IMPLEMENTATION AND OVERSIGHT OF THE MEDICAID MANAGEMENT INFORMATION SYSTEM CONTRACT

Lessons Learned for Future Systems Development and Service Contracts

July 1999 - PERFORMANCE AUDIT

EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

The Auditor Of Public Accounts Ensures That Public Resources Are Protected, Accurately Valued, Properly Accounted For, And Effectively Employed To Raise The Quality Of Life Of Kentuckians.

EDWARD B. HATCHETT, JR.
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July 16, 1999

To the People of Kentucky
The Honorable Paul E. Patton, Governor
John H. Morse, Secretary, Cabinet for Health Services
Aldona K. Valicenti, Chief Information Officer
Donald R. Speer, Commissioner, Department for Administration, Finance and Administration Cabinet
Dennis Boyd, Commissioner, Department for Medicaid Services, Cabinet for Health Services

Re: Performance Audit of the Medicaid Management Information System Contract

Ladies and Gentlemen:

We present our report on the Medicaid Management Information System Contract. We are distributing this report in accordance with the mandates of Kentucky Revised Statute 43.090. In addition, we are distributing copies to members of the committees of the General Assembly with oversight authority for the Medicaid program, as well as other interested parties.

After an appropriate period, we will contact the respective Medicaid officials to determine whether the report's recommendations are implemented and will advise the Legislative Research Commission regarding the status of that implementation. Once the Department for Medicaid Services has advised us that the recommendations have been implemented, they will be considered closed.

Our Division of Performance Audit evaluates the effectiveness and efficiency of government programs, as well as completes risk assessments and benchmarking of those operations. We will be happy to discuss with you at any time this audit or the services offered by our office. If you have any questions, please call James Rose, Director of our Division of Performance Audit, or me.

We appreciate the courtesies and cooperation offered to our staff during the audit.

Respectfully submitted,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

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Executive Summary

Under the joint federal and state Medicaid program, the Department for Medicaid Services (the Department) reimburses about 49,000 health care providers for medical assistance given to approximately 496,000 eligible recipients. Claims for this medical assistance are processed through the state's Medicaid Management Information System (MMIS) which is an automated claims processing and information retrieval system. This system allows the processing of approximately 37 million claims annually. Also, it was envisioned that the system would provide the Department with a comprehensive management tool to administer the Medicaid program.

In Kentucky, a fiscal agent, under contract with the Department, operates and maintains the MMIS system and performs all tasks associated with paying Medicaid claims. In January 1995, the Department contracted with UNISYS Corporation to design, test, and implement a new MMIS, costing $8.7 million dollars. In addition, UNISYS was contracted to provide three years of claims processing, averaging $10.5 million dollars annually. Since its inception, the MMIS contract has been plagued with problems.

Initially, the system was not implemented on time and, in fact, was over eight months late. A short timeframe appears to be the underlying cause of the troubled implementation. Normal implementation issues, such as when a project falls behind schedule or when unforeseen problems occur, became critical as a fixed implementation date had to be met. While UNISYS contributed to implementation problems by not satisfactorily performing its contractual duties and responsibilities, the Department was ultimately responsible for ensuring a successful implementation. However, the Department was unprepared to deal with problems that arose, and it was unable to identify significant project delays in enough time to mitigate its effects.

Performance problems continued during operations. As a result, approximately $10 million dollars in liquidated damages were assessed against UNISYS for not performing according to contract standards. We found the process the Department used to assess damages did not facilitate resolution of the underlying performance problems. The process did not include prospectively agreeing with the contractor on performance measurement, requiring corrective action be taken, following up when performance did not improve, and notifying Cabinet or Finance and Administration officials that problems remained unresolved. Furthermore, since the Department did not ascertain the causes of problems, it could not effectively resolve those problems.

The significant cost of the MMIS contract and the history of contractor problems indicate a need for more focused contract oversight and a reevaluation of current monitoring practices. Consequently, we made recommendations designed to improve the oversight of the MMIS fiscal agent. The Department generally agreed with our recommendations. In addition, we have identified and compiled a list of learned lessons that other state agencies may use to avoid some systems implementation problems and improve contractor oversight. While the Department should benefit from the recommendations made, ultimately we hope other agencies may learn from the problems that have occurred under this contract so that they may be avoided in the future.

Appendices

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Definitions

Department	Department for Medicaid Services
MMIS	Medicaid Management Information System
RFP	Request for Proposal
EDS	Electronic Data Systems Inc.
UNISYS	UNISYS Corporation

Introduction

What Is the Medicaid Management Information System (MMIS)?

Under the joint federal and state Medicaid program, the Department for Medicaid Services (the Department) annually reimburses about 49,000 health care providers for medical assistance given to approximately 496,000 eligible recipients. Claims for this medical assistance are processed through the state's Medicaid Management Information System (MMIS) which is an automated claims processing and information retrieval system. This system allows the processing of approximately 37 million claims annually. The system was conceived to provide the Department with a comprehensive management tool to administer the Medicaid program.

In Kentucky, a fiscal agent, under contract with the Department, operates and maintains the MMIS system and performs all tasks associated with paying Medicaid claims. The system qualifies for federal funding at a 50% rate. A state may have the system certified by the Health Care Financing Administration (HCFA) and receive federal funding at an enhanced rate of 75%. Currently, Kentucky receives this higher rate of funding.

Procuring a New MMIS

Department officials said that HCFA mandated the Department to obtain a new MMIS system. HCFA was concerned that the existing MMIS run by Electronic Data Systems (EDS), the fiscal agent at that time, was outdated and would be unable to handle future functional requirements of Medicaid processing. To help prepare for the bid solicitation process, in June 1993, the Department contracted with MAXIMUS Corporation for $580,000 to assist in determining the requirements for a new MMIS system. In addition, MAXIMUS developed the Request For Proposal (RFP) and proposal evaluation criteria, and assisted the Department with MMIS implementation activities.

In August 1994, the Department solicited bids for the development, implementation, operation, and maintenance of a new MMIS system. The contract was awarded to UNISYS Corporation for $57 million: $8.7 million for design, testing, and implementation of a new MMIS system and $48.5[1] million including three years of operation and an option to extend the contract for two years. EDS, the existing fiscal agent, bid on the contract but did not receive the award. While EDS had a higher technical score than UNISYS, UNISYS submitted a price proposal that was significantly less than EDS according to Medicaid officials. The weighted scoring of the proposals was 60% technical and 40% cost.

Design, testing, and implementation were scheduled during an eleven-month period from January 1995 to December 1995. The system was to begin operating December 1, 1995, when the prior fiscal agent operations ended, and continue until November 30, 1998.

Overview of Problems Under the MMIS Contract

Within a few months after it began, the contract was plagued with a series of problems. The failure of UNISYS to meet scheduled implementation dates first occurred in August 1995. Department officials became concerned in late September 1995 when UNISYS was substantially behind, resulting in "at least

[1] Bid price is based on estimated number of claims processed. This amount may differ somewhat to actual operational payments.

one month's delay" of the project. With the existing fiscal agent contract set to expire November 30, 1995, the Department requested that UNISYS submit a plan on how it intended to meet the critical deadline. UNISYS provided assurances of being fully committed to completing implementation by December 1st.

In early November 1995, MAXIMUS, the contractor that assisted the Department in the implementation process, assessed the status of the MMIS project and concluded:

- "The project was far behind schedule;
- The quality of UNISYS' work was inadequate;
- A December 1st implementation was likely to result in major problems with claims payment, unfavorable publicity and a significant negative impact on providers; and
- It was not possible, at this late date, to reconfigure resources in such a way to eliminate or significantly reduce the anticipated problems."

This assessment, although untimely, was accurate and the Department had to evaluate alternative courses of action in order to assure continued payment of medical costs for Medicaid recipients. The system was not operational on December 1, 1995. Department officials decided to implement the new MMIS as soon as possible and pay providers, in the interim, based on the level of claims paid historically and the number of claims submitted for the period. Interim payments were paid from December 1995 to May 1996. These interim payments substituted for actual claim payments until the processing system was functioning.

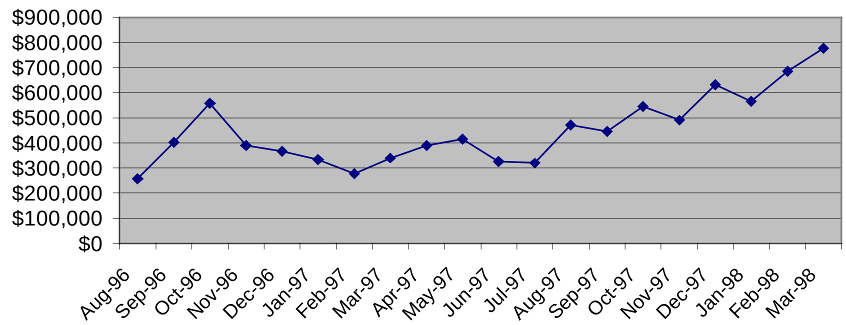
The interim payments process resulted in significant provider inconvenience, and numerous complaints led to legislative committee hearings in the 1996-1997 interim session. Actual, as opposed to estimated payment processing, began in February 1996 but was not fully implemented until May 1996.

The Commonwealth issued the first cure letter December 20, 1995 stating that UNISYS failed to satisfactorily perform its contractual duties and responsibilities. This letter provided UNISYS with the opportunity to cure the failure or be subject to termination for default. UNISYS provided a Corrective Action Plan but continued to miss implementation dates; on June 11, 1996, six months after full implementation should have occurred, a second cure letter was sent.

Problems continued with operations. As of February 1997, the Department reported a host of implementation requirements still outstanding. In addition, operational problems existed with the accuracy and timeliness of ad hoc reporting, aged claims inventory, claims history errors, and claims approval rates. The Department did not achieve MMIS certification until December 1997, retroactively effective to August 1, 1996.

During operations, UNISYS failed to perform according to contract requirements, and the Department assessed approximately $10 million dollars in liquidated damages. The Department also calculated, but never assessed, damages of $14 million for failing to meet deliverable dates during implementation and $460 million for failure to settle claims and adjustments within 30 days, a federal requirement.

Figure 1: **MMIS Monthly Assessed Liquidated Damages for Operations**
(From certification through settlement)



Source: Department for Medicaid Services

UNISYS contested the assessment of damages and the reasonableness of certain performance criteria. In addition, UNISYS claimed it performed work outside the scope of the contract and the Department contributed to its failure to meet contractual requirements in a timely manner. General Counsels of both the Department and UNISYS settled these issues in March 1998. As a result, UNISYS agreed to pay $4 million in liquidated damages and the Commonwealth was to pay $15.8[2] million for implementation and operational payments previously withheld. Additionally, the Commonwealth contracted with UNISYS to make MMIS Year 2000 compliant at a cost of $3.5 million and extended the contract seven months to June 30, 1999.

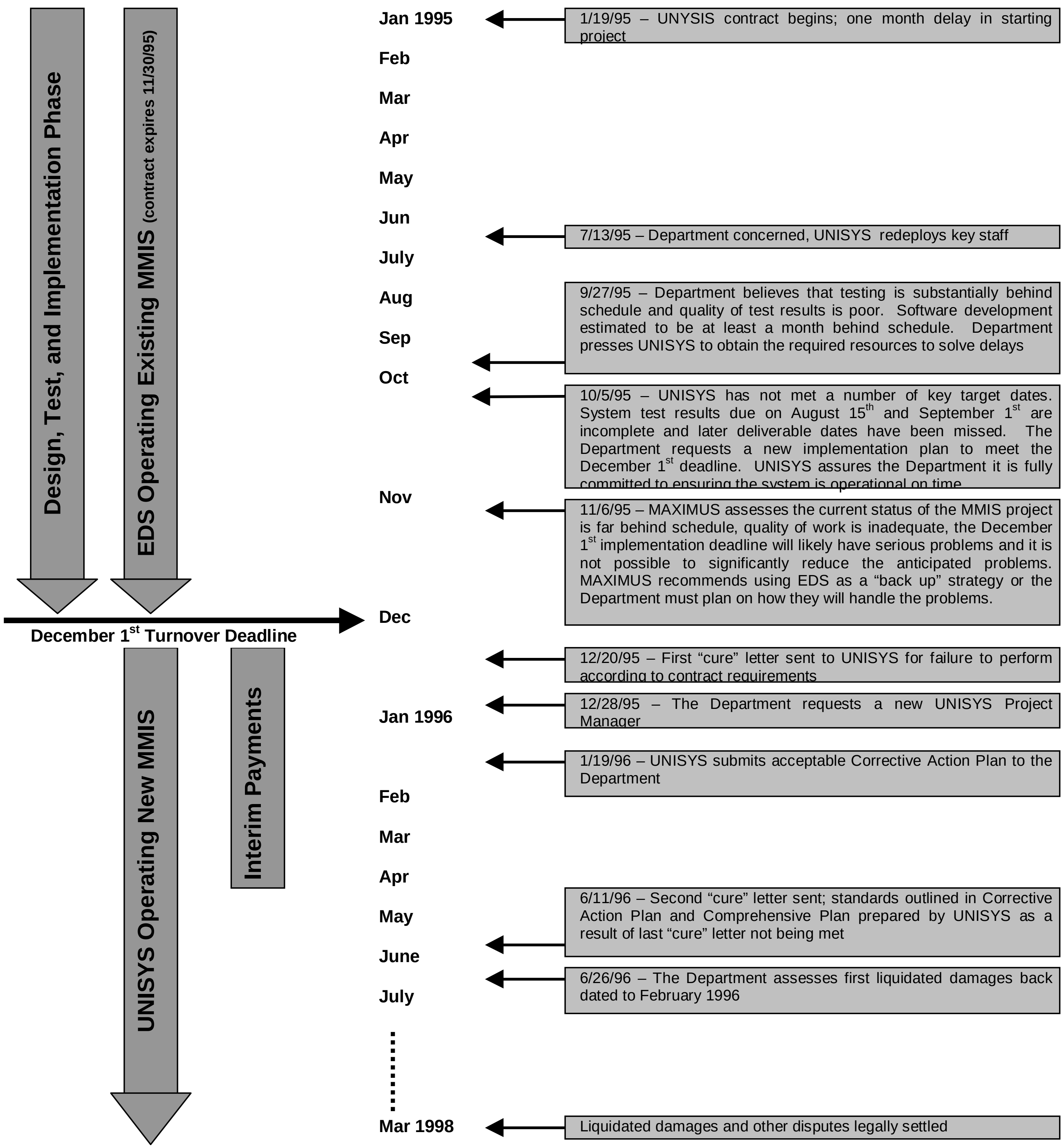
The problems with the contract were numerous, the following effects of which are still being addressed today:

- Interim payments of approximately $486 million were made to providers during 1996. As of August 1998, $1.2 million dollars in overpayments were still being recouped from providers.
- Approximately $5 million in duplicate claims were processed and paid during 1996 and 1997. As of May 1998, $610,000 had not yet been recouped.
- Approximately $4 million was withheld from UNISYS payments for enhanced funding the state did not receive due to lack of federal certification from December 1, 1995 through July 31, 1996.
- MAXIMUS contract was extended for six months, adding $126,000 to the original contract amount.
- Continuing operational problems throughout the fall of 1998, including a backlog of system maintenance and modification requests and poor quality of ad hoc reporting.

[2] The Department did not pay the full amount of operational payments withheld. An additional $4 million dollars was withheld due to lack of federal certification of MMIS from December 1, 1995 to July 31, 1996. During this period, the federal funding received by the Department was reduced by this amount.

Figure 2:

MMIS Contract Event Timeline



Source: Department for Medicaid Correspondence and other documentation

Audit Objectives

Because the Department has experienced many problems with the MMIS contract, and because of the significance of the fiscal agent operations to the successful administration of the Medicaid program, the Auditor of Public Accounts (APA) sought to determine why difficulties arose in the implementation and why problems continued during operations. In addition, the APA endeavored to identify and highlight learned lessons that could assist the Department and all state agencies in dealing with third party contractors, either in the context of systems design and implementation or overseeing service contracts.

This audit was designed to answer the following questions:

- Why were problems encountered during the implementation phase?
- Why did problems continue during the operational phase?

As part of our audit, we interviewed various officials and staff of the Department for Medicaid Services, the current Project Director of UNISYS, Cabinet for Health Services General Counsel, federal officials from the Health Care Financing Administration, Finance and Administration officials, and the state Chief Information Officer. We reviewed the current MMIS contract between the Department and UNISYS, the MAXIMUS contract, and the UNISYS response to the Request for Proposal. In addition, we examined correspondence, documents and reports of the Department and UNISYS regarding contract matters and we evaluated the Department's monitoring practices. Finally, we reviewed a draft of the new MMIS Request for Proposal expected to be issued in early 1999. Appendix I contains a complete description of the scope and methodology of this audit. This audit was conducted in accordance with Generally Accepted Government Auditing Standards as issued by the Comptroller General of the United States.

Chapter 1

Why Were Problems Encountered During the Implementation Phase?

Summary

A short timeframe appears to be the underlying cause of the troubled implementation of the Medicaid Management Information System (MMIS). Normal implementation issues, such as when a project falls behind schedule or when unforeseen problems occur, became critical as a fixed implementation date had to be met. UNISYS contributed to implementation problems by not satisfactorily performing its contractual duties and responsibilities. Despite this fact, the Department was ultimately responsible for ensuring a successful implementation. The Department did not prepare appropriate risk management plans to deal with problems that arose, and it was unable to identify significant project delays in enough time to mitigate their effect.

The Department Is Responsible for Operation of the MMIS

Management has the responsibility for planning, organizing, directing, and controlling functions within an organization. When management makes the decision to contract for a service, it is responsible for making sure that the contract properly specifies what the contractor is to provide, that contract provisions are followed, and that it gets the services it is contracting for. Thus, the Department has to monitor the contract from its inception. In the implementation phase, the Department has to make sure that the contract is feasible, that the contractor has adequate, trained staff; and that specifications are followed. It also has to provide for some mechanism for identifying problems and taking corrective action. These actions do not guarantee that a project will be without problems, but they increase the chances of its success.

The Department contracted with UNISYS to provide a federally certifiable MMIS, according to Kentucky specifications, in time to begin operating December 1, 1995. UNISYS was contracted to perform the following implementation functions:

- Plan and manage functions relating to project start-up and ongoing project management;
- Develop the system design for Kentucky's MMIS;
- Develop and test the software;
- Convert data from the existing MMIS;
- Demonstrate the system meets Kentucky specifications and performs all processes correctly; and,
- Implement the MMIS to begin paying claims by December 1, 1995.

We defined the implementation period as beginning in January 1995, when the contract began, and ending on August 1, 1996, the date the MMIS was certified by the federal Health Care Finance Administration (HCFA). During this period development, testing, and implementation of the new MMIS met federal certification requirements. Our review sought to determine the reasons why the implementation took longer than expected and continued eight months past the date UNISYS was to have had the system fully operational.

The Department Did Not Properly Plan the Implementation

The Department did not adequately plan the implementation. The implementation phase was too short, increasing the risk that the project would not be completed on time and/or in accordance with specifications. Additionally, the Department did not make appropriate plans to moderate this risk, nor did it have effective monitoring mechanisms in place.

Investigating the causes of implementation problems proved difficult. Since implementation occurred over three years ago, we encountered a number of obstacles to identifying what happened during implementation of the MMIS system. The following are illustrative:

- Many of the individuals involved with the project were no longer working for the Department or State Government;
- Specific fiscal agent personnel were not accessible; and
- The Department could not locate specific documentation relating to implementation and risk assessment activities.

The Implementation Timeframe Was Too Short

Implementation was originally scheduled during a 12-month period from December 15, 1994 to December 1, 1995. Start-up was delayed one month and began in January 1995. This left an 11-month timeframe to develop[3], design, test, and implement the new MMIS. The industry standard for implementation of a new MMIS is between 18 and 24 months[4].

Officials from other states who have implemented new MMIS systems agree that 11 months is not enough time to implement a new system. Due to the complexity of these systems, delays in implementation are to be expected. A case in point is Idaho, which recently implemented a new MMIS. Implementation was completed in 2½ years, 13 months beyond the original 18-month schedule. Idaho's contract manager told us that, due to the size and the complexity of the project, the state had an unrealistic expectation to complete implementation in an 18-month timeframe.

Finance and Administration Cabinet and HCFA officials had concerns about the ability to implement a major information technology project, such as Kentucky's MMIS, in such a short period of time. According to these officials, Department management provided assurances that a system could be successfully implemented within the timeframe.

Unfortunately, in the case of Kentucky's MMIS, the implementation timeframe appears to have been dictated by senior Cabinet officials. Various parties involved in implementation said the Department experienced significant pressure to complete implementation by December 1, 1995, before a change in administration. Department staff told us they had concerns that the system could not be successfully implemented in such a short timeframe. Additionally, notes taken by Department staff at a HCFA Systems Conference held June 1993, indicate that officials from two states, Georgia and Mississippi, said 12 months was not enough time to implement a new MMIS system.

Large, Complex Projects Have a High Failure Rate

Industry research also suggests that large, complex projects similar to the $8.7 million dollar MMIS implementation have a high failure rate. Research from the Standish Group[5] indicates that, in 1996, over 80% of government information technology projects failed or were troublesome. Moreover, projects ranging from $6 to $10 million dollars were unlikely to succeed: only 8% of these projects

[3] UNISYS proposed Florida's MMIS system as a base which would be modified to meet Kentucky Medicaid requirements.
[4] The industry standard is based on timeframes recommended by HCFA and other states that have implemented MMIS systems.
[5] The Standish Group is a technology consulting firm based in California.

were successfully completed; 52% were "challenged," meaning they came in over budget, took longer than promised, or ended up with fewer features than specified; and 41% were canceled before completion. This research further suggests that the higher the project cost, the less likely the project will be completed on time, within budget, and with all the features originally specified. Smaller projects, less than $750,000, were most likely to succeed.

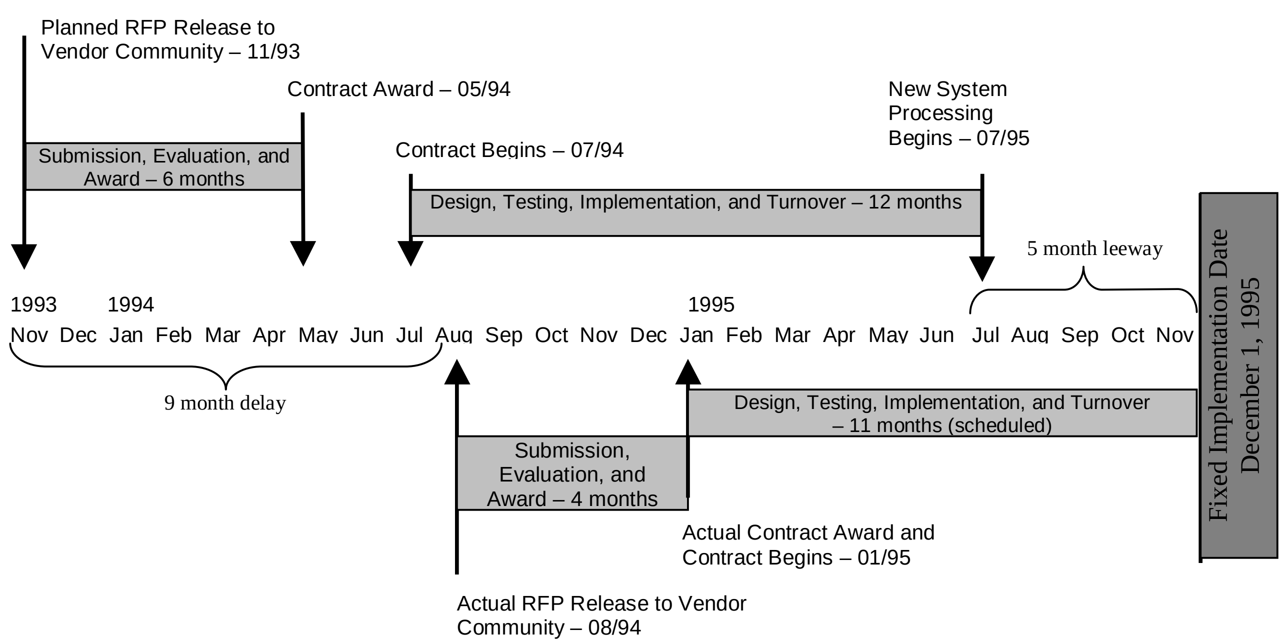
The Department Allowed the Procurement Schedule to Slip

Delays in producing the RFP consumed any leeway built into the procurement and implementation processes.

The Department could have extended the implementation phase if the procurement process had gone according to plan. A 1993 Department schedule shows the RFP was scheduled for release in November 1993, with award in May 1994. In actuality, the RFP was released in August 1994, 9 months later than originally planned. RFP submission, evaluation, and award were compressed from 6 months to 4. As a result of these delays, implementation was pushed back 6 months from July 1994 to January 1995. Adhering to the original schedule would have given an extra 5 months before the system was switched over from EDS to UNISYS by December 1995, or a total of 17 months for implementation, closer to industry standards. When asked why the RFP was released 9 months late, Department staff did not know. As noted below, while the RFP schedule fell behind, the expected implementation date remained fixed at December 1, 1995.

Figure 3: **Planned and Actual Procurement and Implementation Timetable**

1993 Planned Procurement and Implementation Schedule



Actual Procurement and Implementation Schedule

No Risk Management Plans Existed

With any major IT procurement, we would expect to see risk management plans. These plans would detail a course of action for loss of key resources such as key personnel, or a delay in key tasks, or failure to implement important tasks. Furthermore, these plans would evaluate the impact of potential project failure.

These plans become especially important when implementation timeframe is fixed and offers little flexibility for project delay, as in the case of MMIS. We found the Department did not prepare a risk management plan. Furthermore, during the course of our audit, we did not find any documentation indicating the Department considered or identified specific implementation risks or established action plans to effectively deal with these issues should they arise. Accordingly, when problems did arise, the Department had no strategy to complete the project on time or mitigate the problems associated with a late implementation.

Department staff said it was the contractor's responsibility to complete implementation according to contracted terms and the contractor's responsibility to notify them of delays in the implementation. They disagreed with our finding that no risk management plan existed, stating that the interim payment solution was one example of risk mitigation. Proper oversight of contractors, however, requires that the government managers determine whether plans are being implemented in a timely manner instead of relying on the contractor's self reporting. Appendix II gives examples of more in-depth and proactive system review that is being conducted by the Finance and Administration Cabinet during a current contract implementation.

The Department Did Not Have Appropriate Monitoring Mechanisms in Place

The Department was unable to identify significant project delay until nine months into implementation. As late as the end of July 1995, MAXIMUS reported to the Department that software development appears to be on track. Project delay was first detected 2 months later in late September. The Department expressed concern over late and inadequate test results and estimated software development was at least one month behind. In a letter dated October 5th, the Department reiterated its concerns and requested "a detailed explanation of how UNISYS plans to make up the apparent schedule deficit in the 8 weeks remaining to December 1."

By mid-October, just six weeks until turnover of operations from the previous fiscal agent, Department documents indicated UNISYS was 46 days late for tasks associated with paying claims, including control, entry, corrections, and operations. On November 6th, MAXIMUS reported that UNISYS' quality of work was inadequate and implementation would not occur as planned on December 1st. Unfortunately, by the time the Department realized implementation was not going to take place, little time remained to take adequate steps to avoid a failure or to substantially mitigate the effects.

We found that the weekly Implementation Progress Reports prepared by UNISYS never indicated concerns over implementation issues.

According to the contract, weekly progress reports, along with weekly status meetings, were intended to report progress *vis a vis* the implementation work plan for each subtask. We found that the weekly Implementation Progress Reports prepared by UNISYS never indicated concerns with implementation issues. We noted these reports focused on the activities UNISYS performed, but were not compared to the implementation work plan, making it difficult to determine if the UNISYS activities were appropriate and completed on time.

Based on the documentation available, we were not able to determine why the Department did not identify project delay early in the project. Two likely explanations exist. First, the UNISYS detailed work plan may not have contained enough detail or specified appropriate milestones to determine whether work being performed was on schedule. Second, the Department may not have sufficiently monitored implementation progress or required the necessary corrective action when quality of work by UNISYS was inadequate. In either case, the Department did not have a methodology calculated to ensure the project would be implemented on time, and, instead, relied on the contractor to disclose the progress of its work.

Some legislators and officials have questioned whether MAXIMUS was responsible for monitoring the MMIS development and implementation. The Department contracted with MAXIMUS on June 1, 1993 to assist with determining MMIS requirements, developing the RFP, assisting the Department through the procurement process, and assisting the Department with implementation activities. The MAXIMUS tasks were clearly defined in the RFP. The design and implementation tasks included:

- Assisting the Department with turnover activities from EDS;
- Assisting the Department with planning activities for the new MMIS (including reviewing and recommending changes to fiscal agent requirements analysis documents, the detailed implementation schedule, a draft disaster recovery plan, a draft back-up, and a recovery plan);
- Assisting the Department with design, development, and transfer activities (including assisting Department staff in ensuring the new MMIS is certifiable and that system test plan and documentation is acceptable);
- Assisting the Department in monitoring acceptance testing and implementation of MMIS by preparing a monitoring plan of the testing, and reviewing fiscal agent test plans.

MAXIMUS was not contracted to ensure that UNISYS was performing to schedule.

The MAXIMUS tasks were limited to ensuring that contractor design, testing, and transfer activity *plans* are appropriate in form and content, and to *assisting* the Department with testing and turnover activities. For instance, MAXIMUS was contracted to review the detailed implementation schedule to ensure appropriate tasks were included, but not to ensure UNISYS complied with the schedule. Furthermore, MAXIMUS was not contracted to ensure that UNISYS was performing to schedule or to determine if the implementation deadline would be met.

UNISYS Did Not Perform According to the Contract

The fact that UNISYS did not meet scheduled development and implementation dates cannot be overlooked as the primary contributing factor to the failed implementation. In fact, the new MMIS was implemented over 8 months late. This despite repeated assurances from UNISYS Management that the system would be operational by December 1, 1995. The current UNISYS Project Director told us that UNISYS contributed to implementation problems.

However, the responsibility of ensuring the project was completed on time ultimately lay with the Department. It is responsible for administering the Medicaid program and ensuring the $2.5 billion dollars spent on medical assistance is properly processed and accounted for. The monetary and social significance of the Medicaid program warrants better control over fiscal agent activities. On several occasions, Department staff told us that the Medicaid contractor knows the business and what they need to do. Unfortunately, state officials can never delegate their responsibilities for effective and efficient operations of programs.

Recommendations and Lessons Learned

We have included our recommendations and list of lessons learned at the end of Chapter 2, page 28.

Chapter 2

Why Did Problems Continue During the Operational Phase?

Summary

Performance problems continued during operations. As a result, approximately $10 million dollars in liquidated damages were assessed against UNISYS for not performing according to contract standards. We found the process the Department used to assess damages did not facilitate resolution of the underlying performance problems. The process did not include prospectively agreeing with the contractor on performance measurement, requiring corrective action be taken, following up when performance does not improve, and notifying higher level Cabinet for Health Services or Finance and Administration Cabinet officials that problems remain unresolved. Furthermore, the Department did not take a proactive approach to resolving contract problems by determining the causes of those problems.

In addition, the Department's monitoring of contractor activities does not adequately cover all aspects of contractor performance. We recommend improving contract monitoring by expanding the oversight function, establishing key control systems, and formulating related policies and procedures.

Problems Encountered During the Operational Phase

The Department contracted with UNISYS to "…perform all functions necessary to operate a successful, complete, and certifiable Kentucky MMIS." Contractor responsibilities included the following functions:

- Maintaining recipient and provider data;
- Operating long-term care, third party liability, waiver care, and prior authorization processing;
- Performing reference data maintenance;
- Receiving, entering into MMIS, and accurately paying all claims and in a timely manner;
- Providing management and administrative reports;
- Providing the ability to produce ad hoc reports;
- Operating the voice response eligibility verification and drug utilization review systems;
- Performing maintenance and modifications to MMIS.

While operations were intended to include all of the functions specified in the contract, most of them were not available when operations began.

Partial operations under the UNISYS contract began with the expiration of the EDS contract on December 1, 1995; although as shown in Chapter 1, implementation activities were still ongoing months later. While operations were intended to include all of the functions specified in the contract, most of them were not available when operations began. Most importantly, the claims processing functions were not complete, and an alternative process was used until these functions could be implemented.

UNISYS began making estimated payments to providers in lieu of actual claims payments. The level of the lump-sum payments was based on each provider's historical claims payments. This process proved inadequate, resulting in significant provider dissatisfaction. Many providers complained that payments were severely inadequate and that no remittance information was provided, making it difficult to determine what for which they had and had not been paid. Additionally, some providers had trouble contacting UNISYS to help resolve payment problems. Although the interim payment process may have erred on the conservative side for certain providers, in certain cases providers were overpaid. A total of $486 million in estimated payments was made. These funds were recouped over time by offsetting incoming claims. However, as of August 1998, $1.2 million dollars in overpayments were still being recouped from providers.

Actual claims processing, as opposed to the estimated lump-sum payments, began in February 1996 but was not fully implemented until May. Even the actual claims processing operation experienced problems, including over $5 million in duplicate payments made between February 1996 and October 1997. As of May 1998, more than $600,000 was still being recouped from providers.

$9.7 Million in Liquidated Damages Was Assessed Against UNISYS for Not Performing According to Contract Standards

The Department began assessing damages for poor operational performance in June 1996 for work performed beginning back in February 1996 when claims processing began. $9.7 million in liquidated damages were assessed mainly for maintenance and modification requests performed in an untimely manner, ad hoc reporting requests delayed, and electronic claims network and voice response systems not being available according to contract terms. Furthermore, during this period, the Department reserved the right to assess an additional $460 million in damages for late claims processing. These damages were never actually assessed.

Liquidated damages were assessed monthly and were deducted from operational payments through January 1997. In addition, the Department withheld from UNISYS the amount of enhanced funding payments the Department would have received if the system had been certified on December 1, 1995 instead of August 1, 1996. For most months, UNISYS was only paid 50% of what it would have been paid if it had performed according to the contract and the system was certified. After this date, damages were assessed but were not withheld from payments, as UNISYS complained that it was not being paid enough to maintain operations.

UNISYS sent a letter to the Department in October 1996 disputing the legality of liquidated damages and claiming that the amount did not bear adequate relationship to actual damage suffered as required by Kentucky law. The General Counsel of the Cabinet for Health Services told us that, in some instances, UNISYS questioned the level of nonperformance determined by the Department but conceded they were not living up to their performance requirements in all areas. In addition, UNISYS thought that some performance standards were unreasonable. It also claimed it had been asked to perform work outside the scope of the contract, thus limiting the staff available to work on other tasks.

The Department and UNISYS Settled Contractual Disputes in March 1998, Over 2 Years After Operations Began

The dispute over liquidated damages and issues of the scope of work were legally settled in March 1998. As a result of the settlement, UNISYS was required to pay $4 million of the $9.7 million of assessed damages. The state paid for $15.8 million in operational payments withheld. The state also received other consideration, namely specific computer hardware and work performed for managed care that UNISYS claimed to be outside the scope of the contract.

The Department negotiated a contract extension with UNISYS at the same time the settlement was reached that extended the contract from December 1, 1998 through June 30, 1999. The new contract will pay UNISYS a fixed price of $1.1 million a month, 40% over the amount it received under the last year of the contract. Also, the amendment included work to ensure that the MMIS was year 2000 compliant at an additional cost of $3.5 million. In addition, certain performance standards regarding provider data maintenance, prior authorization, claims processing timeliness, and voice response were lowered.

Until the settlement, liquidated damages assessed for nonperformance ranged from $258,000 to $778,000 per month, or 26% to 96% of monthly operational payments. More importantly, the trend in the amount of damages assessed did not indicate an improvement in performance from the time damages were first assessed in July 1996 until the settlement in March 1998. As of August 1998, 5 months after the date of the settlement, the Department has calculated over $3 million in damages for poor operational performance, even though the amount of damages has decreased in specific performance areas. The Department has not assessed any formal damages since March. A Department official told us that Department management would look at how reasonable the damages are and take other operational factors into consideration before assessing them.

The Department's System of Assessing Liquidated Damages Did Not Facilitate Resolution of the Underlying Performance Problems

The magnitude of the damages assessed and the fact that these damages were assessed consistently over time with, until recently, no improvement in performance raises a question of why performance issues were not resolved in a more timely manner. In our review we found that the procedure for assessment of damages did not facilitate the resolution of the underlying performance problems.

The Department's practice was to send the contractor a letter detailing the performance requirement and the amount of damages to be assessed. When the Department issued these letters, it did not require corrective action on the part of the contractor, nor did Department staff prospectively agree with the contractor to obtain agreement on performance measurement.

When performance problems continued, Department staff did not look for the causes of those problems. When problems were not corrected, they did not involve higher level management to assist in resolving them. The Department elected to have the issue of nonperformance solved in a legal arena and therefore did not take a proactive approach to resolving these issues.

Without Corrective Action Plans, Problems Took Longer Than Necessary To Resolve

The letters which notified UNISYS of nonperformance specified each contract performance requirement that was not being met and listed the amount of damages that might be assessed. Because corrective action plans were not required, performance problems have taken more time than necessary to resolve. An example of such a case is ad hoc reporting, a function that allows staff to request special reports developed from information in the MMIS system.

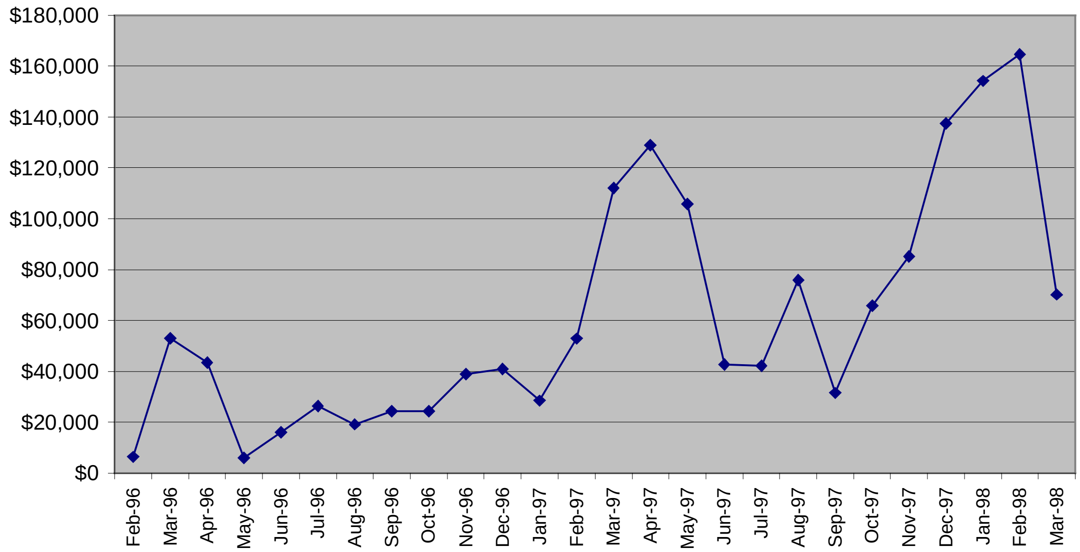
The contract requirement for ad hoc reporting was as follows:

- For "routine" requests, reports will be completed within 24 hours from the time submitted
- For "emergency" requests, reports will be completed within 2 hours from the time submitted.

…the Department assessed approximately $1.6 million dollars…due to untimely ad hoc reporting.

If reports were not completed on time, the contract specified that the Department could assess damages of $100 per day per report. As a result, the Department assessed approximately $1.6 million dollars from February 1996 to March 1998 due to untimely ad hoc reporting. Monthly assessment of damages is shown below.

Figure 4: **Ad Hoc Reporting Assessed Liquidated Damages**



Source: Department for Medicaid Services

As part of its dispute over liquidated damages, UNISYS complained that the performance measure was unreasonable, as ad hoc requests were not based on their complexity. An example given by UNISYS is that a single request could actually be made up of several separate reports. As a result, a report could take from one minute up to several hours of processing time. According to UNISYS, the timeframe imposed to complete reports was arbitrary.

In addition, UNISYS did not expect the level of ad hoc reporting requests it actually received, although the number of ad hoc requests was about the same as those lodged with the previous contractor. For 1997, UNISYS received approximately 750 requests for ad hoc reports. We compared this number of requests to the information provided with the RFP. For 1993, the Department reported 741 requests for ad hoc reports in various forms:

Ad hoc reports	178
Emergency Ad Hoc	5
Report Generator	434
State Run Report Generator	124
Total	741

Although this information shows 1997 ad hoc requests were consistent with levels under the prior contract, UNISYS probably experienced more ad hoc requests than it anticipated because a key alternative reporting system UNISYS proposed as part of the contract did not function as intended. This system was supposed to have allowed Department personnel to produce various reports themselves[6] but staff told us the system was not "user friendly" and did not provide accurate reporting.

…Department staff reported to us that they had to wait weeks or months to obtain reports.

Over time, ad hoc reporting requests backlogged, and Department staff reported to us that they had to wait weeks or months to obtain reports. When some staff received reports, they were often found to be inaccurate and had to be redone. With no other way to extract data from the MMIS, staff had to delay work until reports were received.

UNISYS and the Department began addressing the issue of backlogged ad hoc requests… approximately 2½ years after UNISYS took over MMIS operations.

UNISYS and the Department began addressing the issue of backlogged ad hoc requests and their lack of timeliness about May 1998, approximately 2½ years after UNISYS took over MMIS operations. At that time, the Department agreed to change the requirements for turnaround times and worked with UNISYS in establishing new guidelines. In turn, UNISYS said it hired additional staff and assigned additional staff from their resource pool in Richmond, Virginia. UNISYS also said it cleaned up the data and created a more complete data set for the Intelligent Query system. It also is intending to use a more "user friendly" interface to access the data. These actions allowed UNISYS to clean up the backlog over a few months and produce reports more timely, according to the new standard. Such a solution could have been implemented sooner instead of enduring up to two years of late reporting. The table below shows that the performance by UNISYS has improved since steps were taken to resolve the problem.

Table 1: **Liquidated Damages for Ad Hoc Reporting**[7]

Through Settlement March 1998	Average Per Month (26 mos) To March 1998	April 1998	May 1998	June 1998	July 1998	August 1998
$1,596,800	$61,415	$18,200	$28,900	$3,800	$800	$300

Source: Department for Medicaid Services

UNISYS is now meeting a revised ad hoc reporting standard that could have been met earlier. Under the new requirements established for ad hoc reporting, UNISYS has five days to complete most requests and a maximum of 10 days for all requests. We compared this standard with the performance of UNISYS for ad hoc requests made from January 1997 through March 1997. As demonstrated in the table below, UNISYS only completed 110 of the 194 requests within the current standard. This means that previously, UNISYS was not meeting even the current standard in over 43% of requests. Clearly, the change in the performance of UNISYS was not due to a changed standard. Furthermore, because UNISYS is currently meeting this standard, the Department's failure to follow up and resolve the issue sooner, in effect, allowed UNISYS to underperform for an extended period of time.

[6] Under the contract, UNISYS proposed an ad hoc reporting system for use by Department personnel called MANAGERview. According to the UNISYS' Project Director, this system was not available and UNISYS substituted a system called Intelligent Query (IQ). According to Department staff, the IQ system was not "user friendly" and did not provide accurate reporting. As a result, this reporting system was not used extensively by Department staff and they relied on UNISYS to prepare the ad hoc reports they needed.

[7] Excludes damages for Third Party Liability report requests.

Table 2: **Timeliness of Ad Hoc Reports Completed from January to March 1997**

New Standard sets 10 Day Maximum on All Requests

Completion Time	Number of Requests	%
Within 1 day	48	25%
Within 2 days	15	8%
Within 5 days	21	11%
Within 10 days	26	13%
Subtotal	110	57%
Within 20 days	28	14%
Within 40 days	20	10%
Over 40 days (41 to 75 days)	36	19%
Subtotal	84	43%
Total	194	

Source: APA analysis based on Department for Medicaid Services data.

Nonperformance Issues Muddled with Disputed Damages

One reason the Department gave for not requiring further action from liquidated damage letters was that damages became a legal issue when UNISYS first disputed them in November 1996 and would need to be solved through legal negotiations. Department management believed, therefore, that the underlying performance issues could not be addressed.

In our opinion, however, the issue of performance is separate from the amount of damages that may or may not be assessed as a result of not adhering to contract requirements. Separating the issue of nonperformance from the assessment of damages serves to focus on performance and the resolution of these problems rather than focus on a disputable "penalty."

The Department Did Not Obtain Agreement with the Contractor Regarding How Performance Would Be Measured

In order to facilitate resolution of performance issues, the level of nonperformance must be established. Although the performance requirement is determined by the contract, a mechanism for measuring performance needs to be established and agreed to by both parties. Additionally, this mechanism should be validated to ensure accurate reporting of the performance measure. If measures are not agreed to and validated, inaccurate reporting of performance can result and obscure actual performance. Furthermore, any damages assessed as a result of nonperformance are more likely to be disputed.

A case in point is Kentucky's performance requirement for timeliness of processing. This performance standard requires the contractor to settle claims and adjustments within 30 days of receipt. This information is reported to the Department via a system-generated report. In this case, the report used to measure performance was inaccurate and, at times over the past 2½ years, overstated the number of claims taking over 30 days to settle. The report was fixed by UNISYS in April 1998 to more accurately reflect actual claims taking over 30 days to settle. In the meantime, however, UNISYS' true performance was not established and the Department, having no other way to obtain the performance information, calculated (although never formally assessed) over $460 million dollars in damages based on the erroneous report.

Because this reporting mechanism was inaccurate, the Department could not correctly determine the level of nonperformance and therefore, could not assess the appropriate damages. Moreover, UNISYS was able to use this as an example of why liquidated damages were unreasonable and to cast doubt over the enforceability of all damages assessed.

Even today, the Department and UNISYS do not believe the reporting mechanism accurately reflects all instances where claims are not paid according to contract requirements. However, they disagree about what is wrong with the report.

Other states determine how contract requirements will be measured at the beginning of the contract, either in the contract itself or after award. This method of measurement is established and validated before operations begin to ensure accurate reporting. In Idaho, upon contract award, the state reviews each contract requirement and associated performance measures with the contractor to ensure a mutual understanding of the requirements and an agreement of how each performance requirement is measured and monitored. In many cases, the performance requirements are measured with contractor-generated reports. An Idaho state official said this reduces the likelihood that the fiscal agent disputes the level of nonperformance that actually occurred.

The Department Did Not Look for Causes of Problems When Performance Did Not Improve

Damages were assessed for more than 22 months without signs of improvement, yet the Department did not try to identify the root cause of the problems. Good management practices dictate that, if problems persist, management has a responsibility to identify causes and to assist in their resolution.

The Department said that some of the performance problems were due, in part, to UNISYS understaffing, but the Department did not obtain any staffing information to indicate if this was the case. The Department did not monitor staffing levels throughout the contract and the contractor would not provide this information to us. We did, however, obtain a Resource Requirements Listing, dated November 1997, that UNISYS had to provide to the Department according to contract requirements. This document lists the number of UNISYS staff by functional area and shows total staffing of 270. The Department did not verify its accuracy nor compare it with documented staffing levels for the previous contractor of 174 full time equivalent staff in 1993. The Resource Requirements listing suggests that UNISYS staffing levels were up to one third greater.

Normally, a contractor would determine what staffing levels are required to perform according to contract standards. However, when performance does not improve, the Department needs to take a more proactive approach and identify the cause of problems so they can be appropriately remedied.

The RFP Should Provide More Information About Workload Requirements to Assist Bidders in Making Reasonable Bids

UNISYS claimed it was not understaffed and, in fact, had added staff to try to meet contract requirements. The UNISYS project director cited two examples, Third Party Liability and System Maintenance and Modification, where staff was added because the Department's performance requirements could not be met with staffing levels UNISYS had originally anticipated when bidding the contract. In these cases, the project director indicated that the contract requirements were unclear.

We reviewed the requirements in the RFP to which UNISYS responded, and its appendices. In general, information provided by the Department to offerors during the procurement process was limited, including only basic provider, recipient, and claim information. No information was provided regarding Third Party Liability workload, such as type and number of claims.

Furthermore, responses to offerors questions, attached to the RFP, clearly indicate the need for further information. In these questions, offerors asked the Department to provide historical information regarding the number and types of prior authorizations, volume of drug rebate checks, number of ad hoc requests, number of recipients by aid category assigned to physicians, and number of KenPAC providers.

Other states appear to provide more information relating to resource levels than Kentucky. Florida includes information on the number of provider telephone calls monthly, reasons for telephone calls, number of calls for the Automated Voice Response System, number of checks mailed weekly, number of payments by EFT weekly, etc. A Finance and Administration Cabinet official told us that this type of state information should be made available to offerors to assist them in formulating bids and to understand the level of service that will be expected.

As Problems Persisted, Specific Actions Were Not Taken to Compel Improved Contractor Performance

When problems occurred during system development and implementation, the Department elicited help from senior Cabinet for Health Services and Finance and Administration Cabinet officials. However, after the system was substantially implemented, the Department did not request further assistance from Finance and Administration officials even though performance problems persisted.

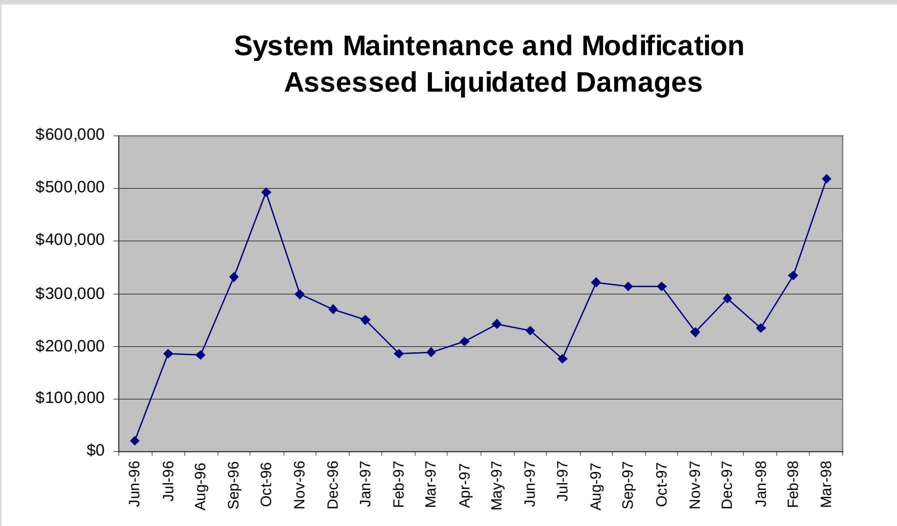
Department staff did make senior Cabinet officials aware of the ongoing operational problems through monthly meetings. However, we found no evidence that these officials addressed these issues in detail with senior management at UNISYS and in such a manner as to compel action. This might have included additional cure letters, agreements on performance monitoring and measurement, or detailed reporting by UNISYS at a time much earlier than the eventual legal settlement.

Good management practices dictate that unresolved problems should be addressed in a timely manner by persons with appropriate authority to resolve the issue. Similarly, a Finance and Administration Cabinet official told us that raising unresolved issues to the proper level of management is important so they may be addressed with the appropriate level of authority. This includes involving the Finance and Administration Cabinet in such issues if necessary.

System Maintenance and Modification: A Longstanding Performance Problem

Liquidated Damages assessed for System Maintenance and Modification are listed below. (Note that damages since the settlement in March 1998 have not been formally assessed.)

Through Settlement, June 1996 to March 1998	$5,824,000
April 1998	616,000
May 1998	575,000
June 1998	512,000
July 1998	408,500
August 1998	334,000



According to the contract requirements, damages can be assessed in the amount of $500 per work day for each modification (Design Change Request) or maintenance change order (Discrepancy Report Form) not operational on the date agreed upon by the Department and the Contractor.

In a December 1996 memo to UNISYS, the Department outlined procedures for establishing the due dates for modification and maintenance requests. Prior to this date, no formal process existed. The procedure states that due dates will be set with mutual agreement between the Department and UNISYS. The due dates are the basis for the damages calculation.

Department staff, in cooperation with UNISYS staff, created a tracking system that was originally to be provided by UNISYS. Both Department and UNISYS staff were charged with reconciling all requests to ensure all were accurately accounted for.

The Department and UNISYS held monthly meetings where outstanding maintenance and modification requests were discussed and dates for new requests were established. Minutes of those meetings indicate that the Department followed up on requests that were not completed by the established due dates.

From October 1997 to May 1998, UNISYS consistently missed mutually agreed to dates and requested new completion dates, extending the original due dates. For approximately 200 requests, the Department accepted the new date but informed UNISYS that damages would be calculated on the original due date. The missed deadlines resulted in an increasing backlog of requests; from October to March 1998, the backlog increased by over 58%

Outstanding DCR and DRF Requests

Opening Balance October 1, 1997	82
Outstanding Balance As Of:	
October 1997	95
November 1997	98
December 1997	127
January 1998	116
February 1998	124
March 1998	130

The Department did establish a procedure to account and track maintenance and modification requests and monitor whether individual requests were completed. However, the Department did not follow up when UNISYS continually missed established due dates. When problems persisted, the Department did not try and determine the cause of poor performance and did not require UNISYS to propose a course of action to resolve the outstanding backlog of requests. The penalties assessed by the Department do not appear to have altered performance and the Department did not get what it wanted—namely timely fulfillment of maintenance and change requests. Ultimately, this means that, under certain conditions, the Medicaid claims may not be paid according to Kentucky Medicaid policy.

In addition, the backlog of maintenance and modification requests that exists, if not resolved, could be left for the incoming fiscal agent under the new MMIS contract scheduled to begin July 1, 1999[8]. The new contractor would be required to resolve these issues as well as fulfill new requests. Lengthy delays to future maintenance and modification requests could arise if outstanding requests are complex and require considerable contractor effort to fix. The Department is currently working with UNISYS to resolve the backlog of requests; but whether the requests will be completed before the contract ends is unknown.

A More Systematic Process Could Assist Problem Resolution and Improve Overall Contract Monitoring

The Department may have been able to minimize many of the problems it has had with the contractor if it had followed a systematic process to assess liquidated damages. This preferred process would include a process for formal notification of nonperformance, requirement of corrective action plans, monitoring to determine if the plans are achieved and performance has improved, and notification of senior management if problems persist. At the end of this process, if performance does not improve, the assessment of damages would take place. This type of procedure provides the contractor with sufficient opportunity to "cure" nonperformance before a penalty is applied. If applied properly, this procedure would be a fair and equitable way of assessing damages, and would provide a documented trail of contractor performance and the Department's good-faith efforts to resolve performance issues.

The process described below is similar to the process used in Idaho, Connecticut, Massachusetts, and New Jersey to resolve problems. These states found this process helpful in making sure the issues were clearly established and gave the contractor every opportunity to solve the problem. With this procedure, contractors are held accountable for their performance. Kentucky's Finance and Administration Cabinet advocates a procedure that requires corrective action plans for specific contract requirements to assist in resolving contract issues.

[8] The Department is currently in negotiations to extend the MMIS contract with UNISYS.

The following chart lays out the key steps of a more systematic process for resolving contractual problems. Based on what other states have found to be successful practices and our discussions with Finance and Administration officials, we recommend that the Department establish a similar process to the one outlined below.

Table 3: **Process for Resolving Problems and Assessing Damages**

1. **Written notification** of nonperformance from the state. Notification should be specific and according to agreed standards.
2. **Contractor acknowledgement of deficiencies**. Shows agreement that a problem exists and ensures the contractor and the state agree that requirements are reasonable and the documented level of nonperformance is accurate.
3. **Requirement of Corrective Action Plan** for continued nonperformance based on predetermined standard. For example, for more than 2 consecutive months.
4. **Approval or Denial of Corrective Action Plan**. The Department determines if steps taken appear to be reasonable and appropriate to resolve problems.
5. **Implementation of Corrective Action Plan** and monitoring by the state.
6. **Formal notification of noncompliance**, when applicable, with a resolution deadline for continued nonperformance.
7. **Assessment of penalty or remedy** applied.
8. **Notification of more senior Cabinet officials** or Finance & Administration Cabinet if performance fails to improve.

While the implementation of a systematic process would not resolve all performance issues. We believe that a controlled approach could provide the following benefits:

- Allows the contractor an opportunity to propose and take corrective action. At a minimum, this process allows for an open dialogue between the contractor and the state regarding the necessary actions to be taken to resolve contract issues.
- The process of resolving problems is progressive and allows for more timely resolution.
- The resulting data gathered regarding performance will be more conclusive if penalties are later assessed.

Common Pitfalls with Liquidated Damages

If the Department uses a more systematic process for assessing damages, then the ability to prove nonperformance and ultimately collect for damages should improve. However, there are a number of common pitfalls to liquidated damages if they are not carefully applied. As seen under the MMIS contract, liquidated damages may be:

- Negotiable,
- Potentially unenforceable unless damages relate to actual loss suffered, and;
- Settled through lengthy legal negotiations distracting focus from underlying performance problems.

Liquidated damages are often assessed at management's discretion. While on the one hand this allows flexibility for management to impose penalties when they think it is appropriate, it also allows for those damages to be negotiated since liquidated damages are not an "automatic" penalty. In addition, damages often are settled at the end of the contract, a long time after nonperformance has occurred. This may diminish the need to assess a penalty, or make a penalty more difficult to collect.

Furthermore, liquidated damages must be reasonable and closely approximate actual loss incurred. The burden to prove nonperformance and actual damage suffered falls on the state, and determining actual loss suffered may prove difficult to calculate. Comprehensive documentation would be required and may prove too cumbersome to produce since losses are often intangible, such as lost productivity and lower employee morale.

Liquidated damages may not be applied to all performance deficiencies. In the case of MMIS, liquidated damages were tied to only a handful of measures. Only 26 of the 78 performance requirements in the contract were tied to or related to a liquidated damage clause. As a result, if the contractor did not perform according to standards in other areas, no penalty could be applied.

As in the case of MMIS, settlement of liquidated damages may involve lengthy legal negotiations cumbersome to both the state and the contractor. Under the MMIS contract, liquidated damages were assessed and in dispute for 21 months until these and other contract disputes were legally settled.

Furthermore, other states and contractors note that liquidated damages provide a negative incentive to perform and do not promote a productive working relationship.

Payment for Performance: An Alternative to Liquidated Damages

From lessons learned under the current MMIS contract, liquidated damages may not provide the most effective remedy for contractor nonperformance. An alternative to liquidated damages as an incentive to perform is the use of “payment for performance.” This concept ties actual performance to the payment a contractor receives. This method takes the legal judgement out of applying a “penalty” to contractors for nonperformance.

One state currently using this payment system for a MMIS contract is Florida. The Chief of the Bureau of Medicaid Contract Management told us that the report card system is designed to focus on what is important and to measure performance over the life of the contract. The contractor is paid based on level of performance.

Before operations begin, the state and the contractor determine and agree what is poor, adequate, and superior performance. Once levels of performance are established, a measuring methodology is created and a reporting mechanism put in place. If the contractor’s performance is beyond adequate, it receives a bonus over and above the operational payment. If, however, the contractor performs less than adequately, a penalty is assessed and deducted from the operational payment. Adequate performance requires no adjustment. In Florida, under this payment system, the contractor can earn or be penalized up to $100,000 per month.

Florida’s Chief told us that this type of system provides a positive way to motivate the fiscal agent. In addition, the adjustment to payments is automatic, and the contractor is being paid only to the level it performs. Furthermore, the report card system automatically documents fiscal agent performance over the life of the contract, making contract monitoring more automatic.

Agreement of performance levels and reporting is critical to this type of payment system. Florida's contractor produces the report necessary to determine performance, while Florida's contract management team monitors the reporting to ensure accuracy. In order to avoid disputes over performance reporting, Florida has independent auditors confirm the information. These auditors also serve as arbitrators if disputes arise.

The Department has incorporated the "payment for performance" concept in its new RFP to be released in 1999. The Department believes this method will improve the quality of contractor performance, document performance levels in all mission-critical areas of the system, improve the management of fiscal agent contracts, and provide value for the money it spends for administration of the Medicaid program.

The new contract is scheduled to begin in the later part of 1999. Payment for performance is structured similarly to Florida's. The contractor may earn up to $100,000 per month in incentives but may lose up to 50% of their operational payment for substandard performance.

The "payment for performance" method also incorporates all of the elements of the systematic process discussed above by obtaining agreement between the contractor and the Department on how performance will be measured, requiring corrective action when performance is poor, issuing a "cure" letter if the contractor fails to improve. The one benefit is that a "penalty" is immediately assessed and automatically reduces monthly operation payments, making the contractor more accountable for its performance.

The Department Needs to Revise Contract Monitoring Practices

In addition to a more systematic process for resolving contract problems, the Department should revise its current monitoring practices. The significant cost of the MMIS contract and the history of contractor problems indicate a need for more focused contract oversight and a reevaluation of current monitoring practices.

The average cost of the current MMIS contract is $11 million per year. This represents approximately 17% of Medicaid's total administration budget. Furthermore, the nature of the MMIS contract requires large commitment from both the contractor and the state. The state cannot administer the Medicaid program without the fiscal agent performing its duties, and the contractor is required to have considerable knowledge of Kentucky's Medicaid policies and significant technical infrastructure to support claims processing and related provider and recipient services. Under these conditions, if a contractor does not perform, it cannot be easily replaced. Therefore, the state must diligently monitor activities to ensure the contractor is performing as intended. Because contractors are keenly aware of the difficulties the state would have in replacing them, only adequate monitoring and follow-up will improve contractor performance. In addition, to reduce the risk that future nonperformance may occur, the state should acquire sufficient understanding of contractor operations.

The state should ensure that appropriate monitoring activities take place. These practices should reflect the current environment—meaning that, if a contractor suffers from poor performance it should be more closely monitored. Moreover, monitoring practices should change and evolve over time. Once effective procedures can become less effective depending on the circumstance under which monitoring takes place. Accordingly, management needs to determine if monitoring practices continue to be relevant and able to address new risks.

In determining what monitoring activities should take place, we recommend that the Department:

- Make contract oversight more comprehensive;
- Establish on-site monitoring;
- Formulate appropriate policies and procedures; and
- Provide training to monitoring staff.

Contractor Oversight Should Be More Comprehensive

The Department's Information Systems Branch is charged with the monitoring of the MMIS contract. According to a procedures manual from 1993, this branch performs specific functions including monitoring fiscal agent operations to ensure that claims are paid in a timely fashion, that monies paid are accounted for, that maintenance and design change requests are tracked, and that testing of system changes are reviewed and approved. Additionally, this branch monitors contractors' performance for contract requirements tied to liquidated damages.

While these functions are important to overseeing the contractor, they do not constitute comprehensive monitoring of contractor performance. Staff from the Information Services Branch acknowledge that more monitoring should take place. Branch staff told us that, with the Department's reorganization, they will have a new Information Technology Division. Within this division, a branch will be dedicated to contract monitoring. Monitoring staff told us this should allow them to perform more in-depth reviews of contractor activities. To date, staff have not determined what new monitoring practices they might undertake.

We found that some recommended monitoring activities are not currently the responsibility of the Information Systems Branch or other Department personnel. They include:

- Review fiscal agent audits and resolve audit comments;
- Review performance in the context of total work outstanding; and
- Independently verify contractor data.

Review Fiscal Agent Audits and Resolve Audit Comments: A review of operating controls put in place by UNISYS is conducted by an independent auditor each year. This audit determines whether UNISYS policies and procedures are suitably designed to provide reasonable control over data processing and operational activities. In part, this audit determines if there is reasonable assurance that:

- Operating system and application software development, acquisition, and maintenance activities are authorized, adequately tested, reviewed, approved, and implemented;
- Access to production application programs and data is restricted to appropriately authorized personnel and programs;

- Adequate procedures exist to minimize the effect on the computer and network facilities of a malfunction or physical disaster; and
- Transactions processed by MMIS contain complete and valid data, and are not duplicated, deleted, or modified.

Three audits performed from February 1, 1996 to August 30, 1998 by independent auditors Ernst and Young, LLP, reported the following deficiencies. The first two deficiencies listed below, occurred each year and, to-date, have not been corrected. The third deficiency appeared in the last two audits.

Deficiency Reported by Ernst & Young, LLP	Effect
UNISYS programmers are not restricted from update access to the production data and programs	Potential for unauthorized changes to application software. If unauthorized changes are made, software may not function as intended.
Business continuity procedures for the UNIX-based applications had not been developed	No plan for continuing operations in event of a disaster.
Prior to October 24, 1997, MMIS was not processing duplicate or suspected duplicate claims properly	Potential for duplicate claims being paid.

Source: Deficiencies reported by Ernst & Young. Effect determined by APA.

Review Performance in Context of Total Work Outstanding: The Department only reviews performance on a per unit basis for a each performance requirement. The Department, generally, does not monitor total work outstanding for a category of work. For example, the Department may determine that a single maintenance request is not completed on time and calculate damages. However, the Department does not review the total number of outstanding maintenance requests to determine if they have increased or decreased since the previous month, nor does the Department attempt to determine if the backlog of requests can be completed by the contractor in a reasonable amount of time. As previously noted in the report, system maintenance and modification requests were monitored individually; however, over time, the backlog increased by 58% and now the Department is currently trying to resolve as many of the outstanding requests as possible before the current MMIS contract expires.

In a similar situation, practices employed by the Commonwealth of Massachusetts' monitoring staff determined whether the outstanding backlog could be completed in a timely manner with the contractor's level of staffing. For example, monitoring staff summed the contractor's estimates for each system maintenance and modification request. The total was divided by the contractor's available person hours to determine if there was adequate staff to complete the backlog in a timely manner.

Verify Contractor Data for Key Performance Indicators: Of the performance measures monitored by the Information Services Branch, many are contractor self-reported. The Department, however, does not always independently verify the information reported by the contractor. Of 13 performance measures monitored from contractor information, about half are not independently verified.

Industry literature states that verification is an important part of contract monitoring. Verification normally requires independent inspections and confirmation of accuracy of contractor's self-reported performance. Verification is performed through inspections, formally documented user complaints, and surveys. For example, Idaho independently verifies each contractor's self-reported performance requirement each month.

To More Closely Monitor the Fiscal Agent, the Department Should Consider On-Site Monitoring

Some states monitor daily fiscal agent activities more closely than Kentucky. Three of the states we talked to have monitoring staff permanently on the contractor's site and two of the states have their entire monitoring section on site. By being on-site, they are able to identify problems almost immediately, more readily determine the causes of problems, constantly verify contractor activities, and develop a good working relationship with the contractor. These states said being on-site provides a better overview of contractor performance than they would otherwise have obtained from off-site monitoring.

For example, New Jersey staff, located at the contractor's site, can walk across the hall to the Provider Services section and listen to how contractor representatives answer provider questions. Immediately they can determine if staff are well trained and are providing reliable information.

An official from Connecticut's Department of Social Services, Fiscal Agent Monitoring, told us that they closely monitor daily operational activities of their MMIS contractor. For example, they monitor phone calls from providers to determine if they have enough staff to answer telephones promptly and to determine if the contractor is doing what it should to resolve provider problems.

Massachusetts performs periodic reviews of specific operational functions. The Director of Internal Control and Audit for the Division of Medical Assistance said these reviews establish a presence as well as ensures the contractor has proper operating procedures and appropriate resources.

Appropriate Policies and Procedures Should be Established

Given the problems we've identified, the Department for Medicaid Services should establish policies regarding contract monitoring and resolving contract issues. These policies should include guidelines for:

- Goals and objectives of contract monitoring;
- How and when a contractor should be notified of nonperformance;
- When problems should be brought to management's attention for continued nonperformance; and
- When cabinet officials or Finance and Administration should be notified to assist in problem resolution.

The current Information Systems Branch contract monitoring manual has not been revised since 1993. The Information Systems Branch should create an up-to-date monitoring manual based on the policies established by the Department and should include:

- A process for addressing nonperformance and communicating issues to senior Cabinet and Finance and Administration officials;

- Procedures for verifying reliability of contractor performance data;
- Procedures for monitoring total work outstanding; and
- Monitoring procedures for each performance requirement.

Furthermore, these policies and procedures should be periodically reviewed to make sure they meet the Department's needs. They also should be updated when conditions change which warrant establishing new procedures and/or discontinuing procedures that are no longer necessary.

Department Should Provide Training to Monitoring Staff

The Department is reorganizing the Department for Medicaid Services to more fully accommodate administration of the fee-for-service and managed care programs. In this reorganization, the Information Systems Branch gains more prominence in the organization by becoming the Division of Management Information Systems. Besides monitoring fiscal agent activities, the division will focus on technology, data exchange, and analysis. The Department hopes to capitalize on the vast amount of information existing in the MMIS from claims payments and managed care data. The Division of Management Information Systems will work with other divisions to identify their data needs and assist them in obtaining and analyzing data. The Department envisions that Division staff will be hired or trained to have the technical competence to support such functions.

While we applaud the Department's efforts to bring technology and data analysis to the forefront, we think it should also consider training for contract monitoring personnel. The Department should identify core competencies for the Information Technology Division staff, including project management, systems analysis, systems development, contract monitoring, data extraction, and data analysis. Training should be established for these individuals based on their area of expertise.

Reengineering Analysis Needs To Be Completed Prior To Implementation

Many of the ongoing problems involving the efficiency and effectiveness of the MMIS stem from continued reliance on inefficient processes. As we noted in our December 1997 performance audit of the Surveillance and Utilization Review Subsystem, reengineering of key processes by eliminating manual processing and simplifying reviews can lead to increased effectiveness. Little reengineering of the MMIS and the Medicaid department seemed to have occurred prior to implementation of the contract.

Recommendations

In order to improve the oversight of the MMIS contractor and ensure effective and efficient administration of the Medicaid Program, we recommend that the Department of Medicaid Services undertake the following:

1. Establish a systematic process for addressing contractor nonperformance. This process should include:
   - Written notification to the contractor of nonperformance;
   - Requiring a Corrective Action Plan and monitoring of the plan by the Department to ensure that performance has improved or the deficiency is resolved;

- Follow-up by the Department to ensure performance has improved, including determining cause of problems if necessary;
- Notification of senior Cabinet for Health Services and/or Finance and Administration Cabinet officials if performance does not improve.

2. Obtain agreement on how performance will be measured regarding existing performance problems. Under new contracts, establish agreement before operations begin.

3. Perform more comprehensive monitoring including:
   - Reviewing fiscal agent audits and resolving audit comments;
   - Reviewing performance in the context of total work outstanding;
   - Independently verifying contractor data.

4. Establish permanent on-site monitoring of the MMIS fiscal agent.

5. Establish contract monitoring policies including guidelines for:
   - Goals and objectives of contract monitoring;
   - How and when a contractor should be notified of nonperformance;
   - When problems should be brought to management's attention for continued nonperformance;
   - When cabinet officials or Finance and Administration officials should be notified to assist in problem resolution.

6. Develop a current contract monitoring manual.

7. Train contract monitoring personnel appropriately.

In order to improve the success of large information technology projects across state government, we believe that an Administrative Regulation should be created which ensures that the procurement and outsourcing of related contracts is appropriately planned. Accordingly, we recommend that:

8. The Finance and Administration Cabinet create and submit to the General Assembly an administrative regulation which requires any agency which wishes to contract for a large information technology project to have their implementation plan, risk management plan, and monitoring plan reviewed by the Finance and Administration Cabinet and the Office of the Chief Information Officer, prior to release of the Request for Proposal.

Lessons Learned for All State Agencies

1. Initiate reengineering studies of key systems and processes prior to development of information technology infrastructure. Along with reengineering, change management training should be provided to all key decision makers and users of the system. This helps to ensure that any new or revised system meets the "business case" for which it was established, i.e., the system efficiently and effectively helps employees fulfill the agency or program goals.

2. Allow adequate time for development, testing, and implementation of new systems. Build in leeway for unanticipated problems. (page 8)

3. To increase the likelihood of success, break large projects into smaller individual projects if possible. (page 8) The new strategic alliances contracts issued by the Department of Information Systems allow for contractors to assist agencies early on in the reengineering phase so that implementation is more likely to help the agency achieve its goals and be delivered in a manner which is more likely to result in a successful implementation.

4. Identify and evaluate project risks in a risk management plan. Periodically review plan to determine if risks and plans for dealing with them are still relevant, address new risks as needed. (page 8-9)

5. Establish monitoring mechanisms that accurately identify project status. Project progress should be independently verified by employees of the Commonwealth or by an independent consultant. High level oversight and steering committees should meet weekly to review specific implementation status and risk issues. Such groups should include the Cabinet Secretary, Commissioners, and the Chief Information Officer when statewide mission critical systems are being implemented. (page 9)

6. Obtain agreement with the contractor regarding how performance will be measured and establish accurate monitoring mechanisms. (page 16)

7. Address contractor nonperformance in a timely manner. Require corrective action plans from the contractor. (page 13)

8. Follow up when performance does not improve and identify the cause of problems. (page 17)

9. Raise unresolved issues to more senior management or the Finance and Administration Cabinet, if necessary, in a timely manner. (page 18)

10. If using liquidated damages, ensure they are reasonable and well supported. (page 21-22)

11. Consider "payment for performance" when appropriate. (page 22)

12. Ensure monitoring practices are comprehensive and suited to the contract environment i.e., more monitoring if the contractor's performance is poor. (page 23 – 27)

13. Ensure appropriate monitoring policies and procedures are in place. (page 26)

14. Provide appropriate training to monitoring personnel. (page 27)

Response to Agency Comments

The Department generally agreed with the audit recommendations and has, or is in the process of, implementing them. The Department's response can be found in its entirety in Appendix III.

Scope

We performed our audit in accordance with generally accepted government auditing standards. The audit's purpose was to determine why problems occurred during the implementation phase of the MMIS and continued during the operational phase and to identify what lessons can be learned and applied to future contracts. Problems related to the current MMIS contract effective, January 10, 1995 until July 1, 1999. Fieldwork was conducted from June 1998 through November 1998.

Methodology

To obtain an overall understanding of the problems occurring during the implementation and operational phases we interviewed Department for Medicaid staff involved with the implementation and Information Systems Branch staff charged with monitoring the MMIS contract. Also, we interviewed Finance and Administration officials, UNISYS' current Project Director, Federal Health Care Financing Administration Officials, and Cabinet for Health Services Legal Counsel and reviewed correspondence between the Department and UNISYS and between the Department and MAXIMUS.

Except for the current UNISYS Project Director, we were not able to speak with other UNISYS personnel involved with implementation or operations. We also found that some Commonwealth personnel involved in the implementation are no longer working for the state.

Also, we reviewed various project related documentation, including:

- The MMIS current contract including the Request for Proposal (RFP) and the UNISYS Response to the Proposal
- Amendment #1 to the MMIS contract
- Settlement Agreement between UNISYS and the Department for Medicaid Services
- Liquidated Damages letters sent from the Department to UNISYS
- Request for Proposal for writing the MMIS RFP
- The "New" RFP to be released January 1999
- Various implementation documentation submitted to the Department by UNISYS
- Minutes of committee hearings

In order to identify contracting best practices, we reviewed industry literature regarding systems implementation, service contracting and contract administration. We interviewed Finance and Administration Cabinet officials and the state Chief Information Officer. Also, we contacted other state's to determine their contracting and monitoring practices.

In order to determine whether the Department had an adequate system to handle contract problems in operations, we reviewed contract performance requirements and evaluated the fulfillment of these requirements by UNISYS. We focused our review on requirements that were not being met. We found that a significant amount of liquidated damages were incurred for three performance requirements: system maintenance and modification timeliness, ad hoc reporting timeliness, and timeliness of processing. For these requirements we interviewed Information System's Branch staff and the UNISYS Project Director. In addition, we reviewed correspondence between UNISYS and the Department to determine what actions were taken to address these problems. In addition, we followed up on another problem that was revealed to be significant at the time of the audit, namely, Third Party Liability.

To determine the amount of outstanding backlog per month for DCR and DRF requests, the auditor obtained a complete file of Design Change Requests (DCR) and Discrepancy Report Forms (DRF) from the Department. The auditor sorted each file by date completed. All entries that were "implemented" prior to October 1997 or "received" after March 1998 were deleted. To determine the amount of entries outstanding as of October 1, 1997, the auditor sorted each file by the date "received" and counted the number of entries raised before October 1, 1997 but not completed as of that date. To determine the number of requests received in a month, the auditor counted the entries based on the date "received". To determine the number of requests completed in a month, the auditor sorted the file by "implementation" and counted the entries. If more than one completion date was provided, the auditor used the earliest completion date to provide the most conservative result.

To determine the timeliness of Ad Hoc reports completed from January to March 1997, the auditor calculated the number of days UNISYS took to fulfill requests for this period. The auditor compared the date the Department made the request to UNISYS to the date the Department received the report. State holidays and weekend days were subtracted to determine the total number of working days to fulfill requests.

Source: Finance and Administration Cabinet & Office of the Chief Information Officer

Monday, March 15, 1999

Incident Summary Report By System

Product	Total #	%	Open	%	Closed	%	Other	%	Resolved	%	Cancelled	%
Web Travel	2	0%	1	50%	0	0%	0	0%	0	0%	1	50%
Unassigned	7	0%	7	100%	0	0%	0	0%	0	0%	0	0%
Reporting Database	1	0%	0	0%	1	100%	0	0%	0	0%	0	0%
Procurement Desktop	1013	62%	190	19%	422	42%	0	0%	397	39%	4	0%
Middleware	1	0%	0	0%	0	0%	0	0%	1	100%	0	0%
Integration-Procurement	17	1%	5	29%	2	12%	0	0%	10	59%	0	0%
BRASS	11	1%	5	45%	6	55%	0	0%	0	0%	0	0%
ADVANTAGE Travel	30	2%	17	57%	3	10%	0	0%	0	0%	10	33%
ADVANTAGE Reports	19	1%	3	16%	7	37%	0	0%	9	47%	0	0%
ADVANTAGE	540	33%	97	18%	339	63%	5	1%	39	7%	52	10%

Management Reporting Status Report

Progress Report Management Reporting

This Progress Report provides the Management Reporting status and accomplishments for the period of March 8, 1999 through March 12, 1999.

PROGRESS FOR THIS PERIOD

- Pending statuses on pre-encumbrances, encumbrance, and expenditures are in opened discussion.
- Disbursement fact table is in opened discussion, need to look into as soon as posible.
- Capturing historical perspective on accounting structure is under review.
- Fields are being added and dropped as the client requested, all the fact tables are up-to-dated in that regard.
- Documentation on Agency notebook is completed as requested.
- Wrapping up the work on Reporting Database data dictionary, the method of approach is to enter the columns and tables into an Access database, and transfer the data into Designer whenever they are ready.
- Documentation of the Advantage section of the MRDB design is complete and ready for review.
- All the identified fact tables have had their corresponding physical tables created, and data populated into it.
- On the PD side – documentation of de-normalized model has been completed and resources are assigned to complete screen to database field mappings.
- Design of data capture for Advantage and PD databases is complete.
- Design of SEC1 security abstraction from the Advantage security structure is complete.
- Design and development of MRDB data management scripts is in process.
- Development of Advantage data extraction code is in process.
- Continued support of System Test for Advantage reports.

ACTIVITIES PLANNED FOR THE NEXT REVIEW PERIOD

A number of concurrent activities will be performed during the next review period. These include:

- Complete database to screen mapping of PD data structure.
- Complete design and documentation of checkwritter/disbursements section of MRDB.
- Submit the Advantage section of the MRDB design for review.
- Continue with design and development of MRDB data management scripts.
- Continue with development of Advantage data extraction process.
- Begin development of Advantage SEC1 security extraction process.
- Address BRASS data design issue.
- Continue support of System Test for Advantage reports.

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Management Reporting Status Report

PROBLEMS AND ISSUES REPORTED (by Date) / STATUS (by Date)

Date Logged	Problems/Issues	Due Date	Status	Date
03/01/99	Process must be developed to synchronize on-going operational database changes with the reporting database.	03/05/99	Developing a database synchronization process with Advantage and PD DBA's.	03/08
03/08/99	Change in strategy to include budget request data from BRASS will impact design and development schedule.	03/12/99	MRDB team working with Stuart Weatherford and John Hicks to determine the scope of this requirement.	03/08
03/08/99	Need additional PD technical support in order to complete MRDB design for PD data.	03/09/99	PD resources have been assigned to complete this task.	03/12
03/08/99	Commonwealth resources have not been identified for MRDB report design and development.	03/12/99	Stuart Weatherford is working with Commonwealth project management to obtain required staff.	03/08

DATE CHANGES WITH POTENTIAL DEPENDENCY IMPACTS

None.

Submitted by: Neal Underwood

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Procurement Desktop Development Status Report

The following table provides a status estimate for the outstanding drop 3 software development work by technical area.

Task Name	Estimated Hours	Approximate Hours Spent to Date	Approximate Percent complete
Advantage Interface Tasks			
• Error Handling in PD (override functionality outstanding)	150	150	100
• Award integration	240	210	85
• Invoice integration	240	200	83
• Receivers integration	150	80	53
• Misc. Quick Pay integration	150	50	33
• Stock Request integration	150	70	46
• Requisition Modification integration	200	0	0
• Award Modification integration	200	0	0
• P-Card integration	150	0	0
PDWeb Tasks			
• Web Desktop	150	140	93
• Web Requisition	200	180	90
• Web Catalog	1600	1385	85
EC Tasks			
• Vendor Registration	250	130	52
• Solicitation Posting	250	205	82
• Bid Receipt/Award View	250	240	96
Client/Server PD Tasks			
• P-Card	200	0	0
C Interface Tasks			
• Fixed Assets	150	130	90
• Auto load Invoices	120	100	83
• P-Card	200	0	0

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Agency Comments

Appendix III

CABINET FOR HEALTH SERVICES
COMMONWEALTH OF KENTUCKY
FRANKFORT, 40621-0001

DEPARTMENT FOR MEDICAID SERVICES
"An Equal Opportunity Employer M/F/D"

June 22, 1999

Edward B. Hatchett, Jr.
Auditor of Public Accounts
144 Capitol Annex
Frankfort, Kentucky 40601-3448

Dear Mr. Hatchett:

The Department for Medicaid Services (DMS) has reviewed the draft report on the Implementation and Oversight of the Medicaid Management Information System Contract and have the following comments on the recommendations.

Recommendations 1, 2, 3, and 5:

Prior to the release of the Request for Proposal (RFP), the CIO recommended that the contractor's performance be measured through a series of report cards. Under the new contract effective December 1, 1999, the card method will be implemented. DMS and the contractor will jointly develop criteria to measure those quality levels. Each month, the contractor shall submit report cards to the DMS which shall assess the contractor's quality performance in several key areas of operations. The contractor can earn incentive payments or be assessed penalities based on several required areas of critical importance to DMS. Attached is RFP Section 5.23.4 which explains the operations of the report cards.

Recommendation 3:

All exceptions found in fiscal agent audits will be monitored more comprehensively.

Recommendation 4:

On-site monitoring of the MMIS fiscal agent has been established on a rotating basis a portion of each week.

Recommendation 6:

DMS is in the process of updating the Contract Monitoring manual.

EDUCATION PAYS

Edward B. Hatchett
Page Two
June 22, 1999

Recommendation 7:

Training activities in the Contract Monitoring Branch have increased.

Recommendation 8:

We agree with this recommendation. The most recently completed procurement was approved by the CIO and the Finance and Administration Cabinet, prior to release of the RFP.

We appreciate the opportunity to provide comments on your recommendations.

Sincerely,

Dennis Boyd
Commissioner
Department for Medicaid Services

DB/aw

Attachment

cc: Harold McKinney
Glenn Jennings
Kay Kirkland
Mary Rhodes

5.23.4 Quality Operations Performance Report Cards

Offerors are required to propose report card incentive arrangements that at least incorporate the items listed within Section 5.26, performance standards. Proposals should reflect a challenging and ambitious plan for accomplishing the Kentucky MMIS contract requirements based upon a "pay for performance" concept. Offerors are encouraged to propose report card incentive arrangements that exceed the basic requirements found within the Terms and Conditions. Compensation represented by the contracted payment shall be disbursed in thirty-six (36) equal monthly payments less any (1) liquidated damages and/or (2) penalties under the report card system, over the life of the original three-year contract. The final, negotiated contract will include the potential for monthly incentive payments based on several required areas of critical importance to DMS. Offerors are also encouraged to propose additional incentive arrangements beyond those listed within this section. A firm commitment to apply incentives in additional areas is required during implementation of the takeover contract.

Only one monthly base payment and potential incentive award shall be provided to the Contractor. Distribution of payment to any subcontractors of the performing entity involved in the contract is the responsibility of the Contractor.

The contractor's performance shall be measured through a series of report cards. Each month, the contractor shall submit report cards to the Department of Medicaid Services which shall assess the contractor's quality performance in several key areas of operations.

An additional Quality Payment Adjustment of up to a maximum of one hundred thousand dollars ($100,000) per month may be paid to the contractor using a calculation based on performance report cards in a payment methodology designed to improve contractor commitment to quality performance.

The quality payment award shall be based on careful, mutually agreed upon quality measurements performed by the contractor and provided to DMS, then reviewed and approved by state contract management staff. The contractor report cards shall also be used to determine the amount of penalties that the contractor shall pay to the Agency (through withheld payment) if performance standards are not met.

DMS believes this method will improve the quality of contractor performance, document performance levels in all mission-critical areas of the system, improve the management of fiscal agent contracts and get the state and federal governments more value for the money they spend for administration of the Medicaid program.

1) Base-level contractor performance shall include at a minimum, the items contained within the Performance Requirements Section 5.26.

2) DMS will identify areas of contractor performance where quality is critical to the mission of the Medicaid program for inclusion on report cards.

3) During takeover contract implementation, DMS will reach agreement with the contractor concerning the levels of quality that are desirable, acceptable and substandard for each line item on each report card.

4) DMS and the contractor shall jointly develop criteria to measure those quality levels on a monthly basis, using a report card system.

5) DMS shall establish a range of payments for high quality, acceptable quality, and an amount to be deducted (in lieu of liquidated damages) for performance requiring corrective action.

6) During the course of the contract, performance shall be measured by the contractor, using the report cards. DMS contract management staff shall actively participate with the contractor in the report card process and shall evaluate the results recorded.

7) At the end of each quarter, payment adjustment increases will be made for each set of report cards indicating a high level of quality. Deductions will be made for each set of report cards indicating a need for corrective action. No adjustment shall be made for merely achieving the mutually agreed upon "acceptable" level of quality.

Each report card shall have its own weight value finalized through negotiation with the contractor during takeover. The DMS shall have final approval on the weight values established. Each report card shall be composed of scoring elements totaling one hundred (100) points. For each of the report cards, the total number of points scored shall be multiplied by the report card's weight value to determine its final value. The final value of all cards shall be summed to determine the Contractor's total score for that particular month which shall determine either (1) incentive award payment to the contractor for quality, (2) no specific action, or (3) a penalty amount which may be withheld by the Commonwealth from the contractor, as follows:

- 94 to 100 points = 100% of the monthly contracted payment and 100% of the monthly report card incentive award paid to the contractor;
- 87 to 93 points = 100% of the monthly contracted payment and 50% of monthly report card incentive award paid to the contractor;
- 80 to 86 points = 100% of the monthly contracted payment with no incentive award paid to the contractor;
- 73 to 79 points = corrective action required from the contractor, and $100,000 reduction in the monthly contracted payment with no incentive award paid to the contractor;
- 66 to 72 points = corrective action required from the contractor, and 75% of the monthly contracted payment with no incentive award paid to the contractor;
- Below 66 points = corrective action required from the contractor, and 50% of the monthly contracted payment with no incentive award paid to the contractor;

If the contractor earns a score from 66 to 72 points in each of four consecutive months, in the fourth month the contractor shall be paid as if the earned score were below 66 points for that month (50% of the monthly contracted payment with no incentive award paid to the contractor) and for each following month for up to three months that earned scores remain below 73 points.

If the contractor earns a score below 80 points in each of seven consecutive months, the contractor shall be provided with a cure letter and may be terminated for convenience.

Additionally, if the contractor earns a score below 66 points in each of four consecutive months, in the fourth month the contractor shall be provided with a cure letter and may be terminated for convenience.

- If the report cards are not submitted within forty-five (45) days of the close of the month, penalties are imposed as if the score were below 66 points and corrective action is required from the contractor;
- Performance of the required corrective action(s) by the contractor does not reduce the amount of the penalty for the current month's set of report cards. However, it is expected that the implementation of corrective action(s) will improve performance in future periods, resulting in the possibility of future quality incentive adjustments.

A sample report card with associated possible point values follows this subsection. Final point values as well as the line item elements for each report card shall be jointly finalized between DMS and the contractor during takeover. All system functions and related report cards are critical to the successful operation of the Kentucky MMIS. However, the following areas are considered mission critical:

- Claims Processing,
- Encounter Processing,
- Contractor Performance Management,
- MARS Reporting,
- Ad Hoc Reporting,
- Correctness of Payments,

- System Modification and Maintenance,
- Financial Processing,
- Third Party Liability Processing,
- System Availability,
- Prospective Drug Utilization Review/Electronic Claims Processing, and
- Decision Support Reporting.

In particular, "Contractor Performance Management" refers to relationship management between the contractor and the contractor's customers. DMS staff and providers comprise the bulk of the contractor's customer base. Maintenance of good working relationships is a concern of extreme importance to DMS and the provider community. The contractor shall propose two easily measurable, brief customer satisfaction surveys to be administered to a simple random sample of DMS staff and providers on a monthly basis to evaluate the contractor's responsiveness in their interactions.

Other proposed report cards shall include the following critical areas:

- Recipient Data Maintenance,
- Provider Data Maintenance,
- Prior Authorization Processing,
- Reference Data Maintenance,
- Drug Rebate Processing,
- EPSDT Processing,
- SURS Processing,

- Claims Sampling,
- Response Time,
- Mailing Requirements,
- Documentation,
- Retrospective Drug Utilization Review Processing,
- Voice Response Eligibility Verification System Operations, and
- LAN User Response Time.

The Contractor may propose the creation of report cards in addition to the critical areas listed above. All items within each report card shall be measurable. All report cards shall be system generated by the contractor. Due to the changing environment of Medicaid, with the continuing implementation of managed care for example, report cards shall be annually reevaluated for appropriateness and any new report cards shall be finalized through joint negotiation between the Commonwealth and contractor. For example, a one-time "Claims and Adjustments on Hand at Termination of Contract" report card will be included in the last month of contractor operations before any termination of contract.

NOTE: THIS REPORT CARD FOR EXAMPLE PURPOSES ONLY

REPORT CARD - SYSTEM AVAILABILITY	Monthly Report Card Weight - 0.10		
		Possible	Actual
Files	Scoring	Points	Score
System must be available for inquiry and update according to the terms of the contract. The contractor shall produce a report that shows the number of hours each day the system is available.	Subtract 1 point each time the system is down for an unauthorized period.	30 points	________
Imaging			
A. Select 5 claims and 5 provider applications weekly. Compare the date on the source document to the TCN date. Image must be created within 24 hours of receipt.	Subtract 1 point for each late TCN	10 points	________
B. Sample 10 images a month. Record the time it takes to retrieve a record.	1 point for each timely retrieval	10 points	________
POS			
System must be available for receipt and adjudication of point of sale (POS) claims twenty-four hours per day, seven days per week, except state approved scheduled maintenance downtimes.	Subtract 1 point for each hour of downtime not approved by the state	25 points	________
AEVS / VREV			
Request 10 eligibility transactions a week from AEVS / VREV.	Subtract 1 point for each time the system is unavailable	25 points	________
TOTAL POINTS		100 points	________

Auditor of Public Accounts Information

Appendix IV

Contributors To This Report

Edward B. Hatchett, Jr., Auditor of Public Accounts

Harold McKinney, Acting Director of Performance Audit
James A. Rose III, CPA
Kristina Frawley, CIA, Performance Auditor
Wally Haddix, CSIA, Performance Auditor
Ellyn Sipp, CIA, Performance Auditor

Obtaining Audit Reports

Copies of this report or other previously issued reports can be obtained for a nominal fee by faxing the APA office at 502-564-2912. Alternatively, you may

order by mail:	Report Request Auditor of Public Accounts 144 Capitol Annex Frankfort, Kentucky 40601
visit :	8 AM to 4:30 PM weekdays
email:	Hatchett@apa1.aud.state.ky.us
browse our web site:	http://www.state.ky.us/agencies/apa

Services Offered By Our Office

The staff of the APA office performs a host of services for governmental entities across the state. Our primary concern is the protection of taxpayer funds and furtherance of good government by elected officials and their staffs. Our services include:

Performance Audits: The Division of Performance Audit conducts performance audits, performance measurement reviews, benchmarking studies, and risk assessments of government entities and programs at the state and local level in order to identify opportunities for increased efficiency and effectiveness.

Financial Audits: The Division of Financial Audit conducts financial statement and other financial-related engagements for both state and local government entities. Annually the division releases its opinion on the Commonwealth of Kentucky's financial statements and use of federal funds.

Investigations: Our fraud hotline, 1-800-KY-ALERT (592-5378), and referrals from various agencies and citizens produce numerous cases of suspected fraud and misuse of public funds. Staff conduct investigations in order to determine whether referral of a case to prosecutorial offices is warranted.

Training and Consultation: We annually conduct training sessions and offer consultation for government officials across the state. These events are designed to assist officials in the accounting and compliance aspects of their positions.

General Questions

General questions should be directed to Donna Dixon, Intergovernmental Liaison, at (502) 564-5841 or the address above.