

DRAFT

REPORT ON REVIEW OF CONTRACTUAL TERMS RELATED TO THE “PROFIT AND LOSS STATEMENTS” OF TWO VENDORS UTILIZED BY HCA TO PROVIDE INMATE MEDICAL SERVICES (Board Directive No. 28, March 10, 2009)

The Board of Supervisors directed the County Internal Auditor to review the contractual terms of the two vendors as related to the “Profit and Loss Statement” findings raised by the Office of Performance Audit Director in its audit of HCA/Correctional Medical Services.

We conclude that both contracts are “fixed fee” contracts that were designed by HCA to effectively transfer the risk of potential case load and cost escalations for inmate medical care to the vendors instead of to the County. These fixed fee contracts require the vendors to assume in all material regards the risk of unforeseen escalations in utilization and medical severity and the corresponding cost increases.

AUDIT NO: 2807-11
REPORT DATE: MONTH XX, 2009

A Board of Supervisors Directed Analysis
Meeting Date: March 10, 2009

County Internal Auditor: [Peter Hughes, Ph.D., CPA](#)
Deputy Director: [Eli Littner, CPA, CIA](#)



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Letter from Dr. Peter Hughes, CPA



Transmittal Letter



Audit No. 2807-11 **Date**

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA
County Internal Auditor

SUBJECT: Report on Review of Contractual
Terms of the Contracts Related to the
“Profit and Loss Statements” of Two
Vendors Utilized by HCA to Provide
Inmate Medical Services

This report is being issued in response to a Board of Supervisor’s directive number 28, dated March 10, 2009. The directive requested that the Internal Audit Department review the terms of the contracts related to the “Profit and Loss Statements” of the two vendors providing inmate medical services to the County.

Each month I submit an Audit Activities Report to the Board of Supervisors (BOS) where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our reports. Accordingly, the results of this report will be included in a future status report to the BOS.

Please contact me should you wish to discuss any aspect of our report.

Attachments

Other recipients of this report listed on the Internal Auditor’s Executive Report on page 3.



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OC Internal Auditor's Executive Report

Audit No. 2807-11

DATE

TO: Members, Board of Supervisors

FROM: Dr. Peter Hughes, CPA
County Internal Auditor

SUBJECT: Profit and Loss Report of Contractors Utilized by HCA
to Provide Inmate Medical Services

Audit Highlight

The Board of Supervisors directed the County Internal Auditor to review the contractual terms of the two vendors as related to the "Profit and Loss Statements" findings raised by the Office of Performance Audit Director in its audit of HCA/Correctional Medical Services.

We concluded that both contracts are "fixed fee" contracts that were designed by HCA to effectively transfer the risk of potential case load and cost escalations for inmate medical care to the vendors instead of to the County. These fixed fee contracts require the vendors to **assume in all material regards the risk of unforeseen escalations in utilization and medical severity and the corresponding cost increases.**

Board Directive — Scope and Objectives of Review

This report is being issued in response to a Board of Supervisors' directive number 28, dated March 10 2009. The directive was made after the oral presentation of the Office of Performance Audit Director's report titled, Performance Audit of Health Care Agency's Correctional Medical Services.

The Board of Supervisors directed the County Internal Auditor to review the contractual terms of the two vendors as related to the "Profit and Loss Statement" findings raised by the Office of Performance Audit Director. These findings are detailed below for easy reference. HCA utilizes the following two vendors to provide the inmate medical services to the County.

1. Correctional Managed Care Medical Corporation (CMC): Provides physician services. CMC is currently paid \$257,781 per month for services.
2. Western Medical Center-Anaheim (WMC-A): Provides the custody hospital facility where CMC provides its physician services. WMC-A is currently paid \$455,303 per month for their secure facility.

The "Performance Audit of Health Care Agency's Correctional Medical Services" contained the following findings regarding the above contractors:

- Finding 23.1: Profit and Loss Statements are not prepared according to the contract period as required.
- Finding 23.2: CMC over-reported expenses included on Profit and Loss Statements.
- Finding 23.3: CMC's Revised Profit and Loss Expenditures do not agree with supporting documentation.



OC Internal Auditor's Executive Report

- Finding 24: CMC's profit margin from the CMS contract far exceeds industry standards.
- Finding 25.1: WMC-A is unable to provide sufficient documentation to explain the expenses reported in the Profit and Loss Statements provided to the County.
- Finding 25.2: Profit and Loss Statements are not provided or prepared according to the terms of the contract.

Work Performed by Internal Audit

1. The Internal Audit Department met with the Office of the Performance Audit Director to gain a better understanding of inmate medical services and to obtain a limited amount of documentation related to the above findings regarding contract non-compliance. We did NOT audit or review any aspect of the above findings; nor, are we expressing an audit opinion regarding these findings.
2. We obtained and read the terms of the CMC and WMC-A contracts.
3. We discussed the above contracts and the basis for how they were negotiated in 2004 with the HCA contract administrator for these two contracts.

Conclusion

We conclude that both contracts are "fixed fee" contracts that were designed by HCA to effectively transfer the risk of potential case load and cost escalations for inmate medical care to the vendors instead of to the County. These fixed fee contracts require the vendors to **assume in all material regards the risk of unforeseen escalations in utilization and medical severity and the corresponding cost increases.**

Additionally, **neither contract contains** penalties or financial consequences for non-conformance as related to the "Profit and Loss Statement" findings cited by the Office of Performance Audit. Lastly, the Profit and Loss Statement" contract terms do not **impact or change in any way the payment obligations of the County in this regard.**

We have one recommendation to assist in future negotiations of these contracts (these contracts expire June 30, 2009). The recommendation is detailed on page 4 and addresses a contract pricing issue common to both contracts. The County has at least eight years of dependable medical service data on inmates and that data may enable HCA to better predict medical services required in upcoming years. HCA concurred with this approach in an effort to manage costs in their upcoming contract negotiations.



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Contractual Terms for "Profit and Loss Statements"

Both the CMC and WMC-A contract terms (page 8 of contracts) require the vendor to annually provide an "Expenditure and Revenue Report" to HCA for informational purposes only as shown in this clause of the contracts below:

"No later than sixty (60) days following each Period or termination of this Agreement, CONTRACTOR shall submit to ADMINISTRATOR, **for informational purposes only**, an Expenditure and Revenue Report relating to the actual cost of Custody Physician Services for the proceeding Period, or portion thereof. Such report shall be prepared in accordance with the procedure that is provided by ADMINISTRATOR and generally accepted accounting principles."

Benefits to Orange County from Issuing a Fixed Price Contract

HCA informed us that providing medical services to inmates is perhaps one of the most difficult areas HCA is obligated to address. This is because HCA is not in a position to control the population of inmates, their medical histories or addictions, or their utilization of medical services and/or the severity of their medical issues. HCA informed us that it **was critical** to be able to budget a known and manageable amount in advance for the provision of these services so as to avoid potentially large budget "overruns" in inmate medical care. HCA indicated that they must provide requisite medical care regardless of the authorized budget allocations.

HCA stated that the general terms of the "fixed fee" contract with these two vendors effectively transferred in all material regards the risk of such potential case load and cost escalations to the vendors instead of to the County. These fixed price contracts require the vendors to **assume in all material regards the risk of unforeseen escalations in utilization and medical severity and the corresponding cost increases.**

In some years, it could be possible for a vendor to experience a loss because of unexpected medical severity or usage. Vendors consequently required longer-term agreements in order to balance out potential service fluctuations in any given year.

HCA stated they knew jail expansion was static for the next five years of these current contracts and they then had three years of dependable medical utilization history accumulated. When HCA went out to bid providing such relevant information for bidders interested in the RFP, they received no bids from any other potential providers. The only bids received were from each of the current providers. Despite this challenge, HCA felt they negotiated contracts with each of the vendors that provided quality and responsive medical care under terms that were beneficial to the County.



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Recommendation

1. We recommend that HCA consider the merits of negotiating in future contracts a two tier approach to contract pricing. The first tier would be a level base for those services which are more consistently provided and predictable in nature. The second tier would involve some cost control for the more unpredictable medical services. Such contract provisions may help control risk for the contractor and reduce profit requirements when providing services at a fixed price. HCA indicated that this recommendation may be more appropriate for hospital services than for physician services, but nevertheless concurred and will attempt to implement it (See Attachment). HCA cannot assure its full implementation because the contract provisions will depend upon negotiations with the selected vendors.

We appreciate the cooperation and assistance extended to us by the Office of the Performance Audit Director and the Health Care Agency during our review. If you have any questions, please contact me directly or Eli Littner, Deputy Director at (714) 834-5475.

Attachment

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Audit Oversight Committee

Thomas G. Mauk, County Executive Officer

Foreperson, Grand Jury

Darlene J. Bloom, Clerk of the Board of Supervisors

Office of the Performance Audit Director

David L. Riley, Assistant Agency Director, Health Care Agency



ATTACHMENT: Health Care Agency Management Response



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HEALTH CARE AGENCY
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April 2, 2009

TO: Eli Littner, Deputy Director
Internal Audit Department

SUBJECT: Review of Contractual Terms Related to Inmate Medical Services Vendors

RECEIVED
INTERNAL AUDIT DEPARTMENT
2009 APR - 3 PM 1: 24

We appreciate your review of the two inmate medical services vendor contracts. Your report accurately states the facts and we concur with the recommendation.

Please let me know if you have any questions.


David L. Riley, Interim Director

DLR:eo(09-083)