Edmund G. Brown Jr., Governor
State of California
Health and Human Services Agency
**DEPARTMENT OF MANAGED HEALTH CARE**
**980 9th Street, Suite 500, Sacramento, CA 95814**
**Telephone: 916-255-2444 | Fax: 916-255-2280**

**Via USPS Delivery and eFile**

December 13, 2017

Dr. Manmohan Nayyar
Chair, Board of Directors
**CHOICE PHYSICIANS NETWORK, INC.**
18564 Highway 18, Suite 105
Apple Valley, CA 92307

**FINAL REPORT OF ROUTINE EXAMINATION OF CHOICE PHYSICIANS NETWORK, INC.**

Dear Dr. Nayyar:

Enclosed is the final report of a routine examination of the fiscal and administrative affairs of Choice Physicians Network, Inc. (Plan) for the quarter ended March 31, 2017 (Final Report). The examination was conducted by the Department of Managed Health Care (Department), pursuant to Section 1382(a) of the Knox-Keene Health Care Service Plan Act of 1975.[1] The Department issued a preliminary report to the Plan on September 25, 2017 (Preliminary Report). The Department accepted the Plan's electronically filed response on November 8, 2017.

This Final Report includes a description of the compliance efforts included in the Plan's November 8, 2017 response, in accordance with Section 1382(c).

Section 1382(d) states, "If requested in writing by the plan, the director shall append the plan's response to the final report issued pursuant to subdivision (c). The plan may modify its response or statement at any time and provide modified copies to the department for public distribution not later than 10 days from the date of notification from the department that the final report will be made available to the public. The addendum to the response or statement shall also be made available to the public."

[1] References throughout this report to "Section" are to sections of the Knox-Keene Health Care Service Plan Act of 1975, as codified in the California Health and Safety Code, Section 1340, et seq. References to "Rule" are to the regulations promulgated pursuant to the Knox-Keene Health Care Service Plan Act of 1975 found within Title 28 of the California Code of Regulations.

Please indicate within ten (10) days from the date of the Plan's receipt of this letter whether the Plan requests the Department to append its response to the Final Report. If so, please indicate which portions of the Plan's response shall be appended, and electronically file copies of those portions of the Plan's response excluding information held confidential pursuant to Section 1382(c).

If the Plan requests the Department to append a brief statement summarizing the Plan's response to the Final Report or wishes to modify any information provided to the Department please provide the electronically filed documentation no later than ten (10) days from the date of the Plan's receipt of this letter through the eFiling web portal. Please file this addendum electronically via the Corrective Action Plan system ("CAP system") within the Online Forms Section of the Department's eFiling web portal https://wpso.dmhc.ca.gov/secure/login/, as follows:

- From the main menu, select "eFiling."
- From the eFiling (Home) menu, select "Online Forms."
- From the Existing Online Forms menu click on the "Details" for the DFO Corrective Action Plan S17-R-470.
- Go to the "Messages" tab:
    - Select "Addendum to Final Report" (note this option will only be available for 10 days after the Final Report has been issued).
    - Select the deficiency(ies) that are applicable.
    - Create a message for the Department.
    - Attach and Upload all documents with the name "Addendum to Final Report."
    - Select "Send Message."

As noted in the attached Final Report, the Plan's response of November 8, 2017 did not fully respond to the deficiencies raised in the Preliminary Report issued by the Department on September 25, 2017. Pursuant to Rule 1300.82, the Plan is required to submit a response to the Department's request for additional corrective action described in the attached Final Report within 30 days after receipt of the Final Report. If the Plan fails to fully respond and/or resolve the deficiencies addressed in the Final Report, then a referral will be made to the Office of Enforcement for appropriate administrative action for any remaining, unresolved deficiencies.

**The Plan is hereby advised that any violations listed in the attached Final Report may be referred to the Office of Enforcement for appropriate administrative action upon the completion of all remediation addressed in the Final Report.**

Please file the Plan's response electronically via the CAP system within the Online Forms Section of the Department's eFiling web portal https://wpso.dmhc.ca.gov/secure/login/, as follows:

- From the main menu, select "eFiling."
- From the eFiling (Home) menu, select "Online Forms."

- From the Existing Online Forms menu click on the “Details” for the DFO Corrective Action Plan S17-R-470.
- Go to the “Data Requests” tab:
    - Click on the “Details” for each data request that does not have a status of “Complete.”
    - Follow the Instructions and/or use the form shown to add the requested data (depending on the type of data requested: New Filing, Document Request, Claims Data, or Financial Statement refile).

The Department will also send the Plan an e-mail(s) requesting those items that are still outstanding. The e-mail(s) will contain a link to the CAP system for the Plan to file the response electronically.

Questions or problems related to the electronic transmission of the response should be directed to Vijon Morales at (916) 255-2447 or email at Vijon.Morales@dmhc.ca.gov. You may also email inquiries to wpso@dmhc.ca.gov.

**The Department will make the attached Final Report available to the public in 10 days from the Plan’s receipt of this letter through the eFiling system. The Final Report will be located at the Department’s web site at View Financial Examination Reports.**

If there are any questions regarding this Report, please contact me at 916-255-2444 or email: Steven.Alseth@dmhc.ca.gov.

Sincerely,

Orginial Signed By

Steven J. Alseth
Examiner IV (Supervisor)
Office of Financial Review
Division of Financial Oversight

cc: Margherita Leone, Controller, Choice Physicians Network, Inc.
Tin Kin Lee, Attorney, Choice Physicians Network, Inc.
Pritika Dutt, CPA, Deputy Director, Office of Financial Review
Eri Fukuda, Examiner, Division of Financial Oversight
Neetu Bhangu, Examiner, Division of Financial Oversight
Munir Chechi, Office of Plan Licensing
Laura Dooley-Beile, Chief, Division of Plan Surveys
Paula Hood, Staff Services Manager I, Help Center

# STATE OF CALIFORNIA
# DEPARTMENT OF MANAGED HEALTH CARE

## DIVISION OF FINANCIAL OVERSIGHT

## FINAL REPORT OF ROUTINE EXAMINATION

## OF

## CHOICE PHYSICIANS NETWORK, INC.

## FILE NO. 933-0470

## DATE OF FINAL REPORT: DECEMBER 13, 2017

## OVERSIGHT EXAMINER: STEVEN ALSETH

## EXAMINER-IN-CHARGE: ERI FUKUDA

## FINANCIAL EXAMINERS: ANNA BELMONT, NINA MOUA, AND ERICA SHORT

## BACKGROUND INFORMATION FOR CHOICE PHYSICIANS NETWORK, INC.

| | |
|---|---|
| Date Plan Licensed: | September 14, 2009 |
| Organizational Structure: | Choice Physicians Network, Inc. (Plan) is a for-profit "S" corporation owned by two shareholders. The Plan contracts with two medical groups affiliated with the above two shareholders. In addition, the Plan leases office space and received administrative services from entities controlled by the above two shareholders. |
| Type of Plan: | The Plan is a full-service health care plan providing health care services to Medicare Advantage enrollees through plan to plan contracts with other health care service plans. The Plan does not contract directly with employer groups or members. |
| Provider Network: | The Plan contracts with medical groups, including affiliated entities, independent physicians, hospitals and ancillary providers for the provision of medical services to its Medicare Advantage members. Providers are reimbursed on a capitated, per-diem, or fee-for-service basis. |
| Plan Enrollment: | The Plan reported 13,771 enrollees as of March 31, 2017. |
| Service Area: | The Plan operates in parts of San Bernardino, Fresno, Kern, Los Angeles, Madera, Riverside, Modesto, and Tulare Counties. |
| Date of prior Final Routine Examination Report: | January 16, 2015 |

**FINAL REPORT OF A ROUTINE EXAMINATION OF CHOICE PHYSICIANS NETWORK, INC.**

This is the final report (Final Report) of a routine examination of the fiscal and administrative affairs of Choice Physicians Network, Inc. (Plan), conducted by the Department of Managed Health Care (Department) pursuant to Section 1382(a) of the Knox-Keene Health Care Service Plan Act of 1975.[1] The Department issued a preliminary report to the Plan on September 25, 2017 (Preliminary Report). The Department accepted the Plan's electronically filed response on November 8, 2017.

This Final Report includes a description of the compliance efforts included in the Plan's November 8, 2017 response to the Preliminary Report, in accordance with Section 1382(c). The Plan's response is noted in *italics*.

**The Plan is hereby advised that any violations listed in this Final Report may be referred to the Office of Enforcement for appropriate administrative action upon the completion of all corrective actions required in response to this Final Report.**

The Department examined the Plan's financial report filed with the Department for the quarter ended March 31, 2017, as well as other selected accounting records and controls related to the Plan's various fiscal and administrative transactions. The Department's findings are presented in this Final Report as follows:

| | |
|---|---|
| Section I. | Financial Statements |
| Section II. | Calculation of Tangible Net Equity |
| Section III. | Financial Viability |
| Section IV. | Compliance Issues |
| Section V. | Non-Routine Examination |

**Pursuant to Rule 1300.82, the Plan is required to submit a response to the Department for any requests for additional corrective action contained within this Final Report, within 30 days after receipt of this Final Report.**

[1] References throughout this report to "Section" are to sections of the Knox-Keene Health Care Service Plan Act of 1975, as codified in the California Health and Safety Code, Section 1340, et seq. References to "Rule" are to the regulations promulgated pursuant to the Knox-Keene Health Care Service Plan Act of 1975 found within Title 28 of the California Code of Regulations.

## SECTION I. FINANCIAL REPORT

## A. BALANCE SHEET AT THE QUARTER ENDED MARCH 31, 2017

| ASSETS | Bal. per F/S @ | AJE or RJE | Exam Adjustments | | Bal. per Exam @ |
|---|---|---|---|---|---|
| **Account** | **3/31/17** | | **Dr.** | **Cr.** | **3/31/17** |
| Cash and Cash Equivalents | $12,102,908 | | | | $12,102,908 |
| Short-Term Investments | | | | | |
| Premiums Receivable – Net | | | | | |
| Interest Receivable | | | | | |
| Shared Risk Receivables – Net | | | | | |
| Other Health Care Receivables – Net | | | | | |
| Prepaid Expenses | 24,017 | | | | 24,017 |
| Secured Affiliate Receivables – Current | | | | | |
| Unsecured Affiliate Receivables – Current | | | | | |
| Aggregate Write-Ins for Current Assets | 521,504 | | | | 521,504 |
| **TOTAL CURRENT ASSETS** | **12,648,429** | | | | **12,648,429** |
| Restricted Assets | 4,649,272 | | | | 4,649,272 |
| Long-Term Investments | 166,606 | | | | 166,606 |
| Intangible Assets & Goodwill – Net | | | | | |
| Secured Affiliate Receivables – Long-Term | | | | | |
| Unsecured Affiliate Receivables – Past Due | | | | | |
| Aggregate Write-Ins for Other Assets | | | | | |
| **TOTAL OTHER ASSETS** | **4,815,878** | | | | **4,815,878** |
| Land, Building and Improvements | | | | | |
| Furniture and Equipment – Net | 3,371 | | | | 3,371 |
| Computer Equipment – Net | 2,000 | | | | 2,000 |
| Leasehold Improvements – Net | 214,841 | | | | 214,841 |
| Construction in Progress | | | | | |
| Software Development Costs | | | | | |
| Aggregate Write-Ins for Other Equipment | | | | | |
| **TOTAL PROPERTY & EQUIPMENT** | **220,212** | | | | **220,212** |
| **TOTAL ASSETS** | **$17,684,519** | | | | **$17,684,519** |

**BALANCE SHEET (Continued)**

| LIABILITIES | Bal. per F/S @ | AJE or RJE | Exam Adjustments | | Bal. per Exam @ |
|---|---|---|---|---|---|
| **Account** | **3/31/17** | | **Dr.** | **Cr.** | **3/31/17** |
| Trade Accounts Payable | $215,291 | | | | $215,291 |
| Capitation Payable | 552,645 | | | | 552,645 |
| Claims Payable (Reported) | 2,259,972 | | | | 2,259,972 |
| Incurred But Not Reported Claims | 9,899,689 | AJE | | $1,491,745 | 11,391,434 |
| POS Claims Payable (Reported) | | | | | |
| POS Incur But Not Reported Claims | | | | | |
| Other Medical Liability | | | | | |
| Unearned Premiums | | | | | |
| Loans & Notes Payable | | | | | |
| Amounts Due to Affiliates – Current | 46,528 | | | | 46,528 |
| Aggregate Write-Ins-Curr Liabilities | 357,689 | | | | 357,689 |
| **TOTAL CURRENT LIABILITIES** | **13,331,814** | | | **1,491,745** | **14,823,559** |
| Loans and Notes Payable (Not Subordinated) | | | | | |
| Loans and Notes Payable (Sub.) | | | | | |
| Accrued Sub Interest Payable | | | | | |
| Amounts Due To Affiliates – LT | | | | | |
| Agg Write-Ins for Other Liabilities | | | | | |
| **TOTAL OTHER LIABILITIES** | | | | | |
| **TOTAL LIABILITIES** | **13,331,814** | | | **1,491,745** | **14,823,559** |
| **NET WORTH** | | | | | |
| Common Stock | 2,200,000 | | | | 2,200,000 |
| Preferred Stock | | | | | |
| Paid in Surplus | | | | | |
| Contributed Capital | | | | | |
| RE (Deficit)/Fund Balance | 2,147,850 | | | | 2,147,850 |
| WI- Other Net Worth Items | 4,855 | | | | 4,855 |
| **EXAMINATION ADJUSTMENTS (from Income Statement)** | | (A) | $1,491,745 | | (1,491,745) |
| **TOTAL NET WORTH** | **4,352,705** | | **1,491,745** | | **2,860,960** |
| **TOT LIABILITIES & NET WORTH** | **$17,684,519** | | **$1,491,745** | **$1,491,745** | **$17,684,519** |

## B. STATEMENT OF INCOME AND EXPENSES FOR THE QUARTER ENDED MARCH 31, 2017

| REVENUE AND EXPENSES<br>Account | Bal. per F/S@3/31/17 | AJE or RJE | Exam Adjustments Dr. | Exam Adjustments Cr. | Bal. per Exam@ 3/31/17 |
|---|---|---|---|---|---|
| **REVENUES:** | | | | | |
| Premiums (Commercial) | | | | | |
| Capitation | $29,213,070 | | | | $29,213,070 |
| Co-payments, COB, Subrogation | | | | | |
| Title XVIII – Medicare | | | | | |
| Medicaid, Healthy Families | | | | | |
| Fee-For-Service | | | | | |
| Point-Of-Service (POS) | | | | | |
| Interest | 2,614 | | | | 2,614 |
| Risk Pool Revenue | | | | | |
| Aggregate Write-Ins for Other Revenues | 415,420 | | | | 415,420 |
| **TOTAL REVENUE** | **29,631,104** | | | | **29,631,104** |
| **EXPENSES:** | | | | | |
| **Medical and Hospital** | | | | | |
| Inpatient Services–Capitated | | | | | |
| Inpatient Serv–Per Diem/Managed Hosp | 8,572,956 | | | | 8,572,956 |
| Inpatient Serv–Fee-For-Serv/Case Rate | 5,930,591 | AJE | 1,491,745 | | 7,422,336 |
| Primary Professional Services–Capitated | 13,771,841 | | | | 13,771,841 |
| Primary Prof Services–Non-Capitated | | | | | |
| Other Med Prof Services–Capitated | 70,272 | | | | 70,272 |
| Other Med Prof Services–Non-Capitated | | | | | |
| Non-Contracted Emergency Room and | 256,580 | | | | 256,580 |
| Out-of-Area Expense, Not including POS | | | | | |
| POS Out-Of-Network Expense | | | | | |
| Pharmacy Expense–Capitated | | | | | |
| Pharmacy Expense–Fee-for-Service | | | | | |
| Aggregate Write-Ins for Other Capitated | | | | | |
| Medical and Hospital Expenses | | | | | |
| Aggregate Write-Ins for Other Non-capitated Medical and Hospital Expenses | 583,628 | | | | 583,628 |
| **TOTAL MEDICAL AND HOSPITAL EXPENSES** | **29,185,868** | | **1,491,745** | | **30,677,613** |
| **Administration:** | | | | | |
| Compensation | 140,986 | | | | 140,986 |
| Interest Expense | | | | | |
| Occupancy, Depreciation and | 30,925 | | | | 30,925 |
| Amortization | | | | | |
| Management Fees | | | | | |
| Marketing | | | | | |
| Affiliate Administration Services | | | | | |
| Aggregate Write-Ins for Other Administration | 187,688 | | | | 187,688 |
| **TOTAL ADMINISTRATION EXPENSES** | **359,599** | | | | **359,599** |
| **TOTAL EXPENSES** | **29,545,467** | | **1,491,745** | | **31,037,212** |
| **INCOME (LOSS)** | **85,637** | | | | **(1,406,108)** |
| Provision for Taxes | 1,329 | | | | 1,329 |
| **NET INCOME (LOSS)** | **$84,308** | (A) | **$1,491,745** | | **($1,407,437)** |

## C. EXPLANATION OF EXAMINATION ADJUSTMENTS

### ADJUSTING JOURNAL ENTRIES (AJE)

| AJE No. | ACCOUNT NAME | DR. | CR. |
|---|---|---|---|
| AJE | Inpatient Services – Fee-For-Service/Case Rate<br>Incurred But Not Reported (IBNR) Claims<br><br>To accrue an additional liability for incurred but not reported claims. | $1,491,745 | $1,491,745 |

The Plan was required to provide written assurance that the above adjusting journal entry was posted to the books and/or provide an explanation regarding its disposition. In addition, the Plan was required to refile the DMHC Reporting Form for the quarter ended March 31, 2017 to include the required adjusting journal entry noted above. The Plan was also to state, in its response to the Preliminary Report, the date the requested DMHC Reporting Form was re-filed with the Department.

*In its response to the Preliminary Report, the Plan confirmed that it has made the adjusting journal entries to its books and records as required by the Department. In addition, the Plan has re-filed the DMHC Reporting Form on October 18, 2017 for the quarter ended March 31, 2017 to include the required adjustments.*

**The Department finds that the Plan's compliance effort is responsive to the corrective action required. Therefore, no further response is required.**

### SECTION II. CALCULATION OF TANGIBLE NET EQUITY (TNE)

| | |
|---|---|
| Net Worth and TNE per Examination as of Quarter Ended March 31, 2017 [From section I.A.] | $2,860,960 |
| Required TNE per Examination | 3,891,370 |
| TNE Deficiency per Examination | ($1,030,410) |

The Plan was not in compliance with the TNE requirement of Section 1376 and Rule 1300.76 as of March 31, 2017. The deficiency was due to the adjusting journal entry that was proposed above.

The Plan was required to correct the TNE deficiency of $1,030,410 as of March 31, 2017. The Plan was also required to submit all applicable documentation necessary to provide sufficient evidence that the TNE deficiency was corrected.

In addition, the Plan was required to describe the procedures implemented to assure

the Department that the Plan will continue to maintain adequate TNE at all times, as required by the above Section and Rule. The Plan was also to state the date of implementation of these procedures and the management position(s) responsible for ensure ongoing compliance.

*The Plan responded that to correct its TNE deficiency, it has implemented the Hierarchical Condition Category/Risk Adjustment Factor revenue accruals as of April 30, 2017, and will ensure ongoing compliance with these revenue accrual procedures. The Plan acknowledged that it was not in compliance with the TNE requirement of Section 1376 and Rule 1300.76 as of September 30, 2017, but has developed a plan to get back into compliance. The Plan indicated that it will correct the TNE deficiency as of September 30, 2018 from receipt of prior year RAF revenue adjustments that are provided downstream from CMS annually every August to November for prior year revenue adjustments and mid-year revenue adjustments.*

*The Plan's contracted Chief Financial Officer (CFO) and controller are responsible for ensuring that adequate TNE is maintained at all times as required by Section 1376 and Rule 1300.76 .*

**The Department finds that the Plan's compliance effort is not fully responsive to the corrective action required. The Plan's proposal to have the anticipated risk adjustment factor (RAF) receivable does not cure the TNE deficiency noted as of March 31, 2017. In addition the RAF receivable is uncertain as to the amount the Plan might receive, and as such it should not be booked in the accounting records until received. The Plan is required to provide evidence of additional capital funding to be in compliance with the TNE requirement.**

## SECTION III. FINANCIAL VIABILITY

Section 1375.1 requires every licensed plan to demonstrate that it has a fiscally sound operation and adequate provision against the risk of insolvency.

Rule 1300.75.1 requires that every plan demonstrate fiscal soundness and assumption of full financial risk through its history of operations and through projections that the plan's arrangements for health care services are financially sound, provide for the achievement and maintenance of a positive cash flow, and demonstrate adequate working capital, including provisions for contingencies.

The Department's examination disclosed that the Plan does not have a fiscally sound operation. The Plan reported negative working capital since September 30, 2015. As of March 31, 2017, Plan had negative working capital of $2,175,130 after the examination adjustment of $1,491,745, as stated in section I.A. above. The Plan's financial reports filed with the Department disclosed net losses of $47,843 and $479,532 for the fiscal years ended December 31, 2015, and December 31, 2016, respectively.

In order to demonstrate the Plan's continued compliance with the financial

viability requirements, the Plan was required to file financial projections prepared on a monthly basis for one year or until breakeven, whichever is later; and on a quarterly basis for an additional year. These projections were required to be accompanied by all assumptions which are necessary to support the projections, including a description of the marketing program, member retention, sources of additional capital funding, if needed, and any other significant operational changes. The projections were to begin, and be prepared, based on the financial statements for the quarter ended March 31, 2017, as filed with the Department.

The Plan was required to electronically file the requested financial projections as an amendment in accordance with Section 1352(a) and Rules 1300.52 and 1300.52.4, separate from the Plan's response to this Final Report. In addition, the Plan was required to provide evidence (eFile number) in its response to this Final Report that the requested filing was submitted to the Department.

The Plan was also required to identify the management position(s) responsible for overseeing the proposed operational changes to ensure compliance with the financial viability requirements of the Section and Rule cited above.

*In response to the Preliminary Report, the Plan indicated that it has filed financial projections to include a balance sheet, a statement of income and expenses prepared in accordance with generally accepted accounting principles through the Department's electronic filing system (E-file number 20172803).*

*The Plan's Administrator and its contracted CFO are both responsible for overseeing the proposed operational changes ensuring ongoing compliance.*

**The Department acknowledges that eFiling number 20172803 was filed on November 8, 2017, and it is under review by the Department. The Department finds that the Plan's compliance effort is responsive to the corrective action required. Therefore, no further response is required.**

## SECTION IV. COMPLIANCE ISSUES

### A. INCURRED BUT NOT REPORTED CLAIMS LIABILITY- REPEAT DEFICIENCY

Section 1377(c) requires each plan which reimburses providers of health care service on a fee-for-service basis to estimate and record in the books of account a liability for incurred and unreported claims. Rule 1300.77.2(a) requires that the estimate of incurred and unreported claims be pursuant to a method held unobjectionable by the Director. Such method may include a lag study, an actuarial estimate, or other reasonable method of estimating incurred and unreported claims.

The Department's examination disclosed that the Plan's estimate for total claims liability was understated by $1,491,745 as of March 31, 2017. As a result, the examination required an adjusting journal entry (AJE on page 7 of this Report) to increase the Plan's incurred but not report (IBNR) claims liability. In addition, the

Plan did not perform a hindsight analysis based on paid claims data to determine whether the recorded estimate for total claims liability for previous periods was adequate.

The Plan's underestimate of IBNR claims liability is a repeat deficiency, as this issue was previously reported in the Department's Final Report of Examination dated January 16, 2015 (for the quarter ended March 31, 2014). This examination disclosed that the Plan's compliance efforts in response to the prior examination report have not achieved the necessary levels of compliance with the Section and Rule cited.

The Plan was required to provide a Corrective Action Plan (CAP) to revise its methodology for estimating its IBNR claims liability accurately. The methodology should be unobjectionable by the Director. The CAP should also include the date corrective action was implemented, and the name of the management position(s) responsible for the corrective action and monitoring continued compliance.

The Plan was also required to explain the reasons for the understatement and why the previous corrective action taken was not effective to prevent this repeat deficiency, and to state the measures taken to prevent further recurrence of noncompliance in this area.

*In its response to the Preliminary report, the Plan indicated that is has reviewed its methodology of determining the accrual for total claims liability which is based on a 24-month lag schedule and is satisfied that it's estimated accruals for IBNR claims and claims payable are accurate. The confidence in the accuracy is due in part to membership stabilization along with the termination of high cost contracts.*

*The Plan stated that in order to monitor and verify the accuracy of its IBNR calculation, it will prepare for each reporting period a quarterly hindsight analysis of the previous four quarters.*

*The Plan also stated that it contracted with several new medical groups with a limited claims lag history and an increasingly growing membership which resulted in the understatement of the IBNR.*

*In addition, the Plan stated that in order to prevent reoccurrence, the preparation of a hindsight analysis was implemented on October 1,2017 to ensure an adequate estimate of IBNR claims liability is recorded on its books subsequent to that date and to ensure accurate reporting for the third quarter of 2017.*

*The Plan’s contracted CFO and the controller are responsible for ensuring that adequate estimates of IBNR and total claims liability are recorded on its books monthly.*

**The Department finds that the Plan’s compliance effort is not fully responsive to the corrective action required. The Plan does not appear to**

**have made changes to its IBNR method and has stated that it is satisfied that its current IBNR method is accurate. Further, the Plan did not provide an explanation as to why its corrective action in response to the Final Report dated January 16, 2015 did not prevent reoccurrence of this deficiency.**

## B. MATERIAL MODIFICATIONS AND AMENDMENTS

### 1. NOTICE OF CHANGES IN MANAGEMENT

Section 1352(c) and Rule 1300.52.2 set forth the requirements that a plan shall, within five days, give written notice to the director in the form as by rule may be prescribed, of a change in the officers, directors, partners, controlling shareholders, principal creditors, or persons occupying similar positions or performing similar functions, of the plan and of a management company of the plan, and of a parent company of the plan or management company.

The Department's examination disclosed that the Plan had multiple management changes; however, the Plan failed to file an amendment within five days as required by the above Section and Rule. The following management changes were noted in the Board minutes from February 2015 to May 2017:

- New Chair of the Board of Directors was elected on November 24, 2015.
- New CFO was hired on July 26, 2016.
- A Board director resigned and was replaced by the CFO on September 27, 2016.

The Plan was required to file an amendment with the Department to reflect the above management changes.

The Plan was also required to state the policies and procedures implemented to ensure that key management changes will be filed with the Department pursuant to the above Section and Rule. In addition, the Plan was required to state the date these policies are implemented, and the management position(s) responsible for ensuring continued compliance.

*In its response to the Preliminary report, the Plan indicated that it submitted an amendment to reflect the noted management changes through the Department's e-filing system (E-file number 20171871).*

*The Plan also indicated that it has promulgated and implemented a policy and procedure to ensure that changes to Plan operations are filed with Department pursuant to Section 1352(a), Rules 1300.52 and 1300.52.4 and Section 1367(h)(1). The Plan submitted a revised policy and procedure with its response to the Preliminary Report. This policy and procedure was adopted and implemented on November 1, 2017.*

*The Plan's Administrator is responsible to ensure continued compliance.*

**The Department finds that the Plan's compliance effort is not fully responsive to the corrective action required. The policy filed by the Plan did not provide for the reporting of changes in officer and directors within five days of the change. The Department acknowledges that eFiling number 20171871 was filed on July 14, 2017, and it is under review by the Department.**

**The Plan is required to revise its policies to report changes of officers and directors within 5 days, and file a copy of the revised polices in its response to the Final Report.**

## 2. AMENDMENTS TO PLAN APPLICATION

Section 1352 (a) and Rule 1300.52 require all plans to file an amendment with the director within 30 days after any changes in the information contained in its application, other than financial or statistical information. Rule 1300.52.4 sets forth standards for amendment filing.

The Department's examination disclosed that the Plan did not file the following amendments within 30 days:

- Plan's Bylaws, Corporation Information Form, Organization Chart, and Narrative Explanation of Organization Chart to reflect the Plan's increase of the authorized number of directors from three to six members.
- Administrative Services Agreement (ASA) with Desert Physicians Management, LLC (DPM).
- ASA with Corwin Medical Group, Inc. (Choice Medical Group or CMG) to provide the Plan with an employee to act as the Plan's CFO.

The Plan was required to file an amendment with the Department to submit the amended Corporate Bylaws, Corporation Information Form, Organization Chart, Narrative Explanation of Organization Chart, and the ASAs with DPM and CMG.

The Plan was also required to state the policies and procedures implemented to ensure that amendments will be filed with the Department pursuant to the above Section and Rules. In addition, the Plan was required to state the date these policies are implemented, and the management position(s) responsible for ensuring continued compliance.

*In its response to the Preliminary report, the Plan indicated it has submitted the following amendments through the Department's eFiling System:*

1. *Corporate Bylaws (E-file number 20172805); amended Corporation Information Form, Organizational Chart, and Narrative Explanation of Organization Chart (E-file number 20171871 dated 7/14/17 and 20172761 dated 11/3/17).*

2. *An Administrative Services Agreement with Desert Physicians Management, LLC (E-file number 20171921).*

3. *An Administrative Services Agreement with Corwin Medical Group, Inc. dba Choice Medical Group to provide the Plan with an employee to act as the Plan's CFO (E-file number 20172805).*

*The Plan also indicated that it has promulgated and implemented a policy and procedure to ensure that changes to Plan operations are filed with Department pursuant to Section 1352(a), Rules1300.52 and 1300.52.4 and Section 1367(h)(1). The Plan submitted a revised policy and procedure with its response to the Preliminary Report. The policy and procedure was adopted and implemented on November 1, 2017. The Plan stated that the Administrator is responsible to ensure continued compliance.*

**The Department finds that the Plan's compliance effort is not fully responsive to the corrective action required. The Plan's policy submitted stated it would file an amendment within 30 days of any material modification in the information contained in its application. Section 1352(b) requires a Plan to file a material modification with the Department before any material change. Changes not material can be filed within 30 days after the change. The Plan is required to restate its policies and procedures to be in compliance with Section 1352, and file a copy of the revised policies in its response to the Final Report.**

## C. UNCLAIMED PROPERTY

Section 1500 et seq. of the California Code of Civil Procedure, title 10, Chapter 7 sets forth the requirements for submitting unclaimed funds to the California State Controller's Office (Controller's Office). Funds unclaimed for three years or more should be escheated to the Controller's Office.

The Department's examination disclosed that the Plan has outstanding checks dated back to 2012 that have not been escheated to the Controller's Office. The examination also found that the Plan's current escheatment policy does not specify that checks aged more than three (3) years are to be escheated to the Controller's Office. During the examination, the Plan revised its policy to include the three years escheatment requirement.

The Plan was required to provide evidence that it has escheated unclaimed funds older than three years to the Controller's Office, in accordance with the applicable law and regulations.

*In its response to the Preliminary Report, the Plan submitted evidence that it has escheated all unclaimed funds older than three years to the Controller's Office in accordance with the applicable law and regulations.*

**The Department finds that the Plan's compliance effort is responsive to the corrective action required.**

## SECTION IV. NON-ROUTINE EXAMINATION

The Plan is advised that the Department may conduct a non-routine examination, in accordance with Rule 1300.82.1, to verify representations made to the Department by the Plan in response to this Report. The cost of such examination will be charged to the Plan in accordance with Section 1382 (b).

**No response was required to this Section.**

CHOICE PHYSICIANS NETWORK

December 18, 2017

Mr. Steven J. Alseth
Senior Examiner (Supervisor)
Office of Financial Review
Division of Financial Oversight
Department of Managed Health Care
320 West 4th Street, Suite 880
Los Angeles, CA 90013-2344

Via eFile, Email and Postal Service

**RE: ADDENDUM TO FINAL REPORT OF ROUTINE EXAMINATION OF CHOICE PHYSICIANS NETWORK, INC. ("The Plan")**
**REF: Filing no. 20171167**

Dear Mr. Alseth:

We have received the Department's Final Report of the routine examination of the Choice Physicians Network ("The Plan").

In accordance with Section 1382(d) of the Knox-Keene Health Care Services Plan Act, The Plan wishes to append its November 8, 2017 response to the Final Report as The Plan in discussions with the Department, refiled financial statements including expense and revenue accrual adjustments and is not TNE deficient as of March 31, 2017.

The following sets forth the Plan's addendum to the Department of Managed Health Care's (the "Department") Final Report of Routine Examination of the Plan dated December 13, 2017 (the "Examination"). We trust these responses are sufficient to satisfy the required actions and address and resolve the deficiencies noted in the Final Examination Report.

**SECTION II - CALCULATION OF TANGIBLE NET EQUITY (TNE)**

**REQUIRED ACTION**

**The Plan is required to correct the TNE deficiency of $1,030,410 as of March 31, 2017. All applicable documentation necessary to provide sufficient evidence that the TNE deficiency was corrected must be submitted with the Plan's response to this report.**

**In addition, the Plan is required to describe the procedures implemented to assure the Department that the Plan will continue to maintain adequate TNE at all times, as required by Section 1376 and Rule 1300.76. The Plan is also to state the date of implementation of these procedures and the management position(s) responsible for ensure ongoing compliance.**

Response:

1. The Plan is in compliance with the TNE requirement of Section 1376 and Rule 1300.76 as of March 31, 2017. Please refer to the revised quarterly filing.

**SECTION IV - COMPLIANCE ISSUES**

**A. Incurred but Not Reported (IBNR) Claims Liability**

***REQUIRED ACTION***

**The Plan is required to provide a Corrective Action Plan (CAP) to revise its methodology for estimating its IBNR claims liability accurately. The methodology should be unobjectionable by the Director. The CAP should also include the date corrective action was implemented, and the name of the management position(s) responsible for the corrective action and monitoring continued compliance.**

**The Plan is also required to explain the reasons for the understatement and why the previous corrective action taken was not effective to prevent this repeat deficiency, and to state the measures taken to prevent further recurrence of noncompliance in this area.**

Response:

1. The Plan has reviewed its methodology of determining the accrual for total claims liability which is based on a 24 month lag schedule and is satisfied that it's estimated accruals for incurred but not reported (IBNR) claims and claims payable. The confidence in the accuracy is due in part to membership stabilization along with the termination of high cost contracts and a look back performed over the last eight (8) months.
2. To monitor and verify the accuracy of its IBNR calculation, at a minimum, the Plan will prepare for each reporting period, a quarterly hindsight analysis of the previous four quarters.
3. As explained to the Examination team during the audit, the Plan had contracted several new medical groups with a limited claim lag history and an increasingly growing membership which resulted in the understatement.

4. The Corrective Action plan response to the Final Report dated January 16, 2015 did not correct this deficiency due to key staffing changes, along with the limited lag history as noted in item #3 above.
5. To prevent reoccurrence, the preparation of a hindsight analysis was implemented on October 1, 2017 to ensure an adequate estimate of IBNR claims liability is recorded on its books subsequent to that date and to ensure accurate reporting for the third quarter of 2017.
6. The Plan refiled January to October 2017 monthly and quarterly financials to adjust the understated IBNR as requested by the Department.

The Plan's contract CFO along with its contract controller are responsible for ensuring that adequate estimates of IBNR and total claims liability are recorded on its books monthly.

## B. Material Modifications and Amendments

### 1. Notice of Changes in Management

**REQUIRED ACTION**

**The Plan is required to file an amendment with the Department to reflect the following management changes: (1) New Chairman of the Board elected November 24, 2015; (2) New CFO hired September 6, 2016; (3) Board Director resigned and replaced by CFO on September 27, 2016.**

**The Plan is also required to state the policies and procedures implemented to ensure that key management changes will be filed with the Department pursuant to the above Section and Rule. In addition, the Plan is required to state the date these policies are implemented, and the management position(s) responsible for ensuring continued compliance.**

Response:

1. The plan has promulgated and implemented a revised policy and procedure (filed herewith) to ensure that changes to Plan operations are filed with Department pursuant to Section 1352(a), Rules 1300.52 and 1300.52.4 and Section 1367(h)(1). The revised policy and procedure was adopted and implemented on November 1, 2017. The Plan's Administrator is responsible to ensure continued compliance with regards to a change in the officers, directors, partners, controlling shareholders, principal creditors, or persons occupying similar positions or performing similar functions, of the plan and of a management company of the plan, and of a parent company of the plan or management company.

### 2. Amendments to Plan Application

**REQUIRED ACTION**

**The Plan is required to file an amendment with the Department to submit the amended Corporate Bylaws, Corporation Information Form, Organization Chart, Narrative Explanation of Organization Chart, and the ASAs with DPM and CMG.**

**The Plan is also required to state the policies and procedures implemented to ensure that amendments will be filed with the Department pursuant to Section 1352(a) and Rule 1300.52. In addition, the Plan is required to state the date these policies are implemented, and the management position(s) responsible for ensuring continued compliance.**

Response:

1. The plan has promulgated and implemented a revised policy and procedure (filed herewith) to ensure that changes to management are filed with Department pursuant to Section 1352(a), Rules 1300.52 and 1300.52.4 and Section 1367(h)(1). The policy and procedure was adopted and implemented on November 1, 2017. The Plan's Administrator is responsible to ensure continued compliance.

Please contact me with any questions or comments.

Respectfully,

Shawn Curtis, CFO
Choice Physicians Network