



Division of Financial Oversight

**CADP PRESENTATION
MAY 29, 2008**

*Allan V. Campbell, MS, CPA
Senior Financial Examiner (Supervisor)
Division of Financial Oversight
Department of Managed Health Care*



Responsibilities

Licensing

Financial Statement Review

Examinations

Enforcement Referrals



Licensing

- **Amendments & Material Modifications**
 - Projections grounded on reality.
 - **All assumptions for projections clearly presented.**
 - Specificity of dollar amounts
 - 'Transfer of xxx subsidiary' with no \$\$ value is inadequate for declaring dividend.
 - **Explain clearly in Exhibit E-1 the nature and purpose of the filing.**
 - **Network access subcontracted with no apparent assumption of financial risk by Plan. Entire cost of specialty treatment apparently borne by enrollee.**



Licensing

- **Amendments & Material Modifications**
 - Tangible Net Equity impacts
 - Subordination agreements properly executed
 - Security for 'secured affiliate receivables'
 - All laws complied with, including Corporation Code §500
 - Clearly defined contracts with providers and affiliates
 - Right of setoff
 - Pricing, payment, and settlement terms
- **License Applications**
 - All of the above and more.



Financial Statements

- Timely Filed
- Consistent with prior periods
 - Beginning cash balance ties to ending cash balance of prior reporting period of the same type (month, quarter, year)
 - Beginning net worth ties to ending net worth of prior reporting period of the same type (month, quarter, year)
 - Account for adjustments – use notes or blank tabs for clarification
- Internally consistent
 - Are major variances in account activity between periods consistent with enrollment gains or losses?
 - Statements should balance and tie to one another. Since the time of Brother Luca, debits should equal credits.



Financial Statements

What do we see?

- Cash and/or net worth increases or decreases between close of business on the last day of the reporting period and opening of business on the first day of the next period. (month, quarter, year)
- Significant fluctuations in income statement items that are not consistent with enrollment. This may indicate improper accrual accounting or other bookkeeping errors.
- Unexplained differences between affiliate receivables as reported on the balance sheet and as reflected in the TNE calculation.



Financial Statements

- **What do we see?**
- Balance sheets that do not balance and income statements that do not tie to the changes in equity on the balance sheet. Statements should balance and tie to one another.
- **Brother Luca Pacioli, in 1494 in his textbook on mathematics, described double entry bookkeeping used in Renaissance Italy at the time. The father of Modern Accounting warned that "a person should not go to sleep at night until the debits equaled the credits!"**



Actions Taken

- Nothing
- Telephone call to plan
- Letter to Plan
- Corrective Action Plan
- Nonroutine Exam
- Enforcement referral



Financial Viability

- **Fiscally sound operation and adequate provision against the risk of insolvency**
 - Adequate working capital
 - Positive cash flow from operations
 - Positive net earnings
 - Financially sound rates and charges
- **Maintain required levels of Tangible Net Equity**
 - Capitalization
 - Subtractions (intangibles, etc.)
 - Subordinated debt
 - Secured affiliate receivables



Financial Viability

- **What makes an unsecured affiliate receivable 'tangible'?**
 - For goods and services
 - In the ordinary course of business
 - Arm's length pricing (on equivalent terms as similar transactions with non-affiliates)
 - Not past due



Financial Examinations

- **Routine Exams**

- Orientation exams 6 – 12 months after license issued.
- Periodic financial examinations required by law.
- Follow-up examinations focused on findings.
- Focus is on:
 - Financial Viability
 - Statutory compliance, especially TNE
 - IBNR accrual methodology
 - Claims processing
 - Affiliate transactions
 - Contracts – terms and settlement provisions
- Currently about once every 3 years

Non-routine Exams

- May be billable
- Focused on specific areas



Financial Examinations

- **Our Goals:**
 - **Examination reports issued timely.**
 - Our internal goal is to have the final report within 180 days of the date of the financial statements examined.
 - **Information contained in the examination report is timely and useful to the Plan.**
 - **Follow-up survey at the end of the examination helps us**
 - **measure the efficiency and effectiveness of the exam team and s focused on findings**
 - **And helps us improve the examination process. Please help us by completing it**



Financial Examinations

DEFICIENCY REPORT (D AND D/V) (1/1/2005 – 5/19/2008)

ADMINISTRATIVE CAPACITY

- 4 – NO OVERSIGHT OF ASA OR DELEGATED ENTITY
- 2 – INSUFFICIENT STAFFING
- 2 – NON-EMPLOYEES PERFORM DISCRETIONARY FUNCTIONS
- 2 – GENERAL
- 1 – LACK OF KNOWLEDGEABLE STAFF

CLAIMS PAYMENT

- 10 – PAYMENT OF INTEREST
- 3 – CLAIMS PAYMENT > 30 DAYS
- 3 – 1455 – UNTIMELY PROCESSING/OTHER MISCELLANEOUS DEFICIENCIES
- 2 – 1455 FAILURE TO PROVIDE DISPUTE RESOLUTION MECHANISM
- 2 – ACCURACY OF CLAIMS PAYMENT
- 1 – 1455 FAILURE TO ACKNOWLEDGE RECEIPTS
- 1 – STATUS OF CLAIMS – 1300.77.4



Financial Examinations

DEFICIENCY REPORT (D AND D/V) (1/1/2005 – 5/19/2008)

FINANCIAL REPORTING

- 7 → INCONSISTENT WITH GAAP
- 7 → RECLASSIFICATION OF BALANCES
- 2 → ADJUSTMENT OF BALANCES
- 1 → FINANCIALS OF AFFILIATE REQUIRED
- 1 → MISSING INFORMATION IN FINANCIAL STATEMENTS

FINANCIAL VIABILITY

- 2 → GENERAL VIABILITY ISSUES (WORKING CAPITAL, CASH FLOW, ETC.)

INSURANCE ISSUES

- 6 → FIDELITY BOND INSURANCE
- 2 → GENERAL LIABILITY INSURANCE
- 1 → MALPRACTICE INSURANCE

INTERNAL CONTROLS

- 5 → MISCELLANEOUS ISSUES
- 2 → CASH CONTROL
- 2 → NO PROCEDURES MANUAL



Financial Examinations

DEFICIENCY REPORT (D AND D/V) (1/1/2005 – 5/19/2008)

CLAIMS LIABILITIES

- 4 → CLAIMS PAYABLE
- 3 → IBNR UNDER ACCRUED
- 1 → IBNR OVER ACCRUED

OTHER

- 1 → ADMINISTRATIVE COSTS
- 1 → VIOLATION OF UNDERTAKINGS

TANGIBLE NET EQUITY (TNE)

- 5 → TNE NOT CALCULATED CORRECTLY
- 2 → TNE DEFICIENCY

COMPLIANCE ISSUES

- 4 → BOOKS AND RECORDS
- 2 → JUSTIFICATION FOR EXCESSIVE ADMINISTRATIVE EXPENSES

AMENDMENTS OR MATERIAL MODIFICATIONS

- 1 1 → FAILED TO FILE MATERIAL MODIFICATION OR AMENDMENT
- 1 → UPDATE CONTRACT(S) TO CURRENT LAWS AND REGULATIONS



Financial Examinations

SAMPLE FINDINGS FROM EXAMINATIONS

- THE PLAN HAS ALLOWED CERTAIN UNRECONCILED CASH ITEMS TO BE CARRIED FORWARD FROM MONTH TO MONTH WITHOUT APPROPRIATE RESOLUTION AND ADJUSTMENT. EXAMINERS IDENTIFIED STALE-DATED PAYROLL CHECKS, NUMEROUS CASH OVER (SHORT) ITEMS AND OTHER UNRECONCILED ITEMS IN MANY OF THE ACCOUNTS.
- OUR EXAMINATION DISCLOSED THAT THE PLAN DOES NOT COMPLY WITH THE ADMINISTRATIVE CAPACITY REQUIREMENTS OF §1367(G) AND RULE 1300.67.3
- OUR EXAMINATION DISCLOSED THAT THE BROKER/AGENT COMMISSIONS WERE NOT ACCOUNTED FOR IN ACCORDANCE WITH GAAP. THE PLAN RECORDS PREPAID COMMISSIONS AS AN ASSET RATHER THAN EXPENSING COMMISSIONS AS INCURRED AS REQUIRED BY GAAP.
- OUR EXAMINATION DISCLOSED THAT THE PLAN FAILED TO COMPLY WITH §500(B)(1) OF THE CALIFORNIA CORPORATIONS CODE.
- OUR EXAMINATION DISCLOSED THAT INSURANCE POLICIES AND SUPPORTING DOCUMENTATION FOR JOURNAL ENTRIES POSTED BY THE PLAN'S PARENT WERE RETAINED AT THE OFFICES OF AFFILIATES OUTSIDE OF CALIFORNIA IN VIOLATION OF RULE 1300.81.
- OUR EXAMINATION DISCLOSED THAT A SIGNIFICANT NUMBER OF THE PROVIDER CONTRACTS REVIEWED DID NOT CONTAIN THE HOLD HARMLESS LANGUAGE REQUIRED BY §1379



Financial Examinations

SAMPLE FINDINGS FROM EXAMINATIONS

- OUR EXAMINATION DISCLOSED THAT THE PLAN FAILED TO DEDUCT \$XXX,XXX OF UNSECURED AFFILIATE RECEIVABLES FROM TNE AS REQUIRED BY RULE 1300.76. **THIS IS A REPEAT DEFICIENCY.**
- OUR EXAMINATION ALSO DISCLOSED THAT THE PLAN FAILED TO USE THE CORRECT ANNUALIZED HEALTH CARE EXPENSES AMOUNT IN CALCULATING MINIMUM REQUIRED TNE.
- THE PLAN'S PROCEDURES DID NOT ACCURATELY CAPTURE THE DATE OF RECEIPT ON 27% OF THE CLAIMS REVIEWED. **(VIOLATION OF RULE 1300.77.4)**
- OUR EXAMINATION DISCLOSED THAT THE PLAN FAILED TO PAY CLAIMS WITHIN 30 WORKING DAYS AFTER RECEIPT FOR 10% OF THE PAID CLAIMS SAMPLED AND DID NOT PAY INTEREST AND PENALTIES ON 67% OF THE LATE PAID CLAIMS
- OUR EXAMINATION DISCLOSED THAT THE RECONCILIATIONS OF KEY BANK ACCOUNTS BY THE PLAN'S AFFILIATES WERE PREPARED WITH ON OVERSIGHT REVIEW PERFORMED BY A PLAN EXECUTIVE OR PLAN'S MANAGEMENT STAFF. **THIS IS A REPEAT DEFICIENCY.**
- OUR EXAMINATION DISCLOSED THAT THE PLAN DID NOT HAVE POLICIES AND PROCEDURES IN PLACE TO ASSIGN ENROLLEES TO GENERAL DENTISTS WHEN THE ENROLLEES DID NOT SELECT ONE FOR THEMSELVES.



Financial Examinations

SAMPLE FINDINGS FROM EXAMINATIONS

- OUR REVIEW OF THE PLAN'S FIDELITY BOND DISCLOSED THAT THE NOTICE OF TERMINATION ENDORSEMENT CONTAINS THE WORD "ENDEAVOR" REGARDING NOTIFICATION OF THE DIRECTOR 30 DAYS PRIOR TO TERMINATION. THE REGULATIONS STATE THAT THE BOND ISSUER "SHALL" PROVIDE 30 DAYS NOTICE TO THE DIRECTOR. ENDEAVOR IS DEFINED AS AN "EARNEST ATTEMPT" AND IS NOT AN ACCEPTABLE SUBSTITUTION FOR "SHALL".
- OUR EXAMINATION DISCLOSED THAT THE PLAN DETERMINES THE TOTAL CLAIMS LIABILITY BUT DOES NOT ALLOCATE AN AMOUNT TO CLAIMS PAYABLE BASED ON THE ACTUAL INVENTORY OF CLAIMS RECEIVED BUT NOT YET PROCESSED.
- THE PLAN'S FIDELITY INSURANCE DOES NOT PROVIDE A DETERMINABLE AMOUNT OF EXCLUSIVE COVERAGE FOR THE PLAN.
- THE PLAN DID NOT DEDUCT INTANGIBLE ASSETS IN THE CALCULATION OF TNE IN VIOLATION OF THE REQUIREMENTS OF RULE 1300.76.
- OUR EXAMINATION DISCLOSED THAT THE PLAN HAS NOT DEMONSTRATED A FISCALLY SOUND OPERATION. IT IS NOT GENERATING POSITIVE CASH FLOW FROM OPERATIONS AND DID NOT MAINTAIN ADEQUATE CASH TO MEET ITS CURRENT OBLIGATIONS. ON OCTOBER 9, 20XX, THE PLAN FILED AN APPLICATION FOR SURRENDER OF LICENSURE.



Financial Examinations

- **Routine Exams may become non routine (billable) if:**
 - Plan unable to respond to exam staff
 - Plan unable to provide appropriate documentation
 - Plan unable to support transactions
 - Exam team uncovers indications of serious non-compliance
- **Non-routine Exams (generally billable)**
 - Through monitoring or other means, indications of serious non-compliance with Act or Rules surface
 - Plan fails to adequately respond to documentation or information requests related to an amendment or material modification
 - Lack of veracity or conformance with GAAP of financial filings is indicated
 - Inappropriate patterns of claims payment need to be investigated



Referrals to the Office of Enforcement

Referrals can arise from Exams, Financial Statement Review, or Licensing.

Referrals are made for

- Claims payment violations
- Tangible Net Equity violations
- Financial Viability violations
- False Filings with the Department
- Request to subpoena records
- Delinquent filing of financial statements
- Takeover of plan or license revocation





QUESTIONS???

Thank you for your time and attention!

*Allan V. Campbell, MS, CPA, SMSgt, USAF (Ret)
Senior Financial Examiner (Supervisor)
Division of Financial Oversight
Department of Managed Health Care*