REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

STATUS OF THE MEDI-CAL PROCUREMENT PROJECT AND REVIEW OF ITS DRAFT REQUEST FOR PROPOSAL

P-228.3

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REPORT BY THE

OFFICE OF THE AUDITOR GENERAL

TO THE

JOINT LEGISLATIVE AUDIT COMMITTEE

228.3

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FEBRUARY 1983

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228.3

Honorable Art Agnos
Chairman, and Members of the
Joint Legislative Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General respectfully submits its report concerning our monitoring of the efforts of the Medi-Cal Procurement Project (MCPP). Specifically, the report details the status of the procurement of Medi-Cal fiscal intermediary services. In addition, the auditors express concerns regarding deficiencies in the MCPP's draft Request for Proposal.

Respectfully submitted,

THOMAS W. HAYES
Auditor General

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SUMMARY

This is the fourth Auditor General report addressing issues pertaining to efforts of the Health and Welfare Agency's Medi-Cal Procurement Project (MCPP) to select the next Medi-Cal fiscal intermediary. Our work is intended to help ensure that problems experienced under the current contract are not repeated in the new contract. During the course of our monitoring, we have expressed our concerns on various issues both verbally and in written form to the MCPP. This report updates the status of the Medi-Cal Procurement Project and cites our principal concerns with the draft Request for Proposal (RFP).

The Status of the Project

The Medi-Cal Procurement Project continues to remain on schedule. MCPP management has established the following major milestones for the project: (1) release of the final Request for Proposal on March 1, 1983; (2) contract award on September 1, 1983; (3) processing of all new claims by the next contractor on October 1, 1984; and (4) earliest phase-out of the current contractor on January 1, 1985. These milestones assume that the current fiscal intermediary contract will be extended for at least 10 months, although the MCPP management has been unable to determine the exact length of the required extension.

The MCPP Director has stated that the documentation of the present claims-processing system, a problem we addressed in earlier reports, is adequate for review by bidders. Bidders

must be able to review the system documentation to understand how the system operates, and inadequate documentation might result in protests by bidders alleging their inability to compete fairly. Protests may result in delays in procuring the next fiscal intermediary. Members of the Fiscal Intermediary Management Division are working with the Computer Sciences Corporation (CSC), the current fiscal intermediary, to correct deficiencies in the documentation. The final report on the adequacy of the system documentation, by the Compass Consulting Group, Inc., and Peat, Marwick, Mitchell & Co., the State's fiscal intermediary monitoring consultants, has been delayed several times and is expected in January 1983.

Reform legislation enacted in 1982 authorized a number of changes in the Medi-Cal program. Our monitoring indicates that major legislative changes are being included either in the present contract or in the new RFP. Additionally, the draft RFP also contains background on the Medi-Cal program, a summary of major legislative changes, and an explanation of the reduction in the number of claims to be processed by the contractor resulting from these changes. However, in discussions with the special hospital negotiator, we were informed that while his activities may result in program savings, there will be no appreciable immediate reduction in the volume of claims processed.

The Draft Request for Proposal

During our monitoring assignment we have continually briefed MCPP management on the improvements needed in the new RFP if the State is to avoid the problems that exist under the present contract. Although the MCPP has made numerous changes

to the RFP's drafts in response to our recommendations, we remain concerned with two areas of the draft RFP: quality control provisions and payment for the contractor's operations.

The quality control provisions in the draft RFP appear deficient. The draft RFP does not have clearly identifiable performance standards, nor does it set accuracy standards for significant areas of contractor performance, including claims processing. It also does not provide for an independent monitoring system to measure the contractor's performance against established standards. Furthermore, the provisions for assessing damages for failure to comply with the contract may be difficult to enforce. If these conditions are not corrected, problems with the current contract may be repeated in the next contract.

The provision for paying the contractor for operations in the draft RFP should be more specific. Under the proposed RFP the State would pay for operations only when the contractor meets contractual requirements. However, the draft RFP does not specify certain requirements, nor does it adequately describe damages to be assessed if the contractor fails to meet these requirements. Because the language is subject to conflicting interpretations, these provisions may be difficult to enforce.

INTRODUCTION

Since May 1982, we have been monitoring the Health and Welfare Agency's (agency) project to select the next Medi-Cal fiscal intermediary. Our most recent monitoring activity has involved evaluating the agency's draft Request For Proposal (RFP). The RFP is a document that describes the requirements of the fiscal intermediary system, terms and conditions of the contract, and technical information requested from the bidder. This document is distributed to potential bidders and becomes part of the final contract with the contractor.

This report, our fourth, discusses the status of the agency's efforts to resolve issues we discussed in our previous monitoring reports, and it expresses our principal concerns with the draft RFP. The Supplemental Report of the 1982 Budget Act contains provisions intended to ensure that problems with the current fiscal intermediary contract are not repeated under the new contract. In this report we specifically address the draft RFP's provisions for quality control and for paying the contractor.

Medi-Cal is California's version of the federal Medicaid program. The program, which is administered by the State Department of Health Services (department), provides medical assistance to the State's poor and needy. Medi-Cal's annual expenditures of approximately $5 billion place it among the State's largest programs. Under Medi-Cal's fee-for-service payment system, medical providers, such as physicians and hospitals who render services to eligible recipients, submit claims for the services rendered to a nongovernmental fiscal intermediary under contract to the State. The fiscal intermediary processes the claims and sends them to the State for payment. The Medi-Cal payment system is predominantly a fee-for-service, or retrospective payment system. However, recent reform legislation emphasizes a prospective payment system. Under the prospective payment system, the State could contract with organizations such as insurance companies and provider groups to provide medical services at a predetermined amount for each person who is a program beneficiary. Prospective contracts place the contractor "at risk" in that the contractor assumes liability for costs exceeding the contracted amount.

The first fiscal intermediary contract was awarded to Medi-Cal Intermediary Operations on a no profit/no loss basis; that is, the State reimbursed Medi-Cal Intermediary Operations for the costs it incurred. With the Legislature's concurrence,

the State Department of Health Services decided in 1976 to seek competitive bids for a new fiscal intermediary system. This effort resulted in the State's awarding the current contract to the Computer Sciences Corporation (CSC) for an estimated $129.6 million.* This contract became effective September 1, 1978, and is scheduled to terminate on February 29, 1984. The contract also provides for up to a one-year extension at the State's option.

The new fiscal intermediary system was intended to increase the financial responsibility of the contractor and to establish a more efficient and effective claims-processing system. Additionally, the new fiscal intermediary system was intended to strengthen the State's management of the Medi-Cal program and to ensure that the State had the option of operating the claims-processing system itself. While the current contract has met some of the State's objectives, achieving these objectives has caused considerable difficulties for the State, the CSC, and the providers of Medi-Cal services.

* This figure is based on anticipated claim volumes and is thus an approximation. It excludes certain items, such as postage, for which the contractor is reimbursed. Additionally, it does not reflect the cost of certain changes made to the claims-processing system.

In order to select the next fiscal intermediary, the State established a task force to develop the request for proposal. An interagency agreement, effective October 1, 1981, shifted responsibility for the procurement effort from the Director of the State Department of Health Services to the Secretary of the Health and Welfare Agency. The agreement also provided for staffing and funding for the Medi-Cal Procurement Project (MCPP) within the agency and for a management consulting contract. The MCPP is responsible for drafting the new Request For Proposal, evaluating contract proposals, and phasing in the next contractor. The management consulting contract provides the State with a study of procurement issues in order to avoid repeating the problems associated with the present contract.

In November 1981, the State awarded the consulting contract to the Compass Consulting Group, Inc., which in May 1982 released a final report entitled "Medi-Cal Fiscal Intermediary Reprocurement Study." This study included an analysis of contract methodologies, competitive bidding approaches, and contractual performance issues. The study also provided a scheduled list of tasks required for the transition to the next fiscal intermediary.

The Compass Consulting Group and its subcontractor, Peat, Marwick, Mitchell & Co., also were awarded an $832,770 contract by the State Department of Health Services for monitoring the fiscal intermediary's operations. The contract, authorized by Assembly Bill (AB) 737 (Chapter 1039, Statutes of 1981), requires the consultants to perform numerous tasks including reviewing for adequacy the fiscal intermediary's systems documentation. "Systems documentation" is the material containing programming, system, and logic information necessary to process Medi-Cal claims. The consultants are also required to do the following: evaluate the accuracy with which the fiscal intermediary processes claims; develop, implement, and operate a monitoring and control system (which includes a detailed fiscal intermediary management work plan with job descriptions and staff levels); and evaluate the department's federally-required Medi-Cal Quality Control program. AB 737 also gives the department director the authority to enter into a subsequent fiscal intermediary monitoring contract upon expiration of the initial contract.

To assist the MCPP staff in procuring the services of the next contractor, the director of the MCPP established a Policy Advisory Committee consisting of representatives from state agencies and other public organizations. This committee met bi-weekly from the end of May through August in 1982 and once in the following December to discuss issues presented by

the MCPP staff and to provide policy direction to the MCPP management. The MCPP director and the Deputy Director of the State Department of Health Services' Fiscal Intermediary Management Division made policy decisions after considering the comments of the Policy Advisory Committee and the recommendations made by the MCPP staff.

In October 1982, the MCPP released the Summary Preview Request for Proposal, which contained both conceptual issues and specific contract provisions. As part of a multi-step evaluation process, the MCPP distributed this document for comment to potential bidders, state control agencies, the Federal Health Care Financing Administration, provider associations, certain legislative committees, and other interested groups. The MCPP considered suggestions from these groups in preparing the draft RFP. On December 22, 1982, the MCPP distributed the draft RFP to the same groups. Comments on the draft RFP were due back to the MCPP by January 14, 1983.

As mentioned earlier, this is the fourth Auditor General report addressing the Health and Welfare Agency's fiscal intermediary procurement project. Our first report, Management Letter 228.1, was addressed to the project director in June 1982; it identified several areas in which the Medi-Cal Procurement Project staff needed to complete additional work

before determining whether a 12-month extension of the current contract is necessary. The second report, Letter Report 228.4, released in October of 1982, provided data on expenditures for the operations of the current fiscal intermediary and on lost federal financial participation payments. Our third report, P-228.2, also issued in October of 1982, discussed the overall status of the procurement project and the extent to which the agency had implemented our recommendations concerning an extension of the current fiscal intermediary contract. That report also provided a synopsis of the major policy decisions made by project management.

SCOPE AND METHODOLOGY

During the course of our monitoring of the Medi-Cal Procurement Project, we have expressed our concerns to the MCPP's officials on various issues. However, our role as an independent oversight agency precludes either our participating in actual decision-making or our approving the adequacy of the MCPP's work. From an auditing perspective, such approval can only be gained through formal auditing procedures conducted according to established governmental auditing standards. These standards state that positive assurance can be provided only when audited items have been found to be in compliance

with applicable laws and regulations. Such assurances can be given only upon completion of a formal, after-the-fact audit review rather than through monitoring.

During the phases of our monitoring process culminating in this report, we reviewed the contract with the existing fiscal intermediary to determine the State's current contractual requirements. We also examined state and federal laws and regulations to determine the requirements of the Medi-Cal program, and we met with officials of the Federal Health Care Financing Administration and the State Department of Health Services' Fiscal Intermediary Management Division.

In order to identify weaknesses in the current contract and to determine the advisability of implementing various options in the new contract, we examined the procurement study prepared by the Compass Consulting Group, Inc. We also interviewed staff from the Department of General Services, the State Department of Health Services' Office of Legal Services, the Attorney General's office, and selected legislative committees. Additionally, we reviewed new legislation that affects the Medi-Cal program, other states' requests for proposals, responses from members of the provider community, and comments on the Summary Preview Request for Proposal from various other groups.

To monitor the development of policy decisions, we attended MCPP Policy Advisory Committee meetings and reviewed MCPP memoranda dealing with various issues of the procurement project. We also met with members of the MCPP to determine the status of the project and the work completed. We reviewed both the Summary Preview RFP and the draft RFP, and we reported our concerns to the MCPP verbally and in written form.

In the first section that follows, we discuss the status of the procurement project and update the status of issues we discussed in our previous monitoring reports. In the second section we present our principal concerns about major contract issues that the RFP does not adequately address.

We have also included two appendices. Appendix A, a summary of prior Auditor General reports, is intended to provide a brief background on previously identified problems related to fiscal intermediary operations. Appendix B presents a synopsis of major policy decisions made since the release of the previous Auditor General status report in October of 1982.

ANALYSIS

I

STATUS OF THE PROCUREMENT PROJECT

The Medi-Cal Procurement Project (MCPP) is proceeding according to its established schedule, a schedule that incorporates a 10-month extension of the current fiscal intermediary contract. MCPP management assumes this extension will be necessary to complete the transition from the current fiscal intermediary to the next. In an earlier report, we pointed out that the State Department of Health Services had contracted with a group of consultants to determine the condition and adequacy of the system documentation. The consultants' final report has been delayed, and as of January 14, 1983, it had not yet been released. Potential bidders began reviewing this documentation in January 1983, and if this documentation is found to be subtantially inadequate, delays in the procurement project could occur. Finally, the Legislature's 1981-1982 session enacted several major Medi-Cal reform bills. These bills are being incorporated into the present contract or into the Request for Proposal. It is possible that this legislation, as well as future changes in policy, could reduce the volume of Medi-Cal claims that are processed.

Procurement Project Schedule

As of October 1982, the MCPP management had established the following major milestones for the project: (1) release of the final Request for Proposal on March 1, 1983; (2) contract award on September 1, 1983; (3) processing of all new claims by the next contractor on October 1, 1984; and (4) earliest phase-out of the current contractor on January 1, 1985. These milestones assume that the current fiscal intermediary contract will be extended for at least 10 months.

In order to meet the March 1, 1983, release date for the final Request for Proposal, the MCPP distributed two preliminary versions of this document for comment to potential bidders, state control agencies, the Health Care Financing Administration, provider associations, legislative committees, and other interested groups. The first version of the RFP, the Summary Preview Request for Proposal, was released on schedule on October 12, 1982. The second version, the Draft Request for Proposal, was released ahead of schedule on December 22, 1982. The final Request for Proposal is still scheduled for release on March 1, 1983.

Decision to Extend
the Present Contract

In our previous reports 228.1 and 228.2, we discussed the MCPP's decision to recommend an extension of the current contract. In October 1982, we reported that the MCPP's schedule indicated that a contract extension of at least 10 months, plus a two-month contingency period, was necessary. Although the contingency period has been omitted, MCPP management has still not determined the actual amount of time needed to phase out the operations of the current contractor. Therefore, although MCPP management can determine when the next contractor will begin to process claims, management stated that the time required to phase out the operations of the current contractor, the Computer Sciences Corporation (CSC), could take longer than 10 months.

During the transition phase, claims processing will be conducted concurrently by the current contractor and the next contractor. According to MCPP management, the next fiscal intermediary will begin processing its first group of claims received after July 5, 1984, and will begin processing its second group of claims received after October 1, 1984. The CSC will transfer any remaining claims to the next fiscal intermediary on December 1, 1984. However, MCPP management

stated that the CSC will continue to process any residual inventory and conduct other closeout activity until at least January 1, 1985, which is 10 months into the extension period.

Documentation of the Present Fiscal Intermediary System

In reports 228.1 and 228.2, we discussed the significance of system documentation to the procurement process. Basically, "system documentation" is the material containing programming, system, and logic information necessary to process Medi-Cal claims. Prospective bidders review the system documentation to understand how the fiscal intermediary system operates. If the system documentation does not adequately represent the system, a bidder might file a protest alleging that inadequate system documentation prevented fair and equitable competition for the contract. Should this happen, delays in the procurement may occur.

At the time of our review of the procurement project in June 1982, the State knew neither the condition of the system documentation nor whether it was adequate for review by bidders. To determine the condition of the system documentation and to identify any deficiencies, the State Department of Health Services contracted with the Compass Consulting Group, Inc., and Peat, Marwick, Mitchell & Co.

Our ensuing Management Letter 228.1 (June 11, 1982) recommended that the MCPP ask the State Department of Health Services to develop a plan for the prompt correction of any deficiencies found during the consultants' review of system documentation. The consultants' final report on the condition of the system documentation was scheduled for release on December 1, 1982. However, funding for this consulting contract was delayed by the Governor's hiring freeze that was in effect at the time. After an exemption to the freeze was approved, a second delay occurred during the approval process at the Department of General Services. In response to these delays, the consultants prepared a revised workplan, scheduling the final report of their findings on December 17, 1982.

The State Department of Health Services received a draft of the report on December 22, 1982, but as of January 14, 1983, the final report had not yet been released. The Chief of the System Monitoring Section of the department's Fiscal Intermediary Management Division, which reviews and evaluates the performance of the contractor, stated that the report was delayed in part because the State asked the consultants to review supplemental documentation.

Additionally, he stated that although no formal plan has been developed, members of the Fiscal Intermediary Management Division have been working with the CSC to correct

deficiencies in the system documentation. While the consultants' draft report addressed various weaknesses in the system documentation, the MCPP director stated that the system documentation is adequate for review by bidders. Potential bidders began reviewing the system documentation in January 1983 after the draft Request for Proposal was released.

Effect of Medi-Cal Reform Legislation

The Legislature enacted a significant amount of Medi-Cal reform legislation during the 1981-82 session. This legislation includes Assembly Bill (AB) 799, (Chapter 328, Statutes of 1982) and Senate Bill (SB) 2012, (Chapter 1594, Statutes of 1982); these bills have affected Medi-Cal benefits, restricted recipient eligibility, and have produced other program changes such as authorizing a special negotiator to negotiate prospective contracts with hospitals and other groups. Other bills have added and deleted certain Medi-Cal services that can be reimbursed, changed policy to better utilize Medi-Cal resources, and created demonstration and pilot programs for the delivery of Medi-Cal services.

In Report 228.2 (October 15, 1982), we said that potential bidders should be made aware of the nature and diversity of the legislative changes and reforms. In addition, changes made to the Medi-Cal program by recent legislation

should also be fully represented in the RFP. Our monitoring indicates that the MCPP has included the major legislative changes either in the present contract as change orders or in the new RFP. Furthermore, the draft RFP section detailing the background of the Medi-Cal program includes a summary of major legislative changes and explains that these changes will result in a reduction in the number of claims to be processed by the contractor.

However, the special negotiator, established by AB 799 (Chapter 328, Statutes of 1982), has recently negotiated several prospective contracts with hospitals to provide Medi-Cal services. The negotiator stated that although the new contracts contain different payment provisions that will result in program savings, the hospitals will still have to submit claims for review by the fiscal intermediary in order to satisfy federal and state reporting requirements. Therefore, the actual volume of claims related to these contracts will not be reduced. The negotiator noted that any shift from the fee-for-service program to other prospective contracts will also have to satisfy the same reporting requirements. Most likely, reductions in the volume of claims will result only as changes in recipients' eligibility occur or as reporting requirements are modified.

The negotiator also stated that major policy changes could take place in the next few years that will substantially reduce the volume of Medi-Cal claims. The negotiator said it is therefore logical to include in the RFP a shorter term for the contract than the presently proposed term of five years plus a one-year extension. We have accordingly presented the negotiator's observations on shortening the term of the contract to the MCPP management. MCPP management has agreed to consider this recommendation.

II

REVIEW OF THE DRAFT REQUEST FOR PROPOSAL

During the course of our monitoring assignment, we have continually briefed MCPP management on improvements needed in the new RFP if problems that exist under the present contract are to be avoided. The MCPP has made numerous changes to drafts of the RFP which address our concerns. This section discusses our two principal concerns which remain unaddressed by the MCPP in its draft RFP: quality control provisions and operations payments. In addition to having shared these concerns with the MCPP, we have provided the MCPP's director with a page-by-page analysis recommending other, less significant, corrections to the draft RFP.

Quality Control Provisions

The quality control provisions of the draft RFP are deficient. The draft RFP does not have clearly identifiable performance standards, nor does it set accuracy standards for important areas of contractor performance including the processing of Medi-Cal claims. In addition, the draft RFP does not provide for an independent monitoring system to measure the contractor's performance against predetermined standards.

Finally, the provisions for assessing damages against the contractor may be difficult to enforce. If these conditions are not corrected, problems encountered with the current contract, including overpayments and difficulties in enforcing contractor compliance, may continue under the new contract.

In letting a contract for a complex system, the contracting entity needs a quality control program to ensure that what is produced by the contractor's system is consistent with the desired results. An effective quality control program has three components: standards for performance, measurement techniques to monitor performance independently, and a means of assessing damages if the contractor's performance does not meet the desired results.

Standards used to evaluate a contractor's performance should be sufficiently comprehensive to cover all key products of the contractor's system. Among the more important criteria are these: standards should be as simple and precise as possible in order to avoid conflicting interpretations; and they should be readily identifiable within the contract.

In addition, the standards should be "outcome standards" rather than "process standards." Process standards define the responsibilities that the contractor must meet, while outcome standards define and quantify the expected

products of the contractor's efforts. Outcome standards are clearly relevant to the objectives of the contract, and they are specific, simple, and measurable. Techniques used to measure the system's products against the established standards must provide accurate, timely information.

An example of a process standard would be the following: "The contractor shall be responsible for processing claims accurately." In this statement, there is no definition of "accurately" and therefore the concept of accuracy is susceptible to differing interpretations. An output standard for this concept would be: "The contractor shall process claims with an accuracy rate of at least 95 percent." In this statement the term "accuracy" is simple, precise, and measurable.

Furthermore, to ensure the reliability of the results, there must be a monitoring entity that is independent of the contractor and that has access to the contractor's system. Unless the monitoring entity is outside of the contractor's control, there is no assurance of an objective assessment of the system's performance.

Finally, the last element of an effective quality control program is the means for assessing damages when the products of the contractor's system do not meet the established

standards. Without this element, there is no incentive for the contractor to take corrective action. Withholding payment due to the contractor and assessing liquidated damages against the contractor are common ways of assessing damages. Liquidated damages are pre-established rates of compensation for damage when actual damages are difficult or impossible to assess.

Using the above principles as our criteria, we evaluated the quality control provisions of the draft RFP and found them to be deficient. In the following pages we discuss those deficiencies.

Standards for Contractor Performance

The draft RFP does not have a distinct section that includes all necessary outcome standards. Instead, contractor requirements, which include process as well as outcome standards, are spread throughout the draft RFP under such headings as "Deliverables," or "Responsibilities." The draft RFP defines "requirement" as "any service, deliverable, or other duty which the contractor is required to provide or perform under the contract."

In our November 17, 1982, letter to the MCPP director, we requested that the RFP include language that clearly identifies outcome standards. The MCPP management

claims that if the RFP clearly identifies outcome standards and links damage assessments to these standards, the State would be unable to assess damages for the contractor's failure to fulfill requirements that are not included in the outcome standards.

Under the present contract with the Computer Sciences Corporation, contractor performance has not been sufficiently defined or controlled because the standards defining contractor performance are vague. Our Report P-021 found that because of lack of clarity in the contract, the Computer Sciences Corporation and the State have had differing interpretations of standards. In addition, the many clauses identified as performance standards in the current contract, combined with the absence of related quantifiable measures, provide few effective controls over the contractor.

The Medi-Cal Procurement Project has attempted to draft an RFP to remedy the problems of the current contract. However, because the draft RFP does not contain provisions for measuring the contractor's performance by clearly identifiable outcome standards that are specifically related to provisions for assessing damages, we believe the draft RFP does not increase the State's control over the contractor.

As an illustration of a standard lacking simplicity, precision, and measurability, the draft RFP states that "Every report due the State will contain sufficient and accurate information to fulfill the State's purpose for which the report was generated."

The report by the Compass Consulting Group, Inc., states that, to the maximum extent possible, standards should be of the outcome type and should be clearly identified in the next RFP. According to the report, having outcome standards clearly identified "should not only facilitate contract management...it should also simplify for bidders the process of preparation of technical proposals and bids."

Although the draft RFP does contain some outcome standards and related damages pertaining to timeliness, it does not contain outcome standards pertaining to accuracy. Standards of performance must be comprehensive--that is, including both timeliness and accuracy--so that timeliness standards are not met at the expense of accuracy standards. According to the Compass Consulting Group, if standards are not comprehensive, the contractor's incentive is to perform tasks quickly but not necessarily accurately.

Standards and related damages to ensure that claims are processed accurately are especially important. In a limited review of the fiscal intermediary's performance under the current contract, which also does not contain standards and related damages pertaining to accuracy in processing claims, the Auditor General identified between $12.6 million and $25.3 million in overpayments.*

Since this is a most important area of the contractor's performance, we requested, in our November 17, 1982 letter to the MCPP's director, that the Medi-Cal Procurement Project establish standards for accuracy in processing claims. The State Department of Health Services states that it cannot set standards for accuracy in processing claims until errors, and processes to measure them, have been defined and reasonable error rates have been determined. The Fiscal Intermediary Management Division does not anticipate having this information until after the next fiscal intermediary contract terminates in 1988.

* Report P-044, September 1981.

Measuring Contractor Performance

The draft RFP does not appear consistent with the principle of independent monitoring necessary for an effective quality control program. We base our conclusion on two observations we made in reviewing the draft RFP section entitled, "Quality Control Responsibilities." First, the draft RFP does not include a discernible plan for independently measuring the contractor's performance. Second, it gives the contractor quality control responsibilities that are rightly the province of the State.

The draft RFP does not include a discernible plan by which the Fiscal Intermediary Management Division can independently measure the contractor's performance.* Although the draft RFP does make a general statement that the State will monitor the contractor's efforts, the draft RFP does not describe a specific monitoring methodology, what will be measured, or the frequency of the measurement.

* The State Department of Health Services' Medi-Cal Quality Control (MCQC) program performs an independent review of the accuracy with which the contractor processes claims. However, the MCQC program is of limited value in measuring performance because it only reviews claims that are eligible for federal funds. Furthermore, it does not review claims for duplicate payments or service limitations. The MCQC also does not review denied claims. The Compass Consulting Group is helping the department to upgrade the MCQC function as one of its responsibilities under the fiscal intermediary monitoring contract.

In our letter of November 17, 1982, we recommended to the MCPP that the RFP provide for a system to measure the contractor's compliance with the State standards. Since this area is central to the contractor's performance, we emphasized the importance of designing a monitoring system to measure the accuracy with which the contractor processes claims. We recommended that the MCPP consider two methods by which it could measure the accuracy of the contractor's system for processing claims.

The first method, "on-line real time testing," uses fictitious claims to test the accuracy of the claims-processing system. This method, if thoroughly planned and continually used, can identify claims-processing problems quickly before they create a substantial number of erroneous payments. Used in conjunction with the second method, "post-payment review", on-line real time testing can be an effective means of identifying and recovering overpayments. A version of on-line real time testing, known as the Integrated Test Facility, was recommended by the Compass Consulting Group as a system enhancement (i.e., an improvement to the Medicaid Management Information System) under the new contract.*

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* The Integrated Test Facility has a variety of other applications. For example, it can be used during acceptance testing and as a means of independently measuring the timeliness of claims processing and document generating.

Although the draft RFP makes a brief reference to the State's use of the Integrated Test Facility, the section in question does not reflect the detailed planning necessary to make such a system work. The draft RFP does not adequately specify the uses of the Integrated Test Facility nor does it explain the contractor's responsibilities. Furthermore, the draft RFP does not mention the Integrated Test Facility as a potential enhancement to the contract.

The second technique, "post-payment review," examines a statistically valid sample of claims that have already been processed in order to determine rates of error for the entire system. Post-payment review is most effective when it is computer-assisted. Using a limited version of this technique in 1981, we were able to identify between $12.6 and $25.3 million in overpayments authorized by the current fiscal intermediary.

The Legislature, recognizing the need for effective, independent quality control, passed Assembly Bill 737 which mandated the contract for monitoring the fiscal intermediary. The legislation also required the consultants to develop a monitoring plan with recommended staffing levels and the computer software necessary to conduct post-payment reviews of the contractor's performance.

However, despite the availability of the consultant's state-owned computer software, the draft RFP is silent on the State's intentions to use it. Instead, the draft RFP merely allows for the turnover of the software to the next contractor. The State's role would apparently be reduced to monitoring the contractor's quality control reports and checking claims selected for sampling by the contractor.

The State Department of Health Services has not yet developed a plan to use the software to monitor the next contractor. The Acting Director of the State Department of Health Services informed us that the State is awaiting the monitoring and staffing recommendations of the Compass Consulting Group. Further, the Acting Director of the Fiscal Intermediary Monitoring Division stated that the department is uncertain whether the number of staff needed to carry out the consultants' recommendations will be funded by the Legislature. Nevertheless, the department and the MCPP need to provide assurances that an independent quality control program, run by either the State or a fiscal intermediary monitoring contractor, will be in place to measure contractor performance.

Besides not including a discernible plan for independently measuring the contractor's performance, the draft RFP allows the contractor to assume quality control responsibilities that should belong to the State.

Specifically, the draft allows the contractor to set its own performance standards, measure its own performance, and report the results of its measurement. Instead of establishing the State's accuracy standards for key areas of performance, the draft RFP allows the contractor to propose its own standards of performance subject to State approval. Thus, the State is relying on the contractor to propose standards that define the contractor's own satisfactory performance.

As previously mentioned, the draft RFP proposes to turn over the monitoring software developed by the consultants to the contractor. Under the present contract, which does not allow the current contractor such extensive responsibility to define satisfactory performance as proposed by the draft RFP, the State has had considerable difficulty in getting the contractor to perform its quality control function. As we reported in our September 1981 report (P-044), overpayments authorized by the current contractor were attributable to the contractor's failure to adequately meet its contractual requirement of installing and maintaining a quality control program. Moreover, as of January 6, 1983, the department had still not approved the contractor's quality control plan.

The quality control section in the draft RFP requires that the contractor evaluate and report its claims processing error rate. The contractor is to project the error rate to the

total population of claims processed and report an estimate of total erroneous payments. However, because the contractor is required to correct erroneous payments and is also liable to the State for any overpayments that cannot be recovered, we believe it is unreasonable to rely on the contractor to report what could be millions of dollars in inaccurately processed claims for which it may have been responsible.

Enforcing Contractor Compliance

The State has had difficulty collecting damage assessments imposed on the fiscal intermediary under the current contract. The State has assessed liquidated damages of $3.1 million against the current contractor but has been able to collect only $.4 million. Further, the State Department of Health Services has decided not to pursue collecting damage assessments under dispute. Although there may be numerous causes for the State's difficulties, the Compass Consulting Group states that the damage clauses are not always clearly related to performance standards. In addition, the Acting Director of the State Department of Health Services states that there is little relationship between actual damage by the contractor and the amount of the damage assessment.

If certain provisions for assessing damages in the draft RFP are not changed, the State will continue to have difficulties enforcing contractor compliance. The draft RFP includes provisions for payment only upon completion of certain contract requirements and for assessing liquidated damages if the contractor fails to perform adequately. However, as previously mentioned, the draft RFP does not include an independent monitoring system to measure performance against standards for significant areas of contractor performance. Therefore, our fundamental concern with the draft RFP is that the State cannot assess damages for the contractor's failure to meet important, independently measured, desired outcomes of the system.

We have an additional concern regarding damage assessments. One important principle in assessing liquidated damages is that the amount of damages assessed be reasonably related to the potential damage under the circumstances existing at the time the contract is made. If this principle is not adhered to, liquidated damages may be difficult to enforce. The draft RFP, however, may violate this principle.

The draft RFP allows the State to assess the same amount of liquidated damages for each failure of the contractor to fulfill requirements, regardless of the significance of the failure. For example, the State's contracting officer, who is

responsible for managing the contract with the fiscal intermediary, may assess liquidated damages of $500 per day if the contractor fails to fulfill any operations requirement. An operation requirement may relate to any of the following: providers, recipients, claims processing, management and administrative reporting, and surveillance and utilization review. A contractor's failure to perform some of these operations as required may not be as significant as failure to perform others. However, the section in the draft RFP that pertains to assessing liquidated damages for not meeting operations requirements does not relate the amount of the assessment to the significance of the contractor's failure to perform. Unless the Medi-Cal Procurement Project resolves the problems with the provisions for assessing liquidated damages in the draft RFP, we foresee difficulties in enforcing them.

Payments for Contractor Operations

The MCPP's draft RFP provision for paying the contractor for operations should be more specific. The MCPP decided that the next contractor will receive payment for operations only when the contractor has met contractual requirements. However, the RFP section detailing certain requirements and the method of payment is unclear and the requirements may, consequently, be difficult to enforce.

As described in Appendix B, the MCPP has recently changed its policy regarding payments to the contractor. The MCPP determined that it would be beneficial if the State could make payments to the contractor only upon completion of certain contract requirements. In the draft RFP, the total monthly payment for operations for the next fiscal intermediary is to be broken into percentage payments for general operations, claims-processing cycle time, system reports, monitoring accuracy and reports, quality control report production, and updates to system files. It is intended that the contractor should not receive payment for any of the above areas until the contractor fulfills all requirements in each area.

However, the MCPP has not made the provision sufficiently specific, leaving it open to conflicting interpretations. As a result, it may be difficult to enforce. For example, the draft states that the contractor will receive 10 percent of the operations payment for the delivery of various system reports. However, it does not specify whether the full 10 percent will be deemed unearned if a single report is not delivered or whether a pro-rated amount--based on the percentage of undelivered reports--will be deemed unearned. A similar lack of clarity under the current contract has resulted in disputes between the State and the Computer Sciences Corporation. In one instance, the State attempted to assess

liquidated damages of $500 per day for each late report. However, the Computer Sciences Corporation interpreted the contract's language to mean that $500 was the maximum assessment regardless of the number of late reports. Because of the language's lack of clarity, the dispute remains in litigation.

We have informed the MCPP about our concerns with the section in the draft RFP dealing with payments for the contractor's operations. The MCPP staff agree that more specific and detailed language is appropriate and said that they intend to change that section for the final RFP.

CONCLUSION

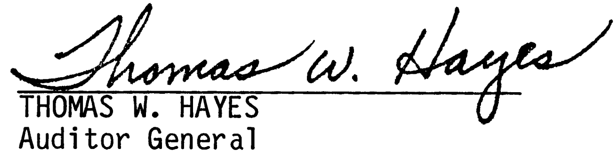
The Medi-Cal Procurement Project continues on schedule. However, the MCPP's milestones assume the current fiscal intermediary contract will be extended for at least 10 months. Although the consultants' final report on the status of system documentation had not been released as of January 14, 1983, the MCPP Director stated that the documentation of the present claims-processing system is adequate for review by bidders. Major Medi-Cal reform legislation, which is being incorporated in the present contract as change orders or in the new RFP,

will reduce claims volumes. However, because of federal and state reporting requirements, the activities of the special negotiator will not immediately affect the volume of hospital claims submitted.

Quality control provisions in the draft RFP appear deficient. The draft RFP has no provisions for accuracy standards for significant areas of contractor performance, including claims processing. It does not provide for an independent monitoring system to measure the contractor's performance, and the provisions for assessing damages may be difficult to enforce. If these conditions are not corrected, problems with the current contract may be repeated in the next contract. Finally, the draft RFP's provisions for operations payments need clarification in order to avoid conflicting interpretations that could render them difficult to enforce.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code. We limited our review to those areas specifically contained in the audit request.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: February 1, 1983

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STATE OF CALIFORNIA

HEALTH and WELFARE AGENCY
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January 27, 1983

Mr. Thomas W. Hayes
Auditor General
Office of the Auditor General
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Hayes:

Thank you for the opportunity to respond to your Draft Report #228.3 entitled, "Status of the Medi-Cal Procurement Project and review of its Draft Request for Proposal". Our ability to discuss and comment on issues identified during your review is appreciated.

Your report addresses the Draft Request for Proposal (RFP) released by the Medi-Cal Procurement Project on December 22, 1983. As you know, the Medi-Cal Fiscal Intermediary contract is very complex and contains a large number of policy issues. To ensure proper resolution of these issues, we have solicited input from many interested parties during this procurement effort.

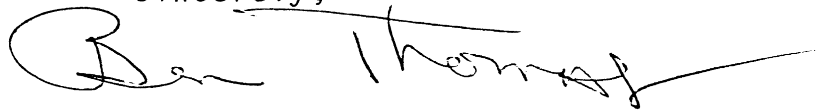
A summary of some of the procurement project efforts follows. An outside consultant was hired to address various procurement issues and prepare a plan for procurement and transition. A Policy Advisory Committee, composed of representatives from concerned State and federal organizations, was formed to provide advice and recommendations on major policy issues. A Payment Advisory Committee was formed to address the contract payment provisions and make recommendations. In October, 1982, the Summary Preview RFP was released and many comments were received from interested parties. We have attended the Secretary's Health Forum each month and reported on our progress for the RFP development and the overall project. Also, we have received many comments on the Draft RFP which was released, ahead of schedule, on December 22, 1982.

There has been an opportunity for potential bidders, provider associations, State agencies, federal agencies, members of the Legislature and other interested parties to provide input throughout this RFP development process.

Based upon the wide variety of issues reviewed by the Auditor General, we are pleased that there were no exceptions taken in the majority of the areas reviewed.1/ Our attached response addresses the major issues areas discussed in your report as follows: Quality Control Provisions, Payment for Contractor Operations, Standards for Contractor Performance, and Enforcing Contractor Compliance.

Again, thank you for the professional manner in which this review has been conducted. Please direct any questions to me at 322-0753.

Sincerely,



BEN THOMAS, Director
Medi-Cal Procurement Project

Attachment

Auditor General Note: The above-referenced footnote and additional footnotes appear at the bottom of page 6 of the MCPP's response. These footnotes present comments to this response that we believe are necessary.

QUALITY CONTROL PROVISIONS

In the Draft RFP, considerable attention has been given to enhancing the contract requirements related to system quality control and State monitoring of the Contractor's operation. These improvements were not addressed in the Auditor General's report. These enhanced requirements are divided into two areas, increased Contractor quality control requirements and increased State monitoring capabilities.

Contractor Performance of Quality Control Activities:

The Draft RFP has provided significantly more stringent requirements than the current contract in regards to the Contractor's internal quality control program. We believe that a critical component of the Fiscal Intermediary contract is the requirement and operation of a quality control or assurance program by the Contractor. This enables the Contractor to identify and correct problems at the earliest possible time. Our belief is supported by general quality control concepts and several audit reports on the current contract, including the Auditor General's report number P-044. In discussing the Contractor's quality control program, this report in part states, "To function effectively, a processing system...must include a quality assurance program that is both preventive and reactive." Based upon the concept that the Contractor must perform its own quality control, the Draft RFP includes the following activities required of the Contractor:

1. Regular and periodic measurement and reporting by the Contractor of each contract function.

2. A review of each payment tape before checks are mailed to providers to detect and correct erroneous payments that may have been missed by the normal processing system.

3. Review of individual employee performance for both effectiveness and accuracy to detect error trends in the Contractor's manual processing. Summary reports are sent to the State in this area.

4. An evaluation of overall claims processing accuracy.

5. Development of corrective action plans by the Contractor to document, initiate and track the resolution of all errors detected.

6. Dedicated Contractor Quality Control staff.

7. Review by the Contractor of all reports to be delivered to the State.

8. Requirements to correct all erroneous payments regardless of source of the error.

As a further means of emphasizing the importance of Contractor quality control activities, payment to the Contractor has been specifically tied to performance in this area. Five percent of the Contractor's payment for taking over the system is tied, in part, to approval of the Contractor's Quality Control plan. Ten percent of the Contractor's operations payment is tied to the Contractor's meeting quality control and erroneous payment collection requirements.

A final provision in the Draft RFP which was included at the suggestion of the Auditor General's staff is the requirement that the Contractor annually contract with an independent Certified Public Accountant to conduct an independent electronic data processing audit. This audit will independently assess the Contractor's system operations.

State participation and review are provided in each review area. As can be seen, the Draft RFP has highly emphasized Contractor quality control to aid in the prevention and resolution of errors. We believe it would be a mistake to remove responsibility from the Contractor for internal quality control to be solely replaced by State monitoring.2/

State Monitoring

While Contractor quality assurance is important, we agree with the Auditor General that the State must independently monitor the Contractor. To this end, we have worked closely with State agencies that monitor and audit the contract. In addition to the concern that the Contractor have a strong quality control program, emphasis has been placed in the Draft RFP to assure that the State has access to information needed to monitor the contract and more sophisticated research techniques. To this end, the Draft RFP has provisions that allow the following:

1. Access to the Contractor's facility, staff, production system and accounting records will allow for complete State monitoring and auditing. Additionally, space for

monitoring staff, any consultants and State and federal staff is provided at the Contractor's facility.

2. The State has absolute right to monitor all aspects of the Contractor's performance.

3. The State is provided on-line access to the Contractor's system to monitor performance and develop and run its own special reports.

4. The State is provided access to use the Contractor's research techniques.

5. The State is provided access to Contractor system tests and to run its own acceptance tests.

6. The State is provided the means to obtain samples from the Contractor to monitor performance.

7. The State's ability to test the system using live transactions (Integrated Test Facility) is continued in this contract. Currently, this monitoring tool is used by the State and is not an enhancement.[3/]

8. The Contractor provides the State with computer resources to run, using State-defined measurements, monitoring reports for use by the State.

9. The State is able to identify problems to the Contractor for resolution and performance requirements are specified for their correction.

It is difficult to see how the inclusion or continuation of these provisions abrogate the State's responsibility.[4/] In fact, these requirements should greatly enhance State monitoring capabilities beyond those available in the current contract. The State's right to monitor is not limited by these provisions.

The Auditor General suggests that the contract should contain the State's monitoring plan. We do not believe this plan should be inserted into the contract as this would limit the State's monitoring ability. Rather, we believe that the State must develop a separate monitoring plan for this contract.[5/] This plan will be based upon the existing plans and experience of the State and Compass Consulting Group's (the FI Monitoring Contractor) recommended monitoring plan as adjusted by new contract requirements.

PAYMENTS FOR CONTRACTOR OPERATIONS

We understand that the Auditor General's concerns in this area are structural in nature and can be resolved by tightening up RFP language. As indicated to your staff, these changes are being made.

STANDARDS FOR CONTRACTOR PERFORMANCE

In drafting the RFP our intent has been to clearly define the Contractor's responsibilities as the State's Fiscal Intermediary and, where possible, to include a measurable standard for each responsibility. We expect the Contractor to comply with all contractual provisions, not just a selected subset which might be isolated in a distinct section of the RFP.

The RFP contains literally hundreds of Contractor responsibilities, as one would expect in a contract of this magnitude and complexity. For example, the Contractor is required to deliver to the State a specific file by the 5th workday of each month. Whether this requirement is labeled an "outcome" or "process" standard is irrelevant. What is important is that this requirement clearly defines the State's expectations as part of the contract. To isolate some requirements as more important than other requirements, as the Auditor General suggests, would only serve to deemphasize the importance of those requirements and lessen their enforceability. We do not believe this would be in the best interest of the State.6/

The only standard that the Auditor General has specifically identified as missing from the Draft RFP relates to claims processing accuracy. The RFP requires that all claims be processed and paid in accordance with Medi-Cal policy and procedures. Therefore, the expected claims payment accuracy rate is 100%. We recognize, however, the potential for erroneous payments and have included in Contractor responsibilities the correction and recovery, if appropriate, of any erroneous payment.

Currently no federal Medicaid claims processing accuracy standard exists. Establishing a standard would be a difficult task, especially if the standard is to be successfully applied in managing the Medi-Cal FI contract. As noted in your report, defining a standard first requires the development of an undisputable definition of an "error" and an undisputable method to be followed to measure Contractor claims processing

accuracy. While work is being done in this area currently, this definition and methodology does not exist. Once these two steps are completed, determining the rate which is reasonable for Medi-Cal would be a sensitive task. If a reasonable rate could be established by periodic measurements over time, the tolerance such a standard implies for a program as large as Medi-Cal may not be acceptable. For example, if the State chose to use the federal standard for eligibility determination accuracy (97%) as the claims payment accuracy standard, approximately $129.4 million in erroneous payments could be made annually without the Contractor exceeding the established standard. 7/

We feel our approach in attempting to clearly define all Contractor responsibilities in the RFP does not conflict with your objectives and will enable the State to better manage the contract resulting from this procurement.

ENFORCING CONTRACTOR COMPLIANCE

The liquidated damages provisions as drafted rest on three basic assumptions:

1. Each and every Contractor requirement is an important interrelated part of the entire complex fiscal intermediary function.

2. Contractor nonperformance of a requirement may severely impact part or all of the fiscal intermediary function which in turn damages the State.

3. Liquidated damages are imposed only when and if the State is damaged, not for mere technicalities, and only after the Contractor is given notice in advance of assessment with the corresponding opportunity to perform the requirement.

The Draft RFP clarifies the contract requirements covered by liquidated damages, provides in certain cases for stepped-up damages for the compounding impact of continued nonperformance, and specifies higher damages for nonperformance of vital deliverables such as the failure to provide the claims payment tape.

Most Contractor requirements are covered by the same minimum liquidated damages assessment of $500 per day as found in the CSC contract. The MCPP accepts the view of many that

$500 per day is proportionately lower than actual or potential damages suffered by the State for nonperformance of the applicable requirements. For example, the State may lose millions of program dollars because of inaccurate reports used by State auditors.

If the State imposes liquidated damages assessment in proportion to or lower than potential damages, the risk that the assessment will be declared unenforceable should not occur. Only if the liquidated damages are disproportionately higher than the potential damage could the Contractor successfully argue that the liquidated damages are unrelated to potential damages. Enforcement should not be a problem so long as any of the requirements, regardless of the varying potential or actual damage incurred, carry liquidated damages assessment in proportion to or lower than actual or potential damages to the State.

AUDITOR GENERAL FOOTNOTES

1/ The MCPP states that we did not take exception to the majority of the areas we reviewed. As we indicated on page 18, this report discusses our principal concerns that remain unaddressed in the MCPP's draft RFP. We also noted that we provided the MCPP's director with a page-by-page analysis recommending less significant but nevertheless important corrections to the draft RFP.

2/ The MCPP believes it would be a mistake to eliminate the contractor's responsibility for internal quality control and make the State solely responsible for this function. We do not take issue with the State's requiring an internal quality control program as long as it does not replace the independent quality control responsibility of the State. Furthermore, as we reported on page 29:

> Under the present contract, which does not allow the current contractor the extensive responsibility proposed by the draft RFP, the State has had considerable difficulty in getting the contractor to perform its quality control function. (Emphasis added)

In addition, while our Report P-044 found deficiencies in the current fiscal intermediary's internal quality control program, it also addressed the need for the State to have an independent and comprehensive quality control function. Indeed, most of our recommendations in that report centered on enhanced quality control by the State.

AUDITOR GENERAL FOOTNOTES (Continued)

3/ The MCPP states an Integrated Test Facility (ITF) is currently used by the State and is not an enhancement. The Compass Consulting Group, in its Reprocurement Study, noted that "the lack of credibility of the present FI system is due in part to the problems of testing and monitoring the system." What the MCPP claims is an existing ITF capability has been cited by the consultants as being inadequate. Moreover, State officials have acknowledged difficulties in using this test capability. We and the consultants have continually cited the need to implement a comprehensive testing capability through an enhancement to the system.

4/ Our report does not suggest that the State abrogate responsibility for monitoring, as the MCPP suggests on page 3 of the response. On the contrary, we recommend that the State assume more responsibility for monitoring the contractor than is evidenced in the draft RFP.

5/ The MCPP believes the contract should not contain the State's monitoring plan. Our concern is that the draft RFP provides the reader no discernible plan outlining the State's intentions to monitor contractor operations independently. On page 28, we state our need for the department and the MCPP to provide assurances of their intentions regarding this critical matter. Further, the MCPP's intention to provide the contractor with the State's proprietary monitoring software--developed under the fiscal intermediary monitoring contract--appears inconsistent with its concern about divulging state monitoring plans.

6/ The difference between outcome standards and process standards is in fact relevant. The example provided by the MCPP on page 4 of the response is an outcome standard. As such, it is simple, measurable, and enforceable. During our review, however, we found a significant number of contractor responsibilities written as process standards. As such, they are vague, nonspecific, and susceptible to misinterpretation. We provide an illustration on page 23 of our report. The MCPP needs to review its consultant's reprocurment study for a clarification of the difference between outcome and process standards.

7/ The MCPP believes that establishing a standard for claims payment accuracy may allow unacceptable amounts of overpayments. However, as we stated in our November 17, 1982, letter to the MCPP:

> Setting a system/claims payment accuracy standard at a percentage less than 100 percent should not, and need not, imply that some level of error is acceptable or approved of. Certainly, the cause of every overpayment should be researched and remedied, and every overpaid dollar recouped, regardless of whether the contractor meets the established standard. However, sanctions need not be applied unless the contractor's performance falls below the established standard.

Further, although we reported the department's position regarding the difficulty of defining and measuring errors, we disagree with the department's position. Defining an error is not the problem; rather, it is establishing responsibility for errors. While this is complex, it can and should be done. This is specifically what we did in attributing overpayments to the current fiscal intermediary in Report P-044. The department's difficulty in establishing responsibility for errors gives us concern about the department's capability for effectively monitoring a fiscal intermediary.

SYNOPSIS OF PREVIOUS AUDITOR GENERAL REPORTS ON MEDI-CAL FISCAL INTERMEDIARY OPERATIONS

Report P-005, May 1980 -- A Review of Computer Sciences Corporation and the Department of Health Services Medi-Cal Fiscal Intermediary Operations

Our review of the Computer Sciences Corporation's (CSC) compliance with contract requirements indicated the following: (1) because the CSC's automated claims processing system was not completely tested before various claim types were put into actual operation, significant problems with the system occurred; (2) for four of the first nine months of operation, the CSC failed to meet the 18-day average monthly time standard for processing; (3) the number of claims suspended from the system exceeded contractual requirements; and (4) in three of the CSC's four subsystems with reporting responsibilities, not all required reports were produced in an accurate and timely manner.

Additionally, by assessing liquidated damages more frequently, the State Department of Health Services (department) could have more rigorously penalized the CSC for not complying with the contract. In part, greater liquidated damages were not assessed because the CSC and the department interpreted differently the intent of the liquidated damages clauses contained in the contract. Because of these problems,

we recommended that the department increase its contract monitoring and oversight activities of the CSC's performance. We also provided specific recommendations directed at improving the efficiency and effectiveness of claims processing.

Report P-021, January 1981 -- The Department of Health Services' Monitoring of the Medi-Cal Contract with the Computer Sciences Corporation

We reported that the department had not developed a comprehensive plan for monitoring the fiscal intermediary. For example, the department had not defined measurements or methods for calculating performance standards necessary to assess the adequacy of the CSC's performance. Because of inadequate monitoring, the department had been unable to ensure that the CSC was meeting the performance standards contained in the contract.

Report P-021.1, January 1981 -- Review of Computer Sciences Corporation's Compliance with Medi-Cal Claims Processing Time Standards

An independent analysis of the CSC's performance, conducted by the international auditing and consulting firm of Coopers and Lybrand, found that after the contract had been in effect for more than two years, the CSC and the State Department of Health Services had not agreed on how to evaluate the CSC's actual performance for purposes of monitoring the CSC's compliance with contract standards. Because the contract

presented a vague discussion of performance standards, the consultants had to independently interpret these performance standards. The consultants found that although the CSC had not fully conformed to the contract standards, its performance was improving.

Report P-044, September 1981 -- The CSC Has Authorized At Least $12.6 Million in Recoverable Medi-Cal Overpayments That An Improved Quality Assurance Program May Have Detected

We conducted six computerized tests of payment accuracy for certain claims processed during a 15-month period and identified overpayments totaling between $12.6 million and $25.3 million. Although the contract requires the CSC to develop a quality assurance program, we found that this program had been inadequate for three reasons: (1) the CSC's testing of both the system design and all system modifications had not identified certain basic errors; (2) the CSC's quality assurance program was incomplete because a key unit was still not functioning; and (3) the CSC had not ensured that the data file used for processing claims was updated and that all data were recorded accurately.

Management Letter 228.1, June 1982

In this report, we recommended that the Medi-Cal Procurement Project (MCPP) delay the decision to extend the current contract until four issues had been fully addressed by

the MCPP staff. These issues included the documentation of the present claims-processing system, the cost of extending the present contract, allowing contract bids for functionally equivalent systems, and time and staffing requirements for preparing the Request for Proposal.

Report P-228.2, October 1982 -- Status Report on the Selection of the Next Medi-Cal Fiscal Intermediary

We provided information on the Medi-Cal Procurement Project's (MCPP) overall status. We found that although the project had not met two of the Compass Consulting Group's recommended goals--the review of the documentation of the current claims-processing system for bidders, and full MCPP staffing by July 1, 1982--the project was underway and, by August 1, 1982, was fully staffed. We also reported the status of the agency's implementation of our recommendations concerning an extension of the current fiscal intermediary contract, and we provided a synopsis of the major policy decisions made regarding the procurement process and the new contract.

Letter Report 228.4, October 1982

In this report, we presented information regarding the State's expenditures for Medi-Cal fiscal intermediary services under the current contract with the CSC. Also, we

estimated that the State lost approximately $3.4 million in federal funds due to delays in gaining the Health Care Financing Administration's full certification of the Medicaid Management Information System within the CSC claims-processing system.

SYNOPSIS OF MAJOR POLICY DECISIONS MADE
SINCE THE AUDITOR GENERAL'S LAST STATUS REPORT
(OCTOBER 1982 TO JANUARY 1983)

The MCPP director and the Acting Director of the State Department of Health Services have made many decisions based upon MCPP staff research, input from the Policy Advisory Committee, and comments from various interested groups. Our October 1982 report (P-228.2) provided a synopsis of the major policy decisions that would affect either the process of procuring the next fiscal intermediary or the terms and conditions of the next contract. Following are brief discussions of three additional policy decisions that may affect both the procurement process and the new fiscal intermediary contract.

Date for Transferring
Claims-Processing Operations

The turnover phase is the period when claims-processing operations are transferred from one fiscal intermediary to another. During the previous turnover phase, the State transferred claims processing to the CSC based on the date on which the Medi-Cal services were rendered--the date of service. Because of several factors, the State, the contractor, and the members of the provider community experienced problems during the turnover phase.

To alleviate some of these problems, the State will transfer claims to the next fiscal intermediary based on the date the claims are received. The MCPP staff believe that using this date will allow the next fiscal intermediary to begin processing a greater volume of claims sooner and therefore help to equalize price bids from bidders.

Location of the Contractor and Dedicated Staff Requirements

During the previous procurement process, the Request for Proposal required only that the successful bidder locate its facility in California. The Computer Sciences Corporation, which was awarded the contract, subsequently chose to locate its facilities in Sacramento. In the current procurement effort, the MCPP has included in the Summary Preview Request for Proposal a requirement that the next fiscal intermediary locate its facilities within 25 miles of the State Capitol Building in Sacramento. The Legislative Counsel has determined that this requirement is legal.

In addition to this requirement, the MCPP has decided that certain members of the contractor's staff assigned to the Medi-Cal contract must be dedicated solely to performing work on this contract. These staff members are those involved in provider relations, processing, and programming. Thus, even if

the next fiscal intermediary performs work on several contracts in the same building, certain staff members assigned to the Medi-Cal contract will not be allowed to work on any other contracts.

Changes in the
Basis of Payment

Under the current contract, the State pays a fixed rate to the CSC for each Ajudicated Claim Service Line (ACSL). The MCPP management had intended to use the same basis for payment in the new RFP. However, as a result of meetings of the Payment Advisory Committee, the MCPP management decided to change the basis for payment.

In the draft RFP, prospective contractors will bid operations in three major volume levels--high, medium, and low--based on an Adjudicated Claim Line (ACL) for all claim types. The new contractor will be paid in twelve equal monthly payments based on the bid for the low volume level. Any additional volume over this low volume level will be paid at the appropriate fixed rate for ACL. If the actual ACL volume decreases by 20 percent below the low volume projection, the fixed price will be renegotiated.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps