PREFERRED HEALTH PARTNERSHIP OF TENNESSEE, INC.

FOR THE PERIOD
JANUARY 1 THROUGH DECEMBER 31, 1994

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June 24, 1996

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
and
The Honorable Bob Corker, Commissioner
Department of Finance and Administration
and
Members of the State Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the report on the compliance audit of the managed care organization (MCO) Preferred Health Partnership of Tennessee, Inc., for the period January 1 through December 31, 1994.

The review of the operations disclosed certain deficiencies which are detailed in the Finding and Recommendation section of the report. This report is intended to aid the Bureau of TennCare in its review to determine whether the MCO has adhered to the terms of the preferred provider organization contract. The Department of Commerce and Insurance should take whatever action it deems appropriate regarding the finding contained in this report.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

cc: Bill Young
Theresa Clarke

State of Tennessee

Audit Highlights

Comptroller of the Treasury   Division of State Audit

Compliance Audit
Preferred Health Partnership of Tennessee, Inc.
For the Period January 1 through December 31, 1994

AUDIT OBJECTIVES

The objectives of the audit were to determine if the managed care organization (MCO) is meeting its contractual obligations, including, but not limited to, proper claims payment, proper accounting for payments from the TennCare Bureau, proper enrollment counts, maintenance of sufficient financial reserves, and recordkeeping sufficient to meet program requirements.

AUDIT FINDING

Insolvency and Deficiency in Financial Reporting
Preferred Health Partnership of Tennessee, Inc. (PHP), according to statutory requirements, is considered insolvent as of December 31, 1994, with adjusted negative equity of ($312,945). PHP has met the requirements of the remaining audit objectives and asserts that its parent company, Fort Sanders Health Systems, has sufficient financial resources to assure sound operation of the company (Page 7).

“Audit Highlights” is a summary of the report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
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COMPLIANCE AUDIT
PREFERRED HEALTH PARTNERSHIP OF TENNESSEE, INC.
FOR THE PERIOD JANUARY 1 THROUGH DECEMBER 31, 1994

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COMPLIANCE AUDIT
PREFERRED HEALTH PARTNERSHIP OF TENNESSEE, INC.
FOR THE PERIOD JANUARY 1 THROUGH DECEMBER 31, 1994

INTRODUCTION

PURPOSE OF THE AUDIT

This report details the results of a compliance audit of the transactions, books, and accounts of Preferred Health Partnership of Tennessee, Inc. The purpose of this audit was to evaluate the programmatic operations of the managed care organization (MCO) in accordance with generally accepted government auditing standards and to determine if Preferred Health Partnership of Tennessee, Inc., was administered in accordance with the requirements of *Tennessee Code Annotated* and the contracts between the state and the MCO. The objectives of the audit were

1. to determine whether the MCO is meeting its contractual obligations under the TennCare agreement with the state;

2. to determine whether the MCO has properly adjudicated claims from service providers and has made payments in a timely manner;

3. to determine whether enrollment counts and categories are accurate and whether monthly payments and withhold amounts from TennCare to the MCO are accurate;

4. to determine if the MCO has sufficient financial capital to ensure uninterrupted delivery of health care;

5. to determine if records maintained by the MCO are adequate to determine compliance with the rules and contract requirements of the Bureau of TennCare; and

6. to recommend appropriate actions to correct any deficiencies.

POST-AUDIT AUTHORITY

This audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform a post-audit of all accounts and other financial records of the state government and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any government entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate. In addition, Section 2-14 of the Contractor Risk Agreement between Preferred Health Partnership of Tennessee, Inc., and the State of Tennessee provides that the books and records "shall be available for review by authorized federal, state, and Comptroller personnel."

SCOPE OF THE AUDIT

The audit examined the records, transactions, and contract provisions of Preferred Health Partnership of Tennessee, Inc., for the period January 1 through December 31, 1994. The audit included tests of insurance claims, review of accounting records, and other auditing procedures considered necessary.

BACKGROUND INFORMATION

Effective January 1, 1994, the State of Tennessee received approval from the U.S. Department of Health and Human Services to begin a five-year Medicaid waiver project which changed most services covered under the Medicaid program to a managed care capitated system. Under the waiver program, known as TennCare, the state contracts with 12 managed care organizations that manage and provide care for enrollees for a stated monthly capitation fee. In addition to recipients eligible under Medicaid criteria, certain uninsured or uninsurable persons may enroll in the TennCare Program. The managed care organizations in turn arrange for a network of hospitals, doctors, and other health care providers to furnish health care services for persons enrolled in the plan.

The Tennessee Department of Finance and Administration is the state agency responsible for administration of the managed care program in Tennessee. The department is authorized to contract with MCOs to provide specified services to people who are or would have been eligible for Medicaid as it was administered during fiscal year 1992-93 and to other Tennesseans who are eligible for and are enrolled in the TennCare system. The managed care organization must

1. be appropriately licensed to operate within the State of Tennessee;

2. demonstrate the existence of a network of health care providers capable of providing comprehensive health care services throughout the community where the plan is offered;

3. clearly demonstrate the capability and intent to provide case management services;

4. assure the availability of service providers outside the community service network for covered services that are not commonly provided in that particular community area;

5. demonstrate sufficient financial capital to ensure uninterrupted delivery of health care on an ongoing basis;

6. demonstrate sufficient financial capital, network capability, and a willingness to accept a reasonable number of enrollees from any failed health plan operating in the community;

7. agree to move to electronic billing for all of its TennCare plans within three years of the effective date of the agreement;

8. unanimously agree with other MCOs in the TennCare system for the provision of pharmacy services to TennCare enrollees who reside in long-term care facilities so that only one pharmacy shall be responsible for their pharmacy services;

9. agree not to require service providers to accept TennCare reimbursement amounts for services provided under any non-TennCare plan operated or administered by the managed care organization; and

10. mutually agree to such other requirements as may be reasonably established by TennCare.

Preferred Health Partnership of Tennessee, Inc., is a wholly-owned subsidiary of PHP Companies, Inc. Effective January 1, 1994, Preferred Health Partnership of Tennessee, Inc., contracted with the State of Tennessee as a preferred provider organization (PPO) to provide medical services under the newly established TennCare program. At December 31, 1994, the enrollment for the plan was approximately 65,000 members.

As a PPO, Preferred Health Partnership of Tennessee, Inc., must establish risk reserves in an amount equal to what would have been required by the Tennessee Department of Commerce and Insurance if Preferred Health Partnership of Tennessee, Inc., had been a health maintenance organization licensed by the State of Tennessee. Also, Preferred Health Partnership of Tennessee, Inc., is allowed to retain up to 10 percent of the monthly capitation amount paid by TennCare as a management fee, with the remainder of the monthly capitation payment available for the payment of covered benefits. TennCare shall not be liable for any excess benefit costs. Any and all excess administrative costs will be borne by Preferred Health Partnership of Tennessee, Inc. In the event of savings, Preferred Health Partnership of Tennessee, Inc., as provided for in Section 2-10(e)(2) of the TennCare contract, is required to share with TennCare a portion of such savings after medical benefits and allowable administrative expenses are paid. The contractor shall be permitted to share 5 percent of the savings with the providers and retain 5 percent for its efficiency. The remainder of the savings shall be returned to TennCare.

This is the first audit of the provisions of the preferred provider organization contract between the State of Tennessee and Preferred Health Partnership of Tennessee, Inc.

RESULTS OF THE AUDIT

Our review of the plan's claims processing system and accounting and financial data revealed discrepancies which are further discussed in the Finding and Recommendation section of the report.

Based on our audit, the capitation payments by TennCare, and the payments by Preferred Health Partnership of Tennessee, Inc., for covered benefits, we have computed a plan loss of $785,867.33 for the year ended December 31, 1994. Schedule 1 exhibits the tentative settlement calculation according to the Division of State Audit. A final settlement will be determined when all transactions for the period under audit have been completed.

Schedule 1

LOSS CALCULATION
FOR THE PERIOD JANUARY 1 THROUGH DECEMBER 31, 1994
PREPARED BY THE DIVISION OF STATE AUDIT

Capitation Amounts Paid by TennCare for 1994 Dates of Eligibility:		
Payable by TennCare in 1994	$70,209,073.29	
Adverse Selection Capitation for 1994	675,933.00	
Retroactive Capitation Adjustment for 1994	3,146,430.87	
Total Capitation Adjustment for 1994 Dates of Eligibility		$74,031,437.16
Less: Management Fee Available (10%)		7,403,143.72
Available for Payment of Covered Services		66,628,293.44
Payments by Preferred Health Partnership of Tennessee, Inc. for Covered Benefits:		
Cash Payments January 1, 1994, through April 12, 1996 for January 1 through December 31, 1994, Services	$68,685,223.77	
Reimbursement by TennCare for First 30 Days of Uninsured Coverage	(1,271,063.00)	
Total Medical Expense		67,414,160.77
Total Loss		($785,867.33)

The loss calculation as computed includes cash payments through April 12, 1996, for calendar year 1994 services. Some payments may still be outstanding for calendar year 1994 services. The claims payable amount at December 31, 1994, was adjusted for actual cash payments at April 12, 1996, for 1994 services. In addition, the calculation does not reduce claims payable by the premium tax amount. The plan had recorded premium tax expense as a reduction of claims payable rather than as premium tax expense.

From the audited financial statements of Preferred Health Partnership of Tennessee, Inc., as of December 31, 1994, the balance sheet reported receivables totaling $4,529,134 due from TennCare for retroactive capitation adjustments and reimbursement for the first month of uninsured coverage. Also, the liability for unpaid TennCare medical claims was reported as $9,483,294. The statement of revenue and expenses for the year ended December 31, 1994, reported total premiums of $7,256,043, interest income of $9,881, operating expenses of $7,240,741, and a net income of $13,296.

Subsequent material events affected the financial statements for Preferred Health Partnership of Tennessee, Inc., for the audit period. A final accounting by the Bureau of TennCare in September 1995 resulted in differences for reported 1994 estimates of money to be received for retroactive capitation, adverse selection, and reimbursement for the first month of uninsured coverage. Additionally, Preferred Health Partnership of Tennessee, Inc., received capitation in 1995 for retroactively enrolled individuals for the calendar year 1994. The net effect of these events was to increase management fee income by $147,101; increase premium receivables by $1,251,766; increase claims payable by $2,076,556; and decrease premium tax payable by $644,650. If the 1994 financial statements were adjusted for claims payments through April 12, 1996, premium tax expense, and final accounting of money from the Bureau of TennCare, total assets would be $12,664,813, total liabilities would be $12,977,758, and stockholders' equity would be ($312,945). Preferred Health Partnership of Tennessee, Inc., does not have sufficient capital to ensure uninterrupted delivery of health care. The adjustments have been reflected in the loss calculation (see the schedule). In April 1996, Preferred Health Partnership of Tennessee, Inc., entered into a capital infusion agreement with Fort Sanders Alliance, a related party. Fort Sanders Alliance agrees to provide the funds necessary to satisfy depository requirements of the Department of Commerce and Insurance provided that the amount shall not exceed $2,100,000.

FINDING AND RECOMMENDATION

INSOLVENCY AND DEFICIENCY IN FINANCIAL REPORTING

FINDING:

Preferred Health Partnership of Tennessee, Inc., is considered insolvent as of December 31, 1994, with an adjusted equity of ($312,945). The plan does not meet risk reserve requirements as specified in the preferred provider TennCare contract.

Section 2-10(e)(4) of the preferred provider TennCare contract states, "The Contractor shall establish risk reserves in an amount equal to the amount that would have been required by Tennessee Department of Commerce and Insurance if the Contractor had been a health maintenance organization licensed by the State of Tennessee."

Section 56-32-201 et seq. of *Tennessee Code Annotated* addresses the statutory requirements for health maintenance organization.

RECOMMENDATION:

Preferred Health Partnership of Tennessee, Inc., should take the appropriate action to achieve positive equity and meet the minimum risk reserve requirements. The Tennessee Department of Commerce and Insurance should take whatever action deemed necessary to ensure that Preferred Health Partnership of Tennessee, Inc., meets the minimum equity requirements.

MANAGEMENT COMMENTS:

As an initial observation, Preferred Health Partnership of Tennessee, Inc. ("PHP"), would like to reaffirm its commitment to the success of the TennCare program. PHP has established its ability to provide quality, comprehensive health care services to TennCare enrollees. Both PHP and its parent and affiliated organizations have demonstrated the management and financial strengths necessary to assure continued successful operation as a TennCare MCO.

PHP respectfully takes issue with some of the conclusions and inferences in the audit report for the period ending December 31, 1994. Specifically, PHP offers the following points:

(1) The report appears to disagree with the manner in which premium tax liability has been handled by PHP. As an initial comment, PHP observes that there, in fact, exists no statutory authority to impose a premium tax on PHP. This issue, however, has been resolved with the State through a negotiated settlement.

To extent that PHP has incurred premium tax liability, its method of accounting is correct and consistent with how all managed care plans handle premium taxes. The liability for premium tax is a direct, front-end expense that is paid before any funds are available for sharing with providers. Since the amounts paid for premium taxes are never available for provider payments, such amounts cannot be properly taken into account in determining calculation of any claims savings.

(2) PHP disagrees with the deficiency indicated as of December 31, 1994. The determination of the deficiency does not take into account a substantial receivable that PHP had from its providers. PHP was permitted by the TennCare Division to treat this receivable as an asset in 1995, and if 1994 is handled on a consistent basis, there would be no negative net worth, and the actual net worth of PHP as of December 31, 1994, would be $14,296.

(3) PHP believes that the conclusions in the audit report relating to risk reserves are incorrect. The audit report quotes the TennCare contract as stating that contractor shall establish risk reserves in an amount equal that required for a health maintenance organization. Section 2-10(e)(4) of the TennCare Preferred Provider Contract specifically states that such reserves are "[to] cover the cost of catastrophic illnesses." As has been discussed previously with the TennCare Division, PHP is not exposed to the risk of any catastrophic illnesses because the providers bear the risk under the contract. Since PHP is not bearing any risk of any catastrophic illnesses, it is illogical to require it to establish reserves.

(4) The audit report seems to suggest that PHP is subject to a minimum net worth requirement beyond the minimum statutory deposit required by *Tennessee Code Annotated*, Section 56-32-212. The deposit obligation has been fulfilled by an agreement with PHP's parent, Fort Sanders Health Systems. PHP is unaware of any statute or regulation that establishes additional minimum net worth requirements for health maintenance organizations. In any event, PHP, together with its affiliated and parent organizations, possesses more than adequate capital to assure the sound operation of PHP.

REBUTTAL:

The Division of State Audit believes that the premium tax should not be a reduction in the amount available to pay medical claims but should be included in the allowable 10% management fee. The Division of State Audit takes no position on the imposition of a premium tax on Preferred Health Partnership of Tennessee, Inc. The applicability of the tax is the responsibility of the Department of Commerce and Insurance.

The 1994 audited financial statements of Preferred Health Partnership of Tennessee, Inc., did not include a receivable from providers. There is no evidence that any monies have been or will be collected from providers.

Although contract section 2-10(e)(4) does mention catastrophic illnesses in reference to risk reserves, section 2-2(f) requires a preferred provider organization to maintain the same risk reserves as a health maintenance organization in order to assure uninterrupted

services to recipients. The risk reserve requirement in section 2-2 must be met before an organization can qualify as a TennCare managed care organization.

Preferred Health Partnership of Tennessee, Inc., is not required to maintain reserves in excess of what is required by the TennCare Program.