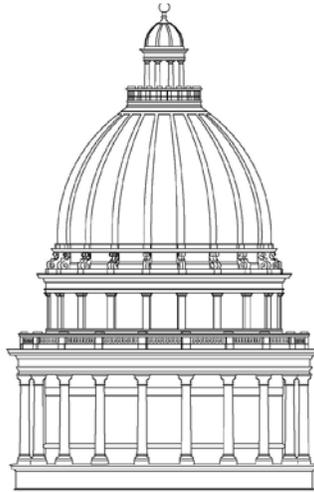


REPORT TO THE
UTAH LEGISLATURE
Number 2012-05



**An In-depth Follow-up Audit of
PEHP's Business Practices**

January 2012

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah



STATE OF UTAH

Office of the Legislative Auditor General

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JOHN M. SCHAFF, CIA
AUDITOR GENERAL

January 2012

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **An In-depth Follow-up Audit of PEHP's Business Practices** (Report #2012-05). A digest is found on the blue pages located at the front of the report. The objectives and scope of the audit are explained in the Introduction.

We will be happy to meet with appropriate legislative committees, individual legislators, and other state officials to discuss any item contained in the report in order to facilitate the implementation of the recommendations.

Sincerely,

John M. Schaff, CIA
Auditor General

JMS/lm

Digest of An In-depth Follow-up Audit of PEHP's Business Practices

This report presents an in-depth follow-up to *A Performance Audit of PEHP's Business Practices* (Report 2011-01), released in January 2011. The 2011 audit found that the Public Employees Health Program (PEHP) needed to make significant improvements in each area reviewed. This follow-up audit reviewed 21 recommendations listed in the 2011 audit. We found that PEHP has fully implemented or are in the process of implementing 18 recommendations. One recommendation has been partially implemented.

Two other recommendations need to be addressed by the Legislature. The Legislature needs to determine whether the state should participate in PEHP's reinsurance pool, and whether the *Utah Code* should be amended to grant the Department of Insurance the authority to require PEHP to comply with its audit recommendations. Two related recommendations that need to be addressed by the Legislature were stated in a follow-up audit of the state's reserves, an *Actuarial Study of PEHP's Contingency Reserves* (Report 2011-06). The Legislature was asked to implement at least a 50-day reserve requirement for the state's medical risk pool and determine what to do with the state's excess reserves.

PEHP Is More Competitively Procuring Vendors. PEHP has made improvements to its procurement practices to help ensure that purchases are procured competitively and fairly. We reviewed 14 procurements from the 2011 audit of PEHP that had not been competitively bid, and found that PEHP has terminated, competitively bid, or sole-sourced nine of those contracts. We also reviewed all new request-for-proposals (RFPs) since July 2011. All seven of those RFPs have been competitively bid. PEHP is still in the process of awarding five of those RFPs. The other two procurements have been completed, and PEHP kept adequate documentation of the procurement process.

A new purchasing agent has been hired to help ensure that PEHP conducts competitive procurements. The purchasing agent has developed an adequate evaluation process and retains all documentation for the procurements. Despite positive changes, PEHP

Chapter I: Introduction

Chapter II: PEHP's New Procurement Practices Help Foster Competition

**Chapter III:
PEHP's Business
Practices
Recommendations
Are in the Process
of Implementation**

needs to continue to eliminate perpetual contracts, as three still exist. Procurement policies also need to be strengthened regarding contract termination dates and advertising RFPs.

PEHP Still Needs to Eliminate Risk Pool Reserves Deficits.

At the end of the 2010 fiscal year, seven risk pools had contingency reserve deficits totaling over \$8.4 million. During the past year, the reserve deficit amount has been reduced by \$4.1 million. Five risk pools still had reserve deficits which totaled \$4.3 million at the end of 2011 fiscal year. PEHP recently reached a settlement with Utah County and Provo City after the end of 2011 fiscal year.

We found that the Utah Retirement Systems (URS) board has not yet refunded excess reserves back to three risk pools, including the state. During the past fiscal year, the total excess risk pool reserves increased by \$34.9 million and now total \$70.4 million. Also, PEHP plans to overhaul its current reinsurance coverage to charge different reinsurance premiums depending on the risk pools experience.

**Chapter IV:
PEHP Pharmacy
Program Has
Addressed Most
Recommendations**

PEHP's Pharmacy and Therapeutics Committee Has Adopted New Policies and Procedures.

The 2011 performance audit concluded that PEHP pharmacy program needed adjustments to ensure members' needs were being met fairly and objectively. The Pharmacy and Therapeutics (P&T) Committee makes important decisions regarding the prescription formulary (medication coverage); therefore, our 2011 report stated that PEHP should have required better processes and rules in this area to ensure that its members' needs are fairly addressed. PEHP is implementing most of the recommendations but still needs to implement an independent review of prior authorizations and co-pay criteria for the pharmacy department.

**Chapter V:
PEHP's Appeals
Process Has
Improved**

PEHP Has Restructured Its Appeals Process. PEHP has made changes to its appeals process to include more clinical expertise. Both the internal and external reviews consist of board-certified physicians who review denied medical claims. PEHP has added a member representation to the executive appeals committee. In addition, PEHP has begun auditing claims adjudication at the disputed claim level, where most denied claims are resolved. Once PEHP has a sufficient number of months of data, PEHP should develop a methodology to statistically audit claim adjudication.

REPORT TO THE UTAH LEGISLATURE

Report No. 2012-05

An In-depth Follow-up Audit of PEHP's Business Practices

January 2012

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Chapter I

Introduction

This report presents an in-depth follow-up to *A Performance Audit of PEHP's Business Practices* (Report 2011-01), released in January 2011. The 2011 audit found that Public Employees Health Program (PEHP) needed to make significant improvements in each area reviewed. PEHP did not compare well against other local insurance carriers in terms of claim costs and contract rates with health providers. PEHP's procurement process demonstrated a significant lack of adherence to acceptable purchasing practices. PEHP's business practices caused financial problems for individual risk pools. The pharmacy program required adjustments to ensure members' needs were being met fairly and objectively. Finally, PEHP's appeal process needed additional controls.

Most Recommendations Are Being Implemented

We found that most of the recommendations have been fully implemented or are in the process of being implemented. This follow-up report defines the progress of implementing recommendations from the 2011 audit in the following four ways:

- Implemented – The recommendation has been completed in the manner intended.
- In process – The department has begun making the necessary improvements, which have not yet been completed. The department intends to continue working towards implementation.
- Partially implemented – The department has taken steps toward implementing the recommendation, but has not completed the process. They have no intention to take further action.
- Not implemented – Either the department or the Legislature has decided not to implement or is awaiting some other action to take place.

The 2011 audit provided 21 recommendations, excluding three recommendations addressing claim costs and contract rates with providers that were not addressed in this follow-up audit, but will be reviewed at a later date. Below is a summary of the status of 19

The 2011 audit discovered that PEHP required considerable improvements in each area reviewed.

The 2011 audit provided 21 recommendations which were reviewed for this follow-up.

recommendations addressed to the PEHP. (Two additional recommendations were addressed to the Legislature.)

- Nine implemented
- Nine in process
- One partially implemented
- Two not implemented (addressed to the Legislature)

One recommendation has been partially implemented. The pharmacy policy review lacks independence.

Also, we do not have verification that the Legislature has addressed two recommendations. The Legislature needs to determine whether the state should participate in PEHP's reinsurance pool, and whether the *Utah Code* should be amended to grant the Department of Insurance the authority to require PEHP to comply with their audit recommendations.

Two recommendations need to be addressed by the Legislature.

Audit Scope and Objectives

We conducted this in-depth follow-up audit at the request of the Legislative Audit Subcommittee. The scope of this audit was to follow-up on the implementation status of recommendations for PEHP's:

- Procurement practices (Chapter II)
- Financial practices (Chapter III)
- Pharmacy benefit (Chapter IV)
- Appeals process (Chapter V)

For this follow-up audit we did not review recommendations addressing claim costs or contract rates with providers because PEHP needs additional time to implement those recommendations. PEHP is reviewing plan designs and plan benefits. Also, PEHP's out-of-state network changed as of July 2011, and PEHP may make other contract changes in 2012. After PEHP has had time to fully implement these changes, we should review the effect of those changes on PEHP's claim costs and contract rates.

This in-depth follow-up audit was requested by the Legislative Audit Subcommittee.

Chapter II

PEHP's New Procurement Practices Help Foster Competition

Public Employees Health Program (PEHP) has made improvements to its procurement practices to help ensure that purchases are procured competitively and fairly. A new purchasing agent has been hired to help ensure that PEHP conducts competitive procurements. The purchasing agent has developed an adequate evaluation process and retains all documentation of the procurements. Despite positive changes, PEHP needs to continue to eliminate perpetual contracts, as three still exist. Procurement policies also need to be strengthened regarding contract termination dates and advertising request-for-proposals (RFPs).

Figure 2.1 lists the 2011 report's recommendations related to procurement practices, the recommendations' status, and a brief explanation of PEHP's efforts to implement the recommendations.

Figure 2.1 Prior Procurement Practices Recommendations' Status.
All four recommendations are implemented or in the process of being fully implemented.

Recommendation	Status	Explanation
We recommend that PEHP follow URS policy by conducting competitive RFPs and bids, imaging and retaining documentation, and keeping a master contract list.	Implemented	URS hired a managing purchasing agent to keep a master contract list, image and retain documentation, and ensure competitive procurements.
We recommend that PEHP follow best practices in the following areas: publicly advertising RFPs, using a decision matrix, retaining evaluation documentation, and retaining sole source documentation.	In Process	PEHP uses a decision matrix, retains evaluation and sole source documentation, and is in the process of joining BidSync to publicly advertise all RFPs.
We recommend PEHP strengthen contract controls by ensuring a contract is in place for each vendor, requiring contract terms to have a definite end, and ensuring there is another competitive RFP or rebidding at the end of the contract.	In Process	PEHP has resolved contract concerns with 11 vendors. However, PEHP does not have contracts for two vendors, but these will be terminated in 2012. One new contract is perpetual and two contracts are still perpetual. Updated purchasing policies do not allow for automatic renewal of a contract.
We recommend URS strengthen the following policies: requiring public advertisement of RFPs, requiring contract terms to have a definite end, and setting parameters for when a sole source vendor needs to be reviewed.	In Process	PEHP has set parameters when a sole source vendor needs to be reviewed, is in the process of requiring public advertisements of RFPs and contract terms to have a definite end.

PEHP has made an effort to strengthen procurement policies and practices.

PEHP has implemented one recommendation and is in the process of implementing three recommendations. The main concern is that PEHP has perpetual contracts with three vendors and one of those is a new contract that began July 2011. PEHP has stated that they are going to eliminate those perpetual contracts. PEHP's efforts to implement each recommendation will be described in detail in the remainder of the chapter.

PEHP Is More Competitively Procuring Vendors

For this follow-up audit, we reviewed all of PEHP's new purchases since July 2011 that are over \$50,000. PEHP has had seven new RFP procurements. All seven of those RFPs have been competitively bid. PEHP is still in the process of awarding five of those RFPs. The other two procurements have been completed. We also reviewed 14 procurements from the 2011 audit of PEHP that had not been competitively bid, and found that PEHP has terminated competitively bid, or sole-sourced nine of those contracts. PEHP has hired a new purchasing agent to manage the procurement process to make sure purchases are competitively bid and documentation is retained for each purchase.

PEHP has hired a new purchasing agent to manage the procurement process.

New Vendors Are Being Procured

PEHP is making an effort to competitively procure vendors. This audit reviewed all seven new RFP procurements since July 2011. Two of those RFP procurement processes have been completed, while the other five had not been finalized as of this audit. However, each of the seven RFPs had been competitively bid. PEHP sent invitations to vendors to submit an RFP for all seven procurements and advertised three of the seven RFPs by submitting a public notice to a newspaper of local circulation. The audit also reviewed two purchases under \$50,000 and found that those procurements had also been competitively bid.

This audit reviewed all new RFPs since July 2011. All seven have been competitively bid.

The 2011 audit of PEHP reviewed the procurement of 21 vendors from fiscal years 2006 through 2010. That audit found 14 out of the 21 sampled dealings with vendors had not gone through the appropriate RFP or vendor selection process. We reviewed each of

The 2011 audit found that 14 out of 21 of PEHP's vendors had not gone through an appropriate selection process.

those 14 vendors for this follow-up audit and found that a majority of the non-competitively procured vendors are being terminated. Figure 2.2 shows the information provided in the 2011 audit as well as the current status for the 14 vendors.

Figure 2.2 Non-Competitively Procured Vendors from the 2011 Audit. PEHP has resolved nine of the 14 vendors not competitively bid. Four vendors are inactive and will need to be competitively bid if those services are needed in the future.

Vendor	Issue	Expenditures: FY 2006 - 2010	Current Status
A	No RFP	\$ 5,257,263	Termination in April 2012
B	No RFP	2,008,170	Sole Source
C	No RFP	1,861,656	Termination in June 2012
D	No RFP	1,461,870	Terminated
E	No RFP	1,358,071	Possible Termination
F	No RFP	750,215	Termination in June 2012
G	No RFP	161,886	Termination in June 2012
H	No RFP	160,956	New Competitive Bid
I	No RFP	128,613	Sole Source
J	No RFP	112,203	Inactive Vendor
K	No RFP	73,364	Inactive Vendor
L	No RFP	67,780	Inactive Vendor
M	No Bids	18,350	Inactive Vendor
N	No Bids	8,636	New Competitive Bid
Total		\$ 13,429,033	

PEHP has reduced the number of non-competitively procured vendors from 14 to five.

To summarize the current status of the 14 vendor contracts shown in Figure 2.2:

- Four vendors' (J, K, L, M) contracts are inactive and have not been used in 2011. If services were to be needed in the future, PEHP would need to competitively procure those services.
- Three contracts (vendors C, F, G) will be terminated by June 2012; new RFPs will be issued for services provided by two of the vendors, and one vendor's services will be brought in-house.
- One contract (vendor D) has been terminated.
- Two vendors (B, I) have been justified and retained as sole source vendors.
- Two vendors' (H, N) services have been competitively bid. Vendor H was a dual award contract. However, a different vendor was awarded the contract for the services previously provided by vendor N.

By continuing to competitively procure vendors, PEHP is ensuring a fair procurement process.

- PEHP has been considering whether to terminate two vendors (A, E). Towards the end of the audit, PEHP amended the contract with vendor A to be terminated in April 2012. PEHP is going to have vendor A complete two projects under the amended contract by April 2012. The services that vendor E provides should also be competitively procured if PEHP determines that those services are still needed. PEHP has been utilizing vendor E since 2002 and has a perpetual contract in place.

By continuing to competitively procure supplies and services, PEHP will help ensure a fair, competitive process for selecting vendors.

A Procurement Management Process Has Been Implemented

Utah Retirement Systems (URS) has hired a managing purchasing agent to oversee procurement practices for URS and PEHP. New purchasing policies outline the purchasing agent's responsibilities that include the following:

- The purchasing agent is the point of contact for all procurement issues for PEHP.
- The purchasing agent is responsible to coordinate the request-for-quote (RFQ) and RFP quotes, evaluation discussions, and award processes with the responsible department head and purchasing committee.
- The purchasing agent is a non-voting member of each purchasing committee to assure the integrity of the purchasing process.

According to policy, the purchasing agent is responsible to review all purchases over \$1,000.

According to the new policy, the purchasing agent is responsible to review all contracts, agreements, and purchase requisitions valued over \$1,000 for required documentation and department approvals. All contracts and related documentation for a purchase, such as a decision matrix or financial analysis are imaged and stored within PEHP's financial accounting computer system as required by policy. This new process will help eliminate missing contracts.

All procurement related documents are imaged and stored in PEHP's computer system.

In addition, the new policy clarifies that the purchasing agent maintains and monitors the master contract list for inclusion of contract documents and contract expiration dates. Since the new

purchasing agent was hired in May of 2011, the purchasing agent began working on developing the master contract list. The purchasing agent has had discussions with the different departments within PEHP to identify vendors that provide supplies or services to PEHP, and the agent continues to review PEHP payment records for unknown vendors.

As of this follow-up audit, the purchasing agent believes that the master contract list is about 80 percent complete. The master contract list has improved significantly since the 2011 audit. At that time, PEHP did not have an accurate and reliable master contract list.

The master contract list has improved significantly since 2011 audit.

Evaluation Process Now Has Documentation

PEHP has improved the evaluation process for RFPs (procurements over \$50,000). Documentation related to such purchases is now electronically filed in a computer system by the purchasing agent. Since July 2011, PEHP has completed two RFP purchases. We reviewed both of those RFP purchases to determine if all documentation was available for the procurement evaluation process. Figure 2.3 below shows that the necessary documentation for both purchases has been retained.

Figure 2.3 PEHP Is Now Documenting the RFP Procurement Process. All documentation was available for both RFP purchases reviewed.

Document Description	RFP I	RFP II
RFP	X	X
Advertisement	X*	X
List of Respondents	X	X
Evaluation Process (Decision Matrix)	X	X
Notification Letters	X	X
Contract or Service Agreement	X**	X

**A public notice was not advertised for RFP I, but a notice was sent directly to 31 vendors to respond to the RFP.*

***PEHP is using the purchase order as the binding legal document between PEHP and the vendor.*

For both RFPs, we were able to obtain the necessary documentation to show that each purchase was procured competitively and fairly. PEHP has also significantly improved the vendor evaluation process.

We were able to obtain adequate documentation to show that two new RFPs were procured competitively.

The 2011 audit of PEHP found that documentation for the evaluation process was not adequate. Since then, however, PEHP has

PEHP now uses pre-determined criteria and a decision matrix to determine to rank proposals.

developed an adequate evaluation process along with documentation that adheres to best practices. PEHP now:

- Establishes a purchasing committee for each RFP
- Develops pre-determined criteria for selecting a vendor
- Uses a decision matrix or scoring sheet for the purchasing committee to rank vendors' proposals
- Documents or summarizes the evaluation

The decision matrix was only partially completed for RFP I, but that procurement's documentation did include a summary sheet to help explain why two vendors were selected. The decision matrix for RFP II was based on price. A third RFP, that has not been awarded yet, used a decision matrix that was complete with criteria and each member of the purchasing committee scored the matrix for each respondent. The purchasing agent summarized the decision matrix, which clearly showed why the successful vendor was selected. We recommend that, to clearly document the evaluation process, PEHP continue to use a similar decision matrix in evaluation processes when using criteria other than price. Documentation is important because it legitimizes the contracts' validity in case of a challenge about conflicts of interest or inappropriate contract awards.

Perpetual Contracts Have Been Reduced

Eight of PEHP's contracts were perpetual, but PEHP is reducing that to four perpetual contracts.

The 2011 audit found concerns with 15 vendor contracts. This follow-up audit shows that PEHP is working to resolve those concerns. Eight vendor contracts were perpetual, but PEHP is in the process of terminating or has terminated three of them. Contracts were missing for six vendors, but PEHP is discontinuing or has discontinued services with five of them and has one new contract in place with the other vendor.

Figure 2.4 shows 15 of PEHP's vendor contracts with which the 2011 audit found concerns. The figure shows the contracts' beginning date and termination provision. We reviewed the 15 vendors for this follow-up audit and show the current status of each contract in the figure.

Figure 2.4 Vendor Contract Concerns Are Being Resolved by PEHP.

The 2011 audit identified concerns with 15 of PEHP’s vendor contracts. As of this follow-up audit, concerns with 12 contracts have been resolved, but contracts with vendors B, E, and P remain perpetual.

Vendor	Contract Date	Contract Terms	Current Status
A	2004, 2009	Perpetual	Termination in April 2012
B	2004	Perpetual*	Perpetual*
C	2006	Perpetual	Termination in June 2012
D	2004	Perpetual	Terminated
E	2002	Perpetual	Possible Termination
F	No Contract	n/a	Termination in June 2012
G	No Contract	n/a	Termination in June 2012
H	No Contract	n/a	New One-Year Contract
I	2006, 2010	One year	New Two-Year Contract
J	No Contract	n/a	Inactive Vendor
K	No Contract	n/a	Inactive Vendor
L	No Contract	n/a	Inactive Vendor
P	2004	Perpetual	New Perpetual Contract
Q	2002	Perpetual	Inactive Vendor
S	2000	Perpetual	Termination in June 2012

**As new ancillary five-year contracts are added, the master contract term is extended to cover the individual five-year contracts. The most recent schedule extended the termination date of the master contract to 2016, but the terms of the master contract automatically renew for successive one-year periods.*

The three vendors with perpetual contracts are a concern. Vendor B has been sole-sourced. (A sole-source vendor is a supplier that is the only qualified source for an item or service or the single source where specific expertise or specialized supplies can be obtained.) PEHP has multiple contracts with vendor B. However, the master contract terms are perpetual and will continue as long as other ancillary contracts are in place. PEHP is deciding whether to terminate business with vendor E. Vendor P was given a new perpetual contract beginning July 2011, but the electronic file showed no documentation of a sole source justification or a competitive procurement. PEHP recognizes vendor P should not have had a perpetual contract. PEHP has stated they are going to resolve these perpetual contracts.

Of the six vendors without contracts (vendors F, G, H, J, K, and L), PEHP has not done business with three of them (vendors J, K, and L) in 2011. The purchasing agent said that PEHP would not do business with those vendors in the future unless they were awarded a new contract through a new competitive procurement process. Two of the vendors (F and G) will be terminated in June 2012, which will give PEHP the time to complete a new RFP process for those services.

Contracts were missing for six vendors, but PEHP is discounting or has discontinued service with five of them. A new contract is in place for the other vendor.

One vendor was given a new perpetual contract beginning July 2011.

PEHP stated that they would not do business with inactive vendors, unless they were competitively procured.

Vendor H was awarded a new contract as a result of a competitive procurement process.

Procurement Policies Are in the Process of Being Strengthened

When we reviewed the seven new RFP procurements, we found that a notice had not been publicly advertised for three of them. URS purchasing policies should require RFPs to be publicly advertised to help increase the number of vendors that respond to the RFP. Though PEHP has reduced the number of perpetual contracts from eight to three since the last audit, purchasing policies should require all contracts to have an expiration date. Both of these recommendations were made in the 2011 audit, and, as a result of this follow-up audit, PEHP now plans on making these changes to policy. PEHP has also updated its purchasing policies related to sole source justification, so that sole source vendors must be justified every two years.

PEHP plans on making additional changes to the procurement policies.

Purchasing Policies Should Require RFPs to Be Publicly Advertised

The 2011 audit of PEHP found that URS' purchasing policies on RFP advertisement was weak compared to the *Utah Code*, the *Utah Administrative Code*, and other states' RFP publication practices. For this audit, we reviewed seven RFP purchases since July 2011 that should have been advertised, and found that PEHP publicly advertised three of the seven RFPs. When purchasing policies were updated, publicly advertising RFPs was not included in policy. After discussing this recommendation with the purchasing agent, the purchasing agent agreed that language should be added to URS' purchasing policies to require public advertisement of all RFPs. The executive director of URS will need to approve the modification to the purchasing policies. As of the writing of this report, current purchasing policies do not mention the public advertisement of all RFPs, but requiring the public advertisement of all RFPs will help ensure a competitive vendor selection process.

PEHP only publicly advertised three of the seven RFPs created since July 2011.

PEHP is joining BidSync to advertise procurements to attract potential vendors that have not been receiving notice of RFPs directly from PEHP. BidSync is an internet program that publishes state, local,

and federal RFPs and bids on a nationwide basis. Currently, PEHP publishes in a newspaper of local circulation and directly notifies potential vendors about RFPs. The purchasing agent requests five responses for each RFP purchase over \$50,000, and three responses for each competitive bid. The only exception is if the vendor is a sole source provider.

Purchasing Policies Need to Include Contract Terms

The 2011 audit of PEHP reviewed 21 vendors. Of those vendors, seven did not have contracts. Of the 14 vendors with contracts with PEHP, 8 of the contracts were perpetual. That audit recommended that URS strengthen its purchasing policies to require contract terms to be explicit and have a definite expiration date. As of this audit, three contracts remain perpetual.

URS purchasing policies do not require a definite contract expiration date. The current policies state, “a contract for supplies or services may be entered into for any period considered to be in the best interest of URS.” Best practices for contract management suggest periodic review of contracts. The general criteria we recommended in the 2011 audit was a common time frame for contracts of three years. We recommend that contract expiration language be added to the purchasing policies, and the purchasing agent plans on making this change. In addition, current purchasing policies require the length of the contract for each vendor contract to be tracked in the master contract list, which will also help provide a control to reduce the existence of perpetual contracts.

New Purchasing Policies Do Not Allow for Automatic Renewal of a Contract. Best practices for contract management recognize that options to renew or extend a contract vary, but generally, options to renew do not run longer than three years. URS’ purchasing policies have been updated to provide criteria stating when contracts should be automatically renewed or extended rather than competitively bid. URS’ purchasing policies now state:

Before exercising any option for renewal or extension of a contract, the department head must ascertain whether a competitive procurement is practical, in terms of pertinent competitive and cost factors, and whether new procurement

PEHP is joining BidSync to publish RFPs on a nationwide basis.

Purchasing policies do not require a definite contract expiration date.

The length of a contract is now tracked in the master contract list.

would be more advantageous to URS than renewal or extension of the existing contract. The department head must supply documentation that validates the reason for the contract extension.

The purchasing agent has the responsibility to determine if a contract extension is appropriate.

The purchasing agent has the responsibility to determine if the documentation that validates the reasons for the contract extension is adequate. Also, office approved vendors are no longer allowed according to policy. This will also help reduce the automatic extension of vendor contracts because office approved vendors meant they didn't need to be competitively bid.

Sole Source Purchasing Policies Have Been Amended

Current URS purchasing policies define a sole source vendor as a "supplier that is the only source for an item or service or the single source where specific expertise, specialized capabilities, compatibility of equipment, accessories, replacement parts, and/or service is the paramount consideration to meet URS requirements." The URS purchasing policies have been updated to require public notice of a sole source award when a contract exceeds \$50,000.

Purchas policies now state that a sole source vendor has a maximum two-year term.

Also, URS sole source policy has been updated to limit the use of a sole source vendor for a maximum two-year term. At the end of the two-year term, a new sole source application and documentation must be submitted to justify using the sole source vendor again. The two-year term requirement is in place to allow for review of market and technology changes, current pricing, available competition, and vendor performance.

All sole source vendors are rejustified at the end of the contract period.

In some situations, a sole source vendor may require a longer contract period than a two-year term. According to policy, when this situation occurs, the sole source vendor will need to be rejustified at the end of contract period. Terminating a contract early would likely require PEHP to pay expensive early termination fees.

If a department within PEHP is going to use a sole source supplier, the department head must complete a sole source supplier application. This form must be reviewed and signed by the purchasing agent. In addition to the form, the department head must provide a pricing evaluation to the purchasing agent to show that the supplier

pricing is reasonable for the items or service. PEHP does not have a current list of all the sole source vendors in use. We reviewed three sole source vendors and found that PEHP had a sole source supplier application completed and signed for two of the three vendors. PEHP did not have documentation of why the third vendor was not competitively bid.

Below are listed the recommendations to improve PEHP's procurement process. These same three recommendations were made in the 2011 audit of PEHP. We believe that PEHP needs to fully implement these recommendations to ensure the procurement process is fair and fosters competition.

Recommendations

1. We recommend that PEHP terminate perpetual contracts with vendors and require that all contracts have a specific termination date.
2. We recommend that PEHP continue to use a decision matrix in the evaluation process of responses to all RFPs.
3. We recommend that URS policies be amended to require all contracts to have a termination date and all RFPs to be publicly advertised.

PEHP did not have documentation of why a vendor, with a new contract, was not competitively bid. However, PEHP stated that they are going to resolve this concern.

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Chapter III

PEHP's Business Practices Recommendations Are in the Process of Implementation

Public Employees Health Program (PEHP) is implementing the business practices recommendations made during the 2011 performance audit. However, we found that some risk pools still have reserve deficits and the Utah Retirement Systems (URS) board has not yet refunded excess reserves back to three risk pools. During the past fiscal year, the total excess risk pool reserves increased by \$34.9 million and now total over \$70 million. Finally, the Legislature needs to determine if the State of Utah risk pool should continue to participate in PEHP's reinsurance program or obtain individual reinsurance coverage from an external insurer.

Figure 3.1 lists the recommendations related to PEHP's business practices, the recommendation status and a brief explanation. More details on selected issues follow Figure 3.1.

Figure 3.1 Status of Business Practices Recommendations from the 2011 Performance Audit. Of the eight recommendations, one recommendation was implemented, five are in the process of implementation, and two await legislative action.

Recommendation	Status	Explanation
We recommend that PEHP adhere to Utah Code and not allow risk pools to run reserve deficits.	In Process	PEHP is working with risk pools to resolve reserve deficits and recently settled with Utah County and Provo City.
We recommend that PEHP either adjust the language in their contracts to charge risk pools with deficit late fees equal to market returns or adhere to the current language found in their contracts.	In Process	PEHP's new contracts clarify the reserve deficit charge. However, the new contracts will not take effect until after the next contract renewal cycle.
We recommend that PEHP adhere to Utah Code and develop actuarially sound reserve requirements for each risk pool.	In Process	PEHP has established a range of reserve levels for risk pools but reserve requirements are not yet specified in contracts.

Six of the six recommendations addressed to PEHP were implemented or are in the process of being implemented.

Recommendation	Status	Explanation
We recommend that if reserve levels exceed the required amount, the URS board should approve a refund back to the risk pool or reduce future premiums to lower excess reserves.	In Process	PEHP has identified risk pools with excess reserves but still needs to determine how they will refund the excess funds to the state and USBA.
Regarding reinsurance, we recommend that PEHP prospectively quote reinsurance rates, actuarially determine stop-loss deductible levels by risk pool, and examine the cost benefit of external reinsurance by each risk pool.	In Process	Prospective reinsurance rates are not yet specified in contracts. However, PEHP obtained actuarial studies which outline adequate reserve levels for risk pools and potential external reinsurance costs for risk pools.
We recommend the Legislature determine if the state risk pool should self-fund reinsurance or allow the current practice to continue where the state risk pool is a part of PEHP's reinsurance pool.	Not Implemented	Legislative leaders have not determined if the state risk pool should obtain external reinsurance. Additional detail is provided in this chapter.
We recommend that the Department of Insurance perform a biennial audit of PEHP rather than accepting audited financial statements in lieu of an audit.	Implemented	The Department of Insurance completed a financial audit on October 2011 and recommended that PEHP require risk pools to maintain adequate reserves.
We recommend the Legislature amend Utah Code 49-20-405 and grant the Department of Insurance the authority to require PEHP to comply with a written improvement plan if issues arise in the biennial audits.	Not Implemented	The Legislature has not taken any action on this recommendation.

Figure 3.1 shows that the majority of recommendations are in the implementation process. Although additional follow-up is needed, in the next sections we have included supplementary information concerning risk pool reserve levels, excess reserve refunds, and reinsurance changes.

PEHP Still Needs to Eliminate Risk Pool Reserve Deficits

Although reserve deficits have decreased since the 2011 legislative audit, five risk pools still had reserve deficits which totaled \$4.3 million at the end of the 2011 fiscal year. PEHP plans to eliminate all contingency reserve deficits within the next few years and recently reached a settlement with Utah County and Provo City. During the past year, two risk pools (Department of Health and Nebo School District) have left PEHP and the Salt Lake County risk pool intends to leave PEHP in April 2012. As a result, the number of individuals enrolled in PEHP's medical program has dropped by 24 percent since 2007.

Reserve Deficits Have Decreased Since Legislative Audit

At the end of the 2010 fiscal year, seven risk pools had contingency reserve deficits totaling over \$8.4 million. During the past year, the reserve deficit amount has been reduced by \$4.1 million, but six risk pools had contingency reserve deficits at the end of the 2011 fiscal year. Figure 3.2 displays the updated contingency reserve levels for 2011.

Six risk pools had reserve deficits totaling over \$4.3 million at the end of the 2011 fiscal year.

Figure 3.2 Updated Risk Pool Contingency Reserves of the 2011 Audit. As of June 30, 2011, six risk pools still had contingency reserve deficits totaling \$4.3 million.

Medical Risk Pools:	2007	2008	2009	2010	2011
State of Utah	\$34,301,501	\$48,838,921	\$41,986,627	\$61,081,636	\$84,777,640
SL County	2,477,102	1,869,392	61,283	(591,459)	(50,702)
SLC	(1,343,639)	(2,618,052)	(4,952,596)	(4,074,077)	(2,153,779)
Dept of Health	(1,539,429)	(2,316,877)	2,778,623	1,938,270	1,438,108
LGRP ¹	8,659,204	14,617,505	17,503,367	23,114,506	31,797,368
Provo City	(558,281)	(24,849)	(368,309)	(437,554)	(455,580)
Utah County	(394,360)	(942,034)	(1,244,677)	(1,410,917)	(1,468,663)
USBA ²	2,513,864	3,488,878	5,039,124	6,992,231	7,337,337
Jordan SD	(549,268)	(550,526)	(401,287)	(96,321)	101,264
Nebo SD	2,266,845	1,979,942	385,211	(1,693,955)	(61,569)
Canyons SD	-	-	-	(106,810)	(154,959) ³
Total	\$44,066,735	\$63,884,690	\$61,011,876	\$84,715,550	\$121,106,465

Source: PEHP Financial Statements

¹ Local government risk pool

² Utah School Board Association

³The Canyons School District had over \$434,000 of additional reserves at the end of June 30, 2011 and did not have an actual contingency reserve deficit. The resulting total contingency reserve deficit for PEHP's risk pools is \$4.1 million.

The five risk pools which are shaded blue have either left or plan on leaving PEHP; Nebo School District and the Department of Health (Children's Health Insurance Program) are in a run-out phase (a year-long period for all pending claims to be processed and paid) and Salt Lake County will terminate its insurance with PEHP in April 2012. According to PEHP, these three risk pools should not have contingency reserve deficits after their yearlong claims run-out period.

As reported in the 2011 audit, the Provo City and Utah County risk pools left PEHP with reserve deficits on January 1, 2009. PEHP recently agreed to a settlement with Utah County and Provo City.

PEHP Has Settled Deficits With Utah County and Provo City

In October 2011, PEHP and Utah County reached a settlement and two months later, PEHP reached a settlement with Provo City. Both settlements were below Utah County's and Provo City's contingency reserve deficit amount. The funds used to reimburse PEHP for settlement reductions came from URS' internal fiduciary

PEHP has recently settled with Utah County and Provo City.

liability fund and PEHP's reinsurance risk pool. PEHP pays annual premiums into URS' liability fund to cover its error and omissions expenses while risk pool reinsurance premiums contribute to reinsurance reserves. Ultimately, risk pools participating in PEHP's medical program paid for the settlement and were penalized for PEHP's poor business practices. The settlement would not have occurred if PEHP had followed *Utah Code* and not allowed risk pools to accrue reserve deficits.

Salt Lake City Reserve Deficit Should Be Eliminated in the Near Future

At the end of the 2010 fiscal year, the Salt Lake City risk pool had the largest reserve deficit of \$2.1 million (Figure 3.2). PEHP and Salt Lake City have implemented three changes to the city's medical coverage in 2011 to reduce their deficit:

- 1.6 percent reserve building premium component (\$540,000 deficit reduction)
- Payroll deficit surcharge (\$1,600,000 deficit reduction)
- Single network (\$1,000,000 deficit reduction)

Although the city has applied changes to resolve its deficit with PEHP, additional measures will need to be taken in the future to build the city's risk pool reserves to actuarially sound levels.

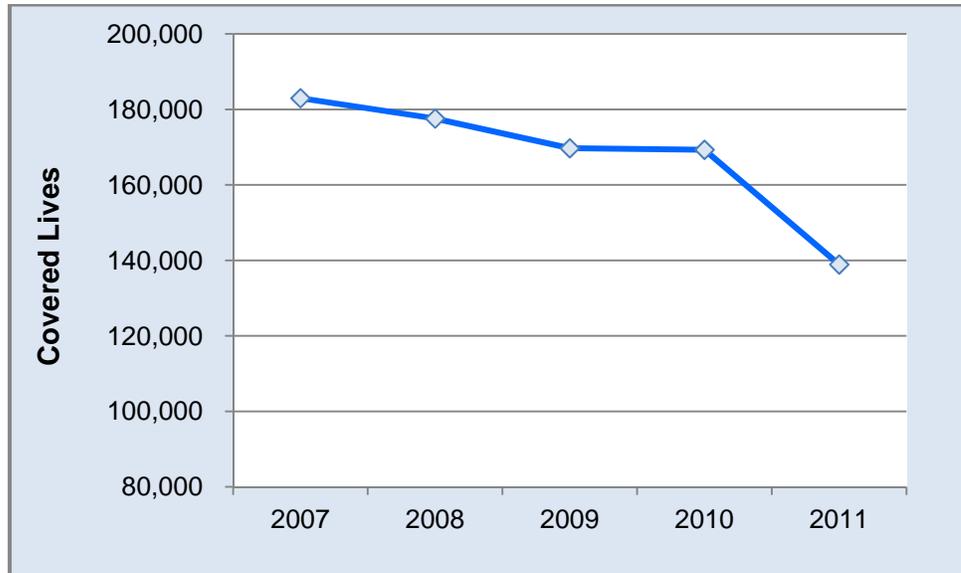
Departure of Risk Pools Has Reduced PEHP Business

As discussed earlier, many risk pool have left or plan to leave PEHP. Figure 3.3 displays the five-year trend of covered lives enrolled in PEHP's medical line of business.

Salt Lake City plans to implement three cost saving changes to its medical coverage in order to reduce its deficit.

Figure 3.3 Four-Year Trend of PEHP’s Medical Program Enrollment.
The number of medically covered lives has dropped from over 182,000 in 2007 to less than 139,000 in 2011 (a 24 percent decrease).

The number of covered lives in PEHP’s medical program has dropped by 24 percent over the past four years.



Source: PEHP 2011 Financial Statements

The number of covered lives enrolled in PEHP’s medical line of business has steadily declined during the past four years. When Salt Lake County leaves PEHP in April 2012, the number of covered lives will drop even further (in terms of annual premiums paid, Salt Lake County is the third-largest risk pool, behind the state of Utah and local government risk pools). The effect is that future administrative rates for risk pools may be higher since costs would be spread among fewer individuals enrolled in PEHP’s medical program.

URS Has Not Refunded Excess Contingency Reserves

In the 2011 audit, we recommended that the URS board refund excess reserves back to the state of Utah, LGRP, and USBA risk pools. However, PEHP had not determined adequate reserve levels for risk pools, which resulted in the Legislature directing the Legislative Auditor’s Office to oversee an actuarial study of the state of Utah contingency reserve. In addition, the URS board has not yet determined how they will refund excess reserves that have grown from \$35 million to over \$70 million during the past fiscal year.

State of Utah Risk Pool Should Maintain a 50-Day Contingency Reserve. Auditors asked Milliman, Inc. to conduct an actuarial study of the state of Utah risk pool reserve requirements to cover the various risks of the state’s benefit plan. Based upon the Milliman report, we recommended in the *Actuarial Study of PEHP’s Contingency Reserves* (Report 2011-06) that the Legislature implement at least a 50-day contingency reserve for the state’s medical risk pool. As of this follow-up, that recommendation has not been implemented. Since the 2011 audit, PEHP has commissioned Milliman to perform an actuarial study of other risk pool contingency reserves, but required reserve levels have not yet been established.

The state of Utah risk pool should maintain a 50-day contingency reserve.

Excess Reserves Have Increased by \$35 Million Since 2010. Excess risk pool reserves have significantly increased during the past fiscal year. Figure 3.4 displays the 2010 excess reserve levels for the three risk pools as reported in the audit and the revised 2011 fiscal year totals.

Figure 3.4 Updated Potential Reserve Refunds. The total excess reserves for the three risk pools was \$34.9 million at the end of the 2010 fiscal year and increased to over \$70 million during the 2011 fiscal year.

Medical Risk Pools	Contingency Reserve on 6/30/2011	Required Reserve	Possible Refund Amount	2011 Audit Refund Amount
State of Utah	\$84,777,640	\$38,229,977 ¹	\$46,547,663	\$19,235,636
LGRP	31,797,368	\$11,299,624 ²	\$20,497,744	\$12,810,506
USBA	<u>7,337,337</u>	<u>\$3,949,641²</u>	<u>\$3,387,696</u>	<u>\$2,895,231</u>
Total	\$123,912,345	\$61,125,237	\$70,433,103	\$34,941,373

At the end of the 2011 fiscal year, the state of Utah risk pool had over \$46.5 million of excess reserves.

Source: PEHP financial statements

¹ The 2011 legislative contingency reserve audit recommended that the state of Utah risk pool maintain a 50-day contingency reserve.

² A recent Milliman report recommends a range of reserve levels, depending on a risk pool’s appetite for risk. To stay consistent with the 2011 legislative audit report, we use a 60-day reserve level.

At the end of the 2010 fiscal year, the state of Utah risk pool had \$19.2 million in excess reserves. Over the past year, the state of Utah risk pool’s excess reserves have doubled and the URS board could refund over \$46.5 million. Additional follow-up is needed in this area to ensure that PEHP and the URS board comply with state statute and refund excess reserves to risk pools. In the *Actuarial Study of PEHP’s Contingency Reserves* (Report 2011-06), we recommended that the Legislature determine what to do with the state’s excess reserves.

As of this follow-up audit, that recommendation has not been implemented.

Legislature Needs to Determine Appropriate Reinsurance Coverage for State of Utah Risk Pool

Since the release of the 2011 audit, PEHP has worked with a consultant to determine adequate reinsurance coverage levels for risk pools. PEHP plans to overhaul its current reinsurance coverage to charge different reinsurance premiums depending on a risk pool's risk tolerance and past claims experience. The state of Utah risk pool should determine if they will continue to participate in PEHP's reinsurance coverage or obtain external reinsurance.

Cost of Reinsurance Will Depend on Stop-Loss Reinsurance Levels and Experience of Risk Pools

PEHP maintains a separate risk pool for reinsurance purposes. Risk pools participating in PEHP's reinsurance coverage pay premiums into the risk pool and all large specific claims are paid with reinsurance funds. In turn, PEHP obtains reinsurance for specific claims above \$1 million from an external insurance company.

Under PEHP's current reinsurance structure, all risk pools have the same specific stop-loss reinsurance levels and all reinsurance premiums and claims are pooled together. We recommended in the 2011 audit that PEHP needs to actuarially establish stop-loss reinsurance levels based on risk pool characteristics and desired assumption of risk. PEHP hired a consultant to review this issue; Figure 3.5 outlines the consultant's recommended range of specific stop-loss reinsurance levels by risk pool.

Figure 3.5 Range of Specific Stop-Loss Reinsurance Levels Should Be Specified. According to the consultant's study, the state of Utah risk pool's specific stop-loss reinsurance level should be between \$250,000 and \$650,000.

Risk Pool	Range of Specific Stop-Loss Reinsurance Levels	
	Low	High
State of Utah	\$ 250,000	\$ 650,000
Salt Lake City	\$ 100,000	\$ 225,000
Salt Lake County	\$ 100,000	\$ 225,000
USBA	\$ 100,000	\$ 175,000
LGRP	\$ 100,000	\$ 200,000
Jordan School District	\$ 100,000	\$ 225,000
Canyons School District	\$ 100,000	\$ 175,000

Source: Milliman study completed in August 2011

PEHP plans to change its reinsurance coverage and allow risk pools to set individual stop-loss reinsurance levels. If risk pools decide to raise their specific stop-loss reinsurance level, they will have higher claims costs but lower reinsurance premiums. In addition, PEHP will evaluate risk pools' reinsurance experience and require higher premiums from riskier pools.

PEHP Plans to Prospectively Charge Reinsurance and Administrative Rates. Before the 2011 legislative audit, PEHP retrospectively charged reinsurance and administrative expenses to risk pools. In turn, some risk pools were unable to pay for additional reinsurance and administrative costs, which contributed to risk pools' reserve deficits. During the next contract renewal cycle, PEHP hopes to establish all rates in contracts, thus eliminating any ambiguity.

PEHP's proposed reinsurance changes represent a good step toward fairness between reinsurance usage and cost. However, risk pools' reinsurance premiums and claims would still be grouped together and PEHP's reinsurance coverage would not follow a true self-funded model. As discussed in the next section, the state of Utah needs to determine if they should obtain separate reinsurance coverage.

PEHP plans to modify reinsurance premiums charged to risk pools, depending on a risk pools' specific risk tolerance and claims experience.

State of Utah Risk Pool Should Determine Reinsurance Needs

In the 2011 legislative audit, we recommended that the state of Utah risk pool consider adopting a self-funded model and obtain individualized reinsurance rather than participate in PEHP's reinsurance program. The previous audit found that reinsurance expenses are spread among the risk pools that participate in PEHP's reinsurance coverage. From fiscal years 2006 to 2010, the state paid \$4 million more in reinsurance premiums than accrued in reinsurance claims.

Reinsurance premiums belong to the reinsurance pool and may be used to cover reinsurance claims for the state and other employer groups that participate in PEHP's reinsurance. The state of Utah risk pool is significantly larger than any other risk pool and its departure would likely increase other risk pools' reinsurance costs. As long as the state participates in PEHP's reinsurance pool, there is a potential that the state's premiums will be used to cover other risk pools that participate in PEHP's reinsurance. A less likely effect is that other risk pools reinsurance premiums may be used to cover the state.

If the state of Utah decided to obtain external reinsurance, the premiums for reinsurance coverage may increase; according to PEHP management, external reinsurers charge a 30 percent premium on reinsurance rates. PEHP has also stated that if the state obtained external reinsurance, the state risk pool would forfeit any claim to reserve funds held in PEHP's reinsurance risk pool. However, the state of Utah risk pool's reinsurance premiums and claims would not be pooled with other risk pools.

Recommendations

1. We recommend that PEHP continue to eliminate risk pool deficits and require risk pools to maintain actuarially sound contingency reserve levels.
2. We recommend that the URS Board exercise its authority under *Utah Code* and refund excess reserves back to risk pools.

3. We recommend that the Legislature determine whether the state risk pool should self-fund reinsurance or allow the current practice to continue, whereby the state risk pool is a part of PEHP's reinsurance pool.

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Chapter IV

PEHP Pharmacy Program

Has Addressed Most Recommendations

The 2011 performance audit concluded that the Public Employees Health Program's (PEHP's) pharmacy program needed adjustments to ensure members' needs were being met fairly and objectively. The Pharmacy and Therapeutics (P&T) Committee makes the important decisions regarding the prescription formulary (medication coverage); therefore, our 2011 report stated that PEHP required better processes and rules in this area to ensure that its members' needs are fairly addressed. PEHP is implementing most of the recommendations but still needs to implement an independent review of the prior authorization and co-pay criteria for the pharmacy department.

PEHP has shown progress in implementing recommendations made in the prior audit. Of the four recommendations on the pharmacy program, three have either been implemented or are in the process of being implemented. One recommendation has been partially implemented. Figure 4.1 outlines the recommendations made in the prior audit and the status of these recommendations.

Figure 4.1 Status of Pharmacy Area Recommendations. Two of the four recommendations have been implemented, one is partially implemented, and one is in the process of being implemented.

Recommendation	Status	Explanation
We recommend PEHP create a Pharmacy and Therapeutics (P&T) committee oversight document which outlines meetings, committee make-up, conflict of interest statements, and signed and dated committee minutes.	Implemented	The pharmacy department has developed and documented policies and procedures for the P&T committee that outline and address the recommendations made in the audit.
We recommend PEHP revise the current P&T Committee Agreement to include disclosure provisions on the acceptance of monies by individual members of the committee by pharmaceutical manufacturers.	Implemented	PEHP has developed a conflict of interest disclosure form.

The 2011 audit stated that PEHP needed to improve processes and rules so members' needs are reasonably addressed.

Recommendations to create a P&T committee oversight document and disclosure provision have been implemented.

Recommendations for PEHP to provide greater oversight have been partially implemented and strengthening the independence of the rebate function is in process.

Recommendation	Status	Explanation
We recommend PEHP provide greater oversight to the pharmacy program by reviewing the responsibilities of the pharmacy director, define the director's role as it relates to the P&T committee, and independently reviewing co-pay and prior authorization criteria rules.	Partially Implemented	Currently a Health Policy Committee is the reviewer for both points; however, this committee is not independent because, the medical director, who participates in the initial changes of formulary and master policy changes, for the pharmacy department, is a voting member.
We recommend PEHP consider having the rebate function handled by an internal section which is independent from the Clinical Department.	In Process	In addition to the pharmacy director, PEHP will have independent members from management (outside of the pharmacy department) participate in the negotiations for rebates.

According to Figure 4.1, PEHP has implemented documented policies and procedures for the P&T committee, which now includes a conflict-of-interest disclosure. PEHP has not independently verified the prior authorization and co-pay criteria used by the pharmacy department. PEHP is in the process of adding independent members of management (not in the pharmacy department), to participate in the negotiations for rebates with prescription drug manufacturers.

P&T Committee Has Adopted Policies and Procedures

PEHP has strengthened the P&T committee by creating a document that outlines its responsibilities. The new document provides guidance for committee composition, member selection, and credentials of individual members, as well as other policies that will provide greater independence and accountability. The P&T committee is an interdisciplinary committee charged with determining a safe, effective, and cost-effective way to administer the prescription benefit.

P&T Committee's Responsibilities Have Been Formalized

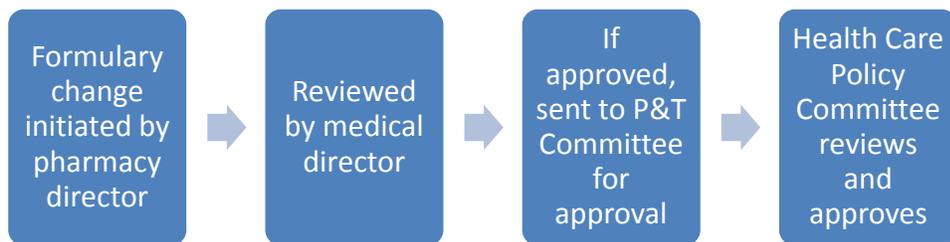
The pharmacy director currently manages the P&T committee, which is composed of independent doctors and pharmacists. The

P&T committee's documentation advises who can participate, what credentials are required, and how the committee will be formed.

biggest role the P&T committee plays is assisting with decisions on the medications that will be covered by PEHP. The formulary is the list of medications that PEHP allows its members to access.

The prior process, by which the P&T committee made changes to the formulary using a mini-P&T committee, has been eliminated. Prior to the audit, the mini-P&T committee would decide whether changes to the formulary were necessary and then send the changes to the P&T committee. The members of this mini-P&T committee had voting rights on the formal P&T committee, potentially introducing bias in the process. Currently, the process is initiated by the pharmacy director. Figure 4.2 shows the new process of changing the formulary.

Figure 4.2 New Approval Process for Formulary Change. The mini-P&T committee has been replaced by the medical director deciding what changes to forward to the P&T committee for consideration.



Approval for any changes to the formulary must be authorized by the health care policy committee.

The differences between the former process and the current process is that the pharmacist and the medical director do not have voting privileges on the P&T committee, which increases the independence of that committee.

In the prior audit, the P&T committee had the authority to change the formulary and to add or remove prior authorizations for specific prescription drugs. Now the P&T committee forwards all recommendations to a health policy committee, at which point a final decision is made whether to implement those recommendations.

The pharmacy department has now created and documented rules by which the P&T committee shall function. The policy and procedures outline the following:

P&T committee policy and procedures now include: schedule of meetings, member selection, procedures to accept committee members, conflict of interest statements.

- Schedule of meetings
- Composition of committee, member selection, and required credentials
- Procedure for approval/acceptance of committee members
- Conflict of interest statements
- Requirement for signature and date on committee minutes

These newly implemented policies help establish accountability and independence and help increase the effectiveness and safety of formulary changes.

Disclosure Provision Implemented For P&T Committee Members

A conflict-of-interest form existed when the prior audit was done; however, the form required strengthening. Specifically, disclosures were needed of any affiliations that might influence a committee member's vote. In the prior audit, we stated the following:

[The conflict of interest form] is lacking in essentials needed for protections of the health plan against outside influence of pharmaceutical manufacturers... [Strengthening the conflict of interest form can help prevent] inappropriate formulary placement of medications by members with financial interests outside that of the health plan.

PEHP has created a conflict of interest disclosure form that must be completed by all members of the P&T committee. PEHP requires P&T committee applicants and members to disclose any financial interest or affiliation with organizations that may have a direct or indirect interest in the business before the committee. This disclosure reduces the risk of inappropriate placement of medications in the formulary by members with financial interests outside that of the health plan.

PEHP Has Defined Pharmacy Director's Role as it Relates to P&T

The prior audit recommended that management should review the role and responsibilities of the pharmacy director and better define the

PEHP's conflict of interest disclosure form is required to be filled out by all committee members.

director’s duties pertaining to the P&T committee. The policy and procedures for the P&T committee states:

“...[T]he P&T Committee and meetings are pharmacy functions, the Director of Pharmacy is responsible for all meeting related duties including but not limited to: preparation of meeting materials, meeting notification, conducting the meeting, etc.”

We found that this recommendation has been implemented and that the pharmacy and medical directors are not voting member of the P&T committee. All recommendations presented to the P&T committee will be voted on by a minimum of five members (PEHP employees are not committee members and do not vote).

Management Still Needs to Provide Greater Oversight for the Pharmacy Department

At the time of the prior audit, the pharmacy director had sole responsibility to make pharmacy benefit rules. Our report recommended that PEHP provide greater oversight to the pharmacy program, by independently reviewing prior authorization and co-pay criteria to assure that rules are safe, effective, and fair; the recommendation included amending the master policy to reflect these changes. Management currently utilizes a health policy committee to perform the above mentioned reviews. However, the composition of this committee does not provide the independence the audit recommended. Specifically, the inclusion of PEHP’s chief medical officer has brought greater subjectivity to the committee’s mission.

Health Policy Committee Lacks Independence

Currently, any changes recommended by the pharmacy department must be initially approved the chief medical officer, as shown in Figure 4.2. If the P&T committee approves additional changes, the chief medical officer is once again involved in deciding whether the change(s) submitted by the P&T committee should be approved. The

Pharmacy and medical directors are no longer voting members on the P&T committee, which occurred in the 2011 audit.

The health policy committee does not provide independence to review changes initiated by the pharmacy department.

medical director's active participation decreases the independence of the committee and is unnecessarily redundant.

The P&T committee provides the independence required in making unbiased decisions since its members are not employed by PEHP, and the committee is also guided by policy and procedures. Decisions sent to the P&T committee should not require further approval.

All Prior Authorizations Should Be Approved by P&T

The prior audit, it was found that some prior authorization requirements were too cumbersome to allow reasonable access to certain medications, and that a balance between cost and fair service was not always being achieved. The pharmacy department currently reviews prior authorizations to increase accessibility to certain medications.

During this follow-up, we found that the P&T committee reviewed prior authorizations for approval, then further review and approval by the Health Policy Committee. The new process is improved and enhances services. For example, a particular drug that treated cancer required the PEHP member to try one or more other prescriptions before approval would be given for the use of this drug. However, once the P&T reviewed the criteria for this drug, it was agreed that taking trial medication before approval was unnecessary and should be done away with.

The pharmacy department's ability to review and decide if prior authorization criteria require changes is sufficient and adequately independent. Any changes to prior authorization criteria should go through the P&T committee. Once the P&T committee has agreed to any changes, further review by the health policy committee should not be necessary.

The P&T committee provides adequate review for prior authorizations for approval.

PEHP Is Addressing Concerns With Rebate Function

The prior audit, reported that the pharmacy department was able to negotiate rebate contracts with manufacturers, allowing potential for inappropriate payments from a manufacturer for putting particular medications on the formulary. Greater oversight was required to reduce the opportunity for fraudulent activity. PEHP is implementing a policy that requires a member of management, not in the same department, to be present during negotiations with vendors, such as pharmaceutical manufacturers.

Providing oversight in the negotiation process will minimize the ability for pharmaceutical manufacturers to influence PEHP in medication placement on the formulary. PEHP believes that having another department's manager participate in the negotiations with vendors will alleviate this risk. PEHP is in the process of providing procedures and policies for rebate negotiations. We agree with these steps.

Recommendations

1. We recommend that PEHP allow the P&T Committee to make the final decisions regarding safety and efficacy changes initiated by the pharmacy department, as opposed to the Health Policy Committee.
2. We recommend that PEHP allow the pharmacy department to change and implement all prior authorization criteria on issues of safety and efficacy once they have been reviewed by the P&T Committee.

PEHP is in the process of requiring a member of management, not in the same department, to participate in negotiations with pharmaceutical manufacturers.

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Chapter V

PEHP's Appeals Process Has Improved

Utah's Public Employees' Health Program (PEHP) has made changes to its appeals process, restructuring it to include more clinical expertise. Both the internal and external reviews consist of board-certified physicians who review denied medical claims. PEHP has also begun to monitor appeals and track appeals trends. In addition, PEHP has begun auditing claims adjudication at the disputed claim level, where most denied claims are resolved.

Figure 5.1 lists the 2011 audit's recommendations related to the appeals process, the recommendations' status, and a brief explanation of PEHP's efforts to implement the recommendations.

Figure 5.1 Status of Prior Appeals Process Recommendations. All five recommendations have been fully implemented.

Recommendation	Status	Explanation
We recommend that PEHP establish a formalized audit function at level one of the appeals process.	Implemented	PEHP is auditing the decisions made at the disputed claims level, where most appeals are adjudicated.
We recommend that PEHP make the following changes to the administrative review committee: add two voting positions, the pharmacy director and a member advocate, and ensure adequate clinical expertise is assigned to the committee.	Implemented	PEHP has restructured the appeals process to ensure that adequate clinical expertise is available. PEHP is adding member advocates to the executive appeals committee.
We recommend that PEHP hire an independent review organization at level three of the appeals process.	Implemented	PEHP has hired independent review organizations (IROs) at two different levels within the appeals process.
We recommend that PEHP establish turnaround schedules for processing appeals levels one through three.	Implemented	PEHP has established a 60-day turnaround schedule.
We recommend that PEHP establish a formal process to track and analyze appeals submitted to PEHP.	Implemented	PEHP prints a quarterly report that is monitored by PEHP's healthcare services policy committee.

PEHP has restructured their appeals process and implemented all five recommendations.

This chapter will first address the changes PEHP made to the appeals process, then discuss PEHP's process to monitor and audit disputed claims and appeals.

The New Appeals Process Includes Additional Medical Reviews

PEHP has restructured the claims appeals process so that each level of the process reviews denied claims independently. In the first level of the appeals process (internal review), PEHP has hired new medical directors to review denied claims and has also contracted with board-certified physicians to review denied claims. At the second level of the appeals process (external review), PEHP has contracted with three independent vendors with board-certified physicians to review denied claims. We believe that these changes make the appeals process more effective.

Appeals Process Has Been Restructured

PEHP has restructured its appeals process to implement the 2011 audit recommendations and meet federal healthcare reform requirements. When PEHP receives an initial request for a review of a denied claim or prior authorization, whether from a provider or a member, the claim is designated as disputed. At that point, benefit review specialists review the disputed claim to determine whether policy was followed. In situations where a clinical review is needed, the claim is submitted to PEHP's clinical services staff.

After a decision is made by the benefit specialists or the clinical services staff, the provider or member is notified of the adjudication. If the disputed claim has been denied, a provider or member can complete and submit an appeal form, asking PEHP to reconsider the prior judgment. The appeals process consists of four separate and independent levels that are briefly described in Figure 5.2.

When PEHP receives an initial request for a review of a denied claim, it is designated as a disputed claim.

If a disputed claim has been denied, a provider or member can submit an appeal.

Figure 5.2 PEHP’s New Four-Level Appeals Process. PEHP has reduced its appeals process from five to four levels.

Level	Reviewer(s)	Description
1	Internal Review	Appeals are reviewed by a five-member executive committee. If a clinical review is needed, PEHP uses medical directors, and, if needed, board-certified physicians to give an opinion to the executive committee.
2	External Review	Appeals are reviewed by IROs consisting of board- certified physicians. PEHP rotates appeals among three vendors.
3	Hearing Officer	According to Utah Code 49-11-613(2), members/providers have the right to appeal to a hearing officer. The hearing officer's decision is then presented to the Utah Retirement Board.
4	Utah Court of Appeals	Utah Code 49-11-613(7) states that the decision of the retirement board may be submitted for judicial review.

PEHP now includes board-certified physicians in the first two levels of the appeals process.

PEHP has also established a guideline for appeals process turnaround time that meets federal policies. Once an appeal has been received, PEHP has 60 days to make a determination. The 60 days includes both the internal and external reviews. This guideline can help protect members as well as PEHP.

PEHP has established a 60-day guideline for the appeals process turnaround time.

Internal Review Has Added Additional Clinical Expertise

When an appeal is submitted for internal review, an appeals coordinator reviews and tracks the claim to ensure it is correctly adjudicated in a timely manner. Appeals involving a medical judgment are forwarded to PEHP’s new medical directors. If the medical directors deny an appeal after reviewing it, the appeal must be forwarded to a new contracted group of board-certified physicians for review. If the appeal is denied after being reviewed by a board-certified physician, it is then reviewed by the executive appeals committee.

An appeals coordinator reviews and tracks appeals to ensure they are adjudicated in a timely manner.

The executive appeals committee consists of six members:

- URS executive director
- PEHP director
- PEHP operations director

The new appeals process allows the chief medical officer to give an independent review at the executive appeals committee meetings.

- PEHP healthcare services director
- PEHP chief medical officer
- A member representative

Following a complete discussion of the appeal, the committee determines the outcome. This new process allows the chief medical officer to give an independent opinion to other committee members. Internal review of appeals by medical directors, contracted board-certified physicians, and PEHP's chief medical officer provides several perspectives to help determine appropriate outcomes. The previous audit found that the former appeals process did not provide adequate medical review.

Appeals that do not need a medical determination bypass clinical staff for review by the appeals coordinator followed by executive appeals committee determination.

Member Advocates Are Now Being Involved in the Appeals Process. Including a member advocate in the appeals process is an industry standard. Other insurance carriers contacted during the 2011 audit include a member advocate in their appeals processes. During this follow-up audit, PEHP changed the executive appeals committee policies and procedures to include member representation. According to policy, the URS executive director may appoint up to three individuals to serve as member representatives on a rotational basis. As of the time of this follow-up, these members have not yet been appointed. Member representation will help to promote fairness for claimants on the committee.

Three individuals may be appointed to serve as member advocates.

Second Level Appeals Involve Outside Clinical Expertise

The purpose of a multi-level appeals process is to promote independent, objective review at each level. The 2011 audit report noted that the same viewpoint was carried through each step of the former appeals process. As a result, we recommended that a level of the appeals process involve an independent review organization (IRO), with board-certified physicians to review the appeals.

PEHP has implemented this recommendation and procured IROs. PEHP's second level review consists of an external board-certified review as required by federal law. PEHP has contracted with three

separate IROs to review appeals. PEHP will rotate appeals among the three IROs so that claims are adjudicated fairly. This control will prevent PEHP from sending all claims to an IRO that might have a higher denial rate than the other IROs. We believe this process is adequate and provides an independent review of medical claims.

PEHP has procured independent review organizations (IROs) with board-certified physicians to review appeals as required by federal law.

PEHP Is Monitoring Appeals

PEHP is tracking medical and pharmacy appeal trends. Appeal approval and denial rates are being reviewed quarterly to help determine if the new appeals process is working and current benefit policies are being followed. Also, PEHP is beginning to audit adjudicated claims at the disputed claim level before an formal appeal is submitted. PEHP will need to develop a methodology to review a statistically valid sample of adjudicated claims. Having a formal audit function at the disputed claim level is appropriate, since most of the denied claims are resolved at this level.

New Policy Requires a Committee to Review Appeal Trends. PEHP's new appeals policy (approved November 1, 2011) requires that disputed claims, prior authorizations, and appeals statistics be monitored and reported to PEHP's healthcare services policy committee on a quarterly basis. This committee reviews and approves healthcare policies, including claim payment processes and policies. The eight-member committee consists of PEHP's management, including the chief medical officer and pharmacy director. Through this committee, PEHP can look for irregularities in the appeals process and make changes as needed.

Disputed claims and appeal statistics are reported to PEHP's healthcare services policy committee quarterly.

PEHP provided us with counts of denied claims submitted for review since the new process has been implemented. Only claims created after July 1 will go through the new appeals process. Figure 5.3 below shows the total number of denied claims that have been reviewed by PEHP's new claims/appeals process.

All claims created after July 1, 2011 go through the new appeals process.

Figure 5.3 Count of Appeals Reviewed as a Disputed Claim and an Appeal. Most denied claims are resolved at the disputed claim level before the formal appeals process.

Review Process	Count*	
	Approved	Denied
Disputed Claims	384	304
Internal Appeal Review	8	24
External Appeal Review	0	0
Hearing Officer	0	0
Utah Court of Appeals	0	0

**The timeframe for the count of denied claims going through the new appeals process is for all new claims created after July 1, 2011 through October 31, 2011.*

The audit function has been appropriately placed at the disputed claims level where a majority of the denied claims are being resolved.

Figure 5.3 shows that most of the claims have been resolved at the disputed claim level, before an official appeal has been instigated. The previous audit recommended that PEHP establish a formalized audit process that reviews a statistically valid sample of first-level appeals, where most of the appeals were resolved. However, since PEHP has changed the appeals process, the audit function has been appropriately placed where a majority of the denied claims are now being resolved—at the disputed claims level.

PEHP can utilize the audit results for continuous improvement, such as training purpose.

Adjudicated Claims Are Being Audited. The clinical services review manager began reviewing adjudicated claims during this follow-up audit. The manager is going to review seven adjudicated claims for each of the five benefit specialists twice a month. This function is in line with industry practices that require an audit of appeals. PEHP can utilize the audit results for continuous improvement within the organization. For example, this audit function will be beneficial for training purposes to make sure that reviewers and claim adjusters are following current policies. After the clinical services review manager has audited adjudications for disputed claims for a few months and looked at initial error rates, PEHP should develop a methodology to review a statistically valid sample of adjudicated claims at consistent intervals such as monthly or quarterly.

Recommendation

1. We recommend that PEHP develop a methodology to review a statistically valid sample of adjudicated claims.

Agency Response

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**PEHP's Response to
In-depth Follow-up Audit of PEHP's Business Practices
Report Number 2012-05**

We appreciate the opportunity to provide this audit response. We have made focused and significant efforts over the last year to improve our ability to serve the State which will continue forward. Our comments below address the recommendations in the report.

CHAPTER II. PEHP Procurement Practices

- 1. We recommend that PEHP terminate perpetual contracts with vendors and require that all contracts have a specific termination date.**

PEHP Response: We agree with and are implementing this recommendation. So far PEHP has a termination date for all but one of the identified perpetual contracts and has included a specific termination date in any continuing contract. PEHP will do the same for the remaining contract and for the audit identified contract entered into after July 1, 2011.

- 2. We recommend that PEHP continue to use a decision matrix in the evaluation process of responses to all RFPs.**

PEHP Response: We agree with and have implemented this recommendation. PEHP uses a decision matrix in its evaluations of RFPs.

- 3. We recommend that URS policies be amended to require all contracts to have a termination date and all RFPs to be publicly advertised.**

PEHP Response: We agree with and will implement this recommendation for all contracts not specified in Schedule D of the Purchasing Policy which involve highly unique professional service contracts. We are in the process of implementing BidSync to actively advertise RFPs.

CHAPTER III. PEHP’s Business Practices

- 1. We recommend that PEHP continue to eliminate risk pool deficits and require risk pools to maintain actuarially sound contingency reserve levels.**

PEHP Response: We agree with and are implementing this recommendation. As of January 10, 2012, there are no risk pool deficits and efforts are being made to attain the appropriate reserve levels.

PEHP Updated Risk Pool Contingency Reserves

As of June 30, 2011, the following six risk pools had contingency reserve deficits. As of January 10, 2012, no pool is in deficit.

Pool	Financial Statements 06/30/2011*	Estimated 1/10/2012
Salt Lake County	(\$50,702)	\$65,000
Salt Lake City	(\$2,153,779)	\$1,782,000
Provo City	(\$455,580)	\$0
Utah County	(\$1,468,663)	\$0
Nebo District	(\$61,569)	\$0
Canyons District	(\$154,959)	\$0
Reserve Balance	(\$4,345,252)	\$1,847,000
* Amounts used in Legislative audit follow up report		

- 2. We recommend that the URS Board exercise its authority under Utah Code and refund excess reserves back to the pool.**

PEHP Response: PEHP agrees with and is implementing this recommendation. The URS Board has authorized a January 1, 2012 refund for the Local Government Risk Pool. A July 1, 2012 refund for the State Pool is planned. PEHP will discuss reserve level options with the Utah School Board Association (USBA).

PEHP Updated Reserve Refunds:

Medical Risk Pools	Reserve Target	Date of Refund	Amount of Refund
State of Utah	60 Days	7/2012	\$22.2 million ⁽¹⁾
LGRP	90 Days	1/2012	\$14.5 million ⁽²⁾

(1) State reserve balance based on 6/30/2012 forecast and 60 vs. 50 day reserve target account for the difference between PEHP's and the legislative auditors estimated refund amount.

(2) LGRP refund implemented 1/1/2012. PEHP refund amount based on a 90 day reserve target compared to the 60 day target shown by the legislative auditors. The 90 day target is consistent with the range established by the Milliman claim contingency reserve study.

3. We recommend that the Legislature determine whether the state risk pool should self-fund reinsurance or allow the current practice to continue, whereby the state risk pool is part of PEHP's reinsurance pool.

PEHP Response: We believe it is in the State's interest to continue the current practice of participating in PEHP's reinsurance pool because: (1) self-funding saves the state about 20% to 30% by not having to pay customary reinsurance profit margin, (2) PEHP has restructured the way the reinsurance pool is administered to allow additional budgeting certainty, flexibility in coverage selection, and additional equity across participating risk pools, and (3) there is a benefit to spread the risk of random large claims across PEHP's entire book of business.

Chapter IV. PEHP's Pharmacy Program

1. We recommend that PEHP allow the P&T Committee to make the final decisions regarding safety and efficacy changes initiated by the pharmacy department, as opposed to the Health Policy Committee.

PEHP Response: We agree with and will implement this recommendation to allow the P&T Committee to make final decisions on safety and efficacy changes initiated by the pharmacy department.

- 2. We recommend that PEHP allow the pharmacy department to change and implement all prior authorization criteria on issues of safety and efficacy once it has been reviewed by the P&T Committee.**

PEHP Response: We agree with and will implement this recommendation to allow the pharmacy department to change and implement all prior authorization on issues of safety and efficacy once it has been reviewed by the P&T Committee.

Chapter V. PEHP's Appeals Process

- 1. We recommend that PEHP develop a methodology to review a statistically valid sample of adjudicated claims.**

PEHP Response: We agree with and will implement this recommendation to develop a methodology to review a statistically valid sample of adjudicated claims.

Respectfully submitted this 10th Day of January, 2012.



R. Chet Loftis
PEHP Director