COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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WENDY L. WATANABE
AUDITOR-CONTROLLER

April 8, 2013

TO: Supervisor Mark Ridley-Thomas, Chairman
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **DEPARTMENT OF HEALTH SERVICES' COMMUNITY HEALTH PLAN FINANCIAL AUDIT FOR THE YEARS ENDED JUNE 30, 2011 AND 2012**

Attached is the independent auditor's report on the financial statements of the Department of Health Services' (DHS) Community Health Plan (CHP) for the years ended June 30, 2011 and 2012. The audit was performed by Simpson & Simpson, Certified Public Accountants (Simpson).

California law requires the CHP and other managed care plans to submit annual financial statements that have been audited by an independent Certified Public Accountant to the State Department of Managed Health Care (DMHC). The statements must be accompanied by an opinion on the fairness of the financial statement presentation. Simpson's opinion indicates that the financial statements present fairly CHP's financial position and operating results, as of, and for, the years ended June 30, 2011 and 2012. We confirmed CHP's audited financial statements have been submitted to DMHC, as required.

In addition, Simpson's report noted that the transfer of CHP's health plan operations to L.A. Care had been completed as of October 1, 2012.

Report on Compliance and Internal Control over Financial Reporting

In completing their audit, Simpson identified an internal control deficiency because of four material adjustments to the financial statements that were not identified by CHP management.

Simpson also reviewed the matters they identified in prior audits, including security over CHP's Novell network system, the need to replace CHP's outdated Patient Management System, and CHP's ability to handle increased growth. Simpson noted that one recommendation from the prior management letters was implemented. CHP management indicated that implementation of the remaining recommendations were on hold due to the restructuring of CHP's operations.

Simpson discussed their report with CHP management. The details of Simpson's findings and CHP's responses regarding the prior matters are included in the management letter, which was sent to your Board separately.

Please call me if you have any questions, or your staff may contact Robert Smythe at (213) 253-0101.

WLW:JLS:RS

Attachment

c: William T Fujioka, Chief Executive Officer
Mitchell H. Katz, M.D., Director of Health Services
John F. Krattli, County Counsel
Public Information Office
Audit Committee

Attachment

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN

Financial Statements for the
Years Ended June 30, 2012 and 2011
with Independent Auditor's Report

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN

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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors of
the County of Los Angeles

We have audited the accompanying balance sheets of **the Los Angeles County Department of Health Services Community Health Plan** (CHP) as of June 30, 2012 and 2011 and the related statements of income and changes in fund balances, and cash flows for the years then ended. These financial statements are the responsibility of CHP's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CHP's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CHP as of June 30, 2012 and 2011 and the results of its operations, changes in its fund balances and its cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

As discussed in Note 13 to the financial statements, on March 29, 2011, the Los Angeles County Board of Supervisors approved the transition of all health plan lines of CHP's business to L.A Care, and subsequently authorized the Director of Health Services to negotiate a Transition and Safety Net Support Agreement between Los Angeles County and L.A. Care. The execution of this agreement will effectively result in the discontinuance of CHP's health plan operations.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 25, 2013, on our consideration of the CHP's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit

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performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Simpson & Simpson

Los Angeles, California
February 25, 2013

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Balance Sheet
For the Fiscal Years Ended June 30

ASSETS	2012	2011
Current assets:		
Cash and cash equivalents	$ 31,653,075	$ 28,405,499
Receivables (Note 3)	3,612,352	38,304,119
Amount due from Los Angeles County (Note 5)	14,941,225	-
Prepaid expenses	-	2,273,266
Total current assets	50,206,652	68,982,884
Noncurrent assets:		
Long-term investments	303,504	303,504
Total noncurrent assets	303,504	303,504
TOTAL ASSETS	50,510,156	69,286,388
LIABILITIES AND FUND BALANCE		
Current liabilities:		
Accrued capitation	871,884	19,071,349
Claims payable (Note 4)	1,712,663	12,492,649
Accounts payable (Note 12)	987,882	3,375,458
Accrued salaries and related benefits	1,620,549	2,553,162
Amount due to Los Angeles County (Note 5)	-	9,165,400
Other liability (Notes 6 and 12)	795,528	2,517,556
Total current liabilities	5,988,506	49,175,574
Fund balance:		
Restricted	3,341,232	4,868,625
Unrestricted - restated (Note 12)	41,180,418	15,242,189
Total fund balance	44,521,650	20,110,814
TOTAL LIABILITIES AND FUND BALANCE	$ 50,510,156	$ 69,286,388

The accompanying notes are an integral part of these financial statements.

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statements of Income and Changes in Fund Balance
For the Fiscal Years Ended June 30

	2012	2011
REVENUES		
Capitation premiums	184,123,166	306,512,144
OPERATING EXPENSES		
Cost of health care services:		
Capitation premiums	121,605,687	219,117,285
Medical services (Note 12)	13,658,615	14,948,842
Pharmacy	13,172,382	25,931,137
Medical supplies	59,101	62,920
Total cost of health care services	148,495,785	260,060,184
General and administrative:		
Salaries and employee benefits	7,213,962	12,912,883
Professional and consulting services (Note 12)	2,680,986	6,695,904
Rent	553,832	1,389,430
Office expense	1,493,708	4,363,511
Communications	353,991	1,578,001
Total general and administrative expenditures	12,296,479	26,939,729
Total operating expenses	160,792,264	286,999,913
OPERATING INCOME	23,330,902	19,512,231
OTHER REVENUES		
Interest income	358,950	336,963
Other revenues	720,984	75,135
Total other revenues	1,079,934	412,098
Net income	24,410,836	19,924,329
FUND BALANCE, beginning of year (Restated - Note 12)	20,110,814	13,564,789
Transfer to LA County (Note 7)	-	(13,378,304)
FUND BALANCE, end of year	$ 44,521,650	$ 20,110,814

The accompanying notes are integral part of these financial statements.

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statements of Cash Flows
For the Fiscal Years Ended June 30

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 24,410,836	$ 19,924,329
Adjustments to reconcile change in net income to net cash provided / used by operating activities		
Changes in operating assets and liabilities:		
Decrease in receivables	34,691,767	6,913,408
Decrease in due from Los Angeles County	(14,941,225)	-
Decrease/(Increase) in prepaid expense	2,273,266	(307,862)
(Decrease)/Increase in accrued capitation	(18,199,465)	1,447,686
(Decrease) in claims payable	(10,779,986)	(9,556,839)
(Decrease)/Increase in accounts payable	(2,387,576)	990,254
(Decrease) in accrued salaries and related benefits	(932,613)	(2,487)
(Decrease)/Increase in amount due to Los Angeles County	(9,165,400)	1,196,997
(Decrease) in other liability	(1,722,028)	(623,955)
Net cash provided by operating activities	3,247,576	19,981,531
CASH FLOWS FROM FINANCING ACTIVITIES		
Transfer to Los Angeles County	-	(13,378,304)
Net cash used by financing activities	-	(13,378,304)
Net increase in cash and cash equivalents	3,247,576	6,603,227
Cash and cash equivalents, beginning of the year	28,405,499	21,802,272
Cash and cash equivalents, end of the year	$ 31,653,075	$ 28,405,499

The accompanying notes are an integral part of these financial statements.

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

The Community Health Plan (CHP) is the Medi-Cal health maintenance organization (HMO) owned and operated by the Los Angeles County Department of Health Services (DHS). It is a federally qualified HMO and is licensed as a prepaid full service health care service plan by the State of California Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975. CHP provides health care services at low or no cost through the State's Medi-Cal Managed Care and Healthy Families Program and the Personal Assistance Services Council - Service Employees International Union (PASC-SEIU) Homecare Worker Health Care Plan (See Note 13).

Medi-Cal Managed Care

CHP is one of five Plan Partners contracting with L.A. Care Health Plan, the Local Health Initiative for Medi-Cal Managed Care in Los Angeles County. CHP has over 1300 primary care physicians, over 1,500 pharmacies, including the chain of Rite-Aid stores, and more than a thousand specialists in the Medi-Cal provider network. Under the Medi-Cal program there is no cost to the member for covered services and no co-payments. Effective January 1, 2012, all Medi-Cal enrollees were transitioned to L.A Care Health Plan (See Note 13).

Healthy Families Program

CHP contracts with the State Managed Risk Medical Insurance Board (MRMIB) to participate as a Healthy Families Program provider. The Healthy Families Program provides comprehensive health, dental and vision coverage to children in families with incomes at or below 250% of the Federal Poverty Level. Since the program began in 1998, Community Health Plan has been designated the Community Provider Plan for Los Angeles County for the provision of health coverage. Effective September 30, 2012, the MRMIB contract will end and the Healthy Families Program will be terminated (See Notes 13 and 14).

PASC-SEIU Homecare Worker Health Care Plan

Effective April 1, 2002, the PASC-SEIU Homecare Worker Health Care Plan was implemented to provide health services to eligible In-Home Supportive Services (IHSS) Workers. The plan provides IHSS Workers access to a provider network comprised of Los Angeles County Department of Health Services facilities and contract providers. Effective February 1, 2012, all In-Home Supportive Services Health enrollees were transitioned to L.A Care Health Plan (See Note 13).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As a managed health care organization, CHP derives the majority of its revenues from capitation premiums received for providing prepaid health services and prepares its financial statements in accordance with the AICPA Audit and Accounting Guide for "Health Care Organizations." The following is a summary of significant accounting policies used in the preparation of the accompanying consolidated financial statements. Such policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of CHP's financial statements relate to the assessment of the carrying value of claims payable and contingent liabilities. While management believes that the carrying value of such assets and liabilities is adequate as of June 30, 2012 and 2011, actual results could differ from the estimates upon which the carrying values were based.

Basis of Presentation - Fund Accounting

The accounts of the County are organized on the basis of funds and account groups, each of which is a separate accounting entity. Each fund is accounted for through a separate set of accounts that comprise its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. CHP, **an enterprise activity**, is reported under the general fund of the County of Los Angeles. General fund is used to account for all financial resources except those required to be accounted for in another fund. Resources or expenditures not restricted for a particular purpose are accounted for in the general fund.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, CHP has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

Concentration of Source of Revenues

CHP received approximately 57% of its premium revenues under service agreements with L.A. Care Health Plan for both fiscal years ended June 30, 2012 and 2011.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

Cash and cash equivalents consist of CHP's equity portion of the Los Angeles County cash and investment pool. Funds received by CHP are deposited into the cash and investment pool for which the County Treasury is the depository. Funds deposited in the pool are similar in nature to demand deposits, (i.e., funds may be deposited and withdrawn at any time without prior notice or penalty). Interest earned on the pooled funds is accrued in a pooled interest apportionment fund and is allocated based on the average daily cash balances of the fund. The average annual interest rates earned on CHP's deposits during fiscal years ended June 30, 2012 and 2011 were approximately 1.31% and 1.29%, respectively. As of June 30, 2012 and 2011, substantially all investments in the County investment pool were U.S. government securities, bankers' acceptances and negotiable certificates of deposit.

Long-Term Investments

Long-term investments consist of restricted investments on deposit with the California Department of Managed Health Care (DMHC). These investments consist of U.S. Treasury securities, and due to their restricted nature, are classified as long-term without regard to contractual maturity. Market values approximate carrying values as of June 30, 2012 and 2011.

Claims Reimbursement Receivable

Claims reimbursement receivable are claims for capitated services paid by CHP that are reimbursable from the contracted medical groups and hospitals. Management believes that uncollectible amounts, if any, will not be material to the financial statements.

Accrued Capitation

CHP pays capitation premiums to the contracted medical groups and hospitals in arrears on a per member per month basis. Accrued capitation consists of capitation payments due the contracted medical groups and hospitals.

Claims Payable

The liability for claims payable includes adjudicated claims, claims pending adjudication and a provision for incurred but not reported claims. The amount payable for the claims pending adjudication is reduced by an allowance for denied claims estimated based on paid/denied ratio of claims closed during the year. The provision for incurred but not reported claims is estimated using a lag study based upon historical data including the period between the date services are rendered and the date claims are received and paid and denied claim activity. The estimate for incurred but not reported claims is made on an accrual basis and adjusted in future periods as required.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Claims Payable (Continued)

Any adjustments to the prior period estimates are included in the current period. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims and losses paid are dependent on future developments, management is of the opinion that the recorded reserves are adequate to cover such costs. These liabilities are reduced by estimated amounts recoverable from contracted health care providers.

Fund Balance

Fund balances are reported as restricted when constraints placed on its use are either: (1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments, or (2) imposed by law through constitutional provisions or enabling legislation. CHP's restricted fund balance consists of the amounts required to satisfy the deposit and tangible net equity requirements of the Department of Managed Health Care as of June 30, 2012 and 2011 (see Notes 9 and 11).

Premium Revenues

CHP's premium revenues are capitation payments received for plan enrollees on a per member per month basis. Premiums are recognized as revenue in the month in which the members are entitled to service.

Cost of Health Care Services

CHP contracts with various medical groups to provide professional care to its members on a capitated, or fixed per member per month fee basis. Capitation contracts generally include a provision for stop-loss and non-capitated services for which CHP is liable. Additionally, CHP contracts with certain hospitals to provide hospital care to enrolled members on a capitation basis.

The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services which have been incurred but not yet reported. Such costs include capitation payments to contracted medical groups and hospitals for primary care, specialty and hospital services and the cost of non-capitated medical services, pharmacy and medical supplies.

Fair Value of Financial Instruments

The estimated fair value amounts of cash equivalents and long-term investments approximate their carrying amounts in the financial statements and have been determined by CHP using available market information and appropriate valuation methodologies. The carrying amounts of cash equivalents approximate fair value due to the similarity in its nature to demand deposits. The fair values of long-term investments are estimated based on quoted market prices and dealer quotes for similar investments.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Tax

As an operating division of the County, CHP is exempt from State and Federal income taxes.

NOTE 3 – RECEIVABLES

Receivables are comprised of interest receivable, capitation premiums receivable, Quality Improvement Funding receivable and claims reimbursement receivable from health care service providers. As of June 30, 2012 and 2011, receivables consisted of the following:

	2012	2011
Capitation premiums receivable	$ 1,613,363	$ 21,220,345
Claims reimbursement receivable	2,096,349	14,416,565
Allowance for doubtful	(925,334)	-
Interest receivable	31,549	62,352
Quality Improvement Funding receivable	694,145	876,602
Other receivable	102,280	1,728,255
	$ 3,612,352	$ 38,304,119

NOTE 4 – CLAIMS PAYABLE

Claims payable are comprised of claims payable, claims pending adjudication and a liability for claims incurred but not yet received, reduced by management's estimate of the amount that will be denied and the amount that will be recoverable from contracted providers. As of June 30, 2012 and 2011, claims payable consisted of the following:

	2012	2011
Claims payable/pending adjudication	$ 9,219,565	$ 46,074,110
Claims incurred but not received	1,066,637	8,619,605
Claims payable	-	164,573
Less: Allowance for denied claims	(8,573,539)	(42,365,639)
	$ 1,712,663	$ 12,492,649

NOTE 5 – AMOUNT DUE TO LOS ANGELES COUNTY

Cash disbursements for CHP are made from the general fund of Los Angeles County Department of Health Services (DHS). CHP transfers funds periodically to the general fund from its County cash and investment pool to reimburse the general fund or to fund its projected cash disbursements. The amount due to Los Angeles County consists of the amount owed to the DHS general fund and the amount due other County funds for services such as telephone, rent and information system support. Amount due from Los Angeles County Funds represents Out-of-Plan (OOP) claims that is the responsibility of the other County facilities; however, such recoupments had not been made at year-end. In the previous years, CHP prepared internal vouchers monthly to recoup the OOP claims from the other County hospitals. In Fiscal Year 2011-12, internal vouchers were made subsequent to the year-end. As of June 30, 2012 and 2011, the amount due to Los Angeles County consisted of the following:

	2012	2011
Amount due from Los Angeles County funds	$ 21,749,925	-
Less: amount due to Los Angeles County funds	(6,808,700)	(9,165,400)
Net of Amount (due to) / from:	$ 14,941,225	$ (9,165,400)

NOTE 6 – OTHER LIABILITY

Other liability is comprised of claims settlements, pay-for-performance, and incentive payment to Department of Health Service passed through CHP. As of June 30, 2012 and 2011, other liabilities consisted of the following:

	2012	2011
Claims Settlements	$ 636,693	$ 2,395,256
Pay-for-Performance Program[1]	-	122,300
Others	158,835	-
	$ 795,528	$ 2,517,556

[1] *The ending balance of 2011 was restated. See Note 12 for detail.*

NOTE 7 – TRANSFER TO LOS ANGELES COUNTY

CHP transfers funds in excess of 150% of the total net equity to the general fund of DHS. However, CHP did not transfer any cash to DHS during the fiscal year ended June 30, 2012. The total transfer to DHS in fiscal year 2010-11 amounted to $13,378,304.

NOTE 8 – RETIREMENT PLAN

The County's retirement plan covers employees and provides for monthly pension payments to eligible employees upon retirement. Salaries and employee benefits expense includes a provision for the retirement plan cost, as well as vacation and sick pay, which is estimated based on a percentage of salaries expense. The actual cost of the retirement plan, actuarial present value of accumulated retirement plan benefits, and net assets available for retirement plan benefits are not separately identifiable for CHP.

NOTE 9 – REGULATORY REQUIREMENTS

CHP, as a California licensed health service plan, is regulated by the State of California Department of Managed Health Care (DMHC). Title 28 of the Code of California Regulations requires that CHP maintain certain deposits assigned to the Director of the DMHC and comply with certain minimal capital or tangible net equity requirements. Management believes that as of June 30, 2012 and 2011, CHP met its regulatory requirements.

NOTE 10 – CONTINGENCIES

The County has agreed to fund CHP's losses, if any, and to cover CHP under its self-insured medical malpractice program when medical services are provided at a County facility. In addition, the County has agreed to cover CHP under its self-insured workers' compensation program. These coverages are provided to CHP at no cost.

NOTE 11 – RESTRICTED FUND BALANCE

As a result of CHP's transition the restricted fund balance will be held until all claims and other liabilities are paid when due. The remaining restricted funds will be transferred to DHS (See Note 14).

NOTE 12 – PRIOR PERIOD ADJUSTMENTS

Prior Period adjustments of $1,657,819 were recorded for the following:

1. At June 30, 2011, CHP had a balance of $1,556,373 for the Pay-for-Performance Program (P4P). During the fiscal year 2011-12, CHP decided to not roll out a P4P program for calendar year 2011 services. The original P4P program was set and funded only for the Medi-Cal Managed Care Program (MMCP) line of business and was only implemented for calendar year 2010 participation. The 2011 P4P program was initially planned (as per which services to be included) by CHP staff, but was not executed due to the announcement of the impending discontinuance of health plan operations. All CHP contractors of any sort were alerted of the March 29, 2011 decision to transition CHP out of managed care as set forth by the Board of Supervisors and the DHS Director. The L. A. Care (as the Local Initiative Health Authority) Plan Partner Services Agreement (PPSA) with the County of Los Angeles (d.b.a. as CHP, the Plan Partner) was eventually terminated by mutual consent effective December 31, 2011; thereby, ending CHP's participation in the MMCP. All of CHP's remaining MMCP provider (hospital and physician) agreements (including the MOU with DHS) also ended on December 31, 2011 (see note 13). As such, $122,300 for FY 2010-11 was paid and the balance of $1,434,073 accrued for FY 2011-12 was adjusted to remove the liability.

2. A prior year adjustment of $223,746 was to correct an error in the accrued expense account which was not properly reversed.

Account	Audited June 30, 2011	Adjustment	Restated June 30, 2011
Professional and consulting service	$ 6,919,650	$ (223,746)	$ 6,695,904
Medical services	$ 16,382,915	$ (1,434,073)	$ 14,948,842
Accounts Payable	$ 3,599,204	$ (223,746)	$ 3,375,458
Other Liability	$ 3,951,629	$ (1,434,073)	$ 2,517,556
Fund Balance	$ 18,452,995	$ 1,657,819	$ 20,110,814

NOTE 13 – CHP'S DISCONTINUATION OF ITS HEALTH PLAN OPERATIONS TRANSISTION AND SAFETY NET SUPPORT AGREEMENT WITH L.A. CARE HEALTH PLAN

On March 29, 2011 the Los Angeles County Board of Supervisors (Board) approved the DHS Director's recommendation that all lines of the CHP business be transferred from CHP to L.A. Care and that L.A. Care assume all health plan functions. This transition was to occur gradually over the subsequent year and would eventually result in CHP's discontinuation as a managed care health plan.

On November 8, 2011 the Board authorized the Director of Health Services to execute an agreement with L.A. Care to structure a long term financial relationship between L.A. Care and the County of Los Angeles and to provide for the orderly transfer of health plan operations from CHP to L.A. Care, effective on the date of Board's approval through December 31, 2021.

NOTE 13 – CHP'S DISCONTINUATION OF ITS HEALTH PLAN OPERATIONS TRANSISTION AND SAFETY NET SUPPORT AGREEMENT WITH L.A. CARE HEALTH PLAN (CONTINUED)

Director of Health Services finalized negotiations with L.A. Care on the transition agreement (Community Health Plan Transition & Safety Net Support Agreement) with an effective date of January 1, 2012. The primary value of CHP to DHS over the years has been the revenue it brings in for patients who receive their care in the DHS system. Thus, in negotiating the long term agreement, the parties were to focus on the elements which would provide the basis for ongoing funding for DHS. The financial terms for the financial support from L.A. Care Health Plan to DHS are confidential and not subject to disclosure. These provisions are protected as proprietary and also subject to Section 1457 of the Health and Safety Code, among other confidential provisions and public record exemptions. The agreement included the following provisions:

1. Mutual indemnification between the parties,
2. The County retained financial and other legal responsibilities as appropriate prior to the transition date. L.A. Care assumed financial and other legal health plan responsibilities thereafter,
3. Each party maintained certain recordkeeping responsibilities as appropriate,
4. The parties established payment to the County of any of its CHP accounts receivables that exist following the transition date(s).

Additionally, this transition included separate Hospital Services and Participating Provider agreements between DHS and L.A. Care (effective May 1, 2011 with the new Medi-Cal Seniors and Persons with Disabilities (SPD) product line). The Medi-Cal Non-SPD line of business was amended into these agreements effective October 1, 2011. The In Home Supportive Services (IHSS) and Healthy Families Program (HFP) lines of business were included in separate amendments, both effective February 1, 2012. These contracts and amendments firmly established DHS as a contracted institutional and professional services provider under L.A. Care Direct (L.A. Care's fully owned and operated HMO subsidiary).

The CHP Medical Managed Care Program (MMCP) members transferred to LA Care Direct on January 1, 2012. The CHP IHSS members transferred to LA Care Direct on February 1, 2012. CHP had the preferred Community Provider Plan (CPP) designation for HFP enrollees for the contract year beginning October 1, 2011. Thus, these CHP HFP enrollees could not be transitioned to L.A. Care, per the Managed Risk Medical Insurance Board (MRMIB, which administers the HFP), and CHP continued as an operating Knox-Keene licensed health plan for the HFP through September 30, 2012. On this date, CHP ceased to be the designated CPP for the HFP. CHP HFP members received an Open Enrollment notification in July 2012 from the MRMIB. During this Open Enrollment period, they were asked to select a new HFP participating health plan and provider to become effective October 1, 2012.

The Knox-Keene license remains in force until DHS and DMHC completes ongoing discussions on its possible future use.

NOTE 14 – SUBSEQUENT EVENTS

As discussed in Note 1, the operation of HFP ceased October 1, 2012.

The CHP has evaluated events or transactions that occurred subsequent to June 30, 2012 through February 25, 2013, the date the accompanying financial statements were available to be issued, for potential recognition or disclosure in the financial statements and determined no subsequent matters require disclosure or adjustment to the accompanying financial statements.

SIMPSON & SIMPSON
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Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Supervisors of
the County of Los Angeles

We have audited the financial statements of the **Los Angeles County Department of Health Services Community Health Plan** (CHP) as of and for the year ended June 30, 2012 and 2011, and have issued our report thereon, dated February 25, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of CHP is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered CHP's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CHP's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CHP's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified one deficiency in internal control over financial reporting, described in the accompanying Exhibit I as FS-12-01 that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CHP's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws,

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regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the County of Los Angeles, management, and the State of California Department of Managed Health Care and is not intended to be and should not be used by anyone other than these specified parties.

Simpson & Simpson

Los Angeles, California
February 25, 2013

EXHIBIT I

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
JUNE 30, 2012

SCHEDULE OF FINDING AND RECOMMENDATION

F-12-01 – Audit Adjustments

Criteria

Pursuant to the Statement on Auditing Standards (SAS) 115, one control deficiency that should be regarded as at least a significant deficiency, and a strong indicator of a material weakness in internal control, is identification by the auditor of a material misstatement in the financial statements that was not initially identified by the entity's internal controls even if management subsequently corrects the misstatement.

Condition

During the course of the audit, we identified four (4) material audit adjustments to the CHP financial statements. Of the audit adjustments, two (2) were resulted from the need to recognize revenues and expenditures for the fiscal year 2011-12; one of them resulted from the restatement of prior year financial statements; and one adjustment was to reconcile between the Cash balance and Due to / from the General Fund of the Department of Health Service.

Cause

Due to discontinuation of the Medical and IHSS programs, the prior year financial team was depleted of certain key personnel who left CHP, and much of the remaining staff's time was charged by DHS to handle other new (non CHP) business lines under the newly created DHS Ambulatory Care Network – Managed Care Services. The renewed financial team, made up of contract workers and remaining permanent staff, that was assigned to perform the year-end closing was given a short period of time to analyze the account balances. As such, certain accounts were not analyzed prior to the start of the audit.

Recommendation

We recommend that CHP review the internal controls over the closing procedures to ensure that all accounts are being reviewed and analyzed properly.