Public Policy Alert

Public policy impacting business

KPMG LLP

Issue 9 | May 2010

U.S. Employers Prepare for an Extended Transition to a New Healthcare Environment

Companies and their boards are moving ahead in an effort to analyze the complexities in healthcare legislation while waiting for the regulations to be issued. Healthcare reform legislation will not only have compliance, accounting, and tax implications but will also impact the costs of healthcare benefits and other workforce management issues.

Executives who want to be ahead of the curve are not waiting for the final regulatory guidance. Debate will continue but however these rules develop, healthcare costs and benefits changes, will be in transition for years to come. The new environment—compounded by a greater demand for transparency, reporting, and accountability; increased regulatory enforcement; and cost pressures—will demand structured transition plans that begin now.

Compliance with Healthcare Legislation

The healthcare reform legislation[1] is complex. Nearly every individual, business, and healthcare participant will be affected by the many questions that await final rules over the next several years. The legislation makes extensive changes to the current system of healthcare insurance and benefits intended to increase access, improve healthcare quality, and reduce costs. Among other things, it mandates health insurance coverage for most legal U.S. residents through a combination of penalties and subsidies, establishes state-run insurance exchanges that provide federal credits, and expands eligibility for Medicaid while reducing payment rates for most services. It is expected to add approximately 32 million newly insured[2] Americans affecting employers, health insurance companies, and the State Medicaid systems which will have to handle the influx of the newly insured. The laws also take significant steps to encourage wellness programs and improve the outcomes of healthcare. These reforms

Some Key Questions to Consider:

1. Does management have the qualified personnel to provide the company with advice on the implications of reform as the rules evolve?
2. Does the organization have the policies, procedures, compliance programs, and systems necessary to manage and comply with the changes over the transition period?
3. Is the organization prepared to assess the potential impact of reform on enterprise risk management, financial reporting, and tax planning on a timely basis during the transitional fiscal years?
4. Does the organization have a plan in place to evaluate healthcare benefit strategies tailored to current workforce needs? Does such planning include consideration of ways to manage costs and influence outcomes such as preventive health plans?
5. Has the focus of regulators on greater transparency and accountability, information protection, and heightened scrutiny and penalties for failures to comply been incorporated into compliance plans?

For additional insights, please visit the KPMG Healthcare and Pharmaceutical Institute.

1 The "Healthcare Reform" legislation is the product of two bills: Patient Protection and Affordable Care Act (PPACA), Pub. L. No. 111-148, March 23, 2010, and Health Care and Education Reconciliation Act of 2010 (HCERA), Public Law No.: 111-152 March 29, 2010.

2 The reform law will provide coverage to an additional 32 million Americans by 2019, The Congressional Budget Office (CBO), March 30, 2010.

AUDIT ▪ TAX ▪ ADVISORY

Hewitt Associates: Selected findings from client briefings

1. Employers are focused right now on what will impact them in 2010 and 2011. Hewitt is doing a lot of work estimating the cost impact from the change in the Medicare RDS tax treatment, the removal of lifetime and restrictive annual limits, and the impact of covering adult children to age 26.
2. Longer-term, employers will be considering what to subsidize and why but those considerations probably won't start until the fall.
3. The considerations may be different for very small companies, since they have access to tax credits, that are not available to large companies.

Bob Tate, Chief Health Care Actuary at Hewitt Associates

are expected to be enabled by the digitization of healthcare records, which will be funded, at least partially, by ARRA[3]. The cost of the healthcare reform is offset in part by changes in the Internal Revenue Code[4]. Among these changes are a reduction in the deduction for contributions to Medicare retiree prescription drug subsidies; fees and excise taxes on the pharmaceutical, medical device, and health insurance industries; increased Medicare taxes, a new "Medicare" tax on unearned income; an excise tax on so-called "Cadillac" health insurance plans; and new limits on flexible spending accounts. In addition, the legislation contains more than 30 sections related to managing fraud and abuse subject to FERA[5] and the False Claims Act (FCA) signaling to employers a renewed focus on the need for oversight and monitoring.

Implications for Corporate Employers

Even as regulatory guidance unfolds, C-suites and board rooms are considering the potential composite impact of healthcare reform on specific components of the current business model including:

Health Benefits and the Workforce Strategy

While the cost impact to benefits is important, companies need to prepare for changes in workforce management and associated healthcare benefits planning[6]. For example, the potential cost of benefits under healthcare reform may influence a company's ability to offer some benefit plans or the coverage available to populations of employees, such as retirees or part time employees. The definition of full-time employees in HCERA is those who work 30 hours per week, which may effectively convert certain employees previously defined as part-time employees to full-time employees eligible for benefits coverage. Companies may need to consider options such as balancing compliance costs and potential penalties against a desire to attract talent. Companies that choose to

[3] American Recovery and Reinvestment Act (ARRA), Feb 17, 2009, provides $1.4 billion in funding for qualified health IT projects.

[4] For additional information on tax provisions, refer to Summary of Tax Provisions in Healthcare Reform, KPMG LLP, March 2010.

[5] Fraud Enforcement and Recovery Act of 2009 extends the enforcement authority and penalties for reporting incorrectly to the Federal Government. For more information on the increased funding and authority for enforcement by the HHS, SEC and IRS, refer to: Public Policy Alert: Preparing for Increased Regulatory Oversight and Enhanced Enforcement, KPMG, LLP October 2009.

[6] "According to Goldman Sachs, '…many companies are indicating that the legislation is leading them to revisit the healthcare benefits. In other words, corporate behavior with respect to benefit offerings could change as a result of the new legislation'. "Perspectives for the Business Community, Bureau of National Affairs Daily Report for Executives, March 6, 2010.

provide healthcare benefit plans will likely need to communicate, measure, monitor and provide incentives for wellness in order to maintain their competitiveness. Under the new guidance, organizations may also require different forms of data aggregation for monitoring compliance than they are currently prepared to address. As an example, employers are giving early consideration to mandatory electronic reporting (such as W-2 requirements) of healthcare benefits to regulators like the IRS.

Regardless of the path taken, changes to healthcare benefit packages must be evaluated in light of their impact on the ability to compete for and retain the right people, or maintain the existing U.S. employee base.

Cost Planning and Process Implications

Although regulatory guidance has yet to be decided, companies will have to consider various cost drivers in the legislation. Examples of provisions that would generally be expected to increase employers' obligations[7] are as follows:

- Effective 2010, consumer protections, such as eliminating lifetime or annual coverage limits and providing coverage for preventive health services, may increase estimates of per capita costs for plan participants. There is still some uncertainty about whether these caps will apply to retiree plans.
- In 2018, an Excise Tax on High Cost Coverage for both retirees and newly defined[8] full-time employees goes into effect.
- State managed Health Care Exchanges are ultimately expected to offer alternative plans to employer-paid plans. As employees opt out to use an exchange plan an employer will be assessed a penalty and will therefore pay for both their own plan as well as the penalty. Anticipating the number of participants in each category each year will be a challenge to most employers particularly as employees make package choices in an evolving environment.

In addition, the overall cost, and impact of change from enhanced reporting[9], potentially broader disclosures, and a high influx of newly insured could stress the internal controls, resources, systems, and processes of even sophisticated employers and must be evaluated so readiness gaps can be addressed in a timely manner.

Hewitt Associates indicates that nearly half of employers say they plan to use financial penalties for workers who eschew certain health programs. "Employers have come to realize that they have to manage their risks, not just costs," says Rick McGill of Hewitt, a benefits consulting firm.

What Firms Will Do With Health Care Reform, Look for higher premiums, more wellness plans in efforts to cut costs, The Kiplinger Letter, March 22, 2010.

"The truth is that the legacy of this new law will be determined by the underlying policy and the competence with which it is implemented. More important, they know that the new law provides unprecedented discretion to the implementing agencies and that close-call decisions can make a huge positive or negative difference …"

Kiplinger's' Personal Finance in the Washington Post article titled "Firms are still on their own until health overhaul takes effect, as quoted in KPMG FlashPoint on Healthcare Reform: Perspectives for the Business Community, KPMG LLP April 16, 2010.

---

7 Defining Issues: U.S. Health Care Reform Creates Potential Accounting and Disclosure Changes, April 2010, KPMG LLP, No. 10-20

8 The definition in HCERA of full-time employees is those who work 30 hours per week, which will effectively convert 32 hour part-time employees to full-time employees eligible for benefit coverage.

Finally, existing and potentially new privacy laws[10] may affect how personally identifiable information (PII) and protected health information (PHI) are used and secured, which requires additional investments in resources. The early integration of privacy and disclosure policies into enterprise risk management models and IT strategic planning must also be considered.

Governance and the Risks of Transition

The undefined aspects of legislation must also be considered when major transition planning is undertaken[11]. For example, the legislation is unclear as to whether the new limitations on annual medical caps apply to retiree medical plans, introducing potential planning and processing challenges for the employer. The potential for unintended consequences during this transition period could also be significant.

Likewise, discrimination may be at issue if current long-term care is offered as nontaxable to retirees but not to current employees. Finally, the effect of the grandfathering rules on a discriminatory executive health benefit plan, and the need to avoid modifying such a plan, may cause planning concerns over the next few years.

Concerns of uncertainty continue to plague the board, audit committees[12], and management. Lack of specificity in key areas is causing boards to look ahead at expanded strategies for oversight and monitoring. A robust understanding of the time-phased requirements, implications, penalties, and costs may even require a different skill set than is resident in the organization today. Well-thought-out transition plans with milestones that address the necessary changes in resources, policies, procedures, and systems are critical to those leading organizations that recognize that planning for change can be a competitive advantage.

"Employers are taking matters into their own hands...

There's a growing recognition that the healthcare bill passed by Congress won't help lower costs in the short term, forcing firms to act on their own if they want to survive. But the real emphasis will be on behavior as businesses use more sticks and fewer carrots in pressuring employees toward healthier lifestyles and programs for chronic illnesses."

Kiplinger's' Personal Finance in the Washington Post article titled "Firms are still on their own until health overhaul takes effect," March 28, 2010.

9 For additional information on reporting refer to Defining Issues: U.S. Health Care Reform Creates Potential Accounting and Disclosure Changes, March 2010, KPMG LLP, No. 10-16.

10 One example of new legislation is the Massachusetts Data Privacy Act. Companies, whether located in Massachusetts or not, must follow extra security precautions to protect Massachusetts individuals regardless of in which state the information is being handled.

11 Details of the relevant events and dates for the transition years can be obtained from KPMG's Healthcare and Pharmaceutical Institute.

12 The Audit Committee Journey: 2009 Public Company Audit Committee Member Survey, KPMG's Audit Committee Institute, April 30, 2009.