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An Audit Report on Selected Management Controls at Certified Non-Profit Health Corporations

December 1998

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Key Points of Report

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Overall Conclusion

Both the UT Southwestern Health Systems and the UTMB HealthCare Systems, Certified Non-Profit Health Corporations, are at risk of not collecting all the money earned on their capitated managed health care contracts or not receiving the agreed upon services associated with these contracts. This is significant because these non-profit corporations negotiate and administer capitation contracts (estimated at \$60 million for fiscal year 1998) for The University of Texas Southwestern Medical Center at Dallas and The University of Texas Medical Branch at Galveston.

Key Facts and Findings

UT Southwestern Health Systems (Southwestern Corporation)

- A well-defined capitated (risk-based) managed health care contract (capitation contract) could have saved the Southwestern Corporation approximately \$160,000.
- Southwestern Corporation's business systems over the billing and collections for The University of Texas Southwestern Medical Center's \$125 million Medical Services, Research and Development Plan are generally effective. The \$125 million includes revenue from capitation contracts and other medical services the institution provides.

UTMB HealthCare Systems (Galveston Corporation)

- Some payors (usually insurance companies) do not provide Galveston Corporation with information it needs to manage approximately \$54 million in capitation contracts. Information, such as the number of health plan members enrolled per month and the members' utilization of medical services, is needed by Galveston Corporation to effectively manage its business. Without it, Galveston Corporation does not know if it is paid according to the contract or if members are using more medical services than estimated.
- Galveston Corporation knew, as of May 31, 1998, that it had a \$5 million aggregated operating loss from its capitation contracts. Because the Galveston Corporation does not have an accounting system that can track costs by individual contract, it cannot tell which contracts are losing money.

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This audit was conducted in accordance with Government Code, Sections 321.0132 and 321.0133.

Executive Summary

Both The UT Southwestern Health Systems (Southwestern Corporation) and The UTMB HealthCare Systems (Galveston Corporation) Certified Non-Profit Health Corporations, are at risk of not collecting all the money earned on their capitated managed health care contracts or not receiving the agreed-upon services associated with these contracts. This is significant for two reasons:

- These two non-profit corporations negotiate and administer capitation contracts (estimated at \$60 million for fiscal year 1998) for two medical institutions, The University of Texas Southwest Medical Center at Dallas (Medical Center - Dallas) and The University of Texas Medical

Branch at Galveston (Medical Branch - Galveston).

- Financial losses from any existing weak contracting practices result in less revenue available to the medical schools. Medical schools rely on such non-state revenue sources to fund their operations.

If not corrected, the risk will increase as the use of capitation contracts grows. These contracts provide the number of patients needed to effectively support the medical institutions' missions of medical education and research.

The corporations' capitation contracts do not consistently specify, in enough detail, performance expectations and penalties for lack of performance. For example, at Galveston Corporation, no documentation was provided by an insurance company to support withholding more than \$1 million in contract revenue from the Galveston Corporation. For one contract, Southwestern Corporation indirectly paid or did not receive \$160,000 in services and interest expected.

As the use of capitation contracts grows, it is important that they are properly structured to protect the interests of the medical institutions. Now is the time for all certified non-profit health corporations serving the State's medical institutions to ensure they follow sound contracting practices. This includes defined performance penalties in the contracts to hold parties accountable when disputes occur.

Therefore, we suggest that other certified non-profit health corporations examine their capitation contracting practices to better manage the risks and liabilities associated with the

What is managed health care and how does it work?

The term "managed health care," or "managed care," has been defined as accepting any contractual agreement that receives payments for less than what is billed. The managed care business operates primarily on two types of contracts: the discounted fee-for-service contract (non-risk based) and capitation contracts (risk based).

Capitation contracts require the corporation to provide medical services to members in a health plan for a flat monthly fee. They are risk-based contracts because the medical services required by the members can exceed the level of monthly income received on the contract.

These types of risk-based contracts are necessary for medical institutions to compete for patients in the current managed health care environment. The universities created certified non-profit health corporations to engage in capitated managed care contracting. As state agencies the universities could not legally enter into these types of risk-based contracts.

Because the presidents of the medical institutions are the sole members of the corporations, the medical institutions receive the benefits of the corporations' contracting activities, and, ultimately bear the risks.

Executive Summary

managed health care business. They could also review any physician billing and collection functions administered on behalf of the medical institutions to minimize risks. The State Auditor's Office can provide audit materials for the corporations to use.

Additional observations about Southwestern Corporation include:

- It should strengthen controls over cash and checks received through the mail to reduce the risk of misapplication of funds.
- It is generally effective in its billing and collection services for The Medical Center - Dallas \$125 million Medical Services Research and Development Plan.

Additional observations about Galveston Corporation include:

- It cannot tell which of its capitation contracts are losing money. This is because it does not have an accounting system that can track costs by individual contract. As of May 31, 1998, Galveston Corporation knew that it had a \$5 million aggregated operating loss from its capitation contracts. It needs to complete the design and implementation of its accounting system so that it can determine the profitability of its individual contracts.
- During fiscal year 1998, the Galveston Corporation took positive steps to address its rapid growth from an organization with less than 10 staff members to more than 250 employees. To manage this growth, Galveston Corporation has hired consultants to assist in developing effective business operations. Many of

these initiatives were in progress during our fieldwork.

Summary of Management's Responses

Both Southwestern Corporation and Galveston Corporation generally concur with our recommendations. Their specific responses follow our recommendations in this report.

Summary of Objective, Scope, and Methodology

The objective of this audit was to determine if selected certified non-profit health corporations associated with Texas medical institutions have effective controls over key operations to minimize risks associated with its operations. This audit was conducted in accordance with Government Auditing Standards.

The scope of our work included the operations of the corporations and the oversight role provided by the universities. Fieldwork was conducted at Southwestern Corporation from June 8 to June 25, 1998, and from July 20 to July 31, 1998 at Galveston Corporation.

The methodology used on this audit included reviews of operating policies and procedures, walk-throughs of operating processes, interviews with members of the corporations and universities' management teams, and reviews of contracts and other pertinent documents.

UT Southwestern Health Systems

Overall Assessment

The UT Southwestern Health Systems (Southwestern Corporation) should reduce its operating risks and better protect the interests of The University of Texas Southwestern Medical Center (Medical Center - Dallas) by:

- Improving risk-based capitation contracts to save money and better manage risk. In fiscal year 1998, these capitation contracts generated approximately \$6 million in revenue earned for Medical Center - Dallas.
- Strengthening controls over cash and checks received through the mail to reduce the risk of misapplication of funds.

Southwestern Corporation's control systems over the billing and collections for Medical Center - Dallas' \$125 million Medical Services, Research and Development Plan are generally effective. This \$125 million includes revenue from capitation contracts and other medical services the Medical Center - Dallas provides. We determined that the Medical Center - Dallas receives timely financial and program reports to monitor the activities of Southwestern Corporation.

Section 1-A:

Improve Managed Health Care (Capitation) Contracts With Insurance Companies

The term "managed health care," or "managed care," has been defined as accepting any contractual agreement that receives payments for less than what is billed. The managed care business operates primarily on two types of contracts: the discounted fee-for-service contract (non-risk based) and the capitation contracts (risk based).

Capitation contracts require the corporation to provide medical services to members in a health plan for a flat monthly fee. They are risk-based contracts because the medical services required by the members can exceed the level of monthly income received on the contract.

These types of risk-based contracts are necessary for medical institutions to compete for patients in the current managed health care environment. The universities created certified non-profit health corporations to engage in capitated managed care contracting. As state agencies, universities cannot legally enter into risk-based contracts.

Southwestern Corporation does not have adequate policies and procedures for capitation contracting to ensure its interests are effectively protected. Without an effective contract, Southwestern Corporation does not have any recourse when performance problems occur.

A well-defined capitation contract could have saved the Southwestern Corporation approximately \$160,000. One of the four capitation arrangements the Southwestern Corporation has entered into is in the form of a Letter of Agreement with a health care insurance company, not a contract. This Letter of Agreement includes the general terms and responsibilities of the parties, but does not include specific performance penalties to maintain accountability when disputes occur.

Southwestern Corporation had to pay a separate company \$12,000 to format critical information into useful reports because the insurance company was unable to provide the information in a timely and useful manner. This was a demonstration of one month's data. To purchase a reporting system will cost approximately \$144,000. The Letter of Agreement required the insurance company to manage the claims payment process and provide the utilization data (information on members' use of medical services) to Southwestern Corporation. However, it did not specify how the insurance company should format this data so that it would be useful to Southwestern Corporation.

This same insurance company overdraw more than \$62,000 from premiums belonging to Southwestern Corporation. The insurance company returned the money after 14 months, but did not pay any interest for using these funds, which would have totaled approximately \$4,000. The Letter of Agreement requires the insurance company to pay (adjudicate) the claims of the 20,000 members covered in its health plan. To do this, the insurance company writes checks on Southwestern Corporation's account.

Southwestern Corporation could avoid, or remedy, situations such as these if it consistently used well-prepared contracts. A well-prepared contract would protect the interests of Southwestern Corporation by clearly specifying the responsibilities of the parties and provisions for accountability and recourse when there are problems. For example, the contracts should have penalty provisions, such as principal and interest due on funds inappropriately disbursed by the payor from Southwestern Corporation's account.

The timing is right for the Southwestern Corporation to improve its contracting process for capitation agreements. Capitation contracts are becoming more prevalent in managed health care as the insurers shift their risks associated with health care costs to the providers of medical services, such as Southwestern Corporation and, ultimately, the Medical Center - Dallas. Currently, risk-based capitation contracts are 5 percent of the Southwestern Corporation's business, and they are growing.

Beginning in fiscal year 1999, the Medicaid contract for the Dallas service area will be awarded on a capitated basis. Currently, Parkland Health and Hospital System (Parkland), the Medical Center - Dallas' primary teaching hospital, serves approximately 60 percent (84,000 people) of the Medicaid patients in Dallas County, which is Parkland's largest population of patients. To compete for this capitated business, Southwestern Corporation and Parkland are joining together to bid on the contract for these patients.

Recommendation:

To effectively guide the contracting process, the Southwestern Corporation should establish policies requiring contracts to be used when entering into a managed health care agreement. Procedures should be developed on structuring the contracts to better manage the associated risks and liabilities. Well-prepared contracts will better serve the needs of the University by limiting the liabilities of the Southwestern Corporation.

Management's Response:

UT Southwestern Health Systems currently has negotiated and is managing over 64 managed care contracts [4 of which are capitated contracts]. Some managed care companies cannot fulfill the Corporation's requirement for management and utilization reporting. The need to purchase outside reporting systems is a function of entering into "at risk" business. No managed care firm will provide the number of permutations of utilization data needed for decision support and analysis. In assuming capitation, the contract has to provide for access to the detail claims data that the corporation can load into its own reporting system. The corporation has received detailed claims data on a monthly basis as provided by the managed care contract; however, we did not have an effective reporting system for loading and analyzing the data. The \$12,000 payment was a fee for testing a UM [utilization management]. The \$144,000 annual cost is an estimate for the purchase of such a system.

We concur with the need to improve our contracting policies and procedures. Existing working guides and checklists will be formalized to cover all contracting (risk and non-risk). We also concur with the inclusion of interest penalties (where appropriate) and they will be incorporated into future contracts. The policies and procedures will be completed by April 1999.

Section 1-B:

Appropriately Protect All Cash and Checks Received Through the Mail

Only one person is responsible for handling approximately \$2,000 a day (approximately \$500,000 per year) in cash and checks received through the Corporation's mail. This increases the risk that misapplication or theft of funds could go undetected. While the majority of the faculty physician billings are appropriately collected in a lock box at the bank or through an electronic funds transfer, patients mail some payments directly to the Corporation.

Recommendation:

The Corporation's policies need to be changed to require that two people be involved in the mail opening process to reduce the risk associated with only one person having control over opening the mail, endorsing the checks for deposit, and logging all cash receipts.

Management's Response:

Agreed. UTSHS will implement this staffing change by December 1, 1998.

UTMB HealthCare Systems

Overall Assessment

The UTMB HealthCare Systems (Galveston Corporation), a non-profit organization, can reduce the risk of (1) not being paid enough for managed health care services and (2) not knowing when it is losing money on a contract. To reduce these risks, the Corporation needs to strengthen its managed health care capitation contracts and complete the design and implementation of its accounting system:

- Not all payors (usually insurance companies) provide the Galveston Corporation with information it needs to manage its managed care capitation contracts. Information from payors, such as the number of members enrolled per month and the members' utilization of medical services, is needed by Galveston Corporation to effectively manage its business. Without this information, Galveston Corporation does not know if it is paid according to the contract, or if members are using more medical services than were estimated.
- As of May 31, 1998, Galveston Corporation knew that it had a \$5 million aggregated operating loss from its capitation contracts. Because Galveston Corporation does not have an accounting system that can track costs by individual contract, it cannot tell which contracts are losing money.

Galveston Corporation enters into managed care capitation contracts with payors (usually insurance companies) to provide patients for The University of Texas Medical Branch at Galveston (Medical Branch - Galveston). In fiscal year 1998, the Galveston Corporation had an estimated \$54 million in capitation contracts with payors.

For the Medical Branch - Galveston to fulfill its mission of medical education and research, it must have patients. Through capitation contracts, health insurance companies pay Galveston Corporation a monthly fee for providing medical and hospital services to its members. The Medical Branch - Galveston ultimately provides these services and receives the revenues from Galveston Corporation.

Medical Branch - Galveston pledged \$30 million to fund Galveston Corporation's start-up costs, which indicates that Galveston Corporation's success is very important to it. Galveston Corporation has used approximately \$8 million of this funding to date.

We reviewed Galveston Corporation's operations during a time of rapid expansion as it changed its business focus. Galveston Corporation changed from a facilities manager, with less than 10 staff members in September 1997, to a managed health care business, with approximately 250 staff members in July 1998. Galveston Corporation has used consultants to address the operational and administrative challenges associated with this growth. Several initiatives to manage this organizational growth were in progress during our review.

Improve Contracting Practices to Better Protect the Interests of Galveston Corporation and The Medical Branch - Galveston

The following terms are used in the managed health care business:

Payor - is the party that pays the revenue to the Corporation. This is usually an insurance company that operates the health care plan and collects premiums from members.

Member - is a participant in the payors health care plan. Members are identified by payors in monthly eligibility files.

Provider - is the party that provides medical services (physicians), and facilities (hospitals) to the members in a health plan. The Medical Branch - Galveston is the provider through the Galveston Corporation. Revenue for a provider that is calculated by "per member-per month" increments and is based on the percentage of the premiums the payor collects from members in their plan. For example, a contract will call for a payor to pay a provider \$70 per member-per month. The amount is negotiated in the contract.

Adjudication of claims - is the business of paying claims of providers who have treated members. The payors adjudicate many of the contracts because they have the business operations to perform this service. The Galveston Corporation is currently developing the ability to adjudicate claims in house.

Utilization Data - is information that identifies the types and volume of medical services that members are using. Utilization data is generated as claims are adjudicated. When Galveston Corporation begins to adjudicate claims, this information will be more readily available.

Galveston Corporation does not have key information to actively manage its capitation contracts. Galveston Corporation uses this data to verify that the payors have paid the correct amount for health care services. Six out of seven capitation contracts did not hold the payor accountable for failure to provide key information or perform according to the contract terms. There are no formal written policies and procedures to guide the capitation contracting process.

Between September 1, 1997, and May 31, 1998, Galveston Corporation received approximately \$45 million in revenue from capitation contracts. These funds, less Galveston Corporation's 15 percent administrative fee, flow through Medical Branch - Galveston for providing health care services to the covered members.

Without the necessary information, the following conditions exist and Galveston Corporation cannot hold the payors responsible:

- It does not reconcile some health plan payors' capitation payments on a timely basis. This lack of monitoring is mainly due to the difficulty that Galveston Corporation has in obtaining the eligibility files (member enrollment data) from various payors. As a result, Galveston Corporation is

unable to verify if it has been paid for all the members enrolled in accordance with the capitation contract agreements.

- Revenue from capitation contracts accounted for 88 percent of Galveston Corporation's revenue as of May 31, 1998. It is essential that Galveston Corporation reconcile these revenues with eligibility files to ensure that payors (insurance companies) are paying the correct amounts each month.
- One payor (an insurance company) has withheld more than \$1 million from capitation premium payments to Galveston Corporation for claims it has paid on "out-of-network" medical services for its members. Galveston

Corporation cannot determine whether the "out-of-network" claims were preauthorized, as required, based on the information from the payor. The payors generate claims data as they pay claims on behalf of members of the capitation contract. Galveston Corporation requested additional detailed information for several months, but had not yet received any supporting information to verify these charges as legitimate claims covered under the contract.

An "out-of-network" claim arises when a member receives medical services from a provider (physician or facility) who does not have a contract with the payor.

Recommendation:

Galveston Corporation should require payors (insurance companies) to provide timely, detailed, and useful member enrollment and member utilization data on all capitation contracts.

To manage capitation contracts effectively, Galveston Corporation should include necessary provisions, such as performance penalties. Effective contract management would better protect the interest of Galveston Corporation, and, in turn, The Medical Branch - Galveston.

To ensure such provisions are included in the contracts, Galveston Corporation should strengthen the contracting process by developing policies and procedures.

Management's Response:

UTMB HealthCare Systems is a vendor of healthcare services contracting with numerous payors under terms that in some instances, do need renegotiations for a variety of reasons. We have established specific policies and procedures to this end and have engaged outside counsel for help in drafting language to fortify our agreements to include performance penalties when possible and strategically important. In addition, effective September 1, 1998, we have assumed utilization management and claim payment processes from NYLCare in order to more effectively control information flow and subsequent reporting. Information from MSCH has been more timely and complete. These two contracts represent 75 percent of our capitated membership and significant improvement in the control of information has been achieved. The Medicare capitation contract that was of most concern to UTMB HealthCare Systems management has since been terminated. We will continue to improve relationships with our other third party payors in the coming months.

Section 2-B:

Track the Profitability of Individual Product Lines by Completing the New Chart of Accounts

Galveston Corporation is unable to accurately track its revenue and expenses by product line (contracts with individual payors). As of May 31, 1998, Galveston Corporation could tell it had total premium income from capitated contracts of \$45 million with an aggregate operating loss of \$5 million. However, it could not determine which of its seven product lines accounted for this loss.

If Galveston Corporation is not able to determine which product line is losing money, both Galveston Corporation and The Medical Branch - Galveston are at financial risk of not being able to manage their operations effectively. When product lines are losing money, Galveston Corporation should take steps to determine the extent of the loss and the cause.

Once Galveston Corporation can determine which product line is losing money, it has several options including:

- Review its costs to decide whether to reduce costs or retain a larger percentage of the capitation amount (premium) with a smaller percentage going to the University.
- Negotiate an increase in the per member per month capitation rate with the insurance company.
- Terminate the contract.

When the current accounting system was created, it was not designed to track revenue and expenses by product line. Rather, it was set up to track profit and loss by department. However, each department may work on individual products to varying degrees, and a system is needed to identify the related costs to administer each product.

Currently, a new chart of accounts is being developed to identify costs by product line this improved chart of accounts should make it possible to track profit and loss by product line. One of the steps that remains in this development is to determine the method used in allocating costs, including administrative salaries, to the various product lines.

Recommendation:

We recommend that Galveston Corporation quickly complete the development of its new accounting system so that it can effectively manage its business operations.

Management's Response:

We realize that product line reporting is important and have implemented a revised accounting matrix that has been in operation since September 1, 1998. This allows UTMB HealthCare Systems to track membership and book revenue by product line. We also book medical loss in a similar fashion. We recognize that we have been unable (until recently) to substitute actual claim dollars for estimated medical loss for those contracts where UTMB HealthCare Systems is at risk. Our partners have recently provided actual claim data to allow us to more clearly evaluate our financial position. We are still evaluating the best method to allocate administrative expenses to each product line to identify overall product profitability. We anticipate being able to monitor and report performance and meaningful data by product line by the end of our first fiscal quarter.

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine if selected certified non-profit health corporations associated with Texas medical institutions have effective controls over key operations to minimize risks associated with its operations. This audit was conducted in accordance with Government Auditing Standards.

Scope

The scope of our work included the operations of the corporations and the oversight role provided by the universities. Fieldwork was conducted at Southwestern Corporation from June 8 to June 25, 1998, and from July 20 to July 31, 1998, at Galveston Corporation.

Methodology

The methodology used on this audit included reviews of operating policies and procedures, walk-throughs of operating processes, interviews with members of the corporations and universities management teams, and reviews of contracts and other pertinent documents.

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