McGraw Wentworth

BENEFIT Advisor

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In This Issue

In this seventh issue of the McGraw Wentworth Benefit Advisor for 2008, we will discuss dependent eligibility audits. In these tough times, many employers are considering these audits to manage health plan costs. Costs are impacted when ineligible dependents are removed from coverage under the plan.

Even the most diligent employers likely cover some ineligible dependents under their plan. Verifying dependent eligibility and tightening the administrative process will ensure your plan is only covering dependents that meet the plan's eligibility requirements.

We welcome your comments and suggestions regarding this issue of our technical bulletin. For more information on this Benefit Advisor, please contact your Account Manager or visit the McGraw Wentworth web site at [www.mcgrawwentworth.com.](http://www.mcgrawwentworth.com)

"Dependent Eligibility Audits"

Because of their rising benefit costs, more employers are attempting to verify that dependents enrolled in their benefit plans are, in fact, eligible. According to the McGraw Wentworth Mid-Market Benefit Survey, roughly 50% of employers intend to conduct a dependent eligibility audit in 2008.

Employers can either conduct an in-house audit or use an outside vendor. Organizations conducting internal audits need to consider a variety of factors. Even organizations hiring outside vendors must understand the issues involved.

This Advisor explains the key issues relating to dependent eligibility audits:

- Potential Impact on Plan Costs
- Timing of the Audit
- Options for Conducting an Audit
- Audit Process
- Improving Eligibility Management

Audits can impact cost and it is likely your plan is covering at least one ineligible dependent. As you conduct audits and keep your employees informed of the eligibility requirements their dependents need to meet, your actions will have a sentinel effect. The audit will remind your employees to make sure the dependents they list are eligible.

Potential Impact on Plan Costs

Plans realize true savings when they remove ineligible dependents, although the exact amount they will save cannot be calculated in advance. Most organizations would not even venture a guess at how many ineligible dependents their plans cover. In general, it is believed that 5% to 15% of dependents may not meet your eligibility requirements. Many employers estimate that each ineligible dependent they remove saves from $2,400 to $5,000. Employers with self-funded plans – where the employer pays claims directly – could potentially save even more. If an ineligible dependent uses significant health plan resources, savings could be substantial:

- According to Business Finance (September 2006): *"The Proctor & Gamble Co. undertook dependent eligibility audits of employees in all of its U.S. plants over a*

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period of 13 years. Although the number of ineligible dependents identified during the audits varied by plant, the inventories have generally revealed that 5% to 10% of individuals insured under the company's health benefit plan are actually ineligible for coverage ..."

- According to USA Today (April 4, 2004): *"DaimlerChrysler found 27,000 employees who, by error, oversight or design, had ineligible family members on their policies. Some workers must now repay what Daimler spent on health care for those dependents…Ford Motor, which spent $3.2 billion on health care last year, is also looking to recoup some costs from workers. It says intensive audits found 50,000 ineligible dependents since 2000, reducing its health care rolls by about 10% . . ."*

Mid-market organizations can also reap potential savings from a dependent audit.

Even employers with the best administrative practices may still be enrolling ineligible dependents for a number of reasons:

- **Employee Error and Fraud**: Eligibility rules can be confusing, especially for dependent children. In fact, your employees may not even realize when a dependent loses eligibility as in some of the situations listed below:
  - A 19-year-old dependent child, financially supported by an employee but not attending school full-time, is eligible under some plans, most notably Blue Cross Blue Shield of Michigan. But other plans require an adult child to be a full-time student. It's not uncommon for employees to be unsure of how a dependent child is defined. This confusion results in employees covering children improperly.
  - An employee may refer to a live-in partner as a spouse and add that person as a dependent, even if the partner is not eligible under the plan. If the plan covers traditionally married couples only, but does not require proof that a traditional, legal relationship exists, an employer will not know whether a named spouse is truly eligible.
  - Employees may deliberately leave ineligible dependents on the plan in some situations, such as following a divorce or when a child reaches the benefit plan's age limit. For example, to avoid paying an ex-spouse's COBRA as part of a divorce settlement, the employee may decide not to tell the employer about the divorce and continue to cover the spouse as a dependent.
- **HRIS or Carrier System Issues**: Many systems still require data to be entered manually which can lead to inaccuracies.
  - If a clerk enters the wrong date of birth for a dependent child, for example, the plan may not request proof of student status at the proper time.
  - Established systems can experience "glitches" from time to time.
  - Data may no longer be accurate after a software upgrade. Upgrades may offer more flexibility, but the upgrade can sometimes alter your database.
- **Strained Human Resources Departments**: Among their many other responsibilities, human resources departments must also maintain meticulous records when they enter new hires, add dependents, administer mid-year status changes,

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Notable Thoughts

Trust yourself. You know more than you think you do.

Benjamin Spock (1903-1998)

and process coverage and employment terminations. Some information could easily be overlooked, especially when there is a high volume of data, or when there have been many personnel changes in the human resources department. The annual enrollment period presents another challenge because employees can add dependents outside of a change in eligibility (an event which commonly requires substantiating documents).

Some employers mistakenly expect their insurers or third party administrators to confirm dependent eligibility. In most cases, however, health plan vendors and administrators rely on the employer to confirm dependent eligibility. Some vendors will periodically ask employees to confirm that adult children are full-time students, if that is a requirement of the plan. If the employer sends eligibility information electronically or uses the health carrier's electronic enrollment system, the contract usually specifies the employer must verify dependent eligibility.

In fact, last year a health plan carrier actually sued an employer for covering an ineligible dependent who incurred a large number of high dollar claims. Since the employer had signed a contract agreeing to monitor eligibility and failed to do so correctly, the carrier was forced to pay significant claims for an ineligible dependent. The case is still making its way through the court system, but it does illustrate the importance of managing eligibility properly as an employer.

Some employers would like their vendors to manage the eligibility process, although this arrangement may not be the best option. Health plan vendors do not necessarily know when changes occur among health plan participants. Also, vendors are not as personally vested as the employer in ensuring the plan covers only eligible individuals. An employer, for example, may learn of a divorce through managing the retirement plan. This change should flag the retirement plan administrator to check with the benefit administrator to make sure the divorce is processed for health and even life coverage. So while employers may wish to delegate this responsibility to the health plan vendor, that vendor is probably not going to be able to monitor eligibility as well as the employer can.

A dependent may be ineligible under the health plan for many reasons. Some may tie back to the employer, the health plan vendor or, in some cases, directly to the employee. A dependent audit, therefore, is an opportunity to verify eligibility and reduce covered risks.

Timing of the Audit

What is the best time to conduct an audit? The answer will probably be different in every organization. If you are conducting the audit in-house, it is important to schedule it when your human resources department will have the time to devote to the process.

Before you decide when to conduct the audit, you need to decide on the purpose of the audit. If your organization is conducting the audit as a cost savings measure and intends to publish the savings generated, then it is important to conduct the audit separately from the open enrollment process. If measuring cost savings is not a primary concern, conducting the audit during open enrollment may make sense.

The following are key considerations in timing a dependent audit:

- If identifying cost savings is your goal, do not conduct the audit during open enrollment. Open enrollment typically allows employees to change their health plan elections. If your audit coincides with open enrollment, your organization will not be able to identify which changes were prompted by the audit and which changes were associated with open enrollment. You can take two different approaches to avoid conducting audits during open enrollment:
  - ***Six months before open enrollment***: If your organization estimates the audit process will take two or three months, it makes sense to schedule the audit six months before open enrollment. One benefit of this approach is the audit will be completed before the increased workload associated with open enrollment. Another benefit is that this timing allows you to correct enrollment problems quickly. Some employees will not respond to the

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request to provide proof of dependent eligibility. The result of the non-response would be dependents being removed from the health plan. If the dependents are eligible but the employee simply failed to act on the request, the employee will have the chance to add back legitimate dependents at open enrollment.

- ***Two months after open enrollment***: Your organization could conduct the audit two months after open enrollment. One of the benefits of this approach is you can inform employees of the upcoming audit during open enrollment and give them the opportunity to remove ineligible dependents before the audit. Your organization would wait a couple of months after open enrollment to clean up any post open enrollment issues.

- If your organization is not as concerned with identifying the cost savings associated with the audit, it may be easier to do the audit during open enrollment when communication and paperwork are the norm. It also allows you to start the year with the confidence that enrollment is clean. Open enrollment is typically a very busy time for most employers and processing the paperwork associated with an audit will take more time.

Once you decide to conduct the audit, the right timing becomes a key factor. Make sure you conduct your audit during a time period that will meet your goals and when your human resources department has the time to handle the extra work.

Options for Conducting an Audit

Organizations have several options to consider when they conduct a dependent eligibility audit. The first choice will be whether to conduct the audit using internal resources or using an outside vendor. It does take time to contact all your employees and evaluate all the paperwork associated with verifying eligibility. If your human resources department does not have the time to conduct the audit, an outside vendor would make sense. In many cases, an outside vendor may take a more aggressive approach. The vendor may not only clean up the eligibility but also try to recover claim payments made for the ineligible dependents.

If you decide to use internal resources to conduct an audit, you must first determine the best approach:

- ***Relaxed Approach***: This approach is faster, but it will not deliver the best results.

The relaxed approach involves asking employees to complete a detailed questionnaire to determine whether their dependents meet the eligibility requirements. Employees are asked "Yes" and "No" questions to confirm that dependents are eligible. Employees then sign the questionnaire to certify that the information they provided is accurate. Essentially, employees are on the honor system. Because employees are not required to submit documents to prove the dependent is eligible (beyond the audit questionnaire itself), this approach is the least invasive, disruptive, and time-consuming for both employees and the employer. It is not always effective, however, because employees who are knowingly covering ineligible dependents can easily continue to certify they are eligible.

- ***Moderate Approach***: This approach blends the relaxed and aggressive approaches. It starts with the detailed questionnaire used in the relaxed approach. The employer then sorts the questionnaires and flags the situations listed below that may indicate an ineligible dependent:
  - A dependent spouse's or child's last name that is different from the employee's.

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- Any child above the dependent age limit.

If a dependent sets off any red flags, the employer asks for written proof of eligibility. Employees must provide documentation to confirm these dependents meet the eligibility requirements. Documentation may include:

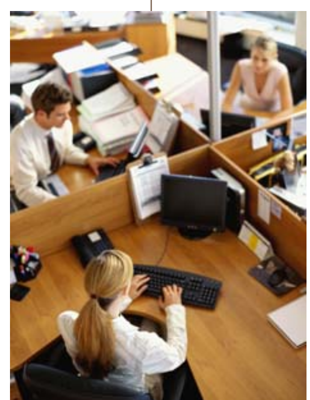
- tax returns
- birth certificates
- evidence of student status (such as a letter from the school's registrar), and a copy of a dependent child driver's license (to prove residence)
- marriage certificates
- adoption or court orders to prove coverage responsibility

Although the moderate approach is more effective than the relaxed approach, it is less effective than the aggressive approach because it focuses its efforts simply on verifying eligible dependents in situations where there may be an issue.

- ***Aggressive Approach***: This approach is most time-consuming for employers because it requires all employees to submit written proof that their dependents are eligible for coverage. Examples of the documents required would be marriage licenses, tax returns, birth certificates, evidence of student status (such as a letter from the school's registrar), and copies of the dependent child driver's license (to prove residence).

  This approach is also burdensome to employees because they must dig up the proper paperwork. For this approach to be successful, employers must identify the necessary documents and state the due date. The employers must clearly explain the consequences of not providing proof – the dependent will lose coverage under the plan.

  The benefit of this approach is that the employer has one point in the year when the eligibility is correct.



If your organization decides to hire an outside vendor to conduct the audit, that vendor should use an aggressive approach in verifying eligibility.

Audit Process

Once you decide to conduct an audit, you need to plan a process to make sure the audit is successful. If you hire an outside vendor, the vendor should explain the audit process and set the action plan.

If you decide to conduct an audit in house, first determine which approach you will take – relaxed, moderate or aggressive. Next discuss amnesty. What incentive will you offer to encourage employees to reveal ineligible dependents? Determine how you will handle this situation before you begin the audit.

Most employers considering amnesty use one of these approaches:

- ***Employment Amnesty***: This approach lets employees know that their employment will not be terminated or otherwise affected if they disclose ineligible dependents.
- ***Claims Amnesty***: This approach is more favorable to the employee and states the employer will not try to recover any claims the plan has paid for ineligible dependents. Employers need to be very careful about claims amnesty. If your plan is fully insured, your insurance carrier needs to agree to the offer this amnesty. Carriers do not usually want to allow this type of amnesty. If you are self-funded, you need to get approval from your stop-loss carrier. If an ineligible dependent was a stop-loss claim, the stop-loss vendor will likely want to recover claim payments because the dependent was not eligible for coverage. Claims amnesty is difficult in practice because your organization cannot identify ineligible dependents up front.

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The next step would be to build a time line for the entire audit process that includes these key steps:

- ***Pre-Audit Announcement***: Employees do not always respond positively to the audit. Therefore drafting and distributing a pre-audit bulletin is critical. Employees need to know that an audit is coming. Explain the reason for conducting the audit and list the employee's responsibilities, such as completing a questionnaire or providing written proof a dependent meets the requirements. Make sure your employees understand that their dependents may lose coverage under the plan if they do not respond to the audit.

  Use a positive tone. If your organization is offering amnesty, this bulletin should restate the requirements for eligible dependents and encourage employees covering ineligible dependents to come forward before the audit begins.

- ***Audit Process***: The audit formally begins when your organization notifies your employees that they will need to prove their covered dependents are eligible. Once the formal audit starts, any amnesty offers are off the table. You will need to keep track of employees that need to verify dependent eligibility and when they respond. Your actions will vary depending on the approach your organization is using. In the relaxed approach, your organization will be tracking the questionnaires. In the moderate approach, your organization will be reviewing the questionnaires and setting aside the ones with flags to request more documentation. In the aggressive approach, you will be analyzing all the proof and documenting dependents are eligible. After your administrative tasks are complete, you can work on removing the ineligible dependents from your plan.

- ***Removing Ineligible Dependents:*** It's important to choose a date ineligible dependents will be removed and apply that date consistently to all situations. Some employers may prefer to extend coverage for a short time to give that dependent the chance to find other coverage. However, your organization needs to be mindful of your vendor. Your insurance carrier or stop-loss carrier may not agree to continue coverage for an ineligible dependent.

  More aggressive employers may decide to end coverage as of the date the dependent became ineligible. In this case, your employee may need to repay all claims incurred during the period of ineligibility. If the plan is insured, the employer may simply step aside and allow the carrier to tackle the issue of repayment with the individual employees.

  If an employee does not come forward to identify ineligible dependents during the amnesty period, the dependent's ineligible status may not be discovered until your organization completes the audit. In this case, it may also be best to end coverage as of the date the dependent became ineligible. There's no benefit in offering claims or employment amnesty if there are no repercussions to employees who choose not to take advantage of this generous approach in the allotted time frame.

Employers also need to consider potential COBRA liability when they remove ineligible dependents. Not all ineligible dependents may be eligible for COBRA:

- Dependents that were never eligible under the plan are also not eligible for COBRA; for example, a significant other covered as a spouse would not be eligible without proof of a legal marriage. In this case, the significant other was never eligible as a dependent and therefore is not eligible for COBRA.
- In certain circumstances, for example, divorce or a child ceasing to satisfy the plan's eligibility requirements, COBRA may apply. It is the *employee's obligation* to notify the employer when a dependent is no longer eligible. If an employee notifies the employer within 60 days, the employer must offer COBRA. On

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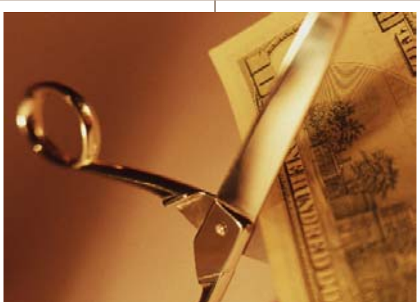
the other hand, if the employee notifies the employer after 60 days, the employer is not obliged to offer COBRA.

You may want to be more generous and extend COBRA to these dependents, even though you are not obligated to do so. If this is the case, you should get written approval from your insurance carrier or your stop-loss vendor.

Improving Eligibility Management

Once your organization completes an audit, you will likely be surprised by the number of ineligible dependents your plan has been covering. You also will be surprised at the amount of work necessary to conduct a thorough audit. Your organization can take steps to improve your administrative process to minimize the number of covered ineligible dependents in the future:



- Remind employees of dependent requirements frequently and also remind them that covering ineligible dependents constitutes insurance fraud and could result in termination of employment.
- Ask for documentation whenever a new dependent is added to the plan—for example, new hires, open enrollment and mid-year plan changes.
- Conduct an affirmative enrollment annually. Require employees to verify their dependents meet the eligibility requirements at open enrollment. Require employees to sign a statement verifying the information is correct and include a strongly worded fraud clause.
- Try to centralize employee benefit administration. Make sure to share employee status changes for payroll, pension and other employment areas when these changes may affect employee benefits.

If your organization improves its administration process, dependent audits can be done every three or four years.

Concluding Thoughts

In these tough times, employers are looking to numerous strategies to help control health plan cost. One of these strategies is auditing for dependent eligibility. Whether employers conduct these audits in-house or use outside vendors, the result will be fewer dependents covered and, therefore, cost savings.

If your organization is considering an audit, make sure you plan the process carefully. If you have any questions, please call your McGraw Wentworth Account Director. MW

McGraw Wentworth, Inc.

3331 West Big Beaver Road, Suite 200
Troy, MI 48084
Telephone: 248-822-8000 Fax: 248-822-4131
www.mcgrawwentworth.com

250 Monroe Ave. NW, Suite 400
Grand Rapids, MI 49503
Telephone: 616-717-5647 Fax: 248-822-1278
www.mcgrawwentworth.com