

# DEPARTMENT OF HEALTH CARE SERVICES

Review Report

## PROCESSES, PROCEDURES, AND INTERNAL CONTROLS OVER MEDI-CAL PROGRAM

*Medi-Cal Managed Care Delivery System  
January 1, 2015, through December 31, 2015*

*Hospital Quality Assurance Fee Program  
January 1, 2014, through December 31, 2016*



**BETTY T. YEE**  
California State Controller

January 2018



**BETTY T. YEE**  
California State Controller

January 8, 2018

Jennifer Kent, Director  
California Department of Health Care Services  
1500 Capitol Avenue, MS 20001  
Sacramento, CA 95814

Dear Ms. Kent:

The State Controller's Office (SCO) reviewed the California Department of Health Care Services' (DHCS) processes, procedures, and internal controls over the California Medical Assistance Program (Medi-Cal) to assess whether revenue, expense, and provider payments are appropriate and program funds are adequately monitored to ensure that funds are evaluated for risk and consideration of fraud. Specifically, the SCO reviewed the Medi-Cal Managed Care delivery system for the period of January 1, 2015, through December 31, 2015, and the Hospital Quality Assurance Fee (HQAF) program for the period of January 1, 2014, through December 31, 2016.

We identified inadequate controls over the Medi-Cal Managed Care delivery system and the HQAF program. We found that:

1. The DHCS has inadequate controls over the HQAF program to ensure that increased capitation payments to Medi-Cal managed care plans are expended for hospital services to Medi-Cal enrollees.
2. The DHCS does not perform audits for Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments.
3. The DHCS' Audits & Investigations (A&I) Division lacked communication and documentation to support adequate processes, procedures, and internal controls.

In addition, we observed that the DHCS' A&I Division did not perform an adequate number of audits and reviews to determine whether Medi-Cal Managed Care payments are sufficient and appropriate.

On November 7, 2017, we issued a draft review report. We received management responses to the draft review report on December 1, 2017. The Department of Health Care Services' responses have been incorporated within the report, and your responses have been included in their entirety as an attachment.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310, or by email at [afinlayson@sco.ca.gov](mailto:afinlayson@sco.ca.gov).

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/rg

cc: Bruce Lim, Deputy Director, Audits & Investigations Division  
California Department of Health Care Services  
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# Review Report

## Summary

The State Controller's Office (SCO) reviewed the California Department of Health Care Services' (DHCS) processes, procedures, and internal controls over the California Medical Assistance Program (Medi-Cal) to assess whether revenue, expense, and provider payments are appropriate and program funds are adequately monitored to ensure that funds are evaluated for risk and consideration of fraud. Specifically, the SCO reviewed the Medi-Cal Managed Care delivery system for the period of January 1, 2015, through December 31, 2015, and the Hospital Quality Assurance Fee (HQAF) program for the period of January 1, 2014, through December 31, 2016.

We identified inadequate controls over the Medi-Cal Managed Care delivery system and the HQAF program. We found that:

1. The DHCS has inadequate controls over the HQAF program to ensure that increased capitation payments to Medi-Cal managed care plans (MCPs) are expended for hospital services to Medi-Cal enrollees.
2. The DHCS does not perform audits for Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments.
3. The DHCS's Audits & Investigations (A&I) Division lacked communication and documentation to support adequate processes, procedures, and internal controls.

In addition, we also observed that the DHCS' A&I Division did not perform an adequate number of audits and reviews to determine whether Medi-Cal Managed Care payments are sufficient and appropriate.

## Review Authority

The SCO conducted its review pursuant to California Government Code (GC) section 12410, which states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, GC section 12411 states that "The Controller shall suggest plans for the improvement and management of revenues."

## Background

The DHCS administers Medi-Cal, which is California's Medicaid program. Medi-Cal is a public health insurance program that provides healthcare coverage to low-income individuals, including families with children, seniors, persons with disabilities, pregnant women, persons in skilled nursing or intermediate care homes, and low-income people with specific diseases such as tuberculosis, breast cancer, and HIV/AIDS. Medi-Cal is financed equally by the State and the federal government.

Medi-Cal provides services through two delivery systems: fee-for-service (FFS) and managed care; approximately 77% of Medi-Cal is under managed care and 23% is under FFS. The FFS delivery system allows individuals to receive medical services from any health care provider who participates in Medi-Cal, and providers are paid according to the services provided. Managed care requires that enrolled beneficiaries receive services through a single provider within the managed care health plan's network of primary care physicians. MCPs are paid a monthly capitation rate for each enrollee and they accept the risk of managing total costs.

In 2010, the DHCS implemented the HQAF program. The program was created to impose a quality assurance fee on certain general acute care hospitals to draw down federal matching funds. The fee is intended to provide additional funding to California hospitals that serve Medi-Cal patients through supplemental, grant, and increased capitation payments. The program has resulted in California hospitals receiving approximately an additional \$3 billion a year. California Proposition 52 (2016) was passed to continue the fee program beyond January 1, 2018.

## **Objectives, Scope, and Methodology**

The engagement review period was January 1, 2015, through December 31, 2015, for the Medi-Cal Managed Care delivery system and January 1, 2014, through December 31, 2016, for the HQAF. Our review assessed the DHCS' processes, procedures, and internal controls over the Medi-Cal program to assess whether revenue, expense, and provider payments are appropriate and program funds are adequately monitored to ensure that funds are evaluated for risk and consideration of fraud. Specifically, the SCO reviewed the Medi-Cal Managed Care delivery system and the HQAF program. Our review objectives were to:

- Determine whether the DHCS has documented processes and procedures for the accounting and budgeting process for its headquarters and other centers of operations;
- Evaluate the effectiveness and efficiency of these internal administrative and accounting controls over payments and revenue;
- Determine the process that management uses to prioritize key processes and how the controls over those processes are monitored and evaluated; and
- Assess whether management evaluation and monitoring of those controls are properly safeguarding assets (payment and revenue) by testing management assertions and independently validating results of controls.

We accomplished the review objectives through various methodologies including, but not limited to:

- Ascertaining the key functions by having executive management identify them in order of importance and priority, then:
  - Documenting management's process for prioritization of key functions; and

- Evaluating executive management’s monitoring process over these functions.
- Determining management’s identification of the key processes within those functions to:
  - Determine the key controls of that process;
  - Determine the key personnel responsible for those controls and their stakeholders;
  - Identify the risk and impact of those controls;
  - Determine how the DHCS mitigates those risks;
  - Obtain existing documentation of the process and procedures used;
  - Determine how these processes are evaluated for effectiveness and efficiency; and
  - Determine the frequency and timing for the evaluation.
- Evaluating the documented process provided to:
  - Determine whether the documentation is adequate;
  - Develop a level of concurrence with management’s identification of key controls;
  - Test those key controls for effectiveness and efficiency;
  - Determine the DHCS’s operational staff’s understanding of these processes; and
  - Assess how the controls mitigate risk and the impact of inadequate controls.

## **Conclusion**

Our review found that the DHCS has inadequate processes, procedures, and internal controls over the Medi-Cal program to assess whether revenue, expense, and provider payments are appropriate and program funds are adequately monitored to ensure that funds are evaluated for risk and consideration of fraud. Specifically, the DHCS cannot ensure that HQAF increased capitation payments are used for Medi-Cal beneficiaries’ hospital services. In addition, the DHCS does not perform audits to ensure that services were provided for Maternity, Hepatitis C, and Behavioral Health Treatment supplemental payments. With these deficiencies noted, it also appears that the DHCS’ A&I Division did not perform an adequate number of audits of the Medi-Cal program, leaving billions of dollars at risk of being improperly spent.

## **Views of Responsible Officials**

On November 7, 2017, we issued a draft review report. We received management responses to the draft review report on December 1, 2017. DHCS partially agrees with the findings. DHCS’ responses have been incorporated within the report and included in their entirety as an attachment.

**Restricted Use**

This report is solely for the information and use of the Department of Health Care Services and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

January 8, 2018



# Findings and Recommendations

**FINDING 1—  
DHCS has  
inadequate  
controls over the  
HQAF program to  
ensure that the  
increased  
capitation  
payments to Medi-  
Cal managed care  
plans are expended  
for hospital  
services to Medi-  
Cal enrollees**

The DHCS lacks adequate controls over the HQAF program. Specifically, the DHCS lacks controls to ensure that the increased capitation payments to Medi-Cal MCPs are paid to hospitals and expended on hospital services to Medi-Cal enrollees. The DHCS is responsible for disbursing these payments through capitation rates. However, the DHCS has no processes or controls in place to monitor whether MCPs appropriately expend these payments. With the passage of California Proposition 52 (2016) to continue the HQAF program permanently, these risks will continue if they are not mitigated.

Although our review scope was the calendar year of January 1, 2015, to December 31, 2015, we reviewed Phase 4 of the HQAF program covering the period of January 1, 2014, through December 31, 2016. We evaluated the HQAF program for calendar year (CY) 2014 through CY 2016, as the fee went into effect for that three-year period. To adequately assess one program, we evaluated all three years encompassing the entire cycle of the fee-collection period. For this period, the amount to be distributed through the managed care capitation increase is approximately \$9.4 billion; \$4.7 billion of this total is federal matching funds.

We requested documentation for actual expenditures; however, the DHCS did not provide us this documentation. Instead, the DHCS indicated that HQAF managed care calculations and expected payments for the state fiscal year (FY) 2015-16 were being finalized for Centers for Medicare and Medicaid Services (CMS) submission. Welfare and Institutions Code (WIC) section 14167.37 (a) (1) states, “The department shall make available all public documentation it uses to administer and audit the program...” Our review noted that the DHCS has inadequate procedures or processes in place to audit the increased capitation payments to MCPs. The DHCS has not audited and had no plans in place to audit the HQAF program. The DHCS cannot provide any assurance that these funds have been properly expended.

WIC section 14169.57 states:

- (a) Each managed health care plan receiving increased capitation payments under Section 14169.56 shall expend the capitation rate increases in a manner consistent with actuarial certification, enrollment, and utilization on hospital services. Each managed health care plan shall expend increased capitation payments on hospital services within 30 days of receiving the increased capitation payments to the extent they are made for a subject month that is prior to the date on which the payments are received by the managed health care plan.
- (b) The sum of all expenditures made by a managed health care plan for hospital services pursuant to this section shall equal, or approximately equal, all increased capitation payments received by the managed health care plan, consistent with actuarial certification, enrollment, and utilization, from the department pursuant to Section 14169.56.

- (c) Any delegation or attempted delegation by a managed health care plan of its obligation to expend the capitation rate increases under this section shall not relieve the plan from its obligation to expend those capitation rate increases. Managed health care plans shall submit the documentation that the department may require to demonstrate compliance with this subdivision. The documentation shall demonstrate actual expenditure of the capitation rate increases for hospital services, and not assignment to subcontractors of the managed health care plan's obligation of the duty to expend the capitation rate increases.

According to the DHCS, the agency plays no role in how MCPs distribute these funds to hospitals; therefore, the DHCS does not monitor whether MCPs are appropriately expending the increased capitation payments to hospitals based on services provided to Medi-Cal enrollees. With no oversight of MCPs, improper distribution of the payments could benefit hospitals that provide little care to Medi-Cal enrollees. In addition, the DHCS does not obtain documentation of actual expenditures from MCPs to ensure that all the capitation rate increases are actually expended within 30 days. The DHCS stated that it believes the hospitals would complain if they were not being paid and so, as hospitals have not complained, it assumes that there are no issues with payments. This is not an effective control, as the DHCS management is relying on outside sources to respond to risks.

In addition, the DHCS does not post information regarding the HQAF program on its website, as required by WIC section 14167.37. The DHCS does not provide quarterly updates on HQAF payments or information regarding managed care rate approvals. Although there is a fee schedule, there is no information about any payments to hospitals or MCPs. In addition, only the dates of final federal approvals are noted on the website. No additional information or documentation is provided on rate approvals. Transparency is lacking on the managed care rate approvals and payments of HQAF funds.

WIC section 14167.37 states:

- (b) Notwithstanding subdivision (a), the department shall post all of the following on the department's Internet website:
  - (2) Quarterly updates on payments, fee schedules, and model updates when applicable.
  - (3) Within 10 business days after receipt, information on managed care rate approvals.

### Recommendation

We recommend that the DHCS request documentation from MCPs to demonstrate actual expenditures of the increased capitation payments to the hospitals to ensure that MCPs are following the provisions stated in WIC section 14167.37. This will create transparency between the DHCS and MCPs to determine whether the distribution of the payments to the hospitals appear reasonable and appropriate.

**FINDING 2—  
DHCS does not  
perform audits for  
Maternity,  
Behavioral Health  
Treatment, and  
Hepatitis C  
supplemental  
payments**

DHCS' Response

DHCS agrees with the finding and recommendation.

The DHCS does not perform audits to ensure that Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments are appropriate and to verify that these services were actually provided. This control deficiency leaves the DHCS at risk of improper payments if not mitigated. Based on the *Quality Measures for Encounter Data* document published by DHCS, the DHCS expects and allows for a 10% error rate on encounter data matched to the data warehouse. With over \$130 million in supplemental payments, allowing for a 10% error rate, the DHCS could potentially accept erroneous claims totaling up to \$13 million.

DHCS developed supplemental payments for Maternity, Behavioral Health Treatment, and Hepatitis C costs to more appropriately match payment to risk. MCPs receive payment for these services when the event occurs and data is submitted by MCPs. The DHCS relies on payment system edits to detect any errors. While the payment system validates active enrollment, appropriate aid codes, and other eligibility criteria prior to payment, the system does not ensure that the delivery of service occurred. According to the DHCS' Managed Care Operations Division (MCO) staff, validation of services should be performed through audits. However, DHCS' A&I Division stated that audits for these supplemental payments are not performed.

WIC Article 5.3, section 14170 (a)(1), states:

Amounts paid for services provided to Medi-Cal beneficiaries shall be audited by the department in the manner and form prescribed by the department. The department shall maintain adequate controls to ensure responsibility and accountability for the expenditures of federal and state funds.

The DHCS relies on MCPs to detect improper claims for supplemental or "kick" payments submitted by providers. The DHCS is not conducting audits to verify delivery of services or whether MCPs have adequate controls in place to monitor these claims. If improper claims are paid, the data used to calculate future kick payments can inflate capitation rates, leading to unnecessary higher costs.

Recommendation

We recommend that DHCS conduct audits of kick payments to ensure the delivery of services.

DHCS' Response

DHCS agrees with the finding, but disagrees with the recommendation.

Such audits are currently not performed because existing audit resources are strategically allocated to (1) statutorily mandated audits, (2) areas of greatest risks within the program, and (3) high-risk program areas with the greatest materiality relative to the Medi-Cal budget as a whole.

Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments currently do not fall under any of the stated categories. DHCS considers the current practice as prudent and justified.

#### SCO's Comments

While SCO has brought this finding to the attention of DHCS as a potential area of concern, we also recognize that, as the cognizant agency, your management team will prioritize resources based on risk and materiality.

### **FINDING 3— DHCS' A&I Division lacked communication and documentation to support adequate processes, procedures, and controls**

During the review, DHCS' A&I Division lacked adequate communication and documentation to support adequate processes, procedures, and controls as required by GC 13403. As noted in Findings 1 and 2, the DHCS was unable to provide relevant and reliable information, and communication that would allow the agency to adequately carry out its responsibilities in a timely manner and address related risks.

As stated in Finding 1, the DHCS could not provide documentation to support the distribution of HQAF funds. DHCS staff members stated that approximately \$2-3 billion had been disbursed to MCPs. We requested documentation of the actual amount of HQAF funds disbursed to MCPs as of December 31, 2015. We made the initial request on December 15, 2016, through the DHCS Audit Coordinator, and followed up on January 3, 2017, and again on January 9, 2017. The DHCS did not respond to our requests until March 30, 2017, 78 days later. This delay reflects poorly on the DHCS's ability to provide information within a reasonable timeframe.

Based on MCQMD's *Quality Measures for Encounter Data* document as of January 1, 2015, DHCS' A&I Division evaluates encounter data. *Quality Measures for Encounter Data 2.3.1 DCMT.003 Overview* states:

The DHCS' Audits and Investigations Division (A&I) evaluates encounter data completeness. A&I performs a comparative analysis between the encounter data in the DHCS warehouse and the data in the medical records. This measure validates whether a specific encounter can be found in both the medical records and the DHCS encounter data.

We made an initial request for this comparative analysis on October 17, 2016. We made follow-up requests on October 26, 2016; November 3, 2016; November 18, 2016; November 29, 2016; January 9, 2017; and January 18, 2017. Neither the DHCS' A&I Division nor MCQMD responded by email or provided substantiation to support this claim. DHCS' A&I Division's only response was to state in a meeting that the comparative analysis has not been implemented.

The MCO staff relies on audits to ensure that the kick payments, as discussed in Finding 2, are appropriate. We followed up with DHCS' A&I Division regarding audits that are performed for kick payments to ensure that services were rendered. We requested this information on December 16, 2016. Follow-up emails were sent on January 3, 2017; January 9, 2017; and January 18, 2017. No documentation was provided by MCO to validate the statement. Representatives from DHCS' A&I Division eventually stated in a meeting that audits are not performed for kick

payments. Without adequately communicating internally and externally, the DHCS cannot appropriately achieve its objectives and address related risks.

#### Recommendation

We recommend that the DHCS' A&I Division maintain open and effective communication channels, and produce relevant and reliable information for any requests they receive. This will help avoid miscommunication and delays in providing information, and will ensure that information is cohesive and DHCS achieves its objectives and addresses related risks.

#### DHCS' Response

DHCS disagrees with the finding and recommendation.

The SCO cites DHCS' inability to provide documentation in both Finding 1 and 2 as the basis for Finding 3. DHCS clearly stated and acknowledged that audit procedures for both the HQAF and supplemental payments are currently not in place because existing audit resources are allocated to statutorily mandated audits and program areas of higher risk and materiality. As such, DHCS could not feasibly be responsive to SCO's request for audit documentation in these areas.

DHCS strives to maintain open and effective communication with all external parties. The department takes the work of auditors seriously and prioritizes audit related work loads. While the SCO report notes a delay in providing needed data in a timely manner, DHCS continually discussed requests with the audit team to ensure they were feasible and within the audit scope. SCO's comment regarding a 78 day delay in providing a response is inaccurate. Although the request made in December 2016 was not completed until March 31, 2017, DHCS provided preliminary updates to the SCO within three weeks of their original request. Additionally, due to the complexity and ongoing changes within the Medi-Cal program, DHCS offered and held numerous in person discussions throughout the audit period with SCO personnel to answer questions and clarify documentation requests.

#### SCO's Comments

Our finding remains unchanged.

We recognize the complexity of the Medi-Cal program. However, documentation related to the distribution of HQAF funds is necessary to support adequate processes, procedures, and controls.

# Observation

**OBSERVATION—  
The DHCS’ A&I  
Division did not  
perform an  
adequate number  
of audits and  
reviews to  
determine whether  
Medi-Cal Managed  
Care payments are  
sufficient and  
appropriate**

DHCS’ A&I Division did not perform an adequate number of audits and reviews to ensure that Medi-Cal Managed Care payments are sufficient and appropriate. During our review, we noted that 77% of Medi-Cal beneficiaries are under the Medi-Cal Managed Care delivery system. However, the DHCS performs few audits for this delivery system. The lack of audits and reviews leaves the DHCS at risk of failing to detect improper processes, procedures, and payments in managed care.

DHCS’ A&I Division employs over 700 staff members who work in the following areas: Financial Audits Branch, Investigations Branch, Medical Review Branch, Strike Team Branch, and Internal Audits. In FY 1999-2000, DHCS’ A&I Division had approximately 450 filled positions; however, despite an approximate increase of 55% in the number of positions, the A&I Division has not shifted more audits toward addressing managed care risks.

The SCO inquired whether DHCS’ A&I Division performed audits other than the compliance audits for managed care. DHCS’ A&I Division stated that the only audits required were the annual medical audits. Other audits are performed only when MCPs inform the DHCS of fraud or misconduct. A reactive instead of a proactive approach does not ensure that risks are being adequately addressed.

As noted in the findings, with no audits or reviews performed on the encounter data, supplemental payments, or the HQAF program, the DHCS cannot ensure whether controls over the Medi-Cal Managed Care delivery system are adequate and effective. We believe that DHCS’ A&I Division could better use its resources to perform more audits and reviews in managed care, as managed care encompasses the majority of Medi-Cal expenditures.

## DHCS’ Response

DHCS disagrees with the observation.

DHCS considers its current managed care program integrity efforts to be adequate based upon its annual managed care compliance audits and controls that exist within the managed care rate setting process. Furthermore, fraud complaints received from all sources are fully vetted and investigated as appropriate.

## SCO’s Comments

This observation is similar in nature to Finding 2. The SCO has brought this to the attention of DHCS’ management as a potential area of concern to ensure that managed care risks are being adequately addressed.

**Attachment—  
Department of Health Care Services Response  
to Draft Review Report**

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State of California—Health and Human Services Agency  
Department of Health Care Services



EDMUND G. BROWN JR.  
GOVERNOR

Andrew Finlayson  
Chief, State Agency Audits Bureau  
State Controller's Office  
Division of Audits  
P.O. Box 942850  
Sacramento, CA 94250-5847

Dear Mr. Finlayson:

The California Department of Health Care Services (DHCS) has prepared its response to the State Controller's Office (SCO) draft report entitled, *Process, Procedural, and Internal Controls Over [the] Medi-Cal Program*.

DHCS appreciates the opportunity to respond to SCO's draft review report regarding DHCS' processes, procedures, and internal controls over the California Medical Assistance Program (Medi-Cal). Specifically, as stated in the draft review report, the SCO reviewed the Medi-Cal Managed Care delivery system and the Hospital Quality Assurance Fee (HQAF) program based on the respective review periods.

Attached are DHCS' detailed responses to SCO's review findings and observation; however, we do not believe report provides an accurate picture of the Medi-Cal program's breadth and complexity, and the impact these program characteristics have on the adequacy and reasonableness of DHCS' internal controls. For example, in the Summary Section of the report, SCO states in part, "We identified inadequate controls over the Medi-Cal Managed Care delivery system and the HQAF program." This finding was based on SCO's narrow scope and testing combination of the Medi-Cal Managed Care delivery system and HQAF, only two of the many Medi-Cal programs.

The report concludes, "Our review found that the DHCS has inadequate processes, procedures, and internal controls over the Medi-Cal program to assess whether revenue, expense, and provider payments are appropriate and that program funds are adequately monitored to ensure that funds are evaluated for risk and consideration of fraud." This broad conclusion based upon a limited audit scope does not provide proper context and presents an inaccurate reflection of the Medi-Cal program controls as a whole.



Mr. Andrew Finlayson  
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DHCS respectfully requests the SCO include this letter in addition to its audit responses in the final published report.

Please contact Ms. Sarah Hollister, External Audit Manager, at (916) 319-8529 if you have any questions.

Sincerely,

[Original Signed by Jennifer Kent]

Jennifer Kent  
Director

Enclosure

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**Department of Health Care Services' Response to the State Controller's  
Office Report entitled, *Department of Health Care Services Process,  
Procedural, and Internal Controls over [the] Medi-Cal Program***

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<b>Finding #1:</b>	<b>DHCS has inadequate controls over the HQAF program to ensure that the increased capitation payments to Medi-Cal managed care plans are expended for hospital services to Medi-Cal enrollees.</b>
<b>Recommendation 1:</b>	<b>SCO recommends that DHCS request documentation from the MCPs to demonstrate actual expenditures of the increased capitation payments to the hospitals to ensure that the MCPs are following the provisions stated in WIC section 14167.37. This will create transparency between DHCS and MCPs to determine whether the distribution of the payments to the hospitals appear reasonable and appropriate.</b>
<b>Response:</b>	<p><b>DHCS agrees with the finding and the recommendation.</b></p> <p>DHCS is not aware of any managed care plans who did not expend HQAF risk-based capitation payments on hospital services. DHCS does acknowledge inadequate controls were in place to verify managed care plans fully expended HQAF risk-based capitation payments on hospital services for the HQAF IV program period of January 1, 2014 through December 31, 2016.</p> <p>Changes in federal managed care rules now prohibit the states from directed expenditures by managed care plans except under approved exemptions. DHCS is currently working with the Centers for Medicare and Medicaid Services (CMS) to modify the HQAF program to meet the federal requirements. The new HQAF V directed payment program will require managed care plans to fund private hospitals a uniform payment increase for contracted services based on actual service utilization for private hospitals services. The Department intends to implement proper controls over the new HQAF V Directed Payment program. These controls will include and not be limited to a process to confirm actual HQAF V directed capitation payments are fully expended on private hospital services.</p> <p>DHCS agrees with the recommendation surrounding the collection of documentation from the managed care plans for the new HQAF V directed payment program periods.</p> <p>DHCS asserts, adequate controls are in place for all rate development and payment activities of risk-based capitation payments made to managed care plans.</p>

DHCS anticipates completion by January 1, 2018 for approval of new program by CMS.

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**Finding #2:** DHCS does not perform audits for Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments.

**Recommendation 2:** SCO recommends that DHCS conduct audits of kick payments to ensure the delivery of services.

**Response:** DHCS agrees with the finding, but disagrees with the recommendation.

Such audits are currently not performed because existing audit resources are strategically allocated to (1) statutorily mandated audits, (2) areas of greatest risks within the program, and (3) high-risk program areas with the greatest materiality relative to the Medi-Cal budget as a whole. Maternity, Behavioral Health Treatment, and Hepatitis C supplemental payments currently do not fall under any of the stated categories. DHCS considers the current practice as prudent and justified.

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**Finding #3:** DHCS' A&I Division lacked communication and documentation to support adequate processes, procedures, and controls.

**Recommendation 3:** SCO recommends that DHCS' A&I Division maintain open and effective communication channels and produce relevant and reliable information for any requests they receive. This will help avoid miscommunication and delays in providing information, and will ensure that information is cohesive and DHCS achieves its objectives and addresses related risks.

**Response:** DHCS disagrees with the finding and recommendation.

The SCO cites DHCS' inability to provide documentation in both Finding 1 and 2 as the basis for Finding 3. DHCS clearly stated and acknowledged that audit procedures for both the HQAF and supplemental payments are currently not in place because existing audit resources are allocated to statutorily mandated audits and program areas of higher risk and materiality. As such, DHCS could not feasibly be responsive to SCO's request for audit documentation in these areas.

DHCS strives to maintain open and effective communication with all external parties. The department takes the work of auditors seriously and prioritizes audit related work loads. While the SCO report notes a delay in providing needed data in a timely manner, DHCS continually discussed requests with the audit team to ensure

they were feasible and within the audit scope. SCO's comment regarding a 78 day delay in providing a response is inaccurate. Although the request made in December 2016 was not completed until March 31, 2017, DHCS provided preliminary updates to the SCO within three weeks of their original request. Additionally, due to the complexity and ongoing changes within the Medi-Cal program, DHCS offered and held numerous in person discussions throughout the audit period with SCO personnel to answer questions and clarify documentation requests.

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**Observation:**                    **The DHCS' A&I Division did not perform an adequate number of audits and reviews to determine whether Medi-Cal Managed Care payments are sufficient and appropriate.**

**Response:**                    **DHCS disagrees with the observation.**

DHCS considers its current managed care program integrity efforts to be adequate based upon its annual managed care compliance audits and controls that exist within the managed care rate setting process. Furthermore, fraud complaints received from all sources are fully vetted and investigated as appropriate.

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