



AUDITORS REPORT

CALENDAR YEAR 2017

KAISER FOUNDATION

HEALTH PLAN RATE

DEVELOPMENT

TEMPLATE

September 9, 2020

Contents

- 1. Executive Summary 1
- 2. Procedures and Results..... 2
- 3. Summary of Findings 6

1

Executive Summary

Pursuant to federal requirements under Title 42 of the Code of Federal Regulations 438.602(e), the 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)¹. DHCS contracted with Mercer Government Human Services Consulting (Mercer) to fulfill this requirement for the financial data submitted in the Medi-Cal Rate Development Template (RDT) for calendar year (CY) 2017 by the 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 Bridge Year rating period (July 1, 2019 – December 31, 2020). The RDT tested was the final version, including any revisions stemming from resubmissions as a result of the RDT Q&A 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 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 2017 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 calendar year reported.

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

¹ 42 CFR 438.602(e)

2 Procedures and Results

We have 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 2017. KFHP's management is responsible for the content of the RDT and responded timely to all requests for information.

Table 1: Procedures

Category	Description	Results
Utilization and Cost Experience	We compared summarized total net cost data from amounts reported in Schedule 1 to Direct Medi-Cal category of service (COS) totals from Schedule 6a and to total incurred claims by COS for Schedule 7 for consistency.	Schedule 1 is overstated by 0.05% when compared to Schedule 6a and no material variance when compared to Schedule 7.
Member Months	We compared MCO reported member months from Schedule 1C to eligibility and enrollment information provided by the State. Our procedures are to request explanations for any member months with greater than 1% variance in total or greater than 2% variance by major category of aid.	Variance: RDT overstated by 0.07% in total.
Capitation Revenue	We discussed how capitation was recorded. KFHP records capitation revenue on an accrual basis using eligibility from the 834 data multiplied by rates established on the most current rate sheet received from DHCS.	Variance: Schedule 6a is understated by 0.47% or \$2,382,916, based on estimated revenue calculation using the known capitation rates in place during 2017.
Interest and Investment Income	We 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 CY2017 RDT. Per discussion with KFHP, no amount was reported on the RDT due to the losses incurred for KFHP on the Medi-Cal program, therefore no interest/investment income earned on this line of business. However, KFHP provided support for an amount that was applicable to the Medi-Cal line of business, thus this was the amount used by Mercer as the RDT reported variance.	Variance: RDT is understated by 100.00%, \$1,448,334, or 0.28% of Net Revenue.

Category	Description	Results
Fee For Service Medical Expense	Using data files (paid claims files) provided by KFHP, we sampled and tested transactions for each major category of service (COS) (Inpatient, Outpatient, Physician, Pharmacy, Facility-Long Term Care (LTC), and All Others) and traced sample transactions through KFHP claims processing system, the payment remittance advice, and the bank statements.	No variance observed.
	We compared detailed lag tables for each major COS (Inpatient, Outpatient, Physician, Pharmacy, Facility- (LTC), and All Others) created from the data files provided by KFHP and compared the information reported in Schedule 7. We compared the paid claims amounts from Schedule 7, line 35 to total paid claims prior to the additional runout detail included in the data files, expecting no changes.	Variance: RDT understated in total by 1.82% of total FFS claims payments reported on Schedule 7, or \$9,308,084.
	We compared total final incurred amounts including incurred but not reported (IBNR) estimates from Schedule 7 to total paid amounts from all months reported in the data files to verify the accuracy/reasonableness of IBNR for each COS. Allowable absolute value variances were deemed to be not greater than 2% for inpatient claims and 1% for all other COS.	Variance: RDT over/(understated): Inpatient (7.37%); LTC (15.39%); Outpatient (0.72%); Pharmacy (1.55%); Physician 0.14%; All Other (5.58%); In Total (1.82%), or \$9,303,585.
	We confirmed and observed pharmacy benefit manager (PBM) fees were inappropriately recorded as pharmacy expense and included in pharmacy FFS claims expenses in the RDT.	Variance: RDT Pharmacy expense line item was overstated by 2.74%, or \$1,859,701.
	We reviewed a sample of claims from each COS to verify control totals, verify eligibility, confirm the COS grouping was correct, and confirm the year reported was correct.	Control totals: No variance noted. Eligibility: Verified for all members selected. COS Map: No variance noted. Service Year: No variance noted.
Sub-capitated Medical Expense	We compared reported sub-capitation payments to amounts reported in Schedule 7.	Variance: RDT overstated by 0.14%, or \$361,801.
	We sampled membership from three subcontractors, verified eligibility of members and analyzed claims to verify none of the FFS claims paid should have been paid by the sub-capitated provider.	No variance noted.

Category	Description	Results
	We reviewed subcontract agreements and recalculated payment amounts for reasonableness.	Variance: RDT is overstated by 18.25%, or \$24,226,396, based on contracted PMPM rates. Variance attributed to additional dollar-for-dollar reimbursements in contract; detail was not sufficient to validate amount reported.
	We attempted to observe proof of payments for a sample of sub-capitated provider payments.	Variance: We were unable to validate sub-capitated medical expense payments as they are journal entry items only in the KFHP organization rather than actual payments.
Provider Incentive Arrangements	We reviewed incentive arrangements and observed sample calculations for contractual compliance and reasonableness.	Variance: RDT is understated by 100.00% as there was nothing reported on the RDT. However, the net amount was \$369 and not material.
Administrative Expenses	We benchmarked administrative expenses as a percentage of capitation 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 5.50% and KFHP reported 5.57%.
	We compared detailed line items from the plan's trial balance mapped to line items in Schedule 6a for reasonableness. We reviewed allocation methodologies and recalculated for reasonableness.	Variance: The RDT is understated by 7.59%, or \$1,859,701. PBM fees were reported in medical expense and should have been reported in administrative expense.
Utilization Management, Quality Assurance, Care Coordination (UM/QA/CC)	We 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. We compared UM/QA/CC costs as a percentage of revenue to benchmark for reasonableness. Confirmed with KFHP management via interview that UM/QA/CC costs were not also included in general administrative expenses.	The benchmark UM/QA/CC percentage was 1.23% and KFHP reported 0.29%.

Category	Description	Results
Pharmacy	We confirmed and observed PBM fees were inappropriately recorded as pharmacy expense and included in pharmacy FFS claims expenses in the RDT.	Variance: As mentioned above, PBM fees of \$1,859,701 were incorrectly reported on the pharmacy expense line item in the medical cost section of the RDT.
Other Information	We reviewed the audited financial statements for the plan for the CY 2017 for a clean audit opinion or identification of significant deficiencies or material weaknesses.	No variance noted.
	We compared reported expenses, including IBNR and administrative expenses, to audited financial statements for consistency.	Audited Financials are for Kaiser Foundation Health Plan, Inc. and subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals). Therefore, internal financials were used to complete this test. See results below.
	We compared reported expenses, including IBNR and administrative expenses, to internal financial statements for consistency.	No material variances noted.
	We inquired how hospital-acquired conditions (HACs) 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.

3

Summary of Findings

Based on the procedures performed, the total amount of gross medical expenditures in the RDT were understated by \$6,848,247 or 1.33% of total medical expenditures in the CY 2017 RDT.

Based on the procedures performed, administrative expenditures in the RDT were understated by \$1,859,701 or 7.59% of total administrative expenditures in the CY 2017 RDT.

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

Based on the defined variance threshold, the results of the audit for administrative expenditures are determined to be a significant variance. The variance is primarily due to the misclassification of PBM fees as medical rather than administrative. KFHP should report these fees correctly in the future to accurately reflect administrative expenses on the appropriate line items in the relevant RDT schedules.

KFHP has reviewed this report and had the following response:

KFHP has reviewed the CY2017 RDT audit findings and note that there were no material differences on medical expense. Although KPHP acknowledges that in CY 2017 we did not reclass any PBM fees to admin expense, we believe that auditor's estimate of \$1.9 million is overstated and the actual number is around \$0.3 million. Starting with our CY2019 RDTs, KFHP now reclasses estimated PBM-like fees from medical expense to admin. KFHP acknowledges that we sent the auditors our non-operating interest and investment income on a PMPM basis for 2017. 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 CY2017 RDT. For sub-capitated medical expense an overstatement of \$24 million was noted related to dollar for dollar reimbursements. This expense was not overstated and KFHP provided the auditors a reconciliation of RDT capitated 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. Thank you for the many meetings and communications as we worked through this first RDT audit.

Mercer (US) Inc.
2325 East Camelback Road, Suite 600
Phoenix, AZ 85016
www.mercer-government.mercer.com