



STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

STATE CHILDREN'S HEALTH INSURANCE PROGRAM CLAIMS PROCESSING

JULY 2007

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

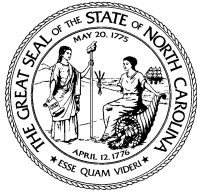
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July 24, 2007

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. George Stokes, Executive Administrator, North Carolina State Health Plan

Ladies and Gentlemen:

We are pleased to submit this performance audit entitled *State Children's Health Insurance Program Claims Processing*. The objective of the audit was to determine if the State could realize cost savings by moving State Children's Health Insurance claims processing from the North Carolina State Health Plan to the Department of Health and Human Services Division of Medical Assistance. Mr. Stokes has reviewed a draft copy of this report. His written comments are included in the appendix.

This audit was initiated by the Office of the State Auditor to identify cost savings and improve efficiency and effectiveness in State government.

We wish to express our appreciation to the staff of the North Carolina State Health Plan and the Department of Health and Human Services Division of Medical Assistance for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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Summary

The State Children's Health Insurance Program (SCHIP) is a State and federally funded program that provides health insurance coverage to the children of low-income families. These children would not otherwise be covered by health insurance because their families cannot afford health insurance and they earn too much to be eligible for Medicaid. Federal funds under Title XXI of the Social Security Act are combined with State appropriations to provide a basic health insurance plan for these children.

The North Carolina SCHIP, in accordance with *North Carolina General Statutes*, is administered through a partnership of the Department of Health and Human Services' Division of Medical Assistance and the North Carolina State Health Plan. The Division of Medical Assistance receives funds appropriated for the SCHIP and then disburses those funds to the State Health Plan. The State Health Plan then disburses funds to Blue Cross Blue Shield of North Carolina (BCBS) who is contracted to process and pay SCHIP medical claims.

Currently, the State has three medical claims processors on contract. The Division of Medical Assistance contracts with Electronic Data Services to process Medicaid claims. The State Health Plan contracts with BCBS and Medco Health Solutions to process claims for the Teachers' and State Employees' Comprehensive Major Medical Plan and the SCHIP.

Our audit objective was to determine if the State could realize cost savings by moving SCHIP claims processing from the State Health Plan to the Division of Medical Assistance.

RESULTS IN BRIEF

The State can realize approximately \$15,912,000 in annual savings and have access to \$3,500,000 currently held in reserve at the State Health Plan by moving the responsibility for SCHIP medical claims processing from the State Health Plan to the Division of Medical Assistance. Based on the SCHIP medical payments budgeted for the 2008 fiscal year, approximately 9,700 additional children could be enrolled in the program and receive medical coverage using the recurring administrative savings and additional rebates.

AGENCY'S RESPONSE

The Agency's response is included after the finding and recommendation.

Introduction

BACKGROUND

The State Children's Health Insurance Program (SCHIP) is a State and federally funded program established under Title XXI of the Social Security Act. The Balanced Budget Act of 1997 amended the Social Security Act to include Title XXI, "State Children's Health Insurance Program," as a way to provide healthcare to low-income children without health insurance coverage. Under Title XXI, federal funds are combined with State appropriations and used to provide a basic health insurance plan for qualifying children.

The North Carolina SCHIP is administered through a partnership of the Department of Health and Human Services' Division of Medical Assistance and the North Carolina State Health Plan. The Department of Health and Human Services has administrative responsibility for the program in accordance with *North Carolina General Statute 108A-70.20*. Responsibility for program claims processing, however, is held by the State Health Plan in accordance with *North Carolina General Statute 108A-70.24*.

To pay for SCHIP medical claims, the Division of Medical Assistance receives funds appropriated for the SCHIP and then disburses those funds to the State Health Plan. The State Health Plan then disburses funds to Blue Cross Blue Shield of North Carolina (BCBS) who is contracted to process and pay SCHIP medical claims. The SCHIP provides basic health coverage to approximately 114,000 children in North Carolina who otherwise would not have medical coverage. Health care under the plan includes basic medical, dental, vision, and auditory services. In the fiscal year ended June 30, 2006, children enrolled in the SCHIP received approximately \$260,200,000 in doctor visits, prescriptions, and medical supplies.

Currently, the State has three medical claims processors on contract. The Division of Medical Assistance contracts with Electronic Data Services to process Medicaid claims. The State Health Plan contracts with BCBS and Medco Health Solutions to process claims for the Teachers' and State Employees' Comprehensive Major Medical Plan and the SCHIP. The three contractors each charge different administrative rates to process medical claims.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of the audit was to determine if the State could realize cost savings by moving SCHIP claims processing from the State Health Plan to the Division of Medical Assistance.

This audit was initiated by the Office of the State Auditor to identify cost-savings and improve efficiency and effectiveness in State government.

The scope of this audit includes operations of the SCHIP from July 1, 2005, through June 30, 2006.

To accomplish our audit objective, we observed operations and interviewed personnel at the State Health Plan, the Division of Medical Assistance, and BCBS. We reviewed the claims processing contracts for BCBS and Medco Health Solutions. We also interviewed General

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Assembly Fiscal Research personnel, as well as State legislators who enacted program legislation or serve on health care committees.

We conducted this performance audit according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

This report contains the results of the audit including conclusions and recommendations. Specific recommendations related to our audit objective are reported. Because of the test nature and other inherent limitations of an audit, together with the limitations of any system of internal and management controls, this audit would not necessarily disclose all weaknesses in the systems or lack of compliance.

We conducted the fieldwork from March 2007 to June 2007. We conducted this audit under the authority vested in the State Auditor of North Carolina by Section 147-64 of *North Carolina General Statutes*.

FINDING AND RECOMMENDATION

Approximately \$15,912,000 in cost savings can be realized by changing the State Children's Health Insurance Program medical claims processor.

The State can realize approximately \$8,437,000 in administrative cost savings, \$7,475,000 in additional vendor rebates, and the use of \$3,500,000 in cash reserves by moving the responsibility for State Children's Health Insurance Program (SCHIP) medical claims processing from the State Health Plan to the Division of Medical Assistance. Based on the SCHIP medical payments budgeted for the 2008 fiscal year, approximately 9,700 additional children could be enrolled in the program and receive medical coverage using the recurring administrative savings and additional rebates.

Administrative Cost Savings

Approximately \$8,437,000 in administrative cost savings is available due to a significant difference in administrative fees charged by the contractor for the Division of Medical Assistance and the contractors for the State Health Plan.

The Division of Medical Assistance processes all Medicaid claims; medical, pharmacy, and medical supply; through their contractor, Electronic Data Services. For the fiscal year ending June 30, 2006, Electronic Data Services' administrative charges averaged \$0.41 per claim for each submitted Medicaid claim.

Administrative costs for processing SCHIP medical claims are nearly 12 times those paid to process Medicaid claims. The SCHIP medical claims are currently processed by the State Health Plan through their contractor Blue Cross Blue Shield of North Carolina (BCBS). BCBS administrative charges are based on the number of children enrolled in the program each month and averaged \$4.88 per claim for the fiscal year ending June 30, 2006.

Administrative costs for processing SCHIP pharmacy and medical supply claims are also higher than those paid for processing Medicaid claims. The SCHIP pharmacy and medical supply claims are currently processed by the State Health Plan through another contractor, Medco Health Solutions. In accordance with *North Carolina General Statute* 135-40.4a, the contract terms between the State Health Plan and Medco are confidential and can not be disclosed in a public record. Consequently, we will not disclose Medco's average processing costs per claim. We reviewed the contract, however, and determined that Medco's administrative charges are significantly higher than those charged by Electronic Data Services to process Medicaid claims.

We estimate that administrative cost savings of \$8,437,000 can be realized annually by moving administrative responsibility for SCHIP medical claims processing to the Division of Medical Assistance. The estimated annual savings would be enough to provide medical coverage for approximately 5,200 additional children.

Additional Vendor Rebates

Approximately \$7,475,000 in program cost savings is available due to a substantial difference in pharmacy rebates received by the Division of Medical Assistance and the rebates received by the State Health Plan from its pharmacy claims contractor.

The SCHIP pharmacy claims are currently processed by the State Health Plan through their contractor, Medco. *North Carolina General Statute* 135-40.4a establishes the confidentiality of the contract terms between the State Health Plan and Medco. As a result, we will not disclose the Medco's pharmacy rebate amount received by the SCHIP in this report. We determined through our review of the Medco contract that the company's pharmacy rebates are significantly lower than those received by the Division of Medical Assistance.

We estimate that an additional \$7,475,000 in pharmacy rebates can be realized annually, if SCHIP medical claims processing is moved to the Division of Medical Assistance. The estimated annual savings would be enough to provide medical coverage for approximately 4,500 additional children.

Reduction in Cash Reserves

Processing SCHIP medical claims through the Division of Medical Assistance and Electronic Data Services would also provide access to \$3,500,000 currently held in reserve by the State Health Plan. The State Health Plan maintains the reserves to pay for SCHIP medical claims that exceed expected monthly claims.

The Division of Medical Assistance transfers funds to the State Health Plan at the beginning of each month to cover average monthly payments. When medical claim payments exceed the transferred amount, the reserve is accessed to cover the additional payments. The SCHIP reserve fund is replenished at the beginning of the following month. This reserve would not be needed to process claims at the Division of Medical Assistance. The \$3,500,000 reserve currently maintained at the State Health Plan would then become available to pay health care costs of the SCHIP enrollees. The release of these funds would be a one time return of assets and not a recurring cost-savings. Therefore, we did not estimate any additional program enrollment based on the use of the cash reserves.

Programming Costs and System Capacity

We did not perform audit procedures to independently determine Electronic Data Service's current system capabilities or the programming costs necessary to enable Electronic Data Services to process SCHIP medical claims. We did ask Division of Medical Assistance management if Electronic Data Services could process the program's claims and to estimate any additional cost necessary to make the processing change.

Division of Medical Assistance management told us that they do not expect any system problems should SCHIP claims be processed at Electronic Data Services. In fact, none were encountered when the new-born to five-year-old population was switched from the SCHIP to Medicaid in January 2006. The additional claims from the SCHIP that would be processed by

FINDING AND RECOMMENDATION

Electronic Data Services' system are less than three percent of the current volume of Medicaid claims and should not result in any system capacity problems.

Division of Medical Assistance management estimates that \$250,000 to \$375,000 in programming costs will be necessary to enable the contractor, Electronic Data Services, to process SCHIP claims. The programming costs are minimal when compared to the potential administrative cost savings and additional pharmacy rebates that will be realized annually. Management also estimates that one additional position will be required.

Reasons for Current Claims Processing Arrangement

Any change in administrative responsibility for the SCHIP will require a change in legislation. North Carolina General Statutes assign administrative responsibility for the SCHIP to the Department of Health and Human Services and program claims processing responsibility to the State Health Plan.

Members of the Joint Legislative Health Care Oversight Committee told us that there were several reasons for selecting the State Health Plan to administer the program claims processing during its inception. Recent events, however, indicate that those reasons may no longer be valid for maintaining the current claims processing arrangement.

One reason that the State Health Plan was chosen to administer the SCHIP claims processing was because the State Health Plan and its contractor, BCBS, had a ready platform for processing the SCHIP medical claims. In April of 1998, a special session of the North Carolina General Assembly was called to enact legislation to establish the SCHIP. The North Carolina General Assembly wanted to pass legislation to get the program in place quickly because there was a September 30, 1998 deadline to access federal funding for the program. The plan called for program medical claims to be reimbursed at the State Health Plan rates. Consequently, there was an advantage in processing SCHIP claims through the State Health Plan and its contractor, BCBS. As a result, the State Health Plan was given administrative responsibility over claims and the SCHIP was successfully established before the federal funding deadline.

The advantage in processing program claims at the State Health Plan ended in July 2006, when the reimbursement rates for SCHIP medical claims were changed to agree with Medicaid rates. Since they routinely process the State's Medicaid claims, the Division of Medical Assistance and its contractor, Electronic Data Services, are now in a position to more efficiently process the SCHIP medical claims. As part of its contract to process Medicaid claims, Electronic Data Services remains current with Medicaid rates and policy changes. Remaining current with Medicaid rates and policy changes is not a function that BCBS has historically performed for the State Health Plan. Therefore, if SCHIP claims processing remains with BCBS, the State may incur additional programming and administration costs to compensate BCBS for performing additional responsibilities.

Another reason that the State Health Plan was chosen to administer the program was that State legislators were concerned about provider acceptance. State legislators were concerned that the SCHIP would not be readily accepted by health care providers and that enrollees would

FINDING AND RECOMMENDATION

not receive an adequate quality of care if the program was considered part of Medicaid. By processing program claims through BCBS, it was believed that the program would be viewed the same as any other insurance plan because member cards would be issued under the names of the State Health Plan and BCBS. Association with both the State Health Plan and BCBS was intended to foster provider acceptance and give program enrollees better access to health care.

Association with the State Health Plan and BCBS may no longer significantly influence the quality of care received by SCHIP members. Beginning in July 2006, SCHIP claims are reimbursed at Medicaid rates. Health care providers are more likely to be concerned with the level of reimbursement for their services than with the name of the insurer on the health plan card. Since SCHIP claims are reimbursed at Medicaid rates, it is not likely that association with the State Health Plan and BCBS makes a significant difference in the quality of care provided. Additionally, in January 2006, the new-born to five-year-old population was switched from the SCHIP to the Medicaid program. Division of Medical Assistance management told us that they were not aware of any problems or complaints concerning the quality of care received by the children who were switched to the Medicaid program.

A final reason that the State Health Plan was chosen to administer the program was that State legislators wanted the SCHIP to be maintained separately from Medicaid. Legislators did not want the State to incur additional Medicaid expense. Medicaid expenditures rapidly increased during prior years, and State legislators wanted to make sure that the SCHIP did not worsen the situation. Maintaining the SCHIP separately from Medicaid may no longer be an issue since clear legislation and proper accounting of the sources and uses of federal and State funds has, and should continue, to address this concern.

Conclusion

The SCHIP medical claims should be processed in the most economical and efficient way to minimize administrative costs, maximize available vendor rebates, and eliminate unnecessary cash reserves. Based on the results of our audit, the SCHIP medical claims can be processed more economically and efficiently through the Division of Medical Assistance and its contractor, Electronic Data Services. The Division of Medical Assistance and its contractor currently process the State's Medicaid health claims. Since the reimbursement rates for the SCHIP were changed to agree with Medicaid rates in January 2006, significant reductions in administrative cost can be realized by allowing the Division of Medical Assistance to process claims for the program.

Recommendation: The State Health Plan should propose legislation to move administrative authority for SCHIP claims processing to the Division of Medical Assistance, or take other appropriate action, so that the State can take advantage of available administrative costs savings, additional pharmacy rebates, and the use of cash reserves.

FINDING AND RECOMMENDATION

Agency Response: The State Health Plan administers the SCHIP program, as required by existing statute, on behalf of the Department of Health and Human Services (“The Department”). The State Health Plan will provide any required information to support The Department’s determination of appropriate action regarding this finding.

North Carolina
State Health Plan
Teachers' and State Employees' Comprehensive Major Medical Plan

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July 19, 2007

The Honorable Leslie W. Merritt, Jr., State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Re: Response to July 2007 Performance Audit of the State Children's Health Insurance Program

Dear Mr. Merritt:

Thank you for the opportunity to respond to the Performance Audit of the State Children's Health Insurance Program (SCHIP). On behalf of the State Health Plan and staff, I want to express our appreciation to you and your staff for the time and attention that you devoted to our office during this performance audit.

The State Health Plan administers SCHIP on behalf of the Department of Health and Human Services ("The Department"). North Carolina General Statute 135-42 sets out the undertaking of such administration. The performance audit recently conducted determined certain potential financial impacts to this program. The State Health Plan can not verify the findings; however, should The Department determine appropriate action needs to be taken based on these findings the State Health Plan is prepared to provide any requested information as necessary.

Thank you again for your time and attention.

Sincerely



George C. Stokes
Executive Administrator
North Carolina State Health Plan

GCS: lsm

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