



COUNTY OF LOS ANGELES DEPARTMENT OF AUDITOR-CONTROLLER

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OSCAR VALDEZ
INTERIM AUDITOR-CONTROLLER

May 3, 2023

TO: Each Supervisor
FROM: Oscar Valdez, Interim Auditor-Controller
SUBJECT: **L.A. CARE HEALTH PLAN – FINANCIAL CONDITION REVIEW FOR FISCAL YEAR 2019-20**

With the support and active participation of L.A. Care Health Plan (L.A. Care or Agency) management, we evaluated the Agency’s financial condition for Fiscal Year (FY) 2019-20 and assessed the outlook of the Agency’s FY 2020-21 revenues and expenses.

We noted that L.A. Care’s income from operations decreased by approximately \$334.8 million in FY 2019-20 compared to FY 2018-19, contributing to a negative change in net position, and the Agency projected decreases in both income from operations and net position in FY 2020-21. In addition, we noted that L.A. Care does not conduct multi-year forecasts beyond one year. Specifically:

- L.A. Care’s expenses exceeded their revenues by approximately \$131.6 million (\$8.354 billion in operating revenues less \$8.485 billion in operating expenses) at the end of FY 2019-20. Agency management indicated the operating loss occurred due to higher than budgeted healthcare and administrative expenses. In addition, L.A. Care’s net position was approximately \$916.6 million (\$5.109 billion in total assets less \$4.193 billion in total liabilities) in FY 2019-20.
- L.A. Care’s FY 2020-21 Operating and Capital Budget, as compared to their FY 2019-20 actual results, projected a decrease in operating revenues and expenses to \$7.711 billion and \$7.849 billion, respectively, contributing to a continuing net loss from operations of approximately \$138.1 million. Agency management indicated this was due to lower Medi-Cal reimbursement rates, the transition of pharmacy service claims to the State, and the expected renewal of the Medi-Cal redetermination process. L.A. Care management indicated that they will work with their Board of Governors to assess the feasibility and benefits of implementing multi-year financial forecasts.

For details of our review, see Attachment I. The Agency’s response, Attachment III, indicates general agreement with our review, including our one finding and recommendation.

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 mpirolo@auditor.lacounty.gov.

OV:RGC:MP:JU:rc

NUMBER OF RECOMMENDATIONS
PRIORITY 1 1 CORRECTIVE ACTION REQUIRED WITHIN 90 DAYS
PRIORITY 2 0 CORRECTIVE ACTION REQUIRED WITHIN 120 DAYS
PRIORITY 3 0 CORRECTIVE ACTION REQUIRED WITHIN 180 DAYS

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 2.8 million members as of December 2022.

Each Supervisor
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Attachments

c: Fesia A. Davenport, Chief Executive Officer
Celia Zavala, Executive Officer, Board of Supervisors
Christina Ghaly, M.D., Director, Department of Health Services

**L.A. CARE HEALTH PLAN
FINANCIAL CONDITION REVIEW
FISCAL YEAR 2019-20**

BACKGROUND AND SCOPE

We have completed a review of L.A. Care Health Plan's (L.A. Care or Agency) annual financial condition for Fiscal Year (FY) 2019-20. The County of Los Angeles (County) is required by the State of California (State) Welfare and Institutions Code (WIC) Section 14087.9675 to perform an annual financial condition review of its Local Initiative Health Authority (local initiative). We conducted our review in conformance with the *International Standards for the Professional Practice of Internal Auditing* and will continue to review L.A. Care's financial condition annually, as required.

Background

L.A. Care is the local initiative for the County. The Agency is an independent, tax-exempt public agency created by the County, and initially funded by the State and the Federal Government of the United States of America, to provide managed health care services to low-income County residents. L.A. Care 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.

Scope and Objectives

We evaluated L.A. Care's financial condition for FY 2019-20 and assessed the outlook of the Agency's FY 2020-21 revenues and expenses. Our review included interviewing L.A. Care financial management, analyzing their audited financial statements and FY 2020-21 Operating and Capital Budget (budget), and reviewing regulatory agencies' reports issued on L.A. Care during FY 2019-20. 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 has been reviewed in prior audits. Although not required by WIC, we can review these areas at our discretion.

This financial condition review was delayed due to priority assignments, such as the Audit Committee requested Department of Health Services' Office of Diversion and Reentry – Fiscal, Program, and Contracting Review, and the COVID-19 state of emergency, which impacted operations countywide and inevitably required the reprioritization of all projects/workloads. By FY 2023-24, we plan to conduct a consolidated financial condition review of the next two fiscal years to bring us current on these annual reviews.

FINANCIAL CONDITION AND OUTLOOK

Operating Revenues and Expenses

We reviewed L.A. Care's independently audited financial statements and noted that the Agency's operating revenues totaled approximately \$8.354 billion in FY 2019-20 and included funds from the State's Department of Health Care Services (DHCS), Centers for Medicare and Medicaid Services (CMS), State, County, and individual member premiums. L.A. Care's operating expenses totaled approximately \$8.485 billion in FY 2019-20 and mainly consisted of health care

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.

expenses, such as capitation payments for professional services (e.g., office visits, immunizations, and medical procedures), inpatient/outpatient claims (e.g., hospital stays, emergency room visits, and Skilled Nursing Facility (SNF) stays), and pharmacy claims. In FY 2019-20, L.A. Care's operating revenues and expenses increased by \$451.7 million (6%) and \$786.6 million (10%), respectively from FY 2018-19, primarily due to increased revenues (i.e., Medi-Cal rate changes, increased Proposition 56 revenues, and increased Health Homes Program revenues) and was offset by increases in expenses for capitation payments for professional services, inpatient/outpatient claims, and pharmacy claims. The COVID-19 state of emergency resulted in higher Medi-Cal reimbursement rates for SNF claims, which increased operating revenues, but also resulted in increased inpatient/outpatient and pharmacy claims, which increased operating expenses.

Details of L.A. Care's revenues and expenses for FY 2017-18 through FY 2019-20 are provided in Table 2 of Attachment II.

Financial Analyses

We used L.A. Care's financial information for FY 2019-20, 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 and liquid assets (i.e., cash, short-term securities, and accounts receivable) exceeded their current liabilities by 16%. 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 become due.
- **Ability to generate revenues in excess of expenses** - L.A. Care's expenses exceeded their revenues by approximately \$131.6 million (\$8.354 billion in operating revenues less \$8.485 billion in operating expenses) at the end of FY 2019-20. L.A. Care management indicated the operating loss occurred due to higher than budgeted healthcare expenses (i.e., higher rates for inpatient/outpatient claims, including SNF) and administrative expenses (i.e., increased salaries and employee benefits, including elevated hiring rates and increases in strategic projects spending to process the higher rate of claims), resulting from the COVID-19 state of emergency.
- **Financial performance requirements** - L.A. Care met the minimum tangible net equity (TNE) requirement and had a positive net position of approximately \$916.6 million (\$5.109 billion in total assets less \$4.193 billion in total liabilities). Title 28 of the California Code of Regulations (CCR) 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 5% remained below the 15% maximum administrative cost ratio (total administrative expenses over total revenue), as required by Title 28 of the CCR Section 1300.78(b).

Details of L.A. Care's assets and liabilities for FY 2017-18 through FY 2019-20 are provided in Table 1 of Attachment II.

Outlook of Revenues and Expenses

Based on our review of L.A. Care's FY 2020-21 budget as compared to their FY 2019-20 actual results, we noted that membership was projected to decrease by approximately 118,000 (5%) to

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.

2.2 million by fiscal year-end (September 2021). L.A. Care indicated that the expected decrease was primarily due to the State resuming the Medi-Cal redetermination process (i.e., members' eligibility is reassessed) in October 2020, following the anticipated end of the COVID-19 state of emergency. The State had suspended the process during the COVID-19 state of emergency, resulting in higher membership as people who might have lost coverage during the redetermination process were not dropped. In addition, we noted that operating revenues and expenses were projected to decrease to \$7.711 billion (8%) and \$7.849 billion (8%), respectively, contributing to a continuing net loss from operations of approximately \$138.1 million. L.A. Care indicated the projected decrease in revenues and expenses was primarily attributed to lower Medi-Cal rates set by DHCS, the transition of pharmacy service claims from L.A. Care to the State effective January 2021, and the expected renewal of the Medi-Cal redetermination process, which would cause a decrease in Medi-Cal's eligible population, as previously stated.

As noted, L.A. Care had a net operating loss in FY 2019-20 and projected a continuing net loss in FY 2020-21. To address the decreases in Medi-Cal reimbursement rates and increasing healthcare costs caused by the COVID-19 state of emergency, L.A. Care management indicated that they intended to limit administrative spending and implement cost-reduction opportunities, including renegotiating vendor contracts and reduce staffing.

However, we noted that the Agency does not project financial outcomes beyond the following fiscal year. Although L.A. Care is not legislatively required to do so, it is a best practice to create multi-year (e.g., 3-5 years) financial forecasts to appropriately identify, track, and manage the effects of future trends (e.g., decreasing revenues, increasing expenses, and legislative or industry changes, such as ones noted in this report) that could have immediate or long-term impacts on operations. In addition, financial forecasting allows for the strategic planning and implementation of management's goals and objectives. L.A. Care management should work with their Board of Governors to assess the feasibility and benefits of creating multi-year financial forecasting.

Recommendation:

1. **Priority 1** – L.A. Care management should work with their Board of Governors to assess the feasibility and benefits of implementing a multi-year financial forecasting process.

Department Response: Agree

Implementation Date: December 31, 2023

We will assess and report on the status of our recommendation during a future follow-up review or concurrent with a following annual financial condition review.

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.

Priority Ranking: Recommendations are ranked from Priority 1 to 3 based on the potential seriousness and likelihood of negative impact on the Agency's operations if corrective action is not taken.

Table 1			
L.A. Care Assets, Liabilities, and Net Position			
Fiscal Years (FY) 2017-18 Through 2019-20			
(In Thousands)			
	<u>FY 2017-18</u>	<u>FY 2018-19</u>	<u>FY 2019-20</u>
Current Assets:			
Cash and Cash Equivalents	\$ 598,403	\$ 1,634,374	\$ 1,144,914
Investments - At Fair Value	773,375	897,935	1,310,365
Capitation Receivable	2,517,158	2,420,401	2,490,434
Other Current Assets	103,853	7,093	52,595
Total Current Assets	\$ 3,992,789	\$ 4,959,803	\$ 4,998,308
Non-Current/Capital Assets	\$ 130,486	\$ 138,204	\$ 110,928
Total Assets	\$ 4,123,275	\$ 5,098,007	\$ 5,109,236
Current Liabilities:			
Accounts Payable and Accrued Liabilities	\$ 78,261	\$ 50,138	\$ 98,247
Sub-Capitation Payable	2,103,750	3,059,134	3,244,683
Medi-Cal Adult Expansion Payable	253,609	53,863	-
Grants Payable	9,421	11,841	11,977
Reserves for Claims	567,605	558,640	620,735
Other Accrued Medical Expenses	185,230	199,709	131,068
Reserves for Provider Incentives	82,492	88,247	68,396
Total Current Liabilities	\$ 3,280,368	\$ 4,021,572	\$ 4,175,106
Deferred Rent / Revenue	\$ 25,422	\$ 22,320	\$ 17,570
Total Liabilities	\$ 3,305,790	\$ 4,043,892	\$ 4,192,676
Net Position:			
Invested in Capital Assets	\$ 105,599	\$ 112,322	\$ 106,386
Restricted	300	300	300
Unrestricted	711,586	941,493	809,874
Total Net Position	\$ 817,485	\$ 1,054,115	\$ 916,560
Total Liabilities & Net Position	\$ 4,123,275	\$ 5,098,007	\$ 5,109,236

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

Table 2			
L.A. Care Revenues and Expenses			
Fiscal Years (FY) 2017-18 Through 2019-20			
(In Thousands)	<u>FY 2017-18</u>	<u>FY 2018-19</u>	<u>FY 2019-20</u>
Operating Revenues			
Capitation	\$ 7,870,654	\$ 7,901,970	\$ 8,353,703
Grant Income	7,716	-	-
Total Operating Revenues	\$ 7,878,370	\$ 7,901,970	\$ 8,353,703
Operating Expenses			
Capitation - Professional Services	\$ 4,086,451	\$ 4,169,129	\$ 4,461,443
Inpatient/Outpatient Claims	2,481,210	2,322,749	2,758,981
Pharmacy Claims	648,480	661,929	693,186
Administrative Expenses	394,670	415,719	451,660
Provider Incentives and Shared Risk	69,321	67,205	39,098
Medical Administrative Expenses	53,606	61,943	80,887
Total Operating Expenses	\$ 7,733,738	\$ 7,698,674	\$ 8,485,255
Income from Operations	\$ 144,632	\$ 203,296	\$ (131,552)
Non-Operating Revenue / (Expense)			
Investment / Income / Tax Revenue	\$ 160,527	\$ 165,429	\$ 146,486
Grant Income	-	13,304	1,667
Provision / Tax Expense	(164,629)	(145,399)	(154,155)
Total Non-Operating Revenue / (Expense)	\$ (4,102)	\$ 33,334	\$ (6,002)
Increase / (Decrease) in Net Position	\$ 140,530	\$ 236,630	\$ (137,554)
<i>Source: L.A. Care's Audited Financial Statements</i>			



March 20, 2023

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

RE: L.A. Care Health Plan – Financial Condition Review for Fiscal Year 2019-20

Dear Ms. Barrera,

Thank you for your letter dated March 2023 and we appreciate the opportunity to work collaboratively on the financial condition review for Fiscal Year (FY) 19-20 as well as the outlook for FY 20-21.

We have reviewed the report from the Department of Auditor-Controller for the Financial Condition Review for Fiscal Year 2019-20, and are in agreement with the recommendation to assess the feasibility and benefits of implementing a multi-year financial forecasting process.

Historically, we have not generated a multi-year financial forecast since our rates are set on an annual basis and predicting future rate actions are challenging and prone to significant differences. Our Capitation rates that are paid to our Plan Partners and Providers are influenced by the rates received from the Department of Health Care Services (DHCS). We do, however, generate a multi-year forecast on membership which is presented to our Board and plan to do a multi-year forecast in the fourth quarter of 2023 upon receipt of the 2024 rates from DHCS.

Additionally, the outlook that we forecasted for FY 20-21 was for a specific point in time during the first year of the COVID-19 public state of emergency. As you noted in your Review of Outlook of Revenue and Expenses, we had a plan in place to address some of the projected losses by re-negotiating vendor contracts and reducing staffing costs, however, our primary efforts were in the participation of the ongoing communication with the DHCS regarding identifying appropriate rates and payments to sufficiently support our membership population.

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

Sincerely,

Marie Montgomery
Chief Financial Officer, L.A. Care