Benefits Insights

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Dependent Eligibility Audits

With health care costs continuing to rise, many employers are looking for additional ways to cut costs. Making sure your health plan covers only those who are eligible can be a significant cost saver. How can you do this? A dependent eligibility audit may be an option.

The purpose of a dependent eligibility audit is to identify dependents that should not be covered under your plan. Examples include children who have reached the maximum age limit, divorced spouses or friends, roommates or other relatives who are ineligible for coverage. Estimates are that 3 to 12% of covered dependents are not actually eligible. Removing ineligible dependents from their health plans can translate into significant cost savings for employers.

Additionally, ERISA requires plan sponsors to follow the rules contained in the plan documents, including the plan's eligibility rules. Performing an audit helps make sure that the employer complies with ERISA by providing benefits only to eligible participants. There may also be tax implications associated with covering ineligible dependents.

One important factor to remember is the change in rules for dependent children, based on the health care reform law. For all plan years beginning on or after Sept. 23, 2010, children can be considered dependents until age 26. This includes both married and unmarried children, and student status is not required.

Audit Planning Considerations

When planning an audit, an employer should consider the following:

- Are all plan documents, including the summary plan description, consistent in defining dependents?
- What will the scope of the audit be and who will perform it?
- What documents will satisfy proof of eligibility for various types of dependents?
- What will be the message communicated to employees?
- How will you communicate the message to employees?
- How will employees perceive an audit? Are there other employee relations issues that need to be addressed prior to the audit?
- How will privacy issues be addressed?

One of the most essential aspects of a dependent eligibility audit is employee communication. Employees should be informed in advance of the coming audit so they can gather the proper documentation. Employees should also be frequently reminded about the importance of responding to the audit to ensure the highest possible participation rate. Use familiar mediums for communicating the message, including your company intranet, emails, bulletin board postings and payroll stuffers.

Preparing for a dependent eligibility audit requires cooperation throughout the company. These communication initiatives include:

- Senior management: The support of the senior executives is crucial to the success of your dependent eligibility audit. They need to be prepared to answer questions and overcome objections to the audit.
- HR and managers: Managers need to understand and be able to communicate all the details and information regarding the audit. More importantly, they need to be able to communicate why the audit is important and necessary in the first place.
- Employees: The employee communication initiatives should focus on fairness. Explain that the reason the health plan exists is to provide coverage only for employees and their eligible dependents. The health plan's ability to provide for those it aims to benefit is significantly compromised when ineligible persons receive benefits.

Dependent Audit Steps

Typically there are two steps to a dependent audit, as outlined below:

1. Employers establish a period of amnesty when employees can voluntarily remove ineligible dependents without penalty. Employees are notified by letter, explaining eligibility rules. An employee can then review all covered dependents for status, and no penalty will apply to those dependents removed due to ineligibility. Employers generally give employees one month to respond. Ineligible dependents that are voluntarily removed by employees are terminated at the end of the following month.
2. For all remaining dependents after the initial amnesty period, employers should require employees to provide documentation to verify dependent status/relationship. Documents must establish both a dependent relationship and that the relationship still exists. Examples may include:
    - Marriage certificates
    - Domestic partner affidavits
    - Legal documents that establish custody, guardianship or foster care
    - Birth certificates
    - Tax forms
    - Medical documentation of disability
    - Adoption papers

If an employee is unable to establish a dependent relationship, the employer may impose penalties, terminate coverage or seek reimbursement for claims paid for ineligible dependents. It is not typical for employers to seek out disciplinary action as a result of the initial audit. Some employers also offer an appeals process to give those deemed to have ineligible dependents (or non-respondents) a chance to reinstate their children or spouses.

The health care reform law limits an employer's ability to retroactively remove ineligible dependents from coverage. Under the law, a rescission (or retroactive cancelation of coverage) is permissible only if the individual obtained coverage through fraud or an intentional misrepresentation of material fact and the individual is given at least 30 days' advance notice of the rescission. An employer can avoid the law's restrictions on rescissions by canceling coverage on a prospective basis.

Disenrollment may not be a COBRA qualifying event, but an employer may choose to offer COBRA to all, not just those that are truly COBRA eligible as a result of the audit. Self-insured plans should get permission from their stop-loss carriers and insured plans should get permission from their insurers before offering COBRA coverage to all ineligible dependents removed from coverage.

Also, an employer may need to retroactively adjust employee W-2s for those employees who made pretax contributions for an ineligible dependent. For this reason, some employers choose not to seek reimbursements for past claims, but simply to deny coverage to ineligible dependents going forward.

It is recommended that plan documents be amended to reflect the process that will be followed in determining dependent eligibility going forward, such as frequency of audits, verification process at the point of new employee enrollment and penalties.

Many companies choose to hire an independent audit firm. This can be done on a risk sharing basis where payment is based on the percentage of recovered amounts or estimated savings. Using an outside firm can also help with employee perception of the independence and objectivity of an audit. In addition, the auditing process can be cumbersome and time-consuming, so larger companies may find that a third-party auditor more practical.

It is important to weigh your company resources against the potential payoff of cost control and ongoing risk exposure when deciding whether a dependent eligibility audit is right for your company.