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SERVICE COOPERATIVES' INSURANCE PROGRAMS SPECIAL REVIEW

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EXECUTIVE SUMMARY

Report Summary:

The State Auditor's Office conducted a review of the contractual practices of eight regional cooperatives created pursuant to state law. These cooperatives provide 700 entities, including school districts, cities, counties and other local government entities, with healthcare insurance services for 59,000 employees. By using the negotiating process that accrues to larger purchasers, these cooperatives are supposed to reduce the cost of providing employee health insurance. However, the Auditor found for some of the cooperatives that the use of consulting contracts, diversion of administrative fees, use of vendor payments for lobbying expenses, underfunding of reserve accounts, and entanglement with their current carrier may be preventing some of the cooperatives from fulfilling their statutory purpose.

Seven cooperatives hired a Consultant to perform a list of general and vaguely defined services. Under these contracts, the Consultant has received on average \$600,000 per year, for each of the past five years. Since at least 2003, the Consultant also has a contract with BlueCross/BlueShield of Minnesota (the Blues). Under this contract, the Consultant is able to receive \$8,928 quarterly for each of the seven cooperatives to which he provides services for the Blues. Under this contract, the Consultant could receive almost \$250,000 per year, and the Blues can reduce the amount the Consultant receives if the Blues stop doing business with the cooperatives, or if business with the cooperatives declines more than 50 percent.

Seven cooperatives have entered into five-year contracts with the Blues.

The existence of the contract between the Consultant and the Blues was apparently disclosed to the cooperatives and a written acknowledgement was signed by six executive directors of the cooperatives and a representative of a non-profit organization connected with the seventh.

Serious doubts are raised as to whether the Consultant can represent the best interest of the cooperatives in finding the best health insurance carrier for their needs, while simultaneously being paid \$250,000 a year by the insurance carrier interested in maintaining the cooperative's business.

Administrative Fees

Under the operating agreements between the cooperatives and the Blues, both the cooperatives and the Blues are paid an administrative fee for the healthcare insurance program.

The joint powers agreement between the school districts and the cooperatives provide that all program funds received by the service cooperatives can only be used for group employee benefits. Because these agreements specifically authorize the payment of an administrative fee, five of the cooperatives do not consider the fees to be program funds subject to the requirement that they would be used for the employee insurance program. These cooperatives spend part of their fee on community education, recognition banquets, and extra-curricular activities. Money contributed by employees and their employers for health insurance should not be diverted by the cooperatives to other programs. The diversion of employee health insurance fees to other projects disguises the true costs of health insurance.

Service Fees/Research and Development (R&D) Fees

Seven of the service cooperatives received a monthly fee from the Blues for "research and development activity," including the development of a "Network." Essentially, the Blues are paying the cooperatives part of the health insurance premiums paid by local public entities. The cooperatives provided the State Auditor's Office with documents indicating that the Network donated to them by Consultant was, in fact, a limited liability company Consultant had formed in 2001. In November 2002, the cooperatives were assigned membership in the limited liability corporation. Amounts paid under these provisions are placed in a research and development (R&D) account: \$442,798 was placed in the R&D account in 2003 by the Blues, and \$427,583 was placed in the R&D account in 2004 by the Blues and by the cooperatives themselves. Among other expenditures, funds from this account were used for lobbying. In 2001, the cooperatives created the Minnesota Multi-Regional Service Agency (MRSA), and the R&D account appears to have been made available to MRSA for lobbying contracts. On one of the cooperative's financial statements, the R&D account is identified as an account for "Minnesota Service Cooperatives" (MSC). The Auditor was informed that the MSC was an informal confederation of service cooperatives that no longer exists. The MSC reported the lobbying expenditures to the Campaign Finance Board. It is not clear from the documents whether lobbyists paid from the R&D account were representing the Minnesota Multi-Regional Service Agency, an informal confederation of the seven service cooperatives, or the limited liability company. The State Auditor questions whether the service cooperatives can operate a limited liability company where Minnesota state law specifically prohibits public entities from creating corporations. The State Auditor recommends that lobbying expenses be paid for by the entity entering into the lobbying contracts. The cooperatives should not act as an "informal confederation" when expending public funds.

Reserve Funds

As self-insured entities, the service cooperatives are required to create and maintain reserve accounts. Once these reserve accounts are fully funded, they act as cushions against unexpected claims. It appears that some of the cooperatives are not monitoring reserves, but are relying almost exclusively on information provided to them by the Blues.

The service cooperatives should constantly evaluate the performance of their health plans, including monitoring reserve amounts and obtaining independent reviews of the reserve amount calculations. The reserve amount should be fully funded. Some of the cooperatives could use the amounts they are currently spending from administrative fees on non-insurance-related purposes to fully fund their reserves and to provide better monitoring over the reserves and renewal rates.

Financial Statement Reporting

The State Auditor found that there is a great inconsistency in the way the insurance risk pools financial statements are reported. The State Auditor recommends that service cooperatives work closer with their auditors to more accurately report insurance risk pool activity in conformance with generally accepted accounting principles. Under these principles, these pools should be reported as enterprise funds in a service cooperative's financial statements.

Public Access to Information

The Auditor found that the cooperatives have contractually agreed with the Blues that they would not reveal any information under the agreement without the written consent of the Blues. This and other provisions of their contract attempt to make secret many of the public activities of these cooperatives in violation of the Minnesota Data Practices Act. At least one service cooperative has taken the position that anything related to "claims" is private under the Data Practices Act. In a recent decision by the Department of Administration, the Commissioner determined that this approach to secrecy is not warranted by the language of the Minnesota Data Practices Act. Some of the cooperatives' reluctance to share public information was further evidenced in the cooperatives' response to requests for financial information by the Office of the State Auditor. Two cooperatives provided information directly, while six others operated through their attorneys, expending considerable attorney fees in response to requests for information. The cooperatives are public entities, the contracts they enter into are public contracts, and the funds they expend are public funds. Public entities are required by law to respond to requests for information by the public and to provide requested financial information to the State Auditor.

The cooperatives must conduct their business in a more public and transparent manner, and discontinue any current practice that frustrates the attempts of the public and the state to gain financial information from them.

Competitive Concerns

The service cooperatives informed us that they did not use the Consultant to draft the RFP requests and to review the RFP responses from health insurance carriers in 2002. However, review of the cooperative minutes indicates that the Consultant was involved in the RFP process, and it was part of his defined contractual duties.

When the Consultant donated the Network to the cooperatives, the Blues began paying the cooperatives to maintain and develop the Network, and incentives were built into the arrangement promoting the service cooperatives ongoing contracting with the Blues. The cooperatives need to evaluate their relationship with the Blues and open up the process to allow more vendors an opportunity to do business with the cooperatives. This cannot be done unless potential vendors are given complete and accurate data upon which to base their proposals to the cooperatives. The Auditor recommends that the cooperatives more frequently use an RFP process for its insurance carriers, allowing all qualified vendors an equal opportunity to do business with the cooperatives.

Recently, three large school districts have dropped out of a service cooperative and sought health insurance for their employees separately. All three of these districts were able to find fully-insured programs that cost less than the service cooperative's self-insured program. Service cooperatives should be able to provide lower costs. The experience of these school districts offers more evidence that the cooperatives need to open up their process so that market forces are allowed to help contain the ever-rising price of health insurance for public employees. Increasing competition for those services, as well as increasing transparency and monitoring of their health insurance contracts, will help the service cooperatives provide greater benefit to affected school districts, their employees, and ultimately taxpayers.

Major Findings:

- Seven of the service cooperatives together paid on average \$600,000 per year for each of the last five years to a Consultant whose duties under the contract included developing bid specifications for the contract process through which the cooperatives select a health insurance carrier. Since at least 2003, the same Consultant has had a contract to receive approximately \$250,000 a year from BlueCross/Blue Shield of Minnesota (the Blues), conditioned on the Blues' continued business with the cooperatives. The Auditor found that the five-year contracts between the cooperatives and Consultant did not adequately define the Consultant's duties, establish performance measurements, and were orally modified to increase the compensation paid to Consultant by each cooperative. The Consultant's apparent conflict of interest was acknowledged by the executive directors of six of the cooperatives. The Auditor found no evidence that the apparent conflict was waived by the governing boards.

- The cooperatives are required to spend program funds on healthcare activities. The cooperatives receive back from the Blues an administrative fee for the health insurance program. The annual amount of this administrative fee received by all of the cooperatives is approximately \$7 million. Five of the cooperatives do not consider these funds to be limited to healthcare expenditures, so some of these health insurance administrative fees are spent on activities unrelated to health insurance such as community training, employee banquets, and extra-curricular activities.
- The Blues pay seven of the cooperatives a “research and development fee” (R&D). The payments appear to be paid due to the cooperatives’ membership in a limited liability company. During 2003, \$442,798 was placed into the R&D account by the Blues. During 2004, \$427,583 was placed in the R&D account by the Blues and the service cooperatives. The cooperatives created the Minnesota Multi-Regional Service Agency (MRSA) in 2001, and this organization entered into lobbying contracts and approved the creation of a political action committee (PAC). The R&D account, consisting of health care Network dollars, is used to pay for lobbying expenses.
- Several of the reserve accounts maintained to support health insurance costs are under-funded and are not monitored adequately by some of the cooperatives. Some of the cooperatives rely too heavily on the Blues year-end reporting and do not regularly and independently monitor the insurance reserves.
- The secrecy to which the cooperatives have agreed in their contract with the Blues is inconsistent with the Minnesota Government Data Practices Act. The contract between the cooperatives and the Blues indicates that, in all matters regarding the agreement, information cannot be released without the consent of the Blues. The reluctance to readily share information continued in the contacts between some of the cooperatives and the State Auditor’s Office, with most of the cooperatives dealing only through their attorneys. Some of these attorneys asserted that the operating agreements themselves were trade secrets that could not be made public. Public entities cannot make such agreements and thereby shield their activity from public scrutiny under the terms of the Minnesota Data Practices Act.
- The Blues have consistently been the insurance carrier contracting with the cooperatives. A Network donated by Consultant and Network fees paid by the Blues to seven of the cooperatives appear to further entangle the cooperatives with the Blues. In the past two years, three large school districts left one of the service cooperatives and obtained complete medical insurance for their employees at rates less than the amounts they were paying for self-insurance under the current cooperative-Blues contract.

Key Recommendations:

- All consultants should be required to fully disclose any contracts they have with cooperative vendors or other related parties. Cooperatives should only approve such conflicts of interest after full disclosure and a vote of the governing board. All consultant contracts should describe in detail the project, and contain measurable performance standards. Policies and procedures should be adopted to ensure arm-length transactions, and contracts should contain clauses and conditions required by state law.
- Administrative, service, and any other health insurance fees, should not be diverted to non-insurance uses, and all transfers of insurance funds should be reflected on the cooperative's financial statements. The cooperatives should not operate through limited liability companies and "loosely-knit confederations."
- Reserves should be independently monitored and maintained at adequate levels. The cooperatives need to better track claims data and other components of their reserve funds.
- The public should be permitted access to financial information pursuant to the Minnesota Data Practices Act.
- Ways to increase competition during the insurance carrier selection process should be explored.