DEPENDENT ELIGIBILITY VERIFICATION AUDITS

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In an environment of skyrocketing health care costs combined with a struggling economy, employers are increasingly looking at new methods to reduce costs and at the same time stay competitive. Health care costs are the third largest expense for employers, and therefore a significant cost containment area available to employers. One tool to reduce health care costs that has gained quite a bit of attention recently is the dependent eligibility verification audit. This relatively new type of audit is becoming a standard in large and small companies alike because of the impact it can have on costs. Statistics vary by source but in general show that approximately 3% to 12% of dependents in a health plan are not eligible for coverage. By removing these ineligible dependents, employers are experiencing cost reductions related to medical costs.

The basic objective behind a dependent eligibility verification audit is to confirm that all individuals covered by the employer sponsored plan meet the plan's eligibility criteria. In general, there are two approaches to performing a dependent eligibility verification audit. The first is an amnesty type of program which relies on the "honor system" by asking employees to give their "word" that any dependents enrolled in the employer's plan are in fact eligible for coverage under the plan. The other approach, the document verification audit, is much more effective in identifying ineligible participants. This type of audit requires that employees produce supporting documentation for their covered spouse and dependents in order to maintain coverage for their dependents. This documentation may include marriage licenses, birth certificates, and excerpts from income tax returns. This can be performed on 100% of dependents, or it can be done on a sample of participants.

These audits can work in several different ways. Dependent eligibility audits can be done in-house, through the employer's human resources or internal audit department, or the plan sponsor can bring in an independent firm to perform the audit. Some of the benefits of audits performed in-house are a reduced learning curve in understanding the employer's systems and culture, flexibility in timing of the audit, as well as obviously not having to incur the additional cost. However, hiring an external firm to perform the audit lends experience and expertise to the process, particularly if a targeted document verification approach is preferable, while providing additional staffing in an environment where resources might already be stretched. These types of audits require continuous follow-up and communication with employees, and can be very labor intensive in reviewing all of the documentation provided. Another consideration is that employees may view their company more favorably if an independent party is acting as the "bad guy" and therefore the employer might be able to preserve a little bit of their goodwill and help morale. Generally, consulting firms have a variety of billing structures, including flat fees, per participant fees, as well as contingent fee arrangements where the consultant gets paid based on a percentage of the employer's savings – which is really a "no lose" situation for the employer. They will benefit from a reduction in health plan costs by removing ineligible dependents and they only have to pay their consultant a portion of the savings.

Another important consideration for plan sponsors is that there are additional risks involved for the plan sponsor if they cover ineligible dependents. In an environment where fiduciary liability is a hot topic, this is

yet another example of fiduciary responsibility. If the plan covers ineligible dependents, then potentially there is a failure to prudently administer the plan and follow the plan document. The employer could also have a tax liability due to the failure to withhold on imputed income related to covering ineligibles (if the employer covers an ineligible dependent, then there is no tax exemption for the cost of coverage, and therefore this benefit is taxable). Finally, under Sarbanes-Oxley, the financial significance of health plan costs may create exposure if the plan pays ineligible dependents. All of these factors lead to the conclusion that performing a dependent eligibility audit is just good business practice.

But like everything else health care related, health care reform also impacts dependent eligibility audits. The Affordable Care Act (the "Act") simplifies covered dependent criteria through the "coverage-to-age-26" mandate which removes the requirement to prove financial dependency, residency and student status of dependent children. This change will theoretically reduce the number of ineligible dependents. The Act also prohibits rescission of coverage unless there is evidence of fraud or intentional misrepresentation. This means that an employer will probably not be able to recoup the costs of covering these ineligible dependents. These changes mean that the employer will have to give proper notice to employees that the dependents will be removed prospectively. Even taking these changes into consideration, a dependent eligibility audit is still a prudent choice for most employers.

In the end, it is important that the plan sponsor document the results of the audit and establish a procedure going forward to ensure continuing compliance with the eligibility requirements of the plan. Without implementing these procedures, the plan will quickly end up covering many ineligible dependents again.

Given the fiduciary and legal implications, as well as the cost savings considerations, it is easy to understand why dependent eligibility verification audits are becoming a popular method of cost containment and risk minimization.