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Letter Report 114

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
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Dear Mr. Chairman and Members:

In response to your request, we have answered four questions you asked regarding contracts that the State awarded to four different insurance carriers to provide dental care to state employees. The four questions you asked were as follows:

- Why did the Department of Personnel Administration (DPA) not require the California State Employees Association (CSEA) to competitively bid the contracts it sponsored?
- How do the costs and benefits of the CSEA-sponsored dental plans compare with the plans selected by the State?
- Are there any bonding requirements for the Aetna and Safeguard contracts that are not required under the CSEA-sponsored contracts?
- Do the CSEA-sponsored contracts enable the CSEA to collect an administration fee?

This letter provides background information on the issues and answers each question individually. The review was conducted under the authority vested in the Auditor General by Sections 10527 through 10528 of the Government Code.

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 2

BACKGROUND

The Governor's Reorganization Plan No. 1 of 1981 established the Department of Personnel Administration (DPA) as the agency responsible for managing the nonmerit aspects of the state personnel system, including state employee benefits and other terms and conditions of employment.

The State Employer-Employee Relations Act, contained in the California Government Code, provides for collective bargaining for all nonmerit terms and conditions of employment; that is, only issues regarding the classification, selection, and discipline of employees are excluded from collective bargaining. The State Personnel Board is responsible for these excluded matters. Under Section 3517 of the Government Code, the State must "meet and confer in good faith" with recognized employee organizations regarding wages, hours, and other terms and conditions of employment. If the State and the employee organization agree on a negotiated issue, they sign a memorandum of understanding.

Under the Employer-Employee Relations Act, employees may organize themselves into bargaining units in accordance with certain criteria established by the Public Employment Relations Board. Once organized, employees elect an organization to serve as their exclusive representative. Currently, there are 20 certified bargaining units covering the rank-and-file state employees. The California State Employees Association is the exclusive representative for ten of these units. The DPA, on the other hand, retains responsibility for nonrepresented employees and, in the case of dental benefits, retired annuitants.

In 1980, the Legislature enacted the State Employees' Dental Care Act (Chapter 1039, Statutes of 1980). This act authorizes the State to contract with insurance carriers for dental care plans for state employees and annuitants. The act further specifies that the State may contract with insurance carriers only after it has negotiated with employee organizations regarding terms and conditions of the dental contracts and after the Legislature has appropriated the necessary funds.

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 3

The State offers employees the choice of either an indemnity type dental plan or a prepaid dental plan. Under an indemnity plan, the individual selects the provider of dental service, and the insurance carrier pays for the charges in total or in part after a deductible is paid by the patient. A prepaid dental plan, on the other hand, pays a group of dentists a capitation rate (i.e., a uniform payment for each person enrolled) regardless of how many patients the group sees. Consequently, a patient is limited in his or her selection of a dentist; however, the patient pays no deductible.

In response to the State Employees' Dental Care Act, the DPA negotiated with the various employee organizations and ultimately signed with each bargaining unit a memorandum of understanding regarding dental coverage. To fund the dental plans, the Legislature appropriated approximately \$21.2 million in the Budget Act of 1981.

We limited our review to examining only the four contracts identified in the request. In conducting our examination, we reviewed these contracts, interviewed DPA and CSEA officials, and reviewed appropriate statutes.

STUDY RESULTS

The audit request asked four specific questions regarding the dental plan contracts. On the following pages, we address each of these questions individually.

Why did the DPA not require the CSEA to competitively bid the contracts it sponsored?

The DPA did not require the CSEA and all other exclusive representatives to select their dental care insurance carriers through a competitive bidding process for two reasons. First, the DPA believed that state law did not require exclusive representatives to use a competitive bidding process to select insurance carriers. Second, the DPA believed it was fulfilling the intent of competitive bidding by requiring the CSEA-sponsored contracts to be comparable in cost and coverage to the contract that the State had competitively bid and awarded for nonrepresented employees. The DPA did not attempt

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 4

to impose the carriers it had selected upon the employees represented by CSEA or other exclusive representatives because it felt such an action would result in a charge of unfair labor practices. The DPA believes there are no apparent legal restrictions to including a competitive bidding requirement as an item for negotiation during the meet-and-confer bargaining process. When the contracts expire in 1983, the DPA could choose to rebid them and negotiate with the exclusive representatives for competitive bidding.

Section 14615 of the Government Code assigns the Department of General Services the powers of supervision over matters concerning the financial and business policies of the State. Section 14780, et seq., requires that all service contracts entered into by any state agency must be transmitted to the Department of General Services for approval, although the department may occasionally grant certain specific exceptions. To meet its responsibilities in reviewing contracts, the Department of General Services has developed policies that are outlined in the State Administrative Manual. Sections 1204 and 1213 of the manual specify that at least three competitive bids or qualifying proposals must be secured on all contracts awarded by state entities. The DPA believed, however, that exclusive representatives were not subject to these contracting provisions.

Although the DPA neither required nor negotiated with the CSEA to use competitive bidding for the contracts, the DPA believed that it met the intent of competitive bidding through the process it employed. For the 62,000 employees and annuitants not represented by a bargaining unit, the DPA issued a request for proposal outlining specific criteria for dental coverage. Twenty dental insurance carriers responded to the request for proposal. The DPA requested each carrier to provide estimates of the cost of covering incremental numbers of rank-and-file employees whose exclusive representative might choose to enroll its employees in the plans offered to excluded employees. After evaluating the proposals submitted by the carriers, the DPA selected Safeguard Insurance to provide a prepaid dental plan and Aetna Insurance to provide an indemnity dental plan. The Department of General Services subsequently approved these contracts.

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 5

Concurrent with the request for proposal process, the DPA held meetings with each bargaining unit's exclusive representative to discuss selecting dental carriers for the employees that the bargaining unit represented. Through this "meet-and-confer" process, each exclusive representative was given the option of either proposing a plan for the employees of its bargaining unit or enrolling its employees in one of the state plans. However, if an exclusive representative chose to propose its own insurance carriers, the DPA required that the plans offered by these carriers would have to be comparable to the state plans in coverage and total cost (premium, deductible, and indirect cost). Through this process, the DPA was assured that any plan proposed by an exclusive representative would not cost significantly more than the plans that the DPA had selected through the competitive bidding process.

Finally, the DPA did not attempt to impose the Safeguard and Aetna dental plans upon employees who were represented under a bargaining unit. Since virtually all terms and conditions of employment are negotiable under the law, the DPA believed that the exclusive representatives would charge the DPA with an unfair labor practice if it failed to meet and confer in good faith.

All dental care contracts currently in effect expire on July 31, 1983. Before that date, the State has the option of extending the contracts or entering into negotiations with the bargaining units. The DPA could, as one of its proposals during the negotiations, request the exclusive representatives to use a competitive bidding process in selecting future dental care contracts. However, there is no certainty that all exclusive representatives would accept competitive bidding as a term of the memorandum of understanding between the DPA and the bargaining units.

How do the costs and benefits of the CSEA-sponsored dental plans compare with the plans selected by the State?

To ensure equitable costs and benefits among the various plans, the DPA required all dental insurance carriers sponsored by an exclusive representative, including the CSEA, to propose a plan that met certain criteria and that did not cost the employee significantly more than either of the two plans selected by the

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 6

State through competitive bidding. In evaluating the total cost of a proposed plan, the DPA considered the indirect cost of both deductible charges and charges for noncovered procedures as well as the direct cost of the monthly premium. The DPA's comparative analysis of each plan's coverage and cost indicates that the CSEA-sponsored plans provide comparable benefits and do not cost significantly more than the state-selected plans.

As discussed earlier in this report, the Budget Act of 1981 appropriated \$21.2 million for dental care contracts for all state employees and annuitants. Because the act did not specifically allocate the money among the various groups of state employees, the DPA categorized state employees into three broad groups: University of California employees, California State University employees, and all other civil service state employees and retired annuitants. Based upon the number of employees (full-time equivalents), the DPA allocated about \$14.4 million for civil service employees as well as retired employees. By applying a distribution formula, the DPA determined that there was an average of \$15.50 per month available for each individual. The period of coverage would be from January 1, 1982, to June 30, 1983.

To ensure that all state employees would receive equitable dental plans, the DPA required that all dental plans proposed by an exclusive representative met the criteria that the DPA had included in its request for proposal for dental plans for employees excluded from the bargaining units. These criteria addressed funding, eligibility, services and treatments, deductibles, and other provisions and carrier responsibilities. If a plan did not meet these criteria, the DPA considered it to be unacceptable.

In evaluating the cost of the various dental plans, the DPA estimated each plan's total annual cost. The DPA analyzed the direct cost of the premium as well as the indirect costs of the deductible and the noncovered services. To analyze the cost of noncovered procedures, the DPA selected a sample of 22 procedures and determined their frequency of occurrence over an

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 7

18-month period for a population of 1,000 people. The DPA then gathered information from each carrier on its usual and customary charges for these procedures, computed averages, and determined the cost to the employee under each plan. The cost of each plan submitted by an exclusive representative was, therefore, evaluated based upon both direct and indirect costs. The table on the following page summarizes the information for the state-selected contracts and the CSEA-sponsored contracts.

TABLE 1

COST COMPARISON OF STATE-SELECTED
 AND CSEA-SPONSORED DENTAL PLANS

MONTHLY PREMIUMS

<u>Cost for Number of Persons Covered</u>	<u>Insurance Carrier</u>			
	<u>Safeguard (State)</u>	<u>PMI (CSEA)</u>	<u>Aetna (State)</u>	<u>Cal-West (CSEA)</u>
Employee Only	\$7.49	\$7.95	\$8.33	\$15.50
Employee +1	\$11.47	\$11.90	\$15.50	\$15.50
Employee +2	\$15.44	\$17.90	\$28.01	\$21.40 ^a
Average	\$11.47	\$12.58	\$17.28	\$17.47

^a Premium for this category will increase to \$24.25 on August 1, 1982.

ANNUAL COST ANALYSIS

	<u>Prepaid Dental Plans</u>		<u>Indemnity Dental Plans</u>	
	<u>Safeguard (State)</u>	<u>PMI (CSEA)</u>	<u>Aetna (State)</u>	<u>Cal-West (CSEA)</u>
Annual premium ^b	\$137.64	\$150.96	\$207.36	\$209.64
Annual deductible	0	0	50.00	25.00
Estimated annual cost of noncovered procedures	<u>4.55</u>	<u>4.27</u>	<u>16.78</u>	<u>27.19</u>
Total annual cost	<u>\$142.19</u>	<u>\$155.23</u>	<u>\$274.14</u>	<u>\$261.83</u>

^b Based on average monthly premium.

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
May 3, 1982
Page 9

As the table indicates, there is only about a \$13.00 difference between the annual costs of the prepaid plans and about a \$12.00 difference in the average cost of the indemnity plans.

Are there any bonding requirements for Aetna and Safeguard that are not required under the CSEA-sponsored contracts?

The DPA did not impose bonding requirements on any of the insurance carriers. However, the DPA did place certain qualification requirements upon the carriers. For example, the carriers had to have been in operation for at least three years, and each prepaid program had to have an enrollment of 20,000 individuals.

Do the CSEA-sponsored contracts enable the CSEA to collect an administration fee?

The CSEA-sponsored contracts do not identify any provisions for the payment of administrative fees to the CSEA by the carrier. All dental care contracts, including those sponsored by the CSEA, do provide that the carrier will pay the DPA an administrative fee up to 2 percent of the premium. This fee is designed to cover actual administrative costs incurred by the State for such items as data processing and issuing warrants.

According to a CSEA official, both PMI and Cal-West reimburse the CSEA for the expenses that it incurs as their sponsoring organization. This reimbursement is not, however, paid for out of the premiums.

If we can be of any further assistance, please contact me.

Respectfully submitted,


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Auditor General

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