Mercer

Government Human Services Consulting

Calendar Year 2019 Health Net of California Coordinated Care Initiative Rate Development Template

Auditor's Report

California Department of Health Care Services

October 25, 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 1.1–1.3 — Utilization and Cost Experience
- Schedule 1A — Global Subcontracted Health Plan Information
- Schedule 1B — Incentive Payments Arrangements
- Schedule 1C — Base Period Enrollment by Month
- Schedule 1.1U–1.3U — UM/QA/CC
- Schedule 5 — Large Claims Report
- Schedules 6.1a–b and 6.2.3a–b — Financial Reports
- Schedule 7.1–7.3 — 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 CMC	Results Non-CMC
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 Coordinated Care Initiative Medi-Cal program, confirm the COS grouping was correct, confirm the year reported was correct, and confirm enrollment with HNC for date of service.	• Control totals: No variance noted. • Eligibility: Verified for all members. • COS Map: No variance noted. • Service Year: No variance noted.	• Control totals: No variance noted. • Eligibility: Verified for all 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	Variance: RDT FFS Expenses are over/(understated): • Inpatient (1.41%) • Outpatient 0.06% • LTC (0.62%) • Physician 0.02% • Pharmacy (1.58%) • All Other 0.49% In Total (0.49%) or (296,033), which is (0.17%) of total medical expense.	Variance: RDT FFS Expenses are over/(understated): • Inpatient (14.55%) • Outpatient 0.11% • LTC (0.09%) • Physician 2.55% • Pharmacy (0.20%) • All Other (0.42%) In Total (0.48%) or ($3,885,665), which is (0.42%) of total medical expense.

Category	Description	Results CMC	Results Non-CMC
	not reported (IBNR) amount from Schedule 7, line 40 to total paid claims data as provided by HNC. Allowable absolute value variances were deemed to be not greater than 2% for inpatient claims and 1% for all other COS.		The larger variances above are due primarily to over/under estimating of IBNR.
	Using data files (paid claims files) provided by HNC, Mercer sampled and tested 60 transactions for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility-LTC, and All Others) and traced sample transactions through HNC's claims processing system, the payment remittance advice, and the bank statements.	No variance observed.	No variance observed.
Global Subcontracted Payments	Mercer requested overall global capitation supporting detail. Mercer compared the support provided to the amounts reported in Schedule 1A.	N/A. HNC does not have a global subcontract arrangement for CMC.	Variance: RDT Global Capitation Expense is overstated by 30.43% or $13,701,248. This represents 1.50% of total medical expense. The total of the detail provided was more than the amounts reported in the RDT.

Category	Description	Results CMC	Results Non-CMC
			Of this amount, $12,819,382 relates to a reconciliation that took place between HNC and Molina after submission of the RDT, due to classification of members based on Medicare coverage.
	Mercer reviewed the contractual arrangement with HNC's global subcontractor(s) and recalculated the total payment amount using global roster information provided for all 12 months of 2019 multiplied by the contracted rates.	N/A.	Variance: Detailed support for global capitation expense was understated by 0.48% or $210,332 as compared to the recalculated roster information. This represents 0.02% of the total medical expense.
	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 via relevant bank statements, clearing house documentation or other online financial institution support for the sampled global capitated payments.	N/A.	Variance: Detailed support for global capitation expense is overstated by 0.23% or $66,399. The proof of payment information was lower than the supporting detail provided for the sampled global capitation payments.
	Mercer compared the global per member per month (PMPM)	N/A.	Global arrangement with Molina is for 100% of services.

Category	Description	Results CMC	Results Non-CMC
	payment rates to relevant PMPM experience for non-global members for reasonableness.		The estimated global expense PMPM of $491.14 is 17.48% less than the estimated non-global medical expense PMPM of $595.18. This differential is considered reasonable.
	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.	N/A.	Per review of the global contract, Molina provides a number of 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 Mainstream members or payments provided in the steps above.	N/A.	Confirmed.
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.	Variance: RDT Sub-capitated Medical Expense is overstated by 0.08% or $85,455, which is 0.05% of total medical expense.	Variance: RDT Sub-capitated Medical Expense is overstated by 0.37% or $174,675, which is 0.02% of total medical expense.

Category	Description	Results CMC	Results Non-CMC
		The total of the detail provided was less than the amounts reported in the RDT.	The total of the detail provided was less than the amounts reported in the RDT.
	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.	No variance observed. The recalculated amounts were equivalent to the supporting detail provided.	No variance observed. The recalculated amounts were equivalent to the supporting detail provided.
	Mercer observed proof of payments via relevant bank statements, clearing house documentation or other online financial institution support for the sampled sub-capitated provider payments in the previous step.	Variance: Detailed support for the sampled sub-capitated providers is overstated by 0.67% or $40,092, which is 0.02% of total medical expense.	Variance: Detailed support for the sampled sub-capitated providers is overstated by 0.82% or $60,425, which is 0.01% of total medical expense.
	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.	No variance noted.	No variance noted.

Category	Description	Results CMC	Results Non-CMC
	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.	Mercer confirmed Full-Dual COA subcontracted PMPM payment rates are at an appropriately reduced rate as compared to the non-Full Dual COAs.	Mercer confirmed Full-Dual COA subcontracted PMPM payment rates are at an appropriately reduced rate as compared to the non-Full Dual COAs.
	For sub-capitated arrangements 5% or more of total medical expense or major COS, Mercer reviewed the sampled sub-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.	Mercer reviewed one sub-capitated contract to determine the level of administrative functions included. See Appendix A for details. Related administrative dollars were not segregated out and reclassified as administrative expense.	No sub-capitated contracts met the 5% threshold.
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.	There is no variance when Schedule 1 is compared to Schedule 6a. Schedule 1 is understated by 0.24% or $407,477 when compared to Schedule 7.	Schedule 1 understated by 0.16% or $1,469,845, when compared to Schedule 6a. There is no variance when Schedule 1 is compared to Schedule 7.
Provider Incentive Arrangements	Mercer requested a listing of all provider incentive arrangements, by	Variance: RDT Provider Incentive Expense is overstated by 4.21%	Variance: RDT Provider Incentive Expense is understated by

Category	Description	Results CMC	Results Non-CMC
	provider, by month and compared the amounts to Schedule 6a, lines 34–36.	or $155,396, which is 0.09% of total medical expenses.	1.72% or $4,301, which is 0.00% of total medical expenses.
	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 noted.	No variance noted.
	Mercer reviewed the listing of provider incentive payments for any payments to related parties.	N/A.	N/A.
	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	N/A.	N/A.
Reinsurance	Mercer reviewed the reinsurance contract and compared the amount on the RDT to the requested supporting schedule.	N/A. No reinsurance in place for CMC.	Variance: Reported Reinsurance Net of Recovery on the RDT is understated by 7.02% or $14,768, which is 0.00% of total medical expenses.
	Mercer recalculated reinsurance premiums, based on 2019 member months and	N/A.	Variance: RDT was understated by 6.52% or $13,705. This amount is

Category	Description	Results CMC	Results Non-CMC
	compared to reported amounts.		included in the overall variance reported in the prior line item.
	Mercer recalculated recoveries for a sample of five members.	N/A. No reinsurance in place for CMC.	N/A. No cases exceeded the reinsurance threshold.
	Mercer compared the amount of reinsurance recoveries as compared to the information in Schedule 5 for reasonableness.	N/A. No reinsurance in place for CMC.	N/A. No cases exceeded 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 did not incur any settlements for CY 2019.	HNC did not incur any settlements for CY 2019.
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 Two-Plan/GMC plans reporting a value for TPL.	The benchmark TPL PMPM and percentage were $0.10 and 0.01%, respectively. HNC reported $0.00 PMPM and 0.00% for the TPL PMPM and percentage of medical expense, respectively. HNC does pursue recoveries and	The benchmark TPL PMPM and percentage were $0.24 and 1.97%, respectively. HNC reported $0.00 PMPM and 0.00% for the TPL PMPM and percentage of medical expense, respectively. HNC does pursue recoveries and

Category	Description	Results CMC	Results Non-CMC
		reports their claims expense net of TPL recoveries.	reports 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 4.60% and HNC reported 5.70%. This percentage remains within an acceptable range.	The benchmark administrative percentage was 4.17% and HNC reported 2.68%. This percentage remains within an acceptable range.
	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.	No variance noted.
Taxes	Mercer reviewed to ensure proper reporting of federal, state, and local taxes on line 59 of Schedule 6a. If no taxes reported on Schedule 6a, we confirmed the organization is not subject to taxes.	HCN discovered an error in the allocation formula for taxes which excluded allocating taxes to CMC, thus RDT is understated 100%. HNC will correct in future reporting.	HNC properly reported provision for taxes on Schedule 6a.

Category	Description	Results CMC	Results Non-CMC
Related Party Transactions	Mercer obtained related party agreements for medical services and 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.	HNC has stated they do have related party relationships with Health Net, LLC, Health Net Pharmaceutical Services (HNPS), Envolve Vision, Inc., Managed Health Network, LLC (MHN), and Envolve PeopleCare, Inc.	
		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 $1.2 million for CMC and $1.3 million for non-CMC. This represents 14.44% and 29.18% of pharmacy expense for CMC and non-CMC, respectively. The PBM expense is appropriately included in administrative costs, however, appears notably high compared to industry standards. HNC contracts with MHN 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. See non-CMC results for relationship with the global subcontractor, Molina. However, HNC CMC does not contract with Molina.	

Category	Description	Results CMC	Results Non-CMC
	If related party contracts are a material portion of the related medical COS, Mercer also reviewed any allocation methodologies for reasonableness.	HNC pays HNPS under a traditional pricing model for Medicaid members. Rates are negotiated in the pharmacy network and 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 reviews 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 recalculated 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 plan under review when reviewing the results.	The benchmark UM/QA/CC percentage was 3.14% and HNC reported 0.76%. Per review of HNC reporting methodology, relevant departmental costs are identified systematically in the general ledger utilizing the costs incurred by specific administrative	The benchmark UM/QA/CC percentage was 2.15% and HNC reported 0.63%. Per review of HNC reporting methodology, relevant departmental costs are identified systematically in the general ledger utilizing the costs incurred by specific administrative

Category	Description	Results CMC	Results Non-CMC
		departments and reported appropriately as UM/QA/CC.	departments and reported appropriately as UM/QA/CC.
	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 overstated by 1.13%, or $15,174, which is 0.00% of total medical expense.	Variance: Schedule 1-U is overstated by 1.13%, or $65,498, which is 0.01% of total medical expense.
	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.	Confirmed.
Pharmacy	Mercer confirmed and observed pharmacy benefit manager fees were recorded as administrative expenses and not included in pharmacy	Confirmed. See note in Related Party section above regarding reasonableness of PBM expense.	Confirmed. See note in Related Party section above regarding reasonableness of PBM expense.

Category	Description	Results CMC	Results Non-CMC
	claims expenses in the RDT.		
	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 ($43.70) and HNC reported $0.00. HNC should ensure all available rebates are claimed and reported appropriately.	The benchmark pharmacy rebate PMPM was ($0.11) and HNC reported ($0.01). HNC should ensure all available rebates are claimed and reported appropriately.
Capitation Revenue	Mercer compared capitation amounts reported in Schedule 6a with the CAPMAN file received from DHCS. The CAPMAN file contains all amounts paid to the health plan by DHCS.	Variance: RDT is understated by 2.61%, or $988,669.	Variance: RDT is understated by 0.04%, or $399,823.
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 understated by 11.66% or $129,114. The variance is due to the methodology utilized for RDT versus Audited Financial Statements.	Variance: RDT is overstated by 3.02% or $158,069. The variance is due to the methodology utilized for RDT versus Audited Financial Statements.
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.	Clean audit opinion observed.	Clean audit opinion observed.

Category	Description	Results CMC	Results Non-CMC
	Mercer compared reported expenses, including IBNR and administrative expenses, to audited financial statements for consistency.	No material variances noted.	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 perform monthly screening and reviewing of claims and encounter data. After thorough evaluation and determination, HNC claims department addresses the reconciliation of prohibited payments. Based on support provided, HNC does not exclude HAC costs from RDT reporting. Per federal guidelines, HAC costs are not allowable costs for capitation rate setting data and therefore should not be included in the RDT reporting. HNC should exclude these costs in future reporting.	

Section 3

Summary of Findings CMC

Based on the procedures performed, the total amount of gross medical expenditures in the RDT were understated by $407,403 or 0.23% of total medical expenditures in the CY 2019 RDT.

Based on the procedures performed, administrative expenditures in the CY 2019 RDT showed 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 the following comments:

Section 4

Summary of Findings Non-CMC

Based on the procedures performed, the total amount of gross medical expenditures in the RDT were overstated by $8,627,161 or 0.94% of total medical expenditures in the CY 2019 RDT.

Based on the procedures performed, administrative expenditures in the CY 2019 RDT showed 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 the following comments:

Appendix A

Administrative Duties in Subcontracted Arrangements

Administrative Task	Molina (Global)	Regal
Quality Management	X	
Quality Measure Tracking	X	
Utilization Management	X	
Case Management	X	
Member Services	X	
Member Grievance	X	
Claims Processing	X	
Claims Adjudication and Payment	X	
Encounter Submission	X	X
Provider Services	X	
Provider Contracting	X	
Provider Relations and Education	X	
Credentialing and Recredentialing	X	

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