Mercer

Government Human Services Consulting

Calendar Year 2019 Health Net of California Mainstream Rate Development Template

Auditor's Report

State of California Department of Health Care Services

January 17, 2023

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Section 1

Executive Summary

Pursuant to federal requirements under Title 42 of the Code of Federal Regulations 438.602(e), the State of California Department of Health Care Services (DHCS) must periodically, but no less frequently than once every three years, conduct, or contract for the conduct of, an independent audit of the accuracy, truthfulness, and completeness of the encounter and financial data submitted by, or on behalf of each managed care organization (MCO). DHCS contracted with Mercer Government Human Services Consulting (Mercer), part of Mercer Health & Benefits LLC, to fulfill this requirement for the financial data submitted in the Medi-Cal rate development template (RDT) for calendar year (CY) 2019 by Health Net of California (HNC). Mercer designed and DHCS approved procedures to test the accuracy, truthfulness, and completeness of self-reported financial data in the RDT.

The specific financial schedules selected for testing are used by Mercer as a critical part of the base data development process for capitation rate development related to the CY 2022 rating period. The RDT tested was the final version, including any revisions stemming from resubmissions as a result of the RDT Question and Answer discussion guide process with the MCO.

The key schedules subject to testing from the RDT include, but were not limited to:

- Schedule 1 — Utilization and Cost Experience
- Schedule 1A — Global Subcontracted Health Plan Information
- Schedule 1C — Base Period Enrollment by Month
- Schedule 1U — UM/QA/CC
- Schedule 5 — Large Claims Report
- Schedules 6a and 6b — Financial Reports
- Schedule 7 — Lag Payment Information

The data collected in the RDT is reported on a modified accrual (incurred) basis for CY 2019 and does not follow generally accepted accounting principles with regards to retroactivity from prior year activity, including claim or capitation accruals, retroactive enrollment, or termination of enrollment of members from prior years. The data provided is designed to report only financial and enrollment activity incurred for the CY reported.

The procedures and results of the test work are enumerated in Table 1 of Section 2.

Section 2

Procedures and Results

Mercer has performed the procedures enumerated in Table 1 below, which were designed by Mercer and were reviewed and agreed to by DHCS, solely to test the completeness, accuracy, and truthfulness of information reported in the Medi-Cal RDT from HNC for the CY 2019. HNC's management is responsible for the content of the RDT and responded timely to all requests for information.

Table 1: Procedures

Category	Description	Results
Fee-for-Service (FFS) Medical Expense	Mercer reviewed all paid claims data for each category of service (COS) to verify control totals, verify eligibility and enrollment in the Mainstream Medi-Cal program, confirm the COS grouping was correct, confirm the year reported was correct, and confirm enrollment with HP for date of service.	• Control totals: No variance noted. • Eligibility: 99.85% of claims received were for eligible members • COS Map: No variance noted. • Service Year: No variance noted.
	Mercer compared detailed lag tables for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility-LTC, and All Others) created from the paid claims data files provided by HNC and compared the information reported in Schedule 7. Mercer compared the paid claims amounts from Schedule 7, line 35 and the incurred but not reported (IBNR) amount from Schedule 7 line 40 to total paid claims data as provided by HNC.	Variance: RDT FFS Overall over/(understated): • Inpatient 0.79% • Outpatient (0.89%) • LTC 0.32% • Physician (0.55%) • Pharmacy (3.05%) • All Other 3.14% In Total understated by 0.35% or $5,476,404 or 0.18% of Total Medical Expense.

Category	Description	Results
	Allowable absolute value variances were deemed to be not greater than 2% for inpatient claims and 1% for all other COS.	
	Using data files (paid claims files) provided by HNC, Mercer sampled and tested 62 transactions for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility-Long Term Care [LTC], and All Others) and traced sample transactions through HNC's claims processing system, the payment remittance advice, and the bank statements.	No variance.
Global Subcontracted Payments	Mercer requested overall global capitation supporting detail. Mercer compared the support provided to the amounts reported in Schedule 1A. The total of the detail provided was less than the amounts reported in the RDT.	Variance: RDT reported capitation amounts are overstated by 0.29% or $573,790 or 0.02% of Total Medical Expense.
	Mercer reviewed the contractual arrangement with HNC's global subcontractor and recalculated the total payment amount using eligibility information as of June 2020 multiplied by the rates established on the most current rate sheet received from DHCS, adjusted for the global subcontracted arrangement. The	Variance: RDT reported capitation amounts are overstated by 3.02% or $6,006,183 or 0.20% of Total Medical Expense. The recalculated estimate is based on an average rate using only the base capitation payment across all counties. Therefore, a variance is expected and the results are considered reasonable.

Category	Description	Results
	estimated recalculated amounts were less than the global capitation amount reported in the supporting detail provided.	
	Mercer selected the three highest months of payment by globally subcontracted health plan/provider and five randomly selected additional months of payment. Mercer observed proof of payments for the sampled global capitated payments. The proof of payment information was more than the supporting detail provided for the sampled global capitated providers.	Variance: Proof of payment for the sampled global payments was overstated by 2.13% or $3,440,822 or 0.11% of total medical expense. A portion of this variance is due to membership retroactivity unknown at the time of payment.
	Mercer obtained roster information for the globally subcontracted provider and verified eligibility of members, confirmed enrollment with HNC, and analyzed claims to verify none of the FFS claims paid should have been paid under the global arrangement.	Enrollment was confirmed for 99.84% of the members on the provided rosters. FFS claims totaling $373,610, or 0.21% of capitation paid, were paid for members that were part of the global contract. This is 0.01% of total medical expense.
	Mercer compared the global per member per month (PMPM) payment rates to relevant PMPM experience for non-global members for reasonableness. Estimated PMPM amounts were calculated by dividing total medical expense, less global medical expense, by direct member months and	The estimated global expense PMPM of $183.55 is less than the estimated non-global medical expense PMPM of $203.67. This differential is reasonable.

Category	Description	Results
	comparing that PMPM amount to the global medical expense divided by the global member months.	
	If applicable, Mercer reviewed full-dual member global contracted PMPMs to determine if the amount(s) are at a reduced rate as compared to the non-full dual category of aid (COA) groups.	HNC pays the global contractor 93% of DHCS rates and therefore follows the expected reductions by COA group.
	Mercer reviewed the sampled global capitated contracts to determine delegated administrative duties. Using this information, Mercer then reviewed the amount of administrative dollars reported in the RDT as compared to the delegated administrative functions.	Per review of the global contract, Molina provides several administrative services, see Appendix A for details. HNC did not segregate a portion of the global capitation expense as administrative expense, therefore overstating medical expense and understating administrative expense.
	Mercer reviewed members included on the member roster to ensure there were no Coordinated Care Initiative (CCI) members or payments provided in the steps above.	None identified.
Sub-capitated Medical Expense	Mercer requested overall non-global sub-capitation supporting detail. Mercer compared the support provided to the amounts reported in Schedule 7. The total of the detail provided was less than the amounts reported in the RDT.	Variance: RDT reported sub-capitation amounts are understated by 0.39 % or $5,042,202 or 0.16% of Total Medical Expense.

Category	Description	Results
	Mercer reviewed a sample of the five highest provider payments, ten random payments, reviewed the related contractual arrangements, and recalculated the total payment amounts by sub-capitated provider using roster information provided by HNC. The recalculated amounts were less than the sub-capitation amount reported in the supporting detail provided.	Variance: Detailed support is overstated by 3.82% or $3,557,924, or 0.12% of total medical expense.
	Mercer observed proof of payments for the sampled sub-capitated provider payments in the previous step.	No Variance Noted.
	Mercer obtained roster information for the sampled provider payments and verified eligibility of members, confirmed enrollment with HNC, and analyzed claims to verify none of the FFS claims paid should have been paid under the sub-capitated arrangement.	Variance: Enrollment was confirmed for 99.94% of members that were part of the sampled provider payments. No FFS claims paid should have been paid under the sub-capitated arrangement.
	If applicable, Mercer reviewed full-dual COA subcontracted PMPM payment rates to determine if the amount(s) are at a reduced rate as compared to the non-full dual COAs.	Confirmed.

Category	Description	Results
	If any of the sub-capitated arrangements are a significant portion of HNC's overall medical expense and/or major COS, Mercer obtained encounter data support and/or documentation supporting the reasonableness of the PMPM amounts included in the sub-capitated arrangement.	Not applicable.
Utilization and Cost Experience	Mercer compared summarized total net cost data from amounts reported in Schedule 1 to Direct Medi-Cal COS totals from Schedule 6a and to total incurred claims by COS for Schedule 7 for consistency.	Schedule 1 overstated by 0.07% or $2,215,590 when compared to Schedule 6a. HNC commented in their RDT submission a known variance due to bucketing differences between the schedules. Schedule 1 showed minimal variance ($1,551) when compared to Schedule 7.
Member Months	Mercer compared MCO-reported member months from Schedule 1C to eligibility and enrollment information provided by the State. Mercer's procedures are to request explanations for any member months with greater than 1% variance in total or greater than 2% variance by major COA.	Variance: RDT overstated by 0.15% in total.
Provider Incentive Arrangements	Mercer requested a listing of all provider incentive arrangements, by provider, by month and compared the amounts to Schedule 6a, lines 34–36.	Variance: RDT is understated by 2.65% or $774,476 or 0.03% of Total Medical Expense.

Category	Description	Results
	From the listing of provider incentive payments, Mercer sampled the highest two payment amounts and one random payment. Mercer observed proof of payments for the sampled provider incentive payments.	No variance.
	Mercer reviewed the listing of provider incentive payments for any payments to related parties. If the review of the provider incentive payment listing showed payments to related parties, and the sample selection in the previous step did not include related party arrangements, Mercer selected the two highest related party provider incentive payments. Mercer observed proof of payments for the sampled related party provider incentive payments. The proof of payment information was less the supporting detail provided for the sampled related party provider incentive payments.	Not applicable, no related party incentives identified.
	If related party provider incentive payments were noted, Mercer reviewed the incentive terms to determine if the terms align with similar arrangements for non-related parties	Not applicable
Reinsurance	Mercer reviewed the reinsurance contract and	No Variance Noted

Category	Description	Results
	compared the amount on the RDT to the requested supporting schedule.	
	Mercer recalculated reinsurance premiums, based on 2019 membership as of June 2020, to compare to reported amounts.	Variance: RDT was overstated by 0.02% or $436.
	Mercer recalculated recoveries for a sample of five members.	No cases exceeded the reinsurance threshold.
	Mercer compared the amount of reinsurance recoveries as compared to the information in Schedule 5 for reasonableness.	Reported amounts in Schedule 5 are consistent with reinsurance recoveries reported based on review of the reinsurance threshold.
Settlements	Mercer inquired of HNC if they incurred any settlement amounts with providers related to CY 2019 dates of service. If settlements exist, Mercer noted whether the amounts are actual or estimates based on the status of the settlements and where the amount(s) are reported in the RDT.	HNC reported settlements of $1,421,319 on Schedule 7. Audit support reported actual settlements paid of $1,340,731 and estimated settlement amounts totaling $595,280 are still outstanding as of the date of this audit. Variance: Settlements reported in the RDT were understated by 36.21% or $514,692, or 0.02% of total medical expense.
	If settlement amounts are material, Mercer requested supporting documentation and performed additional procedures.	Not applicable, not material.

Category	Description	Results
Third Party Liability (TPL)	Mercer reviewed TPL as a PMPM and as a percentage of medical expense on Schedule 6a line 39 as compared to benchmark information across those plans reporting a value for TPL.	The benchmark TPL percentage was 0.04%. HNC did not report any TPL, however, HNC does pursue recoveries and report their claims expense net of TPL recoveries.
Administrative Expenses	Mercer benchmarked administrative expenses as a percentage of net revenue across all Two-Plan/GMC plans and compared to the amount reported in Schedule 6a, taking into consideration the membership size of the plan under review when reviewing the results.	The benchmark administrative percentage was 6.07% and HNC reported 7.33%. A portion of administrative expense is paid to related parties as detailed in the Related Parties Transactions section below. HNC's overall administrative expense percentage is considered reasonable.
	Mercer compared detailed line items from the plan's trial balance mapped to line items in Schedule 6a and Schedule 6b for reasonableness. Mercer reviewed allocation methodologies and recalculated for reasonableness.	No variance noted. Overall administrative expense had no variance, however there were significant variances by line item.
Taxes	Mercer reviewed to ensure proper reporting of federal, state, and local taxes on line 59 Provision for Taxes of Schedule 6a. If no taxes reported on Schedule 6a, we confirmed the organization is not subject to taxes.	HNC properly reported provision for taxes on Schedule 6a.
Related Party Transactions	Mercer obtained related party agreements for medical services and	There are two significant related party arrangements for medical services:

Category	Description	Results
	reviewed to determine if the terms are at fair market value. Mercer compared the terms (e.g., PMPM or other payment rate amounts) to other similar non-related party terms for reasonableness.	Health Net Pharmaceutical Services (HNPS) and MHN Services (MHN). HNPS contracts with HNC for Medicaid members with a “Traditional Pricing Model” for services plus any applicable dispensing and other fees. Services are based on Average Wholesale Price (AWP) and the discounts agreed upon. The Pharmacy Benefit Management (PBM) expense related to HNPS was $14.9 million, which is reasonable and is appropriately included in administrative costs. MHN contracts with HNC to provide behavioral health administrative services. The costs incurred by MHN are allocated directly for dedicated service units, or indirectly for shared service units based on various methodologies. The agreement is for administrative services only, any claims costs related are passed through as-is.
	If related party contracts are a material portion of the related medical COS, Mercer also reviewed any	HNC pays HNPS under a traditional pricing model for Medicaid members. Rates are negotiated in the pharmacy network and

Category	Description	Results
	allocation methodologies for reasonableness.	invoiced based on AWP and the discounts agreed upon. No allocation applied. The MHN contract is for administrative services only. Medical expenses related to MHN are FFS claims that are passed through to HNC. No allocation applied.
	Mercer reviewed that all services included in the related party agreements are allowable for Medicaid rate setting.	Confirmed
	When applicable, Mercer obtained related party corporate allocation methodologies for administrative services. Where significant, Mercer reviewed the amounts for reasonableness.	HNC has an Administrative Services Agreement (ASA) with related party Health Net, LLC (HNI). HNI is compensated based on actual costs plus allocation of professional costs including Salaries, Employee Benefits, and Employment Taxes. Based on the administrative expense benchmark noted above, the amounts reported are not unreasonable.
UM/QA/CC	Mercer benchmarked UM/QA/CC expenses as a percentage of total medical expense across all Two-Plan/GMC plans and compared to the amount reported on Schedule 6a, taking into consideration the membership size of the	The benchmark UM/QA/CC percentage was 1.67% and HNC reported 0.93%. See additional finding below that increases the actual UM/QA/CC expenses and therefore percentage. This variance is considered reasonable.

Category	Description	Results
	plan under review when reviewing the results.	
	Mercer compared detailed line items from the plan mapped to line items in Schedule 1-U for reasonableness. Mercer reviewed allocation methodologies and recalculated for reasonableness.	Variance: Schedule 1-U is understated by 6.94% or $1,976,682 or 0.06% of total medical expenses. Variance is primarily due to an error in data pull used to classify UM/QA/CC expenses for the RDT submission.
	Mercer interviewed financial management to determine how health care quality improvement activities such as care coordination are isolated from general administrative expenses in the general ledger. Confirmed with HNC management via interview that UM/QA/CC costs were not also included in general administrative expenses.	Confirmed.
Pharmacy	Mercer confirmed and observed pharmacy benefit manager fees were recorded as administrative expenses and not included in pharmacy claims expenses in the RDT.	Confirmed
	Mercer benchmarked pharmacy rebate expenses on a PMPM basis across all Two-Plan/GMC plans and compared to the amount reported on Schedule 7.	The benchmark pharmacy rebate PMPM was $1.39 and HNC reported $2.04. This variance is considered reasonable.
Capitation Revenue	Mercer compared capitation amounts	Variance: Total Net Revenue reported in the

Category	Description	Results
	reported in Schedule 6a with the CAPMAN file received from DHCS. The CAPMAN file contains all amounts paid to the health plan by DHCS.	RDT is understated by 0.13% or $4,528,653. It should be noted that CBRC Supplemental Payments (LA County Only) is understated by $9,007,343 or (122.87%), due to HNC not properly reporting the accrual for payment made after submission of the RDT.
Interest and Investment Income	Mercer requested interest and investment income for the MCO entity as a whole and information regarding how the income provided in Schedule 6a was allocated to the Medi-Cal line of business.	Variance: RDT is overstated by 3.11% or $802,644 or 0.02% of Net Revenue.
Other Information	Mercer reviewed the audited financial statements for the plan for the CY 2019 for a clean audit opinion or identification of significant deficiencies or material weaknesses.	No material variance noted.
	Mercer compared reported expenses, including IBNR and administrative expenses, to audited financial statements for consistency.	No material variances noted.
	Mercer inquired how hospital-acquired conditions (HACs) were treated in the RDT and policies for payment.	Medical Management Health Care Services Unit is designated to monthly screening and reviewing of claims and encounter data. After thorough evaluation and determination, HNC Claims department

Category	Description	Results
		addresses the reconciliation of prohibited payments. Based on support provided, HNC does not exclude HAC costs from RDT reporting.

Section 3

Summary of Findings

Based on the procedures performed, the total amount of gross medical expenditures in the RDT were understated by $7,435,146 or 0.24% of total medical expenditures in the CY 2019 RDT.

Based on the procedures performed, administrative expenditures in the CY 2019 RDT report no variance.

Based on the defined variance threshold, the results of the audit are determined to be immaterial and do not warrant corrective action.

HNC reviewed this report and had no comments.

Mercer

Appendix A

Administrative Duties in Sub-capitated Arrangements

Administrative Task	Molina
Case Management	X
Claims Adjudication and Payment	X
Network Development and Maintenance	X
Pharmacy Management and Formulary Compliance	X
Provider Credentialing	X
Provider Services	X
Quality Management Chart Review	X
Utilization Review and Management	X
Capitation Processing	X

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