



# Managed Care Organizations' Administrative Expenses

**The Legislature and DHS should be more directly involved in oversight of managed care administrative costs for Medical Assistance - programs.**

## Key Facts and Findings:

- Minnesota has relied on managed care organizations (MCOs) for decades to help administer its Medical Assistance (MA) program. Administrative spending by the four largest MCOs totaled about \$278 million in 2012.
- The Department of Human Services (DHS) determines how much to pay MCOs for these services, and relies primarily on MCOs' financial data to set the administrative portion of payment rates.
- In our audits of MCOs' 2012 financial reports, we sampled administrative expense records and found a small number of miscategorized transactions. Total costs related to these discrepancies ranged from \$1,702 to \$3.0 million.
- We identified some opportunities for MCOs to more directly allocate administrative expenses to specific lines of business. We also questioned some costs allocated to public programs and found that MCOs did not have adequate documentation to support some subcontracted services.
- DHS implemented important cost-savings initiatives for 2014, but its technical execution of some rate-setting options for administrative expenses was sometimes lacking during 2013.
- Minnesota statutes, rules, state contracts, and accounting principles do

not ensure consistent reporting by MCOs and compliance with policymakers' intent.

- During 2013, DHS directives and requests to MCOs were too general to sufficiently address data complexity, data integrity, and variations among MCOs' allocation and recordkeeping processes.

## Key Recommendations:

- The Legislature should amend statutes to clarify how MCOs must allocate administrative expenses and investment income on state-required financial reports, refine managed care administrative spending limits, and further define the types of unallowable expenses for state public programs.
- The Legislature should amend statutes to specify requirements for MCOs' subcontracts for administrative services that are expensed to Minnesota's public programs, and DHS should incorporate such language into its contracts with MCOs.
- DHS should enhance instructions, definitions, and technical guidance to facilitate MCO compliance with administrative expense reporting requirements.
- DHS should implement ad-hoc audits of financial data, unallowable expenses, and other information reported to the department by MCOs under state contracts and *Minnesota Statutes* 2014, 256B.69, subd. 9c.

## Report Summary

In 2012, the Department of Human Services (DHS) contracted with managed care organizations (MCOs) to help administer Medical Assistance (MA) services for nearly 620,000 individuals. Administrative expenses for the four largest MCOs—Blue Plus, HealthPartners, Medica, and UCare—totaled about \$278 million, or about 84 percent of all managed care administrative spending.

DHS must determine how much to pay MCOs for their services and ensure that payment amounts are within limits of law. The state's current "at-risk" payment method requires DHS to work with an actuary to develop reasonable and appropriate rates using data based on Medical Assistance services for MA enrollees.

Changes in DHS rate-setting practices and initiatives by state policymakers—including competitive price bidding and legislatively imposed caps on payment rate increases—likely have limited growth in managed care administrative costs in recent years. Managed care administrative expenses per member-month in 2013 were comparable to 2009 rates for some programs, and increased about 8 percent for others. Enhancements in the financial reporting relationship between DHS and managed care organizations should advance oversight and understanding of the costs of public health care programs.

**DHS implemented important cost-savings initiatives for contract year 2014, but its technical execution was sometimes lacking.**

DHS modified its rate-setting methods and used competitive price bids to determine 2014 managed care payment rates. For 2014 contracts, about 16 percent of the Prepaid Medical Assistance Program (PMAP) and

MinnesotaCare payments were set through competitive price bids. However, competitive price bids from contract year 2012 had a multi-year impact on rate-setting methodology.

DHS also modified its previous rate-setting methods with a goal of reducing trends in 2014 administrative costs by \$47 million. For MCOs compensated through a prepaid capitation payment method, there are few statutory restrictions on the types of expenses they may incur for public programs. Any restrictions on administrative expenses are imposed when DHS renews contracts and determines new overall payment rates.

DHS did not execute some statutory provisions related to controlling managed care administrative expenses. State law imposes limits on growth in MCO administrative spending. DHS waived this restriction in 2013, noting a lack of clarity in the law and shifting coverage in populations. DHS staff also said that the statutory provision is technically incompatible with current rate-setting methods, competitive price bidding, and aggregate limits in managed care trends specified elsewhere in law.

**DHS's use of some MCO financial reports for determining managed care payment rates has been a long-standing source of controversy.**

For 2014 contracts, DHS and its actuary relied primarily on data reported and certified by the MCOs—data they consider comparable to data used by the federal government and other states. These data included the MCOs' 2012 annual statutory financial filings with the Minnesota Department of Health (MDH). MCO representatives said that the financial information is correct for purposes of reporting to MDH and that the reports were not developed to be used for DHS rate setting. This controversy supports recent legislative

work to expand the direct reporting relationship between DHS and MCOs.

**MCOs generally complied with accounting standards when categorizing administrative expenses, with some exceptions.**

We audited MCOs' 2012 accounting practices and financial reports. Among approximately 100 samples tested for each MCO, MCOs miscategorized a small number of administrative expense transactions. However, total costs related to these discrepancies ranged from \$1,702 to \$3.0 million. DHS used the MCOs' reports to determine their 2014 payment rates.

**We identified some opportunities for MCOs to more directly allocate administrative expenses to specific products, but MCO representatives said that this practice would increase public program costs.**

MCOs have complex processes to record and allocate their administrative expenses across numerous entities, products, and programs. MCOs process tens of thousands of transactions annually for such costs as general overhead, subcontractors, intercompany fees, and capital projects. For the majority of their 2012 administrative costs, MCOs consistently allocated at least some portion of each expense across state public programs. Some MCO costs for their subcontracted administrative services could have been more directly allocated to individual state programs or to commercial products that benefitted from the service.

**MCOs' accounting and allocation practices did not sufficiently restrict some unreasonable expenses from the Medical Assistance programs on state-required reports in 2012.**

Among our sample transactions, we questioned some expenses allocated to

the state's public programs on reports used by DHS for rate setting for contract year 2014. For each MCO, we identified between one and four cost items that we considered unreasonable, unrelated to Medical Assistance services, or out of compliance with MDH rules. We estimated the total costs of these transactions allocated among state public programs ranged from \$376 to \$2,144, depending on the MCO.

We also questioned some other indirect marketing and charitable contribution expenses subject to DHS review for rate-setting purposes. In total, these types of transactions for each MCO ranged from \$5,198 to \$8.5 million. During 2013, DHS separately requested and received from the MCOs information about these types of expenses when determining payment rates.

MCO representatives said that their allocation practices comply with federal or state law, state contracts, reporting requirements, or accounting principles. More direction from state policymakers could diminish controversy about the types of managed care administrative expenses disallowed for Medical Assistance programs. DHS's use of these MDH reports will require ongoing reconciliation of disallowed expenses.

**Managed care organizations did not have adequate documentation to support expenses for some administrative service subcontracts.**

For some contract-related expenses we tested, MCOs did not have adequate documentation to verify whether their subcontractors were paid appropriately, assess the reasonableness of MCOs' allocations, or determine how the costs related to public programs. Some subcontracts were not fully signed or had expired, payments did not match the contract rates, or there was no statement of work. The number of

these cost items ranged from two to four, depending on the MCO.

**Minnesota statutes, rules, and state contracts do not ensure consistent reporting by MCOs and compliance with policymakers' intent.**

Our examination of MCOs' detailed financial data, supporting documentation, and allocation practices revealed that reporting requirements could be improved. In particular, lack of definitions, details, and conflicting language in law and state contracts do not support recent efforts by policymakers. Insufficient guidance in accounting principles contributes to these inconsistencies, too. More direction in law regarding program-specific and cost allocation requirements, and the form and content of MCOs' subcontracts for administrative services, could reduce variation and misinterpretation.

**In 2013, DHS directives and requests to MCOs were too general to sufficiently address data complexity, data integrity, and variations in MCOs' recordkeeping and allocation processes.**

During our audit work, DHS staff were still refining new financial reporting

templates for MCOs. We think the specifications for administrative expenses were too general and likely resulted in inconsistent or incomplete data, based on our audits of MCOs. DHS contracts with MCOs require them to submit and "certify" certain filings or other financial data as requested by DHS, but we found inconsistencies among federal law, contract language, and certification documents.

**Enhanced financial reporting by MCOs may have minimal value for managed care payment rate setting without independent verification of the data.**

DHS and its actuary accept the MCOs' data certifications but do not independently audit their summary-level data reports. Given the significant amount of information now compiled by DHS, more rigorous, ad-hoc verification of administrative expenses by DHS would be reasonable. Absent these actions, we question the extent to which state resources needed for oversight of additional MCO financial reporting will translate into cost savings. Such work also will help assure that MCOs costs are appropriately allocated to the state's public programs.

## Summary of Agency Response

*In a letter dated March 5, 2015, Department of Human Services Commissioner Lucinda Jesson said that DHS has "implemented significant changes to its rate-setting practices and worked closely with the Legislature to pass meaningful financial reporting, quality assurance, and independent audit requirements." She said that "some of these changes have just begun implementation and were after the time period of the audit," and that DHS supports the recommendations as they "provide the tools for DHS to continue its progress on this effort." In response letters, representatives from managed care organizations mostly disagreed with our findings, and emphasized that they have sound financial practices. They also cited an absence or lack of clarity in federal and state regulations, accounting standards, or contract requirements for reporting administrative expenses.*

The full evaluation report, *Managed Care Organizations' Administrative Expenses*, is available at 651-296-4708 or: [www.auditor.leg.state.mn.us/ped/2015/mcoadminexp.htm](http://www.auditor.leg.state.mn.us/ped/2015/mcoadminexp.htm)