

# STATE AUDITOR'S OFFICE PERFORMANCE REVIEW



## **K-12 Employee Health Benefits**

**February 2011**

**Report No. 1004979**



WASHINGTON  
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## Overview

Washington State provides health benefits to more than 100,000 public school employees in 295 school districts and nine educational service districts. In late 2010, the State Auditor’s Office contracted with The Hay Group, actuarial experts in health benefits, to examine this system. Our study found opportunities for the state and public schools to:

- Streamline the system to improve efficiency, transparency, and stability.
- Standardize coverage levels for more affordable, quality medical benefits.
- Reduce costs by restructuring the health benefits system.

The study identifies changes that, depending on how they are structured, could save up to \$180 million per biennium – enough for salaries and benefits for about 1,000 teachers.

These reforms could greatly simplify and stabilize a health benefits system that many, including state legislators and other policy-makers, find too tangled to understand. The current system:

- Includes more than 1,000 separate benefits-funding pools that pay for more than 200 different medical plans offered through 10 different insurance companies.
- Provides very uneven out-of-pocket costs for different groups of K-12 employees. About 27 percent of employees, who insure just themselves, pay no premiums at all, while those who buy family coverage pay average monthly premiums of \$500.

## Background

Since 1969, the Legislature has appropriated funds to public schools to provide health benefits for their employees. In 1990 the Legislature said this funding is intended to:

- Provide access to basic coverage for school employees and their dependents while minimizing employees’ out-of-pocket premium costs.
- Eliminate major differences in out-of-pocket premium expenses for employees who do and do not need coverage for dependents by pooling funds at the school district level.
- Encourage plans that promote appropriate use of health benefits without creating major barriers to receiving care.

## Study objectives and methodology

The study asked two main questions:

1. What is the current cost of public school employee health-benefits coverage and what level of benefits do the plans provide?
2. Are there opportunities to reduce current or contain future costs through alternative health care coverage? If so, how might these opportunities be realized?

## Performance review conducted under authority of I-900

We conducted this review under the authority of Initiative 900, approved by Washington voters in 2005 and enacted into state law in 2006. Specifically, the law directs the State Auditor’s Office to “review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs and accounts.”

The law identifies several specific elements that we considered in reviewing K-12 employee health benefits, including potential cost savings, gaps or overlaps in programs or services, recommendations to change departmental roles or functions, analysis of performance data, and identification of best practices.

This review does not constitute an audit under Generally Accepted Government Auditing Standards (GAGAS). However, it was conducted in a manner consistent with the independence principles specified by GAGAS.

The State Auditor’s Office worked with The Hay Group of Philadelphia to examine these questions. We developed a survey after discussing health benefits issues with staff from the Office of the Superintendent of Public Instruction, Health Care Authority, Office of the State Actuary, Legislature, public school employee unions, school district administrators and professional school associations. Hay sent the survey to all public school and educational service districts to collect information about health benefits coverage, costs, and associated district administration for 2009-10.

A total of 129 districts responded, representing 42 percent of all public K-12 districts and 68 percent of all employees— a very high response rate. The survey responses are representative of all districts and their employees. The Hay Group used actuarial methods to analyze the health benefits plans and costs.

### Current K-12 employee health benefit costs and coverage

Public school employee-health benefits totaled about \$1.21 billion during the 2009-10 school year. Of that, vision and dental benefits cost \$181 million (15 percent). Medical benefits cost about \$1,029 million (85 percent).

#### Funding health benefits

Districts used about \$1 billion (84 percent) from state, federal and local levy funding sources to provide their employees with health benefits. The rest is paid by employees. In 2009-10, about 10.4 percent of districts’ total general fund operating costs paid for employee health benefits.

In 2009-10, the state provided about \$778 million (64 percent of total cost) to fund health benefits. Washington State funds public school employee health benefits on a per-full-time equivalent employee basis<sup>1</sup> (e.g., \$745 per FTE in 2009-10). The state includes additional money for health benefits in funding formulas for specific programs such as special education and pupil transportation. About \$90 million in federal and other funding (7 percent of total benefits cost) helped to pay for health benefits to employees in federally sponsored school programs, such as the school lunch program.

For public school retirees, districts pay the Health Care Authority (HCA) an amount per current, active employee who is eligible for benefits (e.g., \$59.59 per eligible employee in 2009-10). The HCA collected about \$77 million from districts in 2009-10 for retiree benefits. Districts typically use local levy money to pay the HCA.

2009-10 Total Health Benefit Costs by Benefit Type (Dollars in millions)		
Benefit Type	Cost	Percent of Total Cost
Dental	\$155	13%
Vision	\$26	2%
Medical	\$1,029	85%
<b>TOTAL</b>	<b>\$1,210</b>	<b>100%</b>

**Source:** The Hay Group based on school district surveys.

2009-10 Total Health Benefit Costs by Funding Source (Dollars in millions)		
Funding Source	Cost	Percent of Total Cost
State	\$778	64%
Employees	\$198	16%
Local Levy	\$144	12%
Federal and Other	\$90	8%
<b>TOTAL</b>	<b>\$1,210</b>	<b>100%</b>

**Source:** The Hay Group and Office of the Superintendent of Public Instruction.

<sup>1</sup> State money is allocated by formula, but the formula usually does not include all employees in a district. School districts often employ more people than the formula includes, and they make up the difference from local levy or federal money.

Districts added about \$144 million (12 percent of total benefit cost) in local-levy money to state and federal funding to provide health benefits to current employees in 2009-10. Local collective bargaining agreements determine the amount of local money a district adds. This affects employees' out-of-pocket premium costs.

Employees paid about \$198 million (16 percent of total benefit costs) in premium costs in 2009-10. Of that amount, employees with plans that just cover themselves paid about 9 percent while employees with plans that cover themselves and their families paid about 42 percent of total out-of-pocket premium costs.

<b>Employees' Share of Total Health Benefit Costs in 2009-10 by Coverage Type (Dollars in millions)</b>			
<b>Coverage Type</b>	<b>Total Employee Premium</b>	<b>Percent of Employee Premium Costs</b>	<b>Percent of \$1.2 Billion Total Premium Cost</b>
Employee	\$18	9%	1%
Employee & Spouse	\$52	26%	4%
Employee & Child	\$46	23%	4%
Employee & Family	\$82	42%	7%
<b>TOTAL</b>	<b>\$198</b>	<b>100%</b>	<b>16%</b>

**Source:** *The Hay Group based on school district surveys.*

The amount employees pay for their health benefits is determined by several factors that vary by collective bargaining unit:

- Local levy money that a district contributes to pay for its employees' benefits.
- The cost of premiums of the health-benefit plans (especially medical plans) available to a unit's employees.
- The amount of benefits money that employees, who are ineligible for benefits or who waive coverage, do not use. This is reallocated evenly among a unit's other employees through a process called "pooling".

### **Differences in what employees pay**

State law requires districts to pool benefits money. The intent of pooling is described in the 1990 law as follows:

"The legislature also intends that school districts pool State benefit allocations so as to eliminate major differences in out-of-pocket premium expenses for employees who do and do not need coverage for dependents." (See RCW 28A.400.200, Intent.)

Just over half of K-12 employees are enrolled in plans that cover themselves only. On average, they pay about 5 percent of their total premium out-of-pocket, or about \$27 per month. Employees enrolled in plans that cover themselves and their families represent about 12 percent of all employees enrolled in a plan. They pay an average of 39 percent of their total premium

out-of-pocket, or about \$500 per month. This gap appears to contradict the Legislature’s intent.

<b>Differences in What Employees Paid for Medical Benefits in 2009-10</b>			
<b>Coverage Type</b>	<b>Percentage Enrollment</b>	<b>Share of Premium Paid by Employee</b>	<b>Average Monthly Employee Cost</b>
Employee	51%	5%	\$27
Employee & Spouse	12%	31%	\$327
Employee & Child	24%	18%	\$145
Employee & Family	13%	39%	\$500
<b>TOTAL</b>	<b>100%</b>	<b>19%</b>	<b>\$151</b>

**Source:** The Hay Group based on school district surveys.

### Medical benefits coverage

While all retired public school employees have standard medical benefit plans available to them through the HCA’s Public Employee Benefit Board (PEBB), active employees may choose any plans their bargaining units approve. Hay’s survey indicated less than 2 percent of active employees were enrolled in a PEBB medical plan in 2009-10.

<b>Enrollment by Medical Provider in 2009-10</b>	
<b>Medical Benefits Provider</b>	<b>Percent of employees covered</b>
WEA-Premera	55%
Group Health	18%
Regence Blue Shield	8%
Premera Blue Cross	6%
Kitsap Physicians Service	2%
Kaiser Permanente	2%
Other (including PEBB)	9%
<b>TOTAL</b>	<b>100%</b>

**Source:** The Hay Group based on school district surveys.

About 55 percent of all public school employees were enrolled in the Washington Education Association’s (WEA) Premera plan. These are mostly certificated employees (teachers), and are typically in WEA collective bargaining units. The remaining 45 percent of employees enrolled in medical plans are classified employees (custodians, bus drivers, food service workers, etc.). Classified employees are represented by many different bargaining units and typically enroll in coverage from plan providers other than the WEA.

## WEA rate stabilization fund

The WEA has a rate stabilization fund designed to reduce premium increases over time. Having such a fund is a common health-insurance industry practice. The fund is subject to legal restrictions and annual audits by a public accounting firm to ensure the money in the fund is used only to benefit WEA plan participants through subsidizing premiums or purchasing benefits. It may not be used for political purposes.

The WEA has a policy to maintain a balance in the stabilization fund equal to 3 to 5 percent of total premiums. However, due to a multi-year lag between management decisions and paying down the balance, the fund has had deficits as well as large surpluses over the last 20 years.

Recently, significantly lower-than-expected medical claims increased the fund balance from about \$16 million (three percent of premiums) in 2005 to over \$106 million (17 percent of premiums) in 2008. The balance began to decrease in 2009, and both the WEA and Hay predict that the balance will be about \$22 million (2.5 percent of projected premiums) by 2013 after subsidizing premiums.

## Opportunities to improve K-12 health benefits system

The Hay Group identified three main opportunities to reform the way health care is delivered to public school employees while still providing quality affordable care. These three options are not mutually exclusive. They are related options that, taken together, could yield significantly greater savings and transparency.

- 1. Streamline the system by simplifying the pooling process.** Create fewer and larger funding pools to create stability, save money through reduced administrative costs and greatly increase transparency.
- 2. Standardize coverage levels for more affordable, quality medical benefits.** Provide affordable, quality care by creating standard benefit levels or “tiers.” Public school employees could choose from these benefit tiers.
- 3. Restructure the health benefits system.** Completely restructure the public-school employee health-benefits system. Create a separate, statewide, self-funded program with its own governing board.

### Option 1: Streamline the system

School districts use a process called “pooling” to help subsidize some employees’ premium costs. The current pooling system is extremely complicated and places a significant burden on district administration. State law requires districts to pool benefits money not used by employees in a bargaining unit that are ineligible or that waive coverage, and then redistribute that money evenly among the other employees in that unit’s pool to reduce their premium costs. These pools should not be confused with what insurers call “risk pools.” In the K-12 system, pools are places where the money goes before it is reallocated.

There are more than 1,000 pools in the current system; some individual districts have more than a dozen. Each funding pool is unique and is shaped by

the employees’ labor bargaining unit. There is no uniform approach among the local districts. More than half of the pools reallocate benefits funding multiple times per year.

Money in each funding pool is divided evenly among the enrollees in that pool. But at this point it becomes more complicated to follow the money, because each pool operates differently. Some employees have enough extra funding to buy richer benefits or have zero out-of-pocket premium costs. When this happens it is usually because the district has enough part-time, benefits-ineligible employees to fully subsidize others’ coverage. Part-time employment is more common among classified employees (bus drivers, food service workers) because certificated employees (teachers) are usually full-time.

Because funding from the pools is reallocated after employees enroll in their medical plans, the employees do not know how much they will have to pay in out-of-pocket premium costs until after they have signed up for benefits. This often causes significant changes in benefits enrollment from year to year.

Hay recommends limiting the number of pools in a district to two (i.e., for certificated and classified staff) and establishing a minimum pool size. Restructuring the pooling process would:

- Increase the stability of participation rates.
- Improve administrative efficiency.
- Increase the transparency of premium costs.

### Option 2: Standardize coverage levels

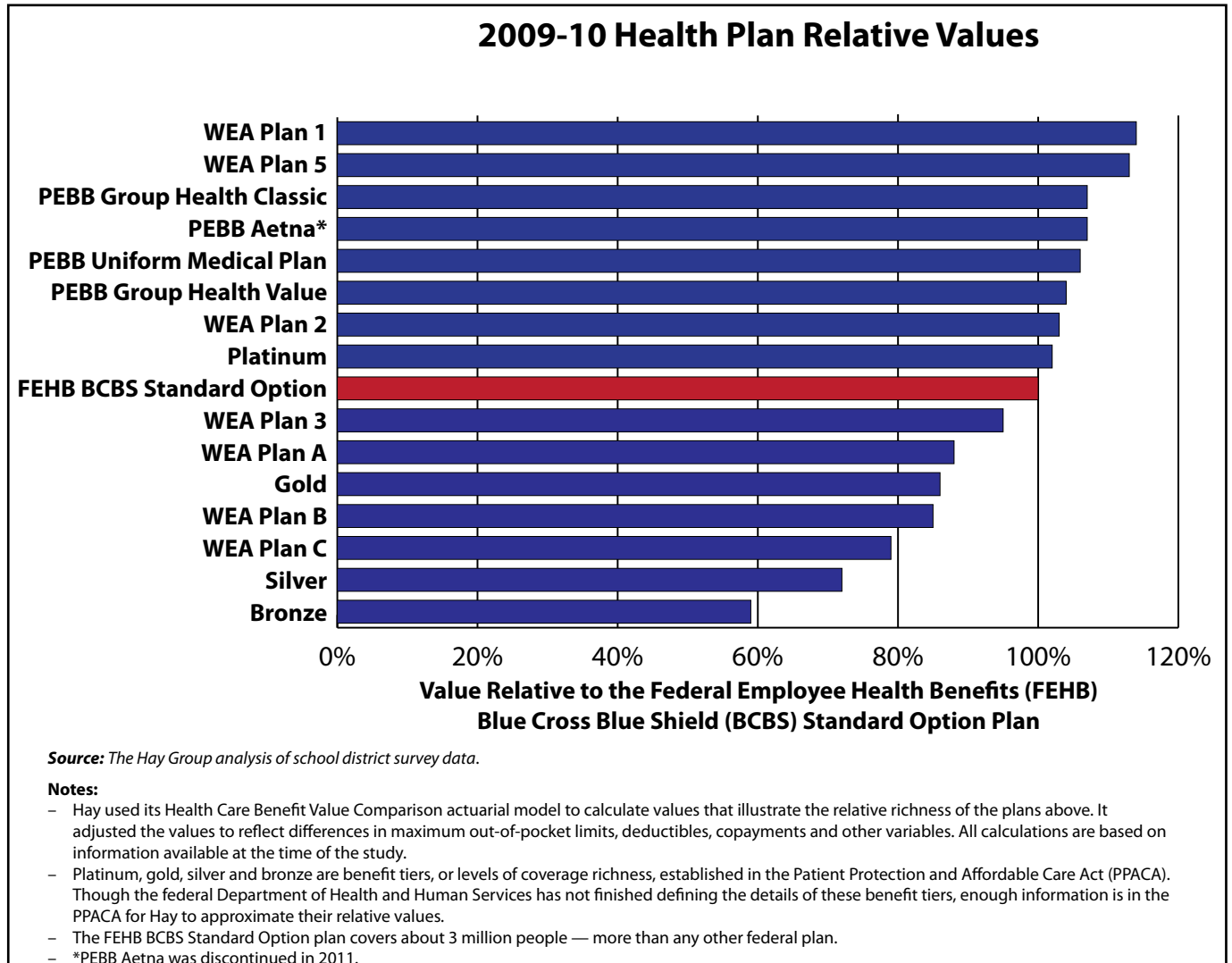
After reviewing the health benefits available to public school employees, Hay concluded that districts generally provide generous benefits. For example, Hay estimated that the two most popular WEA plans provide benefits that are up to 14 percent richer than the Federal Employee Health Benefits (FEHB) Blue Cross Blue Shield (BCBS) Standard Option plan.

#### The 55% of Employees in WEA-Premera By Plan

WEA-Premera Plan Name	Percent of Employees Covered
WEA Select Plan 1 & 5	60%
WEA Select Plan 2	21%
WEA Select Plan 3	14%
WEA EasyChoice Plans A/B/C Combined	6%
<b>TOTAL</b>	<b>100%</b>

Source: The Hay Group based on school district surveys.

The following chart shows the relative values, or comparative richness, of the plans in PEBB, the WEA, the FEHB BCBS Standard Option Plan, and the platinum, gold, silver and bronze benefit tiers established in last year's federal health-care reform law (the Patient Protection and Affordable Care Act).



A platinum plan will pay the most medical costs, but its premium is normally higher than for the lower tiers. About 82 percent of public school employees have plans closest to the platinum tier; 18 percent have plans closest to a gold tier. None have plans near the silver or bronze tiers.

The Hay Group estimates that if the whole public school employee health benefits system funded plans at the level of the FEHB BCBS Standard Plan, the overall savings would be about \$13 million annually. Standardizing health benefits for all public school employees in alignment with the tiers of the federal health-care reform law could result in further savings as shown in the following table.

**Estimated Annual Cost Differences by Standardizing Medical Benefits for All Employees  
(Dollars in millions from all sources)**

<b>Benefit Level</b>	<b>Cost Savings / Increases</b>	<b>Percentage Cost Savings / Increases</b>
PEBB <sup>1</sup>	<b>Increase \$45</b>	<b>Increase 3.7%</b>
FEHB BCBS Standard Option Plan	\$13	1.1%
Platinum	<b>Increase \$7</b>	<b>Increase 0.6%</b>
Gold	\$157	13.0%
Silver	\$300	24.8%
Mapped to Closest Plan <sup>2</sup>	\$28	2.3%

**Source:** The Hay Group based on school district surveys. Estimates are based on 2009-10 health benefits costs of \$1.21 billion.

<sup>1</sup>**“PEBB”** represents the average level of coverage richness currently available through the PEBB program. It does not assume that the PEBB program would administer the benefits.

<sup>2</sup>**“Mapped to Closest Plan”** assumes that, if only the platinum, gold and silver tiers were available, employees would choose a plan closest to the value that they currently have. Currently, 82 percent of public school employees have benefit plans closest to the platinum tier and 18 percent have benefit plans closest to the gold tier. This would likely be the least disruptive change in benefits.

**Option 3: Restructure the health benefits system**

Hay concludes that creating a new, separate self-funded program for K-12 employees that provides standardized benefits that map most closely to current benefits could save as much as \$90 million per year.

A statewide, self-funded program for public school employees, that is separate from PEBB, could be administered by the HCA or some other organization. Separating the public school employee program from the PEBB program would avoid many issues with merging the programs (e.g., differences in funding rates and benefit designs). Also, merging a larger portion of public school employees and state employee populations would not save money because economies of scale quickly decrease after insurance risk pools exceed 50,000 employees. A separate public school program could have its own governance structure, including both district management and labor representation, providing greater confidence in the new system.

**Estimated Annual Cost Savings by Restructuring  
(Dollars in millions from all sources, based on 2009-10 health benefits costs of \$1.21 billion)**

<b>Savings by Funding Source</b>	<b>Voluntary Participation<sup>1</sup></b>	<b>Mandatory Participation<sup>2</sup></b>
State and federal	\$21	\$46
Local levy	\$3	\$8
Employees	\$5	\$10
<b>TOTAL</b>	<b>\$29 (2.4%)</b>	<b>\$64 (5.3%)</b>

**Source:** The Hay Group based on school district surveys. Estimates are based on 2009-10 health benefits costs of \$1.21 billion.

1. **“Voluntary Participation”** assumes that all districts would offer plans through the statewide program along with other plans, and that about 45 percent of all employees currently covered would enroll in a plan through the statewide program. Hay believes that this is a conservative estimate.
2. **“Mandatory Participation”** assumes that all districts would only offer plans through the statewide program, and that 100 percent of all employees currently covered would enroll through that program.

By just restructuring the many current public school employee health plans, the program could achieve about \$29 million in annual cost savings if 45 percent of public school employees voluntarily participated in the program (a conservative estimate), and up to \$64 million annually if all employees participated. Consistent eligibility and benefit management would produce other administrative efficiencies.

The combined savings from restructuring the system to either a voluntary or mandatory system and standardizing the benefits plans to match different coverage levels are reflected in the following table.

<b>Estimated Annual Savings or Cost Increases                      from Standardizing Medical Benefits and Restructuring the System                      (Dollars in millions from all sources)</b>							
<b>Program Structure</b>	<b>Current Plans</b>	<b>PEBB<sup>1</sup></b>	<b>FEHB</b>	<b>Platinum</b>	<b>Gold</b>	<b>Silver</b>	<b>Mapped to Closest Plan<sup>2</sup></b>
Current Structure	No change	\$45 3.7% increase	\$13 1.1%	\$7 0.6% increase	\$158 13%	\$300 24.8%	\$28 2.3%
Voluntary <sup>3</sup>	\$29 2.4%	\$16 1.3% increase	\$41 3.4%	\$22 1.8%	\$182 15%	\$321 26.5%	\$56 4.6%
Mandatory <sup>4</sup>	\$64 5.3%	\$21 1.7%	\$76 6.3%	\$57 4.7%	\$213 17.6%	\$347 28.7%	\$90 7.4%

**Source:** The Hay Group based on school district surveys. Estimates are based on 2009-10 health benefits costs of \$1.21 billion.

1. **“PEBB”** represents the average level of coverage richness currently available through the PEBB program. It does not assume that the PEBB program would administer the benefits.
2. **“Mapped to Closest Plan”** assumes that, if only the platinum, gold and silver tiers were available, employees would choose a plan closest to the value that they currently have. Currently, 82 percent of public school employees have benefit plans closest to the platinum tier and 18 percent have benefit plans closest to the gold tier. This would be the least disruptive change in benefits.
3. **“Voluntary participation”** assumes that all districts would offer plans through the statewide program along with other plans, and that about 45 percent of all employees currently covered would enroll in a plan through the statewide program. Hay believes that this is a conservative estimate.
4. **“Mandatory participation”** assumes that all districts would only offer plans through the statewide program, and that 100 percent of all employees currently covered would enroll.

### Implementation considerations

The Hay Group did not calculate the costs to create a statewide, self-funded plan. A fiscal note to the 2009 Senate Substitute Bill 5491 — An act relating to developing a strategy to reduce the cost of providing health benefits for K-12 employees — outlined some of the necessary implementation steps to create a statewide program. Because school district payroll systems are separate and do not talk to each other, a new IT system would need to be created to interface between the program and each district’s payroll system. Staffing would be necessary to administer the statewide program. The fiscal note estimated that it would cost the Health Care Authority up to \$1.5 million per year to administer the program. Finally, a substantial reserve fund would need to be established to pay insurance claims and mitigate insurance risk.

View the [full study](#).

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