



COUNCIL AGENDA: 03-08-11
ITEM: 3.3

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Dennis Hawkins, CMC
City Clerk

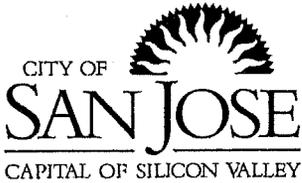
SUBJECT: SEE BELOW

DATE: 02-17-11

**SUBJECT: STATUS REPORT ON THE ALTERNATIVE SERVICE DELIVERY
EVALUATION FOR WORKERS' COMPENSATION ADMINISTRATION
AND EMPLOYEE HEALTH SERVICES**

RECOMMENDATION

As recommended by the Public Safety, Finance and Strategic Support Committee on February 17, 2011 and outlined in the attached memo previously submitted to the Public Safety, Finance and Strategic Support Committee, accept the status report on the Alternative Service Delivery Evaluation for Workers' Compensation Administration and Employee Health Services and direct staff to continue to work on the referrals noted in the report.



Memorandum

TO: PUBLIC SAFETY, FINANCE AND
STRATEGIC SUPPORT COMMITTEE

FROM: Edward K. Shikada
Kay Winer

SUBJECT: SEE BELOW

DATE: February 9, 2011

Approved

Date

2/10/11

SUBJECT: ALTERNATIVE SERVICE DELIVERY EVALUATION FOR WORKERS' COMPENSATION ADMINISTRATION

RECOMMENDATION

1. Accept this report on the service delivery evaluation for Workers' Compensation administration.
2. Continue to pursue structural changes to the City's retirement, disability, and medical benefits as further described in this report to reduce Workers' Compensation claims and disability leave supplemental pay within the context of the City's overall labor negotiation strategy.
3. Direct staff to evaluate as part of the 2011-2012 budget process contracting with a third party claims administrator on a pilot basis to manage a portion of the City's overall claims.
4. Direct staff to continue to develop recommendations for implementing greater management oversight and accountability for reducing Workers' Compensation claims and to regularly report progress to the Public Safety, Finance, and Strategic Support Committee through the quarterly Workers' Compensation report.

BACKGROUND

In February 2010, the Administration advanced a list of service delivery proposals for consideration as part of the 2010-2011 Budget in accordance with Council Policy 0-41, Service Delivery Evaluation. Workers' Compensation Administration was selected for a business case analysis, given the high cost of the City's Workers' Compensation Program (WC Program) and preliminary data indicating that transitioning these services from the current internal delivery model to other service providers or methods might generate cost savings for the City.

In 2009-2010 the total cost of the City's Workers' Compensation program (including administration, claims, disability leave costs, contractual services, and claims investigation)-was

approximately \$30.9 million. The costs are expected to increase in 2010-2011 to approximately \$32.7 million. Given the large expense that the WC Program represents, a number of studies have been undertaken over the last decade to evaluate the City's Workers' Compensation Program. The City Auditor's Office has conducted several performance audits of the City's Workers' Compensation Program including:

- January 1994 *Audit of The Workers' Compensation Claims Database*
- August 1994 *Audit of The Workers' Compensation Program*
- December 2005 *Audit of The Workers' Compensation Claims Liability*
- April 2009 *Audit of the Workers' Compensation Program*

These reviews included a total of 57 recommendations. Fifty-five out of the 57 recommendations made in these four performance audits have subsequently been resolved and closed. The 2009 audit compares the cost of the City's WC Program to other comparable California cities and counties and found that in spite of recent improvements, the cost of the City's program is higher. The report proposed among several other recommendations, structural changes to the City's Policy for Disability Leave and Disability Retirement Program. Attachment A. provides a status of *2009 City Audit Recommendations*.

In addition, the City contracted with ARM Tech, an actuarial, risk management, and claims consultant to perform two audits – a *Workers' Compensation Claims Audit* which was issued in September 2004 and a *Risk Management Assessment Audit*, issued in March 2007. The findings of the March 2007 ARM Tech *Risk Management Assessment Audit* formed the basis of transferring the Risk Management function from the Finance Department to Human Resources and adding five adjusters to the staffing compliment.

In preparation for the most recent staff analysis, a Request for Information (RFI) was released in April 2010. The RFI sought information from qualified companies to provide Workers' Compensation claims administration services to determine whether to proceed to a competitive solicitation for the services. City staff's initial analysis for Workers' Compensation claims administration was subsequently reviewed by County of Santa Clara Risk Management staff to validate the findings and to identify potential program improvements which are discussed later in this report. The findings of this analysis substantiate the findings of prior studies in that efficiencies and other structural changes are needed within the current service delivery model to begin to contain the high cost of the program.

ANALYSIS

This memorandum provides an overview of the City's WC Program, staff's analysis of the results of the RFI for Workers' Compensation Claims Administration including an evaluation of continuous improvement opportunities and recommendations for next steps.

Workers' Compensation Program

While the RFI focused solely on claims administration, there are several factors that contribute to the City's overall cost of the WC Program. The City's WC Program is administered by the

Workers' Compensation Unit in the Department of Human Resources. The Department also contracts for services to provide bill review, utilization review and nurse care management. The City Attorney's Office conducts claims investigation through in-house staff and contractual services. In addition, the City pays a self-insurance assessment fee to the State to support their Workers' Compensation Board and their Division of Workers' Compensation. The City is obligated to pay this fee whether we provide claims administration or a third party provides the service. The greatest cost of the City's WC Program stem from our medical, legal, indemnity, and disability leave supplemental pay costs. As Table 1 below illustrates the total cost of the City's medical, legal and indemnity costs in 2009-2010 was \$17.3 million and the costs are expected to increase in 2010-2011 by \$2 million. Departments also budget for salaries paid to employees out on disability leave. The total cost to the City for its WC Program in 2009-2010 was approximately \$30.9 million, and the budget in FY10-11 is \$32.7 million.

Table 1. Total Cost of Workers Compensation Program

	2009-10	2010-11*
Claims Administration		
Personal Services	\$2,700,000	\$2,390,000
Non-personal/equipment expenditures	\$116,000	\$116,000
Rent and Overhead	\$537,000	\$537,000
Contractual Services	\$1,100,000	\$1,200,000
Claims Costs		
Citywide Expenditures-Medical, Legal, and Indemnity Costs	\$17,300,000	\$19,500,000
Departmental Expenditures – Disability Leave Costs	\$7,500,000	\$7,500,000
Self-insurance Assessment Fee	\$664,000	\$650,000
City Attorney's Litigation and Claims Investigation Services	\$950,000	\$850,000
Total	\$30,867,000	\$32,743,000

*Adopted Budget

Workers' Compensation Unit

Employees in this unit administer the Workers' Compensation claims for City of San José employees for all existing and future claims as required by California law and the City's Memorandum of Agreements. These services include determining compensability of claims filed, determination and payment of various benefits, and concluding final disposition of claims.

The Human Resource's Department Workers' Compensation Unit is budgeted in 2010-2011 for a staff of 21 full-time equivalent positions (FTEs). Total funding budgeted in the General Fund for this program is \$2.39 million in personal service expenditures and \$116,000 in non-personal/equipment expenditures. In addition, the estimated cost of rent and overhead (\$537,000) bring the estimated cost for the Administration of the Workers' Compensation Unit to \$3.04 million in 2010-2011. Included in the 2010-2011 Adopted Operating Budget is the elimination of four positions 2.0 of these positions (1.0 Workers' Compensation Claims Adjuster and 1.0 Senior Office Specialist) were eliminated effective July 1, 2010 and an additional 2.0 Workers' Compensation Claims Adjuster positions effective June 30, 2011. In light of the City's on-going General Fund structural budget deficit, further reductions in staff will likely be proposed for 2011-2012. Additional costs are budgeted in the City Attorney's Office for

litigation services and claims investigation services and in City-Wide Expenses for claims costs (Medical, Legal, and Indemnity Costs).

On average the City has an incident rate of 17 incidents, or claims, per 100 employees. By comparison, Santa Clara County has 13 claims per 100 employees. In addition, their medical and indemnity claims costs are approximately equal (\$17 million) to the City's cost and yet they have approximately three times the number of employees (18,000 employees).

Request for Information Results

The Administration received responses from eight companies. A summary comparing budgetary estimates from each RFI respondent to the San José's staffing and program costs follows in Table 1, below. This analysis concludes that the City's cost to administer the program is lower than the RFI respondents. Although Corvel's bid is 4% lower than the City's cost, in order to accurately compare Corvel costs to other respondents, an additional seven (7) adjusters would be required to deliver Corvel's proposed caseload level of 125-150 per adjuster. Additionally, Corvel mandates use of their integrated cost containment service (a service which the City currently contracts out and maintains as a separate vendor contract).

Table 1. Analysis of Staffing and Program Costs

Vendor	Average Indemnity Caseload per Adjuster	Total Staff	Total Year One Vendor Cost	Increase as Compared to CSJ WC Budget
FARA	170	32	\$ 5,118,600	68%
Intercare Option #1	150	46	\$ 5,072,650	67%
Intercare Option #2	175	43	\$ 4,819,397	59%
JT2	150	47	\$ 4,595,000	51%
AIMS	175	39	\$ 4,431,600	46%
York	170	33	\$ 4,294,240	41%
Tri-Star (Option 1)	150	35	\$ 4,196,400	38%
Tri-Star (Option 2)	175	30	\$ 3,703,200	22%
Gallagher Bassett	180	30	\$ 3,378,012	11%
City of San José WC (Adopted FY 2010-2011) ¹	285	21	\$ 3,043,000	
Corvel	125-150	27	\$ 2,912,600	-4%

¹ The 2010-2011 Adopted costs of \$3,040,399 include \$537,062 in rent and overhead costs that will not result in direct expenditure reductions in the General Fund should this program be contracted out. In addition, the revised estimate for the 2011-2012 Preliminary General Fund Forecast is \$2,924,348. Due to the reduction of 2.0 FTEs only funded until June 30, 2011, as approved and adopted as part of the 2010-2011 Adopted Budget, offset by higher personnel costs as of October 2010.

The primary factor driving the difference in cost between the City of San José's internal service provision model and that of the proposing vendors appears to be that the vendors' staffing levels meet industry standards and State best practice standards of case load per adjuster, and the salary per adjuster is lower than City salaries. The City's current adjusters are handling workloads that are over two times industry best practices and state guidelines of 150-175. In 2010-2011 each City of San José Workers' Compensation Claims Adjusters has an average caseload of 285 claims. The majority of vendors who responded to the City's RFI projected caseloads of 125-175 with a maximum assignment of 180 claims per adjuster. In order to meet State timeframe mandates, the result is less thorough review of claims and a potential for errors. Further, given the differences in average case load between the City operation and the information from each of the vendors, it is clear that the average cost per employee including indirect costs is significantly less in the private sector.

In association with this study, staff also explored the cost that the City would incur in managing the contract if the workers' compensation program were completely outsourced. Using the San Francisco Municipal Transportation Agency as an example of a public agency that outsources its workers' compensation program, staff estimates that staffing levels needed to manage the contract would be approximately 3.5 FTEs, or \$470,000 based on 1.0 Division Manager, 1.0 Senior Office Specialist, 1.0 Analyst position and 0.5 Nurse Practitioner. The Human Resources Department would need to evaluate and determine the appropriate compliment of additional resources needed to ensure sufficient levels per the estimates above should the Administration consider outsourcing this function. The San Francisco Municipal Transportation Agency maintains 7.5 FTEs to manage their Third Party Administrator (TPA) but has roughly half the total open claims of the City of San José.

These preliminary findings suggest that the cost savings for contracting out claims administration are difficult to quantify with the information available at this time. The evaluation further reinforced the findings of recent studies and that for the coming fiscal year our resources may be better focused on claims management and continuing to pursue structural changes to the City's retirement, disability, and medical benefits. At this time, staff recommends that the City continue to aggressively pursue the improvements as described below. The City would benefit from further market testing to evaluate other criteria beyond simply the cost per adjuster to determine whether a third party administrator may better serve the City than our current service delivery model.

Workers' Compensation Program Improvement Opportunities

In conjunction with the County of Santa Clara's Risk Management staff, staff evaluated a number of continuous improvement opportunities. Prior to any further market testing, staff recommends that the City accomplish the following structural changes within the current service delivery model.

- 1. Continue to pursue structural changes to the program that would include reducing disability leave supplemental pay for non-sworn employees with the seven remaining non-public safety bargaining units.**

City of San José employees receive disability leave supplemental pay in addition to the State mandated amounts of Workers' Compensation Temporary Disability when they suffer a work related injury. Public Safety employees receive 100% of their salary for up to one year. Some non-public safety employees receive 85% of their salary for up to 9 months while other recently negotiated a reduction in this supplemental pay to 6 months. County of Santa Clara public safety employees receive disability benefits commensurate to the City of San José but non-safety employees receive only the state mandated minimum disability payments but no additional leave benefit outside of their own accrued sick, vacation and personal leave. According to the 2009 *Audit of the City of San José's Workers' Compensation Program* part of the reason the City's workers' compensation costs are up is that the total amount of time that injured workers stay off work while recovering from injuries has increased.

Changes to the disability leave supplemental pay are subject to meet and confer with the City's bargaining units and must be considered within the context of City's overall labor negotiation strategy. The City has taken steps to moderate the escalation of these costs and has achieved a reduction in the disability leave supplement pay, from nine months to six months, with three of the City's 11 employee groups, including ABMEI, ALP and Unit 99. Additional action will moderate the costs for all non-sworn employees and may reduce the financial incentives to stay off work.

2. Continue to pursue structural changes to the Police and Fire Department Retirement System to provide for offset of Workers' Compensation benefits received by sworn employees who also receive disability retirement benefits.

According to the 2009 *Audit of the City of San José's Workers' Compensation Program* and the 2008 Management Partners Report on ways to solve the City's General Fund structural budget deficit, a factor contributing to the high cost of the City's Workers' Compensation Program is that in San José, unlike other California cities and counties, public safety employees are eligible to collect both their retirement benefit and workers' compensation payments when they retire with a service-connected disability. Other cities and counties reduce the regular pension to the extent that the retiree is also receiving workers' compensation benefits. However, San José's sworn personnel who are disabled when they retire are eligible to receive their full pension in addition to workers' compensation temporary and/or permanent disability payments. Non-sworn San José employees who retire on a service connected disability do not receive both workers' compensation benefits and their full pension, but have their pension allowance offset by the amount of the workers' compensation payments. Such a change would be subject to meet and confer with the unions that represent the police officers and firefighters and must be considered within the context of the City's overall labor negotiation strategy. While the savings are difficult to quantify, it is anticipated that the changes may reduce the financial incentive to file claims.

3. Pursue 30 day medical control of claims for medical treatment.

Currently employees can see the physician of their choosing without pre-designating (or pre-selecting) a physician. A 30 day medical control over claimants will allow the City to direct employees to the medical care provider of its choice in circumstances in which the employee has not already designated a personal treating doctor of his or her own choice. It is believed that this

may result in better health outcomes for the first 30 days of a claim. Better outcomes will allow employees to heal faster and return to work with less treatment, thereby lowering costs.

By law employees also have the option to pre-designate or pre-select the physician of their choosing in the event of a work related injury which would allow them to opt out of the City's 30 day control. A 30 day control may have some impact on cost but it may be mitigated by employees' pre-designating their physician to opt out. The structural changes to the City's Workers' Compensation Program this recommendation proposes may be subject to meet and confer with the City's bargaining units.

4. On a pilot basis, contract with a claims administrator to manage a portion of the City's overall claims.

Within the context of the City's 2011-2012 Preliminary General Fund budget shortfall of \$110 million, this recommendation contemplates conducting a pilot program to evaluate the effectiveness of a third party administrator to manage a portion of the City's overall claims such as high exposure public safety claims, or the claims of a single Department. The County of Santa Clara has established dedicated teams of adjusters and managers that are assigned only high exposure (high potential cost/pay-out) claims from public safety employees. Such a model could prove beneficial because experienced, high-performing adjusters could, in theory, generate better case outcomes on the most complex, difficult, and costly claims. It will also provide the opportunity to evaluate the effectiveness of a third party administrator in managing claims. Staff has not established whether or not the marketplace would support limited outsourced case management as described above and would need to study vendor availability but based on an average of the vendors' cost to manage a claim from proposals to the RFI, initial estimates suggest that a third party administrator would charge approximately \$1,000 per claim. Staff will evaluate establishing this pilot program as part of the development of the 2011-2012 Proposed Budget.

5. Reinforce Department-level responsibility for reducing workers' compensation claims.

The 2004 ARM Tech study recommended allocating all workers' compensation costs to individual departments to make department managers more accountable for workers' compensation expenses. The City Auditor further recommended in its 2009 *Audit of the City of San José's Workers' Compensation Program* that the City Departments whose employees file most of the City's workers' compensation claims, establish a line item in each department's operating budget that would cover the department's projected workers' compensation costs. Departments that spend more than they have available in their departmental budget would require City Council approval for a budget augmentation.

Currently, claims costs are appropriated citywide for medical, legal and indemnity costs, which are budgeted at \$19,500,000 in 2010-2011. City departments only pay for a portion of workers' compensation from their budgets, specifically, the cost of temporary disability and the DLS, estimated at \$7,500,000. In 2009-2010 the City has established a mechanism for tracking workers' compensation claims costs for departments which have accounted for a majority of costs, such as Police, Fire, Transportation, General Services, and Parks, Recreation and Neighborhood Service Departments. Risk Management in Human Resources has been working

with these departments to identify and analyze trends in workers' compensation costs and will develop recommendations for implementing greater management oversight and accountability for monitoring and managing the number and circumstances of claims filed. Recommendations will be reported out, and regular updates will be provided, in the quarterly report submitted to the Public Safety, Finance, and Strategic Support Committee.

CONCLUSION

Staff has examined all of the qualifying vendor responses to requests for information and recommends against proceeding to a formal request for proposal process for 2011-2012. At this time, the cost saving potential of utilizing a third party administrator for claims administration is difficult to quantify with the information available at this time. There are a number of improvements to the current service model that staff recommends the City continue to aggressively pursue with claims management and policy changes to the City's disability leave supplemental pay benefit, and 30 day medical control of claims.

Contracting with a third party administrator to manage a portion of the City's claims as a pilot program and reinforcing department-level accountability are management strategies to strengthen effectiveness of current staff efforts.

PUBLIC OUTREACH

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

The memorandum will be posted on the City's website for the February 17, 2011 Public Safety, Finance and Strategic Support Committee meeting.

To outreach to potential vendors, this RFI was advertised on the City's internet Bidline and the Demand Star bid notification system. In addition, staff sent a draft RFI to affected employees and bargaining unit representatives for their review and comments in March 2010. Staff met with bargaining unit representatives in April 2010 to discuss their comments and concern regarding the RFI and the alternative service delivery process. Furthermore, staff met with bargaining unit representatives in August 2010 to discuss the results of the RFI responses and share with them the next steps for completing the alternative service delivery process.

COORDINATION

This memorandum has been coordinated with the Budget Office and Finance Department.

CEQA

Not a Project, File No. PP10-066 (e), Services that involve no physical changes to the environment.



Edward K. Shikada
Assistant City Manager

/s/

Kay Winer
Interim Director, Human Resources

For questions please contact Ed Shikada, Assistant City Manager, at 535-8190 or
Kay Winer, Interim Director of Human Resources, at 975-1475.

Attachment A
Status of 1009 City Audit Recommendations

Recommendation	Status	Explanation
<p>#1: Propose structural changes to the City's Workers' Compensation Program that would include (1) reducing the City's policy of providing up to nine months of a disability leave supplement pay at 85 percent for non-sworn and one full year at 100 percent for sworn employees and (2) implementing a retirement benefit payment offset for sworn employees receiving disability retirement payments that replicates the offset for retired non-sworn employees.</p>	<p>Partially implemented</p>	<p>The City achieved a change in the disability leave supplement benefit with two of the City's 11 bargaining units which reduced the disability leave supplement from nine months to six months. This change was also implemented for unrepresented employees in Unit 99. Negotiations are scheduled to begin again with all non-sworn bargaining units in January 2011, at which time the City will have another opportunity to achieve a change in this benefit for Fiscal Year 2011-2012. The issue of creating a sworn employee retirement benefit payment offset has been formally referred to the Office of Employee Relations and is a bargaining priority, however, the offset will necessarily be judged as an option amongst several possible options to create the best overall negotiating outcome.</p>
<p>#2: Assign to the City's Return-To Work Coordinator the responsibility for identifying for each of the departments, with the highest frequency of workers' compensation claims, the number of lost work hours attributable to employees off work due to a workplace injury. Each month, this report shall be made available to the City Manager and to each department director to facilitate the department directors' efforts to have the injured employees return to work as soon as the workers' medical conditions allow.</p>	<p>Implemented</p>	<p>The City's Return-To Work Coordinator produces reports and analysis to identify for each of the five most risk exposed departments, with the highest frequency of workers' compensation claims, the number of lost work hours attributable to employees off work due to a workplace injury.</p>
<p>#3: The Police Chief and the Fire Chief work with Risk Management to identify the reasons for the recent significant increase in the time away from work among their injured police officers and firefighters, so that they may be in a better position to address the escalating cost of disability leave payments in their departments.</p>	<p>Implemented</p>	<p>Risk Management reviews lost time cost drivers on a quarterly basis with the Police and Fire Chiefs and with the City's other most risk exposed departments. These reviews include broad trend review and detailed claim analysis.</p>

Attachment A
Status of 1009 City Audit Recommendations

Recommendation	Status	Explanation
<p>#4: Reconsider the feasibility of restoring the Wellness Coordinator position for the Wellness Program and implementing a comprehensive Wellness-Fitness Program for the Fire Department.</p>	<p>Partially implemented</p>	<p>In August 2009, Risk Management requested that the San Jose Fire Department (SJFD) consider the restoration of a comprehensive wellness program. Risk Management researched best practices of similar-sized agencies and prepared a detailed wellness plan proposing that the SJFD consider restoring staffing and resources to wellness. The proposed plan includes the following components: (1) Health and Fitness Coordinator, (2) Mandatory Fitness Training for Sworn Fire Employees, and (3) Mandatory Physical Examinations and Standards. According to the SJFD Administrative Officer, Fire Administration staff, the Human Resources Safety Division Deputy Director, and the City Physician met to discuss implementing changes to the Annual Medical Exam process and to discuss implementing a comprehensive fitness program. The SJFD will continue to work with the Human Resources Department to implement changes to the Annual Medical Exams and to develop a proposal for a comprehensive fitness program that is within the overall City's budget strategy.</p>
<p>#5: Implement the 2007 consultant recommendation to include the accomplishment of safety goals as one of the goals to be considered in the City's performance review process in which the City Council reviews each department's performance during the budget study sessions each spring.</p>	<p>Implemented</p>	<p>In August 2009, Risk Management prepared a memorandum notifying the five most risk-exposed City departments – Fire; Police; General Services; Parks, Recreation and Neighborhood Services; and Transportation – that the departments will be responsible for reporting safety goals, investigations, and disciplines as outlined by Risk Management's 8 Point Safety Plan. All five Departments completed and submitted the 8 Point Safety Plan to Risk Management. Risk Management continues to meet quarterly with these departments to review safety goals, investigations, and disciplines as outlined in the 8 Point Safety Plan and the information is reviewed during budget study sessions each spring.</p>

Attachment A
Status of 1009 City Audit Recommendations

Recommendation	Status	Explanation
<p>#6: For the City Departments whose employees file most of the City's workers' compensation claims, establish a line item in each department's operating budget that would cover the department's projected workers' compensation costs. Departments that spend more than they have available in their departmental budget would have to approach the City Council for a budget augmentation.</p>	<p>Implemented</p>	<p>Separate City-wide appropriations for workers' compensation claims costs have been established for departments which have accounted for a majority of costs, such as Police, Fire, Transportation, General Services, and Parks, Recreation and Neighborhood Service Departments. The figures are currently being tracked on a trial basis at this time.</p>
<p>#7: Prepare a quarterly report to the Public Safety, Finance, and Strategic Support Committee that covers the City's Workers' Compensation Program. This report should identify (1) workers' compensation claims costs for each of the City departments who have the highest frequency of workers' compensation claims, (2) total costs compared to the budgeted costs for each department, and (3) significant components of cost (e.g., the cost for medical treatments, payments of temporary disability, payments of disability leave supplements, and/or payments for permanent disabilities). Risk Management should also make this report available to each of the department directors, whose departments account for the bulk of the City's claims, as a way to closely monitor the City's overall and departmental costs of workers' compensation.</p>	<p>Implemented</p>	<p>A quarterly report is made to the Public Safety, Finance, and Strategic Support Committee that covers the City's Workers' Compensation Program as described in recommendation #6.</p>



Memorandum

TO: PUBLIC SAFETY, FINANCE AND
STRATEGIC SUPPORT COMMITTEE

FROM: Edward K. Shikada
Kay Winer

SUBJECT: SEE BELOW

DATE: February 9, 2011

Approve:

Date:

2/10/11

**SUBJECT: ALTERNATIVE SERVICE DELIVERY EVALUATION FOR EMPLOYEE
HEALTH SERVICES**

RECOMMENDATION

Accept this report on the service delivery evaluation for Employee Health Services.

EXECUTIVE SUMMARY

The Administration issued a Request for Information in April 2010 for a vendor to provide occupational health services to City employees. The preliminary evaluation concluded that there does not appear to be a business case to proceed with a formal request for proposals at this time, however a number of factors limit the evaluation. One measure the City could take to more accurately evaluate the costs of a third party vendor to provide employee health service is to update our records management system to determine more precisely the number of medical procedures that the City performs. Staff acknowledges that a budget addition for a records management system in the current fiscal environment may not be feasible. Staff recommends pursuing this as a future investment to allow for better reporting and tracking of medical services.

Staff also recommends the implementation of a follow-up fitness program as a future investment opportunity to assist employees whose health could be improved as indicated by their annual physical examinations, especially for Police and Fire Personnel. Since many illnesses, such as diabetes, high-blood pressure, heart diseases, and cancer are presumed to be work related (for Police and Fire personnel) according to the State workers' compensation laws, the City is obligated to pay medical costs and disability benefits for employees who suffer these illnesses. Having a follow-up fitness program would help employees to be healthy and generate cost savings to the City.

BACKGROUND

In February 2010, the Administration advanced a list of service delivery proposals being considered as part of the 2010-2011 Budget in accordance with Council Policy 0-41, Service Delivery Evaluation. Employee Health Services was selected for a business case analysis.

In preparation for the business case analysis, a Requests for Information (RFI) was released in April 2010. The RFI sought information from qualified vendors to provide health services to determine whether to proceed to a competitive solicitation for the services. The Administration received two responses to its medical services vendor RFI; from Kaiser Permanente and U.S. Healthworks Medical Group (USHW). The vendor responses were analyzed by staff to assess the potential to realize savings and efficiencies through contracting out the services to private vendors. Staff met with both vendors to review RFI responses to ensure comparison of like services.

ANALYSIS

This memorandum provides an overview of the City's Employee Health Services, staff's analysis of the results of RFI, and outlines recommendations to consider for future investment.

Employee Health Services Unit

Employee Health Services is budgeted in 2010-2011 for a staff of approximately five full-time equivalent positions (FTEs) in all funds and approximately four positions in the General Fund. Major medical services provided by EHS include:

- Physical examinations for Police and Fire personnel
- Medical surveillance examinations
- Hearing conservation services
- Random drug testing
- Wellness screening

The services evaluated in the request for information include only those services performed by positions funded by the General Fund. The one position difference represents the funding provided by the Federated and Police and Fire Retirement Funds to oversee and evaluate disability retirements. Total funding budgeted in the General Fund for the health services program includes \$496,000 in personal service expenditures and \$157,000 in non-personal/equipment expenditures. In addition, the estimated cost of rent and overhead (\$94,000) bring the estimated cost for the Employee Health Services Unit to \$747,000 in 2010-2011 as depicted in Table I. below. It is anticipated that personnel costs of the City will continue to increase in 2011-2012 and over the next few years, therefore, this will require reconsideration of outsourcing this service in the future as the gap between the City's costs and potential outside vendors' costs may be reduced.

Table 1. Cost to provide Employee Health Services In-House

FY 2010-2011	FTE	GF
Personal Services	3.68	\$496,000
Non Personal		\$157,000
Overhead		\$ 41,000
Rent		\$ 53,000
Total		\$747,000

It is important to note that the costs associated with rent and overhead costs will not result in a direct expenditure reduction in the General Fund should this program be contracted out. In addition, the realignment of the remaining duties to provide services for the Retirement Board in relation to retirement disabilities would be necessary.

In addition, there are opportunity costs to consider related to the Health Building at former City Hall. The total Health Building space is approximately 1,600 sq. ft. Currently, the lease cost for comparable office space in the geographic area of the Health Building is between \$1.25 and \$2.00 per square foot. A one-time investment cost of \$60,000 for improvements would also be necessary to make the space ready for occupancy. The evaluation of re-use opportunities for former City Hall is also on-going. If and when a decision is made on the re-use of the former City Hall, the housing and operations of EHS will be evaluated in current City facilities and other leased space.

Request for Information Results

The administration received two qualifying vendor responses to its employee health services RFI in May 2010. Staff met with both vendors to review RFI responses to ensure comparison of like services and both vendors submitted revised cost proposals in the fall of 2010. A summary analysis of the responses, along with a comparison to the City of San José's program costs are detailed in the table below. The analysis suggests that the City of San José's current service delivery model is more cost effective than each of the models proposed by vendors in this RFI process.

As Table 2 below illustrates, the City's cost to provide Employee Health Services is approximately \$747,000. By comparison the approximate cost of USHW to provide the service is approximately \$1.1 million or 32% higher than the City's delivery of the service. Kaiser's cost is \$933,966 or 20% higher than that of EHS. Staff also reviewed the internal staffing that would be necessary to manage a contract of services provided by an outside vendor. Staff concluded that minimum staffing would consist of 1.5 FTEs (estimated annual cost: \$225,000) including one Nurse Practitioner to monitor the provision of medical services and 0.5 Analyst to coordinate service provision with all City Departments and to ensure that the vendor meets the performance standards of the contract. This conclusion is based on analysis of internal needs and on research of other governmental jurisdictions (Long Beach and San Francisco) in California.

Table 2. Analysis of Cost Proposals

Vendor	Proposed Cost of Basic Services	20% Increment (additional cost for services above basic level)	Total Annual Cost
Kaiser	\$778,305 ¹	\$155,661	\$ 933,966
U.S. HealthWorks	\$917,313	\$183,463	\$1,100,776
City of San José EHS (2010-2011 Adopted Budget)	\$747,000	\$0	\$ 747,000

Vendor Proposal Assumptions

There are a number of challenges that limit this evaluation worth noting. First, the vendors' cost proposals are on a transactional basis and rely on the City's estimate of the number of medical procedures that are performed by staff under the current in-source model. While staff believes fair estimates of the number of medical procedures performed were considered, the City does not maintain an electronic medical record keeping system that can provide precise information on the number of as needed tests performed. Currently, the City maintains a manual system for keeping records. A medical chart (folder) is created for each employee. The chart is updated (new information is added) every time employees receive medical services. The charts are kept in alphabetical order and by department in a secured place in the EHS office. Having an electronic records system would enhance the efficiency of record keeping.

It is also important to note a few assumptions made when calculating the vendor costs. For both Kaiser as well as U.S. HealthWorks, revised costs were based on basic service level projections and additional costs for subsequent services and procedures should the basic level prove insufficient. For example, unless a tuberculosis skin test comes back positive, additional tests would not be necessary; therefore, only the cost for the skin test is included in the basic level of services. EHS does have accurate records of medical procedures performed at the basic service level. Based on industry trends identified by the providers, combined with the analysis of the City's medical staff for services provided above the basic level, an assumption of 20% has been added to the original vendor proposals to accurately represent the estimated ratio of instances in which additional services beyond the basic level would be necessary.

Future Investments

Staff considered a number of continuous improvement opportunities given the factors limiting the evaluation. One measure the City could take to more accurately evaluate the costs of a third party vendor to provide employee health service is to update our records management system. To more accurately evaluate the number of medical procedures that the City currently performs,

¹ Staff is continuing the discussion with Kaiser to refine the cost of basic services to ensure that the medical procedures, test, and examinations, described under basic level of services are comparable to those of U.S. HealthWorks and of EHS.

the City would need to invest in an electronic record keeping system. Staff estimates the cost of a software program, based on an informal estimate from a reputable EHS computing solutions vendor, to be approximately \$60,000 one-time, plus an on-going annual maintenance cost of approximately \$8,000. A formal bid process would be needed to validate the cost estimate.

To further refine the evaluation staff could also pursue a different approach to the costing. Under the current model, staff compared cost estimates for the services provided by vendors on a transactional basis to the City's fixed staffing costs. Staff could pursue a unit cost comparison approach. This approach would require EHS staff to calculate average unit cost prices for key services and to compare the costs to the vendors' proposals. Staff also considered pursuing further independent evaluation from a consultant or the City Auditor's Office.

Another potential future investment opportunity evaluated is the implementation of a follow-up fitness program to assist employees whose health could be improved as indicated by their annual physical examinations, especially for Police and Fire Personnel. The estimated annual cost for a Nurse to manage this program is approximately \$140,000. This potential investment opportunity will be evaluated as part of addressing the 2011-2012 Preliminary General Fund shortfall currently estimated at \$110 million. Cardiovascular/heart related injuries in the City of San Jose's Police Department alone accounted for 57 worker compensation claims in the last four fiscal years costing the City an estimated \$3,873,000. In the last 14 months, the City has agreed to pay approximately \$1.8 million as part of workers' compensation settlements for 13 cancer and heart related claims. In addition to the \$1.8 million settlements, the City also agreed to pay life pension to eight out of 13 claimants. Preventing one claim would more than pay for the cost of the proposed program. Staff will further evaluate incorporating these priorities into the existing Employee Wellness Program initiatives.

Staff recognizes the value of the investment opportunities discussed above but the current fiscal environment renders these types of expenditure unrealistic at this time. Staff recommends reviewing the continuous improvement opportunities in future fiscal years when budget conditions improve. Staff could proceed to further refine the cost evaluations; however the potential return on the continued resource investment does not appear to justify further evaluation.

CONCLUSION

Staff has completed an RFI to determine whether to proceed to a formal request for proposal for a third party vendor to provide employee health services to the City. The results indicate with our current information that the existing internal EHS model is more cost effective than the vendor-proposed models. Staff recommends reviewing the continuous improvement opportunities identified in this memorandum in future fiscal years when budget conditions improve.

PUBLIC OUTREACH

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

Although this item does not meet any criteria listed above, the memorandum will be posted on the City's website for the January 20, 2010 Public Safety, Finance and Strategic Support Committee meeting.

To outreach potential vendors, this RFI was advertised on the City's internet Bidline and the Demand Star bid notification system. In addition, staff sent a draft RFI to affected employees and bargaining unit representatives for their review and comments in March 2010. Staff met with bargaining unit representatives in April 2010 to discuss their comments and concern regarding the RFI and the alternative service delivery process. Furthermore, staff met with bargaining unit representatives in August 2010 to discuss the results of the RFI responses and share with them the next steps for completing the alternative service delivery process.

COORDINATION

This memorandum has been coordinated with the Budget Office and Finance Department.

CEQA

Not a Project, File No. PP10-066 (e), Services that involve no physical changes to the environment.



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/s/

Kay Winer
Interim Director, Human Resources

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