Mercer

Government Human Services Consulting

Calendar Year 2019 Kaiser Foundation Health Plan Coordinated Care Initiative Rate Development Template

Auditor's Report

California Department of Health Care Services

January 18, 2024

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Contents

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 Kaiser Foundation Health Plan (KFHP). 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 KFHP for the CY 2019. KFHP's management is responsible for the content of the RDT and responded timely to all requests for information. While KFHP participates in the Coordinated Care Initiative (CCI) Medi-Cal program, KFHP only has a contract for members that are not Cal MediConnect (CMC) members and are classified as Non-CMC. As a result, this report only references Non-CMC results.

Table 1: Procedures

Category	Description	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 CCI Medi-Cal program, confirm the COS grouping was correct, confirm the year reported was correct, and confirm enrollment with KFHP for date of service.	• Control totals: No variance noted. • Eligibility: No variance noted. • COS Map: Confirmed 98.89% of Non-Pharmacy Claims and 100.00% of Pharmacy Claims. • Service Year CY 2019: No variance noted.
	Mercer compared detailed lag tables for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility — Long-Term Care [LTC], and All Others) created from the paid claims data files provided by KFHP and compared the information reported in Schedule 7. Mercer	Variance: RDT FFS Expenses are over/(under) stated: • Inpatient 23.45% or 0.96% of FFS • Outpatient 9.87% or 0.47% of FFS • LTC (5.14%) or (3.98%) of FFS • Physician (6.96%) or (0.08%) of FFS • Pharmacy (241.91%) or (0.13%) of FFS • All Other 33.54% or 4.97% of FFS In Total overstated by 2.16% or $389,438, which is 1.34% of Total Medical Expense.

Category	Description	Results Non-CMC
	compared the paid claims amounts from Schedule 7, line 35 and the incurred but not reported amount from Schedule 7, line 40 to total paid claims data as provided by the KFHP. Allowable absolute value variances were deemed to be not greater than 2% for inpatient claims and 1% for all other COS.	A portion of the large variances above are due to the removal of the overstatement of FFS as a result of FFS testing, detailed below and in Appendix A. The overstated amount was removed from audit calculations of paid FFS claims across all COS in proportion to what was reported as paid in the RDT submission. It should be noted, 91% of the FFS expense is in the LTC and Other COS, and consequently the remaining COS have a relatively smaller denominator which artificially increases the variance percentage reported. As a result, the inclusion of the variance as a percent of total confirmed FFS expense is included.
	Using data files (paid claims files) provided by KFHP, Mercer sampled and tested 65 transactions for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility — LTC, and All Others) and traced sample transactions through KFHP's claims processing system, the payment remittance advice, and the bank statements.	Variance: The sample found 9 claims had errors. After discussion with KFHP, it was determined that the total impact of the findings resulted in a net overstatement of $581,808, or 0.11% of total medical expense. The derived results were removed from the total results mentioned above.
Global Subcontracted Payments	Mercer requested overall global capitation supporting detail. Mercer compared the support provided to the amounts reported in Schedule 1A.	KFHP has no global capitation arrangements.

Category	Description	Results Non-CMC
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. Given the nature of KFHP's unique provider network and subcontracted arrangements, Mercer modified the procedures in this section to align with the contracted arrangements. For additional information see the section below on Related Party Transactions.	Variance: RDT is overstated in total by 35.37%, or $3,550,941, or 12.25% of total medical expense. The total of the supporting detail provided did align with the amounts reported in the RDT. However, upon further review, detail to support the reported expense was redacted and therefore the information provided was not sufficient to validate the full amount reported.
	Mercer reviewed the related contractual arrangements of KFHP's sub-capitated providers, and recalculated the total payment amounts by sub-capitated provider using membership information provided by DHCS.	Variance: RDT is overstated by $101,568, or 1.45%, or 0.35% of total medical expense. This variance is based on recalculated contracted per member per month (PMPM) rates. In addition, dollar-for-dollar reimbursements reported totaling $3,449,373 or 34.36%, or 11.90% of total medical expense, were identified in support documents. The contractual documents submitted as support did not provide sufficient information to validate the purpose of the expense. Both amounts are included in the overall variance noted above.
	Mercer observed proof of payments via relevant bank statements, clearing	Mercer was unable to validate sub-capitated medical expense payments as they are

Category	Description	Results Non-CMC
	house documentation, or other online financial institution support for the sampled sub-capitated provider payments in the previous step.	journal entry items only in the KFHP organization rather than actual payments.
	Mercer obtained National Provider Identification (NPI) information for the subcontractors and utilized that information to analyze claims and verify the FFS claims paid should have been paid under the sub-capitated arrangement and were not also included in sub-capitated expense.	FFS claims paid for the members were contractually appropriate.
	If applicable, Mercer reviewed Full-Dual category of aid (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 determined Full-Dual COA subcontracted PMPM payment rates are not appropriately reduced appropriately as compared to the non-Full Dual COAs. The contracted PMPM is weighted across all Medi-Cal COAs and therefore medical expense maybe over or understated based on the actual member mix versus the member mix assumed in the contracted PMPM development.
	For sub-capitated arrangements 5% or more of total medical expense or major COS, Mercer reviewed the sampled	Two sub-capitated arrangements met the threshold. KFHP did not segregate a portion of the capitation expense as administrative expense. Per review of the provided Medical Service Agreements, KFHP's subcontracts allow for reimbursement of certain costs not included in contracted PMPM. The Medical

Category	Description	Results Non-CMC
	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.	Service Agreements indicate reimbursement amounts are to be identified in the contract or at time of payment; however, in the documentation provided, relevant information was redacted and therefore not sufficient to determine if the expense should be considered administrative or medical.
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 or to Schedule 7.
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 overstated by 76.00% or $158,716 or 0.55% of Total Medical Expense. The total of the detail provided did align with the amounts reported in the RDT. However, upon further review of the support, the criteria of an allowable incentive were not met. KFHP reported a total of three incentive programs, two of which are based on criteria related to net program revenue and operating margin. This type of arrangement does not qualify as an allowable incentive arrangement and therefore should not be included as medical expense.
	From the listing of provider incentive payments, Mercer sampled the highest	Mercer was unable to validate incentive expense payments as they are journal entry items only in the KFHP organization rather than actual payments.

Category	Description	Results Non-CMC
	two payment amounts and one random payment. Mercer observed proof of payments for the sampled provider incentive payments.	
	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.	KFHP's incentive programs are between The Permanente Medical Group, Southern California Permanente Medical Group (Medical Groups), Kaiser Foundation Hospitals (KFH), and KFHP. While the medical groups maintain they are independent from KFHP, their total contract payments are a significant portion of KFHP's medical expenses (35%), including incentives, and have a significant influence over KFHP's financial performance. Mercer was unable to validate incentive expense payments as they are journal entry items only in the KFHP organization rather than actual payments. For additional information see the section below on Related Party Transactions.
Reinsurance	Mercer reviewed the reinsurance contract and compared the amount on the RDT to the requested supporting schedule.	Mercer confirmed KFHP had no reinsurance agreements for CY 2019.
Settlements	Mercer inquired of the KFHP 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	Mercer confirmed KFHP did not report any settlements related to CY 2019 and they are not aware of any settlements related to the Medi-Cal membership that that should have been included in reporting.

Category	Description	Results Non-CMC
	the status of the settlements, and where the amount(s) are reported in the RDT.	
Third-Party Liability (TPL)	Mercer reviewed TPL as a PMPM and as a percentage of medical expense on Schedule 6.1a and 6.2.3a, line 39 as compared to benchmark information across those plans reporting a value for TPL.	The benchmark TPL PMPM and percentage of Total Medical Expense were ($0.24) and (0.05%), respectively. KFHP reported no TPL recoveries in line 39 and confirmed no TPL recoveries were identified for CY 2019 RDT reporting.
Administrative Expenses	Mercer benchmarked administrative expenses as a percentage of net revenue across all Two-Plan/Geographic Managed Care (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 4.17% and KFHP reported 4.20%.
	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	No variance noted. KFHP reported administrative expenses are allocated based on direct patient care expense and based on member months. Information related to other lines of business member months was not made available and therefore Mercer was unable to recalculate.

Category	Description	Results Non-CMC
	recalculated for reasonableness.	
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.	Mercer confirmed that the plan is not subject to federal and state income taxes.
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.	Forty percent of KFHP's medical expenses are part of agreements between KFHP, the Medical Groups, KFH, and Kaiser Pharmacies. While the Medical Groups maintain they are independent from KFHP, total payments are approximately 35% of the medical expenses reported by KFHP and all contractual payment transactions are completed via internal journal entries. Therefore, the Medical Groups are determined to have an influential impact on the financial performance of KFHP similar to what would be considered a related party. The majority of the remaining KFHP medical expense is comprised of FFS reimbursement; therefore, KFHP does not have any similar non-related party arrangements to compare for reasonability and Mercer is not able to determine if the terms are at fair market value.
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	The benchmark UM/QA/CC percentage was 2.15% and KFHP reported 2.35%.

Category	Description	Results Non-CMC
	into consideration the membership size of the 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: RDT is understated by $3,741 or 0.55%, or 0.01% of total medical expense.
	Mercer interviewed financial management to determine how health care quality improvement activities such as CC are isolated from general administrative expenses in the general ledger.	Mercer confirmed with KFHP management via interview that UM/QA/CC costs were not also included in general administrative expenses.
Pharmacy	Mercer confirmed and observed pharmacy benefits manager (PBM) fees were recorded as administrative expenses and not included in pharmacy claims expenses in the RDT.	For the CY 2019 CCI RDT, KFHP determined that due to the fact that minimal pharmacy costs are reported as Medi-Cal expense, that PBM Fees would be immaterial and therefore were not reported. The majority of the members' pharmacy expense would be covered under the member's primary coverage (e.g., Medicare). Therefore, the administrative expense in the RDT would be understated by KFHP's estimated PBM-like fee. As KFHP owns its pharmacies, and there is no actual PBM fee, KFHP calculates an allocation using direct pharmacy costs when appropriate.

Category	Description	Results Non-CMC
	Mercer benchmarked pharmacy rebate PMPMs across all Two-Plan/GMC plans and compared to the amount reported on Schedule 7.	The benchmarked pharmacy rebate PMPM was ($0.11) and KFHP reported ($0.00). For RDT reporting KFHP utilizes the actual purchase price of each prescription drug dispensed from our pharmacy system and reduces this amount by the average rebate rate net of the average other costs not in the pharmacy system, creating a cost of goods sold (COGS). Then COGS is increased by allocating the direct pharmacy cost including salaries, wages and benefit costs for pharmacist and pharmacy techs and supplies. While the rebate is considered in KFHP's calculation of COGS it should be noted that the benchmark pharmacy expense PMPM was $4.97 and KFHP reported $0.14.
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 overstated by 0.52% or $159,484.
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.	Interest and Investment income was not reported on the CY 2019 RDT. KFHP did not report on the RDT due to the losses incurred for KFHP on the Medi-Cal program, therefore KFHP did not report interest/investment income earned on this line of business. If in actuality interest or investment income was earned related to the Medi-Cal line of business, the RDT is understated 100%.

Category	Description	Results Non-CMC
Other Information	Mercer reviewed the audited financial statements for the plan for CY 2019 for a clean audit opinion or identification of significant deficiencies or material weaknesses.	Mercer confirmed a clean audit opinion for the period. However, in the 2019 Internal Control Letter provided by KFHP, the external auditor identified an issue in internal control that was determined to be a significant deficiency. The external auditor identified certain contractors had inappropriate access to KFHP's systems after their termination date, creating a risk that inappropriate access to the systems could mean data could be manipulated or errors or irregularities could occur. KFHP Management's response was to initiate the development of a comprehensive plan to support timely enforcement of contractor resource termination. The 2020 internal control letter mentioned a similar significant deficiency related to inappropriate access to KFHP's systems after non-managed contractors are terminated.
	Mercer compared reported expenses, including incurred but not reported and administrative expenses, to audited financial statements for consistency.	Support provided by KFHP did not provide sufficient detail to analyze Medical and admin expense as compared to the RDT. However, the review of total direct Medi-Cal operating income is consistent to that reported in the RDTs.
	Mercer inquired how hospital-acquired conditions (HAC) were treated in the RDT and policies for payment.	Possible HACs are identified by Quality and Risk, Infection Prevention, or coding teams at Kaiser Hospitals, and billing is stopped pending review, consistent with CDC guidelines. KFHP does not pay any Kaiser hospital or any external hospital for treatment of HACs and no cost to provide HAC care is included in KFHP's RDT.

Section 3

Summary of Findings Non-CMC

Based on the procedures performed, the total amount of gross medical expenditures in the RDT were overstated by $4,095,354 or 14.13% 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 material yet do not warrant corrective action. The majority of this variance is due to subcapitation reimbursements where the documents submitted as support did not provide sufficient information to validate the purpose of the expense. Much of the support provided had some level of redacted information which made it difficult to validate the appropriateness of the amounts under review. In some instances, 100% of the amounts being tested were considered a variance if the detail necessary to understand the nature of the expense was redacted.

In addition, the issues uncovered during FFS sample testing identified multiple concerns with the way data from outside the KFHP organization is used and retrieved for RDT reporting. As KFHP reviewed the sample selection, they identified the root of the issues and provided DHCS with the steps necessary to correct and prevent the issues from reoccurring.

Furthermore, the subcontracted PMPM rates paid by KFHP are weighted across all Medi-Cal COAs. This method of payment may cause medical expense to be over or understated based on the actual member mix versus the member mix assumed in the contracted PMPM development.

It should be noted that due to KFHP's unique organization structure, their limited subcontracted network, and the lack of detail provided in support, numerous audit procedures were altered or were unable to be performed. Where relevant, this has been noted in the procedure description column.

Therefore, no corrective action is warranted, as long as it is confirmed the system improvements outlined by KFHP have been implemented.

KFHP reviewed this report and had the following comments:

KFHP has reviewed the CY2019 RDT audit findings and note that the system improvements have been implemented. For the 2021 reissue of the quarterly CY 2019 RDT, we pulled all claims data directly from the claims system instead of pulling from the encounter data. We have also built internal checking logics to ensure that only the most recent version of clean claims is used to eliminate duplicates and reversals or re-adjudications. For CY 2020 and thereafter, we pulled all claims data directly from the claims system and apply similar

internal checking logics to avoid errors. KFHP acknowledges there was no variance shown on administrative expenses. For sub-capitated medical expense, an overstatement of $3 million was noted related to dollar-for-dollar reimbursements. This expense was not overstated and KFHP provided the auditors a reconciliation of RDT medical expense that tied to our audited financial statements as support. It is KFHP's normal practice to reimburse the Permanente Medical Groups through inter-entity accounting and the journal entries referenced in the audit report represent actual payments. KFHP acknowledges Full Dual COA subcontracted PMPM payment rates are not reduced as compared to non-Full Duals COA. While KFHP acknowledges the assessment on provider incentive arrangements in which some of the incentive programs are based on criteria related to net program revenue and operating margin, this is discretionary, and there were no clear definitions provided in the RDT template. KFHP acknowledges the assessment on related party transactions given the nature of KFHP's unique provider network and subcontracted arrangements. KFHP acknowledges that we sent the auditors our non-operating interest and investment income for 2019. However, as we run a large negative cash flow from our Medi-Cal business, none of this can be attributed to our Medi-Cal line of business and it was appropriate for us to exclude it from our CY2019 RDT. Thank you for the many meetings and communications as we worked through this RDT audit.

Mercer Health & Benefits LLC
2325 East Camelback Road, Suite 600
Phoenix, AZ 85016
www.mercer-government.mercer.com