



Office of the Internal Auditor
HEALTH AND HUMAN SERVICES

Special Investigations

Cardinal Innovations Healthcare Solutions

**INTERIM INVESTIGATIVE REPORT AND
INTERIM FOLLOW-UP ASSESSMENT (OSA PER-2017-4445)**

October 2, 2017

Fieldwork Completed: August 10, 2017
Release Date: October 2, 2017
Case Number: 5017-03

EXECUTIVE SUMMARY

The Office of the Internal Auditor (OIA), Special Investigations Unit, performed this investigation at the request of Department of Health and Human Services' (DHHS) Secretary Mandy Cohen. This request included the following objectives:

1. Continue to investigate the findings and recommendations identified in the North Carolina Office of the State Auditor (OSA) performance audit report PER-2017-4445 of Cardinal Innovations Healthcare Solutions (Cardinal), related to State law, regarding Local Management Entity/Managed Care Organization (LME/MCO) functions.
2. Evaluate Cardinal's compliance with the contract and funding from the Division of Medical Assistance (DMA), and allocation letters and agreements with the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services (DMHDDSAS).

DHHS wishes to acknowledge the significant work of the Office of the State Auditor in conducting a performance audit of Cardinal Innovations Healthcare Solutions to evaluate whether Cardinal is 1) operating within its statutory mission, and 2) a good steward of State and Federal resources. DHHS takes very seriously the findings of the State Auditor. After receiving the report from the State Auditor, DHHS communicated with the Cardinal Board of Directors, and this Interim Investigative Report and Interim Follow-up Assessment is based on, and in follow-up to, the State Auditor's Performance Audit Report dated May 2017.

Based on investigative procedures performed, OIA determined the following items warrant the attention of the Cardinal Board of Directors and DHHS management:

1. The employment contract with Cardinal's CEO provides severance payments for a broad range of reasons, whereas the other three LME/MCOs with severance arrangements with their CEO limit the reasons to termination of employment without just cause.

Specifically, Cardinal's CEO is eligible for severance if:

- a. Cardinal ceases to be an independent entity;
 - b. an unaffiliated third party becomes responsible for the day-to-day operations of Cardinal;
 - c. a majority of the Board is replaced within a 12-month period without the endorsement of the Board; or
 - d. statutory or regulatory changes occur that materially alter Cardinal's services, revenues, governance, or employment practices.
2. The employment contract with Cardinal's CEO provides for severance payments to be made for up to 36 months but not less than 24 months, which is two to four times greater than the period of time provided in the employment contracts of any of the other three LME/MCOs with severance arrangements with their CEOs. The other three LME/MCOs with severance agreements with their

CEOs limit their severance periods to 12 months or less. (Three LME/MCOs do not have severance arrangements with their CEOs).

3. The employment contracts with Cardinal's six other executives and four key employees include severance provisions. No other LME/MCO has a severance arrangement with an employee other than their CEO.

Cardinal's employment contracts with its six other executives and four key employees require severance payments to be made for reasons other than their termination of employment, including:

- a. Cardinal ceasing to be an independent entity;
- b. an unaffiliated third party becomes responsible for the day-to-day operations of Cardinal;
- c. the termination or resignation of the CEO (if employee reports directly to the CEO); or
- d. statutory or regulatory changes that materially alter Cardinal's services, revenues, governance, or employment practices.

These employment contracts require severance payments to be made for a period of up to 36 months but not less than 24 months.

4. Cardinal's contracts requiring payment of severance to the CEO and 10 other employees for reasons other than termination of employment without cause, poses a substantial risk and may not be in the best interest of Cardinal, beneficiaries, and/or the State to the extent that they—
 - a. jeopardize the ongoing operations of Cardinal and potentially interrupt services to beneficiaries if the CEO is terminated or resigns and all or key members of the executive leadership or other employees with severance arrangements leave Cardinal;
 - b. increase the financial impact on Cardinal of terminating the employment of the CEO or due to the CEO's resignation;
 - c. insulate the CEO and employees from current or future legal changes in the organization and/or its operation despite it being a quasi-governmental entity; or
 - d. provide for excessive severance payments to be made.
5. The salary and bonus opportunities for Cardinal's CEO are more than three times higher than those of the CEOs at the State's six other LME/MCOs. Additionally, compensation for Cardinal's CEO is three times higher than the maximum allowable for the position established by the North Carolina Office of State Human Resources (OSHR).
6. Only three of the seven LME/MCOs pay bonuses to employees, and Cardinal's average bonus from FY 2016 is 156% to 311% higher than the other two LME/MCOs who pay bonuses.

Further, as described in more detail below, DHHS continues its investigation of Cardinal, and continues to seek responses from Cardinal's leadership and Board regarding a number of outstanding requests for information and action.

INTRODUCTION

Background

Within available resources, it is the obligation of the State and local government to provide mental health, developmental disability and substance abuse services through a delivery system designed to meet the needs of clients and to maximize their quality of life. State and local governments are tasked with developing and maintaining a unified system of services centered in area authorities. The furnishing of services to implement this obligation requires the cooperation and financial assistance of counties, the State and the Federal government.

DHHS is responsible for providing for the coordination of public mental health, developmental disability and substance abuse services between area authorities and State facilities. DHHS is also responsible for enforcing the provisions of North Carolina General Statutes, Chapter 122C, which is the Mental Health, Developmental Disabilities and Substance Abuse Act of 1985.

DHHS must monitor the fiscal and administrative practices of area authorities to ensure that the programs are accountable to the State for the management and use of Federal and State funds allocated for mental health, developmental disability, and substance abuse services. DHHS must ensure that the practices of area authorities are consistent with professionally accepted accounting and management principles.

Cardinal is an area authority, or Local Management Entity/Managed Care Organization (LME/MCO) created by North Carolina General Statute 122C. Cardinal is responsible for management and oversight of the public system of mental health, developmental disability, and substance abuse services at the community level in 20 counties across North Carolina. A primary function of an LME/MCO is the financial management and accountability for the use of State and local funds for the delivery of publicly funded services.

Cardinal is the largest of the State's seven LME/MCOs, serving more than 850,000 Medicaid-enrolled members and providing services to all residents across 20 counties. Cardinal contracts with DHHS's Division of Mental Health, Developmental Disabilities, and Substance Abuse Services (DMHDDSAS) to provide for the management and oversight of the public system of mental health, developmental disabilities, and substance abuse services at the community level. Cardinal contracts with DHHS's Division of Medical Assistance (DMA) to operate the managed behavioral healthcare services under the Medicaid waiver through a network of licensed practitioners and provider agencies. The contract between DMA and Cardinal requires Cardinal to "comply with all laws, ordinances, codes, rules, regulations and licensing requirements that are applicable to the conduct of its business, including those of Federal, State and local agencies having jurisdiction and/or authority." If Cardinal substantially fails to comply with the requirements of any applicable State or Federal law, statute, rule or regulation, and fails to take appropriate action to immediately correct the problem, DMA would have grounds to terminate the contract.

Cardinal's most significant funding is provided by DMA. Funding from Medicaid totaled \$567 million and \$587 million for State fiscal years 2015 and 2016, respectively. Cardinal also received funding from DMHDDSAS with payments of \$86 million and \$88 million for State fiscal years 2015 and 2016, respectively. Cardinal is governed by an area board consisting of 13 members, whose primary responsibilities include strategic planning, budgets, and hiring and evaluation of the CEO. Cardinal's

current CEO has been in position since July 1, 2015 and was Cardinal's Executive Vice President and General Counsel prior to holding this position.

Scope / Methodology

The scope of our investigation focused on the supporting documentation required to achieve the stated objectives. Our examination was conducted in accordance with standard investigative techniques, which include, but are not limited to, examination of books and records, voluntary interviews with appropriate personnel, and other such evidence-gathering procedures as necessary under the circumstances.

Investigators

Jeff Minor, Senior Audit Manager, DHHS Office of the Internal Auditor
Michelle Blackwelder, Senior Auditor, DHHS Office of the Internal Auditor

Subject Matter Experts

Christal Kelly, Associate Director of Provider Reimbursement, DMA
Alfred Greco, Financial Manager, DMA
Deb Goda, Behavioral Health Unit Manager, DMA
Renee Rader, Waiver Contract Manager, DMA
Dennis Farley, Team Lead for Financial Audit, DMH
Mabel McGlothen, Team Lead for LME/MCO Systems Performance, DMH

Procedures

As part of the examination, OIA and subject matter experts took the following actions:

- Examination of contracts/agreements between Cardinal and DHHS.
- Review of minutes of Cardinal Board Meetings
- Communication with the NC OSHR
- Interviews with the following individuals:
 - Chuck Hollowell, General Counsel, Cardinal
 - Steve Martin, Deputy General Counsel, Cardinal

INVESTIGATIVE RESULTS

- 1. The employment contract with Cardinal's CEO provides severance payments for a broad range of reasons, whereas the other three LME/MCOs with severance agreements with their CEO limit the reasons to termination of employment without just cause. Specifically, Cardinal's CEO is eligible for severance if Cardinal ceases to be an independent entity; an unaffiliated third party becomes responsible for the day-to-day operations of Cardinal; a majority of the Board is replaced within a 12-month period without the endorsement of the Board; or statutory or regulatory changes occur that materially alter Cardinal's services, revenues, governance, or employment practices.**

CEO's Severance Agreement

The employment contract for the current CEO is for the three-year period of July 1, 2016 through June 30, 2019. A severance clause is included in the agreement, in which the CEO would receive severance of varying length, depending on the circumstances of departure. The longest severance period was for a period of up to 36 months, if there was a change in control within Cardinal. The agreement included four scenarios which would satisfy the change of control provision:

1. The Company, pursuant to an agreement or by operation of law, in one or a series of related transactions, ceases to exist as an independent entity;
2. The entry of the Company into a contractual arrangement in which an unaffiliated third party effectively becomes the manager of the day-to-day operations of the Company;
3. A majority of the directors of the Board are replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the Board before the date of appointment or election; or
4. Any statutory or regulatory change that materially alters the Company's services, revenues, governance, or employment practices.

As noted in the table below, only four of the seven LME/MCOs have a severance arrangement with their CEO, and only Cardinal has such arrangements with other employees. The other LME/MCOs with severance arrangements limit severance payments to those situations in which the CEO's employment is terminated without cause, whereas Cardinal's arrangements include other reasons, i.e., Cardinal ceasing to be an independent entity, an unaffiliated third party becomes responsible for the day-to-day operations of Cardinal, a majority of the Board being replaced within 12 months without the endorsement of the Board (CEO only) or the termination or resignation of the CEO (if a direct report to the CEO), or statutory or regulatory changes that materially alter Cardinal's services, revenues, governance, or employment practices.

Severance Agreements by LME/MCO			
LME/MCO	Employees Eligible	Severance Length	Severance Terms
Alliance	CEO	6 months	Severance equal to six months of base compensation for termination without just cause, or if employee terminates for good reason (e.g. material reduction in annual base compensation; Alliance's failure to comply with a material term of employee contract). Health insurance coverage also provided for severance period.
Cardinal	CEO, all six other executives and four key employees	24-36 months	Severance equal to 24-36 months, if there is a change in control (e.g. For CEO: majority of Board replaced during any 12-month period by directors whose appointment/election is not endorsed by majority of Board; company ceases to exist as an independent entity; unaffiliated party effectively becomes manager of day-to-day operations of Company; any statutory or regulatory change that materially alters the Company's services, revenues, governance or employment practices); For other employees, all above apply, except board changeover; however, additional severance clause triggered for the seven employees who report to the CEO, if the CEO is terminated or resigns. Severance includes up to 18 months of COBRA health insurance coverage.
Eastpointe	CEO	12 months	Severance equal to one year of annual salary, and health insurance coverage, if Board elects to discontinue employment without just cause (e.g. reclassification of executive's title or duties resulting from a merger or other reorganization, unless post-merger title/duties is consistent with that of Executive Vice President, and total compensation is not reduced.)
Partners BH	N/A	N/A	N/A
Sandhills	N/A	N/A	N/A
Trillium	N/A	N/A	N/A
Vaya	CEO	0-12 months	Severance equal to one month for each full year of CEO's employment if terminated without just cause, 12-month maximum. Health insurance coverage also provided, up to the point of new coverage or expiration of severance period.

2. The employment contract with Cardinal’s CEO provides for severance payments to be made for up to 36 months but not less than 24 months, which is two to four times (or more) greater than the period of time provided in the employment contracts of any of the other three LME/MCOs with severance arrangements with their CEOs. The other three LME/MCOs with severance agreements with their CEOs limit their severance periods to 12 months or less. Three LME/MCOs do not have severance agreements with their CEOs.

As noted in the table above, only four of the seven LME/MCOs have a severance arrangement with their CEOs. Of the other three LME/MCOs with severance arrangements, the period during which severance payments are made after termination of the CEO's employment without cause ranges from one month to twelve months. The period during which Cardinal may pay severance ranges from 24 to 36 months. The other three LME/MCOs with severance agreements with their CEOs limit their severance periods to 12 months or less. Three LME/MCOs do not have severance arrangements with their CEOs.

3. The employment contracts with Cardinal’s six other executives and four key employees include severance provisions. No other LME/MCO has a severance arrangement with an employee other than their CEO.

Cardinal’s employment contracts with its six other executives and four key employees require severance payments to be made for reasons other than their termination of employment, including:

- a. Cardinal ceasing to be an independent entity;**
- b. an unaffiliated third party becomes responsible for the day-to-day operations of Cardinal;**

- c. the termination or resignation of the CEO (if employee reports directly to the CEO); or
- d. statutory or regulatory changes that materially alter Cardinal's services, revenues, governance, or employment practices.

These employment contracts require severance payments to be made for a period of up to 36 months but not less than 24 months.

As noted in the table on the previous page, only Cardinal has severance arrangements with other employees. The arrangements provide for severance to be paid for reasons other than the employee's termination of employment without just cause. The period during which Cardinal may pay severance ranges from 24 to 36 months.

On July 24, 2017, OIA interviewed Cardinal's General Counsel and Deputy General Counsel about the severance packages. Cardinal's General Counsel stated that the executive employment agreements were prepared by outside counsel, Nelson Mullins Riley & Scarborough, LLP. According to the General Counsel, the independent counsel has significant experience in labor and employment issues. According to Cardinal's Deputy General Counsel, the June 30, 2019 end date on the employment agreements was chosen because it was the day before the projected go-live date for the pre-paid health plan (PHP) contracts under the Medicaid Reform legislation passed in September 2015. The agreements were intended to retain executive and other key personnel at Cardinal through the critical deadline.

4. Cardinal's contracts requiring payment of severance to the CEO and 10 other employees for reasons other than termination of employment without cause poses a substantial risk and may not be in the best interest of Cardinal, beneficiaries, and/or the State to the extent that it –

- a. jeopardizes the ongoing operations of Cardinal and potentially interrupts services to beneficiaries if the CEO is terminated or resigns and all or key members of the executive leadership of other employees with severance arrangements leave Cardinal;
- b. increases the financial impact on Cardinal of terminating the employment of the CEO or the CEO's resignation;
- c. insulates the CEO and employees from current or future legal changes in the organization and/or its operation despite it being a quasi-governmental entity; or
- d. provides for excessive severance payments to be made.

To the extent that the severance arrangements with the six executives and four key employees permit the executive or employee to begin receiving severance benefits upon the termination or resignation of the CEO, it may create a conflict of interest by aligning these executives and employees' interests more closely with the CEO than the ongoing operation of Cardinal, and result in a potential interruption in its operations and ensuring that services are provided to beneficiaries. The potential financial and operational impact may influence the Board's decision making with regard to terminating the employment of the CEO or taking an action that may result in his resignation.

In addition to the unusually broad severance protections afforded to Cardinal’s CEO, other executives, and key employees, the length of Cardinal’s severance provisions, when combined with other severance provisions not offered at other LME/MCOs, could present significant financial and operational risks. For example, one contract term provides employees their “base salary for a period of 24 months, or for the remaining term of the agreement, whichever is longer.” Given this provision, Cardinal could be compelled to pay each of the seven employees who report directly to the Chief Executive Officer (CEO) 24 months of their base pay, if the CEO resigns the day before the contracts expire on June 30, 2019. If such an event were to occur, Cardinal would be obligated to pay more than \$3.5 million in severance to the seven employees who report to the CEO, for the 24 months of base pay beyond the employment contract period.

Finally, Cardinal is an LME/MCO created by North Carolina General Statute 122C. As a quasi-governmental entity, its services, revenues, governance, and employment practices are prescribed by statute. To the extent that Cardinal’s severance arrangements may insulate its CEO, executives, and key employees from changes to those statutes, they are inconsistent with public policy.

5. The salary and bonus opportunities for Cardinal’s CEO are more than three times higher than those of the CEOs at the State’s six other LME/MCOs. Additionally, compensation for Cardinal’s CEO is three times higher than the maximum allowable for the position established by the North Carolina Office of State Human Resources.

In FY2016, the base salary for Cardinal’s CEO was \$517,526, and when combined with his bonus of \$100,000, he received \$617,526 in total compensation that year. OIA obtained the CEO salary and bonus information from each of the other six LME/MCOs. That information is detailed below for all seven LME/MCOs:

Salary and Bonus of LME/MCO CEOs (FY16)			
LME / MCO	CEO Salary	CEO Bonus	Total
Alliance	\$177,500	-	\$177,500
Cardinal	\$517,526	\$100,000	\$617,526
Eastpointe	\$175,000	-	\$175,000
Partners BH	\$166,294	\$15,000	\$181,294
Sandhills	\$177,288	-	\$177,288
Trillium	\$190,272	-	\$190,272
Vaya	\$217,155	-	\$217,155

OIA also requested and received from OSHR the maximum salary range for the Area Director/CEO position for the LME/MCOs, which is reflected in the table below.

Area Director/CEO Salary Range		
Year	Minimum	Maximum
2015	\$107,843	\$190,612
2016	\$109,461	\$193,471
2017	\$110,461	\$194,471

Of the seven LME/MCOs operating in the State, two, Cardinal and Vaya, have exceeded the maximum of the range. While Vaya exceeded the maximum amount by \$23,684, Cardinal exceeded the maximum of the range for base salary by \$324,055 and by \$424,055 total by paying the CEO \$617,526 in FY 2016, which is more than three times the maximum of OSHR's allowable range of \$193,471.

Cardinal's response in OSA's May 2017 report stated that its Board of Directors complied with the statutory guidelines in setting its CEO's salary, and that "OSHR has not established any salary range for the LME/MCO Area Directors." Cardinal also said that it submitted its salary plan to OSHR each year, as required, and that OSHR's acceptance of its annual salary plan serves as acceptance of any salary adjustments made.

OIA sought guidance from OSHR regarding the salary established for Cardinal's CEO. On August 7, 2017, OSHR's Deputy Director, provided the following response:

"We (OSHR) can find no proof of Cardinal sending in a request, or supporting documentation, for a salary increase for the CEO per NCGS 122C-121. Cardinal has submitted an annual pay plan to this office. However, the pay plan should not be used to circumvent the requirements of NCGS 122C-121 as the pay plan does not contain the required information per NCGS 122C-121. Unless Cardinal had submitted a request and supporting documentation for a salary increase per NCGS 122C-121, we would not be reviewing for such. Absent any written approval from the State Human Resources Director, nothing has been approved."

OSHR also stated that it agreed with OSA's finding and recommendations regarding Cardinal's CEO pay issues in its May 2017 report. As a result of one of OSA's recommendations, OSHR's Deputy Director said OSHR has requested CEO salary rates and supporting documentation from all LME/MCO entities, and that all seven LME/MCOs had submitted CEO salary information. The Deputy Director also said that OSHR has adjusted the Area Director/CEO salary range to reflect the legislative increases awarded since 2010, plus a 5% salary exception, which will be communicated to the LME/MCOs. "Please note that even with the new adjusted salary range, the Cardinal CEO will still be above the maximum rate allowed. The State Human Resources Director has not approved any salary above the adjusted Area Director/CEO salary range maximum."

On August 10, 2017, OSHR sent a letter to Cardinal. The letter stated the new maximum of salary range of the Area Director/CEO position is \$194,471, although OSHR is willing to approve 5% above the new maximum of the range as an exception, which is \$204,195. The OSHR letter then states, "Based on the information you submitted, the salary of your Area Director/CEO is above this new rate and therefore, out of compliance. Please work to adjust the Area Director/CEO salary accordingly and notify us of how you have remedied this situation. In the future, please ensure that any salary adjustment complies with the provisions of G.S. 122C-121 – the Mental Health, Disabilities, and Substance Abuse Act of 1985." OSHR sent a similar letter to Vaya Health.

6. Only three of the seven LME/MCOs pay bonuses to employees, and Cardinal's average bonus is 156% and 311% higher than the other LME/MCOs who pay bonuses.

In its May 2017 report, OSA determined Cardinal paid about \$1.9 million in FY15 employee bonuses and \$2.4 million in FY16 employee bonuses. The average bonus per employee was about \$3,000 in FY15 and \$4,000 in FY16. The bonuses were coded to Cardinal’s administrative portion of Medicaid funding source in both years. OIA, with the assistance of DHHS subject matter experts, requested and received bonus information from each of the six other LME/MCOs, which OIA reviewed and is presented in the chart below.

Average Bonus of LME/MCO Employees (FY17)			
LME / MCO	Total Bonus to Employees	Number of Employees	Average Bonus
Alliance	N/A	527	N/A
Cardinal*	\$2,432,420	618	\$3,936
Eastpointe	N/A	315	N/A
Partners BHM	\$1,148,576	454	\$ 2,530
Sandhills	N/A	289	N/A
Trillium	N/A	417	N/A
VAYA	\$611,971	483	\$1,267

*Cardinal bonus information is from FY16.

Bonus information received from each of the LME/MCOs indicate only three of the seven LME/MCOs offer bonuses to employees, and of the three that did, Cardinal average bonus of \$3,936 per employee is three times higher than Vaya’s average employee bonus of \$1,267, and also exceeds the \$2,530 average bonus per employee at Partners Behavioral Health Management.

RECOMMENDATIONS

1. The Cardinal Board should carefully review its current severance arrangements with its CEO, other executives and key employees to ascertain whether it can sustain its operations and fulfill its statutory, regulatory and contractual obligations without adversely impacting services to beneficiaries, if these employees exercise the rights afforded to them.
2. The Cardinal Board and management should implement procedures and align its operations with other LME/MCOs and State laws to ensure its spending, including compensation and potential severance obligations, are appropriate for a local government entity. In particular, the Cardinal Board may offer severance benefits as an incentive for an Area Director/CEO to accept its offer of employment at its discretion in accordance with NCGS122C-121 (a2); however, the Cardinal Board should align the terms of its severance arrangements with the other LME/MCOs in the State.
3. In accordance with NCGS122C-121 (a1), the Cardinal Board and management should adjust its CEO’s salary to comply with allowable salary range established by OSHR.

MATTERS REQUIRING ADDITIONAL ACTION

DHHS continues to address a number of outstanding items.

First, Cardinal must provide information to DHHS on whether it has addressed, or plans to address, a number of items from Secretary Cohen's June 12 letter to the Board.

- a) **Issue:** Policy changes that will be enacted to address any excessive spending on Cardinal Innovations Healthcare board meetings and trainings.
Action Needed: Cardinal's Board of Directors' Governance Committee approved motion on 2/17/17 to recommend to full Board that FY 2018 Board meetings and trainings be held at Cardinal's corporate headquarters in Charlotte. During the 2/17 - 2/18/17 Board meeting, Cardinal's General Counsel, provided an update on the proposed Board of Directors Meeting Schedule for FY 2018 that included this location. However, the Board minutes reviewed do not include more specific details on spending on future board meetings and trainings, and Cardinal has not provided any documentation that supports actual changes to its policies and procedures. Cardinal must make appropriate changes and provide documentation.
- b) **Issue:** Personnel policy changes that will bring Cardinal Innovations Healthcare salary and compensation package in line with accepted public entity packages and current law.
Action Needed: On 5/30/17, OSHR sent a memo to all LME/MCOs requesting information on CEO salaries above \$187,354 and support for the ranges. Cardinal responded to the request with an Executive Market Compensation Survey by Willis Towers Watson requested back in 2016. On 8/10/17, NC OSHR sent a letter to Cardinal outlining a new maximum of \$194,471 for the CEO, effective immediately, with a 5% maximum exception of \$204,195 permitted. OSHR requested Cardinal adjust the CEO's salary to comply with this maximum. Cardinal has not responded to this letter nor addressed this matter. Cardinal must come into compliance with the OSHR guidance.
- c) **Issue:** Changes to travel policy that will bring Cardinal Innovations Healthcare in line with North Carolina Public Agency policies.
Action Needed: DHHS has informally learned that Cardinal's executive team internally decided to stop using charter flights as a travel practice and the last charter flight occurred November 2015. The Ad Hoc Committee of the Board concurred with this decision on June 13, 2017, although Cardinal has not provided any documentation that supports any actual changes to its policies or procedures regarding charter flights or aligning its travel policies with North Carolina Public Agency policies. Cardinal must make appropriate changes and provide documentation.
- d) **Issue:** Any disciplinary action taken by Cardinal's Board concerning CEO actions.
Action Needed: At the 6/23 - 6/24/17 meeting of the Cardinal Board of Directors, the Ad Hoc Committee of the Board discussed correspondence between Cardinal's Chairman of the Board of Directors and Secretary Cohen with the full Board. The Board agreed to respond with full board concurrence regarding Ad Hoc Committee's actions. Cardinal must provide additional information.

In addition, DHHS will continue to review Cardinal's response to the OSA report. Cardinal has not identified a specific corrective action plan related to the OSA findings. DMA and DMHDDSAS will request a corrective action plan from Cardinal for their review and approval and revise its allocation letters, contracts, and polices to specifically address OSA's findings.

Finally, DHHS intends to identify and review compensation packages in collaboration with OSHR for additional highly-compensated employees at Cardinal.

Cardinal's Response:

September 8, 2017

The Honorable Mandy Cohen, MD, MPH
Secretary
Department of Health and Human Services
State of North Carolina
2001 Mail Service Center
Raleigh, NC 27699-2001

Dear Secretary Cohen:

Thank you for the opportunity to review and comment on the draft interim report regarding the Department of Health and Human Services (DHHS) investigation of Cardinal Innovations Healthcare. We recognize that DHHS has raised important questions about our employment practices, and we agree that these questions need to be resolved.

In the report, DHHS raises several questions regarding Cardinal Innovations' employment practices, and compares Cardinal's practices to those of the other six LME/MCOs. In contrast to the other LME/MCOs, Cardinal received approval from the state to leave the state personnel system more than 20 years ago. As a result, Cardinal's employees are not part of the state pay scale, do not receive state benefits, and are not part of the state retirement program. We adopted market-based employment practices to attract and retain well-qualified staff so that we can continue to deliver high-quality outcomes for members and maintain their service continuity while the State completes its efforts to reform the Medicaid program.

Despite this important distinction, we look forward to working through the appropriate channels to resolve these issues.

Sincerely,



Lucy U. Drake, Chairman
Board of Directors

cc: Richard Topping, CEO, Cardinal Innovations Healthcare
Mark Payne, Interim Audit Director, NCDHHS



OIA's Response

The Office of the Internal Auditor (OIA), Special Investigations Unit, of the Department of Health and Human Services (DHHS) provides this additional explanation in light of Cardinal Innovations Healthcare Solutions' (Cardinal) response dated September 8, 2017 to OIA's Interim Investigative Report and Interim Follow-up Assessment (OSA PER-2017-4445). While we appreciate that Cardinal agrees that DHHS OIA's Report has raised important questions about Cardinal's employment practices, the response does not describe planned corrective actions.

Cardinal's response states, in relevant part, "[i]n contrast to the other LME/MCOs, Cardinal received approval from the state to leave the state personnel system more than 20 years ago. As a result, Cardinal's employees are not part of the state pay scale, do not receive state benefits, and are not part of the state retirement program."

OIA sought additional guidance from the Office of State Human Resources (OSHR) regarding Cardinal's response. Per OSHR, Cardinal's response is in reference to G.S. 126-11(a1) that provides for the State Human Resources Commission to approve "substantial equivalency" of a personnel system for all employees of the area mental health authority, established by it with approval of each of the boards of commissioners of the counties which comprise it, making its personnel system exempt from aspects of the state personnel system. OSHR noted that six of seven LME/MCOs in North Carolina have received approval for "substantial equivalency" in Recruitment, Selection, and Advancement (25 NCAC 01I.2401) and Classification/ Compensation (25 NCAC 01I.2402), in accordance with G.S. 126-11(a1). As such, it does not appear that Cardinal stands "in contrast" to other LME/MCOs in its exemptions from the state personnel system.

Although Cardinal (as Piedmont Behavioral Health) may have received approval as a "substantially equivalent" area mental health authority in 1993, and a review may have been undertaken in 2003 and 2008 by OSHR, it does not appear that Cardinal has complied with 25 NCAC 01I.2408, which outlines the criteria required for ongoing expectations to maintain the "substantially equivalent" designation. This criteria states, in part:

Ongoing Expectations:

In order that the Office of State Human Resources shall have access to the information and materials necessary to an informed judgment of whether an exempted, local personnel system remains substantially equivalent, local jurisdictions desiring to maintain exempted systems shall comply with the following requirements:

- (1) Recertification. Recertification of the commitment by a Board of County Commissioners of authority to maintain a system or portion of a system of personnel administration in accordance with the Basic Requirements for a Substantially Equivalent Personnel System may be necessary, at the discretion of the State Human Resources Commission, in the following instances:
 - (a) Upon significant change in the membership of the Board of Commissioners or Area Authority.
 - (b) Upon passage of significant new legislation or policy which will apply to the local system or system portion.

(c) Upon major reorganization, restructuring, or downsizing of the personnel system of the county or Area Authority.

(3) Filing of System Documentation. Each jurisdiction which has been granted a substantially equivalent personnel system exemption by the State Human Resources Commission shall annually, or upon substantial interim change, file with the Office of State Human Resources:

(a) All personnel policies currently pertaining to exempt portions of the local system, which have been adopted by the Board of County Commissioners, County Manager, Area Authority, or Area Director.

(b) Documentation which in material and substance fully illustrates the design, method, and process currently being employed in the administration of exempted portions of the local personnel system. If there has been no substantial change in personnel policies or technical method within an annual period, the County Manager or Personnel Director shall so certify in a letter to the Local Government Coordinator, Substantially Equivalent Systems, Office of State Human Resources.

(c) Jurisdictions with exempted systems shall cooperatively respond to related requests by the Office of State Human Resources for additional information which is deemed essential to a complete and accurate understanding of the design and process of a local system.

More specifically, Piedmont Behavioral Health became Cardinal Innovations Healthcare Solutions effective July 1, 2012. As stated in Cardinal's 2011-2012 annual report, "On July 1, 2012, we [Cardinal] transitioned from five to 15 counties. The PBH name was retired, and we left behind a Board that has served us well for the past 37 years." OSHR has no record of receiving the requisite recertification from Cardinal. See, Recommendation 3 in OIA's Report.

Cardinal's response additionally states, in relevant part, "We adopted market-based employment practices to attract and retain well-qualified staff..."

Per OSHR, the staff compensation must be in compliance with 25 NCAC 01I.2401 and 25 NCAC 01I.2402, in accordance with G.S. 126-11(a1). An entity is exempt from state rules relevant to approved personnel system portions "for all employees of the area mental health authority. . ." when any entity is approved for as "substantially equivalent" per G.S. 126-11(a1). Cardinal's contracts requiring payment of severance to ten other employees (in addition to the CEO) appears to be contrary to this statute and OSHR's approval of Cardinal's personnel system as a "substantially equivalent" mental health authority in that this arrangement was not provided to all employees. See, Recommendation 3 in OIA's Report.

Although Cardinal's CEO salary is not subject to "substantial equivalency" requirements of G.S. 126-11(a1), it is governed by G.S. 122C-121. G.S. 122C-121(a1) states, in relevant part -

(a1) The area board shall establish the area director's salary under Article 3 of Chapter 126 of the General Statutes. Notwithstanding G.S. 126-9(b), an area director may be paid a salary that is in excess of the salary ranges established by the State Human Resources Commission. **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. 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]

As noted in OIA's Report, the salary and bonus opportunities for Cardinal's CEO are more than three times higher than the maximum allowable for the position established by OSHR and more than three times higher than those of the CEOs in the State's six other LME/MCOs. In light of the fact that the Cardinal CEO is paid a salary that is in excess of the salary ranges established by OSHR, and no evidence has been provided that the Director of OSHR gave prior approval to Cardinal CEO's salary range, the reported comparable salaries in comparable operations (i.e., LME/MCOs) is relevant and supports Recommendation 3 that Cardinal's Board should adjust its CEO's salary to comply with allocable salary ranges established by OSHR.

And, although G.S. 122C-121(a2) permits the Cardinal Board to, in its discretion, offer severance benefits to an applicant for the position of director as an incentive for the applicant to accept an offer of employment, the comparable severance benefits offered by comparable operations (i.e., other LME/MCOs) is relevant and supports Recommendation 3.

Finally, Cardinal's response notes that its employees do not receive state benefits and are not part of the state retirement program. In point of fact, other LME/MCO employees have local or "substantially equivalent" benefits and are not part of the Teachers and State Employees Retirement System.