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The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

This letter reports on the transfer of operational responsibility for the California Medicaid Management Information System (CA-MMIS) from Hewlett-Packard to Affiliated Computer Services (ACS), a Xerox company. Senate Bill 853 (Chapter 717, Statutes of 2010) requires the California State Auditor (state auditor) to monitor the transfer of operational responsibility for CA-MMIS to ACS and the subsequent design, development, and implementation of a replacement system.

Background

In 1965 Congress amended the federal Social Security Act to create Medicare, and in that same year established a state-optional medical assistance program known as Medicaid. As authorized by federal law, California implemented the California Medical Assistance Program (Medi-Cal), which provides health care services to eligible beneficiaries that the states and the federal government finance jointly. The Department of Health Care Services (Health Care Services) administers Medi-Cal. CA-MMIS is a computer system used to process payments to health care providers who participate in the Medi-Cal fee-for-service program, including physicians, pharmacies, hospitals, and other providers. CA-MMIS was originally developed in the late 1970s, and since 1987 was operated by Electronic Data Systems. Hewlett-Packard acquired Electronic Data Systems in 2008 and continued to operate CA-MMIS. Later in 2008 Health Care Services solicited proposals from firms qualified to assume operational responsibility for CA-MMIS, including processing provider claims for payment and providing certain other services to providers and beneficiaries, and to design, develop, implement, and operate a replacement system. ACS was the successful bidder, and in 2010 Health Care Services awarded a \$1.7 billion contract to ACS with an expiration date of June 30, 2016, for the baseline contract, although optional extensions could allow the contract to be extended through December 31, 2022.

Health Care Services was ultimately responsible for overseeing the transfer of CA-MMIS operations from Hewlett-Packard to ACS. In addition, the California Technology Agency had a statutory responsibility to monitor the transfer of CA-MMIS to ACS, and continues to have a responsibility for monitoring ACS' design, development, and implementation of the system that will replace CA-MMIS. Health Care Services also contracted with Eclipse Solutions, Inc. (Eclipse) to provide independent project oversight and independent verification and validation services.¹ To help assure that project oversight is unbiased, independent, and effective, we believe that independent project oversight and independent verification

¹ *Project oversight* is an independent review and analysis of a project to determine if it is on track to be completed within the estimated schedule and cost, and will provide the functionality required by the sponsoring business entity. *Independent Verification and Validation* is the process of evaluating software to determine whether the products of a given development phase satisfy the conditions imposed at the start of that phase and evaluating software during or at the end of the development process to determine whether it satisfies specified requirements.

and validation services should generally be performed by different vendors. This allows the independent project oversight vendor to objectively evaluate the performance of the independent verification and validation vendor and to assess Health Care Services' response to the independent verification and validation vendor's findings and recommendations. This will be even more important as ACS begins to design, develop, and implement a replacement for CA-MMIS. We will continue to monitor this issue.

As part of our own monitoring activities, our technical consultant reviewed Eclipse's monthly oversight reports and met regularly with Eclipse staff as well as Health Care Services' project director to stay apprised of project developments. We also observed executive steering committee meetings, attended by leaders of Health Care Services, ACS, Hewlett-Packard, Eclipse, and the California Technology Agency, to ensure that the committee was appropriately responding to emerging issues and risks. Finally, we attended periodic updates Health Care Services provided to legislative staff to confirm that the status of the transfer of operational responsibility for CA-MMIS to ACS was communicated appropriately.

ACS Successfully Assumed Operational Responsibility for CA-MMIS After Two Delays

The original contract required ACS to assume operational responsibility for CA-MMIS in February 2011. However, in February 2011, after many months of negotiation, Health Care Services and ACS amended their original contract to postpone the transfer of operations to ACS until June 2011. Health Care Services' contract with Hewlett-Packard was supposed to end on June 30, 2011; therefore, that was the latest Health Care Services could extend its ACS contract without first negotiating an additional extension with Hewlett-Packard. As part of the extension agreement, ACS agreed to reimburse Health Care Services for additional costs resulting from this postponement which, according to Health Care Services' calculations, totaled \$3.6 million. One million dollars of these costs were initially paid from the Health Care Services' general operating fund resources; following ACS' reimbursement, Health Care Services returned this amount to its general operating fund. The remaining \$2.6 million was initially paid with federal funds, which Health Care Services returned to the federal government by reducing its next federal draw.

Meanwhile, in January 2011—just prior to the execution of the contract amendment described above—Health Care Services notified the Legislature that the scheduled transfer of CA-MMIS to ACS would further be delayed until September 2011. In July 2011 ACS sent a notification of claim to Health Care Services for costs it asserts it incurred or expected to incur due to alleged scope changes and schedule delays. ACS estimated these costs to be \$52.5 million over the life of the baseline contract, which expires in June 2016. In August 2011 Health Care Services denied ACS' claim in its entirety, asserting that ACS did not substantiate a basis for an adjustment to the price or performance schedule of the contract. However, it directed ACS to address its concerns regarding a \$4.1 million portion of the claim related to collateral impacts to ACS' work on the Health Insurance Portability and Accountability Act of 1996 enhancement project outside of the notification of claims process. Although Health Care Services denied ACS' notification of claim, it stated that it is currently engaged in informal discussions with ACS over the costs associated with the second delay. We will continue to monitor the outcome of these discussions.

Despite these delays, ACS successfully assumed responsibility for operating CA-MMIS in September 2011. Specifically, on September 30, Hewlett-Packard ceased using CA-MMIS to process Medi-Cal claims and backed up its systems. ACS then flew Hewlett-Packard's back-up tapes from Sacramento to its processing facility in Texas, at which time ACS began processing Medi-Cal claims.

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The transfer generally went smoothly, and ACS' performance data indicates that certain key metrics improved in the following weeks. However, one performance metric—the suspended claims inventory—which was approximately 1.8 million claims at the time of the transfer, grew to almost 2 million suspended claims over the first 30 days. This metric gradually improved and, as of March 27, 2012, the suspended claims inventory was reportedly down to 717,110—a measure comfortably below Health Care Services' target of no more than 800,000 pending claims.

ACS Is in the Beginning Stages of Developing a New System to Replace CA-MMIS

A key provision of the contract between Health Care Services and ACS requires ACS to develop a new system to replace CA-MMIS. According to Health Care Services, CA-MMIS needs to be replaced because it is about 30 years old, its operations are inefficient, maintenance is difficult, and the risk of system failure is high. In addition, CA-MMIS is not currently compliant with Medicaid Information Technology Architecture (MITA) standards. Health Care Services asserts that it must begin transitioning to a MITA compliant system by 2013, or risk losing some federal funding.

To address these issues, ACS is in the preliminary stages of developing a replacement for CA-MMIS, which will be called Health Enterprise. Health Care Services required ACS to implement Health Enterprise in a series of phases, and ACS is currently in the planning phase. According to Health Care Services, its contract with ACS requires ACS to design, develop, and implement Health Enterprise within five years of its assumption of CA-MMIS operations. We will continue to monitor ACS' development of Health Enterprise.

Respectfully submitted,



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