OC Board of Supervisors'

Internal Audit Department

ORANGE COUNTY

Analysis of the Savings from the Health Insurance Change as Part of the New Retirement Cost Offset

On May 20, 2008, the Board of Supervisors directed the Internal Audit Department to provide the Board with a more detailed analysis of the savings realized from the health insurance changes as part of the new retirement cost offset.

The County actually experienced cost savings of $16 million and therefore $16 million of savings was applied on a pro-rata basis to all participating labor organizations based on their medical cost.

AUDIT NO: 2807-3
REPORT DATE: SEPTEMBER 5, 2008

A Board of Supervisors Directed Analysis
Meeting Date: May 20, 2008

Audit Director: Peter Hughes, Ph.D., CPA
Deputy Director: Eli Littner, CPA, CIA

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Letter from Director Peter Hughes

Transmittal Letter

Audit No. 2807-3 **September 5, 2008**

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Analysis of the Savings from the Health Insurance Change as Part of the New Retirement Cost Offset

This report is being issued in response to a Board of Supervisor's directive number 22, dated May 20, 2008. The directive requested that the Internal Audit Department provide the Board with a more detailed analysis of the savings realized from the health insurance changes as part of the new retirement cost offset.

Please contact me should you wish to discuss any aspect of our analysis.

Attachments

Other recipients of this report listed on the Internal Auditor's Report on page 2.

Table of Contents

Analysis of the Savings from the Health Insurance Change as Part of the New Retirement Cost Offset
Audit No. 2807-3

OC Internal Audit Report

INTERNAL AUDITOR'S REPORT

Audit No. 2807-3 **September 5, 2008**

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Analysis of the Savings from the Health Insurance Change as Part of the New Retirement Cost Offset

Audit Highlight

On May 20, 2008 the Board of Supervisors directed the Internal Audit Department to provide a more detailed analysis of the savings realized from the health insurance change as part of the new retirement cost offset.

The County actually experienced cost savings of $16 million and therefore $16 million of savings was applied on a pro-rata basis to all participating labor organizations based on their medical cost totals.

This report is being issued in response to a Board of Supervisors' directive number 22, dated May 20, 2008. The directive requested that the Internal Audit Department provide the Board with a more detailed analysis of the savings realized from the health insurance changes as part of the new retirement cost offset.

At the request of the Board of Supervisors under a separate directive, the Internal Audit Department recently conducted an audit of the County's enhanced pension benefit (known as 2.7% at 55) to ensure that employees were paying the entire yearly cost for the benefit enhancement and that the County was not making any contribution to the enhanced pension benefit on behalf of its employees. The enhanced pension benefit was the agreement made by the labor organizations in their negotiations with the County and involved two major cost categories:

1. Medical insurance cost concessions were made to the medical plans and resulted in increased cost and reduced benefits for employee medical services and care. The consequence of these concessions was a reduction in medical insurance costs to the County. The County agreed to apply the amount so saved in the medical insurance plans as a dollar for dollar offset on the cost of the enhanced pension benefit.

2. The labor organizations agreed that the yearly cost of the enhancement to the pension benefit, after accounting for the medical plan savings offset, would be entirely payable by their employee members through payroll withholding.

In Audit Report 2765, dated April 3, 2008 and titled Audit of the Source of Funding for the 2004 OCEA Pension Enhancements, the Internal Audit Department determined OCEA (the major labor organization in the County representing approximately 11,700 employees and composing approximately 71% of all County employees) employees accurately paid for their enhanced pension benefit for the three year period of our review.

We reviewed Fiscal Years 2005/06, 2006/07, and 2007/08 and concluded that OCEA members paid $80 million for the enhanced pension benefit component. This was the total of the annually required contributions for the three year period. The $80 million dollar total is composed of $46.4 million paid directly from employee contributions and $33.6 million from medical insurance savings applied as a cost offset. Furthermore, the OCEA employee members continue to pay their annually required payments for their share of costs under their old plan.

Moreover, the above payment over the three years also reduced the Unfunded Accrued Actuarial Liability (UAAL) of their enhanced pension benefit component. Their required payment includes costs specifically that amortize the UAAL of the enhanced pension component.

CHANGES TO THE MEDICAL INSURANCE PLANS

The analysis of the following details the specific changes made to the medical insurance plans and the savings the County's consultant, Mercer Human Resources Consulting, had projected for each change made. The County actually experienced cost savings of $16 million and therefore $16 million of savings was applied on a pro-rata basis to all participating labor organizations based on their medical cost totals. The savings applied as an offset to OCEA were calculated at $11.2 million per year. The balance of $4.8 million was allocated to the remaining participating labor organizations.

	Originally Estimated Savings
1. Consolidate Preferred Choice plan into WellWise	($2,203,359)
2. Eliminate Indemnity A plan	($ 37,099)
3. Increase WellWise employee deductible to $300	($1,835,524)
4. Eliminate Rx through TPA	($ 134,306)
5. Increase employee HMO office visit cost to $15	($2,888,065)
6. Increase employee Rx copay to $10/$15	($2,499,285)
7. Add $100 to employee HMO hospital deductible	($ 240,614)
8. Add employee HMO emergency room copay to $50	($ 267,487)
9. Add 5% contribution for single employees	($1,150,683)
Total	($11,256,422)
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CONCLUSION

To date, the County is cost neutral with respect to the enhanced pension benefit. The OCEA employee members are completely paying directly through payroll deductions and indirectly through structural changes to health insurance plans the yearly cost for the enhanced pension benefit.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

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