

LOS ANGELES COUNTY AUDITOR-CONTROLLER

John Naimo
AUDITOR-CONTROLLER

Arlene Barrera
CHIEF DEPUTY

Peter Hughes
ASSISTANT AUDITOR-CONTROLLER

Robert Smythe
DIVISION CHIEF

AUDIT DIVISION

February 8, 2018

L.A. Care Health Plan FINANCIAL CONDITION REVIEW FOR FISCAL YEAR 2015-16



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REPORT #K17FH

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FACT SHEET

L.A. Care Health Plan

FINANCIAL CONDITION REVIEW FOR FISCAL YEAR 2015-16

With the support and active participation of L.A. Care Health Plan (L.A. Care or Agency), we evaluated the Agency's financial condition for Fiscal Year (FY) 2015-16, and assessed the outlook of the Agency's FY 2016-17 revenues and expenses.

Key Results

We noted that L.A. Care's income from operations significantly declined by approximately \$250 million in FY 2015-16 compared to FY 2014-15. However, L.A. Care continued to generate a positive income from operations and net position, and both are projected to increase in FY 2016-17. Specifically:

- L.A. Care continued to generate revenues in excess of expenses, generating nearly \$27 million in income from operations (\$7.758 billion in operating revenues less \$7.731 billion in operating expenses) in FY 2015-16.
- L.A. Care's net position was approximately \$524 million (\$4.136 billion in total assets less \$3.612 billion in total liabilities) in FY 2015-16.
- L.A. Care's FY 2016-17 projections indicate approximately \$128 million in income from operations (\$8.417 billion in operating revenues less \$8.289 billion in operating expenses).

FAST FACTS

L.A. Care is the Local Initiative Health Authority for the County of Los Angeles and the nation's largest locally-based, publicly-operated health plan with approximately 2.2 million members, as of September 2017.



This report is also available online at auditor.lacounty.gov
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For questions regarding the contents of this report, please contact Robert Smythe, Audit Division Chief, at rsmythe@auditor.lacounty.gov or (213) 253-0100.

REPORT #K17FH



**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-3873
PHONE: (213) 974-8301 FAX: (213) 626-5427

JOHN NAIMO
AUDITOR-CONTROLLER

February 8, 2018

TO: Supervisor Sheila Kuehl, Chair
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Janice Hahn
Supervisor Kathryn Barger

FROM: John Naimo 
Auditor-Controller

SUBJECT: **L.A. CARE HEALTH PLAN - FINANCIAL CONDITION REVIEW FOR
FISCAL YEAR 2015-16**

We have completed a review of L.A. Care Health Plan's (L.A. Care or Agency) annual financial condition for Fiscal Year (FY) 2015-16. L.A. Care is the Local Initiative Health Authority (Local Initiative) for the County of Los Angeles (County). Details of our review are included in Attachments I and II.

We conducted our review in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

Scope and Objectives

We evaluated L.A. Care's financial condition for FY 2015-16, and assessed the outlook of the Agency's FY 2016-17 revenues and expenses. Our review included interviewing L.A. Care financial management, analyzing their audited and forecasted financial statements, and reviewing the most recent regulatory agencies' reports on L.A. Care.

What Prompted the Review

The County is required by the State of California Welfare and Institutions Code (WIC) Section 14087.9675 to perform an annual financial condition review of its Local Initiative. We will continue to review L.A. Care's financial condition annually, as required.

Scope Exclusions

We did not evaluate L.A. Care's internal controls over their financial and administrative operations, or the financial performance of other comparable local initiatives. Although not required by WIC, we can review these areas at our discretion.

Review of Report

We discussed our report with L.A. Care management. L.A. Care's attached response (Attachment III) indicates general agreement with the results of our review.

We thank L.A. Care management and staff for their cooperation and assistance during our review. If you have any questions please call me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:PH:RS:JU

Attachments

c: Sachi A. Hamai, Chief Executive Officer
Fred Leaf, Interim Director, Los Angeles County Health Agency
Christina Ghaly, M.D., Acting Director, Department of Health Services
Lori Glasgow, Executive Officer, Board of Supervisors
L.A. Care Health Plan
John Baackes, Chief Executive Officer
Marie Montgomery, Chief Financial Officer
Audit Committee
Countywide Communications

**L.A. CARE HEALTH PLAN
FINANCIAL CONDITION REVIEW
FISCAL YEAR 2015-16**

Background

L.A. Care Health Plan (L.A. Care or Agency) is the Local Initiative Health Authority for the County of Los Angeles (County). L.A. Care is an independent, tax-exempt public agency created by the County, and initially funded by the State of California (State) and the Federal Government of the United States of America, to provide managed health care services to low-income County residents. The Agency was developed in response to the State's plan to transition Medi-Cal recipients to managed care. In 1994, Senate Bill (SB) 2092 was enacted, which enabled the creation of L.A. Care. Shortly after passage of SB 2092, the Board of Supervisors adopted an ordinance to establish L.A. Care as a separate legal entity from the County.

Operating Revenues and Expenses

We reviewed L.A. Care's independently audited financial statements, and noted that the Agency's operating revenues totaled approximately \$7.758 billion in Fiscal Year (FY) 2015-16, and included funds from the California Department of Health Care Services (DHCS), Centers for Medicare and Medicaid Services (CMS), State, County, individual member premiums, and various grant sources. L.A. Care's operating expenses totaled approximately \$7.731 billion in FY 2015-16, and mainly consisted of health care expenses, such as capitation for professional services (i.e., payments to providers), inpatient/outpatient claims (e.g., hospital and emergency room claims), and pharmacy claims. In FY 2015-16, L.A. Care's operating revenues and expenses increased by \$1.390 billion (22%) and \$1.640 billion (27%), respectively, from FY 2014-15 primarily due to a decrease in Medi-Cal Expansion (MCE) capitation rates and continuing increase in Medi-Cal memberships.

Although L.A. Care continued to generate revenues in excess of expenses of approximately \$27 million in FY 2015-16, their income from operations significantly decreased by approximately \$250 million from FY 2014-15. L.A. Care indicated that the decrease in income from operations was mainly due to the decrease in MCE capitation rates, in combination with the continued growth of Medi-Cal membership, which increased the number of inpatient/outpatient claims, and an increase in claims settlement liability. L.A. Care indicated that the increase in claims settlement liability was a result of prior years and FY 2015-16 underpaid provider claims caused by claims processing system errors, but that the majority of the claims settlement liability, totaling approximately \$104 million, was expensed during FY 2015-16. However, the Agency indicated that a new claims processing system was implemented in September 2016, which will correct the issue moving forward.

Details of L.A. Care's revenues and expenses for FY 2013-14 through FY 2015-16 are provided in Table 2 of Attachment II.

Financial Analyses

We used L.A. Care's financial information for FY 2015-16, and various financial ratios to determine the Agency's financial health and stability. We noted the following:

- **Short-term solvency, debt-paying capability, and ability to carry operating costs** - L.A. Care's current assets exceeded their current liabilities by 14%, while liquid assets (i.e., cash, short-term securities, and accounts receivable) exceeded current liabilities by 5%. This indicates the Agency has sufficient current resources to cover short-term liabilities, and is able to finance current operations, and meet obligations as they fall due.
- **Ability to generate revenues in excess of expenses** - As previously noted, L.A. Care continued to generate revenues in excess of expenses. L.A. Care generated nearly \$27 million in net operating income (\$7.758 billion in operating revenues less \$7.731 billion in operating expenses).
- **Financial performance requirements** - L.A. Care met the minimum tangible net equity (TNE) requirement, and had a positive net position of approximately \$524 million (\$4.136 billion in total assets less \$3.612 billion in total liabilities). Title 28 of the California Code of Regulations Section 1300.76 requires all health plans to maintain a minimum TNE to ensure a health plan's financial viability. In addition, L.A. Care's total administrative expenses of 3.7% remained below the 15% maximum administrative cost ratio (total administrative expenses over total revenue), as required by Title 28 of the California Code of Regulations Section 1300.78(b).

Details of L.A. Care's assets and liabilities for FY 2013-14 through FY 2015-16 are provided in Table 1 of Attachment II.

Outlook of Revenues and Expenses

Based on our review of L.A. Care's FY 2016-17 financial forecast, we noted that membership is projected to grow to 2.2 million (12%) by the end of FY 2016-17, while operating revenues and expenses are projected to increase to \$8.417 billion (9%) and \$8.289 billion (7%), respectively, which would increase income from operations to approximately \$128 million. L.A. Care indicated that the continued increase in revenues and expenses is attributed to the continued growth of Medi-Cal membership, and the increase in income from operations is mainly due to the decrease of claims settlement liability. The claims settlement liability is projected to decrease by \$67 million to approximately \$37 million in FY 2016-17, and is expected to continue to decrease in upcoming years with the implementation of the new claims processing system.

Oversight by Governing Agencies

L.A. Care's operations are reviewed by various governing agencies, including the Department of Managed Health Care, CMS, and DHCS. These regulatory agencies perform a variety of audits and reviews, including financial, operational, and administrative. Regulatory compliance findings in these audits and reviews may lead to corrective action plans, fines and penalties, and/or suspension or revocation of the State license, which could affect L.A. Care's financial condition. We reviewed the governing agencies' recent reports, and noted no issues that would affect the Agency's current or future financial condition.

Table 1			
L.A. Care Assets, Liabilities, and Net Position			
Fiscal Years (FY) 2013-14 Through 2015-16			
(In Thousands)			
	FY 2013-14	FY 2014-15	FY 2015-16
Current Assets:			
Cash & Cash Equivalents	\$ 595,351	\$ 182,755	\$ 642,865
Investments - At Fair Value	300,208	1,501,100	2,060,639
Capitation Receivable	393,087	1,053,007	1,030,897
Other Current Assets	27,298	51,687	312,279
Total Current Assets	\$ 1,315,944	\$ 2,788,549	\$ 4,046,680
Non-Current/Capital Assets	\$ 38,805	\$ 69,118	\$ 89,463
Total Assets	\$ 1,354,749	\$ 2,857,667	\$ 4,136,143
Current Liabilities:			
Accounts Payable and Accrued Liabilities	\$ 41,509	\$ 48,485	\$ 70,947
Sub-Capitation Payable	609,737	663,692	1,087,602
Medi-Cal Adult Expansion Payable	62,910	970,295	1,538,346
Grants Payable	827	1,502	2,697
Reserved for Claims	302,457	450,900	579,834
Other Accrued Medical Expenses	49,616	105,691	221,221
Reserves for Provider Incentives	50,258	84,400	62,808
Total Current Liabilities	\$ 1,117,314	\$ 2,324,965	\$ 3,563,455
Deferred Rent/Revenues	\$ 17,361	\$ 39,762	\$ 48,876
Total Liabilities	\$ 1,134,675	\$ 2,364,727	\$ 3,612,331
Net Position:			
Invested in Capital Assets	\$ 28,654	\$ 46,591	\$ 64,508
Restricted	300	300	300
Unrestricted	191,120	446,049	459,004
Total Net Position	\$ 220,074	\$ 492,940	\$ 523,812
Total Liabilities & Net Position	\$ 1,354,749	\$ 2,857,667	\$ 4,136,143

Source: L.A. Care's Audited Financial Statements

Table 2			
L.A. Care Revenues and Expenses			
Fiscal Years 2013-14 Through 2015-16			
(In Thousands)	<u>FY 2013-14</u>	<u>FY 2014-15</u>	<u>FY 2015-16</u>
Operating Revenues			
Capitation	\$ 4,137,151	\$ 6,366,010	\$ 7,755,317
Grant Income	3,182	1,719	2,290
Total Operating Revenues	\$ 4,140,333	\$ 6,367,729	\$ 7,757,607
Operating Expenses			
Capitation - Professional Services	\$ 2,531,919	\$ 3,350,294	\$ 3,888,706
Inpatient / Outpatient Claims	933,551	1,831,100	2,975,145
Pharmacy Claims	283,888	426,312	472,632
Administrative Expenses	176,825	255,852	298,419
Provider Incentives and Shared Risk	52,039	148,758	43,280
Risk Sharing Provision	57,785	14,801	1,223
Medical Administrative Expense	58,521	63,995	51,789
Total Operating Expenses	\$ 4,094,528	\$ 6,091,112	\$ 7,731,194
Income from Operations	\$ 45,805	\$ 276,617	\$ 26,413
Non-Operating Revenue / (Expense)			
Investment/Income/Tax Revenue	\$ 158,279	\$ 252,968	\$ 276,498
Provision/Tax Expense	(159,953)	(256,719)	(272,038)
Total Non-Operating Revenue / (Expense)	\$ (1,674)	\$ (3,751)	\$ 4,460
Increase in Net Position	\$ 44,131	\$ 272,866	\$ 30,873
<i>Source: L.A. Care's Audited Financial Statements</i>			



January 11, 2018

County of Los Angeles
Department of Auditor-Controller
ATTN: Jon Naimo
500 West Temple Street, Room 525
Los Angeles, California 90012-3873

RE: L.A. Care Health Plan – Financial Condition Review for Fiscal Year 2015-2016

Dear Mr. Naimo,

We have reviewed the report from the Department of Auditor-Controller for the above-mentioned Financial Condition Review and agree in substance with the information as presented.

Sincerely,

A handwritten signature in blue ink that reads "Marie Montgomery".

Marie Montgomery
Chief Financial Officer, L.A. Care