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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(3)

March 9, 1978

The Honorable Henry M. Jackson
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

Your August 4, 1977, letter requested us to provide certain information regarding the contract between the State of Washington and Electronic Data Systems Federal Corporation (EDSF) for implementing and operating the Medicaid Management Information System (MMIS). Specifically, you asked us to determine (1) if the lowest technically acceptable and responsible offeror was awarded the contract, (2) if the State had assumed any responsibilities which were originally to be provided by the offeror in accordance with the request for proposals, and (3) the difference in cost between the lowest unsuccessful offeror's proposal and the cost of the contract.

We reviewed the State's request for proposals; the proposals submitted in response to the request; the MMIS contract with EDSF; Department of Health, Education, and Welfare (HEW) and State documents relating to the procurement; and HEW's regulations and policies relating to MMIS and State procurements under Medicaid. We also reviewed documentation regarding the operation of Washington's MMIS.

SOLICITATION FOR AND EVALUATION OF PROPOSALS

The objective of any MMIS is to improve the capability of Medicaid State agencies to effectively process claims, help control utilization of services, and provide management with the necessary information for planning and administering the Medicaid program. States may contract with private companies to develop, install, and/or operate such a system. Section 1903(a)(3) of the Social Security Act requires Federal sharing in the costs of MMIS. HEW must pay 90 percent of the costs of developing and installing MMIS and 75 percent of MMIS operational costs. Federal regulations regarding requirements for approval of a system as an MMIS are in 45 C.F.R. 250.90, and those for State Medicaid procurement actions are in 45 C.F.R. 74.

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At the time of the State's MMIS procurement, HEW's Social and Rehabilitation Service (SRS) was responsible for Federal administration of Medicaid. SRS' Associate Administrator for Information Systems was responsible for approving MMIS contracts and determining if State systems met MMIS requirements. These functions are now the responsibility of the Medicaid Bureau of HEW's Health Care Financing Administration.

The State issued a request for proposals to potential offerors on July 18, 1975, that solicited both cost and technical proposals for the following options:

- Option 1 - The contractor performs claims preparation/entry functions (such as opening mail and key punching) and processes the claims on its computer.
- Option 2 - The State performs claims preparation/entry functions on its equipment, and the contractor processes claims on its computer.
- Option 3 - The contractor performs claims preparation/entry functions and processes claims on the State's computer.
- Option 4 - The State performs claims preparation/entry functions, and the contractor processes claims on the State's computer.

Offerors were also permitted to submit proposals for additional options.

Nine firms submitted proposals in response to the request. The State, after its initial evaluation of proposals, selected those submitted by two firms, EDSF and Blue Cross of Washington and Alaska, for additional evaluation and negotiation. The State said that these firms' proposals were clearly superior to those of the seven others.

The final evaluations were made by a panel consisting of State officials assisted by the consulting firm of Griffenhagen-Kroeger, Inc., and a committee representing the State hospital, medical, dental, pharmacy, and nursing home associations. The EDSF and Blue Cross proposals were further evaluated, primarily for Option 1 proposals. The State obtained additional information from each firm about the proposals, heard oral presentations of each firm's proposal, and visited each firm's facility.

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The evaluation panel concluded that EDSF's Option 1 proposal was functionally superior to Blue Cross' proposal. The panel based this conclusion on its belief that EDSF's proposed MMIS was relatively trouble free and that EDSF's proposal and presentation showed intimate knowledge of both the proposed MMIS and the Medicaid program. Conversely, the evaluation panel concluded that Blue Cross' proposal and presentation showed limited familiarity with the proposed MMIS and a lack of understanding of Medicaid.

The evaluation panel recognized that accepting EDSF's Option 1 proposal would result in costs of \$14.9 million, which exceeded Blue Cross' \$10.7 million proposal by about \$4.2 million over the 5-year term of the contract. However, the panel believed that its perceived deficiencies in Blue Cross' proposal would delay an operational MMIS by 6 to 12 months over the time it would take EDSF to install an operating system. It estimated that such a delay would cost the Medicaid program between \$5.3 million and \$10.5 million in benefit payments. The State felt Medicaid costs would be reduced by about \$1 million per month by an operational MMIS because of its claims processing superiority over the existing system. No studies were made or documentation available to support this estimate.

Based on its final evaluation, the panel recommended selection of EDSF for award of the MMIS installation and operation contract. On October 21, 1975, the State announced its selection of EDSF.

HEW review of State's selection process

SRS' Associate Administrator for Information Systems concluded that the State's selection of EDSF violated 45 C.F.R. 74 because Blue Cross' proposed price was considerably lower and so informed the State. Moreover, the Associate Administrator said SRS would approve the selection of Blue Cross. He also instructed his staff to evaluate the State's proposal evaluation and contractor selection process.

On January 27, 1976, he requested the State to submit an analytical summary of its evaluation process including responses to a number of specific questions. The Associate Administrator was also aware that EDSF had submitted a supplementary option (hereinafter referred to as Option 5) under which EDSF would provide the State with an online MMIS; this system would combine the claims entry function and medical review function into a real

time, interactive system. 1/ EDSF would provide the data entry equipment and the computer, and the State would provide the personnel for claims entry and medical review. SRS knew that the State was seriously considering Option 5 and advised the State to obtain a competitive proposal from Blue Cross for Option 5.

The Associate Administrator's staff evaluated the two proposals submitted in response to the request for proposals and the State's response to the January 27 letter and advised the Associate Administrator to deny approval of EDSF's selection. The Associate Administrator had also requested the Institute for Computer Services and Technology, National Bureau of Standards, Department of Commerce, to evaluate the two proposals and the State's summary of its evaluation process. The Bureau of Standards reported in March 1976 that it accepted the State's judgment and conviction that the EDSF proposal was technically superior, primarily because the Bureau had no strong basis for not accepting the State's judgment.

On March 30, 1976, after receiving the Bureau's report, the Associate Administrator approved Washington's selection of EDSF contingent on negotiating a "fair and reasonable price." His staff still felt the selection should not have been approved.

Although EDSF had been processing claims since April 1976, the State and EDSF did not formally enter into a contract until July 9, 1976. SRS approved the system as an MMIS on November 17, 1976. The cost of operating the system, therefore, became eligible for 75-percent Federal sharing, and the eligibility was made retroactive to July 1, 1976. EDSF did not charge the State development or installation cost so the State did not claim the 90-percent sharing available for such cost.

Contract negotiation

Although the State's evaluation of EDSF's and Blue Cross' proposals focused on Option 1, the contract negotiated was a

1/Claim data would be entered on a terminal and processed by the computer, and the processing results would be displayed on the terminal. If necessary, any required medical review could be performed immediately and the claim disposed of. This type of processing would eliminate the need to send data back and forth between the State and the contractor and would also speed up the claims payment cycle.

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combination of features from Option 1 and Option 5. The contract provides for an online system (Option 5), with EDSF performing the claims-entry function and processing the claims on its computer (Option 1). However, the State is responsible for the claims preparation function that under Option 1 would have been a contractor responsibility. Although SRS had told the State to provide Blue Cross with an opportunity to submit a proposal for Option 5, the State did not do so but instead negotiated the Option 1/Option 5 contract with EDSF.

Was the contract awarded to the lowest technically acceptable and responsible offeror?

We attempted to determine if this negotiated contract was awarded to the lowest priced, technically acceptable, responsible offeror. We accepted the State's determination that both Blue Cross and EDSF were responsible offerors. However, Blue Cross was not given an opportunity to submit a proposal on Option 5, and neither Blue Cross' nor EDSF's original proposal specifically offered on the functions included in the EDSF contract. Therefore, we began our cost comparison by comparing the expected cost of EDSF's 5-year contract to Blue Cross' proposed 5-year cost for Option 1 which was the option closest to the contract in required contractor functions. Both figures were based on the same number of claims processed during the 5-year period. Our comparison showed Blue Cross' proposed price to be about \$3.8 million lower than EDSF's contract price. In the contract between the State and EDSF, the State assumed responsibility for claims preparation--a function which Blue Cross had intended to perform in bidding on Option 1. Therefore, we added our projected cost for the State for performing these functions--\$1.6 million--to the cost differential. Our figures showed the Blue Cross proposal for Option 1 to be about \$5.4 million lower than EDSF's contract price. ^{1/}

However, there are two factors which affect the comparison of proposed and contract costs:

--The value of the benefits of an online system. Because Blue Cross' proposal had not included an online system, any benefits from such a system would have reduced Blue Cross' price advantage.

^{1/}We used actual expenses for July 1, 1976, through June 30, 1977, multiplied by 5 years.

--The State's belief that Blue Cross would have taken 6 to 12 months longer to have an operational system than EDSF even though Blue Cross was determined otherwise responsible. If the State was correct in its belief and if an operational MMIS would have saved program dollars over the existing State system, this factor also would have reduced Blue Cross' price advantage.

We were unable to place a reliable value on either of these factors. The State did not estimate any additional value of having an online system. It did estimate that having an operational MMIS saved Medicaid between \$10 million and \$12 million during the first year of the contract. However, we noted that some of the savings in the State's estimate were related to items not requiring MMIS and which could have been accomplished by any claims processing system. An example is reductions in billed charges to levels meeting the State's definition of reasonable charges. Because the State uses fee schedules extensively to determine reasonable costs, reductions could be accomplished by a manual system.

CONCLUSIONS

Blue Cross' proposed prices for implementing Washington's MMIS were lower than EDSF's proposed prices for all of the options included in the request for proposals. However, the State awarded a contract for a system not specifically included in the request for proposals; and we were unable to place a value on any benefits this system might have over the systems in the request for proposal. Also, the State believed EDSF could install its system 6 to 12 months faster than Blue Cross thereby saving the State from \$5.3 million to \$10.5 million. We were unable to substantiate or refute the State's claimed savings or place a value on the savings.

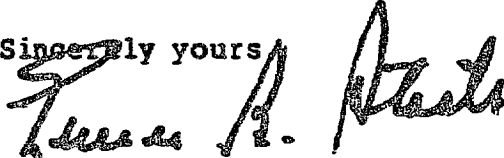
We were unable to quantify either the value of an online system or the effects of a possible Blue Cross schedule slippage, which were two of the factors which resulted in the State's believing EDSF's price was lower than Blue Cross'. Thus, we were unable to conclusively determine if the State awarded its MMIS contract to the lowest technically acceptable and responsible offeror.

The State assumed responsibility for claims preparation under the contract, which increased the price differential between the EDSF contract and Blue Cross' proposal for Option 1 to about \$5.4 million before considering possible schedule slippage or benefits of an online system.

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As requested by your office, we have not obtained written comments from the State or HEW on this report, but we have discussed the report with State and HEW officials. Also, as requested by your office, we will make no further distribution of this report until after you receive the report the Subcommittee requested on our more comprehensive review of MMIS activities and anticipated hearings are held regarding the matters discussed in the two reports.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Thomas A. Starks".

Comptroller General
of the United States