

LOS ANGELES COUNTY AUDITOR-CONTROLLER

John Naimo
AUDITOR-CONTROLLER

Arlene Barrera
CHIEF DEPUTY

Peter Hughes
ASSISTANT AUDITOR-CONTROLLER

Mike Pirolo
INTERIM DIVISION CHIEF

AUDIT DIVISION

November 15, 2018

L.A. Care Health Plan FINANCIAL CONDITION REVIEW FOR FISCAL YEAR 2016-17



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REPORT #K18ET

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FACT SHEET

L.A. Care Health Plan

FINANCIAL CONDITION REVIEW FOR FISCAL YEAR 2016-17

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) 2016-17, and assessed the outlook of the Agency's FY 2017-18 revenues and expenses.

Key Results

We noted that L.A. Care's income from operations increased by approximately \$121 million in FY 2016-17 compared to FY 2015-16, contributing to a positive change in net position. Both income and net position are projected to increase in FY 2017-18. Specifically:

- L.A. Care continued to generate revenues in excess of expenses, generating approximately \$148 million in income from operations (\$8.771 billion in operating revenues less \$8.623 billion in operating expenses) in FY 2016-17.
- L.A. Care's net position was approximately \$677 million (\$5.958 billion in total assets less \$5.281 billion in total liabilities) in FY 2016-17.
- L.A. Care's FY 2017-18 projections indicate a decrease in operating revenues and expenses to \$7.813 billion and \$7.643 billion, respectively, but income from operations will increase to approximately \$170 million.

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 2.21 million members, as of June 2018.



This report is also available online at auditor.lacounty.gov
Report Waste, Fraud, and Abuse: fraud.lacounty.gov

For questions regarding the contents of this report, please contact Mike Pirolo, Audit Interim Division Chief, at mpirolo@auditor.lacounty.gov or (213) 253-0100.

REPORT #K18ET



JOHN NAIMO
AUDITOR-CONTROLLER

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

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November 15, 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 2016-17**

We have completed a review of L.A. Care Health Plan's (L.A. Care or Agency) annual financial condition for Fiscal Year (FY) 2016-17. L.A. Care is the Local Initiative Health Authority (Local Initiative) for the County of Los Angeles (County). Please see Attachments I and II for details of our review.

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 2016-17, and assessed the outlook of the Agency's FY 2017-18 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. The appropriateness of L.A. Care's administrative costs have been reviewed in prior audits. 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 Mike Pirolo at (213) 253-0100.

JN:AB:PH:MP:JU

Attachments

c: Sachi A. Hamai, Chief Executive Officer
Fred Leaf, Interim Director, Los Angeles County Health Agency
Christina Ghaly, M.D., Director, Department of Health Services
Celia Zavala, 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 2016-17

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 \$8.771 billion in Fiscal Year (FY) 2016-17, 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 \$8.623 billion in FY 2016-17, 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 2016-17, L.A. Care's operating revenues and expenses increased by \$1.013 billion (13%) and \$891 million (12%), respectively, from FY 2015-16 primarily due to an increase in various Medi-Cal capitation revenue rates, an increase in capitation expense rates, and membership growth.

Details of L.A. Care's revenues and expenses for FYs 2014-15 through 2016-17 are provided in Table 2 of Attachment II.

Financial Analyses

We used L.A. Care's financial information for FY 2016-17, 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 liabilities slightly exceeded their liquid assets (i.e., cash, short-term securities, and accounts receivable) by 4%. The Agency indicated that this was primarily due to a reclassification of Coordinated Care Initiative (CCI) program receivables to current assets, which in prior fiscal years were netted with the CCI program payables and reported under current liabilities at a time when the materiality of the receivable was minimal. In FY 2016-17, CCI program receivables

were appropriately reported under Other Current Assets (non-liquid assets), which increased current liabilities, since the program receivables were no longer offsetting the program payables. Despite the reclassification, L.A. Care's current assets exceeded their current liabilities by 12%.

- **Ability to generate revenues in excess of expenses** - L.A. Care continued to generate revenues in excess of expenses. L.A. Care generated approximately \$148 million in net operating income (\$8.771 billion in operating revenues less \$8.623 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 \$677 million (\$5.958 billion in total assets less \$5.281 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 3.8% 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 FYs 2014-15 through 2016-17 are provided in Table 1 of Attachment II.

Outlook of Revenues and Expenses

Based on our review of L.A. Care's FY 2017-18 financial forecast, we noted that membership is projected to grow to 2.22 million (3%) by fiscal year-end (September 2018), while operating revenues and expenses are projected to decrease to \$7.813 billion (11%) and \$7.643 billion (11%), respectively, but income from operations will continue to increase to approximately \$170 million. L.A. Care indicated that the decrease in revenues and expenses is primarily attributed to the State's termination of the In-Home Supportive Services benefit from the CCI program, which eligible L.A. Care members received.

In addition, L.A. Care accepted a settlement agreement from DHCS over disputes with respect to its participation in the Medi-Cal program, increasing L.A. Care's revenues by \$31 million each fiscal year for five years, beginning in FY 2017-18. The Agency's Board of Governors intends to use the funds to establish medical student scholarships and a workforce development initiative that will issue grants to institutions to recruit new physicians to enhance their provider network, and has designated all \$31 million of the funds to the initiative in FY 2017-18.

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) 2014-15 Through 2016-17 | | | |
|---|---------------------|---------------------|---------------------|
| (In Thousands) | | | |
| | <u>FY 2014-15</u> | <u>FY 2015-16</u> | <u>FY 2016-17</u> |
| Current Assets: | | | |
| Cash and Cash Equivalents | \$ 182,755 | \$ 642,865 | \$ 915,825 |
| Investments - At Fair Value | 1,501,100 | 2,060,639 | 1,521,878 |
| Capitation Receivable | 1,053,007 | 1,030,897 | 2,588,459 |
| Other Current Assets | 51,687 | 312,279 | 817,744 |
| Total Current Assets | \$ 2,788,549 | \$ 4,046,680 | \$ 5,843,906 |
| Non-Current/Capital Assets | \$ 69,118 | \$ 89,463 | \$ 114,059 |
| Total Assets | \$ 2,857,667 | \$ 4,136,143 | \$ 5,957,965 |
| Current Liabilities: | | | |
| Accounts Payable and Accrued Liabilities | \$ 48,485 | \$ 70,947 | \$ 97,094 |
| Sub-Capitation Payable | 663,692 | 1,087,602 | 3,118,940 |
| Medi-Cal Adult Expansion Payable | 970,295 | 1,538,346 | 1,205,733 |
| Grants Payable | 1,502 | 2,697 | 5,964 |
| Reserved for Claims | 450,900 | 579,834 | 449,160 |
| Other Accrued Medical Expenses | 105,691 | 221,221 | 247,185 |
| Reserves for Provider Incentives | 84,400 | 62,808 | 82,466 |
| Total Current Liabilities | \$ 2,324,965 | \$ 3,563,455 | \$ 5,206,542 |
| Deferred Rent/Revenues | \$ 39,762 | \$ 48,876 | \$ 74,469 |
| Total Liabilities | \$ 2,364,727 | \$ 3,612,331 | \$ 5,281,011 |
| Net Position: | | | |
| Invested in Capital Assets | \$ 46,591 | \$ 64,508 | \$ 86,925 |
| Restricted | 300 | 300 | 300 |
| Unrestricted | 446,049 | 459,004 | 589,730 |
| Total Net Position | \$ 492,940 | \$ 523,812 | \$ 676,955 |
| Total Liabilities and Net Position | \$ 2,857,667 | \$ 4,136,143 | \$ 5,957,966 |
| Source: L.A. Care's Audited Financial Statements | | | |

| Table 2 L.A. Care Revenues and Expenses Fiscal Years 2014-15 Through 2016-17 | | | |
|--|---------------------|---------------------|---------------------|
| (In Thousands) | | | |
| | <u>FY 2014-15</u> | <u>FY 2015-16</u> | <u>FY 2016-17</u> |
| Operating Revenues | | | |
| Capitation | \$ 6,366,010 | \$ 7,755,317 | \$ 8,764,307 |
| Grant Income | 1,719 | 2,290 | 6,242 |
| Total Operating Revenues | \$ 6,367,729 | \$ 7,757,607 | \$ 8,770,549 |
| Operating Expenses | | | |
| Capitation - Professional Services | \$ 3,350,294 | \$ 3,888,706 | \$ 4,616,186 |
| Inpatient / Outpatient Claims | 1,831,100 | 2,975,145 | 2,912,280 |
| Pharmacy Claims | 426,312 | 472,633 | 598,467 |
| Administrative Expenses | 255,852 | 298,419 | 343,909 |
| Provider Incentives and Shared Risk | 148,758 | 43,280 | 100,287 |
| Risk Sharing Provision | 14,801 | 1,223 | 2,802 |
| Medical Administrative Expense | 63,995 | 51,789 | 48,712 |
| Total Operating Expenses | \$ 6,091,112 | \$ 7,731,195 | \$ 8,622,643 |
| Income from Operations | \$ 276,617 | \$ 26,412 | \$ 147,906 |
| Non-Operating Revenue / (Expense) | | | |
| Investment/Income/Tax Revenue | \$ 252,968 | \$ 276,498 | \$ 164,100 |
| Provision/Tax Expense | (256,719) | (272,038) | (158,863) |
| Total Non-Operating Revenue / (Expense) | \$ (3,751) | \$ 4,460 | \$ 5,237 |
| Increase in Net Position | \$ 272,866 | \$ 30,872 | \$ 153,143 |
| Source: L.A. Care's Audited Financial Statements | | | |

August 29, 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 2016-2017

Dear Mr. Naimo,

We have reviewed the report from the Department of Auditor-Controller for the above-mentioned Financial Condition Review.

We are in agreement with the report and in its presentation.

Sincerely,

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

Marie Montgomery
Chief Financial Officer