 9 percent of monthly salary over $317 per month and percent does not apply to all State Safety employee classifications.

Some area governments have recently negotiated changes to labor agreements that increase the employees' pension shares and decrease future benefits for new hires. For example, the City of Folsom approved an agreement in February with its largest bargaining unit (Local 39). Starting in July, the City will no longer pay the entire 8 percent employee contribution towards CalPERS. Instead, employees will cover 7 of the 8 percent employee contribution beginning in July 2011 and then the full 8 percent the next fiscal year. Additionally, future employees represented by this union will be hired under a less costly pension formula.

In March, the State of California's attorney's union and the State reached an agreement to increase these employees' pension contributions from 6 to 9 percent for Miscellaneous employees and from 7 to 10 percent for Safety employees.

As Sacramento's pension contributions are projected to increase and these expenses represent more than $60 million per year, it is important for the City to consider options to contain these costs. Negotiating for greater employee contributions towards pensions could yield significant savings.

RECOMMENDATIONS

We recommend that Human Resources:

18. Negotiate a change in contributions to require that all employees pay some share of the employee contribution portion of pensions.
19. Consider the employee contributions required by nearby government employers when negotiating the City's pension share.

Finding 4: City Payments Towards Retiree-Health Costs Are Growing And The Way The City Pays For These Benefits Could Result In Overpayments

The City contributes towards health premiums for about 1,800 retirees. However, not all former Sacramento employees receive health benefits from the City, as these benefits are generally provided only to those with at least 10 years of City service. Retiree health benefits are negotiated and specified in labor agreements. Under most agreements, retirees receive a set amount towards premiums. The amounts paid are based on years of service and the number of dependents covered. Retirees pay the difference between the City contribution and the monthly premium costs.

Contributions for Fire retirees are calculated differently. Amounts are based on the premium amounts of the retiree health and dental coverage. There is no additional City contribution if retirees have dependents. For both general and Fire retirees, City-paid contribution amounts increase with years of service and employees must work at least 20 years to receive the full benefits.

We found that:

- Annual retiree health contributions are projected to nearly double in the next eight years; and
- The City does not have a system in place to ensure it pays correct amounts towards retiree health benefits.

Considering projected retiree-health costs increases, the City should continue its current cost-containment efforts and should apply the lessons learned from transitioning to self billing with active employees to its retiree-health benefits operations.

Annual Retiree Health Contributions Are Projected To Nearly Double In The Next Eight Years

Based on the City's most recent (September 2010) actuarial valuation of the retiree healthcare plan, the amount that Sacramento will pay each year towards retirees' health benefits will increase from about $11.6 million from Fiscal Year 2010-11 to more than $20.8 million in Fiscal Year 2018-19. This 8-year change represents a nearly 80 percent increase. The actuarial report projects that during this time, the contribution as a percent of payroll will also increase. In 2010-11, the report specified that the contribution towards retiree health benefits were the equivalent of 4.1 percent of payroll and they are projected to cost the equivalent of 5.7 percent of payroll in 2018-19. Assumptions are based on the number of City employees remaining constant and the City continuing to fund these benefits using the same method. Estimates do not account for the addition of future employees.

The City currently funds retiree health benefits on a pay-as-you-go basis. This means that the City is not setting aside money for future retiree health benefits, but instead relies on current City funds to make payments.

The City contributes as much as $365 towards health premiums per month for most retiree classifications, and a greater amount for Fire retirees. Fire retirees' rates for 2011 are based on the formula that adds the cost of the more expensive Kaiser retiree health plan, the more expensive dental plan and $25 each month for those who retire with 100 percent of the benefit. These benefits for Fire employees are specified in labor agreements and a 2006 LOU. The City contributions for non-fire retirees and Fire retirees are shown below:

Exhibit 29: City Contributions To Retiree Health Premiums

Most Retirees	Percent	Retiree	Retiree+1	Fire Retirees[A]	Percent	Retiree
20+ Years	100%	$300.00	$365.00	**20+ Years**	100%	$634.34
15-20 Years	75%	$225.00	$273.75	**15-20 Years**	75%	$475.75
10-15 Years	50%	$150.00	$182.50	**10-15 Years**	50%	$317.17
Under 10 Yrs	0%	$0	$0	**Under 10 Yrs**	0%	$0

Source: Generated from information provided by Human Resources

A. Unlike Misc. retirees, Fire Retirees do not receive an additional City contribution towards dependant coverage.

Tying the City contribution amounts to the cost of premiums for Fire retirees means City expenses will increase as premiums increase. The annual City contribution for a Fire retiree with 20 or more years of service will be about $7,600 this year. If the annual premium rates continue to increase in line with historical rate increases and the $25 per month addition continues, the five-year cost to the City for this benefit will exceed $43,000 per Fire retiree.

As noted above, non-Fire retirees receive as much as $365 towards health premiums per month. While this number is included in the labor agreements, it is not tied to premium changes. The following shows the five-year projected costs of Fire and Non-Fire retirees who retiree with 20 years or more of service. The Fire retiree cost is shown based on the above assumptions and Non-Fire retiree cost assumes that the monthly maximum will remain at $365.

Exhibit 30: Projection of Annual City Cost Per Retiree With Full Benefits

Year	Non-Fire projection Per Year	Fire Projection Per Year
2011	$4,380	$7,612
2012	$4,380	$8,095
2013	$4,380	$8,609
2014	$4,380	$9,158
2015	$4,380	$9,742
5-Yr Total	$21,900	$43,427

Source: Generated from information provided by Human Resources and Auditors' analysis

Retirees do not receive cash back if their premiums are less than the City payments, and they are generally able to switch to less expensive plans when they reach Medicare eligibility age. According to the Benefits and Retirement Manager, the department is researching options that could reduce the City's cost for retiree benefits while offering similar types of benefits.

The City Does Not Have A System In Place To Ensure It Pays Correct Amounts Towards Retiree Health Benefits

While the City has self billed for employee health premiums since July 2009, it currently relies on the health providers to bill the City for retirees' health premiums. With self billing, as described in Finding 1, Human Resources uses eCaps' benefit information to determine which employees should be enrolled in which health plan. Human Resources currently pays the bills that providers send and does not perform a reconciliation to ensure that those who the City pays to cover are eligible for coverage and are in the correct plan.

According to the Benefits and Retirement Manager, the City is converting to a self-billing method for retirees and will begin self billing for this group by May 2011. As the switch to self billing for active employees found that the City was paying for some who should not have been covered, it is possible that such a switch for retirees will reveal similar cases. To ensure that amounts are accurate, Human Resources should match the retirees who should be enrolled to their respective health plans. Additionally, the department should set up a reconciliation process that compares the retirees' and City contributions to the premium amounts to ensure that retirees are contributing the correct amounts to their benefits. Retirees contribute to their health benefit premiums either through deductions from their pensions or by making payments to the City.

Towards the end of 2010, Human Resources realized that it was overpaying Health Net for a portion of retiree health benefits. According to the Benefits and Retirement Manager, the City was overpaying for out-of-area charges for retirees enrolled in Health Net. Retirees contribute $10 per month to subsidize coverage for some employees and retirees who live out of the area.[30] Human Resources did not realize until recently that the subsidy amounts were included in premium bills for retirees in Health Net plans. In addition to the City paying premiums on behalf of retirees that include the subsidy amounts, the City has been calculating the amount that retirees should pay towards the subsidy separately. The City then uses the calculation to pay Health Net. This results in the City double-paying the subsidy fee for retirees enrolled in Health Net.

In February, we discussed these overpayments with the Benefits and Retirement Manager. In response, Human Resources compiled information about retirees in order to determine the overpayment and request a refund from Health Net. According to Human Resources' analysis, about 1,800 retirees contribute to the subsidy and the department estimates that the City has been overpaying for 532 retirees who are enrolled in Health Net plans.[31]

[30] Employees and Retirees represented by Local 39 do not contribute to the subsidy or receive subsidized coverage.

[31] The Benefits and Retirement Manager informed us that the City stopped making overpayments in February 2011.

As of the end of February, Human Resources was working with Health Net to request a refund for overpayments going back to August 2009. Based on Human Resources' analysis, subsidy overpayments during that time are estimated at $95,000. While we recognize the efforts to pursue these funds, Human Resources should have worked with the provider to stop these overpayments as soon as the department became aware of them.

RECOMMENDATIONS

We recommend that Human Resources:

20. Work towards negotiating a change to the City's contribution for Fire retirees' benefits to bring them more in line with contributions made toward other City retirees.
21. Continue pursuing options to reduce retiree health costs.
22. Continue working with Health Net to pursue overpayments for the out-of-area subsidy.
23. Continue work to implement the self-billing method for retiree health benefits.

Finding 5: Rising Benefit Costs Require The City To Evaluate Cost Containment Options Like Those That Other Governments Employ And Best Practices Recommend

Overall, the costs of providing employee benefits have risen in recent years while City revenues have declined. This trend, when combined with the total amount that the City already pays towards benefits each year, is troubling. While the City engages in a request for proposals (RFP) process for selecting health insurers every five years and Human Resources works with a health insurance broker to remain aware of trends, Sacramento does not have a formal process in place to identify and evaluate potential cost savings measures.

Given the rise in health and pension costs, it is imperative that the City considers cost containment strategies. With that in mind, we considered strategies of other government employers and industry practices.

We found that:

- Changes to the type of benefits offered and share of who covers costs could reduce city spending:
  - *Changing Plan Design*
  - *Adding a High Deductible Plan*
  - *Purchasing Health Insurance Elsewhere*
  - *Wellness Programs*
  - *Alternative Retiree-Health Benefit Plan*
  - *Reduced Pension Benefits For New Employees*
- Best practices in benefit cost containment focus on creating plans and evaluating performance.

By exploring these options, the City may be able to help contain its costs while continuing to provide quality benefit packages at competitive rates.

Changes To The Type Of Benefits Offered And Share Of Who Covers Costs Could Reduce City Spending

Changing Plan Design

In recent years, many employers have changed plan design and shifted shares of benefit expenses in order to contain costs. According to a Kaiser Family Foundation and Health Research & Education Trust (Kaiser/HRET) Employer Health Benefits 2010 Annual Survey, which surveys employers (including government employers) nationwide, employers changed health benefits as a result of the recent economic downturn. The study found that in 2010, 36 percent of large firms (those with 200 or more workers) increased the workers' share of premiums and 38 percent reduced the scope of health benefits or increased cost sharing. Sacramento's employees who participate in City plans pay either $15 or $25 co-pays for most physician visits. Premiums for the plan with the lower co-pay cost 5 percent more than the one with the higher co-pay. The difference in 2011 premiums for the Kaiser plans are specified below:

Exhibit 31: City Premiums Vary Based On Co-Pay Amounts

Type	$25 Co-Pay (less expensive premiums)	$15 Co-Pay (more expensive premiums)	Premium Difference	Percent greater with smaller co-pay
Employee	$529.86	$557.88	$28.02	5%
Emp+1	$1,059.72	$1,115.76	$56.04	5%
Emp+2+	$1,409.46	$1483.98	$74.52	5%

Source: Generated from Human Resources' rate sheet and Auditors' analysis

Increasing co-pay amounts could lead to further reductions in premiums. According to the Kaiser/HRET study, the average in-network co-payment in 2010 for workers covered under a co-payment system was $22 for primary care and $31 for specialty physicians.

In addition to changing the co-pay amounts, the City could also build into its plans incentives for employees to participate in health screenings that aim to detect and prevent chronic illnesses.

Adding a High Deductible Plan

In addition to changing co-payment amounts, some employers have begun offering High-Deductible Health Plans (HDHP). In general, these plans involve lower monthly premiums than conventional plans, but participants pay annual deductibles of $1,000 or more of the medical care costs before the insurance pays the remainder (HDHPs may provide preventive care without a deductible or below the minimum annual deductible amount). If employees meet their annual deductible limit, most additional medical expenses are borne by the provider. Some plans allow participants to set aside funds in tax-free accounts to cover medical expenses.

Locally, the City of West Sacramento offers a HDHP HMO through Kaiser. The plan has an annual $1,000 deductible for employee only coverage and an annual $2,000 deductible for employees with one or more dependents. Under the plan, preventive care in various areas is covered outside of the deductible-required amounts. Monthly 2011 premiums for West Sacramento's high deductible Kaiser HMO plan and conventional Kaiser HMO plan are shown below:

Exhibit 32: Premium Difference Between A High-Deductible And Standard HMO Plan

Type	Kaiser HDHP HMO Plan	Kaiser HMO Plan	Monthly Difference	Annual Difference
Emp.	$333.93	$466.12	$132.19	$1,586.28
Emp+1	$667.85	$932.24	$264.39	$3,172.68
Emp+2+	$918.29	$1,281.84	$363.55	$4,362.60

Source: Generated from information provided by the City of West Sacramento and Auditors' analysis

According the U.S. Office of Personnel Management, the federal agency charged with administering health benefits for Federal employees, HDHPs could be suitable for employees whose medical expenses are primarily limited to preventive care and who could afford to pay the annual deductible amounts if necessary. According to the Kaiser/HRET study, about a third of large firms (those with 1,000 or more employees) that offer health benefits offer an HDHP option.

Purchasing Health Insurance Elsewhere

As noted above, the City engages in an RFP process every five years to select health insurers, but the City does not have a formal process in place to research potential cost savings. However, Human Resources has in the past evaluated other options with the goal of saving the City money. According to the Benefits and Retirement Manager, the division studied in 2007 the cost of purchasing health benefits through CalPERS. She said that doing so then would not have saved the City money.

Purchasing health care elsewhere in future years might help Sacramento contain costs. For example, the City's least expensive Kaiser premiums are currently slightly more expensive than the Kaiser plan that CalPERS offers to local governments in the Sacramento Region. Other governments in the area, including Davis and Elk Grove, purchase insurance for their employees through CalPERS. The following shows the difference in premiums between the City's and CalPERS' least expensive Kaiser plan.

Exhibit 33: Cost Difference Between CalPERS Plan and City Plan

Types of Coverage	City of Sacramento	CalPERS Sacramento Region (with Fees)
Employee	$529.86	$526.77
Emp. +1	$1,059.72	$1,053.53
Emp. +2+	$1,409.46	$1,369.59

Source: Generated from information provided by Human Resources and CalPERS, and Auditors' analysis

While monthly premiums for the CalPERS plan are less expensive than the City plan, Sacramento would likely not save money by switching to CalPERS, as current law requires employers who choose CalPERS to provide the same contribution amounts towards retirees as active employees. Such a shift under current requirements would likely cost the City several million dollars more than its current overall costs. However, we would encourage Human Resources to evaluate this and other similar options periodically.

Wellness Programs

As health premiums are based on the past costs to cover a group of employees, improving and maintaining employees' health could help hold medical premiums in check. Some employers provide wellness programs for employees. According to the Kaiser/HRET study, 93 percent of the State and local government employers that offer health benefits and responded to the survey provide at least one employee wellness program. The most common type offered by these employers are classified as Web-based resources for healthy living (86 percent) and wellness newsletters (81 percent). Wellness programs vary, and can include things like providing smoking cessation counseling, nutrition classes, or health newsletters.

An article in *Occupational Health & Safety* magazine said that a best practice for wellness programs is to provide programs to influence behavior of employees at all health levels. The article stressed providing the most programs to those with the higher risks, including those with chronic conditions or those with the potential to develop them. For example, the article mentions targeting those who are overweight, use tobacco, have prehypertension, or prediabetes.

According to the Benefits and Retirement Manager, the City is working with its health providers to implement a wellness program. In February, the City held blood pressure screenings for employees. The

Benefits and Retirement Manager said she is planning to hold wellness events every month. While the City hosted health fairs for employees in the past, these events have not been held for several years.

Some area government employers have more developed wellness programs. CalPERS, which is based in downtown Sacramento and is the largest purchaser of public employee health benefits in California, has a wellness program for its employees. The CalPERS program includes an onsite fitness center with group exercise classes; courses and workshops on nutrition, weight loss, stress management, smoking cessation, and personal safety; employee walking groups with maps of local walking routes; onsite biannual health screenings; annual flu clinics; and health newsletters. CalPERS has a Wellness Committee of employee volunteers who plan and promote programs.

According to the Partnership For Prevention, a nonpartisan organization that aims to make disease prevention and health promotion a national priority, a review of 42 published studies related to worksite health promotion programs showed the following benefits:

- Average 28 percent reduction in sick leave absenteeism
- Average 26 percent reduction in health costs
- Average 30 percent reduction in workers' compensation and disability management claims costs
- Average $5.93-to-$1 savings-to-cost ratio

If the City's wellness program could reduce the health costs to cover employees, it is possible that the City could help hold its premium costs in check. As premiums represent such a large expense to the City, a modest reduction in premiums could be significant. As there are costs associated with some wellness program activities, the City should work with its providers to obtain free or low-cost wellness services that would target reducing the City's overall health benefit costs.

Alternative Retiree-Health Benefit Plan

As the annual cost of retiree health benefits grow, the City may want to consider alternatives to its approach for new employees or for current employees who would voluntarily shift to a different plan. Instead of agreeing to provide future benefit payments, some governments have moved to defined contributions towards retirees' health benefits. Sacramento County, for example, contributes $25 per pay period towards eligible employees' retiree health savings plans (RHSP). Employees are not taxed on RHSP contributions or benefits paid towards medical expenses. Under this plan, employees can choose how to invest their funds. After leaving County service, former employees can spend the funds on medical expenses.

If the City also contributed $25 each pay period towards eligible employees' plans, this $650 per year contribution would represent an additional current City expense. But, it would eliminate a future liability. If an employee worked for the City for 10 years, for example, the City contribution per employee would be $6,500. This is equivalent to covering about three years of what the City currently pays towards a Non-Fire retiree's premiums who had 10 years of service. However, under the current system, a retiree can continue to receive benefits for decades. Changing to an RHSP might not necessarily translate to a City savings since employees who work less than 10 years receive no benefit under the current system.

The above example simplifies City contribution calculations and more complex analysis would be needed to determine if switching to a plan like an RHSP would save the City money while still providing retirees with a meaningful future benefit.

Reduced Pension Benefits For New Employees

Some government employers have reduced pension benefits for new hires. Sacramento's benefit formulas through CalPERS are 2% at 55 for Miscellaneous employees and 3% at 50 for some Safety workers and 3% at 55 for other Safety employees. Pension amounts for employees are based on their highest earning year. The formulas above mean that employees will receive a percent of their highest salaries in pension benefits. So 2% at 55, for example, means that if an employee retired at 55, he would receive 2 percent of his income for each year of service. An employee who worked 15 years under this formula, earned $65,000 during the highest paid 12-month period, and retired at age 55 would receive a benefit of $19,500 per year (15 x $65,000 x .02).

In 2010, the State of California changed pension formulas for newly-hired State workers. Pension formulas changed for Miscellaneous Tier I and Industrial employees from 2% at 55 to 2% at 60 – meaning that employees would have to retire at an older age to receive the 2 percent payments for each year of service. For new State Peace Officers, Firefighters and Highway Patrol, the formula changed from 3% at 50 to 3% at 55. The State also changed the basis for the final salary amount from the highest 12 months compensation to the highest annual average compensation over a 36 month period. Since future benefit payments will be reduced by these formulas and compensation calculation changes, the amounts that government employers pay towards these shares also decreases.

RECOMMENDATIONS

We recommend that Human Resources:

24. Establish a process to annually review health plans for possible cost savings options.
25. Continue plans to implement a wellness program that includes assessing the program's impact.
26. Consider changes to the retiree health benefits program.
27. Consider changes to pension formulas and final compensation calculations for new employees.

Best Practices In Benefit Cost Containment Focus On Creating Plans and Evaluating Performance

The Government Finance Officers Association (GFOA), a group with the mission of enhancing and promoting the professional management of government, produces best practices for governments. This includes guidance related to employee and retiree benefits. Overall, the organization recommends that governments plan for these programs, evaluate costs and measure performance.

For employee health benefits, GFOA recommends that governments adopt long-term strategic health-care plans that include guiding principles and key objectives for managing health costs and improving participant wellness. The following are portions of the GFOA's Strategic Health-Care Plan Design Best Practice that explain steps to create a strategic health-care plan:

1. Determine the purpose of a health-care plan.
2. Establish and define cost objectives using performance measures.
3. Use analytical tools to measure the cost drivers and health risk factors of plan participants.
4. Determine appropriate cost-containment measures as needed, and review the purpose of the health-care plan in light of the cost objectives and related performance goals that have been set.

5. Make sure the long-term strategic plan design for health care is understood and can be taken into consideration during labor negotiations.
6. Establish ongoing education initiatives.
7. Consider how the provision of retiree health-care benefits affects the costs and sustainability of the overall health-care benefit package provided.

Creating a strategic health-care plan could help the City focus its health priorities. The plan could inform policymakers as they evaluate options in light of the growing costs of providing employee and retiree health benefits.

RECOMMENDATIONS

We recommend Human Resources:

28. Create and manage a strategic health-care plan.

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Department's Response to Audit Report

CITY OF SACRAMENTO
HUMAN RESOURCES DEPARTMENT
OFFICE OF THE DIRECTOR

MEMORANDUM

TO:	**Jorge Oseguera, City Auditor**
FROM:	**Geri Hamby, Director of Human Resources**
SUBJECT:	**Response to the City Auditor's Audit of Employee Health and Pension Benefits**
DATE:	**March 25, 2011**

Introduction

The Department of Human Resources recognizes the significance of the findings and recommendations in the *Audit of Employee Health and Pension Benefits* Report. Staff is ready and committed to continue on the course of improvements and potential savings opportunities as raised in the audit, many of which were started prior to the completion of audit. We thank the City Auditor and staff for their dedication and time on this audit and resulting report.

The Department of Human Resources consists of seven divisions: Administration, Office of Civil Rights, Employment & Classification, Risk Management, Worker's Compensation, Labor Relations and Benefits & Retirement. The general fund portion of the department budget is $2,841,804. The Risk Management/Worker's Compensation portion of the budget is $27,115,067. While the employer share of health benefits are paid from the Risk Fund, the Benefits & Retirement labor costs, and supplies and services is solely funded from the department's general fund budget. The general fund portion of the department’s budget has been reduced for five consecutive fiscal years. Thus, some of the responses as outlined below are impacted by the practical realities of operating with fewer resources.

Another pertinent issue to note is that until FY10-11 Labor Relations was a separate department. Labor Relations was charged with negotiating collective bargaining agreements, while Human Resources was charged with implementation of the agreements made. While this issue has been eliminated with the merger of the departments, the consequences of years of this structure remain impactful. A concerted effort to sort through, and clean-up residual effects is underway and remains a major priority.

While we acknowledge there is work to be done yet, the Benefits and Retirement Division has made noteworthy accomplishments recently. In the past five years Benefits has had the following successes:

- **Implemented Self-Billing for active employees**
  Instead of relying on the health carriers to provide accurate billing statements, Benefits staff now calculate how much is owed to health providers based on employee enrollment.

  Benefits provide “real time” information to providers with online interfacing of employee benefit information

- **Implemented Employee Self Service**
  Employee self service allows employees to view their health benefits and costs online at any time

  Open enrollment is now automated. Employees can make changes to their benefits selections more conveniently

  Charitable contribution selections were incorporated into self service, thereby reducing paper and creating efficiencies

- **Open Enrollment Fairs**
  Benefits staff host fairs with vendors in attendance to assist employees and retirees with making benefits selections

- **Automated processes**

Developed reporting tools to provide data to the Sacramento Employees Retirement System (SCERS) actuary directly from eCAPS, as opposed to creating manual reports

Integrated SCERS and PERS retirees into eCAPS

Automated the SCERS active employees' retirement system and annual statements

Provided crucial support for the Citywide Content Management (CCM) project to transition the City's personnel files to electronic files

- **Tracking & Reconciliation**
  Implemented a reconciliation process for benefit costs for employees' on a leave of absence that gives the City the ability to obtain reimbursement for benefits where appropriate

The Benefits Division is preparing for the following accomplishments:

  - Implement self-billing for retirees (scheduled for May 2011)
  - Completion of "Lunch and Learns" with the City's Health Carriers for updates to changes brought by the Affordable Healthcare Act (in progress)

Recommendations & Responses

Recommendation 1: Continue to work with health providers and the City Attorney's Office to determine if the City can recover overpayments.

Response: The department fully supports this recommendation and is currently working to recover any amount of overpayments. The department will solicit the City Attorney's support on the matter. With the implementation of self-billing (the procedure for paying health care providers based on enrollment for active employees) this issue has been rectified.

Recommendation 2: Develop a system to reconcile self-billed amounts to actual amounts deducted in payroll.

Response: The department supports this recommendation and will develop a system to reconcile self-billed amounts to actual amounts deducted in payroll to the extent that it is possible. The Human Resources Department took over paying carrier invoices in January of 2009. Shortly thereafter, self-billing for health premium costs was implemented in July of 2009; prior to the audit. As referenced in Exhibit 4 in the Auditor's report, there was an immediate and significant decrease once the Benefits division implemented self-billing.

In the report, the Auditor estimates that between 2004 and 2009 the City paid about $750,000 in premiums to Kaiser for employees that should not have been covered. While the department recognizes that overpayments occurred, this number is largely speculative. As the Auditor notes, variation occur regularly, in a complex system of administering benefits that involves employees entering and exiting employment at various points in the month. The health carriers billing system is in arrears. For example, when the City receives an invoice for payment the March payment, the service date is for the middle of January to the middle of February. This further complicates the reconciliation process.

As a result of the implementation of eCAPS, Human Resources has been able to prevent payments to health carriers for employees who should have not have been covered. The previous system was not equipped to track employee enrollment. Staff had to rely on departments' notification of employee status changes which included deceased members, employees failing to show up to work, or employees who terminated City employment. There was no way to reconcile the costs unless a manual process was used to match each individual employee against the bills. This would have required reconciling thousands of employees with over 60 health carrier invoices.

The new self-billing process has reduced, and largely eliminated any overpayments to the carriers for active employees because the City now pays based on employees' enrollment in plans. However, reconciliation to the actual amounts deducted in payroll may not be possible in all cases. For example, employees on an approved leave of absence may not receive a paycheck to deduct medical benefits. Under the federally mandated Family Medical Leave Act (FMLA), the City is required to pay for employee's medical costs while on a qualifying leave up to 12 weeks. However, Benefits & Retirement staff will develop and implement a reconciliation system and address nuances that come up as a result of FMLA and other challenges with paycheck reconciliation.

Since the Benefits division has been charged with the task of paying carrier invoices, and various other benefit related financial functions, it is the department's goal to obtain staff with accounting knowledge and skill sets appropriate to properly perform Accounts Payable work, as current staff are Personnel Technicians without this background. This resource is required to enable the department to continue on the path of tracking and accountability. The Department is exploring the possibility of reclassifying a position that will like be vacated soon to address this issue.

Recommendation 3: Inventory all previous LOUs and present them to Council for incorporation into labor agreements as necessary.

Response: The Department of Human Resources fully supports and is implementing this recommendation. This effort was initiated by the new Labor Relations Division Manager in the fall of 2010 as a result of the recommendation by the City Attorney. With the adoption of Resolution No. 2010-700, the signing authority concerning LOUs is clear and the Labor Relations staff works closely with the City Attorney's Office to ensure the LOU's entered into are legally binding. The Labor Relations Division has been meeting with all unions attempting to reach agreements regarding the disposition of existing LOUs. Upon reaching agreement regarding which LOUs have continuing effects, they will be submitted to the City Council for approval by resolution.

Recommendation 4: Create a formal procedure related to LOUs to ensure the implementation of Resolution No. 2010-700 and that LOUs become part of the labor agreements.

Response: The Department of Human Resources supports this recommendation and will develop a written procedure ensuring the Resolution is implemented. The Labor Relations Division will also seek to incorporate the provisions of those continuing LOUs in the language of successor MOUs that are negotiated with the unions in the future, however this will require that the unions agree to do so in order for this recommendation to be fully implemented.

Recommendation 5: Post all active LOUs online along with labor agreements.

Response: Upon completing the review of, and reaching agreement with the unions regarding continuing LOUs referenced in the response to Recommendation 3, those continuing LOUs will be posted on-line. Subsequent LOUs approved pursuant to the provisions of Resolution No. 2010-700 will also be posted on-line in the future.

Recommendation 6: Establish a written procedure to review labor agreements. Such a procedure should entail a review of key amounts specified in the documents as well as a sign-off form that indicates Human Resources' staff and management review of agreement terms.

Response: This recommendation is fully supported and will be implemented by the Department. Traditionally, an implementation schedule is developed and published by the Labor Relations Division for use by operating and support departments in ensuring applicable MOU provisions are implemented in a scheduled and timely manner. The written procedure will incorporate the development and publication of the implementation schedule and will require the sign-off form evidencing review and acknowledgment of those negotiated provisions by HR staff, management, and responsible support functions in other departments.

Recommendation 7: Establish a written procedure for creating rate sheets to ensure that amounts in agreements are correctly transferred to eCAPS and rate sheets.

Response: The audit report references the employee-only contribution amount was incorrect for the 2011 rates. This was due in part to a typo that was present in the Personnel Resolution Covering Unrepresented Officers and Employees (Personnel Resolution). At the time the Personnel Resolution is presented to Council traditionally, the following year's rates are unknown. Therefore, there is language in the Personnel Resolution (language that mirrors most of the collective bargaining agreements for represented employees) that indicates a stated amount, i.e. $520, or the lowest cost single rate health and dental plan. In 2011, the lowest cost health and dental plan was $554 (with the exception of one bargaining unit's rates which was frozen at the $520 level) Therefore, staff presented the $554 amount on rate sheets. In the section of the Personnel Resolution that applies to 2011, the words, "or lowest cost health and dental" were omitted, however, the language was in the previous section of the document and has been present in the document for years evidencing the intent. When the City Auditor brought this omission to the attention of staff, the department coordinated with the City Attorney's Office to remedy the issue prior to the 2011 contribution rates being effective on paychecks.

Due to the timing of information received, the employees whose rates were frozen were incorrect on the initial Open Enrollment rate sheet, but were subsequently corrected upon receipt of the information.

There is a procedure in place and upon receiving final and agreed upon rates from the health carriers; however, Benefits staff will improve the procedure in place by double checking for accuracy of the rates prior to sending rates to IT to upload into the rate table in eCAPS for Open Enrollment.

Recommendation 8: Modify its current review process for open enrollment to ensure that premium amounts and shares of costs are correct and in compliance with labor agreements.

Response: This too is supported by the department and as addressed in the response to Recommendation 7, the procedure will be improved to ensure accuracy.

Recommendation 9: Work with Accounting and Information Technology to change electronic paycheck information to clearly display how much the City and employees' contribute towards benefits.

Response: The current paycheck stub configuration is a product of the eCAPS system (the Citywide Accounting and Payroll system) that was implemented in August of 2008. The paycheck stub was configured in this manner to accommodate the City's obligation to pay "cash back" for employees who waive insurance as required in the collective bargaining agreements and the Personnel Resolution. At the time of implementation of eCAPS, the Human Resources Department, in collaboration with the Finance and Information Technology Departments, explored all available options for paycheck stub configuration. It was determined at that time to be the best available option, without customizing the eCAPS system. Any customization of the system was very expensive and strongly and discouraged by the system implementers.

The Auditor's report asserts employees may be confused as to how much they contribute towards benefits. Prior to the "go-live" of the new system, significant outreach through the Change Management Team was done to prepare employees. Payroll sent instructions on how to read one's paycheck at that time. These instructions were inserted with the first eCAPS paycheck employees received. In addition, Payroll completed several trainings entitled, "How to read your paycheck," some specifically targeted to groups, such as employees of the Fire Department. As recently as February 4, 2011, the Finance Department held half day training and one topic was "How to read your paycheck."

In version 9.0 of PeopleSoft (eCAPS) new configurations may be available to revise the paycheck information. Staff will reevaluate this issue with all involved and determine whether customization at this point is feasible and prudent balanced against the costs.

Recommendation 10: Change the practices for crediting employees who leave the City to ensure that they are refunded the correct amounts for health premium payments.

Response: The Human Resources Department absolutely agrees that employees who leave the City should be credited the correct amounts. This is fundamentally a payroll issue, thus Human Resources staff will review the current process with the Finance Department and coordinate to address this recommendation.

Recommendation 11: Formalize the out-of-area plan and the subsidy methodology in the labor agreements.

Response: While the Department of Human Resources supports this recommendation and will seek to incorporate these provisions in the labor agreements, the success of this effort will depend on the willingness of each union representing City employees to agree with this effort. Successor MOU negotiations over the next two and one-half years will include this recommendation as a proposal at the bargaining table.

Recommendation 12: Establish a formal process to periodically compare the costs of the City's health premiums to what other area governments pay.

Response: The Human Resources Department receives comparative data from the benefits consultant annually and it is presented to the Recognized Employee Organizations during the annual health and welfare meetings. As acknowledged in the audit report, the City's health premiums are in line with other governmental agencies that were surveyed by the Auditor.

Health care costs are based on many factors. They include regional data, experience ratings, and utilization of the plans. Another factor impacting the City's rates are pre-Medicare retirees that are blended into the active population utilization.

Also, the Auditor's report included private employers. Private sector employers typically have few or no retirees covered under their health plans. Private sector employers also have a lower average age with higher turnover than the public sector. Further, public sector employees are more likely to be unionized. These factors generally result in lower premiums for private employers.

In so far as out of state employers are used to compare premium costs, it should be noted that that costs of health care are regionally driven. Thus, regional rates should be a factor to make the most relevant comparisons. Within the state of California experience ratings differ from northern California and southern California for example. Traditionally, health carriers set rates based on experience ratings coupled with our City's utilization of the plans.

In addition, demographics of enrollees are crucial to our rates. Active rates are blended with non-Medicare retirees. Other employers with fewer retirees per actives would have a lower average age, and thus lower health care costs.

The Human Resources Department will give more specificity and request the consultant to provide separately a formal process of comparison of other municipal governments from the list of City Council approved comparable cities, and geographically relevant governmental agencies

Recommendation 13: Report to City Council how the City's premium amounts compare with those paid by area governments.

Response: The Department of Human Resources fully supports this recommendation. The Department understands the importance of showing due diligence in staying competitive with benefits offered to employees for retention purposes and commits to presenting this to City Council. In addition and/or as an alternative, Benefits staff could post this information via the intranet and the Benefits Division website available for city employees to have the opportunity to review how the City compares to similar area governments.

Recommendation 14: Consider employee equity when negotiating with unions the City's contributions to health benefits.

Response: Employee equity and fairness is a shared concern between the City and the unions representing City employees in collective bargaining. To that end, the Department fully supports the basis for the Auditor's recommendation and will seek to ensure that equity is fully considered in successor MOU negotiations. Health Benefit contribution levels do in fact vary depending on the enrollment level of the employee and those varying levels are the result of conscious, deliberate attempts to strike a balance between an employee who is single with no dependents, versus those employees supporting other dependent family members. The choices made by the City and unions in reaching agreements at the bargaining table often involve prioritizing the interests of one group of employees over another group. That is the nature and essence of collective bargaining.

Recommendation 15: Establish a process to obtain and review trends in area governments' contributions towards employees' health premiums.

Response: To the extent that staffing in the Labor Relations Division allows, other state and local jurisdictions are surveyed to obtain a variety of salary and benefits data in preparation for bargaining. To the extent that this survey process exists, the Department supports the Auditor's recommendation within the limits of available staffing. The unions also engage in surveying comparable jurisdictions for the same purpose. Ultimately, trend data is useful in negotiations, but does not necessarily create the basis for an agreement at the bargaining table. In some cases, concessions involving an increase in health benefit contributions by the City may be made in order to obtain a corresponding, but unrelated concession from the union in another economic-based proposal.

Recommendation 16: Consider regional trends when negotiating benefit shares.

Response: Regional trends can be incorporated in the surveys of other jurisdictions and as discussed in the response to Recommendation 16, this recommendation will be included in the City's preparation for successor MOU negotiations.

Recommendation 17: Negotiate terms that require increasing employees' contributions to their benefits.

Response: The department fully supports this recommendation and will incorporate it into the City's strategy for the conduct of future labor negotiations. On March 1, 2011, the City Council was briefed regarding the City's strategy to seek salary and benefits concessions from the unions in order to reduce the need for layoffs and service level reductions in Fiscal Year 2011/2012.

One of the strategies involves reducing the City's contribution to employee health benefits. Because the unions have MOUs that do not expire before the beginning of Fiscal Year 2011/2012, they are under no obligation to negotiate and existing benefit contribution levels will remain in force until the respective MOUs expire. Successor MOU negotiations in the future will fully adopt the reduction in City contributions as a bargaining strategy, but the strategy's success will depend on a number of related and unrelated economic variables that cannot be anticipated until the parties meet and confer at the bargaining table.

Recommendation 18: Negotiate a change in contributions to require that all employees pay some share of the employee contribution portion of pensions.

Response: As in the response to Recommendation 18, the Department fully supports the recommendation of the Auditor. The strategy involving employees assuming all or a portion of the employee contribution to CalPERS retirement was included in the March 1, 2011, City Council briefing on concession bargaining strategy. The success of this strategy depends as well on the unions' willingness to negotiate concessions as part of the deficit reduction strategy in order to avoid layoffs in Fiscal Year 2011/2012 as well as during successor MOU bargaining in the future.

Recommendation 19: Consider the employee contributions required by nearby government employers when negotiating the City's pension share.

Response: This too is supported by the Department and, as was addressed in the responses to Recommendations 16 and 17, will be incorporated into the survey work accomplished in advance of successor MOU negotiations.

Recommendation 20: Work towards negotiating a change to the City's contribution for Fire retirees' benefits to bring them more in line with contributions made toward other City retirees.

Response: The Department supports this recommendation and will incorporate this as a bargaining objective when the successor MOU is negotiated. It is of course dependent on the willingness of the union to agree to this change in the City's contribution.

Recommendation 21: Continue pursuing options to reduce retiree health costs.

Response: The Department of Human Resources fully supports this recommendation and as inferred in the recommendation we are pursuing options and strategies currently in preparation for the City's strategy for future labor negotiations. The strategy involving reducing retiree health costs was included in the March 1, 2011, City Council briefing on concession bargaining strategy. The success of this strategy depends on the unions' willingness to negotiate bargaining in the future.

Benefits and Retirement has met with another provider of retiree benefits that would give retirees age 65 and over many choices for their benefits no matter their place of residence at a reduced cost resulting in reduced City contributions. This is one option being pursued.

Recommendation 22: Continue working with Health Net to pursue overpayments for the out-of-area subsidy.

Response: The Department of Human Resources fully supports the recommendation Health Net is reviewing the information provided by the Benefits & Retirement division and is awaiting responses from their appropriate departments. In the meantime, Benefits ceased payment of Health Net retiree subsidy starting February 2011, which was as soon as practicable.

Recommendation 23: Continue work to implement the self-billing method for retiree health benefits.

Response: The Department of Human Resources fully supports the recommendation. The implementation for retiree self-billed insurances is scheduled for May 2011. Much more was involved to build this group in eCAPS as all retirees were not a part of the eCAPS system. Benefits staff, IT and CalPERS IT has been working diligently to make this a smooth transition. The Human Resources Department is confident that the transition is on target and will begin May 2011.

Recommendation 24: Establish a process to annually review health plans for possible cost savings options.

Response: The Department of Human Resources fully supports the recommendation, and the department does currently conduct a review of the health plans on an annual basis. The Benefits Consultant has over the years, and will continue to, bring many industry best practices to the annual health and welfare meetings with the goal of reducing costs. For example, high deductible health plans, and health savings plans options have been offered. Implementing these cost reducing strategies is dependent on the concurrence of the Recognized Employee Organization groups represented at the meetings.

Recommendation 25: Continue plans to implement a wellness program that includes assessing the program's impact.

Response: The Department of Human Resources wholly supports the recommendation. The Department of Human Resources had a fully staffed Organizational & Development Division which included a Wellness program, richly integrated into the City culture. The Wellness Program promoted physical, mental, and emotional health and well being. The Human Resources Department coordinated and sponsored annual health fairs, and subsequently quarterly health fairs, on site at various City locations. The health fairs had a wide variety of offerings which included blood pressure and cholesterol screenings, education for such issues as diabetes, and weight management; and stress reduction resources such as massage and yoga instruction. In addition, City University had a Wellness curriculum that included courses in Reiki, Yoga, Tai Chi, dance and nutrition. The Wellness program staff worked with our health carriers to indentify issues based on the City's Utilization reports. These reports include data about the most popular prescription drugs utilized by the City employee population. This information was used to create the most relevant programs for our employees, with the goal of reducing our healthcare costs. The Wellness Program staff coordinated discounts for City employees to fitness centers, chiropractic and acupuncture services, weight management facilities, etc. While the goal of the program was to improve the health of City employees, thus reducing our health care costs, there were many added benefits. Employees felt valued – that the City was willing to invest in such a comprehensive Wellness program for the benefit of its employees. These programs promoted positive employee morale.

The Human Resources Department would like to resume the comprehensive Wellness Program we once had. However, when the Department was forced to make reductions as the City faced significant budget shortfalls this division was eliminated with the Wellness Program, one of many employee development program cuts.

For the past four months, Benefits has been working with the health carriers to continue the City's Wellness program with little or no cost to the city. There have been city wide blood pressure events in February and a survey is on the intranet to capture the interests of what employees are interested in seeing in their wellness program. But the reality is it would be impossible to resurrect the comprehensive Wellness program that the City once had with the current resources available. The Human Resources Department recognizes that health of its employees directly impacts the rates of the premiums and studies show it takes at least four years of employee participation to see the impact in the rates.

Recommendation 26: Consider changes to the retiree health benefits program.

Response: The Department supports this recommendation and will incorporate this as a bargaining objective when the successor MOU is negotiated. It is of course dependent on the willingness of the unions to agree to this change in the City's retiree health benefit program.

Recommendation 27: Consider changes to pension formulas and final compensation calculations for new employees.

Response: The Department supports the Auditor's recommendation to consider changes to pension formulas and final compensation calculations. One example cited in the report, that a "second tier" retirement benefit be created for new employees, has been successfully bargained at the state level and other local jurisdictions. This strategy will not produce short term savings needed to address the on-going budget deficit and hiring new employees has been significantly reduced in the face of layoffs of existing personnel who have return rights when jobs do become available. However, it is a viable bargaining objective. These recommendations will be incorporated into the City's successor MOU bargaining strategy.

Recommendation 28: Create and manage a strategic health care plan.

Response: The Department of Human Resources fully supports the recommendation of the Auditor. The City and the Benefits Consultant works together annually and/or the Benefits Consultant works directly with the health plan carriers strategizing the following years' health care. Again much of the success of this is dependent on the willingness of the unions to agree to changes in the City's health benefit program.

<u>Conclusion</u>

The Department of Human Resources takes very seriously the responsibility of negotiating and administering employee and retiree benefits. As the City has faced several years of budget deficits, the goal of reducing labor costs has become even more imperative. As the City Auditor has indentified cost saving opportunities, efficiencies, and ways to prevent error, the department has benefited from this process and appreciates the recommendations therein.