

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



CARDINAL INNOVATIONS HEALTHCARE SOLUTIONS

PERFORMANCE AUDIT
MAY 2017



NC OSA
The Taxpayers' Watchdog

EXECUTIVE SUMMARY

PURPOSE

The audit evaluates whether Cardinal Innovations Healthcare Solutions (Cardinal) is (1) operating within its statutory mission, and (2) a good steward of state and federal resources.

BACKGROUND

Cardinal is a Local Management Entity/Managed Care Organization (LME/MCO) created by *North Carolina General Statute 122C*. Cardinal is responsible for managing, coordinating, facilitating and monitoring the provision of mental health, developmental disabilities, and substance abuse services in 20 counties across North Carolina.

Cardinal is the largest of the state's seven LME/MCOs, serving more than 850,000 members. Cardinal has contracted with DHHS to operate the managed behavioral healthcare services under the Medicaid waiver through a network of licensed practitioners and provider agencies.

KEY FINDINGS

- Cardinal spent money exploring strategic opportunities outside of its core mission
- \$1.2 million in CEO salaries paid without proper authorization
- Cardinal's unreasonable spending could erode public trust

KEY RECOMMENDATIONS

- Cardinal should consult and collaborate with members of the General Assembly before taking any actions outside of its statutory boundaries
- The Office of State Human Resources should immediately begin reviewing and approving Cardinal CEO salary adjustments
- The Department of Health and Human Services should determine whether any Cardinal CEO salary expenditures should be disallowed and request reimbursement as appropriate
- Cardinal should implement procedures consistent with other LME/MCOs, state laws, and federal reimbursement policy to ensure its spending is appropriate for a local government entity

The key findings and recommendations in this summary may not be inclusive of all the findings and recommendations in this report.

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Office of the State Auditor



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AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, Governor
Members of the North Carolina General Assembly
Richard Topping, Chief Executive Officer, Cardinal Innovations Healthcare Solutions
Lucy Drake, Chairman, Cardinal Innovations Healthcare Solutions Board of Directors

Ladies and Gentlemen:

We are pleased to submit this performance audit report titled Cardinal Innovations Healthcare Solutions. The audit objectives were to determine whether Cardinal Innovations Healthcare Solutions is (1) operating within its statutory mission, and (2) a good steward of state and federal resources.

Cardinal Innovations Healthcare Solutions Chief Executive Officer, Richard Topping, reviewed a draft copy of this report. His written comments are included starting on page 22.

This audit was conducted in accordance with Article 5A of Chapter 147 of the *North Carolina General Statute*.

We appreciate the courtesy and cooperation received from management and the employees of Cardinal Innovations Healthcare Solutions during our audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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BACKGROUND

Cardinal Innovations Healthcare Solutions (Cardinal) is a Local Management Entity/Managed Care Organization (LME/MCO) created by *North Carolina General Statute 122C*.¹ Cardinal is responsible for managing, coordinating, facilitating and monitoring the provision of mental health, developmental disabilities, and substance abuse services in 20 counties across North Carolina.²

Cardinal is the largest of the state's seven LME/MCOs, serving more than 850,000 members. Cardinal has contracted with DHHS³ to operate the managed behavioral healthcare services under the Medicaid waiver through a network of licensed practitioners and provider agencies.

Cardinal's most significant funding is provided by Medicaid.⁴ Funding from Medicaid totaled \$567 million and \$587 million for state fiscal years 2015 and 2016, respectively.

Cardinal is governed by an area board consisting of 13 members,⁵ whose primary responsibilities include strategic planning, budgets, and hiring and evaluation of the Chief Executive Officer (CEO). Cardinal's current CEO has been in position since April 27, 2015.

¹ Mental Health, Development Disabilities, and Substance Abuse Act of 1985.

² Union, Mecklenburg, Stanly, Cabarrus, Rowan, Davidson, Davie, Forsyth, Stokes, Rockingham, Caswell, Person, Granville, Vance, Warren, Franklin, Halifax, Orange, Alamance, and Chatham.

³ Since 2005.

⁴ Medicaid funding comprises approximately 85% of Cardinal's funding.

⁵ Board members consist of individuals with expertise in managed care of behavioral health services and individuals who represent the constituencies Cardinal serves.



OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine whether Cardinal Innovations Healthcare Solutions (Cardinal) is (1) operating within its statutory mission, and (2) a good steward of state and federal resources.

The audit scope included Cardinal's operations during state fiscal years 2015 and 2016.

To accomplish the audit objectives, auditors interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting transactions as considered necessary. Whenever sampling was used, auditors applied a nonstatistical approach. Therefore, results could not be projected to the population. This approach was determined to adequately support audit conclusions.

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

As a basis for evaluating internal control, auditors applied the internal control guidance contained in professional auditing standards. However, our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



FINDINGS, RECOMMENDATIONS, AND RESPONSES

1. CARDINAL SPENT MONEY EXPLORING STRATEGIC OPPORTUNITIES OUTSIDE OF ITS CORE MISSION

Cardinal Innovations Healthcare Solutions (Cardinal) spent money, time, and effort exploring strategic opportunities outside of its core mission as a local government entity. As a result, these resources were not available to support behavioral health services in its service area. Once Cardinal's funding changed from direct state appropriations to a Medicaid per-member per-month model, Cardinal chose not to operate as a government entity. However, state law explicitly states Cardinal's core mission as a government entity.

Cardinal Used Resources to Explore Other Opportunities

Cardinal spent money, time, and effort exploring strategic opportunities outside of its core mission as a local government entity. Cardinal entered into several outside consultant contracts and used another entity, Cardinal Ally, to explore strategic options.

Outside Consultant Contracts' Costs and Justifications

Cardinal spent money, time, and effort on consultant contracts to explore strategic opportunities outside of its core mission and geographic area.

1. *Daniel Coughlin* (July 2014 – June 2016)

Scope of Work includes recommending "opportunities to expand its business portfolio" and providing strategic advice and consultation regarding Cardinal's services and potential business opportunities **both locally and nationally**. (*Emphasis Added*)

2. *Companion Professional Services (CPS)*⁶ (July 2013 – June 2016)

CPS's Scope of Work includes helping Cardinal analyze the processing of **physical health** claims through the existing Cardinal systems. According to State law, Cardinal shall focus on providing **behavioral health services**. (*Emphasis Added*)

According to Cardinal's Deputy General Counsel, this service was contracted in response to House Bill H1181, which included a proposal for a pilot program to test whether existing LME's can successfully unite the management of physical and behavioral health care for recipients. This bill did not pass the General Assembly before it adjourned in August 2014 and was no longer eligible for consideration.⁷

However, CPS made a presentation to Cardinal six months later on March 2, 2015, identifying the business processes Cardinal would need to handle physical claims, and the level of effort to start up and maintain those processes.

⁶ CPS' scope of work also includes assisting Cardinal with operational and system changes to stay in compliance with diagnosis and procedure codes.

⁷ Link to H1181: <http://www.ncleg.net/gascripts/BillLookup/BillLookup.pl?Session=2013&BillID=H1181>; Link to version 2 of the legislation, containing the section on the pilot project: <http://www.ncleg.net/Sessions/2013/Bills/House/HTML/H1181v2.html>.

3. *Rory Riley*⁸ (November 2014 – December 2014)

Signed by the former Cardinal CEO in November 2014, the deliverable of the consultant contract was a report exploring **local and national** contractual opportunities related to the delivery of veteran's care. (Emphasis Added)

Cardinal ended up participating in a pilot program with Charlotte Bridge Home⁹ to establish Cardinal's credibility in providing veterans healthcare. Since July 1, 2016, Cardinal has expanded its contract portfolio by securing a contract to provide call center services for the USO of NC (coordinator for the Raleigh/Durham chapter of NCServes).

Rory Riley's resume shows several years of veteran-related experience, an area outside of Cardinal's expertise.

Cardinal Ally's Purpose and Scope of Operation

Using Cardinal Ally (Ally), Cardinal spent time and effort to explore strategic opportunities outside of Cardinal's core mission.

Cardinal's Strategic Plan from 2013 discusses the purpose of Ally: (1) Hold non-behavioral contracts; (2) Explore new non-North Carolina business (opportunistic); and (3) A potential safe haven for all Cardinal staff.

The Cardinal Board and executives met in July 2014 to discuss the setup of Ally. The Cardinal Board was appointed as the Ally Board in September 2015.

Cardinal's Chief Administrative Officer stated that development of Ally stopped after the legislature expressed concerns.

It does not appear the Ally Board ever met to conduct Ally business.

Resulted in Resources Not Available to Support Core Mission

Because Cardinal spent money, time and effort to explore business opportunities outside of its core mission, these resources were not available to support the organization's core mission to provide behavior health services in its specified geographic area.

Caused by Cardinal Not Operating as a Local Government Entity

Cardinal explored opportunities outside of its core mission because it no longer operates as a local government entity. Once Cardinal's funding changed from direct state appropriations to a Medicaid per-member per-month model, Cardinal chose not to operate as a government entity. On September 12, 2016, Cardinal's CEO said:

“...when Piedmont Behavioral Health (PBH) essentially left the government appropriations business, we ceased operating as a local government mental health agency and started operating as a MCO...”

⁸ At the time the contract was signed, Rory Riley was in a personal relationship to the then General Counsel who was later promoted to CEO. Riley is now married to Cardinal's CEO.

⁹ Coordinator for the Charlotte chapter of NCServes. NC Serves is a non-profit, coordinated network of public, private, and non-profit organizations working together to serve veterans and their families.

The CEO also said that Cardinal views itself as a general contractor for the State of NC.

Also Caused by Cardinal Trying to Address Its Revenue Risk

Cardinal explored opportunities outside of its core mission to address revenue risk. Cardinal's enterprise Risk Assessment (completed in 2015 and updated for 2016) rated Cardinal's greatest risk as its concentration of revenues from a small number of state contracts. Its potential action to address this risk is to diversify its business base to include other states or commercial contracts.

Cardinal is A Local Government Entity with Specific Mission and Service Area

An advisory letter from the Attorney General's Office states that as an LME/MCO defined by N.C. General Statute 122C, Cardinal is a local management entity (LME) and a political subdivision of the state. As such, Cardinal is subject to the provisions of *North Carolina General Statute 122C*.

Per §122C-115.4(a):

"An LME shall plan, develop, implement, and monitor [Behavioral Health] services within a specified geographic area to ensure expected outcomes for consumers within available resources."

Good Government Requires Cardinal to Demonstrate Accountability as a Government Entity

The Government Accountability Office states:¹⁰

"The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, economically, ethically, and equitably **within the context of the statutory boundaries of the specific government program.**" (*Emphasis Added*)

RECOMMENDATIONS

Cardinal should consult and collaborate with members of the General Assembly before taking any actions outside of its statutory boundaries.

AGENCY RESPONSE

See page 27 for Cardinal's response to this finding.

2. \$1.2 MILLION IN CEO SALARIES PAID WITHOUT PROPER AUTHORIZATION

Cardinal Innovations Healthcare Solutions (Cardinal) paid approximately \$1.2 million in CEO salaries that exceeded the salary range established by the Office of State Human Resources (OSHR) without prior approval. Cardinal did not seek prior approval because it did not believe approval was required.

¹⁰ Government Auditing Standards, United States Government Accountability Office, 2011 Revision.

Cardinal was able to exceed the established CEO salary range without consequence because OSHR did not enforce the general statutes that required OSHR oversight and approval.

Cardinal Exceeded OSHR Established Salary Range Without Prior Approval

Cardinal paid CEO salaries that exceeded the maximum salary range established by OSHR without: (1) obtaining prior approval from OSHR; (2) supporting its request with documentation of comparable salaries in comparable operations within the region; and (3) documenting the specific amount that Cardinal proposed to pay.

In 2010, OSHR established the following salary range for mental health area directors such as Cardinal's CEO.

Minimum	Midpoint	Maximum
\$105,576	\$146,470	\$187,364

However, a review of three years of CEO salary data showed that Cardinal exceeded the maximum OSHR established salary range without obtaining prior approval. On July 1, 2014, Cardinal's CEO salary was \$260,000. Cardinal increased the CEO salary three times since then. On July 1, 2016, the CEO salary was \$635,000.

Furthermore, Cardinal management acknowledged that it did not receive prior approval from OSHR for any of the CEO salaries that exceeded OSHR's maximum salary range. Auditors provided Cardinal management with a list of its CEO salary adjustments from 2014 through 2017. Cardinal management said it "has not requested specific OSHR approval for any of the CEO salary adjustments that OSA has listed."

Additionally, Cardinal did not submit comparable salary data that supported the CEO salaries to OSHR. Although it was not submitted to OSHR, Cardinal did have a 2016 CEO Compensation Analysis. However, it did not meet state law or state administrative code requirements. Specifically, a review of the compensation analysis found that the CEO salaries used **were not**:

- **In comparable operations.** The analysis did not consider the salaries of the other six LME/MCOs who have the same function, are subject to the same laws, and service the same population. Instead, the analysis benchmarked not-for-profit Health Care MCOs and general industry¹¹ companies.
- **Within the region.** The analysis did not consider the salaries of the other six LME/MCOs that reside in the same state as Cardinal. Instead, the analysis benchmarked the U.S. national geographical competitive market.
- **From counties within the Local Management Entity.** As noted above, the analysis benchmarked the U.S. national geographical competitive market.¹²

¹¹ According to the Occupational Safety and Health Administration (OSHA), general industry refers to all industries not included in agriculture, construction, or maritime.

¹² The analysis did include salaries from counties within the LME. However, all were from national non-governmental companies with the exception of the City of Greensboro, NC OSHR, and UNC Health Care.

Lastly, Cardinal did not submit the specific amount of any proposed CEO salary to OSHR for its approval. Cardinal submitted a “salary plan” to OSHR that included salary ranges for all Cardinal positions, including the CEO. But that did not meet the requirements of state law.

Resulted In Approximately \$1.2 Million In Unauthorized Salaries

Because Cardinal did not receive prior approval for the CEO salary adjustments, it paid approximately \$1.2 million in unauthorized salaries that could have been used for other operational needs.

A comparison of Cardinal CEO salary data to OSHR’s maximum authorized salary identified the following unauthorized salary payments for the previous and current Cardinal CEOs from July 1, 2014 to June 30, 2017.

<u>Unauthorized Compensation</u>			
Dates	Annual	OSHR Max	Unauthorized ¹³
Previous CEO			
7/1/14 – 7/15/14	\$260,000	\$187,364	\$ 3,027
7/16/14 – 6/30/15	\$400,000	\$187,364	\$ 203,776
7/1/15 – 6/30/16	\$417,241 ¹⁴	\$187,364	<u>\$ 229,877</u>
			\$ 436,680
Current CEO			
6/1/15 – 10/15/15	\$400,000	\$187,364	\$ 79,738
10/16/15 – 6/30/16	\$516,000	\$187,364	\$ 232,784
7/1/16 – 6/30/17	\$635,000	\$187,364	<u>\$ 447,636</u>
			\$ 760,158
		TOTAL:	<u>\$1,196,838</u>

Additionally, Cardinal could be required to reimburse the State for any payroll expenditures that are later disallowed because they were unauthorized. *North Carolina General Statute 122C-123.1* states:

“Any funds or part thereof of an area authority that are transferred by the area authority **to any entity** including a firm, partnership, corporation, company, association, joint stock association, agency, or nonprofit private foundation **shall be subject to reimbursement** by the area authority **to the State when expenditures of the area authority are disallowed pursuant to a State or federal audit.**” (*Emphasis Added*)

Caused By OSHR’s Lack of Enforcement

Cardinal did not seek approval for the CEO salary because it did not believe approval was required.

¹³ (Annual Cardinal CEO salary – OSHR maximum) / 12 months x (number of months the salary was paid).

¹⁴ This amount is severance pay for the previous CEO paid in 12 monthly installments on regular payroll date.

Cardinal was able to exceed the established CEO salary range without consequence because OSHR did not enforce the general statutes that required OSHR oversight and approval.

In 1993, when Cardinal was named Piedmont Mental/Behavioral Health, OSHR approved Cardinal's personnel system as "substantially equivalent" under *North Carolina General Statute* 126-11.

The law allowed OSHR to designate local government personnel systems as "substantially equivalent" to the state personnel system. After OSHR approves a local government personnel system as substantially equivalent, the system is generally exempt from OSHR oversight except for annual monitoring that is required by state law to ensure compliance.

However, the law did not apply to mental health directors such as Cardinal's CEO. The law only exempted the personnel system for an entity's staff from OSHR's review and approval.

In fact, state law specifically prohibits OSHR from exempting Cardinal's CEO from OSHR oversight as a result of the "substantially equivalent" designation. In regard to a "substantially equivalent" determination, *North Carolina General Statute* 126-11(b1) states:

"Upon such determination, area mental health authority employees shall be exempt from the provisions of this Chapter relating to the approved portions of the area mental health authority personnel system **except as provided in G.S. 122C-121.**" (*Emphasis Added*)

The requirements of *North Carolina General Statute* 122C-121, which are specifically excluded from a "substantially equivalent" exemption, prescribe procedures for establishing the salary and benefits of mental health area directors such as Cardinal's CEO.

State Law Required OSHR's Prior Approval

Because Cardinal's CEO cannot be exempted from OSHR oversight, state law required OSHR's prior approval for any proposed CEO salary that would exceed the maximum applicable salary range established by OSHR. Specifically, *North Carolina General Statute* 122C-121(a1) states:

"The area board shall not authorize any salary adjustment that is above the normal allowable salary range without obtaining **prior approval from the Director of the Office of State Human Resources.**" (*Emphasis Added*)

Furthermore, state law required OSHR to obtain supporting comparable salary data and the specific proposed CEO salary from the area board. Specifically, *North Carolina General Statute* 122C-121(a1) states:

"Any salary that is higher than the maximum of the applicable salary range shall be **supported by documentation of comparable salaries in comparable operations within the region** and shall also **include the specific amount the board proposes to pay the director.**" (*Emphasis Added*)

The North Carolina Administrative Code further specified the requirements for OSHR approval and comparable salary data. Specifically, 25 NCAC 01I .2108 states:

- a) The salary of an Area Mental Health Director shall be established by the area board of the Local Management Entity and **shall be within the salary range** recommended for Area Mental Health Directors by the Office of State Human Resources and **approved by the State Human Resources Commission**.
- b) Each director's salary **shall be based upon labor market data from counties within the Local Management Entity**. The salary may not be less than the minimum of the range, nor more than the maximum of the range established for Area Mental Health Directors under this Rule.
- c) Area boards **may request an adjustment to the salary range** for Area Mental Health Directors **from the State Human Resources Commission in accordance with G.S. 122C-121(a1)**. (*Emphasis Added*)

RECOMMENDATIONS

The Office of State Human Resources should immediately begin reviewing and approving Cardinal CEO salary adjustments.

The Department of Health and Human Services should determine whether any Cardinal CEO salary expenditures should be disallowed and request reimbursement as appropriate.

AGENCY RESPONSE

See page 34 for Cardinal's response to this finding.

3. CARDINAL'S UNREASONABLE SPENDING COULD ERODE PUBLIC TRUST

Cardinal Innovations Healthcare Solutions (Cardinal) has not demonstrated accountability in the use of its federal and state resources as evidenced by some of its spending. This type of unreasonable spending erodes the public's trust in Cardinal's ability to deliver quality healthcare to a vulnerable population. Cardinal does not operate as a government entity and therefore does not believe that its expenses are unreasonable. However, state law explicitly requires Cardinal to demonstrate accountability as a government entity.

Some of Cardinal's Expenses Appear Unreasonable

Some of Cardinal's expenses appear unreasonable. These expenses are wide ranging and fall into several different categories including spending for board retreats, board meetings, parties at high-end locations, charter flights, CEO benefits, and miscellaneous credit card expenditures.

Board Retreats

In FY 2015 and 2016, Cardinal's board held yearly retreats at the Belmond Charleston Place, a luxury hotel in downtown Charleston, South Carolina. Each retreat was four days: two days of activities, and two days to travel in and out.

The FY 2015 retreat cost \$55,127 for 19 board members and staff plus their guests, and the FY 2016 retreat cost \$78,028 for 19 board members and staff plus their guests, and three speakers.¹⁵

The FY 2015 and 2016 board retreat costs included:

Expense Category	Amount (\$)	%
Hotel	\$ 58,598	44%
Banquets	32,013	24%
Hotel cancellation fees	13,411	10%
Mileage	9,311	7%
Entertainment	5,707	4%
Audio and visual	4,209	3%
Per diems	4,400	3%
Bar services and alcohol	2,127	2%
Other ¹⁶	3,379	3%
Total	\$ 133,155	100%

The board had six hours of meetings at the 2015 retreat and 9 hours of meetings at the 2016 retreat, which effectively cost \$9,188 and \$8,670 per hour of productivity for each retreat, respectively.

Board Meetings

In FY 2015 and 2016, Cardinal's board held 14 meetings with a total cost of \$123,631.

- Nine of the 14 board meetings were held at high-end venues and included rental of conference space with an average total cost of \$12,620 per meeting
- One board meeting held at Cardinal's office had a total cost of \$7,904
- Four meetings were held via phone conference with a cost ranging from \$450 to \$600, all attributed to per diem costs

Ten of the 14 meetings included overnight stays at the Carolina Inn and Ballantyne Hotel with an average nightly rate of \$196/person.¹⁷ The average federal reimbursement rate was \$103/person.¹⁸

¹⁵ For the 2015 retreat, 19 attendees included 11 board members and 8 Cardinal staff members. For the 2016 retreat, 22 attendees included 11 board members, 8 Cardinal staff members, and 3 speakers. Although the number of guests cannot be confirmed, one of the banquet costs for 2016, scheduled in advance, was for 47 people.

¹⁶ Other costs include airline tickets \$657, parking \$757, travel meals \$1,812, and other minor costs of \$152.

¹⁷ The hotel rates ranged from \$175/night to \$249/night per person.

¹⁸ Federal reimbursement rate for hotel is determined by the General Service Agency (GSA) of the US government.

The FY 2015 and 2016 board meetings costs included:

Expense Category	Amount(\$)	%
Catered meals ¹⁹	\$ 45,128	37%
Hotel	40,603	33%
Mileage	15,014	12%
Per diems	12,500	10%
Hotel cancellation fees	6,521	5%
Other ²⁰	3,865	3%
Total	\$ 123,631	100%

Christmas Parties

In FY 2016, Cardinal hosted 75 attendees at the Whitehead Manor Conference Center, a retreat-like historic venue. Cardinal paid \$18,130, with an average cost of \$242 per attendee. The total includes \$3,250 for facility rental, \$6,122 for a caterer, \$1,337 for hotel stays, \$668 for hotel cancellation fees, \$1,385 for decorations, and \$1,126 for alcohol.

In FY2015, Richard Topping²¹ hosted 69 attendees at his personal residence. Cardinal paid \$9,621, with an average cost of \$139 per attendee. The total cost includes \$1,141 for hotel rooms, \$3,491 for a caterer, \$2,072 for decorations, and \$683 for alcohol.

Executives' Use of Charter Flights

Cardinal executives took four chartered flights, all in-state, between September and November 2015.²² The cost of the chartered flights totaled \$15,765 with the average cost per person ranging from \$605 to \$2,061 for flights from the Charlotte area to the eastern part of North Carolina.

Charter Flights				
Flight	Destination	Cost	Persons	Cost/Person
1	Greenville	\$ 4,122	2	\$ 2,061
2	Rocky Mount	\$ 4,075	3	\$ 1,358
3	Smithfield	\$ 3,940	3	\$ 1,313
4	Rocky Mount	\$ 3,628	6	\$ 605

Cardinal stated it had conducted an analysis concluding the charter flights would be cheaper than vehicle travel once hotel, meal, mileage, and "off-line" costs were considered. However, Cardinal could not provide a copy of its analysis upon request.

¹⁹ Catered meals include un-itemized costs for rental of audio and visual equipment.

²⁰ Other costs include travel meals \$1,426, parking \$1,791, gas \$139, and lounge/room service \$509.

²¹ Richard Topping was Cardinal's General Counsel at the time of the party.

²² Three flights were to meet with officials of counties considering joining Cardinal's catchment. The remaining flight was to meet with Trillium MCO mainly to discuss Nash County's decision to seek realignment with Cardinal rather than Trillium.

OSA conducted a preliminary analysis finding the average cost per person would have been approximately \$600 if the executives drove to their meeting locations.²³

CEO Benefits

Cardinal authorized approximately \$16,000²⁴ per year in CEO benefits that were not provided to all of Cardinal's permanent employees. Effective July 1, 2015, Cardinal authorized the CEO to receive:

- \$12,000 per year of car allowance
- Payment of actual auto fuel expenses with company credit card
- Monthly auto detailing service of personal vehicle by a Cardinal vendor

However, no other permanent Cardinal employee receives the benefit at the same rate and in the same manner. No other employee receives both a car allowance for a personal vehicle, payment of actual fuel expenses, and detailing of the personal vehicle.²⁵ All other permanent Cardinal employees either:

- Are assigned a Cardinal-owned vehicle and provided a gas credit card for fuel expenses
- Use their personal vehicles for business purposes and get reimbursed based on mileage²⁶ traveled

Executive Credit Card Expenses

Credit card expenses were reviewed for five former and current Cardinal executives, and an Executive Assistant: 1,591 transactions totaling \$174,454.²⁷ Although many transactions appear to be business related, many were questionable:

- 20 transactions (\$3,281 - 2% of \$174,454) were alcohol purchases
- 12 transactions (\$10,521 - 6%) were first-class airline tickets with an average cost of \$877
- 169 transactions (\$47,987 - 28%) were hotel charges above the federal hotel rate²⁸
- 503 (\$38,177 - 22%) transactions lacked sufficient documentation, therefore auditors cannot determine if unreasonable expenses occurred

²³ The analysis is based on estimated cost for hotel, mileage, and meals. It does not include executives' "off-line" cost.

²⁴ \$12,000/year car allowance + \$3,500 average actual fuel expenses for FY 2015 and 2016 + estimated \$50 x 12 months of auto detailing = \$16,100.

²⁵ Per Cardinal's Deputy General Counsel, only Cardinal-owned vehicles get detailed quarterly by a vendor.

²⁶ To cover the costs of standard maintenance, repairs, taxes, gas, insurance, and registration fees.

²⁷ Included in the \$174,454 is \$13,368 in credit card expenses that were also included in the above sections: \$2,788 in Board Retreats, \$1,246 in Board Meetings, \$3,971 in Executive Christmas Parties, and \$5,363 in Staff Meetings.

²⁸ \$12,510 is the amount spent that exceeds the federal hotel rate as determined by General Service Agency of the US Government.

Cardinal reported that most of the credit card expenses were related to travel and conference/member registrations. Purposes for travel included meetings with DHHS and other MCOs, legislative meetings, and meetings for professional organizations and conferences.

Potentially Results in Erosion of Public Trust

The unreasonable spending on board retreats, meetings, Christmas parties, and travel goes against legislative intent for Cardinal's operations, potentially resulting in the erosion of public trust.

Cardinal was established by *North Carolina General Statute 122C* as a local management entity (LME) and a local political subdivision of the State to plan, develop, implement, and monitor Behavioral Health services within a specified geographic area to ensure expected outcomes for consumers within available resources.

Furthermore, if Cardinal has money available for these types of expenses, it raises questions about whether this money could be used for services to advance its core mission.

News outlets reported concerns when the potential consolidation of Cardinal with another LME/MCO was announced in 2017. The article²⁹ stated that:

"Cardinal's operations, however, had been questioned in recent months by local behavioral health advocates and a bipartisan group of state legislators who sit on health care committees."

In a April 2017 news article,³⁰ a state legislator was quoted:

"regarding the reduction in services since the takeover by Cardinal..."

"This is very disturbing, particularly since the news that Cardinal is paying tremendous salary and bonus to its chief executive," the legislator said. "Our citizens receiving the services they need should be Cardinal's priority."

Caused by Cardinal Not Operating As a Local Government Entity

Cardinal no longer operates as a Local Management Entity (LME) and therefore does not believe that its expenses are unreasonable. Once Cardinal's funding changed from direct state appropriations to a Medicaid per-member per-month model, Cardinal chose not to operate as a government entity. On September 12, 2016, Cardinal's CEO said:

"...when Piedmont Behavioral Health (PBH) essentially left the government appropriations business, we ceased operating as a local government mental health agency and started operating as a MCO..." The CEO also said that Cardinal views itself as a general contractor for the State of North Carolina.

²⁹ Jan 13, 2017, Winston-Salem Journal, *Cardinal Innovations may expand to 32 counties with Eastpointe merger.*

³⁰ April 10, 2017, Winston-Salem Journal, *NC lawmakers take aim at managed care CEO salaries.*

Caused by Cardinal's Claim Some Expenses are Paid For Using Their Own Revenue

According to Cardinal, some of the expenses in question were spent using revenue sources such as interest income, and contracts with other LME/MCOs. Therefore, they do not believe these expenses are unreasonable and they should not be held to federal guidelines for spending.

However, regardless the source of funding, Cardinal should demonstrate accountability on its spending as a local government entity.

State Law Requires Cardinal to Demonstrate Accountability as a Government Entity

Per State laws,³¹ Cardinal is a local management entity (LME) and local political subdivision of the State. The primary functions of an LME include "Financial management and accountability for the use of State and local funds and information management for the delivery of publicly funded services."³²

The Government Accountability Office states:³³

"The concept of accountability for use of public resources and government authority is key to our nation's governing processes. Management and officials entrusted with public resources are responsible for carrying out public functions and providing service to the public effectively, efficiently, **economically**, ethically, and equitably **within the context of the statutory boundaries of the specific government program.**" *(Emphasis Added)*

Federal Guidelines Require Expenses to be Reasonable

Federal cost principles provide basic guidelines to evaluate whether certain costs are necessary and reasonable.

Federal cost principles define "reasonable costs" based on factors such as whether:

- "the cost is of a type generally recognized as **ordinary and necessary** for the operation of the governmental unit" *(Emphasis Added)*
- "it does not exceed that which would be incurred by a **prudent person**" *(Emphasis Added)*
- "the individuals concerned **acted with prudence** in the circumstances considering their responsibility to the governmental unit, its employees, the public at large, and the Federal Government" *(Emphasis Added)*

RECOMMENDATIONS

Cardinal should implement procedures consistent with other LME/MCOs, state laws, and federal reimbursement policy to ensure its spending is appropriate for a local government entity.

³¹ § 122C-3. (20b), § 122C-3. (20c), and § 122C-116

³² § 122C-115.4. (b)(7)

³³ Government Auditing Standards, United States Government Accountability Office, 2011 Revision.

AGENCY RESPONSE

See page 38 for Cardinal's response to this finding.



MATTERS FOR FURTHER CONSIDERATION

During the course of an audit, Office of the State Auditor staff may uncover potential issues that are outside of the audit objective. Although the issues may not have been part of the planned objective, the issues need to be presented to those charged with governance of the organization under audit. Below are such issues.

1. OSHR Did Not Review Cardinal's Personnel System as Required by Law

The Office of State Human Resources (OSHR) should conduct an annual review of Cardinal Innovations Healthcare Solutions (Cardinal) personnel system as required by state law.

Per § 126-11(c), the Office of State Human Resources (OSHR) should “monitor at least annually county or area mental health authority personnel systems approved under this section” to ensure Cardinal’s substantially equivalent status.

However, OSHR’s documentation suggests the most recent annual review of Cardinal’s personnel system, as required by §126-11(c), was performed in 2003.

Piedmont Behavioral Health (PBH), now Cardinal, was deemed substantially equivalent by OSHR in 1993. Cardinal has undergone several organizational changes since 1993.

Six of the seven Local Management Entity/Managed Care Organizations (including Cardinal) have been approved as substantially equivalent by OSHR and are subject to OSHR’s annual review requirement.

2. Cardinal Has Accumulated \$70 Million of Medicaid Savings in FY 2015 and 2016

Based on Cardinal’s accumulated savings, the Department of Health and Human Services (DHHS) should consider whether Cardinal is overcompensated.

For FY 2015 and 2016, Cardinal accumulated approximately \$30 million and \$40 million, respectively, in Medicaid savings. According to the Center for Medicaid and Medicare Services (CMS), Cardinal can use the Medicaid savings as they see fit.

DHHS should monitor Cardinal’s Medicaid savings balance and use the information when setting the funding rate. Medicaid savings is the difference between the Medicaid monies received by Cardinal and the amount of Medicaid expenditures after all claims are paid for a fiscal year.

DHHS indicated the last rate offered to Cardinal was at the low end of the range developed by the actuary. However, for each \$1 reduction in the per member per month capitation rate, the State and Federal Government would save approximately \$4.3 million a year.³⁴

According to DHHS, the capitation rate is first derived as a range by actuary based on Cardinal’s historical expenses plus consideration for trend and program changes. DHHS then selects a rate to offer and negotiate with Cardinal for a final rate.

³⁴ Based on member months reported by Cardinal to DHHS for Medicaid B & C waivers for FY 2016.

3. Cardinal Paid More Employee Bonuses than Other LME/MCOs in FY 2015 and 2016

The General Assembly should consider enacting legislation limiting LME/MCO's authority to grant bonuses to employees.

Cardinal paid about \$1.9 million in FY 2015 employee bonuses and \$2.4 million in FY 2016 employee bonuses. The average bonus per employee was about \$3,000³⁵ in FY 2015, and \$4,000³⁶ in FY 2016. The bonuses were coded to Cardinal's administrative portion of Medicaid funding source in both years.

Cardinal awards bonus to eligible employees³⁷ based on the overall achievement of the organization and/or individual performance.

According to Cardinal, employee bonuses are only awarded if Cardinal achieves administrative savings. However, bonus awards based on organizational achievement such as cost reduction runs the risk of incentivizing Cardinal reducing the utilization of services or rates paid to providers.

Federal guidance states:³⁸ "Incentive compensation to employees based on cost reduction, or efficient performance is allowable to the extent that the overall compensation is determined to be reasonable..." The guidance³⁹ also states that when determining reasonableness of a given cost, "consideration must be given to: Market prices for comparable goods or services for the geographic area."

During FY 2015 and 2016, only two of the other six LME/MCOs paid employee bonuses, and the average payment per employee for these two LME/MCOs was 30% to 50% of the bonus amount paid for Cardinal's employees.

4. Cardinal Deeded Two Properties to Providers

The General Assembly should consider enacting legislation restricting the LME/MCO's ability to convey state-funded property.

In May 2015, Cardinal deeded two state-funded properties to providers, RHA Health Services, Inc. (RHA) and Therapeutic Alternatives, Inc. Neither the State nor Cardinal received money for these deeds, but the deeds did include a Use Restriction Agreement requiring that the provider continue to use the property to provide behavioral health services or revert the property back to Cardinal.

However, RHA deeded its property to Formation Capital for \$561,500 when RHA was acquired by Formation Capital. Cardinal was unaware of the transaction.

According to Cardinal, the use restriction agreements are still in effect for both properties, and they are currently being used to provide behavioral health services.

³⁵ \$1,887,935 / 630 employees = \$2,997 per employee.

³⁶ \$2,432,420 / 618 employees = \$3,936 per employee.

³⁷ Eligible employees are active employees who have worked a minimum of three months and have not received disciplinary action.

³⁸ 2 CFR Appendix XI to Part 200 – Compliance Supplement 2 CFR 200-.430(f) Incentive Compensation.

³⁹ § 200.404 Reasonable costs.



STATE AUDITOR'S RESPONSE

The Office of the State Auditor (OSA) is required to provide additional explanation when an agency's response could potentially cloud an issue, mislead the reader, or inappropriately minimize the importance of auditor findings.

Generally Accepted Government Auditing Standards state,

"When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditor's recommendations, the auditors should evaluate the validity of the audited entity's comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement."

In its 22 page response to this audit, Cardinal Innovations Healthcare Solutions (Cardinal) made numerous inaccurate statements. To ensure the availability of complete and accurate information and in accordance with Generally Accepted Government Auditing Standards, OSA offers the following clarifications for the most significant inaccuracies.

Reason for Audit

In Cardinal's response, it implied that the reason members of the General Assembly requested this audit was due to a change in Cardinal's executive leadership. Cardinal stated that "a change in executive leadership caught several members of the General Assembly by surprise, and they raised questions with Cardinal Innovations' Board about the reason for the change in leadership." Cardinal also stated that "At the conclusion of an in-person meeting between these legislators and Cardinal Innovations' Board in February 2016, the legislators informed the Board that they would seek an audit of Cardinal Innovations."

This assertion made by Cardinal is inaccurate. This audit was initiated due to several concerns and questions from members of the General Assembly relating to Cardinal operating outside of its statutory mission and extravagant or excessive spending.

Audit Objective

Cardinal's response indicates that the objective of this audit was to determine whether Cardinal has used its resources as efficiently as possible to effectively meet the service needs of the citizens in its catchment area.

This assertion made by Cardinal is inaccurate. This audit report clearly states that the audit objectives were to evaluate whether Cardinal is:

- (1) Operating within its statutory mission
- (2) A good steward of state and federal resources

Contrary to what Cardinal's response indicates, this audit did not evaluate Cardinal's performance with regard to meeting the service needs of its members, its payments to providers, or its compliance with its contracts with the North Carolina Department of Health and Human Services.

Therefore, readers should place no reliance on Cardinal's statements that OSA found no deficiencies or findings in these areas.

Furthermore, Cardinal's response states:

"Cardinal Innovations believes OSA's audit report validates our commitment to sound business operations and fulfillment of our public mission."

This assertion made by Cardinal is inaccurate. This audit clearly states that:

- Cardinal spent money exploring strategic opportunities outside of its core mission
- \$1.2 million in CEO salaries were paid without proper authorization
- Cardinal's unreasonable spending could erode public trust

Cardinal Spent Money Exploring Strategic Opportunities Outside of its Core Mission

In its response, Cardinal made two incorrect assertions about Cardinal exploring strategic opportunities outside of its core mission.

First, Cardinal asserts that OSA was wrong when it stated that "Cardinal chose not to operate as a government entity."

This assertion made by Cardinal is inaccurate. Cardinal's current CEO has stated several times that Cardinal doesn't operate as a Local Management Entity/Managed Care Organization (LME/MCO) to news outlets and to the auditors. Specifically:

- 1) During a meeting with auditors, the CEO stated "we ceased operating as a local government mental health agency and started operating as a MCO"
- 2) In an interview with the Charlotte Observer,⁴⁰ the CEO was quoted saying that Cardinal "is not an LME/MCO" and "We've not operated as an LME...Cardinal operates as a public nonprofit and has for 11 years."
- 3) During a state oversight meeting,⁴¹ in defending his pay package, the CEO was quoted as saying "we have gone from 2,000 mostly government employees to 800 non-government employees"

Second, Cardinal asserts that the consultant contracts do not provide evidence that Cardinal was exploring strategic opportunities outside of its core mission. Cardinal states that the contracts were "within Cardinal's business discretion as an MCO and contractor to the State."

This assertion made by Cardinal is inaccurate. State law⁴² clearly defines Cardinal's core mission as providing **behavioral health services** within a **specified geographic area**.

The contracts clearly provide evidence that Cardinal explored business opportunities nationally, beyond its behavioral health services mission, and expanded its business portfolio by entering into a contract with the USO of NC.

\$1.2 Million In CEO Salaries Paid Without Proper Authorization

In its response, Cardinal made several incorrect assertions about the validity of its CEO salaries. The two most significant inaccuracies are discussed below.

First, Cardinal asserts that "Office of State Human Resources (OSHR) has not established any salary range for the LME/MCO Area Directors."

⁴⁰ December 15, 2016, Charlotte Observer, *State officials denounce \$1 million pay package for Charlotte area health services agency CEO*.

⁴¹ November 29, 2016, Winston-Salem Journal, *Legislators question Cardinal exec's salary; Richard Topping's potential compensation tops \$1 million*.

⁴² North Carolina General Statute 122C.

This assertion made by Cardinal is inaccurate. Documentation readily available from OSHR and from the State Personnel Commission's (Commission) website⁴³ show that a salary range was established by the Commission as required by state law.⁴⁴ Specifically:

- OSHR documented the results of its market study and recommended a salary range for Local Area Mental Health Directors in a report dated April 28, 2008
- OSHR presented, and the Commission voted on and approved, a salary range of \$95,760 - \$171,674 during the Commission's June 19, 2008, meeting
- OSHR documented its recommendations for an updated salary range in a memo dated March 1, 2010
- OSHR presented, and the Commission voted on and approved, an updated salary range of \$105,576 - \$187,364 during the Commission's June 17, 2010, meeting

Second, Cardinal asserts that "Cardinal Innovations' Board of Directors complied with the statutory guidelines in setting its CEO salary."

This assertion made by Cardinal is inaccurate. Cardinal's Board of Directors approved a CEO salary that exceeded the Commission established salary range without complying with three specific statutory requirements.⁴⁵ Specifically, as noted in the report, Cardinal did not:

- Submit the specific amount that the board proposed to pay the CEO
- Submit supporting documentation of comparable salaries
- Obtain prior approval from the OSHR Director

Cardinal's Unreasonable Spending Could Erode Public Trust

In Cardinal's response, Cardinal made four incorrect assertions regarding guidelines used by OSA and the impact of extravagant expenses, CEO benefits, and hotel expenses.

First, Cardinal asserts that "OSA's findings are subjective judgments about whether any particular expenditure is 'reasonable' or 'appropriate' in its view."

This assertion made by Cardinal is inaccurate. Auditors made no subjective judgments in regards to Cardinal's expenditures. OSA used federal cost principles, which have been adopted by the state of North Carolina, as a benchmark to evaluate whether Cardinal's expenses were necessary and reasonable. Federal cost principles state that expenditures of government entities (like Cardinal) must be reasonable.⁴⁶

Second, Cardinal asserts that all Cardinal employees are given equivalent "transportation benefits."

⁴³ <https://oshr.nc.gov/about-oshr/state-hr-commission/approved-meeting-minutes-personnel-actions>.

⁴⁴ *North Carolina General Statute 122C121.(a)(a1).*

⁴⁵ *North Carolina General Statute 122C121.(a)(a1).*

⁴⁶ Federal cost principals define reasonable costs as generally recognized as ordinary and necessary for the operation of the government, does not exceed that which would be incurred by a prudent person, and the individuals concerned acted with prudence in the circumstances considering their responsibilities to the government unit, the public at large, and the Federal government.

This assertion made by Cardinal is inaccurate. Cardinal's CEO is the **only** Cardinal employee who receives a car allowance (\$1,000/month), fuel expenses, and monthly auto detailing of his personal vehicle.

Third, Cardinal asserts that their hotel expenses should not be compared to the federal hotel rate because Cardinal is not eligible to get the federal hotel rate.

This assertion made by Cardinal is inaccurate. In auditing, it is appropriate to use authoritative sources such as benchmarks to assist in determining reasonableness. OSA used the federal hotel rate as a benchmark to evaluate whether Cardinal hotel expenses were reasonable.

The federal hotel rate was used as a guideline rather than the state hotel rate (which is a significantly lower and applicable to state agencies) in an attempt to give Cardinal the benefit of doubt when determining the reasonableness of Cardinal's spending on hotels. Using either the federal or state rates demonstrates that Cardinal's hotel expenses were extravagant.

Fourth, Cardinal's asserts that that auditor's extravagant expense findings "represent merely 0.34% of total administrative costs." Cardinal makes this assertion several times in an attempt to minimize the finding.

This assertion made by Cardinal is inaccurate. As a government entity, **there should be no amount of tax payer dollars that is acceptable to be spent on extravagant or unreasonable expenses.**

Additionally, and based on specific legislative concerns, this audit only looked at spending for board retreats and meetings, Christmas parties, charter flights, CEO benefits, and credit card expenses (including hotel charges) for six employees. This audit did not include a full review of all administrative spending by all employees.

Cardinal Paid More Employee Bonuses than Other LME/MCOs in FY 15 and 16

In their response, Cardinal asserts that administrative funds can only be spent on administrative activities.

This assertion made by Cardinal is inaccurate. The Center for Medicare and Medicaid Services (CMS) clarified⁴⁷ that Cardinal can spend administrative funds to provide services to its members. Cardinal is not required to spend administrative funds exclusively on administrative activities.

Per Cardinal, it paid \$4.3 million in employee bonuses during FY 2015 and 2016 from administrative funds. If Cardinal chose to, part or all of this could have been used to provide more behavioral health services.

On a related note, during FY 2015 and 2016, Cardinal accumulated \$70 million dollars in Medicaid savings.⁴⁸ Cardinal has the discretion to spend the \$70 million in accumulated Medicaid savings on anything.

However, as a government entity, spending those funds on anything other than its core mission of providing behavioral health services within its specified geographic area would not demonstrate accountability and stewardship of public tax dollars.

⁴⁷ CMS response to auditor inquiry dated December 22, 2016.

⁴⁸ Medicaid savings is the difference between the Medicaid monies received by Cardinal and the amount of Medicaid expenditures after all claims are paid for a fiscal year.



RESPONSE FROM CARDINAL INNOVATIONS HEALTHCARE SOLUTIONS

May 12, 2017

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

Cardinal Innovations Healthcare appreciates the opportunity to respond to the Performance Audit dated May 2017.

We also appreciate the professionalism and diligence that the audit team demonstrated throughout the audit process.

As noted in the August 2016 audit engagement letter, the objective of this Performance Audit was to determine whether Cardinal Innovations "has used its resources as efficiently as possible to effectively meet the service needs of the citizens in its catchment area."

We are pleased that the audit findings do not find any deficiencies with Cardinal Innovations' performance with regard to meeting the service needs of its members, its payments to providers, or its compliance with its contracts with the North Carolina Department of Health and Human Services. In addition, there were no findings regarding any type of fraud or malfeasance.

Our response to the audit findings is attached.

Sincerely,



Richard F. Topping
CEO

CARDINAL INNOVATIONS HEALTHCARE'S RESPONSE TO OSA'S AUDIT REPORT

PRELIMINARY STATEMENT

A. Executive Summary

Cardinal Innovations Healthcare pioneered North Carolina's managed care model that insures Medicaid populations with complex needs. Cardinal Innovations is North Carolina's largest specialty health plan, insuring more than 850,000 individuals in 20 counties throughout the state. In the past 12 years, this model has raised the standards of care while saving the State hundreds of millions of dollars.

Following an executive leadership change in 2015, Cardinal Innovations welcomed a legislatively-requested State audit of its organization and operations. In August 2016, Cardinal Innovations began working with the Office of the State Auditor ("OSA") to facilitate an extensive review designed to determine whether or not it was utilizing its resources as efficiently as possible to effectively meet the service needs of its enrollees in its service area.

Cardinal Innovations is pleased that there are no findings regarding the management of services for our members and their families. We are proud of our continued record of high-quality service delivery and fulfillment of our contracts with the North Carolina Department of Health and Human Services ("DHHS"). Cardinal Innovations believes OSA's audit report validates our commitment to sound business operations and fulfillment of our public mission. We are glad to provide a detailed response to the audit report and findings. Of important note:

- Cardinal Innovations continually invests resources into enhancing our ability to improve the health and wellness of our members and their families, including preparing for Medicaid Reform, improving our service delivery to Veterans, and facilitating operational efficiencies.
- For 23 years, Cardinal Innovations has operated an approved substantially equivalent personnel system and follows all OSHR guidelines regarding its personnel system, including the annual submission of a salary plan for approval, which outlines the salary ranges for each of our employees, including the CEO.
- Cardinal Innovations is committed to being a good steward of our resources and has among the lowest administrative spending rates in the State. OSA's findings are restricted to Cardinal Innovations' administrative spending and represent merely 0.34% of total administrative costs.
- Cardinal Innovations is a government entity and is also a managed care organization and contractor to the State and, as such, operates in compliance with all applicable federal and state laws, rules, regulations and contractual requirements.

Cardinal Innovations appreciates the effort, detail and cooperation that OSA brought to this audit, and we have provided detailed responses both to each finding, and overall. Cardinal Innovations continues our steadfast support of North Carolina's special populations and stands at the ready to work with the State, local counties and communities, providers and individuals to create a healthcare system that values outcomes and equally serves all.

B. Cardinal Innovations

1. Overview

Cardinal Innovations is the country's largest specialty health plan, insuring more than 850,000 individuals with complex needs. More than one in four North Carolinians enrolled in Medicaid are currently insured by Cardinal Innovations.

Cardinal Innovations is committed to being a good steward within our communities, holding ourselves and others accountable to the highest standards of care. Cardinal Innovations works closely with its network of doctors, hospitals, clinicians and licensed professionals across the state to ensure our members have access to high-quality, community-based services and supports to meet their individual healthcare needs and life goals. In fiscal years 2015 and 2016, Cardinal Innovations spent more than \$1.1 billion on member services. During this same timeframe, Cardinal Innovations approved 98% of all services requested, and paid 99.9% of all claims timely and accurately.

To achieve our mission of improving the health and wellness of our members and their families, Cardinal Innovations continually invests in operational and systems improvements to enhance the quality of service we provide to the State, our members, providers and community partners. For example, Cardinal Innovations has created 22 new or additional services for our members that are not available in the standard Medicaid benefit plan, or through other programs.

Another example of how Cardinal Innovations' investment in operational and systems improvement is positively affecting outcomes for our members is the development of our managed care software platform that supports managed care operations in 43 counties in North Carolina, for approximately 40% of Medicaid enrollees. This software platform streamlines processes to enable providers to seamlessly interact with our care management and claims teams. As a result of this investment, our network of healthcare providers spends more time delivering quality care to our members and less time worrying about getting paid.

In addition, to better support the needs of our members with intellectual and developmental disabilities, we developed a resource allocation program that enables members to choose the services and supports that best meet their individual needs. With this program, Cardinal Innovations is able to ensure its resources equally serve all of our members enrolled in the North Carolina Innovations Waiver. This program was endorsed and adopted by DHHS and now serves as the model for insuring all Medicaid enrollees with intellectual and developmental disabilities.

Our focus on quality is reflected not only in the new and better service delivery models we have developed, but is also demonstrated by how we approach our business operations. Cardinal Innovations' ability to continually pioneer new service delivery models and system improvements is dependent upon our ability to recruit and retain a talented workforce.

For 23 years, Cardinal Innovations has maintained a personnel system, including compensation policies and procedures, intentionally designed to allow us to compete with other employers for our workforce. Cardinal Innovations' workforce is comprised of 840 talented professionals who fulfill various clinical, financial, technological, legal, regulatory, human resources and other professional positions within the company. These professionals come to us from various sectors of industry including healthcare, banking and finance, insurance, manufacturing, energy, higher education, and many others. As a result, the employers we compete with in the market include large for-profit and not-for-profit companies, and other public entities in the Charlotte-metro market, the Triangle market and the Triad market.

Unlike other public entities, Cardinal Innovations does not participate in State or local government retirement systems or health plans. Instead, Cardinal Innovations offers competitive market-based compensation and benefits to all of its employees, which include base salary, deferred compensation retirement benefits, performance-based incentive programs, health insurance, short and long-term disability coverage, and other traditional employer-sponsored benefit programs. As a result of our long-standing compensation and benefits policies, Cardinal Innovations is able to recruit the talent necessary to support our operations without incurring a long term commitment on the part of Cardinal Innovations or the State.

2. History

In 2005, Cardinal Innovations (then PBH) set out to change the way North Carolina provided health insurance to Medicaid's hardest-to-serve enrollees. At the time, Cardinal Innovations, an area authority pursuant to N.C. Gen. Stat. 122C-115, operated in five counties: Cabarrus, Davidson, Rowan, Stanly and Union, with a total budget of \$138 million, and provided healthcare coverage to approximately 60,500 Medicaid enrollees, plus the uninsured members in those counties.

From 2001 - 2005, Cardinal Innovations provided management and oversight of State-funded behavioral healthcare service delivery for the uninsured and underinsured in accordance with its statutory functions and responsibilities as an area authority. During this time, Cardinal Innovations' leadership realized that many of its members frequently transitioned in and out of Medicaid, or received benefits from multiple sources. Recognizing the waste and inefficiency that stemmed from the lack of coordination of multiple public benefit plans, Cardinal Innovations sought to consolidate management of Medicaid and State-funded behavioral healthcare into a single public entity that operated with the same effectiveness and efficiency as a private managed care company, but was responsive locally and, thus, better able to coordinate care for North Carolina's most vulnerable citizens.

Cardinal Innovations collaborated with DHHS to draft a 1915(b)/(c) waiver to implement managed care in North Carolina and submitted it to the federal Centers for Medicare and Medicaid Services for approval in 2004. In 2005, Cardinal Innovations became a vendor to the State of North Carolina and contracted with DHHS to provide health insurance coverage to Medicaid enrollees and individuals lacking access to adequate health insurance, a function not yet contemplated by State laws governing area authorities.

In its first five years of operation as a Medicaid insurer, Cardinal Innovations saved the State over \$200 million. As a result of that success, the North Carolina General Assembly passed S.L. 2011-264 in 2011 (known as House Bill 916), expanding managed care statewide and expressly recognizing Cardinal Innovations' model of managed care as a "proven system for the operation of all public resources for mental health, developmental disabilities, and substance abuse services."

Cardinal Innovations' success is the direct result of the forward-thinking and efficient manner in which we have operated during the last 12 years. As a result of the successful partnership between Cardinal Innovations, DHHS, and the General Assembly, North Carolina has been able to accomplish something that no other State has: providing health insurance and access to high-quality care to the most complex and expensive Medicaid enrollees at a predictable cost.

C. Legislatively-Requested Audit

In April 2015, the Board of Directors of Cardinal Innovations named a new CEO. The outgoing CEO had long-standing working and personal relationships with several members of the General Assembly and their staff. This change in executive leadership caught several members of the General Assembly by surprise, and they raised questions with Cardinal Innovations' Board about the reason for the change in leadership. The Board was unable to answer many of these questions surrounding the change in leadership because North Carolina law prohibits the disclosure of such information¹ and due to the legally-binding nature of the confidentiality provisions contained within the outgoing-CEO's severance agreement.

At the conclusion of an in-person meeting between these legislators and Cardinal Innovations' Board in February 2016, the legislators informed the Board that they would be seeking an audit of Cardinal Innovations. The Board informed the legislators that it welcomed an audit of its operations. In March 2016, the legislators formally requested OSA to conduct "a thorough and complete audit of the organization and operation" of Cardinal Innovations.

OSA began its Performance Audit of Cardinal Innovations in August 2016. In its audit engagement letter, OSA informed Cardinal: "The objective of this audit is to determine if [Cardinal] has used its resources as efficiently as possible to effectively meet the service needs of the citizens in its catchment area." Over the next nine months, Cardinal worked diligently alongside OSA through an extensive audit process.

As anticipated by the Board, OSA did not make any findings regarding any deficiencies in how Cardinal Innovations is meeting the service needs of its members. Furthermore, OSA made no findings regarding any deficiencies in how Cardinal is performing with regard to payments to its providers, how it is performing under its contracts with DHHS for the management of Medicaid and State-funded services, or regarding any type of fraud or malfeasance.

Instead, OSA's findings are limited to subjective judgments that Cardinal explored opportunities outside its core mission, that it failed to seek authorization to exceed a non-existent salary range for its CEO, and that it spent a *de minimis* portion of its administrative funds in a legal, but in OSA's view, questionable manner. Cardinal's response to each of these findings is set forth in detail below.

OSA is to be commended for its professionalism, courtesy and diligence in performing this audit. During this nine-month process, the audit team spent countless hours on site at Cardinal reviewing documents, interviewing staff, and learning how Cardinal operates. It was without question an extremely thorough audit.

Cardinal is proud of its long history of providing high-quality management of health services to its members and the State. Cardinal looks forward to continue working with the General Assembly, DHHS, and all of its stakeholders as North Carolina continues to pursue the Medicaid Reform process that was set in motion by the General Assembly in 2015.

¹ See N.C. Gen. Stat. § 122C-158 ("Privacy of Personnel Records").

CARDINAL INNOVATIONS HEALTHCARE'S RESPONSES TO OSA'S FINDINGS AND RECOMMENDATIONS

FINDING NO. 1: CARDINAL SPENT MONEY EXPLORING STRATEGIC OPPORTUNITIES OUTSIDE OF ITS CORE MISSION

OSA RECOMMENDATION:

- Cardinal should consult and collaborate with members of the General Assembly before taking any actions outside of its statutory boundaries.

Cardinal Response to OSA Finding No. 1:

Cardinal Innovations disagrees with OSA's finding that it spent money exploring strategic opportunities outside its core mission and/or statutory boundaries. As explained below, Cardinal has not taken any actions that are outside its statutory boundaries. Despite this disagreement with OSA's finding, Cardinal agrees with OSA's recommendation that it should continue to consult and collaborate with the General Assembly.

There are several aspects of this finding that are incorrect. Each of these is addressed below.

1. OSA's Assertion that "Cardinal Chose Not to Operate as a Government Entity."

OSA asserts in multiple places that "Cardinal chose not to operate as a government entity." Contrary to OSA's assertion, Cardinal Innovations is a government entity (an LME) and it also operates as a Managed Care Organization ("MCO") and as a contractor to the State of North Carolina, as expressly required by its contract with DHHS.

Cardinal Innovations is a local political subdivision of the State pursuant to G.S. 122C-116 and, as such, it conducts its operations consistent with numerous laws and regulations that are applicable to local political subdivisions, including, among others, the Open Meetings Law, the Public Records Act, and the Local Government Budget Control Act.

At the same time, Cardinal Innovations also operates as a Prepaid Inpatient Health Plan ("PHIP"), which is a type of MCO defined under federal Medicaid managed care regulations. In fact, its contract with DMA explicitly refers to Cardinal Innovations as "a public Medicaid managed care entity, operating as a Prepaid Inpatient Health Plan pursuant to 42 C.F.R. part 438."

MCOs can be governmental entities (like Cardinal Innovations and the other LME/MCOs) or they can be private companies, which is the more typical structure. Under North Carolina's statutes, Cardinal is both a government entity (an LME) and it also operates as an MCO under federal law, as required by its contract with DMA. There is nothing inconsistent with Cardinal operating as both an LME and an MCO.

In OSA's report, the only support cited for the statement "Cardinal chose not to operate as a government entity" is a quote from OSA's September 12, 2016 interview with CEO Richard Topping. That quote is "... when Piedmont Behavioral Health (PBH) essentially left the government appropriations business, we ceased operating as a local government mental health agency and started operating as a MCO..." This quote does not support OSA's conclusion that "Cardinal chose not to operate as a government entity."

Instead, this quote refers to the massive shift in operations that came with PBH (the predecessor to Cardinal) taking on the management of Medicaid funds under a full-risk, capitated contract. Before taking on the responsibility of managing Medicaid funds, approximately 80-85% of PBH's funding came from annual appropriations of State funds for behavioral health services. PBH managed these State funds on a fee-for-service basis. In contrast, as an LME/MCO, the State funds managed by PBH dropped to only 10-15% of its funding, while approximately 85% of its funding began coming from DMA in the form of monthly capitation payments, which PBH was required to manage pursuant to federal managed care rules and its contract with DMA. This transformation of its operations to support these managed care functions was a massive change for PBH. This is the context for the quote selectively relied on by OSA.

Cardinal Innovations continues to manage its 10-15% of State-funded services on a fee-for-service basis, and it continues to manage its 80-85% of Medicaid funding pursuant to managed care rules. It operates both as a governmental LME and as a MCO in compliance with federal managed care rules. It has never ceased operating as a government entity. OSA's assertion to the contrary is incorrect.

OSA also notes that Mr. Topping stated that "Cardinal views itself as a general contractor for the State of NC." OSA appears to believe that that somehow lends support to its conclusion that "Cardinal chose not to operate as a government entity." To the contrary, Cardinal Innovations is quite clearly a contractor to the State of North Carolina and it is also a government entity as described above.

Cardinal's DMA Contract states:

This Contract is hereby entered into by and between the North Carolina Department of Health and Human Services (the Department"), Division of Medical Assistance ("DMA"), and Cardinal Innovations Healthcare Solutions, (herein referred to as, "Contractor" or "PIHP"), a public Medicaid managed care entity, operating as a Prepaid Inpatient Health Plan pursuant to 42 C.F.R. part 438, with its principal place of business in Kannapolis, North Carolina (referred to collectively as the "Parties").

Further, Attachment A (General Terms and Conditions) to the DMA Contract describes the "Relationships of the Parties" as:

Independent Contractor: PIHP is and shall be deemed to be an independent contractor in the performance of this Contract . . .

In summary, it appears that OSA may have been confused about whether Cardinal Innovations' legal status as a government entity (an LME) is consistent with its operations as an MCO and contractor to the State. Cardinal Innovations is a governmental entity and, as such, it operates in compliance with all applicable laws and regulations. Cardinal is also an MCO and a contractor to the State and, as such, it conducts its operations consistent with those functions.

2. OSA's Supporting Evidence Regarding Cardinal "Exploring Strategic Opportunities Outside of Its Core Mission."

OSA highlighted certain expenditures made by Cardinal Innovations that were within Cardinal's business discretion as an MCO and contractor to the State. OSA concluded that, in its judgment, these expenditures were outside Cardinal's core mission. Each of these is discussed below.

A. Dan Coughlin Consulting Agreement.

OSA noted that Cardinal entered a consulting agreement with its former-CEO, Dan Coughlin, and that one portion of the scope of work referred to "providing strategic advice and consultation regarding . . . potential business opportunities both locally and nationally."

Mr. Coughlin was instrumental in bringing the idea of Medicaid managed care to North Carolina in the early 2000's, and he was the CEO who first implemented Medicaid managed care in the State and showed that it could save taxpayer dollars, while at the same time effectively managing care some of the most complex and expensive Medicaid enrollees. Mr. Coughlin is a well-known and respected leader in his field.

At a time when North Carolina is transitioning the entire Medicaid program from fee-for-service to managed care, it is wholly appropriate for Cardinal to consult with its former CEO on how best to navigate the challenges and opportunities presented with this monumental shift in North Carolina's Medicaid program. Looking to national trends and what other States have done as they have transitioned their Medicaid programs to managed care is entirely appropriate and, in fact, is exactly what Mr. Coughlin did when he first brought the idea of a managed care Medicaid pilot project to the State in the early 2000's.

In addition, much of Mr. Coughlin's work under this engagement was focused on Cardinal's consolidation with another LME/MCO, CenterPoint Human Services. Mr. Coughlin's work was well within Cardinal's statutory boundaries and core mission.

B. Companion Professional Services Agreement.

OSA also cites to an agreement that Cardinal Innovations had with Companion Professional Services (d/b/a TM Floyd & Company) ("CPS") that included, among other deliverables, conducting a gap analysis regarding what Cardinal would need to do in order to be able to process physical health claims. OSA contends that this is an example of Cardinal exploring opportunities outside of its core mission. We disagree.

At the time Cardinal Innovations engaged CPS to conduct this analysis, the General Assembly was considering a provision for a pilot program to test whether Cardinal could "successfully unite the management of physical and behavioral health care for recipients with intellectual and developmental disabilities through a single payment." The CPS engagement was directly related to this pilot program that was under consideration at that time.

OSA notes that the General Assembly adjourned in August 2014 without this provision passing, and that CPS continued its work on the project after that date. This is because this pilot project (or another legislative initiative to integrate behavioral and physical services in Medicaid managed care) was likely to return. It would not have made sense to stop

this work mid-stream when national trends, best practices, and discussions within the State all indicated that whole-person care would soon return for further consideration by the General Assembly.

In fact, this is exactly what happened the following year when the General Assembly passed Medicaid Reform in 2015 which provides that "Capitated PHP [Prepaid Health Plan] contracts shall cover all Medicaid and NC Health Choice services, **including physical health services**, prescription drugs, long-term services and supports, **and behavioral health services** . . ." S.L. 2015-245, s. 4(4).²

In response to this Medicaid Reform legislation, DHHS submitted a Section 1115 Demonstration Waiver Application in 2016. This waiver application emphasizes the importance of integrating physical and behavioral health services and the role LME/MCOs are playing in working towards this important objective. For example, DHHS states in its waiver application:

To effectively manage costs and better serve beneficiaries, DHHS must clinically integrate physical and behavioral health . . .

Several LME-MCOs are reinvesting managed care savings to support the integration of physical health care.

The stage is set for North Carolina to move toward more integrated, whole-person health care. . . . LME-MCOs . . . have begun to invest in these areas . . .

. . . DHHS will work with PHPs, LME-MCOs, providers and other stakeholders to develop policy and pilot programs that better align services and payment to incentivize integration.

The integration of physical and behavioral services has been an acknowledged objective for the North Carolina Medicaid system for many years. The work performed by CPS answered a basic question regarding what would be necessary for Cardinal Innovations to be able to process physical health claims. This engagement was not outside Cardinal's core mission. To the contrary, it was a responsible investment in support of the State's objective of promoting whole-person care.

C. Rory Riley Consulting Agreement.

OSA also cites as an example of "Cardinal exploring strategic opportunities outside its core mission" a consulting agreement that Cardinal entered regarding how it might use its existing expertise and operations to provide services for veterans. It is incorrect to conclude that this was outside Cardinal's core mission as an LME/MCO.

Under G.S. 122C-115.4(g), the coordination of care with the Veterans Administration, and the screening, triage, and referrals for veterans and their families for behavioral healthcare issues, including "traumatic brain injury, posttraumatic stress disorder, depression, substance use disorders, potential suicide risks, military sexual trauma, and domestic violence," are part of the functions of an LME. Many of Cardinal's Medicaid and state-funded members are veterans,

² This 2015 legislation delayed the integration of physical and behavioral services into a single contract until four years after the capitated contracts for physical health services begins.

and Cardinal has endeavored to link these members with services and supports that are veteran-focused or veteran-specific. Understanding the recent changes in federal law around veterans' benefits and the potential impacts and opportunities for Cardinal Innovations to better serve the veteran population is appropriately within Cardinal's core mission.

In fact, this veterans consulting work helped lead Cardinal to begin providing call center services for the United Service Organizations of North Carolina ("USO of NC"), the lead organization charged with supporting military servicemen and women in the state of North Carolina. Assisting veterans with securing appropriate and timely services addresses an important social need, and we are proud to be able to leverage our existing resources to help with this effort.

D. Cardinal Ally.

OSA also asserts that Cardinal Innovations used a subsidiary nonprofit corporation, Cardinal Ally, to explore strategic opportunities outside its core mission. This is not correct.

As an initial matter, it is important to note that there was nothing improper about Cardinal establishing Cardinal Ally. Cardinal Innovations meets the definition of a "public authority" under G.S. 159-7(b)(10). Pursuant to G.S. 159-42.1, public authorities are expressly authorized to establish nonprofit corporations, like Cardinal Ally.

When Cardinal Ally was created in September 2012, the purpose was to serve as a platform for MCO services that Cardinal Innovations would provide to other newly-formed LME/MCOs, such as claims processing services. By 2012, Cardinal had been performing MCO services for seven years. The other LME/MCOs in the State were just forming and beginning to take on managed care responsibilities for Medicaid services for first time. Because Cardinal had already developed operations and expertise in these business processes, it was natural for Cardinal to work with other LME/MCOs in ways that could support their operations. Providing MCO services to other LME/MCOs in North Carolina was within Cardinal's core mission as an LME/MCO. This purpose for Cardinal Ally did not ultimately come to fruition. Although Cardinal did begin providing managed care services to Trillium LME/MCO on Cardinal's IT platform (and continues to do so today), Cardinal Ally was never ultimately used for its intended purpose.

The following year, in 2013, an outside consultant was engaged to conduct an analysis and make recommendations to Cardinal Innovations, in light of the evolving Medicaid system in North Carolina. The consultant made a presentation to Cardinal with its recommendations for "Strategic Options" that Cardinal could consider. This document clearly shows on its face that it is a presentation from a third-party consultant, outlining strategic options for consideration by Cardinal.

It is not correct for OSA to state that this document sets forth the "purpose of Ally." Cardinal Ally had been created in 2012. This 2013 document from a third-party consultant provides a recommendation regarding how Cardinal Innovations might be able to use Cardinal Ally in the future.

Further, Cardinal Ally has never had (and does not currently have) any assets, liabilities, expenditures or revenue. It has never conducted any business of any kind, whether in pursuit of its original purpose or pursuant to a subsequent recommendation by a consultant. As a result, it is incorrect for OSA to contend that Cardinal Innovations' establishment of Cardinal Ally provides support for the finding that Cardinal used resources to explore opportunities outside its core mission.

E. Enterprise Risk Assessment.

OSA states that "Cardinal explored opportunities outside its core mission to address revenue risk," citing enterprise risk assessments conducted by Cardinal Innovations in 2015 and 2016.

Enterprise risk assessments are a regular and customary exercise for organizations of Cardinal Innovations' size and scope that are undertaken to identify potential risks to an organization, its employees, and those it serves, and to propose possible actions for addressing the identified risks. Cardinal regularly conducts risk assessments to ensure it is properly aware of, and responding to, risks to the organization, its 840 employees, and the 850,000 members it serves.

OSA's report creates a false impression about Cardinal's risk assessments. The 2015 Risk Assessment identified as a risk to Cardinal the fact that Cardinal "derive[s] substantially all of our revenues from North Carolina state health plans." However, in its report, OSA referenced only a portion of the recommended action, which reads in its entirety: "When appropriate, diversify business base to include other states or commercial contracts." The emphasized portion was omitted from OSA's report.

The next year, the 2016 Risk Assessment noted that in response to this risk "executive staff are working on strategies to ensure that Cardinal will be able to participate in fully-integrated Medicaid managed care contracts in North Carolina."

Planning for the future for Cardinal Innovations, its employees, and its members under Medicaid Reform is not outside Cardinal's core mission. Rather, it is part of ensuring that Cardinal's members will be able to enjoy all the benefits and opportunities of Medicaid Reform, and that the significant wealth of knowledge and experience that Cardinal Innovations has developed over 12 years of operating a Medicaid managed care plan in North Carolina will not be lost in the transition. It is appropriately within Cardinal's core mission to prepare for Medicaid Reform.

3. OSA's Assertion that "Resources Were Not Available to Support Behavioral Health Services in its Service Area."

OSA states that because Cardinal Innovations spent money, time and effort exploring strategic opportunities outside its core mission, "resources were not available to support behavioral health services in its service area." We strongly disagree with this statement.

This statement is worded in a way that conveys the impression that Cardinal Innovations failed to provide resources that were needed for behavioral health services in its service area and that this failure was because Cardinal had spent money, time and effort on activities outside its core mission. However, there has been no finding or indication that Cardinal failed in any way in delivering on its core mission. Despite OSA stating at the outset that the objective of this performance audit was to determine whether Cardinal "has used its resources as efficiently as possible to effectively meet the service needs of the citizens in its catchment area," OSA has made no finding that Cardinal was deficient in any way in meeting the service needs of its members.

Indeed, OSA makes no finding that Cardinal failed to properly perform any of its statutory or contractual obligations, much less that such failure was because Cardinal had spent money on other activities. There are no findings regarding Cardinal's performance in connection with services for members; payments to providers; efforts to combat fraud, waste

and abuse; efforts to promote quality of care; or Cardinal's performance under its contracts with DHHS. To the contrary, Cardinal has fully met its obligations.

4. OSA's Recommendation that "Cardinal Should Consult and Collaborate with Members of the General Assembly Before Taking Any Actions Outside of its Statutory Boundaries."

To the extent OSA's recommendation implies that Cardinal Innovations has taken actions that are in violation of any statutory boundaries, we disagree. However, to the extent that this recommendation suggests that Cardinal should work with the General Assembly and keep it apprised of its activities, we agree.

Cardinal Innovations endeavors to consult and collaborate with members of the General Assembly on a regular basis. Cardinal stands ready to work with any and all members of the General Assembly who are interested in the important services provided by Cardinal and the other LME/MCOs.

FINDING NO. 2: \$1.2 MILLION IN CEO SALARIES PAID WITHOUT PROPER AUTHORIZATION

OSA RECOMMENDATION:

- The Office of State Human Resources should immediately begin reviewing and approving Cardinal CEO salary adjustments.
- The Department of Health and Human Services should determine whether any Cardinal CEO salary expenditures should be disallowed and request reimbursement as appropriate.

Cardinal Response to OSA Finding No. 2:

Cardinal Innovations disagrees with OSA's finding that it paid \$1.2 Million in CEO Salaries without proper authorization. As explained below, Cardinal followed a process consistent with state law where Cardinal Innovations annually submits its Salary Plan to OSHR with salary ranges for all employees, including the CEO, which OSHR annually accepts. At all times, Cardinal Innovations' Board set the salary for its CEO within the range submitted to OSHR in Cardinal Innovations' annual Salary Plan. This is the same process that the other LME/MCOs have used in setting their CEOs' salaries. OSA's recommendations, which are not directed at Cardinal Innovations, are erroneous, as the amounts paid to the CEO were allowed under Cardinal Innovations' annual Salary Plan submitted to and accepted by OSHR.

There are several aspects of this finding that are incorrect. Each of these is addressed below.

1. OSA's Assertion that the Office of State Human Resources Established a Salary Range for LME/MCO Area Directors.

OSA asserts that "In 2010, OSHR established the following salary range for mental health area directors such as Cardinal's CEO," with a range of \$105,576 to \$187,364. The high end of this purported range serves as the benchmark for Finding #2, with OSA concluding that any amount paid by Cardinal to its CEOs in excess of \$187,364 is unauthorized.

OSHR has not established any salary range for the LME/MCO Area Directors. On the Local Government Support section of its website³, OSHR lists the position of "Area Authority Director," which the linked job description describes as "the Chief Executive Officer (CEO) of a Local Management Entity (LME)."⁴ Unlike the other local government jobs listed on OSHR's website, however, the "Area Authority Director" salary grade is listed as "NG," or "No Grade." There is no other information on OSHR's website about any approved salary range for the LME/MCO Area Directors.

³ <https://oshr.nc.gov/state-employee-resources/local-government-support/LG-class-specs-a-k> (site visited 5/12/2017)

⁴ The job description of the Area Authority Director was last updated in January 2007, more than 4 years before the General Assembly approved the formation of LME/MCOs and the statewide expansion of the 1915(b)(c) Medicaid Waivers in S.L. 2011-264, actions which significantly expanded the size, scope, and functions of the LMEs and the job requirements of the Area Directors. See http://ncoshr.s3.amazonaws.com/s3fs-public/migrated_files/Guide/LocalGovmt/LocalGov%27tSpecs/Area%20Authority%20Director.pdf (site visited 5/12/2017)

OSA based its finding on a March 1, 2010 internal OSHR memorandum titled “LME Salary Range.” However, this memorandum expressly states that “Since each [LME] is responsible for setting the salary of their directors, this salary range is for information purposes only – not used in setting salaries.” (emphases added)⁵

Following receipt of OSA’s draft findings containing the statement that OSHR had established the \$105,576 to \$187,364 salary range for the LME/MCO Area Directors, Cardinal Innovations confirmed with the other LME/MCOs that they, too, are unaware of OSHR having ever established a salary range for LME/MCO Directors. Most of the LME/MCOs were unaware of the March 1, 2010 OSHR memorandum, and none had received a copy from OSHR. If OSHR ever moved this salary range from a recommendation to an established salary range during the past seven years, it has never communicated this range to any of the LME/MCOs or published this range anywhere on its website or in any hard copy material.

2. OSA’s Conclusion that Cardinal Exceeded OSHR Established Salary Range Without Prior Approval.

In its report, OSA concludes that Cardinal Innovations paid salaries to its CEOs which exceeded the OSHR-established salary range without prior approval. As discussed above, OSHR never established a salary range for LME/MCO Area Directors; no such a range has been published on its website. No LME/MCO could pay its CEO above a salary range that does not exist.

Cardinal Innovations’ Board of Directors complied with the statutory guidelines in setting its CEO salary.

Annually, OSHR sends a request to all local government entities, including Cardinal and the other LME/MCOs, to submit their Salary Plans. With the annual request, OSHR informs local government entities that G.S. 126-9(b) authorizes them “to adjust the salary ranges for positions subject to the State Human Resources Act to conform to local financial ability and fiscal policy,” and that the method by which OSHR approves such adjustments is through the entity’s annual Salary Plan.

Biannually, Cardinal Innovations works with an outside market compensation consulting firm to conduct a market compensation study. Although Cardinal Innovations is a local government entity, as a Managed Care Organization with annual service expenditures in excess of half a billion dollars and as the developer and licensor of software designed specifically for use to operate the 1915(b)/(c) Medicaid Waivers, it competes for talent with private-sector insurance companies, hospitals, providers, IT development firms, and other employers. It is imperative to Cardinal Innovations’ ability to succeed and perform on its contracts with DHHS that Cardinal offers competitive salaries to attract and retain talented professionals. These biannual market studies educate Cardinal Innovations about current market trends and enable Cardinal Innovations to make informed decisions about setting salaries.

⁵ OSHR does not appear to have circulated this 2010 internal memorandum to the LMEs in 2010, or since. Cardinal Innovations first received a copy of the memorandum from a third party in March 2017 – seven years after it was written. Prior to that time, Cardinal was not aware of this memorandum or the salary range it contains “for information purposes only – not used in setting salaries.” Additionally, as with the OSHR job description for the “Area Authority Director,” the recommended salary range predates the General Assembly’s approval of the consolidation of the LMEs and the formation of LME/MCOs and the statewide expansion of the 1915(b)/(c) Medicaid Waivers in S.L. 2011-264. At the time of the 2010 memorandum, there were 23 LMEs across the State, with only one (PBH) operating the State’s 1915(b)/(c) Medicaid Waivers. Today, those 23 LMEs have consolidated or merged into 7 LME/MCOs. The size, scope, and functions of the LME/MCOs and the job requirements of the Area Directors/CEOs are significantly larger and more complex than the 23 LMEs in March 2010 when OSHR apparently recommended a salary range.

In Finding #2, OSA contends that the market compensation survey that Cardinal Innovations used in establishing the Salary Plan and setting the CEO Salary was not sufficient under G.S. 122C-121(a1). Cardinal respectfully disagrees. The other LME/MCO CEOs continue to be a part of the state retirement system, where they also receive a significant pension benefit from the State every year after their retirement. In contrast, Cardinal long ago left the State retirement system, and instead offers its employees the opportunity to participate in a 401(k) plan. For purposes of salary, therefore, the other LME/MCOs are not truly "comparable operations." Nonetheless, as OSA noted in its report, the market compensation study did include and take into account all of the publicly-available salary data from the North Carolina Office of State Human Resources. In addition, because the study's market compensation experts found that the Charlotte market was comparable with the overall national market with respect to salaries, they also considered salary information from not-for-profit Health Care MCOs and general industry companies nationwide, as well as in the region.

With the results of the market compensation study as guidance, Cardinal Innovations annually develops and submits a Salary Plan with salary ranges for all employees, including the CEO, to OSHR. Every year, OSHR accepts Cardinal Innovations' Salary Plan. Cardinal Innovations' Board of Directors sets the CEO's salary within the salary range in the annually submitted-and-accepted Salary Plan. All of the CEO salary adjustments described in the OSA report were within the salary range for the CEO position in the Salary Plan submitted to OSHR.

None of the other LME/MCOs are aware of any OSHR-established salary range for the CEO position. The other LME/MCOs each submit an annual Salary Plan to OSHR setting out the salary ranges for all employees, including the CEO. OSHR accepts these Salary Plans. The LME/MCO Boards set their CEOs' salaries within the range submitted to OSHR in the annual Salary Plans.

3. OSA's Calculation of "Approximately \$1.2 Million In Unauthorized Salaries."

OSA's calculation that Cardinal had paid approximately \$1.2 million in "unauthorized salaries," is based on the erroneous assertion that OSHR established a maximum salary for LME/MCO Directors of \$187,364. Without such an applicable maximum, OSA could not calculate any "unauthorized amount" of salaries paid to Cardinal's CEOs. As discussed above, OSHR has not established a maximum salary for LME/MCO CEOs, and all of the adjustments to the CEO salary described in OSA's report were within the salary range submitted by Cardinal Innovations in its annual Salary Plan and accepted by OSHR.

Even assuming \$187,364 to be an applicable maximum CEO salary, OSA improperly included \$677,513 in the "Unauthorized" column on the chart in Finding #2. First, although the audit scope was FY15 and FY16, OSA included \$447,636 as the "unauthorized" portion of the CEO salary for FY17 in its finding, which is outside the audit scope. Second, OSA included \$229,877 as the "unauthorized" portion of the severance package for Cardinal's former CEO. As a matter of law, under G.S. 122C-121(a1) and (a2), severance payments are classified as a "benefit," and not as "salary," making them inappropriate to include in Finding #2. Further, the severance payment to the former CEO was a negotiated amount which took into account the value of her accumulated, unused sick and vacation time, which are also not salary amounts. When both of these amounts are backed out of the table in Finding #2, the purported "unauthorized" salary amount in the FY15 and FY16 audit period was \$519,325, less than half the amount reflected in OSA's report.

4. Cardinal Innovations' Response to OSA's Recommendations.

OSA's Recommendations in Finding #2 are not directed at Cardinal Innovations. However, they are based on the erroneous assumption that OSHR has established a salary range for LME/MCO Directors; it has not. Further, it ignores that annually, Cardinal Innovations (and the other LME/MCOs) submits a Salary Plan at the request of OSHR, which OSHR accepts, and that Cardinal Innovations' sets its CEO salary within the range in that Salary Plan.

FINDING NO. 3: CARDINAL'S UNREASONABLE SPENDING COULD ERODE PUBLIC TRUST

OSA RECOMMENDATION:

- Cardinal should implement procedures consistent with other LME/MCOs, state laws, and federal reimbursement policy to ensure its spending is appropriate for a local government entity.

Cardinal Innovations' Response to OSA Finding No. 3:

In Finding #3, OSA identified an aggregate of \$490,756 in discretionary business expenditures over two fiscal years which it deemed to be "unreasonable." In this finding, OSA did not identify any violation of any statute or legal requirement with respect to any of these expenditures; rather, OSA's findings are subjective judgments about whether any particular expenditure is "reasonable" or "appropriate" in its view. The amount identified represents 0.34% of Cardinal Innovations' total administrative expenditures over those two fiscal years, calculated based on Cardinal Innovations' FY16 audited financial statements.

1. OSA's Findings on Specific Expenditures.

With respect to some of the specific expenditures contained in Finding #3, Cardinal Innovations responds as follows:

A. Board Meetings and Retreats.

Cardinal Innovations' Board of Directors is the governing board for the organization, responsible for planning and oversight of its operations and fulfillment of its core mission to provide high quality, innovative health services to Cardinal Innovations' members across 20 counties, an area which includes more than 25% of the State's Medicaid population. The members of the Board, who oversee the operation of specialty health plans insuring over 850,000 members and currently approaching \$1 billion in revenue commit significant amounts of time and effort to their work, for which they are unpaid other than a \$50 per diem.

Cardinal Innovations' Board meetings are typically held over two days, and with Board members living from Halifax to Forsyth to Mecklenburg Counties, lengthy travel and hotel accommodations are necessary. OSA's reference to the federal reimbursement rate for hotels, as determined by the federal General Services Administration, applies only to the federal government.

In its report, OSA criticizes Cardinal Innovations for holding several of its Board meetings at hotels/conference centers, rather than at its office. Prior to receiving OSA's draft report, Cardinal Innovations' Board of Directors decided that beginning in FY18, it will hold its Board meetings at Cardinal Innovations' corporate offices in Charlotte.

In its report, OSA also criticizes Cardinal Innovations for its annual Board retreat, which was held in Charleston, South Carolina. The annual Board retreat is appropriate for an MCO of this size and complexity, as it allows members of the Board to engage in two days of substantive education sessions, hearing from local and national leaders in the fields of healthcare and Medicaid managed care, and to team-build and develop better working relationships as a Board and with Cardinal Innovations' executives.

B. Charter Flights.

In 2015, Cardinal Innovations' executives took four charter flights from Kannapolis/Charlotte to points in the eastern part of the State. At the time, the use of these charter flights was determined to be cost effective, as they allowed these executives to take these important face-to-face meetings and return in one day, saving effectively two days for each meeting of out-of-the-office travel, hotels and meals. Additionally, the use of the charter flights also greatly reduced the amount of "off-line" time, which OSA admits that it did not take into account in its analysis.

However, while the use of charter flights for these specific meetings was a cost-effective and reasonable decision at the time, Cardinal Innovations discontinued the use of charter flights nearly 18 months ago.

C. CEO Benefits.

While OSA identified the auto allowance, gas purchases on the company credit card, and car detailing as "CEO benefits," these are a transportation benefit. All Cardinal Innovations employees who drive as part of their jobs have a transportation benefit. Based on their job and amount of travel required, some employees are assigned a Cardinal Innovations-owned vehicle and company gas card. Other employees who travel less can use a pool vehicle and company gas card as needed. Or, other employees who drive for work purposes may drive their own vehicles and are reimbursed by the company at the IRS-approved mileage rate. All company owned vehicles, including those used exclusively by an employee, are detailed by a company vendor. Cardinal Innovations has created these different levels of transportation benefits for employees to ensure the most cost effective methods of managing work travel.

Rather than assigning the CEO a company fleet vehicle with a gas card, or reimbursing the CEO for mileage in his own car at the IRS-approved mileage rate, due to the amount of travel that the CEO is required to do, the Board of Directors chose to provide the CEO with an automobile allowance, auto detailing, and to allow the CEO to purchase gas for business travel using a company credit card. This is the same transportation benefits made available by the Board to prior CEOs, and it is equivalent to the transportation benefits provided to other employees depending on their job responsibilities and the amount of travel required for their jobs.

D. Hotels.

Under the heading of "Executive Credit Card Expenses," OSA identified 169 transactions over two fiscal years where hotels were charged "above the federal hotel rate." As discussed above, the federal hotel rate is inapplicable to local government entities, which are not eligible to get the federal hotel rate. Typically, Cardinal Innovations seeks out and obtains the most economical hotel rate for executive travel, including a government rate whenever it is offered or available. Many of the hotel charges included in OSA's calculation were for healthcare or Medicaid conferences in North Carolina or nationally, where the conference organizers have negotiated a discount hotel and conference registration rate. Going forward, Cardinal Innovations will continue to be mindful of hotel rates, and will continue to obtain the most economical hotel rate available.

2. OSA's Conclusion that Expenditures "Potentially Results in Erosion of Public Trust."

Cardinal Innovations' Board, executive team, and employees take very seriously the critical public mission at the heart of Cardinal Innovations: an unwavering focus on our members, our providers, and our communities to deliver high quality, innovative healthcare services for our members. To achieve those goals, Cardinal Innovations works hard to

develop and maintain a deep and wide presence in our communities, regularly engaging local and regional stakeholders including County and municipal officials, providers, hospitals, and individual members and their families.

As noted above, in the two fiscal years that OSA focused on in this audit, Cardinal Innovations spent over \$1.1 billion on healthcare services for our members. Cardinal Innovations authorized 98% of the services requested by our members and providers, and paid over 99.9% of claims timely and accurately. Cardinal Innovations seeks to be, and is, a good steward of its funds.

In concluding that the 0.34% of total administrative expenditures it identified as “unreasonable” could “potentially” erode public trust, OSA questioned whether if Cardinal Innovations had not spent funds for “these types of expenses,” perhaps it “could be used for services.” Such an analysis blurs the important distinction between service and administrative funds and misses the scale of the issue.

OSA includes a partial quote from a State legislator from an April 2017 news article; the full quote is: “[A legislator from Forsyth County] said she is receiving complaints from constituents ‘regarding the reduction in services since the takeover by Cardinal.’” The “takeover by Cardinal” this legislator discussed was the July 1, 2016, consolidation between Cardinal Innovations and CenterPoint Human Services which was approved by DHHS, where Davie, Forsyth, Rockingham, and Stokes Counties were added to Cardinal Innovations’ service area. In fact, in FY17, Cardinal Innovations is actually spending more on Medicaid services, and is on track to spend the same amount on state-funded services, in the former CenterPoint counties than CenterPoint spent in FY16.

Cardinal Innovations agrees with this legislator: our priority is to deliver high quality healthcare services to our members. However, the 0.34% of Cardinal Innovations’ total administrative spending that OSA identified as “unreasonable” simply does not impact the over \$1.1 billion in services that Cardinal Innovations provided during the audit period.

3. OSA’s Recommendation that Cardinal Innovations Should Implement Procedures to Ensure Its Spending is Appropriate for a Local Government Entity.

While making this recommendation, OSA identified no state laws that were violated, and did not identify any specific procedure that Cardinal Innovations should adopt. Cardinal Innovations agrees with OSA about the importance of being cognizant of public perception and the importance of not eroding public trust. Cardinal Innovations constantly reviews its administrative expenditures to ensure that it is a good steward of its resources, while continuing to deliver high quality healthcare to our members.

CARDINAL INNOVATIONS HEALTHCARE'S RESPONSE TO "MATTERS FOR FURTHER CONSIDERATION"

A. Cardinal Has Accumulated \$70 Million of Medicaid Savings in FY15 and FY16.

OSA notes that during FY15 and FY16, Cardinal Innovations accumulated approximately \$30 million and \$40 million, respectively, in Medicaid savings from its efficient management of Medicaid-funded services. OSA recommends that DHHS monitor Cardinal's Medicaid savings and use this information when setting the capitation rate for Cardinal's DMA contract.

We agree with this recommendation and note that this is already part of the annual rate-setting process, which considers historical performance. Federal Medicaid managed care regulations prescribe the formulae to be used in setting capitation rates, and require that those capitation rates be actuarially-sound, taking into account historical spending data and demographic shifts.

In addition, we note that Cardinal Innovations has been investing in numerous initiatives that support its members, providers and communities, including in calendar years 2015 and 2016:

- Enhancement of care coordination services
- Rate increase for ICF/MR services
- Construction of a behavioral health urgent care and wellness center
- Construction of two new crisis recovery centers
- Three new wellness centers
- Wellness initiative with Special Olympics of NC
- Support of NC MedAssist free medication programs

B. Cardinal Paid More Employee Bonuses than Other LME/MCOs in FY15 and FY16.

OSA notes that Cardinal Innovations paid bonuses to its employees in FY15 and FY16 from its *administrative* funds. It further notes that "employee bonuses are only awarded if Cardinal achieves *administrative* savings."

Cardinal's capitation payments from DMA have a portion that is designated for administrative spending, as opposed to spending for Medicaid services. This distinction between *administrative funds* and *service funds* is critical. Cardinal tracks all of its spending and ensures that only *administrative funds* are spent on administrative activities and that all Medicaid services are paid for with *service funds*.

OSA has suggested that perhaps LME/MCOs should be limited in their authority to grant bonuses to their employees. OSA supports this suggestion by stating that "bonus awards based on organizational achievement such as cost reduction runs the risk of incentivizing Cardinal reducing the utilization of services or rates paid to providers." This suggestion is misplaced because OSA has confused administrative spending with service spending.

The risks identified by OSA – reducing utilization rates and reducing rates to providers – involve only *service funds*. As noted by OSA, "employee bonuses are only awarded if Cardinal achieves *administrative* savings." It is improper to conflate these two different sets of funds. Because administrative costs are paid by DMA, and tracked by Cardinal, separately from funding for services, basing employee bonuses on achieving *administrative* savings does not incentivize

any reduction in spending on services. Instead, it incentivizes administrative efficiencies, which lowers the cost to the State.

OSA also notes that Cardinal paid bonuses that were, on average, higher than the bonuses paid by other LME/MCOs. This is irrelevant because, unlike other LME/MCOs, Cardinal does not participate in the State retirement or health programs. Instead of a State retirement program that pays employees a pension every year after retirement, Cardinal provides its employees with a 401(k) retirement plan, which is more typical for private-sector employers. Comparing Cardinal's compensation practices with those of other LME/MCOs is simply not an apples-to-apples comparison.

Finally, OSA cites to federal regulations that are not applicable to the Medicaid funds at issue. By its own terms, 2 CFR Part 200 does not apply to capitated Medicaid payments. 2 CFR § 200.502(i) provides that "Medicaid payments to a subrecipient for providing patient care services to Medicaid-eligible individuals *are not considered Federal awards expended under this part . . .*"

C. Cardinal Deeded Two Properties to Providers.

OSA notes that Cardinal Innovations deeded two properties to providers, without payment by the providers, and that the deeds include a Use Restriction Agreement that requires that the provider continue to use the property to provide behavioral health services or else the property will revert back to Cardinal. OSA suggests that perhaps this type of transfer of property should be restricted.

Prior to the mental health reforms of 2001, LMEs used to act as direct care providers. This was a very different role than the LME/MCOs' current roles, in which they do not provide services directly to members, but instead pay for services that are provided by third-party providers. During that earlier time, the LMEs owned and operated a number of group homes in which they provided services to their members.

Due to this historic role as a direct service provider, Cardinal Innovations owned a number of these group home properties. When third parties began providing services in these homes, Cardinal assumed the role of landlord. Cardinal's core mission is Medicaid managed care and fee-for-service State-funded services. It is not landlording.

Rather than simply sell these properties to anyone who was willing to buy them, Cardinal wanted to ensure that these properties continued to be used for providing behavioral health services to its members. As a result, it entered into discussions with the provider agencies who were providing services in these homes to transfer ownership to the providers, so long as they continued to use the homes for behavioral health services. It made these transfers at no cost to the providers, with the commitment that they continue using the homes for providing these services to members, or else the homes would revert back to Cardinal.

Alternately, Cardinal Innovations could have sold these homes to any willing buyer for the highest price, which would have taken these homes out of the inventory of group homes available for members. This would have also displaced the members and disrupted the services being provided in these homes. Cardinal determined it was much more important to its mission to ensure that these homes stayed in the inventory of group homes available to provide behavioral health services to its members, rather than to simply sell the homes to the highest bidder.

There was nothing improper about the transfer of these homes. In fact, Cardinal recently learned from one of the providers that it will no longer be able to maintain services in its home, so this home will revert to Cardinal exactly as required by the Use Restriction Agreement.

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This audit required 6,200 hours of auditor effort at an approximate cost of \$638,600. The cost of the specialist's effort was \$182,526. As a result, the total cost of this audit was \$821,126 which represents 0.07% of Cardinal's \$1.1 billion Medicaid expenditures over fiscal years 2015 and 2016.