

STATE OF NEVADA

Performance Audit

Public Employees' Benefits Program Contract Management

2020



Legislative Auditor
Carson City, Nevada

Audit Highlights



Highlights of performance audit report on the Public Employees' Benefits Program, Contract Management issued on September 3, 2020.

Legislative Auditor report # LA20-15.

Background

The Public Employees' Benefits Program (PEBP) is a state agency that is legislatively mandated to provide group health, life, and accident insurance for state and other eligible public employees and retirees. PEBP's mission is to provide employees, retirees, and their families with access to high quality benefits at affordable prices.

PEBP currently administers various benefits and is responsible for designing and managing a quality health care program for approximately 44,000 primary participants and 27,000 covered dependents, totaling over 70,000 individuals.

PEBP enters into contracts with vendors to provide services to its participants. In fiscal year 2019, PEBP paid over \$114 million to 19 vendors under contract with the agency. Vendor payments included things like actuarial services and medical, dental, and pharmaceutical administrator services.

A 10-member board oversees PEBP's operations. Nine board members are appointed by the Governor, and the 10th member is the Director of the Department of Administration or a designee approved by the Governor. The Board appoints an Executive Officer to direct the day-to-day operations.

Purpose of Audit

The purpose of the audit was to determine if PEBP has adequate controls to ensure vendor selection and payments complied with state laws, policies, and contract terms; and expenses related to contracts, awards, and accreditations were appropriate. Our audit included a review of contract procurement and payment practices, and award and accreditation expenditures for fiscal year 2019, and prior years for some activities.

Audit Recommendations

This audit report contains four recommendations to improve PEBP's contracting practices and one recommendation to ensure the proper use of PEBP's resources.

PEBP accepted the five recommendations.

Recommendation Status

PEBP's 60-day plan for corrective action is due on December 3, 2020. In addition, the 6-month report on the status of audit recommendations is due on June 3, 2021.

Contract Management

Public Employees' Benefits Program

Summary

The Public Employees' Benefits Program's (PEBP) contracting practices changed over the past several years, focusing more on amending and extending contracts through private negotiations instead of competitive procurements. While contract amendments may be appropriate in some circumstances, for the most part, amendments should be infrequent and not utilized as a default to extend contracts and procure services worth hundreds of millions of dollars. State law creates the PEBP board giving it responsibility for ensuring contracting practices comply with laws and policies, and to help ensure the proper use of agency resources. However, PEBP's contracting practices did not always follow state laws and policies as some amendments significantly modified contracts' scopes of work and contracts were extended without proper approvals. Furthermore, some wasteful spending of agency resources occurred. Without proper contracting practices and agency oversight, there is increased risk the best interests of the State and PEBP participants will not be realized, and agency resources will not be used appropriately.

Key Findings

Between fiscal years 2015 and 2019, PEBP authorized nearly \$96 million in contract services that were not competitively bid through a Request for Proposal (RFP) process, as PEBP began to focus more on extending contracts. For 14 of 19 active service contracts in fiscal year 2019, PEBP amended these contracts to extend them beyond the original contract term, with some extended more than once. As a result, the average contract term increased from almost 5.5 years to over 8.5 years, with two contracts having 11-year terms. Under PEBP's management of the past 5 years, 23 contract extensions were performed and only 12 RFPs. State policy indicates contracts should be competitively solicited at least every 4 years. While PEBP claims a longer contract term is more desirable for some contracts, amending and extending contracts indefinitely does not help ensure the State and PEBP participants receive the best value. (page 6)

Private negotiations became a standard practice as PEBP's management extended vendor contracts for multiple years. Some negotiations took place through direct contact with vendors or by emails. For one contract, negotiations included two vendor paid trips, at the request of PEBP management, in which PEBP employees received transportation, lodging, and meals worth more than \$7,000. Following the second trip, a significant scope modification occurred and the contract was extended 2 years. The amendments and contract extension occurred despite PEBP management and staff dissatisfaction with the vendor's performance. Not only does accepting gifts violate state ethics laws and policies, but it increases the risk of fraud and that contracting decisions will not be in the best interests of the State or PEBP's participants. (page 10)

PEBP management claimed that competitive bidding for contracts was unnecessary as they performed regular market checks to determine the value of the services their current vendors were providing. However, market checks were only performed multiple years for one vendor, and showed PEBP was paying more than other plans of similar size. In addition, cost savings was used to justify several contract extensions, after vendors agreed to lower pricing in exchange for added years to their contract terms. Market checks and cost savings should not be used to supplant bidding processes since additional value and savings may be received through competition. (page 12)

PEBP's board did not provide adequate oversight of contracting practices as it approved significant modifications to contracts' scopes of work and changes to PEBP's policies and procedures that placed less emphasis on competitive procurement. In addition, 6 of 18 contract extensions took place without State Purchasing's approval or being discussed at a PEBP Board meeting; thereby, circumventing state policy and law. (page 14)

During our testing, we observed some agency expenditures were unnecessary and not an efficient use of agency resources. For instance, PEBP allocated over 620 hours and nearly \$51,000 to obtain business awards and an accreditation. It is the responsibility of PEBP's Board and management to ensure funds are spent appropriately. (page 21)

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This report contains the findings, conclusions, and recommendations from our performance audit of the Public Employees' Benefits Program, Contract Management. This audit was conducted pursuant to the ongoing program of the Legislative Auditor as authorized by the Legislative Commission. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

This report includes four recommendations to improve the agency's contracting practices and one regarding better oversight for expenditures. We are available to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other state officials.

Respectfully submitted,

Daniel L. Crossman, CPA
Legislative Auditor

June 29, 2020
Carson City, Nevada

Public Employees' Benefits Program Contract Management Table of Contents

Introduction	1
Background	1
Scope and Objective	5
Better Controls and Oversight Needed to Ensure Proper Contracting Practices and Use of Agency Resources.....	6
Contracting Activities Focused on Extensions Instead of Competition.....	6
PEBP Board Needs to Enhance its Oversight of Agency.....	14
Appendices	
A. Audit Methodology.....	24
B. Response From the Public Employees' Benefits Program.....	27
C. Auditor's Comments on Agency Response.....	31

Introduction

Background

The Public Employees' Benefits Program (PEBP) is a state agency that is legislatively mandated to provide group health, life, and accident insurance for state and other eligible public employees and retirees. PEBP's mission is to provide employees, retirees, and their families with access to high quality benefits at affordable prices. The first group insurance program in Nevada was created in 1963 and restructured into PEBP in 1999.

PEBP currently administers various benefits and is responsible for designing and managing a quality health care program for approximately 44,000 primary participants and 27,000 covered dependents, totaling over 70,000 individuals. Exhibit 1 shows the total PEBP membership, including participants and dependents in fiscal year 2019.

PEBP Membership Fiscal Year 2019

Exhibit 1

Plan	Primary Participants ⁽¹⁾	Dependents	Total
Consumer Driven Health Plan (CDHP)	23,259	19,081	42,340
Exclusive Provider Organization (EPO) – Northern Nevada	4,625	3,815	8,440
Health Maintenance Organization (HMO) – Southern Nevada	3,860	2,790	6,650
Medicare Exchange	12,431	1,755	14,186
Total Membership	44,175	27,441	71,616

Source: PEBP enrollment report.

⁽¹⁾ Primary participants include state and non-state employees and retirees.

A 10-member board oversees PEBP's operations. Nine board members are appointed by the Governor, and the 10th member is the Director of the Department of Administration or a designee approved by the Governor. The Board of the Public Employee's Benefits Program (Board) appoints an Executive Officer to direct the day-to-day operations. The Board's purpose is to adopt regulations and policy for the agency and act as the chief of PEBP for the purposes of awarding contracts.

Explanation of Major Vendors and Service Function

In fiscal year 2019, PEBP had 19 active service contracts. Exhibit 2 shows the main service contracts and amounts.

PEBP Service Contracts Exhibit 2 Fiscal Year 2019

<u>Contracts</u>	<u>Amount</u>
Express Scripts (Pharmacy Benefit Manager) ⁽¹⁾	\$ 54,906,596
Health Plan of Nevada (Southern Nevada HMO)	35,586,807
Standard Insurance (Group Basic Life Insurance)	10,124,772
<u>HealthSCOPE Benefits</u>	
Third-Party Administrator	6,072,148
National CDHP and EPO Networks	2,323,247
Dental Claims Administration	655,129
<u>Hometown Health</u>	
In-State CDHP Network	1,463,274
Utilization and Case Management	1,415,890
Morneau Shepell (Enrollment and Eligibility System)	932,022
AON Consulting (Plan Actuary)	421,900
Diversified Dental (Dental Network)	329,991
Extend Health (Medicare Exchange)	173,162
Total Expenditures	\$114,404,938

Source: PEBP contracting log.

⁽¹⁾ Includes prescription drug claim costs.

Budget and Staffing

PEBP administers one budget account in which funding for operations and insurance plans come primarily from participant and employer contributions. PEBP submits its funding and operational requirements to the Legislature as part of a biennial budget. Upon approval, each state agency is assessed an amount to contribute toward both the active employee and retiree health plans. Exhibit 3 shows revenues and expenditures for PEBP for fiscal year 2019.

**PEBP Revenues and Expenditures
Fiscal Year 2019**

Exhibit 3

Revenues	Amounts
Beginning Cash	\$143,129,728
State Employer Contributions	276,639,847
State Employee Premiums	53,335,377
Non-State Employer Contributions	28,588,398
CDHP Prescription Drug Rebates	9,835,776
Non-State Employee Premiums	4,560,130
Other ⁽¹⁾	2,877,401
Medical Services Charges	288,261
Total Revenues	\$519,254,918
Expenditures	Amounts
State Employee Insurance Costs	\$310,360,033
State Medicare Costs	20,859,611
Non-State Medicare Costs	16,371,115
Non-State Employee Insurance Costs	15,445,494
Personnel	2,721,398
Operating & Travel	2,173,935
Information Services	523,953
Assessments & Cost Allocations	522,947
Total Expenditures	\$368,978,486
Balance Forward to 2020	\$150,276,432

Source: State accounting system.

⁽¹⁾ Other includes miscellaneous revenue and Treasurer's interest distribution.

In fiscal year 2019, PEBP had 34 authorized positions with 1 office located in Carson City. Operations include quality control, accounting, member services and eligibility, public information, and information technology.

Reserves

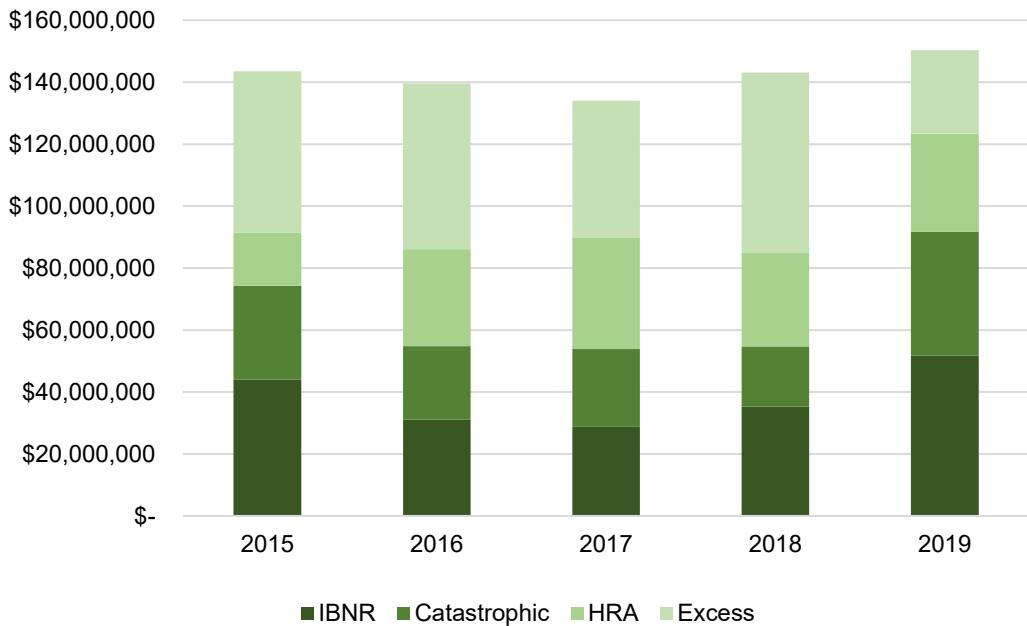
PEBP maintains three separate reserves: 1) an incurred but not reported (IBNR), 2) catastrophic, and 3) health reimbursement arrangement (HRA). The IBNR and catastrophic reserves are for PEBP's Consumer Driven Health Plan (CDHP) and help ensure proper funding. The IBNR is for claims that are incurred during a plan year, but may not be billed for up to a year after the service date. The catastrophic reserve pays extraordinarily large claims to decrease volatility and avoid disruptions to the rates in the following plan year. The level of funding required for these two reserves is calculated by an actuary and is partially determined by claims experience in prior years.

PEBP also maintains a HRA reserve based on the total balance remaining in all HRA accounts for CDHP and Medicare Exchange participants. Excess reserves beyond those mentioned above may be used to pay for new programs and services, program infrastructure improvements, increased or new benefits, and rate mitigation.

Fiscal year end 2019 reserves were \$51.8 million IBNR, \$39.9 million catastrophic, \$31.7 million HRA, with \$26.9 million in excess. Exhibit 4 shows PEBP reserve levels for fiscal years 2015 through 2019.

**PEBP Reserves
Fiscal Years 2015–2019**

Exhibit 4



Source: State accounting system.

Reserve balances are expected to decrease as claims experience in fiscal year 2020 was higher than projected, resulting in a budget shortfall that required the use of catastrophic reserve funds.

Scope and Objective

The scope of our audit included a review of contract procurement and payment practices, and award and accreditation expenditures for fiscal year 2019, including prior years for some activities. Our audit objective was to:

- Determine if PEBP had adequate controls to ensure vendor selection and payment activities complied with state laws, policies, and contract terms; and expenses related to awards and accreditations were appropriate.

This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission, and was made pursuant to the provisions of Nevada Revised Statutes (NRS) 218G.010 to 218G.350. The Legislative Auditor conducts audits as part of the Legislature's oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

Better Controls and Oversight Needed to Ensure Proper Contracting Practices and Use of Agency Resources

The Public Employees' Benefits Program's (PEBP) contracting practices changed over the past several years, focusing more on amending and extending contracts through private negotiations instead of competitive procurements. While contract amendments may be appropriate in some circumstances, for the most part, amendments should be infrequent and not utilized as a default to extend contracts and procure services worth hundreds of millions of dollars. State law creates the PEBP board giving it responsibility for ensuring contracting practices comply with laws and policies, and to help ensure the proper use of agency resources. However, PEBP's contracting practices did not always follow state laws and policies as some amendments significantly modified contracts' scopes of work, and contracts were extended without proper approvals. Furthermore, some wasteful spending of agency resources occurred. Without proper contracting practices and agency oversight, there is increased risk the best interests of the State and PEBP participants will not be realized, and agency resources will not be used appropriately.

Contracting Activities Focused on Extensions Instead of Competition

Between fiscal years 2015 and 2019, PEBP authorized nearly \$96 million in contract services that were not competitively bid through a Request for Proposal (RFP) process, as PEBP began to focus more on extending contracts. Without competition, through a RFP process, private negotiations take place, which can be unduly influenced in many ways. For instance, one contract with an underperforming vendor was extended and amended to provide additional services after two vendor paid trips. Furthermore, on one occasion, two hand-selected vendors were invited to present

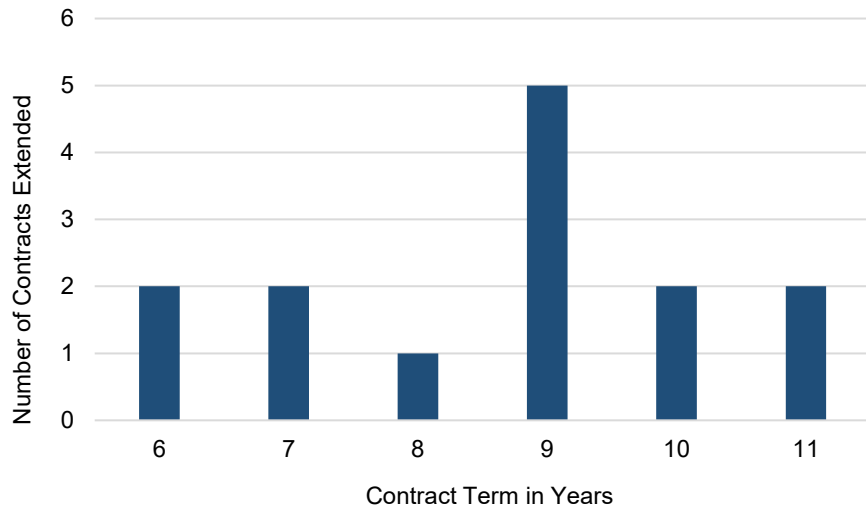
a product, replacing a formal process established in state law. To justify extending contracts without competition, PEBP management claimed it knew the market, regularly performed market checks, and that extensions saved millions of dollars. However, our review found market checks were only performed regularly for one vendor. When competitive procurement of services is viewed as optional, there is a greater risk of fraud or abuse with the State, and its employees not receiving the best services at the best price.

Extensions Replaced the RFP Process and Competitive Bidding

Our review of PEBP's 19 active service contracts in fiscal year 2019 found that 14 were amended to extend them beyond the original contract term. In addition, 4 of these contracts were extended more than once, resulting in 18 contract extensions. As a result, the average contract term increased from almost 5.5 years to over 8.5 years, with two contracts having 11-year terms. The State's policy is that contracts be solicited at least every 4 years, except in the case of an emergency or when it is determined that only one vendor exists that provides the product or service. Exhibit 5 shows the current contract terms for the 14 extended contracts.

PEBP's Extended Service Contracts

Exhibit 5

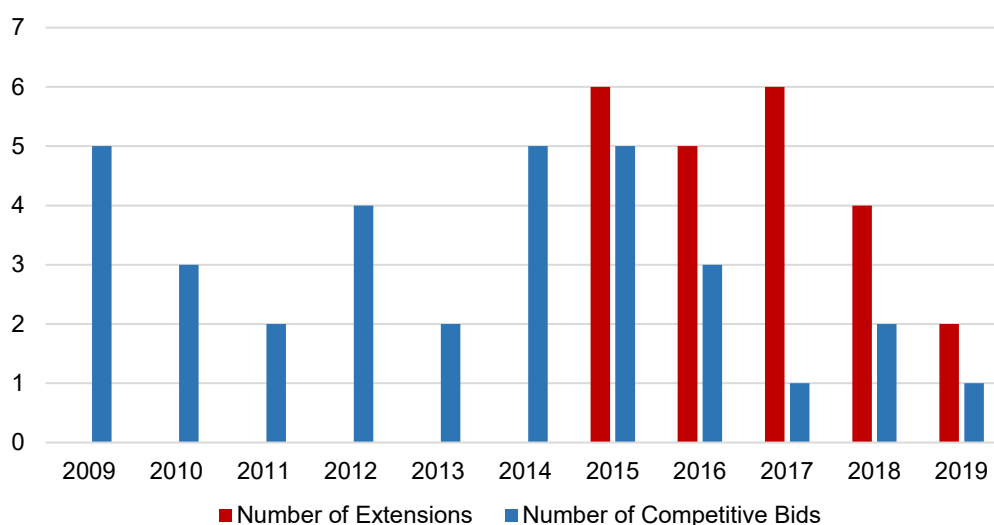


Source: Auditor prepared from PEBP contract records.

The extension of contracts resulted in less competitive procurements than through a RFP process. A RFP process allows the State to publicly solicit for a commodity or service and requests vendors to submit proposals. Submitted proposals are then competitively judged and scored by an evaluation committee prior to being awarded to the selected vendor. This process helps ensure fair competition among vendors, and that they are selected based on established criteria and fair evaluation of proposals. Exhibit 6 shows the number of PEBP RFP's and extensions.

PEBP Contract Activities Fiscal Years 2009–2019

Exhibit 6



Source: Auditor prepared from State Purchasing and PEBP contract records.

Note: In fiscal year 2016, two extensions were the result of a failed RFP, so the contracts were extended 1 year.

For the first 6 years, no contract extensions were performed and 21 competitive bids took place through a RFP process. However, under PEBP's management of the past 5 years, 23 contract extensions were performed and only 12 competitive bids took place.

State laws and regulations establish competitive procurements as the required method for obtaining services that are valued at \$25,000 or more per fiscal year, except in the case of emergencies. In addition, state policy establishes that contracts should be solicited at least every 4 years.

One concern expressed by PEBP management was that some services take a few years for the vendor to become established and functioning properly. Therefore, a contract term longer than 4 years is desirable. While PEBP claims a longer contract term is more desirable for some contracts, amending and extending contracts indefinitely should not replace the RFP process. Furthermore, competitively soliciting contracts every 4 years does not mean a different vendor will be selected. State purchasing laws establish a process where criteria is developed and weighted

for each solicitation and vendors' proposals are scored, with price being only one of the criteria.

Private Negotiations Lead to Contract Extensions

Private negotiations became a standard practice as PEBP's management extended vendor contracts for multiple years. Some negotiations took place through direct contact with vendors or by emails. For one contract, negotiations included two vendor paid trips, at the request of PEBP management, in which PEBP employees received transportation, lodging, and meals worth more than \$7,000. Exhibit 7 shows a breakdown of the two trips and the expenses paid by the vendor.

Vendor Paid Travel Costs	Exhibit 7
July 2017⁽¹⁾	Amount
Flight	\$1,387
Lodging	785
Transportation	59
Meals and Entertainment ⁽²⁾	706
Trip No. 1 Cost	\$2,937
January 2018⁽¹⁾	Amount
Lodging	\$1,874
Flight	1,515
Meals and Entertainment ⁽²⁾	914
Trip No. 2 Cost	\$4,303
Total Travel Costs	\$7,240

Source: PEBP and vendor records.

⁽¹⁾ Trip No. 1 Cost included one individual for 3 days, while Trip No. 2 Cost included two individuals for 3 days.

⁽²⁾ Estimates were conservative as documentation provided by the vendor was heavily redacted.

After the first trip, the contract was amended to include additional performance standards and agreements, as PEBP was not satisfied with the vendor's past performance and system functionality. Following the second trip, a significant scope modification occurred and the contract was extended 2 years. The amendments and contract extension occurred despite PEBP management and staff dissatisfaction with the vendor's performance.

Other contract extensions were negotiated through emails. For example, a contract involving basic life and long-term disability insurance was extended 4 years after PEBP management and the vendor negotiated decreases to the monthly rates. Although the negotiated rates were slightly less than the current year rates, the long-term disability rate was still several dollars higher than the original contract rate. Because these services were not competitively bid, PEBP does not know if the negotiated rates were the best available.

Although interactions with vendors is necessary to ensure contract compliance and delivery of services, private negotiations and vendor paid travel are not acceptable and in violation of state laws and policies. Purchasing laws do not allow for negotiations during contract terms.

Nevada laws and an Executive Order governing ethics require that employees not seek or accept any gifts, services, or favor which could improperly influence decisions. The Executive Order, which was adopted and approved by PEBP in 2014, states that high ethical standards are essential for public employees and prohibits public employees from receiving gifts, including travel, entertainment, lodging, meals, transportation and items of monetary value.

Not only was PEBP's current management team aware of the laws and policies governing gifts, it also reported a former employee for accepting gifts from a vendor. In December 2015, PEBP's management team reported and recommended the termination of a former employee for accepting gifts from a PEBP vendor in the amount of \$282. Although it was determined that the employee did not intentionally violate the law, the employee was fined \$1,000, and later resigned. When agency employees accept gifts from vendors, the potential exists for impropriety or the appearance of impropriety to be present within the agency, and increases the risk that decisions made by management will not be in the best interest of the State.

Formal Request for Information Process Needed

PEBP did not use the formal Request for Information (RFI) process established by State Purchasing. PEBP invited two potential vendors to come present privately to PEBP management the vendors' products and pricing for eligibility and enrollment systems. After hearing the vendors' presentations, PEBP extended the contract with its current vendor, valued at over \$9 million. PEBP did not document this process, including the reason for requesting presentations, why certain vendors were selected to present, the results of those presentations, and the reasons for extending the contract with the current vendor.

State law requires that the Administrator of the Purchasing Division contract for services whose estimated value is \$100,000 or more, or may authorize an agency to contract for those services. Furthermore, NRS 333.162 allows the Purchasing Administrator to designate the method of obtaining a contract, including the use of an RFI. Therefore, an agency must receive approval from State Purchasing to proceed with the RFI process. However, PEBP management did not request approval to solicit information from the potential vendors, and PEBP's policies and procedures do not address the RFI process.

Contract Extensions Justified by Management

PEBP management claimed that competitive bidding for contracts was unnecessary as they performed regular market checks to determine the value of the services their current vendors were providing. In addition, cost savings was used to justify several contract extensions. Market checks and cost savings should not be used to supplant bidding processes since additional value and savings may be received through competition.

Market checks compared PEBP vendors' services and pricing to other vendors for which PEBP's actuary had information. However, based on what PEBP provided, market checks were only performed for two vendors recently and market checks were only performed multiple years for one of those vendors. Exhibit 8 shows one analysis performed by PEBP's actuary in fiscal year 2019 for the pharmacy benefits manager (PBM).

**Market Comparison Example
Fiscal Year 2019**
Exhibit 8

Categories	Contracted	Comp 1	Comp 2	Comp 3	Comp 4	Comp 5
Members	40-45k	45-50k	15-20k	30-35k	80-85k	60-65k
Allowed Charges ⁽¹⁾	\$53,270,000	\$49,970,000	\$50,910,000	\$49,990,000	\$50,880,000	\$49,890,000
Costs and Fees ⁽²⁾	(13,990,000)	(13,420,000)	(13,550,000)	(15,030,000)	(14,480,000)	(13,720,000)
Guaranteed Rebates	(5,580,000)	(12,180,000)	(9,210,000)	(9,740,000)	(6,340,000)	(10,780,000)
Net Cost	\$33,700,000	24,370,000	28,150,000	25,220,000	30,060,000	25,390,000
Cost Differences Compared to PEBP Contracted		\$ 9,330,000	\$ 5,550,000	\$ 8,480,000	\$ 3,640,000	\$ 8,310,000

Source: PEBP's contracted actuary.

⁽¹⁾ Includes gross costs like ingredient costs.

⁽²⁾ Includes member cost share and dispensing and administrative fees.

As shown, the cost for PEBP's vendor is greater than other plans of a similar size. PEBP management stated that market checks help to negotiate better rates, but the following year's market check again showed PEBP continued to pay more.

While market checks could provide insight into determining the value of current service contracts, they do not take the place of competitive bidding, especially when limited in scope and not performed regularly. In addition, cost savings initiatives can be built into contracts when bid, eliminating the need for extensions.

In addition to market checks, PEBP often cited cost savings as a reason for extending contracts. However, the analyses for cost savings were often limited and not comprehensive. The following example relates to a contract that was extended based on testimony that there would be savings to the plan:

- In 2017, PEBP management requested an amendment that extended a contract 2 years, indicating a projected cost savings of nearly \$1 million in the current year.
- Evidence obtained during the audit showed that costs associated with the contract increased by millions of dollars the following years, including an increase of \$1.5 million in administrative costs.

When the claim was made that nearly \$1 million in cost savings would be realized, PEBP did not provide documentation supporting the cost savings and how it was calculated. Given the

lack of documentation regarding how the projected cost savings were calculated and the increased costs, PEBP does not know if savings were actually achieved.

State law and policy emphasize the need for the competitive procurement of services. NRS 333.300(4) requires that every effort must be made to secure competitive bidding. In addition, section 0338 of the State Administrative Manual requires that an agency shall solicit and review at least three bids or proposals for each contract, whenever possible.

When agency management's contracting practices allow for private negotiations and the acceptance of gifts from vendors, there is a greater risk of abuse and fraud, and the appearance of impropriety can arise. In addition, relaxed negotiations and a rushed process of extending contracts have led to contracts with higher costs and rates that are not easily defined. Furthermore, when a contract management process lacks competition it gives preferential treatment to some vendors and makes it difficult to determine if the State and PEBP participants receive the best services at the best prices.

**PEBP Board
Needs to
Enhance its
Oversight of
Agency**

The PEBP Board (Board) needs to enhance its oversight of management's contracting practices and use of agency resources. As part of its duties, the Board is charged with overseeing PEBP's contracting activities and ensuring its assets are used appropriately. Despite this responsibility, some contract amendments had significantly modified scopes of work and several contracts were executed without receiving proper approvals or without supporting documentation. In addition, the Board approved modifications to PEBP's contracting policies and procedures, placing less emphasis on competitive procurement and Board oversight. Finally, the Board allowed agency resources to be spent on unnecessary awards and an accreditation. Without proper oversight, there is less assurance PEBP's contracting practices align with state laws and policies that help safeguard assets, and that agency resources are used appropriately.

Board Responsible to Ensure Contracting Requirements are Followed

Although law designates the PEBP Board as responsible for oversight of certain activities, the Board did not always adequately monitor important contracting functions to ensure compliance.

The 10-member Board that oversees PEBP's operations is comprised of the Director of the Department of Administration and 9 members appointed by the Governor. The Board includes members that represent active and retired public employees, and have experience in risk management, group insurance programs, health care administration, or employee benefits programs. A combination of state laws and regulations place the responsibility for PEBP's contracting activities with the Board. Although not all-inclusive, the following laws and regulation relate to the Board's contracting responsibilities:

- NRS 287.043(3) – requires the Board to use the services of the Purchasing Division of the Department of Administration.
- NRS 287.0434 – allows the Board to enter into contracts relating to the administration of the program.
- NRS 287.04345 – states that PEBP is subject to state purchasing laws found in NRS 333 and establishes the Board as the chief of the agency.
- NRS 333.300(4) – establishes competitive procurement as the method for awarding a contract, except in the case of emergencies and with the approval of the Purchasing Administrator.
- NAC 333.150(3) – requires that contracts be awarded through a RFP process when the estimated value of the contract exceeds \$25,000 per fiscal year.

Because the Board's responsibilities include contract oversight, it is imperative that it be actively engaged in PEBP's contracting activities, and that policies and procedures ensure compliance with state laws and regulations.

Contract Amendments Significantly Modified Scopes of Work

On two occasions, significant modifications were made to existing contracts bypassing competitive solicitation requirements for new services. Without competitive solicitation, the State does not know if it received the best product at the best price. These scope modifications were approved by the Board. The following information provides additional details regarding the scope modifications:

- In September 2014, PEBP competitively bid and awarded a contract, which included a software system with the capability of billing premiums and tracking participant eligibility. However, in September 2018, the contract was extended for 2 years and amended to allow the vendor to create a voluntary services platform that would offer voluntary products to participants in exchange for the vendor collecting commissions on those entities services.
- On a separate occasion, PEBP competitively bid and awarded a contract in February 2011, which included third-party administrative services for the State's self-funded medical, dental, and vision plans. However, in 2017, the contract was amended and extended for 2 years that included a \$2.5 million work order that was vaguely defined in the contract as a cost saving strategy initiative. In 2018, PEBP used the work order to enter into two unapproved contracts. The first contract included a \$100,000 maximum for a specialty care management nurse, while the second contract included a \$480,000 maximum, 3-year commitment, for the creation of a computer application that would allow PEBP members to research the cost of medical procedures from different medical providers.

PEBP's policies and procedures do not address modifications to contracts and what steps will be taken to help ensure the modifications are within the contract's original scope of work. When contract amendments significantly modify the original scope of work, other vendors are denied the opportunity to compete and offer different solutions and pricing, helping ensure the State obtains the best value.

The United States Government Accountability Office addresses contract modifications and states that all modifications must be within the overall scope of the contract and reasonably within the contemplation of the parties when they entered into the original contract. Any modification made to a contract that exceeds the scope of the original contract represents a new requirement that should follow the normal RFP or competitive bidding process. Therefore, any out-of-scope modification is essentially an improper sole-source contract award.

Significant scope modifications that warrant a competitive bid may include the following:

- Changes in the scope of the competition;
- Wasn't within the contemplation of the parties when they entered into the original contract;
- Materially alters the contract;
- Changes in the function of the item or the type of work;
- Changes in the quantity of major items or portions of work;
- The agency had historically procured services under a separate contract.

Extensions Did Not Receive Proper Approvals

For 6 of 18 contract extensions tested, PEBP did not receive proper approvals. This included 4 of 18 (22%) contract extensions that took place without a contract extension waiver and State Purchasing's approval; thereby, circumventing state policy. In addition, 2 of 18 (11%) contract extensions took place without being discussed by PEBP's Board; thereby, violating state laws. Exhibit 9 shows contracts extended without State Purchasing approval and without Board discussion and approval.

**Contracts Extended Without Proper Approvals
Fiscal Years 2015–2019**

Exhibit 9

Contracts Extended Without State Purchasing Approval	Contract Amount (Millions)	Extension Amount (Millions)	Years Extended
Contract 1	\$ 3.1	\$1.7	4.0
Contract 2 ⁽¹⁾	2.0	0.0	0.5
Contract 3	15.5	3.6	2.0
Contract 4	9.0	1.8	2.0

Contracts Extended Without Board Discussion and Approval	Contract Amount (Millions)	Extension Amount (Millions)	Years Extended
Contract 2 ⁽¹⁾	\$ 2.0	\$0.0	0.5
Contract 5	6.1	1.4	2.0

Source: PEBP records.

⁽¹⁾ Same contract with both exceptions, which had been extended for 6 months and included a fee reduction and therefore did not increase the contract maximum amount.

State laws and policies require PEBP follow certain protocols before contracting or amending contracts, including using the services of the Purchasing Division when procuring services. To help verify the validity of contract extensions, State Purchasing requires agencies to use a form that requires full disclosure and compelling justification for contract extensions. In addition, state law governing public meetings requires that most actions of public bodies, and their deliberations, be performed in an open meeting. Furthermore, PEBP's policies and procedures require that all new services for the program will be brought to the Board for approval and all existing services already on a contract will be evaluated by the Board for approval prior to execution.

PEBP's policies and procedures do not require State Purchasing's approval prior to contracts being extended. Furthermore, procedures do not require contracts and contract amendments have supporting documentation showing compliance with state laws and policies, including proper approvals by the Board before submission to the State Board of Examiners.

Amendments Approved Without Supporting Documentation

The Board approved contract amendments without supporting documentation to validate statements made by PEBP management. We observed management provided statements to its Board that, intentional or not, negatively portrayed the

competitive procurement process, or emphasized the partnership with the current vendor. Although it is unknown what effect this had on the Board's contracting decisions, the Board should require PEBP management to provide documentation that would justify any deviation from the State's policies or best practices regarding competitive procurements.

We observed that when competitive procurement was discussed at board meetings PEBP management made statements that indicated bidding was too costly, of little value, or the State risked paying more with a new vendor. The following examples demonstrate how competitive bidding was often portrayed to the Board:

- For a contract extension for its PBM, the Board expressed concerns about extending the contract. In response to questioning by the Board, PEBP management indicated that the RFP process was costly for vendors and that vendors can spend upwards of \$100,000 responding to a RFP. PEBP's management also opined that there was not enough added value to participate in a competitive bid. However, in fiscal year 2019, PEBP paid its PBM over \$53 million in prescription drug costs and another \$1.3 million in administrative fees.
- On a separate occasion, when extending the contract for PEBP's Medicare Exchange provider, PEBP management claimed a RFP was too costly for not only the vendor but also the State. However, state law created the Purchasing Division whose primary function is to assist state agencies to competitively procure products and services.
- For an extension to its contract to perform health claim audits, PEBP management indicated the RFP process was dangerous and scary, and that the vendor provided a specialized service. In addition, when PEBP board members questioned the proposed 5-year extension, management's response was that another vendor might not be able to perform this specialized service. However, without the benefit of a competitive bid, there is no

evidence to suggest that this vendor is the only auditor that can perform this function.

Another concern expressed by PEBP management regarding competitive procurement was that the agency had a good working relationship with vendors and switching vendors could disrupt those partnerships or the services provided to plan participants. While a good working relationship with a vendor is important, it should not be used as a reason to not seek competitive pricing for services. In addition, the State's competitive procurement process does not mean an agency will have to choose a different vendor.

PEBP currently lacks policies and procedures that require management to provide supporting documentation to validate its position when recommending contract amendments. When unverified or inaccurate information is provided to the PEBP Board, it can significantly affect the outcome of those decisions both monetarily and programmatically.

Contracting Policies and Procedures Modified

In recent years, the Board approved modifications to PEBP's policies and procedures, placing less emphasis on competitive procurement and board oversight. Starting in September 2015, policy changes were brought forward by PEBP management that modified contract policy. The policy changes removed the first step in contracting practices that required the agency develop a RFP when a contract is scheduled to expire, or a new service is required. In place of this process, the policy changes required PEBP staff to create a list of contracts scheduled to expire and provide the Board with recommendations for extensions to existing contracts.

Finally, in November 2017, contracting policies were amended a third time. These latest changes replaced the section regarding the RFP process and selecting a vendor with a section that acknowledged PEBP is subject to NRS 333, and the Board is the chief of the using agency. However, the amended policy then delegated the role of chief of the using agency to the Executive Officer.

When an agency's contracting practices circumvent state law and policy, the agency puts itself at risk of the contract becoming void and state officers being liable for the costs of services under NRS 333.810. In addition, a culture may develop within the agency in which there is an increased risk of bribery, collusion, or kickbacks. As the governing body responsible for PEPP's contracting activities, the Board needs to oversee, monitor, and create policies and procedures that emphasize compliance with state procurement laws and policies.

Board Allowed Unnecessary Expenditures

During our testing, we observed some agency expenditures were unnecessary and not an efficient use of agency resources. For instance, PEPP allocated over 620 hours and nearly \$51,000 to obtain business awards and an accreditation.

Additional Board oversight is necessary to ensure limited resources are used appropriately. In fiscal year 2018, PEPP began the process of applying for and obtaining awards and an accreditation as a means to promote itself. Exhibit 10 shows a breakdown of the employees' time and costs for the awards and accreditation.

PEPP Accreditation and Award Costs **Exhibit 10** **Fiscal Years 2018–2019**

Accreditation Costs	Hours	Amount
Contract Amount		\$24,900
Employee Time ⁽¹⁾	482	14,090
Total Accreditation Costs	482	\$38,990
Award Costs	Hours	Amount
Direct Costs ⁽²⁾		\$ 6,136
Employee Time	143	5,709
Total Award Costs	143	\$11,845
Total Costs	625	\$50,835

Source: PEPP records.

⁽¹⁾ Employee time included estimated time spent on applications and training.

⁽²⁾ Direct costs included application fees, award ceremony tickets, and travel expenses.

The American Business Awards, Stevie Awards, were created in 2002 to honor and generate public recognition of the

achievements and positive contributions of organizations and working professionals worldwide. Organizations are encouraged to enter as a means to build and burnish their brand. Based on an analysis of information provided by PEBP and a review of state accounting records, we estimated 143 hours and \$11,845 were spent obtaining and accepting the awards on two separate occasions. This included application fees, travel, and award ceremony tickets. The Governor's Finance Office later removed budget authority for these expenditures because they were not necessary.

The Utilization Review Accreditation Commission (URAC) accreditation is designed to establish national standards within the healthcare industry and show that quality healthcare is provided to patients. URAC is the leading independent entity in promoting healthcare quality through accreditation. The URAC accreditation is generally awarded to frontline healthcare entities that provide direct services and not public health plans where direct services are contracted out and participants don't have a choice in the government entity managing their health benefits. Based on an analysis of information provided by PEBP and a review of state payroll information, 482 staff hours were devoted to obtaining the accreditation, totaling over \$14,000 in employee pay. PEBP was the first and only public sector program nationwide to receive this specific accreditation, which URAC has now discontinued.

State law establishes the expectation that PEBP's funds will be used for costs related to health care and agency operations. Per NRS 287.0434(1), PEBP is required to use its assets only to pay for the expenses of health care for its members and covered dependents, to pay employees' salaries, and to pay administrative and other expenses. Furthermore, it is the responsibility of PEBP's Board and management to ensure funds are spent appropriately.

Recommendations

1. The PEBP Board should develop policies and procedures to ensure:
 - a. Competitive procurement of contracted services once the original term of the contract ends, in compliance with state policies;
 - b. Contracts and contract amendments have supporting documentation, including proper approvals by the Board and State Purchasing Division; and
 - c. Changes to a contract's original scope of work are competitively bid.
2. Comply with state law and agency policy concerning gifts, and include periodic training and documented attestations of Board member and employee acceptance of the policies.
3. Establish formal policies and procedures regarding the Request for Information process and compliance with State Purchasing guidelines.
4. Develop policies and procedures that require accurate information be provided to the Board and other governing bodies when seeking to amend contracts, and supporting documentation be provided.
5. Develop policies and procedures, in consultation with PEBP's Board, to ensure the use of funds and resources directly relate to the purpose of the agency and the statutory intent for the use of those resources.

Appendix A

Audit Methodology

To gain an understanding of the Public Employees' Benefits Program (PEBP), we interviewed staff and reviewed statutes, regulations, and policies and procedures significant to its operations. We also reviewed financial information, prior audit reports, budgets, legislative committee minutes, and other information describing PEBP's activities. In addition, we documented and assessed internal controls related to contract solicitation, monitoring, and payments, as well as other non-payroll expenditures.

To determine if PEBP had adequate controls over contract solicitation, we identified all active contracts during fiscal year 2019. We reviewed all 21 contracts for competitive solicitation practices.

We also reviewed all 18 contract amendments to determine the length of time since the contract had last been solicited and identified changes between each amendment. We also determined whether private negotiations had taken place in exchange for gifts or promises. This included interviewing PEBP staff and sending attestation letters to all vendors with active contracts.

Furthermore, testing of contract amendments included the review of PEBP Board meeting minutes in order to determine if the amendments had been discussed in an open meeting. We also met with the Purchasing Division staff and reviewed all of PEBP's contract extension waiver requests to determine if a waiver had been completed.

Furthermore, we evaluated whether PEBP had adequate controls over contract monitoring and payments. We utilized the state accounting system and captured all vendor payments made by

PEBP in fiscal year 2019. We compared the payments in the state accounting system to PEBP's contract tracking log to verify accuracy. Next, we judgmentally selected 38 payments based on the dollar amount and service month, resulting in 12 vendors and \$36 million (32%) of the \$114 million payment population. For payments selected, we obtained payment vouchers and supporting documentation and tested the payments for accuracy and compliance with the contracted rates and terms. In addition, as 11 of 12 contractor payments were based on per participant per month enrollment numbers, we tested payment amounts to ensure they matched enrollment numbers. To ensure the reliability of participant counts, we compared participant names and information in the vendor's system to employee records from the State's system and vice versa. We then used analytical software to ensure vendor enrollment data did not contain duplicates, terminated or deceased participants, and complied with age requirements. We determined the data to be reliable for our intended purposes.

To determine the adequacy of controls over award and accreditation expenditures, we tested all expenditures in these categories. We identified all direct expenditures for the awards and accreditation between fiscal years 2016 and 2019 in the state accounting system. Next, we identified and interviewed staff involved in obtaining the award or accreditation in order to determine the work hours used and cost of the employees' time. For the accreditation, we also calculated the work hours and costs for other PEBP staff required to take training.

We used nonstatistical audit sampling for our audit work, which was the most appropriate and cost-effective method for concluding on our audit objective. Based on our professional judgement, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provided sufficient, appropriate audit evidence to support the conclusions in our report. For these tests, we did not project the findings to the population because errors were not projectable. Our sample included both randomly and judgmentally selected items.

Our audit work was conducted from March 2019 to March 2020. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In accordance with NRS 218G.230, we furnished a copy of our preliminary report to the Executive Officer of PEBP. On June 18, 2020, we met with agency officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix B, which begins on page 27.

Contributors to this report included:

James T. Thorne, MPA, CCM
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Appendix B

Response From Public Employees' Benefits Program

		
STEVE SISOLAK Governor	STATE OF NEVADA PUBLIC EMPLOYEES' BENEFITS PROGRAM 901 S. Stewart Street, Suite 1001 Carson City, Nevada 89701 Telephone 775-684-7000 1-800-326-5496 Fax 775-684-7028 www.pebp.state.nv.us	ACCREDITED CORE Expires 04/01/2021
LAURA FREED Board Chair		LAURA RICH Executive Officer

DATE: June 15, 2020

TO: Daniel Crossman, Legislative Auditor

CC: Laura Freed, Chair, Public Employees' Benefits Program

FROM: Laura Rich, Executive Officer, Public Employees' Benefits Program

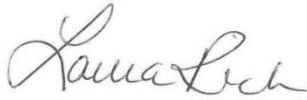
SUBJECT: Legislative Audit Response

Dear Mr. Crossman,

Thank you for the information provided in your audit report dated June 11, 2020. We appreciate the Legislative Council Bureau's professionalism during this audit process and the feedback that has been provided throughout the course of the review.

Please see PEBP's written responses as well as the attached "Response to Audit Recommendations" form indicating PEBP's acceptance to each of the findings.

Sincerely,


 Laura Rich, Executive Officer
 Public Employee Benefits Program

Recommendation 1:

The PEBP Board should develop policies and procedures to ensure:

- Competitive procurement of contracted services once the original term of the contract ends, in compliance with state policies
- Contracts and contract amendments have supporting documentation, including proper approvals by the Board and State Purchasing Division; and
- Changes to a contract's original scope of work are competitively bid

Response: PEBP accepts this recommendation.

PEBP will add this topic as an agenda item for discussion and possible action by the PEBP Board.

Recommendation 2:

Comply with state law and agency policy concerning gifts and include periodic training and documented attestations of Board member and employee acceptance of policies.

Response: PEBP accepts this recommendation.

Although PEBP accepts this recommendation, it is important to highlight additional information not contained in the audit report that PEBP may provide additional perspective:

- In 2017, the former PEBP Executive Officer (EO) traveled to the vendor headquarters to meet with leadership staff to discuss concerns related with the vendors dated benefits management system which was plagued with random issues and limited functionality. The vendor agreed to absorb the travel expenses associated with this trip so that the cost would not be borne by the state.
- In February of 2018, PEBP's former EO directed two members of his executive staff to travel to Toronto to conduct a site visit and assess potential opportunities and system improvements. The staff were instructed by the former EO not to claim any travel expenses, as the vendor would be incurring the cost of transportation, lodging and meals. During this trip, PEBP staff spent two days in the vendor's headquarters working with a team to resolve current concerns and further discuss an opportunity that was identified during the EO's previous on-site visit to the Toronto headquarters. Since PEBP's policies and procedures indicate "Accepting gifts, service, favor, employment, engagement or economic opportunity from any individual, firm or organization doing business with PEBP or the State when the employee is responsible for making any recommendations or decisions affecting their business activities without the approval of the Executive Officer", the designated staff did not question the request. Additionally, refusing the former EO's request may have been considered insubordination.
- At least one of the two staff directed by the former EO to travel to the vendors' headquarters had previously expressed significant concerns to the EO regarding the vendor's capabilities and performance.
- Although the vendor eventually received a contract extension, no additional revenue was granted. Instead, the vendor ultimately agreed to significantly lower administrative fees charged to PEBP while absorbing the entire cost of implementing a voluntary benefit platform.
- The project provided PEBP the ability to offer members an array of voluntary products (with group discounts to members), including AFLAC, a vision buy-up plan, life insurance and many other products. The voluntary benefit platform was added at no cost to PEBP and allowed members the ability to enroll in these products online through their PEBP account. Additionally,

the vendor agreed to upgrade the antiquated member facing enrollment portal at no cost to PEBP.

PEBP accepts this audit finding and agrees the vendors willingness to absorb the travel expenses prior to the award of a contract extension could be misinterpreted.

On May 28, 2020, the current Executive Officer recommended to the PEBP Board the cancelation of the contract amendment (including the two-year extension) due to poor vendor performance. The PEBP Board approved the cancellation and a new solicitation for a Benefits Management System is currently underway.

Based on the audit finding, PEBP Policies and Procedures appear to be in contradiction with the 2014 Executive Order issued by Governor Sandoval. With the assistance of the Division of Human Resource Management, PEBP will ensure the appropriate changes are made to PEBP's Policies and Procedures.

Recommendation 3:

Establish formal policies and procedures regarding the Request for Information process and compliance with State Purchasing guidelines.

Response: PEBP accepts this recommendation.

PEBP will make appropriate updates to its policies and procedures to ensure appropriate procurement practices are used for all solicitations.

Recommendation 4:

Develop policies and procedures that require accurate information be provided to the Board and other governing bodies when seeking to amend contracts and supporting documentation to be provided.

Response: PEBP accepts this recommendation.

PEBP will make appropriate updates to its policies and procedures to ensure supporting documentation validating its position when recommending contract amendments. Additionally, PEBP will propose that the PEBP Board develop criteria and/or guidelines to ensure recommendations being made to the board regarding contract amendments contain sufficient information with data that can be validated.

Recommendation 5:

Develop policies and procedures, in consultation with PEBP's Board, to ensure the use of funds and resources directly relate to the purpose of the agency and the statutory intent for the use of those resources.

Response: PEBP accepts this recommendation.

PEBP will make the appropriate updates to its policies and procedures. Along with recommendation 1, PEBP will also include this topic as part of a future agenda item to ensure the PEBP Board develop a mechanism to ensure expenditures authorized by the Board are spent appropriately per NRS 287.0434(1).

Public Employees' Benefits Program's Response to Audit Recommendations

<u>Recommendations</u>	<u>Accepted</u>	<u>Rejected</u>
1. The PEBP Board should develop policies and procedures to ensure:		
a. Competitive procurement of contracted services once the original term of the contract ends, in compliance with state policies;.....	<u> X </u>	<u> </u>
b. Contracts and contract amendments have supporting documentation, including proper approvals by the Board and State Purchasing Division; and	<u> X </u>	<u> </u>
c. Changes to a contract's original scope of work are competitively bid	<u> X </u>	<u> </u>
2. Comply with state law and agency policy concerning gifts, and include periodic training and documented attestations of Board member and employee acceptance of the policies	<u> X </u>	<u> </u>
3. Establish formal policies and procedures regarding the Request for Information process and compliance with State Purchasing guidelines.	<u> X </u>	<u> </u>
4. Develop policies and procedures that require accurate information be provided to the Board and other governing bodies when seeking to amend contracts, and supporting documentation be provided.	<u> X </u>	<u> </u>
5. Develop policies and procedures, in consultation with PEBP's Board, to ensure the use of funds and resources directly relate to the purpose of the agency and the statutory intent for the use of those resources.....	<u> X </u>	<u> </u>
TOTALS	<u> 5 </u>	<u> </u>

Appendix C

Auditor's Comments on Agency Response

PEBP, in its response on page 28, indicated it wanted to highlight additional information to provide perspective to Recommendation No. 2. Because of this, we have provided our comments on this issue to inform the reader of our position and demonstrate why we believe our finding, conclusion, and recommendation, as stated in the report, are accurate and appropriate.

While additional information was provided by PEBP regarding vendor paid trips, it does not change the details originally reported on pages 10 and 11. As discussed, PEBP management sought a contract amendment for an underperforming vendor, to the financial benefit of the vendor, after the vendor paid for travel expenses for three PEBP employees to visit its facility. The vendor provided lodging and meals that exceeded State travel reimbursement rates. Following are additional details pertinent to understanding the circumstances of this event and PEBP's response to our audit conclusions.

- In its response on page 28, PEBP's current Executive Officer indicates these trips were the result of direction given by the former Executive Officer and appropriate as they were done outside of a solicitation. However, as stated on page 11, Nevada law (NRS 281A.400(1)) prohibits state employees from accepting a gift or other compensation which could improperly influence decisions. Furthermore, Executive Order 2011-02, which was adopted by PEBP leadership in May 2014, prohibits employees from accepting gifts from vendors and defines gifts as including transportation, travel, lodgings, and meals.
- In addition, in its response, PEBP indicates no additional revenue was received by the vendor as a result of these trips. However, a contract amendment was approved providing an additional \$1.8 million to the contract total while also adding two years to the contract term. The PEBP Board discussed this matter in July, 2018, shortly after these trips were completed as detailed in Exhibit 7 on page 10. Furthermore, part of the amendment also included a change in the scope of services to be provided which the vendor would earn additional revenue through commissions charged on voluntary product sales to PEBP participants. Finally, a provision was added that specified if the contract was terminated early, for no fault, the vendor would be compensated for its investment at a reduced rate.

Public officers must commit to avoiding actual and perceived conflicts of interest. Ethics statutes exist to ensure public employees are not improperly influenced and to prevent a public officer or employee from departing from the faithful and impartial discharge of the officer's or employee's public duties.