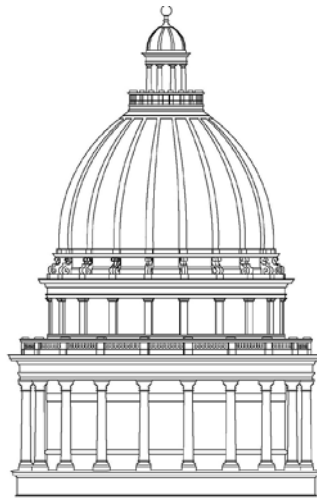


REPORT TO THE
UTAH LEGISLATURE

Number 2017-07



**A Performance Audit of
Public Entities' Oversight of the
Qualified Health Insurance Statute**

August 2017

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah



STATE OF UTAH

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AUDITOR GENERAL

August 22, 2017

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **A Performance Audit of Public Entities' Oversight of the Qualified Health Insurance Statute** (Report #2017-07). 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 A Performance Audit of Public Entities' Oversight of the Qualified Health Insurance Statute

During the 2009 General Session, the Legislature enacted the qualified health insurance (QHI) requirement for state construction and design contracts. The QHI statute establishes a statewide policy that encourages and incentivizes responsible employers who provide health insurance for their employees. As such, the Legislature specified in statute 1) the public entities and projects subject to QHI, 2) the minimum level of health insurance coverage that must be offered, and 3) how public entities can ensure that health insurance offers are sufficient. To evaluate the effectiveness of the requirement, we assessed the compliance of various prime contractors and subcontractors.

Chapter II Public Entity Oversight of QHI Has Been Inadequate

Inadequate Oversight Allowed Contractors to Offer Inadequate Health Insurance.

During our review of 23 contractors, five were identified who did not offer adequate health insurance coverage to their employees, including two who offered no coverage. These instances went uncorrected because public entities, except the Utah Department of Transportation (UDOT), provided inadequate oversight prior to 2016. Recent oversight by the Division of Facilities Construction and Management (DFCM) identified and corrected a project that was initially awarded to a noncompliant contractor. Without DFCM's oversight, the noncompliant contractor would have undercut other compliant bidders.

Most Public Entities Did Not Provide Adequate QHI Oversight. For seven years from 2009 to 2016, public entities, except for UDOT, did not collect QHI documentation from contractors. Required documentation includes a contractor's compliance certification and an actuarial equivalency statement attesting that the contractor's offer complies with statute. While initial implementation had its challenges, UDOT addressed contractor questions and implemented a process to collect QHI documentation back in 2009. During 2016, other public entities began overseeing the QHI requirement. Since their implementation has been recent and ongoing, we recommend that these public entities report to the Legislature on their efforts to provide adequate oversight.

DFCM's Process to Oversee Subcontractor Compliance Is Inadequate. Since public entities started collecting QHI documentation, only DFCM and UDOT have had subcontracts subject to QHI. Per its administrative rules, DFCM subcontractors submit compliance documentation to prime contractors. On one project that we reviewed, DFCM

was unaware of a prime contractor who falsely claimed that its subcontractors were compliant. One subcontractor offered no health insurance, and another offered insufficient coverage. Unlike DFCM's process, UDOT requires that subcontractor documentation be submitted to the department rather than the prime contractor, providing better assurance of subcontractor compliance. It is critical that public entities develop processes where they receive documentation showing subcontractor compliance.

Public Entities Have Not Clarified Actuarial Equivalency Statement Requirements.

Public entities have been collecting actuarial equivalency statements, but some statements have been inadequate. In three instances, statements were not prepared by individuals qualified in statute. Others statements stipulated a minimum premium contribution rate that contractors must provide, but actual contributions were not verified. Finally, inadequate employer premium contributions for dependent coverage were offered by two contractors without actuarial statements. Public entities need to clarify their processes to ensure qualified individuals prepare actuarial equivalency statements and that employer premium contributions are being reviewed.

Chapter III

Certain DFCM Contract Types Circumvent the QHI Statute

DFCM Did Not Subject Complex Facility Projects to QHI Statute. For some of the state's largest and most complex projects, DFCM uses the construction management/general contractor (CMGC) method to complete projects. This method allows the prime contractor to play a key role in the design phase before building the facility. CMGC contracts provide relatively minimal initial compensation for the prime contractor's role in the design phase. Subsequently, massive change orders provide nearly all compensation that the prime contractor receives. Since QHI statute exempts change orders, DFCM exempted prime contracts on CMGC projects. However, this inhibits prime contractor collection of QHI documents for subcontracts that exceed the QHI threshold. In our opinion, change orders on prime contracts for DFCM's CMGC projects should not be exempted. Therefore, we recommend that the Legislature amend statute pertaining to change order exemptions.

DFCM Projects Delegated to Higher Education Lacked Timely Enforcement. The State Building Board has statutory authority to delegate control over some higher education facilities to institutions, including those exceeding QHI thresholds. Statute specifies that delegating control of a project does not exempt the institutions from DFCM's construction requirements. Since DFCM has been focused on developing a compliance process for its own projects, defining a compliance process for higher education institutions has not yet taken place. The QHI requirement was not timely enforced on three delegated projects we reviewed. With its rule making authority, we recommend that DFCM develop a process to ensure adequate oversight of QHI projects delegated to higher education institutions.

REPORT TO THE UTAH LEGISLATURE

Report No. 2017-07

A Performance Audit of the Department of Public Entities' Oversight of the Qualified Health Insurance Statute

August 2017

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Chapter I

Introduction

During the 2009 General Session, the Legislature enacted the qualified health insurance (QHI) requirement for state construction and design contracts. The QHI statute establishes a statewide policy that encourages and incentivizes responsible employers who provide health insurance for their employees. As such, the Legislature specified the following in statute:

- The public entities and projects that are subject to QHI
- The minimum level of coverage that must be offered
- How public entities can ensure that the offers are sufficient

To evaluate the effectiveness of the requirement, we assessed the compliance of various prime contractors and subcontractors. Through these assessments, we observed the compliance issues that are discussed in chapters II and III.

Employees Working on Large State Construction Projects Should Be Offered Health Insurance

While the QHI requirement was placed in the statutory provisions of six public entities, only four of the entities had construction contracts that were subject to the requirement. Contractors with an applicable prime contract or subcontract must offer a health insurance package that meets a minimum statutory value. Since state agencies lack the expertise to determine whether contractors' health insurance offers meet the statutory benchmark, statute requires that contractors obtain an assessment from an actuary or insurance plan underwriter. These actuarial equivalency statements are the statutory tool that public entities should collect and review in select cases to ensure compliance by applicable prime contractors and subcontractors.

While Six Public Entities Are Subject to QHI, Only Four Had Eligible Projects

The QHI statute is narrow in scope as it focuses solely on ensuring that prime and subcontractors involved in design and construction contracts offer health insurance to their employees. In addition, the statute targets only the state's larger construction contracts. Figure 1.1

The QHI statute encourages and incentivizes employers that offer health insurance coverage to employees.

The QHI statute only applies to the state's construction and design contractors.

shows the statutory threshold amounts over time that a contract must exceed to be subject to the QHI requirement.

Figure 1.1 Contractual Limits for QHI Changed After the 2016 General Session. To adjust for rising costs over time, the Legislature increased the threshold of projects subject to QHI.

Key Statistics	HB 331	HB 282
	2009 General Session	2016 General Session
Effective Date	July 1, 2009	March 17, 2016
Prime Contract Amount	\$ 1,500,000	\$ 2,000,000
Subcontract Amount	\$ 750,000	\$ 1,000,000

Source: HB 331 (2009 General Session) and HB 282 (2016 General Session)

As the figure shows, the Legislature increased the QHI thresholds during the 2016 General Session due to rising project costs over time. Because of these thresholds, only the state's largest construction contracts are subject to the requirement. Consequently, our initial risk analysis found that some public entities with the QHI statute have contracts that meet this threshold, while others do not.

Through our discussions with staff at public entities and a subsequent review of expenditures and contracts, we found that the following four public entities have contracts that are subject to the QHI statute:

- Utah Department of Transportation (UDOT)
- Division of Facilities Construction and Management (DFCM)
- Utah Transit Authority (UTA)
- Department of Natural Resources (DNR)

The clear majority of applicable contracts are overseen by UDOT and DFCM, which have responsibility for overseeing the design and construction of the state's roads and facilities. Since 2009, UTA has mostly been engaged in construction projects to develop its rail infrastructure. Additionally, DNR's internal audit team identified two construction and design contracts with initial contract amounts exceeding the statutory thresholds. The scope of our discussion in chapters II and III focused on these four organizations, which we refer to as the "public entities" subject to QHI.

While the QHI statute affected six public entities, the following two state entities and public transit district did not have construction projects of the scale affected by QHI:

Prime contracts must exceed \$2 million and subcontracts must exceed \$1 million to be subject to QHI.

Only four of the six public entities subject to QHI had projects large enough to be subject to QHI.

- State Capitol Preservation Board: The executive director explained that they do not have the skill and expertise in-house to handle projects of that scale. Therefore, DFCM handles the general oversight and QHI compliance of their projects.
- Department of Environmental Quality: We met with management and reviewed their master agreement data stored in the state's finance data warehouse. The only contracts that exceeded the QHI threshold are either pass-through federal grants or projects unrelated to construction. Therefore, the department had no QHI eligible projects.
- Public Transit Districts: We used the state's transparency website to review the capital expenditures for two public transit districts. The only district that had capital projects exceeding the threshold was UTA; these projects were reviewed and are discussed later in this report.

Since these public entities, with the exception of UTA, did not have any construction or design contracts exceeding the statutory thresholds in Figure 1.1, they are not discussed in Chapters II and III.

QHI Contractors Must Offer at Least an Average Medical Benefit to Eligible Employees

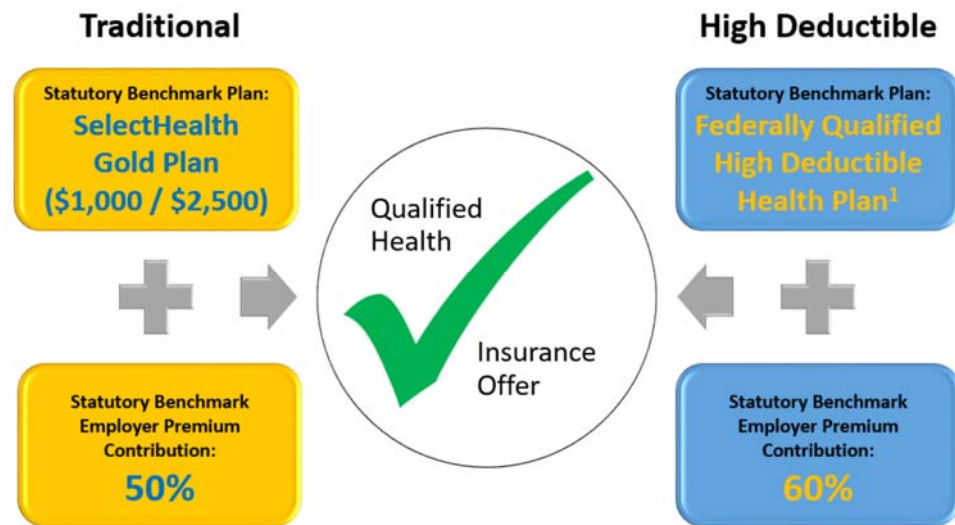
During the audit, we encountered confusion and problems stemming from the differentiation between Utah's QHI requirement and the federal Affordable Care Act (ACA). In one instance, a contractor made assurances that their plan complied with ACA, but we had to clarify that we were assessing compliance with Utah's QHI requirement. Both the QHI requirement and the ACA require employers to provide insurance; however, insurance provided under the QHI requirement must meet or exceed an independent value specified in statute. The value of the benefit consists of the coverage offered by the employer's plan as well as the portion of the health insurance premiums covered by the employer. Since insufficient value of one component can be offset by increased value in the other, it becomes necessary to assess the combined value of both components.

Statute specifies two different health insurance options that contractors can offer to satisfy the QHI requirement. Figure 1.2 illustrates the requirements of a qualified health insurance offer based on the type of health benefit plan offered.

Utah's QHI statute should not be confused with the requirements of the federal Affordable Care Act.

A qualified health insurance offer must meet or exceed the combined value of a statutory benchmark plan and an employer premium contribution.

Figure 1.2 Statute Specifies Two Types of Health Insurance Offers That Satisfy QHI. Contractors must offer a health insurance benefit that meets or exceeds the benchmark value of a traditional health plan (orange) or a high deductible health plan (blue) with corresponding employer premium contributions.



Source: *Utah Code* 26-40-115(1)

As Figure 1.2 shows, contractors are given two options to comply with the requirement. Contractors can either offer a traditional plan and pay 50 percent of the premiums (orange) or offer a federally qualified high deductible health plan and contribute 60 percent toward the premiums (blue). For traditional plans, the minimum statutory benchmark established by the Legislature is prescribed in *Utah Code* 26-40-106(1),

. . . medical program benefits shall be benchmarked . . . to be actuarially equivalent to a health benefit plan with the largest insured commercial enrollment offered by a health maintenance organization in the state.

The bill sponsor in 2009 described this statutory benchmark as being the average health insurance coverage offered in the state of Utah. Thus, contractors working on the state's largest construction contracts

¹ A federally qualified high deductible health plan (HDHP) that meets stipulations regarding deductibles, health savings plan contributions, and out-of-pocket maximums.

are required to offer at least an average health insurance benefit to their eligible employees.

For calendar years 2016 and 2017, SelectHealth's Gold Plan with a \$1,000 individual deductible and \$2,500 family deductible was the statutory benchmark plan that met *Utah Code* 26-40-106(1). Thus, it is the benchmark plan for the QHI statute. This benchmark can be found on the website for the state's Children's Health Insurance Program (CHIP), which also relies on the same statutory benchmark.

Actuarial Equivalency Statements Are The Tool to Assess Contractor Offers

Since public entities do not have staff with the expertise to evaluate whether a contractor's health insurance offer provides sufficient value, the Legislature prescribed a tool to facilitate this analysis. In each public entity's statute, an "actuarially equivalent determination" is required. Using DFCM's statute as an example, *Utah Code* 63A-5-205(7)(c)(1)(C) states:

The actuarial equivalent determination required for the qualified health insurance coverage in Subsection (1) is met by the contractor if the contractor provides the department or division with a written statement of actuarial equivalency, which is not more than one year old, regarding the contractor's qualified health coverage from an actuary selected by the contractor or the contractor's insurer, or an underwriter who is responsible for developing the employer group's premium rates.

These statements are critical as they provide an accurate assessment of the value being offered by contractors to their employees. Public entities that receive these statements from an actuary or underwriter have the statutory assurance that their contractors offer a plan with sufficient value if all stipulations of the letter are met.

Audit Scope and Objectives

With the passage of HB 282 during the 2016 General Session, the Legislature made amendments to the QHI statute. This audit was subsequently prioritized by the Legislative Audit Subcommittee. We focused our review on how well the QHI requirement was being

Actuaries and underwriters assess the value of contractor health plans because public entity staff lack that expertise.

assessed by public entities. To conduct that review, we sampled various prime contractors and subcontractors from the three main public entities that were affected by QHI.

Figure 1.3 Public Entity Contractor Samples. The number of prime contractors and subcontractors selected per public entity are shown in the table below.

Contractor Category	DFCM	UDOT	UTA	Unique Contractors
Prime Contractor	12*	2	3*	14
Subcontractor	5	4	0	9
Total	17*	6	3*	23

Source: Legislative Auditor General's Office working papers

** All three UTA prime contractors reviewed also worked on DFCM projects subject to QHI.*

We systematically selected our sample of 23 contractors based on multiple risk factors; it was not a statistical random sample that could be used for extrapolating population wide compliance rates. Specifically, we conducted this review to understand the extent of noncompliance based on the level of oversight by the public entity. In addition, we conducted project-specific reviews in order to understand whether the QHI statute was being circumvented, and if so, the means whereby this was occurring.

By assessing public entity practices and documentation, meeting with a sample of contractors, and reviewing individual projects, we were able to address the following audit objectives:

- Ensure that state agencies are overseeing the qualified health insurance requirement, specifically documenting instances of noncompliance by contractors and insufficient agency practices (Chapter II).
- Identify areas where the qualified health insurance requirement is being circumvented either through the use of various contracts or delegation of projects (Chapter III).

We reviewed the compliance of 23 contractors based on multiple risk factors.

Chapter II

Public Entity Oversight of QHI Has Been Inadequate

Since the enactment of the qualified health insurance (QHI) statute in 2009, public entities,² except for the Utah Department of Transportation (UDOT), were noncompliant in the oversight of their contractors' compliance. Inadequate oversight by public entities left some contractors' employees with insufficient insurance coverage or no insurance at all. The QHI requirement was intended to achieve the following objectives:

- Encourage, incentivize, and reward employers who offer health insurance.
- Address the uneven playing field that exists when contractors who do not offer insurance undercut those who do.

Without adequate oversight, the effectiveness of the policy has been diminished. Inadequate oversight by public entities, demonstrated by the following practices, allowed noncompliant contractors to receive contracts on state projects:

- For the initial seven years of the QHI requirement (2009-16), public entities, except for UDOT, did not collect documentation demonstrating prime contractor compliance.
- Since May 2016, the Division of Facilities Construction and Management (DFCM) delegated collection of subcontractor documentation to prime contractors. This process has provided some incomplete and ineffective information to DFCM, which can be improved with prime contractors sending subcontractor actuarial equivalency statements to DFCM.
- Going forward, public entities need to review select actuarial equivalency statements to ensure that they are prepared by statutorily qualified individuals and include a review of employer contributions.

The QHI statute was intended to encourage, incentivize, and reward employers who offer health insurance to their employees.

Except for UDOT, public entities have not provided adequate oversight of QHI.

Statute requires actuarial statements be prepared by individuals with specific qualifications.

² As discussed in Chapter I, "public entities" refers to the six entities (five state and one local) in statute that are responsible for construction projects.

While public entities subject to QHI are finally starting to exercise oversight, there are still areas that need improvement.

Inadequate Oversight Allowed Contractors to Offer Inadequate Health Insurance

The QHI requirement was implemented to encourage employers to offer insurance to their employees and create a level playing field for contractors bidding on the state's construction projects. As a result of this policy, the state's largest construction contracts should go to employers who offer health insurance that meets or exceeds a statutory benchmark. Unfortunately, we identified five instances where contractors did not offer adequate insurance coverage to their employees. These instances went uncorrected because public entity oversight has been inadequate.

The selected public entities, except for UDOT, took almost seven years to implement processes to oversee contractor compliance as QHI statute requires. Due to recent oversight efforts, DFCM identified and corrected a project that was initially awarded to a noncompliant contractor. Without DFCM's recent oversight, the noncompliant contractor who did not offer QHI would have undercut the compliant bidders. Thus, better oversight by public entities is needed so the QHI statute can be effective.

Noncompliant Contractors Offered No Insurance or Inadequate Insurance

It took most public entities almost seven years to oversee contractor compliance with the QHI requirement and require documentation. Statute mandates that applicable construction contractors offer health insurance that meets or exceeds a statutory benchmark value. During our review of 23 contractors, as discussed in Chapter I, we identified five who offered inadequate insurance to their employees. Specifically, the five inadequate offers can be grouped into the following three categories:

- No health insurance was offered.
- Employer premium contributions did not reach the minimum rate specified in the actuarial equivalency statement.

It took almost seven years for DFCM and UTA to start collecting compliance documents from contractors.

Five of the 23 contractors we reviewed either offered insufficient health insurance or no insurance at all.

- Fixed employer contribution rates resulted in inadequate dependent coverage.

Although no indication of noncompliance was identified by the remaining 18 contractors, actuarial equivalency statements confirming compliance was missing in some instances. The inadequate coverage discussed in the last two bullets results from insufficient employer contributions toward plan premiums. Consequently, employees who wanted coverage had to pay a higher proportion of the costs than statute allows, which affects the affordability of insurance for those employees.

Two DFCM Subcontractors Offered No Health Insurance to Their Employees. These subcontractors were working on separate projects that were both initiated in May 2016. Neither of them offered employer-sponsored health insurance for their employees. One of the subcontractors used to offer health insurance, but the company's insurance broker said it would be more cost-effective for the company and its employees to obtain subsidized individual plans. Both subcontractors reported that they were unaware of the QHI requirement before they commenced work on their respective projects.

One UDOT Subcontractor Did Not Offer the Employer Contribution Rate Stipulated in Its Actuarial Equivalency Statement. To provide a health insurance benefit that met or exceeded the QHI benchmark, one UDOT subcontractor's actuary calculated that the subcontractor needed to pay at least 57 percent of the premium for all employees. However, the employer only paid 50 percent for hourly employees across all tiers of coverage (employee only, employee and spouse, employee and children, and family). Salaried employees received a 100 percent contribution for employee only and a 75 percent contribution for the other tiers. Since the employer did not make at least a 57 percent contribution towards all employees' premiums (specifically hourly employees), the subcontractor was not compliant with the QHI statute.

Two DFCM Contractors Provided Insufficient Premium Contributions for Dependent Coverage. Since health insurance coverage that includes dependents is more expensive than employee-only coverage, employers must provide higher premium contributions for dependent coverage in order to offer the same contribution rate. Two contractors in our study contributed the same dollar amount

The remaining 18 contractors appear to be compliant, but some lacked actuarial statements confirming compliance.

Employees for two noncompliant DFCM subcontractors had to get individual plans because their employer did not offer coverage.

The plan offered by one UDOT contractor was insufficient because the employer premium contribution was too low.

Two DFCM contractors made the same contribution amount for all employee plans, which made rates for dependent plans inadequate.

toward all tiers of coverage. Consequently, the contribution rates for dependent coverage is quite low. Figure 2.1 lists the monthly premium amount for each coverage tier and shows how much is contributed by one of the contractors in our review.

Figure 2.1 Consistent Employer Contribution Amounts Yield Concerning Rates. Fixed employer premium contribution rates for 2016-17 result in inadequate health insurance coverage for dependent tiers.

Coverage Tier	Monthly Premium	Employer Contribution	Employer Contribution Rate
Employee Only	\$ 259.75	\$ 129.88	50.0%
Employee/Spouse	\$ 576.62	\$ 129.88	22.5%
Employee/Children	\$ 408.32	\$ 129.88	31.8%
Family	\$ 854.55	\$ 129.88	15.2%

Source: A DFCM subcontractor's premium contribution schedule

For this contractor, employer contribution amounts hold steady at \$129.88 across all tiers, while monthly premium amounts fluctuate. This same contribution yields a 50 percent contribution rate for employee only coverage, but only 15.2 percent for family coverage. In addition, the plan in Figure 2.1 had higher deductibles than the benchmark plan, and both healthcare plans offered by the employer had higher co-pays and higher out of pocket maximums that were not commensurate with the benchmark plan. Consequently, we question if the 50 percent employer contribution rate for employee-only coverage was sufficient.

QHI is designed to provide relatively affordable health insurance that meets or exceeds a statutory benchmark stipulating certain levels of employer participation. Statewide wage data provided by the Department of Workforce Services shows a median monthly wage of \$3,100 for drywall installers. After the employer contribution amount of \$129.88, the employee pays the remaining premium balance of \$724.67 per month for family coverage, as shown in Figure 2.1. In this scenario, the employee is using 23 percent of their monthly wages for health insurance premiums. If the employer in this example contributed 50 percent of the health insurance premium, the employee portion of the premium could be reduced to \$427.27, which is 14 percent of monthly wages.

Inadequate employer contributions are not compliant with QHI statute and make dependent coverage less affordable.

Thus, the value of the QHI benchmark plan is an important element that contractor plans must conform to as it addresses affordability to some extent. As health insurance becomes more affordable to employees, then employees are more likely to accept it, which accomplishes a goal of the QHI statute.

DFCM Created a Level Playing Field By Ensuring Contractor Compliance

For the five contractors who did not offer QHI to their employees, health care costs were lower than what statute required. Because these contractors offered inadequate insurance, they could have undercut the compliant contractors. DFCM identified such an instance after they started enforcing QHI in 2016. Figure 2.2 shows the top four bidders who responded to a DFCM solicitation for a construction project. The figure shows the contractor's bid, the bid as a relative percentage of the low bid, and the contractor's QHI status based on documentation we obtained during the audit.

Since DFCM started enforcing QHI in 2016, it already identified and corrected an initial winning bid from a noncompliant bidder.

Figure 2.2 The Low Bidder Lacked QHI, So the Next-Lowest Bidder Received the Contract. DFCM identified and corrected one instance where a noncompliant contractor provided the lowest bid. Because DFCM had begun enforcing the QHI requirement, the problem was corrected.

Contractor	Bid	Percentage of Low Cost	QHI Compliance Status
A	\$ 2,248,191	100%	No
B	\$ 2,407,818	107%	Yes
C	\$ 2,443,400	109%	Unknown
D	\$ 2,459,000	109%	Yes

Source: DFCM contract management software

As Figure 2.2 shows, Contractor A, who did not offer QHI, was able to undercut the other bidders on the project. When DFCM requested QHI documentation from the contractor, DFCM staff reported that the contractor did not offer insurance that complied with the QHI statute. Thus, the project was awarded to Contractor B who offered QHI.

Without public entity oversight, compliant contractors can be undercut by those not offering QHI.

This example illustrates that without QHI, contractors who offer health insurance coverage to their employees can be undercut by those who do not. One objective of the QHI requirement, which was discussed during its initial passage in 2009, was to level the playing field for contractors bidding on the state's largest contracts. Adopting the QHI requirement set the policy that the state chooses to do business with those companies that take responsibility for their employees' health insurance.

Unfortunately, the oversight of QHI by public entities has been inadequate, as illustrated by the five contractors previously discussed. Because oversight has been lacking, we believe there are more instances of noncompliance in projects we did not review. In the next three sections, we discuss specific areas where oversight by public entities has been inadequate, and we make recommendations to improve the oversight of QHI.

Most Public Entities Did Not Provide Adequate QHI Oversight

From 2009 to 2016, public entities, except for UDOT, did not collect QHI documentation from contractors demonstrating statutory compliance. Statute requires that prime contractors certify to public entities that they offer their employees sufficient health care coverage. This certification needs to be accompanied by an actuarial equivalency statement verifying that sufficient coverage is being offered.

Unlike other public entities, UDOT addressed contractor questions and implemented a process to collect QHI documentation beginning in 2009. Starting in 2016, other public entities began enforcing the QHI requirement. To ensure that public entities continue taking steps toward enforcing the QHI, we recommend that public entities report to the Legislature on their efforts.

For Seven Years, Most Public Entities Did Not Collect Evidence Showing Compliance

As discussed in Chapter I, only four public entities have had construction projects that have been subject to QHI. Prime and subcontractors on these public entities' projects should send actuarial equivalency statements showing their compliance. *Utah Code* 63A-5-205(6)(a), which applies specifically to DFCM, states:

Unlike other public entities, UDOT has collected statutorily required documents since QHI was enacted in 2009.

A contractor subject to [QHI] shall demonstrate to the director that the contractor has and will maintain an offer of qualified health insurance coverage for the contractor's employees and the employees' dependents.

We take demonstrating compliance to mean that some form of documentation is submitted to the public entities. At the time of this report, demonstrating compliance means contractors should provide 1) a written certification that they are compliant and 2) an actuarial equivalency statement showing they offer sufficient coverage.

While UDOT was complying with the statute, other public entities were not, based on the following observations:

- DFCM: A performance audit by our office released in July 2015 notified DFCM that they were not collecting any documentation regarding QHI. After 10 months of figuring out what to do and waiting for clarification in statute, DFCM began collecting documentation at the end of May 2016.
- UTA: No efforts were made by UTA to collect required documentation despite a contractual provision in its construction contracts that allowed for collection of evidence. Specifically, the provision stated: "The Contractor under this Construction Services Contract shall comply with . . . requests from UTA for evidence of coverage."
- DNR: No efforts were made to ensure compliance. An internal audit of QHI released in March 2016 reported that "DNR divisions have not requested or verified insurance compliance of these contractors or subcontracts."

As these observations indicate, these three public entities had no compliance documentation for us to review prior to May 2016. Management at DFCM and UTA were clearly aware of the requirement. In 2009, DFCM adopted administrative rules regarding QHI, and UTA added QHI clauses to its contracts. Yet, nothing was done to collect documentation showing their contractors were compliant.

Statute requires that contractors should demonstrate compliance, which should include a written certification and an actuarial statement.

DFCM, UTA, and DNR did not collect documents showing contractor compliance.

While both DFCM and UDOT described initial challenges, only UDOT persisted and developed a workable process.

During initial discussions for this audit, DFCM management expressed frustration with the initial implementation of the QHI requirement. However, some of their concerns were addressed by amendments made during the 2016 General Session, such as clarifying who could provide actuarial equivalency statements and how often they need to be submitted. Other issues, like what actuarial equivalency statements should contain and documenting the benchmark plan, necessitates public entities developing a process that guides contractors as they document their compliance. While some entities did not do so for seven years, UDOT's initial persistence resulted in a reasonable compliance process.

UDOT Developed QHI Processes And Collected Documentation

Since the adoption of the QHI requirement in 2009, UDOT has made efforts to document that its prime contractors and subcontractors are compliant. Staff acknowledged that the initial documentation they collected was not the best, but at least they collected something. Per *Administrative Rule 916-5-7(1)(a)*, which was adopted in July 2009, UDOT collects a written certification that the contractor will offer QHI to its employees. In addition, *Administrative Rule 916-5-7(3)*, adopted at the same time, requires an actuarial equivalency statement from an actuary or underwriter that attests that the health insurance package offered by the contractor is sufficient.

UDOT staff worked with attorneys, contractors, and the Department of Health to develop and clarify its QHI process.

During discussions with UDOT staff, they acknowledged that there were several challenges to implementing QHI. Specifically, they said that there was no lead agency to guide them through QHI issues. Thus, during the first year, UDOT staff worked with legal representatives for their contractors and the Department of Health, which sets the benchmark plan, to clarify what was required and define a process for contractors to demonstrate compliance.

By May 2010, UDOT established a webpage outlining the QHI requirement for contractors that included the following:

- A copy of the QHI benchmark plan
- Template language for a written certification demonstrating that the contractor offered QHI to employees

- An example of language that could be used in an actuarial equivalency statement
- Clarification regarding whom contractors should contact to obtain an actuarial equivalency statement.

These four items seem to address the concerns expressed by other public entities and their contractors who are trying to comply with the requirement. While UDOT devoted time and effort to develop a working process seven years ago, other public entities are just recently starting to develop similar processes. Consequently, the other public entities are experiencing challenges that UDOT encountered previously.

Public Entities Are Starting to Adopt Successful Practices

The Legislature's most recent amendments to QHI took effect on March 17, 2016. Since then DFCM, UTA, and DNR have taken steps toward enforcing QHI. Due to differences in each entity's number of projects subject to QHI, the evidence of their changes varies accordingly.

DFCM Began Collecting QHI Documentation Two Months After the 2016 Legislative Amendments Became Effective. We reviewed all 17 of DFCM's contracts that were QHI eligible between March 17, 2016 to December 20, 2016 when we pulled the data. The following observations illustrate a stark contrast in the availability of QHI documentation before and after July 1, 2016:

- Prior to July 1, five of six QHI-eligible projects had no documentation from prime contractors when the contract began; however, documentation on three of these projects was provided during the audit.
- After July 1, ten of the remaining QHI-eligible projects had signed documentation from prime contractors when contracts began.

In the period after July 1, one of the 17 projects was exempted from the QHI requirement due to large change order. We had concerns with exempting this project from the QHI requirement. Those concerns are discussed in Chapter III.

In July 2016, DFCM records show a stark increase in the amount of QHI documentation collected from contractors.

In its standardized form, DFCM outlined the process its contractors should follow.

Like DFCM, UTA has recently adopted a similar process and standardized QHI form.

DNR is addressing the findings from its QHI internal audit.

To be held accountable for compliance, public entities should give a progress report to the Legislature.

Increased compliance resulted as DFCM developed a standardized form to demonstrate QHI compliance. The form,

- Outlines the responsibilities of the prime contractor
- Provides a template for certifying that offers were made
- Explains that an actuarial equivalency statement is needed
- Provides a link to the benchmark plan

The only additional guidance that was missing can be found on UDOT's website, which includes an example of what an actuarial equivalency statement should contain.

During the Audit, UTA Adopted a Process Similar to DFCM's. Like DFCM, UTA has adopted a standardized form that prime contractors must submit. Specifically, UTA's form 1) certifies that the contractor "complies in full with the Health Benefit Plan Requirements, as set forth in the [*Utah Code* 17B-2a-818.5]" and 2) requires that an actuarial equivalency statement be provided. UTA's implementation was later than DFCM's and has only been used for one project, which had been ongoing for two months when the form was signed in February 2017. Another construction project, which occurred from September to December 2016, did not use the form. The new process was adopted since the initiation of this audit in November 2016.

DNR Has Adopted Administrative Rules but Has No Affected Projects. According to the results from DNR's internal audit of QHI, the number of DNR projects subject to QHI is very few. However, DNR was the only state agency that did not adopt administrative rules related to QHI when the Legislature amended the statute during the 2016 General Session. As part of its increased efforts to enforce QHI, its new rule was filed in September 2016 and became effective in November.

While public entities have implemented several changes to increase oversight of QHI, we believe that the speed of these changes has been relatively slow and reactive. Public entities need to be more accountable for oversight and QHI compliance. We recommend that during the 2018 General Session, public entities subject to QHI report to the Infrastructure and General Government Appropriations Subcommittee. This will give the Legislature an opportunity to ensure that the appropriate actions are taking place.

DFCM's Process to Oversee Subcontractor Compliance Is Inadequate

Since public entities started collecting QHI documentation, DFCM and UDOT are the only public entities with projects where subcontractors are subject to QHI. Per its administrative rules, DFCM subcontractors submit compliance documentation to prime contractors. However, DFCM's incomplete process does not provide the division assurance that its subcontractors are compliant. Thus, DFCM was unaware of a prime contractor who falsely claimed that its subcontractors were compliant.

UDOT has adopted a different practice in administrative rule, where subcontractors send compliance documentation directly to the department. The process seems effective as oversight resides with UDOT. Whatever process is implemented, it is critical that public entities receive actuarial equivalency statements showing that contractors offered health insurance and the offer is statutorily adequate.

DFCM's Process Does Not Provide Adequate Assurance of Subcontractor Compliance

Per statute, prime contractors are responsible for notifying subcontractors who are subject to the QHI statutory requirement and certifying that their subcontractors are compliant. *Utah Code* 63A-5-205(6)(b), which applies specifically to DFCM, states:

If a subcontractor of the contractor is subject to [QHI] the contractor shall (i) place a requirement in the subcontract that the subcontractor shall obtain and maintain an offer of qualified health insurance coverage . . . and (ii) certify to the director that the subcontractor has and will maintain an offer of qualified health insurance coverage . . . (emphasis added).

To avoid making inaccurate certifications about subcontractor compliance, contractors should provide evidence showing that subcontractors' health insurance is adequate. Thus, DFCM's standardized form requires that prime contractors collect actuarial equivalency statements from their subcontractors.

DFCM delegates subcontractor oversight to prime contractors.

In contrast, UDOT subcontractors submit documentation directly to the department.

Subcontractor actuarial equivalency statements confirm that subs were notified of the requirement and offer sufficient coverage.

DFCM has had no verification that prime contractors are collecting actuarial statements from subcontractors.

DFCM's process to oversee subcontractor compliance is inadequate.

One DFCM prime contractor falsely attested that its subcontractors were compliant.

Requiring actuarial equivalency statements from subcontractors serves two purposes. First, it confirms that the subcontractor is aware of the requirement. Second, it gives some assurance that the plan offered by the subcontractor meets or exceeds the value of the benchmark plan. Providing these forms demonstrates that both the contractor and subcontractor are aware of the requirement and are striving to be compliant.

When we met with DFCM management in December 2016, they confirmed that they receive no documentation regarding subcontractor compliance. Instead, subcontractor documentation is maintained by the prime contractor. In addition, DFCM management also reported that they had not reviewed documentation collected by its prime contractors. Thus, there has been no verification that prime contractors were doing what they had agreed to do.

As discussed in the next section, one prime contractor made a false claim that its subcontractors were compliant, resulting in two subcontractors that were not compliant. This instance raises questions about the reliability of prime contractor certifications regarding their subcontractors' compliance. Since DFCM feels it cannot follow-up on its prime contractors without additional funding for staff to do so, the current process provides inadequate assurance of subcontractor compliance. Thus, we recommend that DFCM and other public entities require that prime contractor certifications be accompanied by subcontractor actuarial equivalency statements.

Multiple Instances of Noncompliance Were Observed on One DFCM Project

DFCM did not enforce the QHI requirement for seven years. After it began enforcing the requirement, it exempted some of the state's complex building projects from QHI (discussed in Chapter III). As a result, the population of DFCM subcontractors we could review was limited, which required us to focus on a single project. For this one project, we observed the following:

- The prime contractor falsely attested that its subcontractors were compliant.
- Subcontractors were not being notified about the requirement in their subcontracts.

As a result, two of the three subcontractors offered either inadequate health insurance or no insurance at all to their employees.

The Prime Contractor Filed a False Attestation with DFCM.

As discussed earlier in this chapter, DFCM developed a standardized form where prime contractors can certify that their subcontractors are compliant with QHI. This form was signed by the prime contractor and filed with DFCM prior to the contract start date of the project. While the prime contractor had offered adequate health insurance to its employees, two of its subcontractors did not.

Because no documentation had been requested from the subcontractors, the prime contractor's certification to DFCM lacked any basis. DFCM's standardized form requires prime contractors to collect actuarial equivalency statements from their subcontractors. If prime contractors were required to forward these statements to DFCM, then DFCM could verify that its subcontractors are compliant.

Subcontracts Did Not Notify Subcontractors About the QHI Requirement. All three subcontractors we met with said that the prime contractor did not notify them about the QHI requirement. We also reviewed the master subcontract agreement and work order for one subcontractor and did not find any specific mention of the QHI requirement.

The only vague reference states that the subcontractor may be responsible for additional state or federal requirements. *Utah Code* 63A-5-205(6)(b)(i) says that the contractor shall place a requirement in the subcontract to offer qualified health insurance coverage for the duration of the contract. Therefore, we believe that such a reference to the QHI requirement in the subcontract should be specific.

When we discovered that the two subcontractors were not compliant with QHI in March and April 2017, 10 months had already elapsed since the prime contractor made the false certification. We recommend that DFCM consider adopting a practice where prime contractor certifications of subcontractor compliance are supported with actuarial equivalency statements. Then the prime contractor forwards this documentation on to DFCM. Such a process would stop short of UDOT's where subcontractors submit their documentation directly to the department.

Documentation showing subcontractor compliance was not available and, thus, was not collected by the prime contractor.

The prime contractor did not place the statutorily required QHI notification in its subcontracts.

UDOT specifies in administrative rule that its prime contractors and subcontractors should follow the same process.

All eight unique subcontractors we tested at UDOT submitted required documentation.

Public entities are not required to adopt UDOT's process, but statute requires some assurance of subcontractor compliance.

UDOT Opted for Direct Oversight of Subcontractor Compliance

Unlike other public entities, UDOT requires subcontractors to submit documentation directly to UDOT staff. The process of direct reporting between subcontractors and UDOT began in July 2009, when *Administrative Rule* R916-5-7(1) was adopted. The rule states:

A contractor, or consultant, subcontractors or subconsultants must comply with the following requirements and procedures, and demonstrate, no later than the time of execution of the contract, compliance with [the QHI statute].

UDOT's processes and documentation have always supported this rule. Reviewing archived webpages of UDOT's QHI site from May 2010, we found that the guidance from UDOT has been consistent. Subcontractors should submit a written certification and actuarial equivalency statement to UDOT's resident engineer for approval, and a similar requirement exists for its subconsultants.

When we tested nine subcontractor contracts in UDOT's Heavy Construction Division, all eight unique subcontractors involved in these nine contracts had submitted documentation. Each had a written certification and an actuarial equivalency statement. This is not to say that all submissions were perfect, as issues regarding actuarial equivalency statements were identified and will be discussed later in this chapter. However, the availability of documentation helped facilitate our review and confirmed that the subcontractor was aware of the requirement, which was an issue in the DFCM project.

Following UDOT's specific process is not necessary, and some individuals we spoke with raised concerns about privity of contract. Since the public entity was not a party to the subcontracts, the concern was whether specific documentation should be directly submitted to the public entity. Nevertheless, the problems on the DFCM project illustrate the need for public entity assurance that subcontractors are compliant. Whether this occurs via UDOT's process of direct submission, or a process where prime contractors submit subcontractor documentation, public entities need to be sure subcontractor compliance with state statute is occurring.

Public Entities Have Not Clarified Actuarial Equivalency Statement Requirements

Public entities have been collecting actuarial equivalency statements, but some statements have been inadequate and allowed the following to occur:

- Statements were not prepared by qualified individuals specified in statute.
- Contractors failed to offer the minimum contribution rate stipulated in actuarial equivalency statements.
- Coverage for employees' dependents received inadequate employer contributions.

Public entities need to clarify their processes to ensure actuarial equivalency statements can be used as a tool to ensure prime contractors and subcontractors are compliant. First, we recommend that public entities review select statements to make sure they are completed by qualified individuals in statute. Second, public entities need to ensure that premium contribution schedules are being reviewed either by the qualified individual making the statement or by public entity staff. If actuarial equivalency statements are completed correctly and supported with all necessary information, then the QHI requirement can be effectively enforced.

Public Entities Are Accepting Statements Prepared by Individuals Not Allowed in Statute

As we reviewed actuarial equivalency statements that were submitted to UDOT and DFCM, we found that most contractors followed statute and collected actuarial statements prepared by an actuary or an underwriter. However, we identified three exceptions that should have prompted follow-up by staff. Instead of obtaining a statement from an actuary or underwriter, these three contractors submitted statements from one of the following:

- A premium contribution schedule prepared by the contractor's benefits manager
- A health insurance quote prepared by the contractor's insurance broker

Public entities need to ensure that actuarial equivalency statement stipulations are reliable and followed.

Some statements were not prepared by individuals deemed as qualified in statute.

- An equivalency statement prepared by the company's insurance agent

None of these documents provide the necessary level of analysis by personnel deemed as qualified in statute. Thus, the assurance that these offers were adequate was not provided. We recommend that public entities review actuarial equivalency statements to ensure that they are prepared by an actuary or underwriter. Any deviations from the statutorily designated personnel should require further follow-up from staff.

Public Entities Are Not Verifying Minimum Contribution Rates When Stipulated in Statements

Public entities need to ensure statute is being followed. Several options for verifying compliance exist. During our review, we observed actuarial equivalency statements that expressed compliance with QHI statute in one of two ways: The statement either assured that the contractor's offer complied with QHI, or the statement stipulated a minimum employer contribution rate that would satisfy the QHI requirement. The second option requires public entity staff to calculate contribution rates, which their management does not want. Figure 2.3 shows how the two types of statements are different:

Figure 2.3 Availability of Premium Contributions Affects the Type of Actuarial Conclusion. Premium contribution schedules were provided to Statement A's actuary but not to Statement B's actuary. Thus, the actuaries' conclusions are different.

	Statement A	Statement B
Scope of Review	"To determine actuarial equivalency and contributions, <i>I relied on plan design, premiums and contribution information</i> supplied by [the contractor] and/or its administrator"	"At the request of [the contractor] <i>we have compared the attached benefit plans</i> to the requirements outlined in [statute] and additional clarification by rule."
Actuarial Conclusion	"As requested we tested [the contractor's health insurance plans] and found that <i>each plan has a combined actuarial value that is at least actuarially equivalent</i> to [the statutory benchmark]."	"Based on our understanding of the bill, the attached benefit plans meet the minimum requirements, <i>if the employer contribution is equal to or greater than 57 percent across all tiers.</i> "

Source: Actuarial statements from two UDOT contractors.

Depending on the information they review, actuaries or underwriters either declare compliance or stipulate a minimum employer premium contribution rate.

As Figure 2.3 shows, the scope of review for the two statements was different because the actuary for Statement A reviewed the contractor's health insurance plan and premium contributions, while the actuary for Statement B only reviewed the contractor's health insurance plan. Consequently, the actuary who wrote Statement B did not have enough information to determine if the client was compliant. Therefore, the actuary for Statement B specified a minimum contribution rate that would make the contractor's offer equivalent to the statutory benchmark, which the public entity would have to validate by reviewing the contractor's contribution schedule. In contrast, the actuary for Statement A had all the necessary information. Thus, the actuary attested that the offer met the statutory requirement. In this scenario, public entities do not need to validate the employer contribution rate because the actuary has already done so.

To understand when the two statement types in Figure 2.3 are used, we reviewed a sample of cases. Since UDOT was the only public entity that historically collected QHI documentation, we reviewed 20 of UDOT's actuarial equivalency statements for QHI eligible projects. In 12 cases, the statement was provided by an independent actuary who reviewed premium contribution schedules and declared compliance. However, the remaining eight statements were provided by the insurer's actuary or underwriter. In six of these cases, the actuary solely reviewed the health benefit plan, which resulted in an actuarial statement that specified a minimum contribution rate that the contractor must provide. In the other two cases, a copy of the contribution schedule was provided to the actuary and compliance with the statute was declared.

As discussed earlier in the chapter, we identified one UDOT subcontractor with an employer contribution rate of 50 percent when 57 percent was required for compliance. Therefore, it is important that premium contribution schedules are either reviewed by actuaries or underwriters preparing actuarial equivalency statements or by public entity staff. One option available to public entities is to amend their administrative rules to require underwriters and actuaries to review contribution schedules as part of their analysis. The other option is that public entities could require premium contribution schedules from contractors, and their staff could calculate the rates. Whatever the approach, compliance with QHI statute remains the highest priority.

Six of the 20 UDOT actuarial statements we reviewed specified a rate rather than declaring a contractor's offer was compliant.

Public entities either need to validate employer contribution rates or stipulate in administrative rule that this is an actuarial responsibility.

Some Dependent Coverage May Not Receive Adequate Employer Contributions

Premium contribution schedules are also important for ensuring all plan types meet QHI requirements, especially those covering dependents. As discussed earlier in the chapter, two DFCM contractors were offering premium contribution rates for dependent coverage as low as 19 and 15 percent. The two subcontractors offered fixed employer contribution amounts, which yield higher employer contribution rates for the less-expensive employee-only coverage, and lower rates for the more-expensive family and dependent coverage.

As discussed in the prior section, some actuaries have not been reviewing premium contribution schedules, which means that public entities may have to shoulder this responsibility. Thus, public entities may need to ensure that coverage for all employee tiers (employee only, employee and spouse, employee and children, and family coverage) meets the stipulated minimum contribution rate.

If QHI is going to be effectively enforced, public entities need to ensure that premium contribution schedules are being reviewed. Public entities must also ensure better oversight of subcontractors and overall oversight of the statute. Without these three improvements, the objectives of the QHI requirement will not be realized. We reiterate that it is important for these public entities to report their increased oversight efforts to the Legislature's Infrastructure and General Government Appropriations Subcommittee.

Recommendations

1. We recommend that UDOT and DFCM report to the Infrastructure and General Government Appropriations Subcommittee during the 2018 General Session on their efforts to improve their oversight of the QHI requirement.
2. We recommend that public entities develop processes whereby prime contractors provide subcontractor actuarial equivalency statements as supporting documentation for their certification of their subcontractors' QHI compliance.

If public entities validate employer contribution rates, they should ensure dependent coverages also comply.

3. We recommend that public entities review select actuarial equivalency statements to ensure they are prepared by either an actuary or underwriter, which is required in statute.
4. We recommend that public entities either amend their administrative rules to require that actuaries and underwriters review premium schedules as they prepare their equivalency statements, or request and review premium contribution schedules for statutory compliance.

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Chapter III

Certain DFCM Contract Types Circumvent the QHI Statute

Qualified health insurance (QHI) statutes establish clear criteria regarding which construction projects are subject to the requirement. However, they also allow some exceptions involving emergencies, sole source procurements, and unforeseen changes in project costs. Two practices by the Division of Facilities Construction and Management (DFCM) necessitate clarifications in statute and policy. Specifically, they have avoided the requirement due to how certain contracts are structured and instances where projects are delegated:

- Construction management/general contractor (CMGC) contracts embed nearly all costs into change orders rather than into their initial contract amount. Because change orders are exempted in statute, all contractors, including subcontractors, on some of the state's most complex facility projects were not required to submit QHI documentation. The CMGC method was implemented on 16 percent of all DFCM construction contracts exceeding the QHI threshold since 2009, representing 31 percent of costs.
- Higher education institutions are statutorily authorized to manage and contract for facility projects when delegated authority by the State Building Board. QHI roles and responsibilities for the institutions have not been adequately defined. Three higher education projects initiated during the last year lacked timely QHI oversight. DFCM adopted practices for its own projects within the last year and had not provided QHI guidance to institutions. Thus, inadequate QHI oversight has occurred on multi-million-dollar facility projects at higher education institutions.

Because CMGC contracts and projects delegated to higher education institutions do not follow DFCM's typical process, how QHI should be applied in these situations has not been addressed. Consequently, we believe the Legislature should adopt statutory limits on change order exemptions. In addition, we believe that DFCM should consult with higher education and clarify in administrative rule how compliance will be ensured on delegated projects.

Processes need to be established so CMGC contracts and projects delegated to higher education adhere to the QHI requirement in statute.

DFCM Did Not Subject Complex Facility Projects to QHI Statute

For DFCM's projects using the CMGC method, nearly all compensation to its prime construction contractor is paid through change orders rather than through the initial contract.

A construction contract's initial amount determines whether it is subject to the QHI requirement.

For construction contracts using DFCM's traditional delivery method (design-bid-build), the initial contract price typically includes most of the amount paid to the prime contractor, who oversees construction. DFCM projects that utilize the CMGC method are different because the prime contractor not only builds the facility but also plays a key role in the design phase. DFCM often uses the CMGC method for the state's most complex and largest projects. A contractor's payment in an initial CMGC contract is minimal because it only includes planning and design costs; most of the contractor's compensation is included in subsequent change orders.

QHI statute stipulates that a contract is subject to the requirement based on its initial cost, and change orders are exempt. Consequently, some of the state's most complex projects, which use the CMGC method, have not been subject to documentation requirements by DFCM. This is particularly problematic because DFCM was exempting subcontractors based on the prime contract's change orders. Therefore, we recommend that the Legislature consider adopting a different basis for qualifying DFCM's CMGC contracts and consider limiting the change order exemption.

Large Change Orders on Complex CMGC Projects Are Exempt from the QHI Requirement

The traditional method for building facility projects separates the design and construction phases. This method allows the prime contractor for construction, called the general contractor, to focus on building a facility that was designed by architectural and engineering firms. The general contractor's contract is only focused on the scope of work and compensation associated with providing construction services.

The initial compensation specified in CMGC contracts is for the prime contractor's role in the design phase.

Projects using the CMGC method are different, as the prime contractor for construction also participates in the design phase. During the design phase, the prime contractor participates as the construction manager, providing feedback on design options, risks, and pricing. In the construction phase, the prime contractor assumes the traditional role as general contractor, overseeing the build.

The CMGC method is considered valuable for the state's complex construction projects, which are often among the state's largest. Since 2009, the CMGC method was used 16 percent of the time for construction contracts exceeding the QHI threshold, and those contracts accounted for 31 percent of the costs. Complex projects that utilize the CMGC method include the Days of '47 Arena and the new state prison. However, the challenge with CMGC projects is that since the prime contractor participates in the design and construction phases, the scope of work and compensation for both roles must be detailed in a contract.

We observed two methods used to clarify the scope of work and corresponding compensation for each of the contractor's roles. The first method, which is used by UDOT, utilizes two separate contracts: one contract for the design phase and a subsequent contract for the construction phase. The second method relies on an initial contract for the design phase that includes an outline of the scope of work and compensation structure for the construction phase. Subsequently, change orders are issued that include specifics regarding the scope of work and compensation for the construction phase. DFCM has implemented the second option for its CMGC projects.

The problem with DFCM's contract structure for CMGC projects as it relates to QHI is that the vast majority of costs are added via change orders. However, the applicability of QHI is based on the initial contract amount. Since the initial contract with DFCM only provides compensation for the design phase, the initial amount does not meet the QHI threshold. Figure 3.1 shows the differences between initial costs and subsequent change orders for prime construction contracts on design-bid-build and CMGC projects.

Figure 3.1 The Percentage of Costs Reflected in Initial Amounts and Change Orders Differs by Project Method. While design-bid-build projects have the vast majority of costs reflected in the initial amount, most CMGC costs are in change orders.

Project <i>(Project Method)</i>	A <i>(Design-Bid-Build)</i>	B <i>(CMGC)</i>
Initial Contract Amount	\$ 21,696,364	\$ 10,000
Change Order Amounts	(256,181)	15,355,682
Total Contract Amount	\$ 21,440,183	\$ 15,365,682
Change Order Percentage of Total	1.2%	99.9%

Source: DFCM change order documentation

Subsequent change orders, which are issued on CMGC contracts, detail the compensation paid to the prime contractor during the construction phase.

Unlike traditional design-bid-build contracts, the vast majority of CMGC costs are added via change orders.

Statute does not limit the extent to which change orders are exempt from subjecting a contract to QHI.

Despite using change orders, projects using the CMGC method are advertised as exceeding the QHI threshold.

As Figure 3.1 shows, the vast majority (99.9 percent) of contractual compensation for Project B was added via change order rather than being included in the initial contract amount. This high amount is a stark contrast from Project A, which only had change orders representing 1.2 percent of the total contract amount. The change orders submitted for Project A are more typical, representing unforeseen circumstances and clarifications on design specifications. In contrast, the massive change orders for Project B were facilitating the CMGC contract structure.

Because Project B incurred nearly all costs via change order, it did not meet the QHI initial contract amount threshold. *Utah Code* 63A-5-205(4)(d), which governs DFCM, states that the QHI requirement does not apply to a change order. However, in the following subsection, statute specifically states that using change orders to intentionally circumvent the QHI requirement is a violation of the statute. Since the change orders put the total contract amounts of Project B over the threshold for QHI, the project was not subject to QHI.

The important similarity between the two projects is that both were expected to exceed the \$2 million threshold for total construction costs. While Project A's total costs were clearly reflected in the initial contract amount, Project B conveyed a similar expectation even though the initial contract amount was much less. For Project B, the solicitation and initial contract referenced a \$14.5 million fixed limit of construction costs, which set clear expectations for DFCM and bidders on what the project limits were expected to be. Thus, we believe that exempting Project B when DFCM and the prime contractor knew that the total value of the contract would greatly exceed \$2 million seems inconsistent with statutory objectives. The Legislature should consider amending statute to control instances where change orders will significantly affect the amount of the contract.

Exempting CMGC Contracts Inhibits Subcontractor Enforcement

When a CMGC contract was exempted from QHI due to its low initial cost, DFCM's practice was to exempt the entire project. As a result, subcontractors who received subcontracts that exceeded the statutory \$1 million QHI threshold for subcontracts were also exempted. As discussed in Chapter II, DFCM's prime contractors had primary responsibility for obtaining documentation and assuring that

subcontractors were compliant. Thus, if a prime contractor was not required to sign DFCM's form acknowledging its QHI compliance responsibilities, then no follow-up on subcontractors was expected by DFCM.

Three subcontractors affiliated with Project B in Figure 3.1 had contracts that exceeded the QHI threshold for subcontractors. This is based on the anticipated work and costs that were specified in the change orders, which were for the following amounts:

- \$5,030,000 for specialized fabrication and installation
- \$2,739,489 for electrical
- \$1,482,804 for earthwork

Since the prime contractor was exempted due to the contract's initial \$10,000 amount, none of the subcontractors were notified that they were required to comply. During the audit, multiple individuals told us during the audit that subcontractors were at the greatest risk for noncompliance with the statute.

As we expressed our concerns to DFCM about CMGC projects not complying with the QHI requirement, DFCM retroactively requested that compliance documentation be collected from prime contractors and their subcontractors. On Project B, the prime contractor has not yet provided certification that its subcontractors were compliant. DFCM has requested this information from March to June 2017, but the prime contractor has been unable to provide the documentation.

Projected Cost Limits Should Be Included in QHI Eligibility Considerations

To address the problem created by DFCM's use of large change orders on CMGC contracts, we recommend that the Legislature consider two changes. The first change is to limit the exemption for change orders on all projects. One starting point would be to limit the change order exemption to a percentage of total construction costs. This solution would not adversely affect change orders, like those in Project A in Figure 3.1, where unforeseen issues arise. However, for CMGC projects where the change order represents the vast majority of costs, the QHI requirement would apply when the change order is applied and the construction phase commences.

Since the CMGC prime contract was exempt due to change orders, three subcontracts that exceeded the QHI threshold were also not subject to the requirement.

The Legislature should consider limiting the change order exemption to a percentage of total construction costs.

For DFCM's CMGC contracts, the QHI threshold should be determined by the advertised fixed limit of construction costs.

Another change to consider is relying on the fixed limit of construction costs (FLCC), as specified in CMGC solicitations and the initial contract, as the qualifying criteria for QHI. Project B in Figure 3.1 specified an FLCC of \$14.5 million. This figure was presented to prospective prime contractors during the solicitation process. Consequently, both prospective bidders and DFCM knew that the anticipated project costs were closer to \$14.5 million than to the \$10,000 conveyed in the initial contract. Thus, we recommend amending statute to use FLCC in place of the initial contract amount in order to determine QHI eligibility on CMGC projects.

Because a significant number of subcontractors who should be subject to QHI work on large, complex CMGC contracts, we recommend that the Legislature amend statute to ensure this takes place. Exempting prime contractors and subcontractors due to a large change order in the prime contract limits the effectiveness of the requirement. The objective should be to ensure that project design methods do not become a mechanism for circumventing the QHI requirement.

DFCM Projects Delegated to Higher Education Lacked Timely Enforcement

The State Building Board has statutory authority to delegate control over some higher education facilities to institutions. However, we reviewed three delegated projects where the QHI requirement was not enforced in a timely manner. Statute clearly specifies that delegating control of a project does not exempt the delegated institution from DFCM's construction requirements. While DFCM has worked on developing compliance processes for its own projects during 2016, a compliance process for higher education institutions has not yet been developed. We recommend that DFCM use its rulemaking authority to specify how QHI oversight should occur on delegated projects. This process should include some form of follow-up so DFCM can ensure compliance is occurring.

Projects Delegated to Higher Education Have Not Had Timely QHI Enforcement

Statute allows the State Building Board to delegate control over construction projects to other state entities. The delegation of responsibility is subject to certain limits. Specifically, *Administrative Rule 23-29-3(2)* allows for projects up to \$4 million to be assumed by Utah State University (USU) and projects up to \$10 million to be assumed by the University of Utah (U of U). When special situations arise, *Administrative Rule 23-29-4* allows projects exceeding these dollar thresholds to be delegated; however, these projects require approval from the State Building Board after DFCM has provided feedback. As part of this audit, we reviewed three projects that were delegated to the U of U and USU.

When we met with staff from the U of U's facilities management group, we discussed two recent projects that were delegated to them by the State Building Board and met the QHI requirement. On one project, they reported that no QHI documentation was collected. On the second, they provided a written certification from the prime contractor that was dated January 24, 2017, which was accompanied by an actuarial equivalency statement. However, the groundbreaking for the new facility occurred in October 2016. Staff reported that they began adhering to the statute once they received guidance and a standardized form from DFCM. Since DFCM itself has been slow to oversee QHI, it is no surprise that the same situation existed on these delegated projects.

At USU, we reviewed a third project involving a nonprofit unit of the Utah State Research Foundation, which celebrated its groundbreaking in May 2016. During a meeting with staff for the State Building Board and Commissioner's Office of Higher Education on March 22, 2017, we confirmed that the project should be subject to QHI. When we requested documentation for the project, the documentation we later received showed applicable contractors certifying their compliance as early as March 30, 2017. These certifications were provided nearly 10 months after construction commenced and a week after our meeting with the State Building Board and Commissioner's Office staff. When we discussed the lack of timely documentation with DFCM, staff acknowledged that during our audit they had initiated compliance discussions with the U of U but not with USU.

Statute allows the State Building Board to delegate control over some facility construction projects to higher education institutions.

The University of Utah began collecting QHI documentation in January 2017 once staff received guidance from DFCM.

With no guidance from DFCM, Utah State University collected QHI documentation on one project after we met with staff from the commissioner's office.

Since DFCM has been focused on developing its own QHI process, poor document collection on delegated projects was no surprise.

DFCM should consult with higher education institutions and develop a process for ensuring QHI compliance on delegated projects.

DFCM Needs to Develop a Process to Ensure Delegated Projects Are QHI Compliant

Since Chapter II highlights DFCM's lack of oversight on its own projects, the lack of oversight on these delegated projects is no surprise. *Utah Code* 63A-5-206(4)(a)(i) gives the State Building Board the authority to delegate control of facility construction projects on a project-by-project basis. In addition, paragraph (iii) of subsection (a) clarifies that delegated projects are still subject to QHI, specifically stating the following:

Delegation of project control does not exempt the state entity from complying with the codes and guidelines for design and construction adopted by the division and the State Building Board.

Since these projects would have been subject to QHI if DFCM had maintained control over them, it is expected that they should be subject to the same requirements under the control of higher education.

For these instances where responsibility for project control is delegated, we believe that DFCM should outline a process on how compliance should be demonstrated, after consulting with higher education. During our meeting with staff from the State Building Board and the Commissioner's Office of Higher Education, concern was expressed that statute is the only direction on QHI. Thus, institutions were left on their own to determine how to comply. Since DFCM has been given authority to make rules establishing QHI processes and procedures to follow, DFCM should clarify the process involving delegated projects.

Since inadequate oversight was a problem when subcontractor oversight was delegated to prime contractors (discussed in Chapter II), we are concerned that higher education may also face oversight issues. Thus, the process to be developed needs to clarify how to document prime contractor and subcontractor compliance prior to issuing a notice to proceed. These clarifications in rule should outline expectations for higher education institutions and allow DFCM to ensure that all facility projects, including delegated projects, are compliant with QHI.

Recommendations

1. We recommend that the Legislature consider amending DFCM's QHI statute to 1) clarify that on CMGC projects the fixed limit of construction costs is the basis for subjecting projects to the QHI requirement, and 2) limit the exemptions for change orders to a percentage of total contract amounts.
2. We recommend that DFCM and State Building Board Staff consult with the Commissioner's Office of Higher Education to outline a process in rule to ensure projects delegated to higher education institutions are collecting and reviewing QHI documentation.

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Agency Responses

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State of Utah

GARY R. HERBERT
Governor

SPENCER J COX
Lieutenant Governor

Department of Administrative Services

TANI PACK DOWNING
Executive Director

Division of Facilities Construction and Management

JAMES R. RUSSELL
Director

August 10, 2017

Mr. John Schaff
Legislative Auditor General
Office of the Utah Legislative Auditor General
350 North State Street
Salt Lake City, UT 84114

Re: DFCM's Response to A Performance Audit of Public Entities Oversight of the Qualified Health Insurance Statute

Dear Mr. Schaff:

Thank you for the opportunity to respond to Legislative Report No. 2017-07 concerning a Performance Audit of the Department of Public Entities' Oversight of the Qualified Health Insurance Statute. This letter will address your recommendations to DFCM on this statewide policy.

Recommendations from page 25:

- 1. Recommendation** -- You recommended that UDOT and DFCM report to the Infrastructure and General Government Appropriations Subcommittee during the 2018 General Session on our efforts to improve oversight of the QHI requirement.
Response – We are in agreement with this recommendation and will prepare to discuss our efforts to improve our oversight of QHI with the IGG Committee.
- 2. Recommendation** – You recommended that public entities develop processes whereby prime contractors provide subcontractor actuarial equivalency statements as supporting documentation for their certification of their subcontractors' QHI compliance.
Response – Although current DFCM statute, rule, and process only requires the prime contractor to certify that the sub-contractor/consultants comply, DFCM agrees that this audit has shown the need for a process change for increased oversight of sub-contractor/consultant compliance on DFCM projects.
- 3. Recommendation** – You recommended that public entities review select actuarial equivalency statements to ensure they are prepared by either an actuary or an underwriter, which is required in statute.
Response – DFCM agrees with this recommendation and has begun a more thorough review of the actuarial statements.

4. **Recommendation** – You recommended that public entities either amend their Administrative Rules to require that actuaries and underwriters review premium schedules as they prepare their equivalency statements, or request and review premium contribution schedules for statutory compliance.

Response – DFCM agrees and will develop a process to implement this recommendation as well as propose an Administrative Rule change to the State Building Board.

Recommendations from page 35:

1. **Recommendation** – You recommended that the Legislature consider amending DFCM's QHI statute to 1) clarify that on CMGC projects the fixed limit of construction costs is the basis for subjecting projects to the QHI requirement, and 2) limit the exemptions for change orders to a percentage of total contract amounts.

Response – DFCM agrees with this recommendation and will develop a process to require compliance with the QHI requirements on all GMGC projects. Additionally, DFCM will propose an Administrative Rule to the State Building Board to ensure QHI compliance on CMGC projects.

2. **Recommendation** – You recommended that DFCM and State Building Board Staff consult with the Commissioner's Office of Higher Education to outline a process in rule to ensure projects delegated to Higher Education institutions are collecting and reviewing QHI documentation.

Response – DFCM will work with the State Building Board and the Commissioner's Office of Higher Education to develop a process to ensure compliance with QHI on all projects delegated by the State Building Board.

Thank you for the opportunity to respond to this audit. DFCM appreciates the Legislative Auditor General and staff for their level of professionalism and collaboration with us on this effort to make state government more effective and efficient. Please do not hesitate to call if you have any questions.

Sincerely,



James R. Russell, Director
DFCM

cc: Tani Downing
Marilee Richins
Denise Austin
Marla Workman



State of Utah

GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

DEPARTMENT OF TRANSPORTATION

CARLOS M. BRACERAS, P.E.
Executive Director

SHANE M. MARSHALL, P.E.
Deputy Director

August 3, 2017

John M Schaff, CIA
Auditor General
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W315 Utah State Capitol Complex
P.O. Box 145315
Salt Lake City, UT 84114-5315

Mr. Schaff:

I write in response to **A Performance Audit of Public Entities' Oversight of the Qualified Health Insurance Statute (Report #2017-07)**. The Utah Department of Transportation (UDOT) always welcomes the opportunity to open our records and receive feedback on how we can improve our processes.

We appreciate the recognition in the report that UDOT is a leader among agencies in compliance with the Qualified Health Insurance (QHI) statute and will continue to explore ways to improve compliance.

The report gave the example on page 9 of the UDOT contractor who did not meet the requirements of QHI. This contractor had submitted an actuarial equivalency statement that the contractor complied with QHI, but in fact, did not due to lower than required employer contribution to the plan. UDOT will strengthen the template language so that the actuaries and underwriters understand that they are not only certifying the insurance coverage, but the employer contribution according to statute.

Again, we appreciate the opportunity to comment on the report. You may contact us if you have any further questions.

Sincerely,

Carlos M. Braceras, PE
Executive Director

CMB/RW/dej

Cc: Shane Marshall, UDOT
Randy Park, UDOT
Jimmy Holfeltz, UDOT

Rob Wight, UDOT
Stacy Frandsen, UDOT

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August 11, 2017

John M. Schaff, CIA
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Salt Lake City, Utah 84114-5315

Re: Performance Audit of Public Entities' Oversight of the Qualified Health Insurance Statute (Report #2017-07)

Dear Mr. Schaff:

Thank you for the opportunity to review the draft Qualified Health Insurance (QHI) report. The information provided in this report has allowed us to make several immediate improvements to our QHI compliance procedures including:

- Adding more detailed instructions and template certification language to the bid/proposal instructions included in UTA's section on SciQuest, the Utah public procurement place provided by the Division of Purchasing.
- Updating internal procurement checklists to verify QHI certification documentation is in place prior to applicable construction contract awards.

Besides these changes, UTA will also revise its applicable corporate policies to address recommendations contained in the QHI report.

Finally, let me thank your staff for their thoroughness in discussing the report with us.

Very truly yours,

Robert K. Biles
Vice President - Finance