



# AUDITOR GENERAL LETTER REPORT

DOUGLAS R. NORTON, CPA  
AUDITOR GENERAL

February 18, 1993

Letter Report No. 93-L2

The Honorable Fife Symington, Governor

The Honorable John Greene  
President of the Senate

The Honorable Mark W. Killian  
Speaker of the House of Representatives

**SUBJECT:                    Arizona Health Care Cost Containment System  
   Special Review**

This letter presents the results of our review of professional and outside services expenditures at the Arizona Health Care Cost Containment System (AHCCCS). This review was conducted in response to Laws 1992, Chapter 301, §63, under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §41-1279.03.

Our review consisted primarily of inquiries and the examination of selected accounting records and other documentation related to the expenditures mentioned above. We did not review AHCCCS's internal control structure over purchasing or contracting. Accordingly, we do not express an opinion on the internal control structure or ensure that all material weaknesses in the structure were disclosed.

### Scope and Methodology

Laws 1992, Chapter 301, §63, require that "The Auditor General shall conduct a fiscal audit of the AHCCCS administration to determine the cost effectiveness of the system administration's policy to contract for professional services outside of that agency." Due to time and budgetary constraints, we could not perform the

necessary audit procedures to determine the cost effectiveness of the policy to contract for professional services. However, after discussions with members of the 40th Arizona State Legislature, we determined that the scope of our review should be as follows:

- Analyze the nature and amount of professional and outside services expenditures incurred during fiscal years 1989-90, 1990-91, and 1991-92
- Determine the reasons for the increase in expenditures for professional and outside services from fiscal year 1989-90 to fiscal year 1992-93

As part of our review, we examined expenditures from fiscal years 1989-90, 1990-91, and 1991-92. We examined bid files for payments for professional and outside services during fiscal year 1991-92 to determine if the bidding procedures followed by AHCCCS affected the amount of professional and outside services expenditures. In addition, we contacted AHCCCS officials to obtain any additional explanations regarding these expenditures.

#### Background

During our review, we noted that AHCCCS incurs the following types of professional and outside services expenditures.

- Data Processing - Includes charges from the Department of Administration for data processing services and charges for outside consultants to work on the redesign of the Medicaid data processing system
- Financial - Consists of auditing fees, actuarial services, and accounting firm fees for various financial reviews and evaluations, both internally and for plan providers
- Legal - Consists of fees for legal representation for AHCCCS cases and expert counsel on various legal matters

- Medical and Hospital - Includes fees paid to medical experts to evaluate acute and long-term care fees charged to AHCCCS on a "fee for service" basis by plan providers
- Other Professional Services - Consists primarily of temporary employee services, security services, and other professional services that cannot be included in another category

The following schedule summarizes the expenditures for each of the categories noted above.

AHCCCS  
Schedule of Professional and Outside Services  
Actual Expenditures for the  
Years Ended June 30, 1990, 1991, and 1992, and  
Budgeted Expenditures for the Year Ending June 30, 1993  
(unaudited)

	<u>1989-90</u> <u>(Actual)</u>	<u>1990-91</u> <u>(Actual)</u>	<u>1991-92</u> <u>(Actual)</u>	<u>1992-93</u> <u>(Budgeted)</u>
Data processing:				
Department of Administration	\$ 4,434,046	\$ 7,138,702	\$ 6,426,634	\$ 7,642,000
Outside consultants	6,726,841	5,319,335	4,799,436	4,229,900
Financial	1,567,767	1,398,027	1,643,698	1,190,800
Legal	426,924	654,310	480,934	392,800
Medical and hospital	496,692	487,940	602,249	938,600
Other professional services	<u>849,256</u>	<u>1,813,987<sup>b</sup></u>	<u>450,310</u>	<u>327,900</u>
Total professional and outside services expenditures	<u>\$14,501,526<sup>a</sup></u>	<u>\$16,812,301</u>	<u>\$14,403,261</u>	<u>\$14,722,000</u>

(a) The Arizona Financial Information Systems reports incorrectly include \$753,194 of professional and outside services expenditures. This amount has been excluded from the schedule.

(b) The Arizona Financial Information Systems reports incorrectly include \$747,776 of Other Professional Services that should have been recorded in the specific categories of Professional and Outside Services Expenditures.

Source: Arizona Financial Information Systems (actual) and the AHCCCS budget reports for the Fiscal Year Ending June 30, 1993 (budgeted).

We noted the most significant increase in expenditures for professional and outside services was in the data processing expenditures paid to the Department of Administration. Department of Administration charges have increased as the number of AHCCCS members have increased. There is a direct correlation between Department of Administration charges and the number of AHCCCS members because the amount of processing time and storage space increases with each member added to the plan. Medical and hospital expenditures have also been steadily increasing as the number of AHCCCS members has increased. During fiscal year 1990-91, Professional and Outside Services Expenditures reflected a one-time increase due to start up costs associated with two projects. All other categories of expenditures either decreased or increased only slightly. We did not note any unusual increases during our review; however, we noted the following procedures that appear questionable.

#### Finding I

##### **Electronic Data Processing (EDP) Consulting Services were not Properly Bid**

In May 1990, AHCCCS received authorization from the Department of Administration for the emergency procurement of EDP consulting services. AHCCCS then issued a request for proposals. However the specific projects to be performed were not described in the request. Responsive bids were received from 39 firms. AHCCCS subsequently awarded open-ended contracts, effective through June 30, 1991, to all 39 firms. AHCCCS subsequently extended these contracts for two additional fiscal years without issuing a request for proposals and receiving competitive bids.

As specific EDP consulting services were required, a vendor was selected and issued a purchase order against an issued contract. Although AHCCCS awarded contracts to all 39 responsive bidders, services of only 16 of the vendors were ultimately used.

A review of the EDP contracts indicates that the services and qualifications necessary to perform those services were unique in nature. However, the criterion used in the selection of the vendor for each contract was not documented. Due to the nature of the required services, the method used to

procure the services rendered the bidding process ineffective. Based on the nature of the services used, AHCCCS should issue a request for proposals as each specific project is identified. All projects should be competitively bid at least annually.

## Finding II

### **Conflict of Interest Noted for EDP Consulting Services**

AHCCCS has contracted with a firm to provide a significant amount of EDP consulting services. These services totaled approximately \$1,320,000 and \$1,260,000 for fiscal years 1990-91 and 1991-92, respectively, and \$180,000 for the first quarter of fiscal year 1992-93. On July 1, 1992, AHCCCS employed the firm's president as an Assistant Director in the division responsible for selection of EDP vendors. Upon employment with AHCCCS, this individual resigned as president but remains a director and stockholder of the consulting firm.

To avoid any conflict of interest problems, AHCCCS and the Assistant Director entered into an agreement whereby the Deputy Director of AHCCCS, or her designee, is required to make all decisions regarding the distribution of work to the consulting firm. However, an employee directly supervised by the Assistant Director awarded project assignments to vendors. Our review further indicates that the Assistant Director approved for payment many of the expenditures for services provided by the consulting firm.

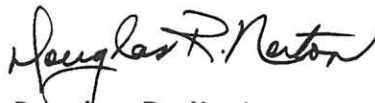
A.R.S. §38-503.C states, in part "...no public officer or employee of a public agency shall supply to such public agency any equipment, material, supplies or services, unless pursuant to an award or contract let after public competitive bidding..." Despite the conflict of interest agreement, AHCCCS appears to be in violation of this statute in regards to the expenditures made to the consulting firm during fiscal year 1992-93.

## Recommendations

AHCCCS should develop formal procedures for evaluating and awarding EDP consulting contracts that include the following elements. These procedures would help ensure that AHCCCS receives the necessary services at the best possible price and that the selection process is free from bias.

- Prior to the bidding process, there should be a careful study and examination of the services needed from a consultant. AHCCCS should then prepare the request for proposals using the information in the study and other sources to ensure it receives the services needed.
- Requests for proposals should be issued as specific EDP consulting projects are identified. All projects should be competitively bid at least annually.
- A committee of unbiased, knowledgeable individuals should formally evaluate all responsive bids.
- Evaluation forms should be completed by each committee member based on information provided in the bids. Contracts should be awarded to the most responsive and responsible bidder.
- Evaluation forms and information used to award EDP consulting contracts should be retained to document the selection process.
- Payments made to EDP consulting firms should be reviewed and approved by an independent employee.

The AHCCCS officials have reviewed this report and their response is attached. My staff and I will be pleased to discuss or clarify any items in this report. This report will be released to the public on March 2, 1993.

  
Douglas R. Norton  
Auditor General



# ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

FIFE SYMINGTON  
Governor

LEONARD J. KIRSCHNER, M.D., M.P.H.  
Director

March 1, 1993

Mr. Douglas R. Norton  
Auditor General  
2700 North Central Avenue, Suite 700  
Phoenix, Arizona 85004

Dear Mr. Norton:

This letter is our response to your Letter Report No. 93-L2, dated February 18, 1993. As I understand, the scope of your review was limited to the following:

- "Analyze the nature and amount of professional and outside services expenditures incurred during fiscal years 1989-90, 1990-91 and 1991-92"
- "Determine the reasons for the increase in expenditures for professional and outside services from fiscal year 1989-90 to fiscal year 1992-93"

Your report, as it relates to this review, states in the findings, "We did not note any unusual increases during our review..." Therefore, in accordance with the scope of your review, I am pleased to note that your findings validate that the Agency's efforts to control professional and outside service expenses have been successful. I have attached a copy of our Agency's policy and procedure on fiscal management which has been in place since 1992 (Attachments 1 and 2)\*. It is unfortunate that your report did not include a comment on how, or why, our expenses have increased "only slightly" in light of the fact that the agency's program budget grew by over 280% between FY 88 and FY 93 and included the addition of major new programs such as long-term care, mental health and children's health programs which required a greater need for consultants' services due to the complexity involved in their implementation as well as limited implementation timeframes.

\* The attachments have not been included due to their length. Interested parties may obtain copies of the attachments upon request from the Office of the Arizona Auditor General.

Mr. Douglas R. Norton  
March 1, 1993  
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Footnote (a) of the schedule of professional and outside services needs further clarification. This footnote on page 3 references federal funds that were brought into the AHCCCS fund and paid out to the County Supervisor Association (CSA). The CSA is acting as the fiscal agent for all the counties in submitting a consolidated invoice for the counties with regard to effort expended by the counties in the SOBRA eligibility process. The counties pay for the initial SOBRA eligibility process and are reimbursed by Title XIX funds after the fact. Initially, AHCCCS processes the transfer of funds as an expenditure against the AHCCCS expenditure authority. It was determined after the end of SFY 90 that funds should be treated as a pass through to CSA since the AHCCCS expenditure authority did not include the SOBRA eligibility effort.

In terms of your findings and recommendations I would offer the following comments:

◦ Finding 1: Electronic Data Processing (EDP) Consulting Services Were Not Properly Bid

This finding is wrong as currently stated as the EDP consultants' services were bid in conformance with the Arizona Revised Statutes and Procurement Code. Instead, at issue is whether AHCCCS should have issued annual requests for proposal as opposed to renewing the contracts (which was legally allowable under the terms of the initial contracts) and whether these contracts should be issued for each specific project or for specific expertise. The EDP consultant services played a critical role in assuring that AHCCCS was able to implement the PMMIS system, a unique fourth-generation mainframe relational database, consisting of multiple subsystems and designed through a coordinated effort between AHCCCS and the Health Care Financing Administration (HCFA) to support the unique, pre-paid capitated program under which AHCCCS operates. In order to accomplish this task, service requirements contracts as opposed to project contracts allowed us to contract for the specific technical and programming expertise in a fourth generation relational data base necessary to complete the PMMIS project. Professional service contracts are not unusual. DOA, for instance, has statewide service contracts with several vendors who are on contract to provide the same type of EDP consulting services as provided for in the AHCCCS contracts.



The Contracts were renewed in June 1991 and again, in February 1992 through June 1993. The reasons for renewal of the existing contracts were: 1) By June 1991, AHCCCS had not completed the final PMMIS implementation phase. (This was completed in September) In addition HCFA certification of the system was scheduled for late 1992. Renewing the EDP consultant contracts allowed AHCCCS to ensure technical continuity in completing these tasks and 2) Although PMMIS implementation was completed during the early months of 1992, AHCCCS was making significant personnel changes within the Information Services Division (ISD), including negotiating for a new Assistant Director. Given the personnel changes and restructuring of the division, AHCCCS again renewed the EDP consulting contracts, to ensure that consultants were retained who were familiar with the recently certified PMMIS.

Now that the situation is more stable within the ISD, AHCCCS will proceed with a new competitive bid effective July 1, 1993. AHCCCS is currently writing the request for proposals.

◦ Finding 2: Conflict of Interest Noted for EDP Consulting Services

AHCCCS feels that it has made every effort to prevent any conflict of interest between the EDP consulting services and the Information Services Division and that the agency is not in violation of A.R.S. 36-503(C). As noted in your report, EDP evaluation and procurement has been delegated to the Administrative Services Manager for ISD, who works in conjunction with the Contracts Unit to arrange EDP consulting services. However as of July 1992 when the new ISD Assistant Director was hired, final approval authority was delegated to the Deputy Director. It is important that an ISD staff person be involved in the decision making process due to their expertise in PMMIS. Although it is a standard AHCCCS procedure that all Assistant Directors approve payments for consultants on October 1, 1992, AHCCCS assigned the responsibility to approve payments for the EDP consulting services to the ISD Administrative Services Manager as to avoid any potential conflict of interest.

Mr. Douglas R. Norton

March 1, 1993

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◦ Recommendations

In general, I concur with the recommendations. Except for the unique circumstances surrounding the awarding of the EDP consulting contracts. AHCCCS has in all other instances followed formalized procedures for evaluating and awarding consulting contracts. For your information, I have attached current policies (Attachments 3 through 5)\*related to EDP consulting services.

Thank you for giving me the opportunity to respond to your report.

Sincerely,



Leonard J. Kirschner, M.D., M.P.H.  
Director

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\* The attachments have not been included due to their length. Interested parties may obtain copies of the attachments upon request from the Office of the Arizona Auditor General.