Self-Insured Health Plans

An Approach for Providing Real Value and Lower Costs

By Joseph Berardo Jr. and Jim Cusumano

Healthcare ranks as one of the top costs for U.S. employers today, and healthcare spending is projected to grow at an annual average rate of 5.8% from 2010 through 2020, reaching $4.64 trillion annually. This rate is 1.1% faster than the expected growth in gross domestic product (GDP), and it will represent 19.8% of GDP in 2020, according to the Health Affairs Blog (Chris Fleming, "U.S. Healthcare Spending Projected to Grow 5.8 Percent Annually," Jul. 28, 2011, http://healthaffairs.org/blog/).

With rapidly rising health insurance premiums straining against efforts to cut costs, many companies have been forced to cut healthcare benefits in order to save money. In the long term, these cuts hamper a company's ability to attract and retain high-quality workers. But one option does allow companies to continue offering quality, cost-effective healthcare: self-insured health benefits.

Financial advisors should consider familiarizing themselves with this specialized area in order to better guide existing and prospective clients that seek alternatives to a fully insured plan. Deep knowledge of a self-insured health plan involves a full understanding of the scope of financial obligations, the opportunities to safeguard against catastrophic health events, and other techniques that can lower healthcare costs. Expertise in self-insured health benefits can give CPAs a competitive edge at a time when healthcare costs represent a significant burden on companies and the U.S. economy as a whole.

Controlling Costs with Stop-Loss Insurance

Self-insured health plans allow employers to pay for individual employee health claims out of pocket, rather than as a monthly fixed premium to a health insurance carrier. Although employers assume the direct risk for payment of claims, costs are based on actual employee healthcare use. This makes them both cost-efficient and more effective than the one-size-fits-all model of a fully insured plan.

In some cases, switching to a self-insured plan enables businesses to cut healthcare costs by 10% to 20%. Besides cost savings, several other reasons have made self-insured health plans increasingly attractive to many small businesses in the past few years; these reasons include—

- increased cash flow;
- greater flexibility in benefit decisions;
- streamlined administration; and
- exemption from state jurisdiction under the Employment Retirement Income Security Act of 1974 (ERISA), and thus exemption from the state premium tax—generally 2% to 3%—levied on conventional insurance plans.

In order to maximize these benefits, self-insured plans often contract with a health plan management provider. As mentioned previously, employers bear the risk associated with offering health benefits. But stop-loss insurance exists to protect them from catastrophic costs. This can be especially useful for small businesses that might otherwise shy away from self-insured plans because of the perceived risk. Stop-loss insurance encompasses two types of coverage, discussed in the following sections. With either type of stop-loss insurance, it is important to remember that risk mitigation is most effective when coordinated by an experienced health plan management firm.

"Specific" stop-loss insurance. Specific stop-loss insurance protects against a catastrophic loss incurred by any individual covered by the plan, with the deductible set at a level appropriate for the size and financial strength of the company. Under this form of stop-loss insurance, an employer pays a fixed premium each month and is liable for the claim payments of an individual up to a chosen deductible, with amounts in excess of that covered by the stop-loss carrier. Some specific stop-loss contracts don't require the employer to fund the claim and wait for reimbursement; instead, the administrator pays the claim directly from the carrier's account.

In one real-life example, a 32-year-old woman delivered a baby boy prematurely in the seventh month; the infant suffered from health issues and had to be treated in the neonatal intensive care unit for 60 days. The claims totaled $285,000. The mother worked for a self-insured company, and the employer's specific stop-loss insurance had an $80,000 deductible. The stop-loss carrier reimbursed the other $205,000.

"Aggregate" stop-loss coverage. Although specific stop-loss insurance protects the employer against a single catastrophic claim, aggregate stop-loss insurance protects against an excessive amount of claim expenditures for the entire plan. Through actuarial studies, stop-loss underwriters can estimate smaller, predictable claims; however, these projections are based on large, industry-wide samples and are therefore subject to variations and fluctuations.

Comparing Self-Insured Healthcare with Full Health Insurance

In 2011, 60% of workers with health insurance nationwide were covered by a self-funded plan, according to the Kaiser Family Foundation. Among large employers, the number was even higher, with 82% of workers self-insuring at companies with more than 200 employees (Katie Thomas, "Self-Insured Complicate Health Deal," *New York Times*, Feb. 15, 2012). To better understand this shift in the marketplace, as well as the advantages of self-insurance with stop-loss protection, it is helpful to compare real-world examples of each type of insurance.

Example 1. A medium-sized textile company, Acme Corp., had a fully insured carrier and paid $1.5 million annually for its health insurance plan. At the end of the year, the company showed only $1 million in claims and administration costs. The carrier kept the other $500,000 as profit.

Acme Corp.'s main competitor, Thread Corp., was self-insured with a health plan management company overseeing its stop-loss insurance. The company's potential worst-case scenario for the year was $1.6 million. Thread Corp. paid $20,000 per month in fixed-premium costs and reserved $1.36 million for potential claims; the company could invest this money, segregate it, or use it for day-to-day business

until a claim occurs. At the end of the year, Thread Corp.'s claims totaled $1 million; it kept the $360,000 it had reserved and saw a savings of $260,000.

Example 2. Small companies are not alone in adopting a self-insured approach to healthcare coverage; municipalities and unions have gotten on board as well. The city of Temple, Texas, after years of being fully insured, switched to self-insurance with third-party administration and stop-loss insurance to mitigate risk. In 2010, when Temple called for proposals for both fully insured plans and self-insurance plans, it received a fully insured plan proposal that presented a 46% increase in cost to the city and its employees, and a second fully insured plan that proposed a 103% increase in cost. The self-insurance plan proposal, on the other hand, was the most affordable. In addition, it brought added advantages—greater transparency in utilization and costs and greater control over future cost increases—that could be applied to any company or organization that opts for self-insurance.

Overview of the Benefits

In essence, self-insured health coverage enables companies to offer quality, cost-effective healthcare at a time when many employers are forced to cut costs—often at the expense of their workforce. Compared with fully insured plans, self-insured plans can lower expenses, increase cash flow, and allow for greater flexibility in benefit design. Moreover, they are exempt from the state premium tax. Gaining expertise in this area not only affords CPAs the opportunity to become valued guides for businesses looking to reduce healthcare costs, but it also serves as a catalyst for differentiation in the marketplace. ❑

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The Top Five Limiting Beliefs about Succession Planning

A Guide for CPA Firms

By Lisa Tierney

What is the most common obstacle that CPA firms face when trying to successfully execute internal succession plans? When trying to implement a smooth transition for senior partners, the most frequent challenge this author has faced is the belief that accounting firms must follow a one-size-fits-all approach. As baby boomers slowly migrate out of their roles as full-time partners in CPA firms across the country, it has become all too apparent that these individuals are having a hard time coming to terms with the new role they will play, either at the firms they have built and run or in their personal lives.

In order to make the transition as easy as possible, relationships with clients and referral sources should be tapped and leveraged appropriately. Clients should not just receive a blanket form letter; retiring partners should not just be told how their future relationship with the firm will play out. An open, honest dialogue can identify the major issues and concerns of both clients and staff, and it can enable the discussion of alternative, innovative solutions.

Common Misconceptions

There are some common misconceptions and limiting beliefs that should be reconsidered by firms engaged in succession planning. For example, most firms believe that the firm's next managing partner—

- is the firm's best business developer,
- should be age 50 or older,
- should be a professional CPA,
- should service his own book of business, and
- should be selected from the firm's current pool of professionals.

It is important to remember that a firm's managing partner needs the skill set—and the time—to serve the firm's shareholders and employees in a way that gives them the attention they deserve. If the managing partner is busy selling products all the time or handling the most important clients, it doesn't leave much time for additional job duties.

If the managing partner is selected because she is next in line, which is often what occurs, the firm is potentially looking at a short reign, without the consistency or time to fully implement new strategies before that individual retires in turn. Ideally, a firm should consider asking the second-tiered generation of professionals for volunteers early in the succession-planning process in order to identify the firm's next leader and start developing that individual's leadership skills. But if the firm doesn't have that luxury of time—and many do not—then it's acceptable to look outside the firm for a replacement managing partner. Up-and-coming professionals at partner-heavy firms or nonaccredited firm administrators who work "outside" the firm's industry might offer a whole new pool of appropriate talent in which to find the perfect person to lead the firm into the future.

An Innovative Approach

Nothing ever stays the same—in business or in life—so it is important that firms evolve accordingly when it comes to succession planning. Firms must be innovative and must think outside the box in order to break away from long-standing, but unnecessary, beliefs that dictate what a firm can or cannot do. Approaching this transition with an open mind and an open heart can empower the firm, its staff, and its clients. ❑

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Double Entry: How the Merchants of Venice Created Modern Finance

By Jane Gleeson-White, W. W. Norton & Company, October 2012, ISBN 978-0-393-08896-0, 304 pages, $25.95 hardcover, $16.95 paperback

Reviewed by Stanley Goldstein

This exciting nonfiction book about accounting is gracefully written. In *Double Entry: How the Merchants of Venice Created Modern Finance*, Jane Gleeson-White does not merely describe the origins of the modern-day accounting system; she also explains the enormous implications of Luca Pacioli's pioneering work in 1494 on today's accounting profession.

Delving into the Past

Pacioli benefited handsomely from the timing of historic events in Italy. In 1095, Pope Urban II called upon all of Christendom to go to war to support the Byzantine Empire, thus launching the Crusades. A major by-product of the Crusades was the growth of the city-republics of Northern Italy: Pisa, Venice, Florence, and Genoa. Pacioli also credits Boethius—also known for the concept of the "wheel of fortune"—for the mathematical underpinnings of the world of commerce at that time.

Most CPAs know that Pacioli was a smart young man who traveled to Venice in order to partake in the business world and develop the mathematical work he had been doing in Sansepolcro. Stitching together snippets of accounting systems extant for millennia, Pacioli published a treatise expounding a robust system of double-entry bookkeeping. Remarkably, this system has survived in a form that would be recognized by every accounting student to this day. Pacioli's breakthrough work spelled out the debits and credits and the T accounts that act as the very structure of basic accounting courses.

Gleeson-White also limns the ways that accounting has affected music, art, and architecture—for example, even Leonardo da Vinci paid tribute to Pacioli after creating the Last Supper by saying that perspective is "the subtlest investigation and invention of the mathematical studies which, by force of lines makes remote that which is near and large that which is small."

Impacts on the Accounting Profession

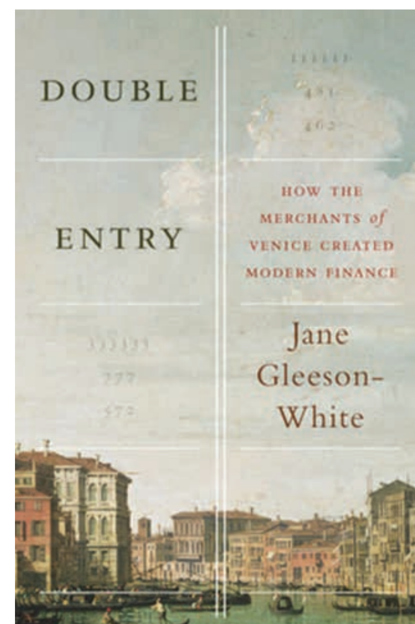
Once the business community recognized the beauty of the double-entry bookkeeping system, rapid growth followed. Initially, adoption was voluntary. Josiah Wedgwood, manufacturer of the china that so many people love, used Pacioli's system in the eighteenth century to create an informal cost accounting system that proved vital to his business and to many companies since then. Such luminaries as E. Irénée du Pont, John D. Rockefeller, and John Pierpont Morgan all credited cost accounting with major roles in building their businesses.

Shortly thereafter, governments passed laws requiring accountants to participate in many transactions, thus launching the huge profession that is an integral part of businesses around the world. In the mid-19th century, William Deloitte, Samuel Price, Edwin Waterhouse, and William Cooper launched accounting firms in England. At the same time, Scottish immigrants—who were to play a leading role in building the accounting profession, along with that of actuarial science—created parallel firms in the United States. In the late 19th century, professional associations were formed both in England and the United States, which became the superstructure of today's accounting profession.

A Worthwhile Lesson

In her book, Gleeson-White also points out the shortcomings of accounting—for example, it makes no provision for social costs, and even the best system and the largest accounting firms in no way preclude fraud, scams, and business failure.

Despite these challenges, the profession has made a fine start in searching for ways to account for the social costs adumbrated in this book. Corporate social responsibility is written about in professional journals and discussed in corporate boardrooms. Just as annual reports only recently required a statement of cash flows, is seems likely that within 10 years, a report of social impact will be appended—voluntarily at first—to corporations' annual reports. The book's preface quotes a speech by Robert F. Kennedy that calls for just this kind of information expansion—



Once the business community recognized the beauty of the double-entry bookkeeping system, rapid growth followed.

and his urging is even timelier today than it was then. Not only is *Double Entry* an exciting read, but the history lesson itself is worth the price. ❑

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Independence and Transparency for School Districts

I was happy to see that there is some focus by the NYSSCPA on the school districts of New York (Joanne S. Barry, "Under Attack: New York's School District Audit Mandate," *The CPA Journal*, March 2013, p. 7). As a resident of Long Island, I can say that district taxation and spending continue to be hotly debated topics. If they are allowed, CPAs can certainly offer two important contributions to the process—independence and additional transparency.

Independence. From what I can see, school boards are composed of district residents, many who have children attending the schools. These board members should certainly be applauded for all the time they contribute. But the certain existence of relationships with administration, faculty, and neighbors—who all have their own agendas—raises the question of independence. Can individuals who are not truly independent of the system be hindered in their ability to make the tough financial decisions needed to properly run a school district? Without the safety provided by independence, a logical course of action can easily turn into an emotional rollercoaster. Unfortunately, when that happens, there is a tendency to look for the easiest targets. Historically, those targets seem to be the students and the taxpayers. In addition, for board members who have children attending district schools, I imagine there might be some fear of reprisal. It is naïve to think that the children are never used as pawns in the chess game of a heated budget negotiation.

Transparency. Districts might present a budget and financial overview for district residents, but it certainly does not contain the detail necessary for a full picture. A full review by individuals who possess the skills necessary to detect possible abnormalities—and to suggest viable solutions—would provide a much better process for establishing an acceptable budget. I am not sure every district's administration would be willing to allow this. I remember going to a district meeting and reviewing some newly crafted spending policies that were being proposed. Thinking that they could be a little stronger, I wrote a letter to the district finance officer suggesting changes. Nothing came of it, other than my receiving a note of polite thanks for my interest. A CPA friend of mine went to a district budget meeting and offered his time for free to review the budget and find possible solutions that would prevent the intended loss of student activities. He was refused—which obviously makes one wonder if there were problems hiding beyond the scope of a typical audit.

In many respects, the American dream seems to be dying. People work to get ahead only to have it taxed away to support poorly crafted and managed financial plans. School district administrations and taxpayers should be working together to produce a final product that is fair to all affected. Both sides should welcome the skills of trained and independent professionals such as CPAs.

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Sound Advice on School Audits

Joanne S. Barry's column on audits of school districts is on the money—but even more valuable is the advice to young CPAs to volunteer to serve on school boards. Their expertise would be of inestimable value. The amount of money involved in school districts is substantial. Instead of spending lots of time and money "networking," school board service is an efficient way to meet people in the community—not to mention those who could result in new business.

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