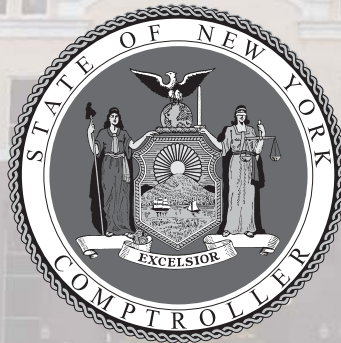




Containing the Cost of Employer-Provided Health Insurance Benefits

2008-MR-2



Thomas P. DiNapoli

Table of Contents

	Page
AUTHORITY LETTER	2
EXECUTIVE SUMMARY	3
INTRODUCTION	5
Background	5
Objective	6
Scope and Methodology	6
Comments of Local Officials	6
EMPLOYEE HEALTH INSURANCE COST REDUCTION STRATEGIES	7
Cafeteria Plans	7
Payments in Lieu of Health Insurance Benefits	8
Self-Funded Insurance	10
Recommendations	12
OTHER COST CONTAINMENT PRACTICES	13
Recommendation	16
APPENDIX A Responses From Local Officials	17
APPENDIX B Audit Methodology and Standards	18
APPENDIX C How to Obtain Additional Copies of the Report	19
APPENDIX D Local Regional Office Listing	20

State of New York Office of the State Comptroller

Division of Local Government and School Accountability

January 2009

Dear Local Officials:

A top priority of the Office of the State Comptroller is to help local government officials manage government resources efficiently and effectively and, by so doing, provide accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of local governments statewide, as well as districts' compliance with relevant statutes and observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations and Board governance. Audits also can identify strategies to reduce district costs and to strengthen controls intended to safeguard local government assets.

Following is a report of our audit of seven local governments located in northeastern New York State, entitled *Containing the Cost of Employer-Provided Health Insurance Benefits*. This audit was conducted pursuant to Article V, Section 1 of the State Constitution, and the State Comptroller's authority as set forth in Article 3 of the General Municipal Law.

This audit's results and recommendations are resources for local officials to use in effectively managing operations and in meeting the expectations of their constituents. If you have questions about this report, please feel free to contact the local regional office for your county, as listed at the end of this report.

Respectfully submitted,

*Office of the State Comptroller
Division of Local Government
and School Accountability*



State of New York Office of the State Comptroller

EXECUTIVE SUMMARY

The cost of employer-provided health insurance benefits is a significant expense for employers of all types and sizes. These costs have risen continuously over recent years and have shown no signs of slowing down. The National Coalition on Health Care (NCHC) reports that in 2007, employer health insurance premiums increased by 6.1 percent, two times the rate of inflation. The annual premium for an employer health plan covering a family of four averaged nearly \$12,100. The annual premium for single coverage averaged over \$4,400.

In planning our audit, we initially surveyed 75 municipalities in northeastern New York State to obtain information about the health insurance benefits they provided to their employees and retirees. We received responses from 41 of the municipalities indicating the respondents spent approximately \$82.4 million for health insurance for 10,315 employees and retirees during fiscal year 2006.

Health insurance expenditures comprise a significant portion of municipal budgets. As such, it is important that local governments continually monitor costs and implement health insurance savings practices so that the level of expenditures for health insurance remains manageable and within the budgeted fiscal constraints. Many local governments employ a variety of strategies in efforts to contain or reduce health insurance costs.

Scope and Objective

The objective of our audit, which covered the period January 1, 2004 to December 31, 2007, was to identify practices that help contain municipal health insurance costs while maintaining employees' current benefit levels. Our audit addressed the following specific questions:

- Have these local governments achieved employee health insurance cost reductions by pursuing self-insurance, using cafeteria plans, and offering payments in lieu of health insurance benefits?
- Have these local governments explored any other notable strategies in an effort to reduce their employee health insurance costs?

Audit Results

Overall, we found that the local governments we examined were implementing a variety of procedures to reduce the costs of health insurance coverage for their employees, retirees, and

dependents. These cost-saving approaches included establishing pre-tax cafeteria plans with flexible spending accounts and offering employees payments in lieu of health insurance, among other alternatives. Although none of the local governments we examined were using self-funded insurance plans, we encourage local government entities with more than 500 employees to actively explore the cost saving potential of this option.

We also found that the local governments included in our audit were involved in evaluating various cost containment practices, including conducting a request for proposals and/or using consultants to obtain insurance; requiring employees to contribute toward the cost of health insurance premiums; and applying for Federal subsidy assistance payments for providing prescription drug coverage to Medicare-eligible retirees. Using these and other strategies¹ can be effective in helping local governments reduce the net cost of health insurance, or at least, limit the increase in the cost of this benefit.

Comments of Local Officials

The results of our audit and recommendations have been discussed with local officials and their comments, which appear in Appendix A, have been considered in preparing this report. Local officials agreed with our recommendations and indicated that they have initiated or, planned to initiate, corrective action.

¹ Additional strategies for lowering health insurance costs are available in Local Government Management Guide, Personal Service Cost Containment, Division of Local Government and School Accountability, February 2008 which can be found at www.osc.state.ny.us.

Introduction

Background

Health care costs have risen continuously over the last several years for U.S. employers. In 2007, the annual premium for an employer health plan covering a family of four averaged nearly \$12,100 and the premium for single coverage averaged over \$4,400. The National Coalition on Health Care (NCHC) reported that employer health care premium costs had increased 6.1 percent – two times the rate of inflation in 2007. According to the consulting firm, Hewitt Associates, the average annual cost for health insurance coverage per employee for major U.S. companies was \$7,982 in 2007, with health care costs projected to rise 8.7 percent, to \$8,676 per employee in 2008.

Health insurance expenditures comprise a significant portion of municipal budgets. Accordingly, it is important that local governments seek to achieve cost savings, while ensuring that their health insurance plans provide the needed coverage for their employees to maintain their health and result in savings over the long-term. It is essential that local governments continually monitor costs and implement health insurance savings practices so that health insurance expenditures remain manageable and within budgeted amounts. Local governments typically employ a variety of strategies in efforts to contain or reduce health insurance costs.

We surveyed 75 local governments in northeastern New York State to obtain information about the health insurance benefits provided to their employees and retirees. We received 41 responses indicating the respondents spent approximately \$82.4 million for health insurance for 10,315 employees and retirees during fiscal year 2006. We selected seven of the 41 survey respondents for further examination. The units we selected included two counties, a city, two villages, a town and a community college.

All the local governments we audited offered all their eligible employees health insurance as part of their compensation packages. The 2006 health insurance costs for these seven local governments totaled more than \$35 million, with costs per employee averaging \$4,711 for individual coverage and \$11,955 for family coverage.

Objective

Our objective was to identify practices that help to contain local government health insurance costs while maintaining employees' current benefit levels. Our audit addressed the following specific questions:

- Have these local governments achieved employee health insurance cost reductions by pursuing self-insurance, using cafeteria plans, and offering payments in lieu of health insurance benefits?
- Have these local governments explored other notable strategies to reduce their employee health insurance costs?

Scope and Methodology

We examined selected financial information and other documentation relating to health care benefit costs in seven local government units that included two counties (Saratoga and Warren Counties), a city (City of Johnstown), two villages (Villages of Tupper Lake and Saranac Lake), a town (Town of Queensbury) and a community college (Hudson Valley Community College) within a 10-county region in northeastern New York State. Our period covered from January 1, 2004 through December 31, 2007, and focused primarily on 2006 data. We conducted our audit in accordance with generally accepted auditing standards. More information on the standards and the methodology used in performing this audit are included in Appendix B of this report.

Comments of Local Officials

The results of our audit and recommendations have been discussed with local officials and their comments, which appear in Appendix A, have been considered in preparing this report. Local officials agreed with our recommendations and indicated that they have initiated, or planned to initiate, corrective action.

Employee Health Insurance Cost Reduction Strategies

It is important that local governments continually monitor costs and implement health insurance savings practices so that the level of expenditures for health insurance remains manageable and within the budgeted fiscal constraints. Local governments around the State and the country employ a variety of strategies in an effort to contain or reduce health insurance costs. What follows is a summary of these strategies, as used by the local governments we included in our audit, and an examination of the impact of their implementation.

Overall, we found that the local governments examined were implementing various procedures to reduce the costs of health insurance coverage for their employees, retirees, and dependents. These cost-savings approaches included establishing pre-tax cafeteria plans with flexible spending accounts and offering employees payments in lieu of health insurance, among other alternatives. Although none of the local governments we examined were using self-funded insurance plans, we encourage all larger government entities for which this approach may be feasible to actively explore the cost saving potential of this option. It is essential for all local governments to seek methods to reduce the constantly increasing financial burden of providing health insurance benefits.

Cafeteria Plans

Section 125 of the Internal Revenue Code authorizes employers to provide certain benefits that are excludable from the gross income of an employee. These benefits may be offered by an employer under a pre-tax cafeteria plan (e.g., health insurance premiums and co-payments for medical services). Offering pre-tax deductions from employees' pay for their health insurance contributions is typically referred to as a Premium Only Plan.

All seven local governments included in our audit had established provisions for the pre-tax treatment of employee contributions for health insurance costs. By implementing these plans, we calculated their combined savings to be approximately \$382,000 over a three-year period. Cafeteria plans can also provide for the pre-tax treatment of contributions into Flexible Spending Accounts. Offering pre-tax deductions for contributions to a Flexible Spending Account allows employees to set aside a portion of their earnings to pay for qualified expenses as established by the cafeteria plan. Most commonly

these plans are used for medical expenses, but they can also be established for dependent care or other qualified expenses. Pre-tax deductions are beneficial for both the employer and its employees because the amounts are deducted before they are subject to taxes, decreasing employees' taxable income. This reduces both the amount of employees' wages for income, Social Security, and Medicare tax employees have to pay and the amount of Social Security and Medicare taxes the employer has to pay. The higher the employee participation rate in a pre-tax contribution plan, the higher the savings for the local government employer.

Hudson Valley Community College (HVCC) established a medical flexible arrangement effective April 1, 2000. Between 2004 and 2007, the College deducted approximately \$590,000 from employees' wages on a pre-tax basis, resulting in estimated savings of \$45,000 for HVCC. During that time, enrollment in HVCC's Dependent Care Account and Health Care Flexible Spending Account averaged 15 and 104 participants, respectively, or about 19 percent of its active eligible workforce of 631² employees. Warren County, the Town of Queensbury and the Village of Tupper Lake did not offer flexible benefit arrangements to their employees. We estimate that Warren County, with 719 active employees, could realize savings of as much as \$15,000 per year if it offered a flexible benefit arrangement and achieved the same 19 percent participation rate (about 137 County employees) as did HVCC. Our analysis of the Town of Queensbury and the Village of Tupper Lake revealed that projected participation rates would not be high enough to achieve more than minimal savings for these local governments. Although the City of Johnstown and Village of Saranac Lake each offered a flexible benefit plan, their savings were also limited by low participation rates. Saratoga County recently initiated a flexible benefits plan effective January 1, 2008.

Payments in Lieu of Health Insurance Benefits

Some local governments offer employees the option of a cash payment in lieu of health insurance if employees can provide evidence that they have alternative insurance. Incentives paid to employees to waive health insurance can vary greatly depending on many factors. When properly structured, payments in lieu of health insurance, or buyouts, can be beneficial to both the local government and eligible employees. The program saves

² Of HVCC's 816 active employees, 185 employees were not eligible to participate in a health care flexible spending plan because they took cash payouts in lieu of benefits; therefore, 631 active employees were eligible to participate.

the employer money because buyout amount is typically much less than the health insurance premium the municipality would otherwise have to pay. Additionally, the employees are increasing their overall compensation in lieu of a benefit they do not need.

Six of the seven local governments we audited had a payment in lieu of health insurance program in place, although the Village of Saranac Lake's program had no current participants. Warren County does not offer this program to its employees. The five units³ that had participants enrolled in a payment in lieu of health insurance program experienced combined savings of almost \$4.3 million over a three-year period,⁴ as detailed below.

Between 2004 and 2006, Saratoga County averaged approximately 200 employees per year who opted out of the health insurance plan. We did not determine the type of coverage (individual, two-person or family) these employees would have received. However, the three-year savings the County experienced ranged between \$1.3 million and \$5.1 million, depending on the type of coverage (individual, two-person or family) the participating employee chose to forgo.

From 2004 through 2007, HVCC averaged 185 employees per year who elected to participate in the program. Each eligible employee agreeing to the waiver was paid \$600 at year-end. We did not determine the amount of savings HVCC realized from the program over this period. HVCC offers its employees a very wide range of health insurance options at varying costs, so it was not feasible to calculate the exact cost savings HVCC derived from its employees' participation in the program during this period. However, we estimate that the current provisions and participation rates resulted in approximate savings of no less than \$730,000 per year, assuming that all of the employees opting out of coverage would have been provided individual coverage. HVCC is considering increasing the amount of the payment in future contract negotiations to increase participation in the program.

The Town of Queensbury established a payment in lieu of health insurance program, with payments of \$420 and \$1,140 in lieu of single or family coverage, respectively. We found that an average of 14 active employees participated in the program each year.

³ Hudson Valley Community College, Saratoga County, Town of Queensbury, City of Johnstown, and the Village of Tupper Lake

⁴ This total includes four years of savings at HVCC, where we were able to include 2007 data in our calculations.

The program resulted in savings to the Town of approximately \$480,000 over a three-year period.

From 2004 through 2006, the City of Johnstown had an average of 10 employees who opted out of the health insurance plan each year. We estimate that the program has resulted in an estimated savings of \$164,000 for the City over the three-year period.

The Village of Tupper Lake established a payment in lieu of health insurance program, with payments of \$2,500, \$3,000, or \$3,500 in lieu of single, two-person, or family benefits respectively. We found that an average of 12 active employees participated in the program each year. The program resulted in savings to the Village of approximately \$142,000 over a three-year period.

Self-Funded Insurance

Local governments have two basic options for providing employees with health care benefits. One option is to pay a periodic premium to an insurance company for an established plan or plans of health care benefits for employees (commonly called “fully insured health plans”). Under this option, the insurance company administers the employee benefit in accordance with the terms of the plan(s) and assumes the financial risk of providing such coverage. Alternatively, municipalities may choose to pay for their employees’ health care benefits directly (commonly called “self-funded health plans”). Generally, when opting to self-fund, municipalities hire a third-party administrator who collects and reviews employee health care bills, negotiates rates with medical service providers and estimates the amount of funding required to pay the employees’ health care costs. To manage the greater liability risks of a self-funded plan, many municipalities also purchase a stop-loss policy from an insurer to cover catastrophic health care costs above a specified amount.

One benefit of a self-funded plan is that, unlike fully insured health plans, local government employers do not pay a State tax that ranges from 1 to 2 percent of the premium. In addition, if employers have employees with relatively good claims histories,⁵ the employers may be able to save money by using a self-funded health plan instead of purchasing equivalent insurance coverage with rates based on the pooled claims histories of all insured

⁵ The number and cost of claims against the insurance company over time establishes the claims history. Claims history is a determining factory for setting insurance rates. Historically, the fewer claims you have, the lower your insurance rate will be.

participants in the community. Due to the enhanced information that employers with self-funded health plans have about medical expenses, they can better determine the causes of large expenses and cost increases and design programs to address them. However, we recognize that self-funded health benefit plans may not be suitable or cost-effective for all local governments. To minimize year-to-year fluctuations and resulting financial risks, employers considering a self-funded health plan should typically have a large number of employees (e.g., 500 or more). With more employees, administrators and risk managers can spread any increased cost associated with fluctuations over a large pool of employees, and thus keep the plan's cost as economical as possible.

None of the seven units we audited use a self-funded plan to provide employees and retirees with health care benefits, although three of the seven units have more than 500 employees.

- Saratoga County, the largest unit in our audit, had previously hired a consultant to study self-funded health plans. The County's benefits consultant performed a cost-benefit analysis of self-funding compared to conventional plans. The analysis showed a potential for cost savings; however, the savings could not be defined to the satisfaction of the County's Insurance and Risk Management Committee. Therefore, the County elected to remain with a conventional plan in 2006 and again in 2007.
- Warren County officials explained that sufficient data to formally conduct a detailed analysis of a self-funded plan was not available due to the current structure and administration of the County's benefit plan.
- Hudson Valley Community College explained that a conscious choice was made to offer and promote Health Maintenance Organizations (HMOs) in 1992. With the introduction of the HMO option, membership in the self-funded indemnity plan decreased to a point where it could no longer be offered. Currently, 84 percent of employees and retirees receiving benefits are enrolled in one of the five HMOs offered by HVCC.

Local government entities that have 500 or more employees and access to sufficient data should consider conducting a detailed cost benefit analysis of self-funding to determine if the entity would benefit from such a plan. When studying this option, it may be helpful for officials to seek out and contact other municipalities, school districts or local businesses that self-fund health care benefits so they can review their plans. Also, since implementing self-funded health plans may be subject to negotiation with employee bargaining groups, it may be advisable to include them in the process.

Recommendations

1. Local governing boards should consider the benefits of offering legally authorized flexible benefit plans to employees on a pre-tax basis.
2. Local governments should explore the cost savings potential of making a payment in lieu of health insurance program available to all eligible employees.
3. Local governments with more than 500 employees and access to reliable information should determine whether implementing a self-funded health insurance plan could result in cost savings.

Other Cost Containment Practices

We found that the local governments included in our audit were involved in evaluating and exploring various cost containment practices, including conducting a request for proposals (RFP) and/or using consultants to obtain insurance; requiring employees to contribute toward the cost of health insurance premiums; and applying for Federal subsidy assistance payments for providing prescription drug coverage to Medicare-eligible retirees. Using these and other strategies⁶ can be effective in helping local governments reduce the net cost of health insurance, or at least, limit the increase in the cost of this benefit.

Competitive acquisition and use of consultants – One of the seven local governments audited, Saratoga County, conducted a formal RFP for health insurance. The others used an insurance broker and, in some instances, a separate consultant to provide expertise in plan design, budgeting, regulatory assistance, renewal strategies and negotiations. Below are some notable examples of the more than \$540,000 these local governments saved by using professional services.

- In 2006, HVCC was facing a 9 percent premium increase for its most popular Health Maintenance Organization (HMO) plan. At the recommendation of its broker, HVCC changed from a \$15 co-pay plan to a \$25 co-pay plan with the same HMO and realized a 7 percent decrease in premiums. Because the \$15 co-pay is specified in collective bargaining agreements, HVCC reimbursed the \$10 difference per co-pay to HMO members in 2006, which cost a total of \$29,840 in reimbursements plus processing costs. However, the significant savings in premiums, even after deducting co-pay reimbursement costs, still resulted in net savings of approximately \$168,000 for HVCC.
- HVCC, together with a neighboring city and county, formed a Cooperative Employee Health Insurance Program for joint prescription benefit management. The objective was to reduce the cost of employee health

⁶ Additional strategies for lowering health insurance costs are available in Local Government Management Guide, Personal Service Cost Containment, Division of Local Government and School Accountability, February 2008 which can be found at www.osc.state.ny.us.

insurance while still providing necessary coverage. The Cooperative could negotiate lower prescription drug prices because it had a greater total number of employees, and therefore more potential enrollees, than did each local government unit alone. Currently, approximately 118 HVCC employees and retirees are covered for prescription drugs under the Cooperative. Belonging to the Cooperative saved HVCC an estimated \$34,500 in 2007.

- After a review of potential savings presented by its insurance broker, the Village of Tupper Lake moved from offering an HMO plan and a Preferred Provider Organization (PPO) plan to offering only the single PPO plan. Because switching to a single plan reduced the Village's overall cost of providing health insurance, the transition resulted in savings of approximately \$38,000 in the fiscal year ending May 31, 2007.

Employee Contributions – Local governments can enter collective bargaining agreements and employment contracts that either provide full health insurance benefits at no cost to employees, or require employees to contribute toward the cost of their health insurance coverage. All seven local governments we examined required active employees, retirees and spouses of municipal retirees receiving benefits to contribute toward the cost of their health insurance premiums. Required employee contributions toward health care premiums offset the combined cost of health insurance for the seven units we audited by nearly \$2 million on an annual basis.

Potential Savings Under Medicare Part D – Under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Part D), if an employer provides prescription drug benefits to its Medicare-eligible retirees that are at least actuarially equivalent to those that otherwise would be provided by Medicare, the Federal government will make subsidy assistance payments either directly to or on behalf of the employer. The provisions of Medicare Part D became effective January 1, 2006. The Federal subsidy offered under this program is intended to provide a financial incentive or assistance to employers to continue providing prescription drug benefits to their Medicare-eligible retirees, thereby relieving the Medicare

program of coverage responsibility. It is expected that these Federal subsidy payments will equal 28 percent of allowable retiree costs (about \$600 per participant) for each Part D eligible retiree enrolled in the employer's prescription drug plan.

Five of the seven units in our audit filed for the Employer Subsidy Payment. The other two units, the Village of Tupper Lake and the Village of Saranac Lake (as of June 1, 2008), used alternative strategies to maximize savings under Medicare Part D. Local governments used these Federal Medicare Part D subsidy payments to defray the costs of health benefits provided to active and retired employees and dependents. The following summarizes the results.

- In 2006, Saratoga and Warren Counties filed for and received \$220,483 and \$92,000, respectively, in Federal subsidy payments. Because the Counties' health plans provide prescription drug coverage that is at least the equivalent of Part D, the Counties qualify for a Federal subsidy for each retired Medicare-eligible individual who chooses to remain in his or her County's health plan rather than enroll in Medicare Part D. Similarly, the Town of Queensbury filed for and received \$16,365 in Federal subsidy payments.
- In 2006, HVCC filed for and received \$42,972 in Federal subsidy payments. We found that not all Medicare-eligible retirees receiving benefits qualified for the Medicare Part D employer subsidy payments because some of them received prescription drug benefits from HVCC that were not actuarially equivalent to those provided by Medicare. However, HVCC is actively seeking cost containment opportunities under Medicare Part D for those retirees.
- In 2006, the City of Johnstown filed for and received approximately \$19,000 in Federal subsidy payments for eligible retirees covered by NYSHIP. The City found that the costs of filing for subsidy payments for Medicare-eligible retirees covered under other plans were too high to make seeking the subsidies cost effective. The City is continuing to explore other options under Medicare part D for those retirees who were not enrolled in a NYSHIP plan.
- The Village of Tupper Lake had 34 Medicare-eligible retirees, including eligible spouses, at the time of our

audit. As an alternative to filing for the Federal employer subsidy, the Village implemented an option that provided greater cost savings than the estimated subsidy of \$20,400. The Village encouraged its Medicare-eligible retirees to join a specific Medicare Drug Plan subsidized by Centers for Medicare and Medicare Services under Medicare Part D. The coverage provided was comparable to the drug coverage previously provided by the Village, but at a significantly lower rate. As a result of implementing this strategy, the Village saved approximately \$71,000 in the fiscal year ending May 31, 2007.

Recommendation

4. Local governments should explore the cost savings potential available under Medicare Part D.

APPENDIX A

RESPONSES FROM LOCAL OFFICIALS

A draft copy of this report was sent to each of the seven local governments audited. The following comments were excerpted from the four responses we received.

Hudson Valley Community College: “The College intends to implement the audit’s recommendations where possible and has recently increased the limit on its pre-tax flexible spending plan. The College will continue to assess the efficacy of self-funding mechanisms for various facets of its program, and is actively exploring potential savings through the use of benefit consultants and joint labor/management study groups.”

Village of Saranac Lake: “The Village of Saranac Lake will be placing more emphasis on educating employees on the various benefits. One factor that contributes to lower participation has been voluntary attendance at informational sessions we provide. A new direction of offering incentives to participate or making meetings mandatory is now under consideration. Although there would be an added cost with this approach, it would be offset by future savings.”

Village of Tupper Lake: “The Village will continue to offer pre-tax deductions from employees pay for their health insurance contributions on a Premium Only Plan. In addition, the Village will annually review its offering of other flexible benefit plans to employees on a pre-tax basis during our annual health insurance review with our insurance broker.”

Warren County: “We have reviewed the draft report “Containing the Cost of Employer-Provided Health Insurance Benefits” and offer this as comment. Warren County is committed to containing the cost of employer provided health insurance not only for the employees of Warren County, but for the taxpayers as well.”

APPENDIX B

AUDIT METHODOLOGY AND STANDARDS

To accomplish our objectives, we initially surveyed 75 municipalities in Northeastern New York State to obtain information about the health insurance benefits provided to their employees and retirees. We received responses from 41 of the municipalities indicating the respondents spent approximately \$82.4 million for health insurance for 10,315 employees and retirees during fiscal year 2006.

We then selected seven units for audit. Our audit reviewed data for the period from January 1, 2004 through December 31, 2007, but we focused more attention on 2006 data.

For each municipality we reviewed the process for monitoring and making health insurance payments for both active employees and retirees. We reviewed insurance listings, employee rosters, and vendor history reports and held discussions with municipal officials. We gathered and analyzed data relating to health care benefit costs, reviewed local practices and considered suggestions made by municipal and community college officials on how to better control the costs of providing health benefits.

We tested all retirees and dependent spouses who received insurance coverage benefits from the units we audited to determine if any of the recipients were deceased.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C

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