



A REPORT
TO THE
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Performance Audit Division

Performance Audit

Arizona Health Care Cost Containment System

Medical Services Contracting

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Debra K. Davenport
Auditor General

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Audit Staff

Dale Chapman, Manager and Contact Person

Jay Dunkleberger, Team leader

Jessica Tucker

Kirk Jaeger

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 5, 2002

Members of the Arizona Legislature

The Honorable Jane Dee Hull, Governor

Ms. Phyllis Biedess, Director
Arizona Health Care Cost Containment System

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Arizona Health Care Cost Containment System (AHCCCS)—Medical Services Contracting. This report is in response to an August 9, 2001, resolution of the Joint Legislative Audit Committee and under the authority vested in the Auditor General by A.R.S. §§41-1279 and 41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

This audit is the third in a series of five audits of AHCCCS. As outlined in its response, AHCCCS agrees with the finding and recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on September 6, 2002.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

SUMMARY

The Office of the Auditor General has conducted a performance audit examining the Arizona Health Care Cost Containment System's (AHCCCS) contracting process for healthcare services. AHCCCS administers healthcare programs for more than 700,000 Arizona residents. This audit, as part of a Sunset review of the Agency, was conducted pursuant to an August 9, 2001, resolution of the Joint Legislative Audit Committee and under authority vested in the Auditor General by Arizona Revised Statutes (A.R.S. §§41-1279 and 41-2951 et seq). It is the third in a series of five audits of AHCCCS. Other audits in the series cover the Division of Member Services, rate-setting processes, quality of care, and an evaluation of the Agency using the criteria in Arizona's Sunset law.

AHCCCS administers healthcare principally through a managed care system involving contracted healthcare plans. AHCCCS pays these plans a negotiated rate to coordinate medical services for each AHCCCS member enrolled in the plan. The goals of its procurement process are to obtain a high-quality healthcare delivery network, increase members' healthcare choices, and reduce costs through competition. In fact, in a 1995 report, the United States General Accounting Office praised AHCCCS' successful efforts to reduce costs through contracting and competition. In state fiscal year 2001, AHCCCS spent approximately \$2.9 billion, from both federal and state funds, on its two largest healthcare programs.

- **Acute Care Program**—AHCCCS contracts with ten health plans to deliver acute care services such as hospital and outpatient services to specific areas of the State. During fiscal year 2002, AHCCCS paid these plans nearly \$1.9 billion in fees. As of July 2002, they were delivering care to over 650,000 members.
- **Long-Term Care Program**—AHCCCS contracts with eight different health plans to provide long-term care services, such as home- and community-based services, and nursing home care to the elderly, and the developmentally or physically disabled. This program, called the Arizona Long-Term Care System, or ALTCS, delivers care to over 33,000 elderly, physically, or developmentally disabled members. In fiscal year 2002, AHCCCS paid these plans nearly \$1 billion in fees.

In state fiscal year 2002, AHCCCS spent nearly:

- \$1.9 billion on acute care services
- \$1 billion on ALTCS services.

AHCCCS has:

- Over 650,000 acute care members
- Over 33,000 ALTCS members.

Contracting process needs minor improvements (see pages 7 through 13)

Exempt from procurement requirements, AHCCCS developed its own practices, including:

- Issuing RFPs
- Meeting with potential offerers.

AHCCCS has an appropriate process for procuring its medical services that could be improved through additional policies and procedures. Although AHCCCS is exempt from following state procurement statutes, its process closely mirrors state requirements and incorporates various options allowed under state guidelines. For example, AHCCCS is consistent with state law in issuing requests for proposals (RFPs) that tell potential contractors what to submit in their proposals, what services they must provide, and how their proposals will be scored. Options allowed under state law and adopted by AHCCCS include issuing requests for information to obtain health plan capabilities and other market information, and holding pre-proposal conferences. AHCCCS' process is also consistent with federal contracting practices, while AHCCCS contractors report that elements of the process are similar to procurement processes used by other state and federal organizations.

While the process is appropriate, it would be improved if guidelines and policies were developed or more clearly documented in several areas. First, AHCCCS should establish general policies and procedures to help guide its procurement process. For example, AHCCCS has not developed policies or procedures defining its medical services procurement process, scheduling and scoring guidelines, and specific responsibilities of AHCCCS divisions and offices in the process. Written procedures, which exist for other types of AHCCCS procurements and which are common across other agencies, would help AHCCCS consistently follow its practices. Second, AHCCCS should ensure that it adequately documents how current contractors' performance is being evaluated when future procurements are under consideration. At present, this evaluation is not fully documented. Third, AHCCCS should include evaluations of current contractors' performance in its procurement process for long-term care (ALTCS). Such evaluations currently are in place only for acute care procurements, though AHCCCS has begun to address how they can be extended to ALTCS plans as well.

Finally, in addition to developing policies and procedures regarding its procurements, AHCCCS should also develop an agency-wide system to track and maintain contract documentation. Maintaining contract documentation is important to ensure AHCCCS' ability to properly oversee its medical services contracts. However, auditors' limited review indicated that tracking documentation may be a problem. A review of one health plan's contract files found eight missing contract compliance and performance documents dating from March 1997 to December 2001.

Other pertinent information (see page 15 through 18)

Because reducing costs through competition is a goal of the procurement process, auditors gathered information about competition in managed care contracts both in Arizona and nationwide. Although 48 states use managed care contracts to provide healthcare services for at least a portion of their Medicaid populations, Arizona goes further than most states because it has adopted a statewide managed care system for its acute and long-term care populations. Nationally, states report that fewer health plans have been competing for managed care contracts.¹ This has caused some states to stop providing comprehensive services under a managed care approach. By comparison, Arizona has been more successful in attracting competition. AHCCCS contracts with seven private and three public health plans for its acute care program, which is above the national average. Further, for AHCCCS' last acute care contract, there were more proposals submitted than awards issued in all but one of the State's nine contracting areas.

Although AHCCCS has been relatively successful generating competition in the acute care program, it is having more difficulty in finding contractors for its ALTCS program. Few other states provide statewide long-term care services within a managed care model, possibly limiting the number of health plans capable of providing managed care long-term services. Additionally, until the federal fiscal year 2001 ALTCS procurement, counties had the right of first refusal to contract with AHCCCS to provide long-term care services. According to AHCCCS officials, this may have discouraged private companies from bidding on this program or developing the capability to provide long-term care services in a managed care setting.

One step that AHCCCS has taken to increase contractors' interest in both programs has been to increase the size of geographic areas covered by contracts. Concerned that reduced revenues, potentially higher medical costs, and a limited number of providers in rural counties would discourage organizations from submitting bids for these areas, AHCCCS switched from a county-by-county approach to one that increases the population in contract areas by combining some counties to form nine geographic service areas for the acute care program and seven for the ALTCS program.

AHCCCS employs a reasonable method for determining the number of contracts to issue in each of these geographic service areas. While AHCCCS bases this initial estimate on population factors, it can change the number of contracts it issues on a case-by-case basis as it reviews contract proposals.

¹ Neva Kaye, *Medicaid Managed Care: A Guide for States*. Portland: National Academy for State Health Policy, 2001.

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit of the medical services contracting practices of the Arizona Health Care Cost Containment System (AHCCCS) as a part of a Sunset review of the Agency. This audit was conducted pursuant to an August 9, 2001, resolution of the Joint Legislative Audit Committee. The audit was conducted under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §§41-1279 and 41-2951 et seq. This is the third in a series of five audits of AHCCCS. The remaining audits in this series will cover quality of care and agency-wide Sunset factors, while previous audits addressed the Division of Member Services, and rate-setting processes.

Contracting an important AHCCCS function

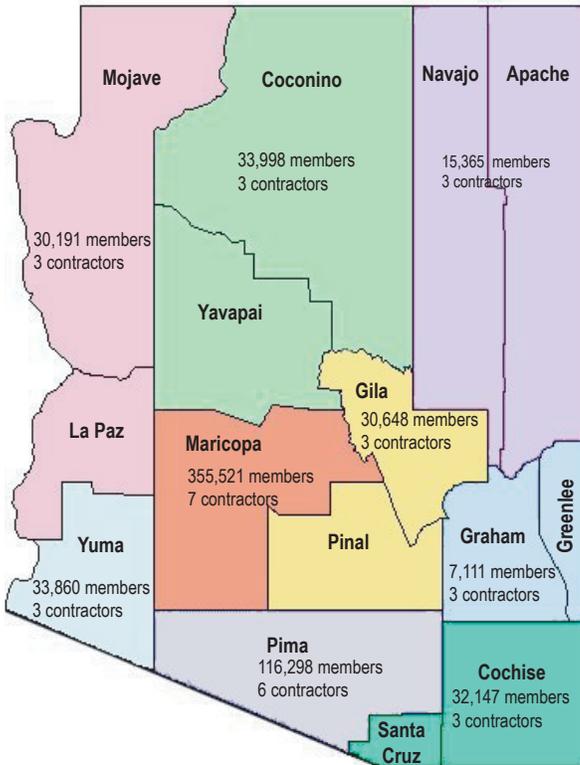
The primary goals of AHCCCS' healthcare services contract procurement process are to obtain a high-quality healthcare delivery network, increase choice for its members, and reduce costs through competition. To fulfill these goals, AHCCCS contracts with various public and private organizations (health plans) that provide medical services through the acute care and Arizona Long Term Care System (ALTCS) programs. Contracts for both programs are effective for 5 years and renewed annually. AHCCCS divides the State into nine Geographic Service Areas (GSAs) for acute care (hospital and outpatient services for patients eligible under federal Medicaid and state healthcare programs) and seven GSAs for long-term care (care provided to the elderly, physically, or developmentally disabled). (See Figure 1 [page 2] for acute care, and Figure 2 [page 3] for ALTCS GSAs). Each GSA is served by one or more health plans.

AHCCCS uses a statewide managed care approach, under which it pays its health plans a fixed payment per member to cover the costs of providing a network of physicians, laboratories, hospitals, and long-term care services. In state fiscal year

In 2001, AHCCCS paid approximately \$2.9 billion to acute care and ALTCS contractors.

Figure 1

Acute Care
Membership and Number of Contractors¹
by Geographic Service Area
As of July 2002



¹ Number of contractors includes a statewide contract with the Department of Economic Security, Comprehensive Medical and Dental Program for medical and dental services to AHCCCS members.

Source: Auditor General staff analysis of information from the Arizona Health Care Cost Containment System's Web site: www.AHCCCS.state.az.us.

2001, AHCCCS paid over \$2.2 billion, from both federal and state funds, to acute care and ALTCS health plans as detailed below:

- Acute Care**—AHCCCS contracts with a total of ten health plans that operate in one or more GSAs. During state fiscal year 2002, AHCCCS paid these plans approximately \$1.9 billion for healthcare services. The acute care program was established in 1982 and offers services including physician care, hospitalization, and pharmacy benefits to AHCCCS members. As of July 2002, AHCCCS' acute care health plans were delivering care to over 650,000 members. AHCCCS conducted the most recent procurement for its acute care program in federal fiscal year 1998, and is currently planning its next procurement for federal fiscal year 2004.
- Long-Term Care (ALTCS)**—AHCCCS contracts with eight different health plans that operate in one or more GSAs. In fiscal year 2002, AHCCCS paid these plans nearly \$1 billion. As of July 2002, AHCCCS' ALTCS health plans were delivering care to over 33,000 members. The Legislature established this program in 1987 and AHCCCS began providing long-term care services, such as home- and community-based services and nursing home care, to the developmentally disabled in 1988. These services were extended to the elderly or physically disabled in 1989. Statute permits AHCCCS to contract with other state and county agencies or private health plans to provide these services to its ALTCS members, although counties had the right of first refusal to contract with AHCCCS until October 2000, when Laws 1997, 2nd S.S. Ch. 2 §§11 and 13 eliminated this right. However, statute does currently require

AHCCCS to contract with the Department of Economic Security's Division of Developmental Disabilities to provide services to the developmentally disabled. The most recent ALTCS procurements were conducted in federal fiscal years 2001 and 2002. AHCCCS conducted two separate procurements—one exclusively for Maricopa County in federal fiscal year 2001, and another in federal fiscal year 2002 for the remaining counties in the State. The Maricopa County procurement marked the first time AHCCCS had conducted a competitive procurement with multiple awards for the State's most populous county, and AHCCCS management decided to issue the contract separately due to the work involved in adding new contractors and reassigning members. AHCCCS is currently in the preliminary stages of planning its next ALTCS procurement for all areas of the State in federal fiscal year 2005.

AHCCCS contracting recognized for reducing costs

A federal study conducted by the General Accounting Office (GAO) praised AHCCCS' successful efforts to reduce costs through contracting and competition. Specifically, in 1995, the GAO reported that AHCCCS had succeeded in containing healthcare costs and that competitive bidding is an effective tool for encouraging contractor participation.¹ According to the GAO, during fiscal year 1991 alone, AHCCCS saved the federal government \$37 million and the State of Arizona \$15 million in acute care costs. Overall, the GAO concluded that AHCCCS had developed effective and cost-efficient contract monitoring and procurement practices.

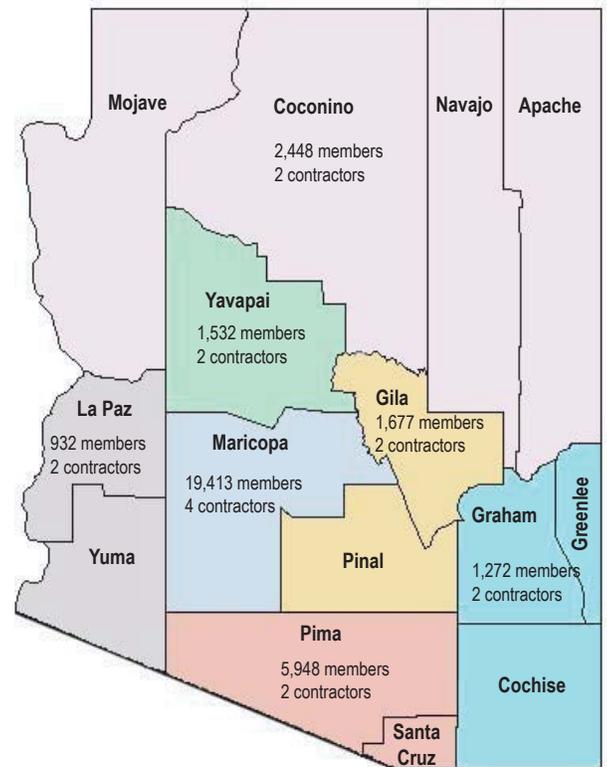
Divisions responsible for contracting

Because it is exempt from the state procurement code for medical service contracts, AHCCCS has developed its own steps for competitive contract procurements for its acute care and long-term care programs. Several organizational units within AHCCCS are involved with contract procurements:

- **Office of Managed Care (OMC)**—AHCCCS' Office of Managed Care is the Agency's primary contact with healthcare contractors, and has several key procurement and contracting responsibilities. Specifically, this Office coordinates procurements, working with other divisions involved with healthcare contracting to develop contract and request for proposal language, and to score and evaluate proposals. Additionally, Office staff negotiate contract terms and monitor the contractors' operational and financial performance through regular review of their financial statements and other required reports, as well as onsite reviews.
- **Division of Business and Finance (DBF)**—The Division is responsible for providing a variety of administrative functions for AHCCCS including developing the budget, processing claims and payroll, and administering contracts. A separate contracts and purchasing unit within the Division is responsible for maintaining some contract records for acute care and long-term care services,

Figure 2

Long-Term Care
Membership and Number of Contractors¹
by Geographic Service Area
As of July 2002



¹ Number of contractors includes a statewide contract with the Department of Economic Security, Division of Developmental Disabilities to provide behavioral health services to AHCCCS members. AHCCCS is required under §36-2940 to issue this contract to the Department.

Source: Auditor General staff analysis of information from the Arizona Health Care Cost Containment System's (AHCCCS) Web site: www.AHCCCS.state.az.us.

¹ United States General Accounting Office (GAO). Report to the Chairman, Committee on Commerce, House of Representatives. *Arizona Medicaid: Competition Among Managed Care Plans Lowers Program Costs*. Washington, D.C.: October, 1995.

working with OMC to coordinate contract procurements, and serving as the health plans' main point of contact during the procurement. In addition, this Division helps to train and advise AHCCCS staff during procurements.

Two other AHCCCS offices provide technical assistance during contract procurements. Specifically, the Office of Medical Management (OMM) ensures that quality-of-care requirements are appropriately reflected in the requests for proposals (RFP) and participates in proposal scoring and evaluation. Staff within the Office of Policy Analysis and Coordination (OPAC) track changes in federal and state legislation to ensure that AHCCCS and its health plans meet legal requirements. In addition, staff from this Office help review final contracts to ensure all federal and state requirements are addressed, and participate in the evaluation of contract proposals.

Once proposals are scored and evaluated, the proposal evaluation teams present their findings and recommendations to AHCCCS' Executive Council for Contracting, which is composed of the director, deputy director, and executive managers from the major AHCCCS divisions such as DBF, OMC, OMM, and OPAC. The Council is responsible for reviewing and approving major management issues, including health services contract awards.

Audit scope and methodology

This audit focused primarily on AHCCCS' contract administration and procurement practices for its acute care and ALTCS medical services contracts. Auditors reviewed the practices used to administer and manage contracts, develop RFPs, and evaluate and score current and potential contractor proposals, and reviewed how AHCCCS promotes and fosters competition within its managed care system.

This report contains one finding regarding AHCCCS' contract administration and procurement practices for medical services. Specifically, while AHCCCS' steps for contract procurement appear appropriate, it should establish policies and procedures detailing these steps and improve its system for maintaining contract records. In addition, this report contains other pertinent information regarding managed care competition both nationally and in the State, and AHCCCS' attempts to foster competition in its managed care system.

Auditors used a number of methods to study the issues addressed in this report. These include reviewing available policies and procedures related to contract administration and procurement; reviewing nine acute, ALTCS, and other medical and nonmedical services contract files; and interviewing AHCCCS staff responsible for contract administration, as well as experts in the field of managed medical care.

While its procurement process is appropriate, AHCCCS should establish policies for its process.

Additionally, auditors reviewed applicable statutes and rules. The following methods were also used:

- To determine the adequacy of AHCCCS' contract administration and procurement practices, auditors reviewed the federal fiscal year 1998, 2001, and 2002 RFPs for acute care and ALTCS; four acute care health plans' federal fiscal year 1997 performance reviews conducted by AHCCCS staff to assess compliance with contracted requirements called Operational and Financial Reviews (OFRs) as well as the associated proposal scoring sheets; internal AHCCCS memos related to the scoring and evaluation process; and one acute care health plan's contract documentation and associated correspondence. Finally, auditors interviewed the consultant AHCCCS hired to review the procurement evaluation process for both the acute care and ALTCS programs, and officials from the State Procurement Office.
- To assess the status of managed care competition in Arizona and nationally, auditors reviewed internal AHCCCS issue papers discussing acute and long-term care contract selection, and AHCCCS' efforts in 1996 and 2000 to develop GSAs, and reviewed past evaluations of AHCCCS' contracting process. In addition, auditors reviewed several major studies involving the managed care market including *Medicaid Managed Care: A Guide for States* by the National Academy for State Health Policy (May 2001), *Partnership Pays: Making Medicaid Managed Care Work in a Turbulent Environment* by the Center for Health Care Strategies (May 2000), and *Trends in Health Plans Serving Medicaid—2000 Data Update* by the Kaiser Commission on Medicaid and the Uninsured (November 2001).

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the director and staff of the Arizona Health Care Cost Containment System, the Division of Business and Finance, the Office of Medical Management, and the Office of Managed Care for their cooperation and assistance throughout this audit.

FINDING 1

Contracting process needs minor improvements

AHCCCS has an appropriate procurement process for its medical services contracts, but this process would be improved if certain guidelines and policies were developed or more clearly documented. AHCCCS' process for awarding and administering contracts for acute and long-term care medical services reflects contracting procedures adopted in state statute and by federal agencies. However, aspects of this process are not well explained or documented, making it more difficult to ensure that the process is followed consistently and thoroughly. AHCCCS should develop better guidance for conducting various procurement steps and evaluating current contractors' performance. Finally, AHCCCS should develop an agency-wide system to track contract documentation and correspondence.

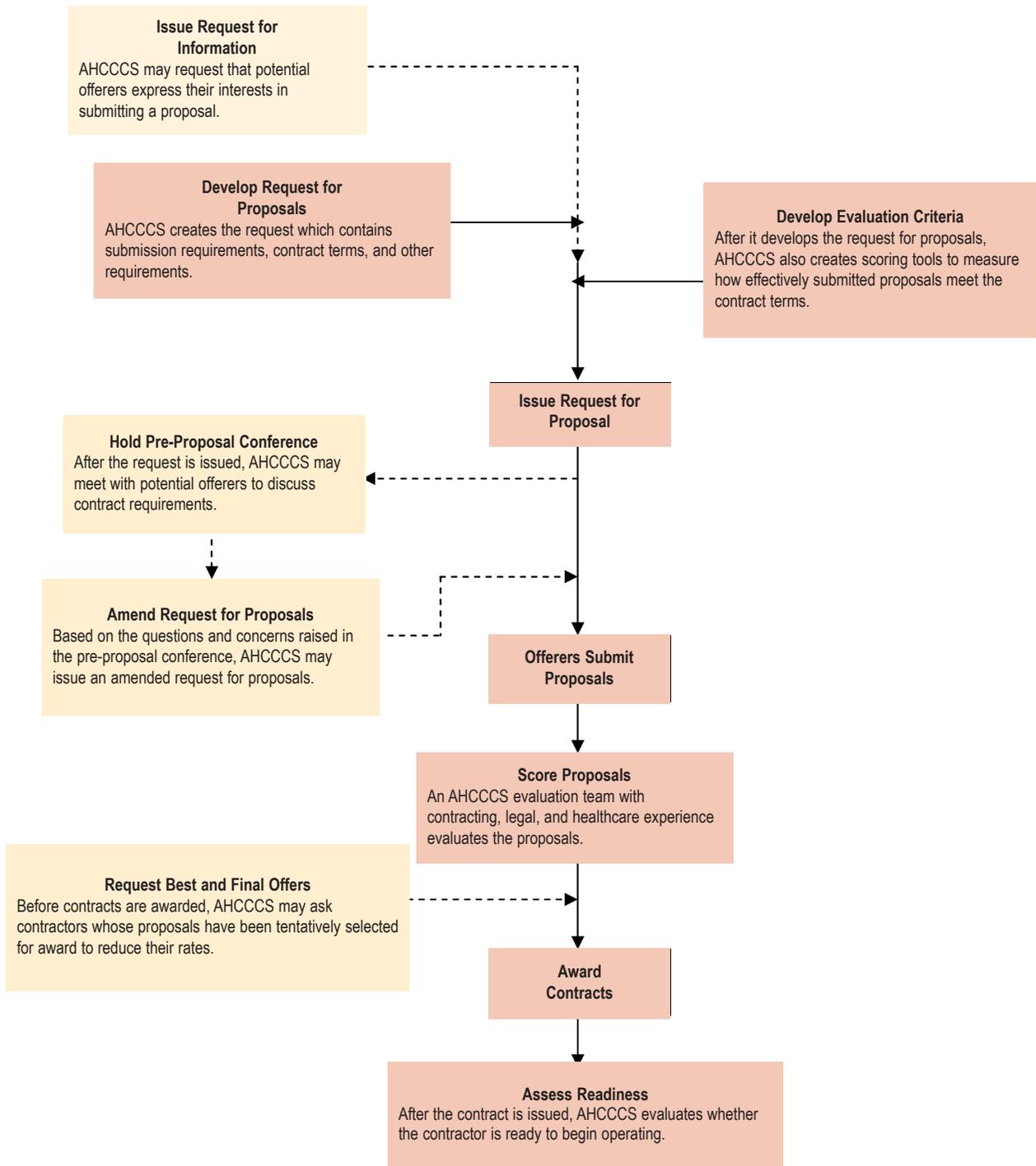
Process consistent with state and federal policies

AHCCCS' process for awarding and administering contracts for acute and long-term care medical services is appropriate. Although AHCCCS is exempt from following state procurement statutes, its process closely mirrors state requirements and incorporates various options allowed under state guidelines. AHCCCS' process is also consistent with contracting practices incorporated into federal regulations, and contractors considered it to be a good process.

Process generally conforms to statutory requirements—AHCCCS has chosen to use a process consistent with the requirements imposed on other state agencies. Unlike these agencies, AHCCCS has considerable latitude in the kind of process it can establish. Under A.R.S. §41-2501, AHCCCS is exempt from state procurement statutes for its acute and long-term medical services contracts. According to AHCCCS management, the Legislature exempted AHCCCS from these requirements because the specialized nature of medical services procurements required greater flexibility and latitude to obtain required services and to negotiate terms that are favorable to both the State and the contractor. The process AHCCCS

Although exempt, AHCCCS' procurement process is consistent with statutory requirements.

Figure 3 Acute and Long-Term Care Contracting Process As of September 2002



The light tan boxes represent optional steps in the Arizona Health Care Cost Containment System (AHCCCS) procurement process.
 The dark tan boxes represent mandatory steps in the Arizona Health Care Cost Containment System (AHCCCS) procurement process.

Source: Auditor General staff analysis of acute and long-term care contracting records and interviews with AHCCCS staff.

has adopted, illustrated in Figure 3 (see page 8), includes an optional request for information and pre-proposal conference, a Request for Proposal (RFP), the development of criteria to evaluate proposals, and a step to solicit best and final offers. This process incorporates all of the requirements set forth in A.R.S. §41-2534 for competitive sealed proposals.

- **Contract proposals solicited through RFPs**—AHCCCS mirrors state requirements in using RFPs for its medical services procurements. Similarly, AHCCCS' procurement administrative rules also mirror state rules for competitive sealed proposals in that its RFPs specify contract terms and conditions, the type of services and work involved, and instructions concerning proposal submission requirements. AHCCCS included this information in its RFPs for its federal fiscal year 1998 acute care, and federal fiscal years 2001 and 2002 ALTCS procurements.
- **Scoring criteria included in RFP**—Procurement statutes require state agencies to disclose the evaluation criteria used to evaluate proposals in RFPs. Similarly, AHCCCS includes evaluation criteria in its RFPs. These criteria specify that AHCCCS develop scores based on its program operations, including client case management, behavioral health, and quality management; the quality of the plan's provider network and management; the plan's proposed fees; and other factors relating to the plan's organization. In addition, AHCCCS' ALTCS' RFPs note how scores for each of these areas will be weighted in determining an overall proposal score. These scoring criteria were published in the federal fiscal year 1998 acute care RFP, and more fully detailed in the federal fiscal year 2001 and 2002 ALTCS RFPs.
- **Contract award based on scoring criteria**—Similar to statutory requirements, AHCCCS' procurement process includes evaluating proposals and awarding contracts based on the evaluation criteria included in the RFP. After receiving proposals, AHCCCS uses staff from various departments, who use the criteria included in the RFP to evaluate the proposals and make award recommendations. Further, AHCCCS has contracted with a consultant to evaluate its scoring process to ensure it is comprehensive and objective.

Process incorporates various options—In addition to AHCCCS' procedures generally mirroring those of other state agencies, they also take advantage of the flexibility granted to AHCCCS. For example, while state rule allows agencies to ask for a revised offer, AHCCCS has statutory authority to ask offerers to alter the prices and services outlined in their proposal. State rule allows agencies to request a "best and final offer" from offerers—a process used to encourage them to improve proposals. However, A.R.S. §§36-2944 and 36-2906 allow AHCCCS to ask for voluntary price reductions from plans tentatively selected for award. In other words, AHCCCS does not have to seek best and final offers from all offerers. According to AHCCCS officials, the Legislature granted this authority to allow AHCCCS the

AHCCCS' procurement process incorporates mandatory and optional statutory provisions.

flexibility to approach the most promising contractors and negotiate lower rates; and AHCCCS has used this authority in its procurements to negotiate rates acceptable to the State. Further, after these contracts are awarded, AHCCCS may negotiate with contractors to modify their services or service areas.

AHCCCS also has incorporated some additional features into its procurement process that are optional under state procurement statutes and administrative rules. For example, A.R.S. §41-2555 states that a request for information (RFI) may be issued to obtain data about services or materials available to meet a specific need. AHCCCS has used an RFI to obtain health plan capabilities and other market information in its federal fiscal year 2001 Maricopa County ALTCS procurement. More recently, AHCCCS has used an RFI in its federal fiscal year 2003 acute care procurement to identify new contractors. A second example of an option AHCCCS has elected to use is pre-proposal conferences. State rules allow for such conferences, and AHCCCS has conducted them in its three previous procurements to clarify the RFP and respond to offerers' questions. Finally, A.R.S. §41-2547 provides that the State may inspect a contractor's place of business related to a contract award. Similarly, AHCCCS conducts a readiness assessment for each new contractor to determine whether the contractor is ready to begin performing under its contract.

Process mirrors federal requirements—In addition to being compatible with state procurement guidelines, AHCCCS' procurement process is similar to the Federal Acquisition Regulation (FAR). Not only does the FAR have many of the same requirements as the state procurement process, it requires a contracting officer to coordinate the procurement process. This officer establishes the evaluation team; ensures consistency in contract notices, instructions, and contract clauses; and ensures proposals are evaluated based on the criteria contained in the RFP. AHCCCS' Division of Business and Finance fulfills this responsibility by coordinating correspondence with offerers and issuing contracts and other procurement documentation.

Contractors indicate process is appropriate—Finally, AHCCCS contractors have indicated that AHCCCS has developed an appropriate procurement process. One contractor noted that the elements of AHCCCS' procurement process, including the RFIs and RFPs, were similar to other state and federal organizations. This contractor also commented that the RFP was well written, organized, and easy to follow. Another contractor with a long history of working with AHCCCS noted that AHCCCS has a good procurement process, adding that RFPs were continually improving, and that the last Maricopa County and statewide ALTCS RFPs had improved significantly. Finally, while some contractors commented that the procurement process was cumbersome, they recognized that the nature of medical services procurements and the dollars involved would require a more detailed contract proposal.

Better guidelines and documentation needed

While the medical services contracting process AHCCCS has adopted is appropriate, AHCCCS needs to do more to develop and document the guidance for various aspects of the process. First, AHCCCS should establish general policies and procedures to help guide its process. Additionally, AHCCCS should ensure that it adequately documents how the performance of current contractors is being evaluated when future procurements are under consideration. Finally, AHCCCS should extend evaluations of current performance to ALTCS contractors—a step AHCCCS is working on but has not yet taken.

AHCCCS should develop policies and procedures for its procurements.

Formal policies needed to guide process—AHCCCS should develop general policies and procedures to guide the various steps of medical services procurements. While AHCCCS has developed administrative rules defining the contents of AHCCCS RFPs, it has not established policies or procedures defining its medical services procurement process as reflected in Figure 3 (see page 8), including guidelines establishing the timelines for completing the various steps in the process, guidelines that establish the relative importance of evaluation criteria, and procedures for evaluating key parts of the proposal. Likewise, the specific responsibilities of AHCCCS divisions and offices in the procurement process are not documented.

Establishing policies and procedures to guide its medical services procurement process can provide several benefits. They can help AHCCCS consistently follow practices from year to year, especially if employee turnover occurs. They also provide the framework for a formalized and documented procurement process. Other types of AHCCCS procurements have such policies. For example, the Department of Administration's State Procurement Office, which oversees state procurements, requires AHCCCS to adopt and maintain policies and procedures for nonmedical service procurements. Similarly, such policies are formalized at the federal level, where they are included in the FAR. Therefore, AHCCCS should develop general policies and procedures for its medical services procurement process similar to those adopted in Arizona and by the federal government.

AHCCCS evaluates contractors' past performance in acute care procurements.

Documenting evaluation of contractors' past performance—In addition to developing general procurement policies, AHCCCS should document how it evaluates contractors' past performance when it considers their bids on future contracts. In reviewing contractors' proposals for the most recent acute care procurement process, AHCCCS included an evaluation of current contractors' performance, using the most recent operational and financial review (OFR) (see Item 1). While AHCCCS gave automatic

Item 1: Overview of the Operational and Financial Review (OFR)

AHCCCS conducts periodic on-site operational and financial reviews of all health plans to assess compliance with the contracts' performance standards and requirements. AHCCCS staff review these standards, which include areas such as quality of care, grievances and appeals, and financial management.

AHCCCS should document how it evaluates current contractors in procurements.

points for good performance, it also reserved the right to deduct points when contractors received noncompliant ratings.

However, in reviewing the scoring records for four contractors who received noncompliant ratings, auditors could not verify how this evaluation was carried out. Specifically, while AHCCCS reviewed all areas of noncompliance, it did not fully document its decision-making process associated with this review. According to an internal memo, AHCCCS identified the significant contract compliance issues for which it needed to review additional information to decide whether to deduct points from these contractors' proposals. For example, for one of the four contractors, AHCCCS reviewed additional information to ascertain contract compliance and appropriately score the contractor's proposal for 6 of the 18 areas of noncompliance. AHCCCS determined that the remaining 12 areas could be evaluated and scored based on the information required in the bid proposals. However, while AHCCCS documented its review of the six areas and its decisions to deduct or not deduct points, it did not document its reasons for not reviewing or considering additional information to score the remaining 12 areas. Even though an outside consultant reviewed this process, without adequate documentation to support its decision-making process, it is difficult to confirm that AHCCCS appropriately scored current contractors' proposals.

AHCCCS should consider current contractors' past performance in ALTCS procurements.

Past performance of ALTCS contractors should be evaluated— As it is already doing with acute care contractors, AHCCCS should use OFR results when evaluating proposals for the ALTCS program. During the most recent ALTCS competitive procurements, AHCCCS did not consider contractor performance when scoring proposals. However, AHCCCS management acknowledges the benefit of using OFRs to score and evaluate its current ALTCS contractors and is planning to develop evaluation guidelines that include assessing health plan performance.

System needed for tracking contract documents

AHCCCS also needs to develop an agency-wide system for keeping track of various documents related to the contracting process. AHCCCS' medical services contracts require contractors to provide documentation for a variety of purposes, from reports measuring the quality of care to correspondence related to contract administration. In accordance with contract requirements, these documents are sent directly to one of eight different locations within AHCCCS, including the Division of Business and Finance, the Office of Managed Care, and the Office of Medical Management. However, these files may not be complete. Specifically, auditors' test work, which was limited to the contract files for one acute care plan, identified eight missing contract compliance and performance documents, dating from March 1997 to December 2001.

For example, one missing document explained the health plan's practices concerning a covered service. Therefore, to assist with contract oversight, AHCCCS should develop a system to track and maintain contract documents and correspondence.

Recommendations

1. AHCCCS should develop general policies and procedures for its medical services procurement process.
2. AHCCCS should ensure that its process for evaluating current contractors' past performance as part of the competitive procurement process is well-documented and sufficiently supported.
3. AHCCCS should continue its efforts to develop guidelines that consider current contractors' past performance for its ALTCS competitive procurement processes.
4. AHCCCS should develop an agency-wide system for tracking and retaining contract documents and correspondence.

OTHER PERTINENT INFORMATION

During the audit, other pertinent information was gathered regarding competition within public managed care systems nationally and within Arizona.

Competition within the managed care system

Promoting competition within the public managed care system is becoming more difficult nationally and within Arizona. Nationally, fewer health plans have been competing for Medicaid managed care contracts. Arizona, while for the most part in a better position than other states, has responded to this challenge by combining its counties into service areas with larger populations in an effort to remain attractive to contractors. Additionally, AHCCCS has developed a reasonable approach to determine how many contracts it will issue in each market.

States struggle with managed care competition—Most states use managed care in their Medicaid programs to some degree. A 2000 survey of 50 states and the District of Columbia by the National Academy for State Health Policy (NASHP) found that 48 states have at least one Medicaid program using managed care. Eighteen of these states use competitive bidding to select and contract with managed care organizations to provide healthcare services to Medicaid clients.¹ More than half of all Medicaid beneficiaries in the country were enrolled in at least one managed care program in 2000.

Nationally, fewer plans are competing for state Medicaid contracts.

Although use of managed care services remains strong, recent industry trends suggest that fewer managed care organizations are bidding for state contracts. The 2001 NASHP report noted that between 1998 and 2000, 82 percent of the states that contract with managed care plans experienced plans moving in and out of their Medicaid programs, with more plans leaving the program than entering. Similarly, a 2001 Kaiser Commission on Medicaid and the Uninsured report noted that while Medicaid managed care enrollment continues to increase, the number of plans leaving the Medicaid market outnumbered new plans by nearly three to one.² This movement may be due to financial reasons, as a 2000 study published by the Center

¹ Kaye, Neva. *Medicaid Managed Care: A Guide for States*. Portland: National Academy for State Health Policy, 2001. The NASHP is a nonprofit, nonpartisan organization seeking to help states achieve excellence in health policies and practices. The 2001 report was the fifth survey the Academy conducted since 1990.

² Felt-Lisk, Suzanne, Rebecca Dodge, and Megan McHugh. *Trends in Health Plans Serving Medicaid—2000 Data Update*. Washington, D.C.: Kaiser Commission on Medicaid and the Uninsured. November, 2001. The Commission serves as a forum for analyzing healthcare coverage and access for the low-income population and assessing options for reform.

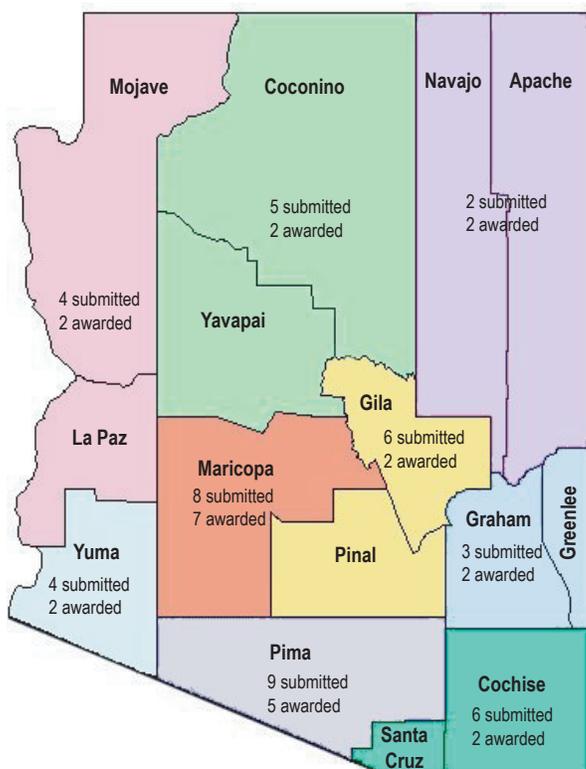
for Healthcare Strategies, Inc. found that in the late 1990s, most managed care organizations were operating at a loss because of rising medical costs.¹ Changes in the industry may also be playing a role. Interviews with experts in public managed care and managed care contracting indicate that the industry is consolidating into fewer organizations, which are increasingly specialized in public managed care.

The reduced numbers of managed care organizations willing to provide Medicaid services have caused some states to adopt medical models that do not involve comprehensive managed care programs. For example, Alabama, Georgia, Mississippi, Montana, and Vermont no longer contract with comprehensive managed care organizations for Medicaid services. Instead, they use a modified fee-for-service system in which the state pays physicians to be case managers for members, but also pays for specific client services.²

AHCCCS more successful in attracting competition—Despite the national trend of fewer organizations competing for contracts, AHCCCS has had success in attracting competition for its acute care program. AHCCCS contracts with more managed care organizations than most other states. In 2002, AHCCCS had contracts with ten health plans for acute care services, while across the country, states using managed care organizations contracted with an average of 8 organizations, according to the 2001 NASHP report. AHCCCS has also been successful in attracting multiple proposals for the same geographic area. For the most recent acute care contract, there were more proposals submitted than awards granted in all but one of the nine Geographic Service Areas (GSA). For the remaining GSA, (Apache and Navajo Counties), AHCCCS received two proposals and issued two contracts (see Figure 4). Further, AHCCCS contacted potential bidders for its upcoming federal fiscal year 2004 acute care contract and three managed care organizations not currently providing acute care services expressed tentative interest in submitting a proposal.

Although the acute care program has seen relative successes in attracting competition, AHCCCS has had more difficulty attracting managed care organizations to its ALTCS program. Only eight organizations submitted proposals to provide ALTCS services in the seven contracting areas in federal fiscal years 2001 and 2002 (see Figure 5, page 17). Specifically, three private companies and

Figure 4 Acute Care Proposals Submitted and Contracts Awarded by Geographic Service Area¹ 1998 Federal Fiscal Year



¹ The number of proposals submitted and contracts awarded does not reflect AHCCCS' statewide contract with the Department of Economic Security to provide medical and dental services to foster care children.

Source: Auditor General staff analysis of Arizona Health Care Cost Containment System contract records.

¹ Hurley, Robert E., and Michael J. McCue. *Partnership Pays: Making Medicaid Managed Care Work in a Turbulent Environment*. Center for Health Care Strategies, Inc. May, 2000. The center awards grants and provides training and technical assistance to state purchasers of publicly financed healthcare, health plans, and consumer groups.

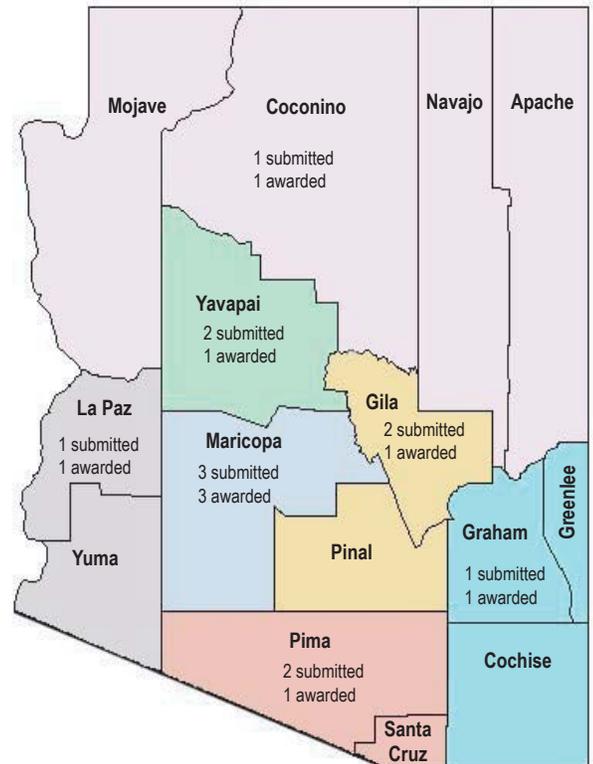
² Kay, Neva. *Medicaid Managed Care: A Guide for States*. Portland: National Academy for State Health Policy, 2001.

five county organizations submitted proposals, each obtaining at least one contract. Further, in four of the seven ALTCS GSAs, AHCCCS had only as many offerers as it had awards.¹

Two characteristics of Arizona's program may help explain why the ALTCS program has more difficulty generating competition among bidders. First, Arizona has a unique program for which a limited number of health plans are capable of providing long-term care services. While other states provide long-term care services using a managed care approach on a limited and optional basis, according to AHCCCS officials, only Arizona provides long-term care services statewide and under a mandatory managed care approach. A 1999 survey by the Center for Home Care Policy and Research found that Arizona was only one of 20 states using a managed care approach to provide long-term services to at least some clients, but only one of seven programs serving more than 5,000 clients using managed care.² Second, according to AHCCCS officials, state law may have discouraged health plans from bidding on the ALTCS program or from developing the ability to provide long-term care services within a managed care environment. Specifically, until the federal fiscal year 2001 ALTCS procurement, counties had the right of first refusal to contract with AHCCCS to provide long-term care services. This may have created a disincentive for private companies to bid on this program. However, the Legislature eliminated counties' right of first refusal to contract with AHCCCS in 1997.

Larger geographic areas created to provide incentive—In an effort to foster continuing competition for its acute and long-term care contracts, AHCCCS has created larger contract areas, which may be more attractive to potential offerers. Before federal fiscal year 1998, AHCCCS issued contracts to managed care organizations for individual counties. However, AHCCCS was concerned that managed care organizations had less incentive to submit offers for the smaller AHCCCS populations in rural counties because of the reduced revenues, potentially higher medical costs, and limited

Figure 5 Long-Term Care Proposals Submitted and Contracts Awarded by Geographic Service Area² 2001 and 2002 Federal Fiscal Years¹



¹ Arizona Health Care Cost Containment System (AHCCCS) most recently awarded its long-term contracts through two separate procurements; one for Maricopa County and one for all other areas in the State. The Maricopa County contract was awarded for the 2001 federal fiscal year, and contracts in all other areas of the State were awarded for the 2002 federal fiscal year.

² Does not include AHCCCS' statewide contract with the Department of Economic Security Division of Developmental Disabilities to provide long-term care services to AHCCCS' developmentally disabled members.

Source: Auditor General staff analysis of AHCCCS contract awards.

¹ The four GSAs were Maricopa, Yuma/La Paz, Apache/Coconino/Mojave/Navajo, and Graham/Greenlee/Cochise. In the Maricopa GSA, AHCCCS awarded a contract to all three offerers. Only one offer was submitted in each of the other GSAs.

² Murtaugh, Christopher M., Ph. D., Michael S. Sparer, Ph. D., Penny Hollander Feldman, Ph. D., Ji Seon Lee, Ph.D., Arielle Basch, M.P.H., Amy Sherlock, M.S.W., Amy L. Clark, B.A., *State Strategies for Allocating Resources to Home and Community-Based Care*. Visiting Nurse Service of New York's Center for Home Care Policy and Research. September, 1999. The center's mission is to advance knowledge that will promote the delivery of high-quality, cost-effective care.

number of providers. Therefore, beginning with the federal fiscal year 1998 acute care contract and in its federal fiscal years 2001 and 2002 ALTCS contracts, AHCCCS combined counties into GSAs composed of one to four counties. This resulted in the current nine acute care GSAs and seven long-term care GSAs. AHCCCS revises the GSA configurations each time it solicits proposals and plans to review its GSAs again prior to issuing its acute care RFP in federal fiscal year 2004.

Practice for determining number of contracts reasonable—Another factor in the contracting process is the number of contracts AHCCCS issues for any one GSA. AHCCCS officials said they determine this number by considering several factors, including the current client population and projected client growth. Further, AHCCCS also considers the need to have additional plans on contract in case one contractor fails or performs poorly. However, AHCCCS can modify this initial estimate on a case-by-case basis during its review process. For example, in its federal fiscal year 2001 ALTCS request for proposals, AHCCCS indicated it would issue up to two contracts for the Pima County GSA. AHCCCS received two proposals for these services, but eventually selected just one contractor. In making its decision, AHCCCS considered the importance of plan choice to members, the administrative burden of contracting with two plans, the economic viability of contracting with two plans in this GSA, and the limited provider network in the GSA.

A review of literature and interviews with experts did not identify alternative methods or additional factors that AHCCCS should consider when determining the number of contractors in each GSA. Currently, little precedent exists in literature for a more comprehensive, methodological approach to determine the number of contracts issued in a given area. Industry experts indicated there were no studies identifying factors that could be considered in determining how many contractors should serve a specific area. For example, according to one public managed care contracting expert, there is no research available that evaluates plan administrative costs, economies of scale, or comprehensive approaches for estimating the population needed to support Medicaid plans.

Additionally, state practices for determining the number of contractors for a given service area vary. Like Arizona, some states use a competitive procurement process to issue a select number of contracts in a given area; however, according to the 2001 NASHP report, 62 percent of states using managed care contract with all qualified proposers. Missouri issues contracts to any plan meeting minimum certification standards at an acceptable price. Both approaches offer advantages and disadvantages. Limiting the number of awards eliminates less-qualified contractors before they begin operating, but it requires state agencies to develop contracting expertise to appropriately identify and select qualified contractors. Further, limiting awards may leave the state dependent on a smaller number of plans. In contrast, contracting with every qualified plan includes more managed care organizations, allowing the market to eliminate noncompetitive plans. However, the larger number of plans can create administrative burdens for the state agency, and plan turnover can disrupt client services.

Unlike Arizona, some states contract with all qualified contractors.

AGENCY RESPONSE

August 30, 2002

Ms. Debra Davenport, CPA
Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Re: Revised Draft Contracting Process Report dated August 19, 2002

Dear Ms. Davenport:

Thank you for the opportunity to review and comment on the revised report of the performance audit of AHCCCS' contracting process for healthcare services. The goals of AHCCCS' procurement process are to obtain a high-quality healthcare delivery network, increase members' healthcare choices and reduce costs through competition. The Agency has worked hard to establish a procurement process that has successfully accomplished these goals and believes that this report reflects this achievement. An indicator of the quality healthcare delivery network is evidenced by our 2000 Member Satisfaction Survey, where more than three-fourths of AHCCCS survey respondents rated the healthcare they received as an "8", "9", or "10" on a scale of from "0" (worst) to "10" (best). This compares to a national average of 70 percent. In addition, the goals of member choice and reduced costs have clearly been achieved, as noted numerous times in the report.

Below is our response to the recommendations of the audit team as listed on page 13.

Recommendation #1:

AHCCCS should develop general policies and procedures for its medical services procurement process.

Response:

The finding of the Auditor General is agreed to, and the audit recommendation will be implemented.

Ms. Debra Davenport, CPA

August 30, 2002

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AHCCCS does have written policies and procedures describing procurement procedures including how procurements are publicized, scheduling of proposal milestones, pre-proposal conferences and requests for information. However, AHCCCS will develop a general policy that describes the medical services contracting process which will include established timelines used for past medical service procurements, a description of how past scoring was done, and assignments to various divisions.

As discussed with the Auditor General staff, procurements take place once every five years for managed medical service programs; therefore, a prescriptive detailed policy may have limited long term value. Each procurement cycle may have different goals to address current healthcare trends that need to be considered. Being exempt from the state procurement code, AHCCCS was granted more latitude to obtain medical services and to negotiate terms that are favorable to both the State and the contractor. AHCCCS retains the right to be more flexible, which may result in less consistency from one procurement to the next, but more appropriate for the rapidly changing healthcare field. We believe that our procurement process has been a big contributor to our ability to attract contractors and the overall success of the program.

Recommendation #2:

AHCCCS should ensure that its process for evaluating current contractors' past performance as part of the competitive procurement process is well-documented and sufficiently supported.

Response:

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

AHCCCS suggests that it was not the scoring of the procurement that was not documented, but one of the many decision-making processes that needed improved documentation. AHCCCS believes that the scoring was appropriately documented. The methodology as well as the scoring results were reviewed and approved by an outside consultant. However, AHCCCS will work to ensure that all decision-making is documented as it relates to the scoring methodology and scoring results in the future.

Ms. Debra Davenport, CPA
August 30, 2002
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Recommendation #3:

AHCCCS should continue its efforts to develop guidelines that consider contractors' past performance for its ALTCS competitive procurement processes.

Response:

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #4:

AHCCCS should develop an agency-wide system for tracking and retaining contract documents and correspondence.

Response:

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

We believe it important to continually make improvements in our contracting process and by complying with the Auditor General's recommendations, we believe improvement will occur. However, we are pleased with our current success in controlling costs and call your attention to a nationally recognized achievement presented in the State Health Monitor, June 2002. "Arizona has the lowest drug costs per Medicaid beneficiary. Most Arizona Medicaid eligible are enrolled in HMOs, and each HMO uses its own strategy for controlling drug expenditures, including rebateable formularies. Health plans may also provide prior authorization, drug utilization review, and disease management programs. Statewide, generics are prescribed 98% to 99% of the time when available."

We appreciate the efforts of the audit team and believe that by implementing these recommendations AHCCCS will be more effective in its' contracting processes.

Sincerely,

Phyllis Biedess
Director

Performance Audit Division reports issued within the last 12 months

01-17	Arizona Board of Dispensing Opticians	01-29	Department of Public Safety—Sunset Factors
01-18	Arizona Department of Corrections—Administrative Services and Information Technology	01-30	Family Builders Program
01-19	Arizona Department of Education—Early Childhood Block Grant	01-31	Perinatal Substance Abuse Pilot Program
01-20	Department of Public Safety—Highway Patrol	01-32	Homeless Youth Intervention Program
01-21	Board of Nursing	01-33	Department of Health Services—Behavioral Health Services Reporting Requirements
01-22	Department of Public Safety—Criminal Investigations Division	02-01	Arizona Works
01-23	Department of Building and Fire Safety	02-02	Arizona State Lottery Commission
01-24	Arizona Veterans' Service Advisory Commission	02-03	Department of Economic Security—Kinship Foster Care and Kinship Care Pilot Program
01-25	Department of Corrections—Arizona Correctional Industries	02-04	State Park—Heritage Fund
01-26	Department of Corrections—Sunset Factors	02-05	Arizona Health Care Cost Containment System—Member Services Division
01-27	Board of Regents	02-06	Arizona Health Care Cost Containment System—Rate Setting Processes
01-28	Department of Public Safety—Criminal Information Services Bureau, Access Integrity Unit, and Fingerprint Identification Bureau		

Future Performance Audit Division reports

Child Protective Services—Removal and Appeal Process
Arizona Health Care Cost Containment System—Sunset Factors