

Issue:	Administrative Expenses Are Higher Than Those In Comparable States
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Condition:

A comparison of North Carolina's Medicaid administrative expenses to those of other comparable states indicates that North Carolina's cost may be higher than necessary. Accountability standards require government programs to operate at the lowest cost necessary to achieve program objectives, and reduced administrative costs could save the State millions of dollars. Although a detailed study of administrative costs has not been performed to definitively identify cost reduction opportunities, two administrative expenses items were identified as a source of potential cost reductions.

Comparisons Indicate Administrative Costs May Be Higher Than Necessary

The North Carolina Medicaid program has higher administrative costs than seven other states with Medicaid programs that make comparable amounts of medical assistance payments.

Table 1 below shows that North Carolina's Medicaid administrative expense of 6.3 percent is almost 1 percent greater than the next highest state Medicaid administrative expense: New Jersey. North Carolina's Medicaid administrative expense is also 2 percent greater than the average administrative expense of the other seven states, which is 4.2 percent.

Table 1: Comparison of NC Medicaid Administrative Expenditures for federal fiscal year 2011

<u>State</u>	<u>Med. Assist. Payments</u>	<u>Admin Expenditures</u>	<u>% Admin Exp to Med. Assist. Pay.</u>
North Carolina	10,297,057,563	648,762,805	6.30%
Arizona	8,988,386,558	155,835,205	1.73%
Georgia	8,064,611,365	400,415,522	4.97%
Massachusetts	13,007,366,707	555,838,633	4.27%

	12,062,932,5		
Michigan	10	515,345,364	4.27%
	8,011,172,21		
Missouri	2	286,268,889	3.57%
	10,501,136,2		
New Jersey	33	571,374,290	5.44%
	7,969,998,38		
Tennessee	9	413,622,139	5.19%

Source: Center for Medicare and Medicaid Services reports and auditor calculations.

The comparisons above indicate that the North Carolina Medicaid program may not be administered as economically as possible.

Government Programs Should Be Operated Economically

The Government Accountability Office (GAO) indicates that government managers should administer programs at the lowest cost necessary to achieve program objectives. Specifically, the GAO states management is responsible for “using its financial, physical, and informational resources legally, effectively, efficiently, **economically**, ethically, and equitably to achieve the purposes for which the resources were furnished or the program was established.”¹

Additionally, federal law indicates that a state’s Medicaid program should be operated economically. Section 1903(a) (7) of the Social Security Act states that each State shall be paid “...an amount equal to 50 per centum of the remainder of the amounts expended during such quarter as found necessary by the Secretary for the **proper and efficient administration** of the State plan.” (Emphasis added by auditor)

Two Administrative Expense Items Identified For Possible Reductions

Auditors did not perform a detailed study of North Carolina’s Medicaid administration expenses for the purposes of identifying cost reduction opportunities. Consequently, the causes of North Carolina’s high administrative expense are not known.

However, auditors noted conditions that indicate contracted administration costs and Medicaid administrative costs incurred in divisions other than the Division of Medical Assistance (Division) are two areas that should be studied to identify potential cost reductions.

First, the Division has exceeded budgeted amounts for contracted administrative costs and interagency transfers (fund transfers to other divisions) for the last four state fiscal years.

The accounts for contracted administrative costs and interagency transfers show that expenditures exceeded the budget by the following amounts:

	2012	2011	2010	2009
Contracted Admin.	\$25.9 million	\$28 million	\$21.4 million	\$37.2 million
Interagency Transfers	\$12.2 million	\$23 million	\$0.5 million	\$18.1 million

Second, Division oversight of contracted administrative costs was weak. The Division paid approximately \$121 million for contracted administrative expenses in state fiscal year 2012. While the Division does monitor contract claims against the overall allowable contract amounts, the Division does not attempt to track current year contract expenditures against current year certified budget amounts by contract to manage contract expenditures to stay within budget. As a result, three months into SFY 2013, the Division discovered it was already over budget in the aggregate.

Third, approximately 65.6 percent (\$425.3 million) of the State's total Medicaid administrative costs are incurred in Department of Health and Human Services divisions other than the Division of Medical Assistance. Of the \$425.3 million in administrative costs incurred by the other divisions, the three (3) divisions that spent the largest amounts were the:

- Division of Social Services at \$230.5 million;
- Division of Mental Health at \$103.1 million; and
- Division of Administration at \$59.4 million.

Although the Division of Medical Assistance has primary responsibility for administering the State's Medicaid program, there is no evidence that the Division monitors or exercises control over administrative expenses incurred by other divisions within the Department of Health and Human Services.

Therefore, an evaluation of contracted administration costs and Medicaid administrative costs incurred in divisions other than the Division may identify some cost reduction opportunities.

Criteria:

See Condition

Cause (may be omitted if not readily determinable):

See Condition

Effect:

See Condition

Recommendation:

The Division should conduct an evaluation of State Medicaid administrative expenses to identify opportunities to reduce administrative costs.

The Division should improve oversight of contracted Medicaid administrative costs and Medicaid administrative costs incurred in other divisions. The Division should compare incurred administrative costs to budgeted costs, analyze significant variances, and report the results of its analysis to the appropriate state officials.

Do you agree or disagree with the finding?

See comments below

Is (are) the recommendation(s) feasible?

See comments below

What would be the cost to implement the recommendation(s)?

See comments below

What are the potential benefits or cost savings? How would they be measured?

See comments below

Comparisons Indicate Administrative Costs May Be Higher Than Necessary

Previous responses were not referenced in the Issue Sheet provided by the State Auditor, nor does it appear the substance of the response was acknowledged or included in the State Auditors findings or comments.

Response provided 11/27/12: DMA provides a pass-through function for other DHHS Divisions to appropriately access federal Medicaid matching funds for administrative functions. Other Divisions with administrative services that support the Medicaid program record expenditures in the NCAS and to draw federal funds. The Cost Allocation Branch of the Controller's Office, in conjunction with Division Budget Offices, maintains comprehensive cost allocation plans (CAP) to ensure accurate and allowable allocations to the Medicaid program. The CAP's are submitted to the U.S. Division of Cost Allocation for distribution to Federal partners including CMS for approval. Expenditures that are eligible for Medicaid federal match are included on the CMS 64 based on amounts recorded in NCAS.

The North Carolina State Auditor's Single Audit covers the Medicaid program each year since it is a major program. The CMS Auditors, based at DMA audits Medicaid costs. There are also CMS program reviews of the CMS 64 report.

One important factor that the Issue Sheet does not recognize is that for the three divisions cited for having excessively high administrative costs, all have expenditures that are not truly divisional administrative costs. For example, of the \$230.5M cited for the Division of Social Services, \$224.1M was paid for County Administration leaving roughly \$6.4M as true divisional administration. \$103.1M was identified as administrative cost for the Division of Mental Health. Of that amount, \$91M was paid to the Local Management Entities (LMEs) with approximately \$12.1M left as divisional administration. Likewise with Central Administration, of the \$59.4M reported as administration, \$39.0 related to special projects such as NC FAST, MMIS and HIT. As such, without these projects, Central Administration would have approximately \$20.4M in administrative cost.

Also, an important factor is that comparing administrative costs with other states is risky in that each state is unique in its organization and the services provided. The elimination of the items cited below would significantly reduce the percentage of administrative expense.

Additional Information: The comparison provided by the State Auditor accurately captures factual information from the comparative states' 2011 CMS 64 reports. However, the comparison is incomplete and misleading. A very important factor is that it does not appear to recognize the administrative cost embedded in capitation rates paid by other states to managed care organizations which results in "an apples and oranges" comparison. For example, 35% of Georgia's expenditures are managed care. The following chart reflects an update to report administrative costs in the capitation payments paid by each state:

	<i>State</i>	<i>Medical Assistance Payments</i>	<i>% Admin Exp to Med Asst Pmt</i>	<i>MCO Adjustment to Medical Assistance Payments</i>	<i>Adj % Admin Exp to Med Asst Pmt</i>
North Carolina	10,297,057,563	648,762,805	6.30%	18,053,164	6.48%
Arizona	8,988,386,558	155,835,205	1.73%	1,079,580,584	13.74%
Georgia	8,064,611,365	400,415,522	4.97%	514,048,432	11.34%
Massachusetts	13,007,366,707	555,838,633	4.27%	321,144,587	6.74%
Michigan	12,062,932,510	515,345,364	4.27%	1,046,878,653	12.95%
Missouri	8,011,172,212	286,268,889	3.57%	139,856,297	5.32%
New Jersey	10,501,136,233	571,374,290	5.44%	331,386,778	8.60%
Tennessee	7,969,998,389	413,622,139	5.19%	1,044,012,253	18.29%

The column entitled “MCO Adjustment to Medical Assistance Payments” reflects the administration cost included in the premiums paid by each state for managed care plans for recipient coverage. The percentages for each state were derived from the medical loss ratios for each state.

The percentage factors used to calculate the additional administrative cost for Georgia, Massachusetts, Michigan, Missouri, New Jersey and Tennessee are from a report published by Milliman in July 2012. The Arizona percentage comes from an Academy of Health report and North Carolina’s percentage is from the actual rate setting formulas used by the state. The percentage applied is based on the Medical Loss Ratio reported for each state.

The above comparison more accurately presents North Carolina as the second lowest in the group identified by the State Auditor.

Finally, North Carolina has been diligent in its efforts to ensure that all appropriate amounts that should be claimed for state Medicaid administrative expenditures are identified and matching Federal dollars are drawn. DMA cannot comment nor has do we have direct knowledge of the process and programs utilized by the states included in the State Auditors Issue Sheet. A much deeper analysis would have to be performed to develop sufficient audit evidence to support a finding. The numbers presented are superficial and cannot be properly compared without a “deep dive” analysis.