



High Risk—Covered California

It Must Ensure Its Financial Sustainability Moving Forward, and Its Use of Sole-Source Contracts Needs Improvement

Report 2015-605

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February 16, 2016

2015-605

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

Dear Governor and Legislative Leaders:

This report presents the results of our high risk audit concerning Covered California's administration of California's Health Benefit Exchange (exchange). State law required Covered California to create and operate the exchange to implement provisions of the federal Patient Protection and Affordable Care Act (Affordable Care Act).

This report concludes that Covered California has made progress in implementing key federal and state requirements pertaining to the establishment of an exchange, but certain concerns remain. Covered California is required to be self-supporting and, although it has developed a plan to help ensure its future financial viability, it needs to continue to monitor its plan and conduct a formal analysis of its reserve level. Covered California projects that in fiscal year 2017–18 it will have enough consumers enrolled in qualified health plans that its revenues will cover its operating expenditures. Covered California annually updates its enrollment projections and used six key assumptions to determine its multiyear enrollment projections. Using these assumptions, Covered California has developed a range of enrollment estimates, from low to high, all of which show continued enrollment growth through fiscal year 2018–19. However, as with all forecasts, some degree of uncertainty about future enrollment should be anticipated, and Covered California's short operational history suggests that its enrollment projections are an area of risk that it will need to carefully monitor in order to ensure its financial sustainability.

Covered California's contracting practices must be improved to ensure the integrity of the process it uses to award sole-source contracts. We reviewed the justifications for 20 of Covered California's sole-source contracts and another 20 applicable amendments to those contracts, for a total of 40 justifications. The policy adopted by Covered California's board of directors (board) and in place during our review stated that sole-source contracts should be justified in writing. In our review, we found that nine of the 40 justifications were insufficient according to Covered California's board-adopted policy. For example, Covered California did not sufficiently justify the use of a noncompetitive procurement method to award a contract for marketing and outreach services totaling nearly \$134 million. In addition, we question the validity of an additional three justifications because, even though Covered California asserts either *timeliness* or *unique expertise* as a basis for using the noncompetitive procurement process, available documentation indicates that either Covered California had sufficient time to use a competitive procurement process or the vendor was not unique. Finally, although the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) is functional, its rapid design, development, and implementation have resulted in some risks to system maintainability. Without continued oversight, specifically from independent verification and validation, these system issues may go unidentified or unresolved, resulting in long-term cost and schedule implications for the ongoing maintenance of CalHEERS.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

Covered California has made progress in implementing key federal and state requirements that pertain to establishing a health insurance exchange (exchange), but certain concerns remain. In our July 2013 report *New High-Risk Entity: Covered California Appears Ready to Operate California's First Statewide Health Insurance Exchange, but Critical Work and Some Concerns Remain*, Report 2013-602, we noted that Covered California's financial sustainability depends wholly on enrollment in qualified health plans (QHPs) offered through the exchange. We also pointed out that future enrollment is both unpredictable and based on market factors outside of Covered California's control. Thus, we concluded that enrollment in the exchange and the financial sustainability of Covered California will need to be monitored. In this current audit we found that Covered California will exhaust available federal funds by September 2016 and, without any federal funds or the State's General Fund to assist it in its operations, Covered California is required to be self-supporting. As a result, it must continue to monitor its revenues from enrollment and its expenditures to ensure its future financial sustainability. For this reason, we believe Covered California should continue to be designated as a high-risk state agency under the California State Auditor's high risk program. In addition, we identified some issues regarding its sole-source contracting practices.

Although Covered California has developed a plan to help ensure its future financial viability, it needs to continue to monitor that plan and conduct a formal analysis of its reserve level. Covered California projects that in fiscal year 2017–18, it will have enough consumers enrolled in QHPs that its revenues will cover its operating expenditures. Until then, if Covered California does not meet its revenue goals, it can increase its plan assessments (the charge it assesses on QHPs), use its reserves, or cut expenditures as necessary to maintain its solvency. However, Covered California has yet to formally analyze whether its goal of maintaining a reserve of three to six months is sufficient. Although Covered California has done some work in this area, we believe that it could benefit from a formal analysis of its reserve level to ensure it maintains financial solvency if enrollment significantly decreases.

Covered California annually updates its enrollment projections. For its *Fiscal Year 2015–2016 Budget* (2015–16 budget), Covered California based enrollment projections primarily on prior year or other recent data as well as the California Simulation of

Audit Highlights . . .

Our review of Covered California highlighted the following:

- » *Although it has developed a plan to help ensure its future financial viability, Covered California needs to:*
 - *Continue to monitor its revenues from enrollment and its expenditures.*
 - *Conduct a formal analysis of its reserve level to ensure it maintains financial solvency if enrollment significantly decreases.*
- » *Its contracting practices must be improved.*
 - *It did not sufficiently justify nine of the 40 sole-source contracts and applicable amendments we reviewed.*
 - *Its board-adopted policy in place during our review used generic terms such as timeliness and unique expertise as justification for using a noncompetitive process.*
- » *Along with the California Department of Health Care Services and the Centers for Medicare and Medicaid Services, Covered California spent \$493 million to rapidly build a system that interfaces with certain state, federal, and private entities— CalHEERS—and which has resulted in some risks to system maintainability.*

Insurance Markets.¹ However, as with all forecasts, some degree of uncertainty about future enrollment should be anticipated, and Covered California's short operational history and its uncertainty about the adequacy of its reserves suggest that its financial sustainability remains an area of risk that needs to be closely monitored.

To help meet its enrollment goals, Covered California's marketing division and its outreach and sales division use strategies that target the populations they need to reach. Under state law, Covered California is required to market and publicize the availability of health care coverage and federal subsidies through the exchange. To satisfy this requirement and to target key populations, the marketing division has adjusted its marketing strategy for each open enrollment period to reach consumers eligible for health insurance. The outreach and sales division generates reports from the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS), the computerized system that enables consumers to enroll in Covered California's QHPs, among other functions. The outreach and sales division uses these reports to review the performance of certified enrollment representatives who inform consumers about and help them enroll in QHPs, and to identify new outreach opportunities to increase enrollment during future enrollment periods.

We also found that Covered California's contracting practices must be improved. State law requires Covered California to establish and use a competitive process to award contracts, and the law also gives it broad statutory authority to establish its own procurement and contracting policy. Covered California's board of directors (board) adopted a procurement policy in 2011 that provided Covered California the flexibility to use sole-source contracts when *timeliness* or *unique expertise* are required. However, we found that Covered California did not sufficiently justify nine of the 40 sole-source contracts and applicable amendments we reviewed from fiscal years 2012–13 through 2014–15, thereby not consistently following its board-adopted policy to do so. Further, we question the validity of an additional three justifications because, even though Covered California asserted either *timeliness* or *unique expertise* as the basis for using the noncompetitive procurement process in these cases, available documentation indicates that Covered California had sufficient time to use a competitive procurement process or that the vendor was not unique.

¹ The California Simulation of Insurance Markets model, a joint project of the University of California, Los Angeles Center for Health Policy Research and the University of California, Berkeley Center for Labor Research and Education, is designed to estimate the impacts of elements of the federal Patient Protection and Affordable Care Act on employer decisions to offer insurance coverage and individual decisions to obtain coverage in California.

Without competitively bidding such contracts, Covered California cannot be assured that the contractor it chooses is the most qualified or cost-effective.

Further, on June 24, 2015, state law was revised to implement a new requirement that Covered California adopt a contract manual that is substantially similar to the provisions in the *State Contracting Manual*. The *State Contracting Manual* permits the use of a noncompetitive process when there is an emergency requiring immediate acquisition for the protection of the public health, welfare, or safety, or when no known competition exists. Our review identified concerns with Covered California's board-adopted policy that was in place during our review which used generic terms such as *timeliness* and *unique expertise* as justification for using a noncompetitive process. These terms are overly broad and do not limit the use of sole-source contracts to the conditions under which such contracts are allowed by the *State Contracting Manual*. In our review of the November 2015 draft procurement manual, we determined that it included criteria allowing for sole-source contracts in circumstances that the *State Contracting Manual* does not authorize. After bringing this to the attention of Covered California, they made changes to the draft procurement manual to address our concerns, which the board formally adopted in January 2016.

Finally, over the first three full fiscal years of the project, fiscal years 2012–13 through 2014–15, Covered California, the California Department of Health Care Services, and the Centers for Medicare and Medicaid Services together spent about \$493 million on CalHEERS, which interfaces, or communicates, with certain state, federal, and private entities. Although CalHEERS is functional, its rapid design, development, and implementation have resulted in some risks to system maintainability, and several changes to systems interfacing with CalHEERS will necessitate continual releases to update the system for several years. Covered California has contracted with consultants for independent oversight of the system, and they have identified various risks, such as risks to the system's maintainability—its ability to isolate and easily correct system issues to maximize the cost-effective productive life of the system—or delays to or partial release of change requests, which could increase project costs. However, the contract with one of these key oversight consultants recently expired and according to the chief of the project management office at CalHEERS, as of January 2016, independent project oversight services have ended. Given the size and technical complexity of the project, as well as the significant number of maintenance items and change orders that remain outstanding, our information technology (IT) expert believes the project should reinstitute the independent verification and validation (IV&V) services. Without this oversight, our

IT expert believes certain system issues may go unidentified or unresolved, resulting in long-term cost and schedule implications for the ongoing maintenance of CalHEERS.

Recommendations

Covered California should continue to monitor its plan for financial sustainability and revise the plan accordingly as factors change. Further, it should complete a formal analysis of the adequacy of its reserve level by December 31, 2016, and update this analysis as needed so that it is prepared if it does not meet its revenue projections and needs to increase its funding or decrease its expenditures to maintain solvency. This formal analysis should identify those contracts it could quickly eliminate, among other actions it would take, in the event of a shortfall in revenues.

Covered California should continue to regularly review its enrollment projections and update the projections as needed to help ensure its financial sustainability.

To comply with state law, Covered California should ensure that its staff comply with the changes to its recently-adopted procurement manual that incorporate contracting policies and procedures that are substantially similar to the provisions in the *State Contracting Manual*.

Before executing any sole-source contracts, Covered California should adequately document the necessity for using a noncompetitive process in its written justifications and, in doing so, demonstrate valid reasons for not competitively bidding the services.

To ensure that CalHEERS does not face delays and cost overruns in the implementation of planned releases, Covered California should immediately contract with an independent party for IV&V services to highlight and address potential risks going forward.

Agency Comments

Covered California agreed with our recommendations and indicated that it has already taken steps to address them, although it recognizes that its work is not complete.

Introduction

Background

State law authorizes the California State Auditor to establish a state high risk audit program and to issue reports with recommendations for improving state agencies or statewide issues that it identifies as high risk. Programs and issues that are high risk include not only those that are particularly vulnerable to fraud, waste, abuse, and mismanagement but also those that have major challenges associated with their economy, efficiency, or effectiveness.

To expand health insurance coverage and make health care more accessible and affordable, in March 2010 the U.S. Congress enacted the Patient Protection and Affordable Care Act (Affordable Care Act). California was the first state to enact legislation creating a state-operated health insurance exchange (exchange), one of the provisions of the Affordable Care Act. This exchange is a competitive insurance marketplace in which eligible individuals and small businesses have been able to purchase qualified health plans (QHPs) since October 1, 2013.

In our July 2013 report titled *New High-Risk Entity: Covered California Appears Ready to Operate California's First Statewide Health Insurance Exchange, but Critical Work and Some Concerns Remain*, Report 2013-602, we reviewed Covered California's establishment of this exchange. In that report we concluded that although Covered California had made great strides in implementing key federal and state requirements pertaining to the exchange and its operations, critical work and some concerns remained. Specifically, we made four initial recommendations to Covered California, including that it conduct regular reviews of enrollment, costs, and revenue; that it make prompt adjustments to its financial sustainability plan based on those reviews; and that it develop monitoring, recertification, and decertification procedures for QHPs offered through the exchange. In this report we update our analysis of Covered California's implementation of those recommendations and reassess its status as a high-risk state agency.

Because of our continuing concern regarding financial sustainability, Covered California remains on our high risk list. We will continue to monitor the risk we have identified and the actions Covered California takes to address this risk. When, in our professional judgment, Covered California's actions result in sufficient progress toward resolving or mitigating the risk, we will remove the high risk designation.

Governance and Funding of Covered California

Covered California is an independent public entity governed by a five-member board of directors (board). The board's membership consists of the secretary of the California Health and Human Services Agency, or the secretary's designee, and four other California residents—two appointed by the governor, one by the speaker of the Assembly, and one by the Senate Committee on Rules. State law requires the board to meet the minimum requirements of the Affordable Care Act, as well as other specified criteria, and prohibits it from using California's General Fund to establish or operate Covered California. To provide initial funding, the federal government has awarded Covered California more than \$1 billion in State Planning and Establishment Grants for the Affordable Care Act's Exchanges (establishment grants) since September 2010. Covered California may spend these establishment grants on a wide range of activities, including marketing, service centers, finance and accounting, and information technology (IT) development.² Beginning with fiscal year 2012–13 an independent auditing firm annually reviews Covered California's compliance with the requirements of the establishment grants. As of December 2015, the most recent available audit report concluded that Covered California complied for the fiscal year ending June 30, 2014, in all material respects, with the establishment grants' requirements, including that it spend these funds only on allowable activities.

Although the Affordable Care Act requires Covered California to be self-sustaining beginning in January 2015, Covered California requested—and was granted—two extensions to continue spending a federal establishment grant it began receiving in January 2013. As of November 2015, documentation from Covered California indicated that it had roughly \$107 million in federal funds remaining and it intends to expend these funds by the new deadline of September 2016.

To generate revenue to support its development, operations, and cash management, Covered California assesses a charge on the QHPs—referred to as *plan assessments*—offered by insurance issuers (issuers). These plan assessments are paid by the issuers who sell insurance to consumers from within the exchange. Since the pooling of risk is fundamental to health insurance, federal regulations require each QHP issuer to spread the cost of plan assessments across all of its insured consumers, both those whom the issuer serves through Covered California and those whom it

² Covered California's service centers are staffed by representatives who assist consumers with understanding health plan options, determining eligibility for subsidies and tax credits, and enrolling consumers in health plans.

insures through its other insurance plans. Specifically, issuers are to include plan assessments in their determination of all consumers' health plan premiums. In fiscal year 2014–15, according to its financial records, Covered California charged QHP issuers more than \$210 million in plan assessments.

In addition, Covered California for Small Business (CCSB), California's small business health options exchange, is available to small businesses with one to 50 employees, as described in Covered California's *Fiscal Year 2015-2016 Budget*. The program makes it possible for small businesses to offer their employees a wide choice of health insurance plans. Although Covered California's financial records indicate that CCSB generated a very small amount of its \$210 million in revenue, beginning January 1, 2016, the program is scheduled to expand to businesses with up to 100 employees, and that larger market should increase the revenue this program generates.

CalHEERS

The California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) is an online system that consumers can use to request evaluation for enrollment in QHPs offered through Covered California and other affordability assistance programs, including the California Medical Assistance Program (Medi-Cal). According to the chief of the CalHEERS project management office, consumers can either complete the application process themselves or seek assistance from certified enrollment representatives, such as insurance agents; Covered California's service center representatives; or county eligibility workers. Once eligibility has been determined, consumers can either continue to shop and enroll in QHPs offered through Covered California or be electronically transferred for assistance to their local county office for confirmation of eligibility and enrollment in California's affordability assistance programs, such as Medi-Cal. CalHEERS consists of three major system components that provide eligibility determination, enrollment functionality, and financial accounting in conjunction with other entities that interface, or communicate, with the system. According to the CalHEERS project management office, these entities include the Centers for Medicare and Medicaid Services, the Internal Revenue Service, and the California Employment Development Department.

Covered California and the California Department of Health Care Services (Health Care Services) jointly sponsored CalHEERS and, according to documentation from the CalHEERS project management office, the cost for the IT project totaled approximately \$493 million over its first three full fiscal years, 2012–13 through 2014–15. This documentation further

indicates that the total costs of the project are estimated to reach more than \$700 million by the end of fiscal year 2015–16. During the first two fiscal years of the project, Covered California paid for 80 percent of the system’s development and implementation costs. However, beginning in fiscal year 2014–15, it has paid for less than 20 percent of the system’s operations and maintenance costs, as Health Care Services and the Centers for Medicare and Medicaid Services have since become the project’s primary funders.

Scope and Methodology

Table 1 presents the status of the four recommendations we made in our 2013 report that we followed up on during this audit. For the first of these recommendations, we found that as of October 2015, Covered California had not updated its administrative manual to agree with the current version of state law pertaining to Covered California’s contract transparency, which became effective October 2013. After our inquiry regarding its outdated administrative manual, Covered California updated its policy in November 2015 to not only remove its reference to obsolete state law but also to further limit its use of its statutory authority to those deliberative processes, discussions, and communications relating to its contract negotiations. As a result of this action, it has fully addressed this recommendation.

In addition, we reviewed Covered California’s contracting processes and practices for its use of sole-source contracts. To review the contracting practices, we accessed Covered California’s contracts database and identified the number of sole-source contracts that Covered California awarded during fiscal years 2012–13 through 2014–15. We judgmentally selected 20 of the 64 sole-source contracts awarded during this period to determine whether Covered California appropriately justified the need to bypass the competitive bidding process. In addition, we judgmentally selected five contracts exempt from competitive bidding, which include interagency agreements and legal services, and we determined that Covered California appropriately classified these contracts as exempt from competitive bidding.

Further, with the assistance of our IT expert, we obtained an understanding of the status of CalHEERS by interviewing key staff from the CalHEERS project management office. In addition, we reviewed the six most current oversight reports as of July 2015 from the independent verification and validation (IV&V) consultant and the independent project oversight (IPO) consultant to identify any significant concerns or risks regarding the project. IV&V is used to ensure that a system satisfies its intended use and user needs, whereas IPO is used to ensure that effective project management practices are in place and in use.

Table 1
Status of Actions Taken in Response to Recommendations in the California State Auditor’s Report 2013-602 and the Methods Used to Assess Their Status

RECOMMENDATION	METHOD	STATUS OF RECOMMENDATION
<p>1. To provide as much public transparency as possible, Covered California’s board should formally adopt a policy to retain confidentiality only for contracts, contract amendments, and payment rates that are necessary to protect Covered California’s interests in future contract negotiations.</p>	<ul style="list-style-type: none"> • Identified and documented the relevant state law pertaining to contract transparency and confidentiality. • Determined whether Covered California’s policy and procedures regarding release of contracts are consistent with state laws. • Selected five contracts that had been requested through the California Public Records Act to determine whether Covered California acted in accordance with federal and state laws and regulations and with its own policies regarding the release of information in these contracts. • Tested these five contracts and found minor inconsistencies with state law that had no material effect on the information sought by requesters. 	<p>Fully implemented</p>
<p>2. To comply with federal requirements, Covered California should develop a plan and procedures for monitoring, recertification, and decertification of qualified health plans.</p>	<ul style="list-style-type: none"> • Identified and documented the relevant federal and state laws and regulations pertaining to qualified health plans (QHPs). • Determined whether Covered California’s plan and procedures regarding monitoring, recertification, and decertification of QHPs are consistent with federal and state laws and regulations. • For each of the three largest QHP issuers by enrollment and one small QHP issuer, determined whether Covered California performed monitoring and recertification procedures for contracts ending December 31, 2015. Reviewed the data collected using these procedures and determined whether the QHP issuers were compliant with key federal and state regulations. • For any QHPs that Covered California decertified, determined whether Covered California acted in accordance with key federal and state regulations. 	<p>Fully implemented</p>
<p>3. To ensure the success of its outreach effort, Covered California should track the effect on enrollment figures of its planned outreach and marketing activities and of its assister program.</p>	<ul style="list-style-type: none"> • Identified and documented the relevant federal and state laws and regulations pertaining to marketing and outreach requirements under the Patient Protection and Affordable Care Act, and determined whether Covered California complied with these requirements. • Determined whether Covered California documented its marketing campaign. Identified its goals and actions for accomplishing those goals. Determined whether Covered California had met its marketing goals during the two open enrollment cycles since its inception, and whether any changes were necessary for the third open enrollment cycle. • Obtained evidence that Covered California tracks the effectiveness of its marketing approach. Interviewed relevant staff and determined whether Covered California used these data in its strategic planning efforts to inform future marketing endeavors. • Interviewed relevant staff to determine how the outreach and sales division managed its certified enrollment representatives. Identified and documented navigator grants from fiscal years 2014–15 and 2015–16 to identify the goals outlined in the agreements and, for fiscal year 2014–15, determined whether the grant recipients achieved those goals. Interviewed staff to determine how the performance of the navigator program during fiscal year 2014–15 affected its strategic planning approach for fiscal year 2015–16. • Obtained and reviewed reports generated by the outreach and sales division to determine the type of information it tracks regarding the effectiveness of its outreach campaign. Interviewed relevant staff and determined whether Covered California used these data to inform its strategic planning efforts for future outreach. 	<p>Fully implemented</p>
<p>4. To ensure financial sustainability, Covered California should conduct regular reviews of enrollment, costs, and revenue and make prompt adjustments to its financial sustainability plan as necessary.</p>	<ul style="list-style-type: none"> • Identified and documented the relevant federal and state laws and regulations pertaining to financial sustainability and determined whether Covered California complied with these requirements. • Using Covered California’s <i>Fiscal Year 2015–2016 Budget</i>, documented the enrollment forecasting methodology and identified the factors, or assumptions, used in this methodology. • Documented how annual budget forecasts have changed since the program began. • Identified which expenditures are fixed and which are projected to decrease to lower total expenditures. • Reviewed its reserve level and determined whether it has conducted a formal analysis of the adequacy of the reserve level. 	<p>Partially implemented</p>

Sources: Recommendations made in the report by the California State Auditor titled *New High-Risk Entity: Covered California Appears Ready to Operate California’s First Statewide Health Insurance Exchange, but Critical Work and Some Concerns Remain*, Report 2013-602, July 2013, and analysis of information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, and recommendations. In performing this audit, we relied on Covered California's data maintained in the California Department of Finance's (Finance) California State Accounting and Reporting System (CALSTARS). We used data from CALSTARS for the period from July 1, 2013, through June 30, 2015, for the purpose of identifying Covered California's expenditures by fiscal year. To evaluate these data, we performed data-set verification procedures and electronic testing of key data elements and did not identify any significant issues. Further, we tested the completeness of the CALSTARS data by comparing Covered California's expenditures to the California State Controller's Office's appropriation control ledger. We found the data to be materially complete. Finally, we tested the accuracy of the CALSTARS data by tracking key data elements for a selection of 31 transactions to supporting documentation and found no errors. Therefore, we found that Covered California's CALSTARS data that are maintained by Finance are sufficiently reliable for the period from July 1, 2013, through June 30, 2015, for the purpose of identifying its expenditures by fiscal year.

Chapter 1

COVERED CALIFORNIA MUST CONTINUE TO MONITOR ITS FINANCIAL SUSTAINABILITY AND ENROLLMENT PROJECTIONS TO ENSURE ITS SOLVENCY

Chapter Summary

Covered California has demonstrated progress in implementing key federal and state requirements that pertain to establishing a health insurance exchange (exchange), but some concerns remain. In our July 2013 report we recommended that Covered California conduct regular reviews of enrollment, costs, and revenue and make prompt adjustments to its financial sustainability plan as necessary. During this current audit we found that Covered California has conducted these reviews and made necessary adjustments as part of its annual budget process. Nevertheless, to better ensure its financial sustainability, Covered California should formally analyze whether its proposed reserve is adequate and determine the steps it would take to reduce its operating expenditures in the event that enrollment significantly decreases. For instance, it could identify the contracts it would eliminate to reduce its expenditures.

This audit found that Covered California has annually updated its enrollment projections. Using six key assumptions to determine its multiyear enrollment projections, Covered California has developed a range of enrollment estimates, from low to high, which show continued enrollment growth through fiscal year 2018–19.

To help ensure that Covered California meets its enrollment projections, the marketing division develops and executes marketing campaigns promoting the products and services offered through the State's exchange. In addition, Covered California has established a network of certified enrollment representatives consisting of entities and individuals that educate consumers on, and enroll them in, qualified health plans (QHPs) and the California Medical Assistance Program (Medi-Cal).

Although Covered California Has a Plan to Help Ensure Its Financial Sustainability, It Must Complete a Formal Analysis of Whether Its Reserve Is Adequate

State law requires Covered California's board of directors (board) to ensure that the costs of establishing, operating, and administering the exchange do not exceed the combination of federal funds, private donations, and other available money. Covered California may not use money from the State's General Fund to help support

If Covered California falls short of achieving its enrollment goals, its financial condition will suffer.

its operations. Its revenue is generated from plan assessments—charges on the QHPs that insurance issuers offer, as state law requires and as discussed in the Introduction. As a result, if Covered California falls short of achieving its enrollment goals, its financial condition will suffer.

In our July 2013 report we found that, given the limits of its information at the time, Covered California appeared to have engaged in a thoughtful planning process to ensure that it would remain solvent in the future. We also noted that Covered California's financial plans greatly depend on patterns of enrollment in its QHPs by individuals and small business employers, which could only be projected at that time. Consequently, we concluded that financial sustainability would continue to be an area of risk that would need to be closely monitored, and we recommended that Covered California conduct regular reviews of enrollment, costs, and revenue and make prompt adjustments to its financial sustainability plan as necessary.

During our current audit we found that Covered California has conducted these reviews and made necessary adjustments as part of its annual budget process. According to Covered California's *Fiscal Year 2015–2016 Budget* (2015–16 budget), this process was conducted over six to seven months, with particular attention paid to updating its enrollment forecast, which relies to a great extent on its actual enrollment experience in 2014 through the end of the second open enrollment period in February 2015. The goal of this process is for Covered California to ensure that its revenues will cover its expenditures for each fiscal year as state law requires. For fiscal year 2015–16 Covered California created a robust budget document that outlines the steps it needs to be financially sustainable. In that document Covered California explains that its fiscal year 2015–16 budget reflects a multiyear financial strategy of providing continuous fiscal integrity, transparency, and accountability. The budget includes low, medium, and high enrollment forecasts and corresponding revenue projections. In its budget Covered California states that, to the extent that enrollment varies from the medium forecasted amounts, it will be able to adjust its revenue by increasing or decreasing its plan assessments or by adjusting its budgeted expenditures.

Table 2 shows Covered California's multiyear budget forecast through fiscal year 2018–19. As the table indicates, Covered California projects that expenditures will decrease while revenues increase so that both are balanced at approximately \$300 million in fiscal year 2017–18—the first year in which Covered California estimates that its operations will break even. Covered California plans to begin fiscal year 2016–17 with approximately \$197 million in reserve funding to address any

unforeseen economic uncertainties and to facilitate the transition to supporting its operations solely on plan assessments. The table also shows that in the beginning of fiscal year 2015–16, Covered California estimated that \$100 million in federal establishment funds were remaining. As of November 2015, documentation provided by Covered California indicated that it had roughly \$107 million in federal funds remaining, which it can spend on a variety of purposes, including consulting with stakeholders and developing information technology (IT). As described in the Introduction, the federal government has extended the deadline by which Covered California must spend these funds to September 30, 2016, and Covered California intends to ensure that it will exhaust these funds by that deadline. Table 3 on the following page summarizes Covered California’s progress in complying with certain federal and state requirements for funding its operations.

Table 2
Covered California’s Multiyear Budget Forecast
(Dollars in Millions)

	FISCAL YEAR			
	2015–16	2016–17	2017–18	2018–19
Effectuated enrollment*	1,476,342	1,666,617	1,809,095	1,977,792
Beginning balance of unrestricted funds	\$197.9	\$197.2	\$156.4	\$160.0
Balance of federal establishment funds	100.0 [†]	-	-	-
Opening balance	\$297.9	\$197.2	\$156.4	\$160.0
Plan assessments—cash basis	\$234.4	\$269.2	\$303.6	\$329.2
Total funds	\$532.3	\$466.4	\$460.0	\$489.2
Expenditures	(\$335.0)	(\$310.0)	(\$300.0)	(\$300.0)
Year-end operating reserve	\$197.2	\$156.4	\$160.0	\$189.2
Estimated number of months the operating reserve will cover expenditures	7.1	5.6	5.4	6.1

Sources: Adapted from Covered California’s *Fiscal Year 2015-2016 Budget* (2015–16 budget), dated June 30, 2015, and documentation provided by Covered California’s financial management division.

* *Effectuated enrollment* is the number of enrollees who complete an application, select a qualified health plan, and pay at least their first month’s premium.

[†] Although Covered California estimated in its 2015–16 budget that it would have \$100 million in federal funds for this fiscal year, as of November 25, 2015, Covered California reported that it had roughly \$107 million of these funds remaining that it plans to spend by September 30, 2016.

Covered California’s 2015-16 budget indicates that if it falls short of meeting its enrollment goals, it will consider increasing plan assessments, reducing costs, or using its reserves to maintain its solvency. Covered California’s interim chief actuary stated that a large body of work from different health economists shows that if health insurance premiums were to increase by 1 percent, with all other factors held constant, the resulting reduction in enrollment

would not be significant—between 0.2 and 0.6 percent. Therefore, Covered California believes that if it needs to moderately increase its plan assessments, the small increases that insurance issuers would distribute across all of their California members would have little effect in causing current enrollees in the exchange to cancel their coverage or in deterring individuals from enrolling in the future.

Table 3
Covered California’s Compliance With Key Federal and State Requirements for Funding Its Operations

REQUIREMENTS FOR COVERED CALIFORNIA	PROGRESS TOWARD COMPLETION	STEPS THAT COVERED CALIFORNIA HAS TAKEN
Federal		
Have sufficient funding to support its ongoing operations beginning January 1, 2015.*	↑	Created a financial sustainability plan (financial plan), which it submitted to the federal government in November 2012 as a part of its grant application. Through its annual budget process, Covered California conducts reviews of enrollment, costs, and revenues; develops multiyear budget forecasts to help ensure its financial sustainability going forward; and makes necessary adjustments.
State		
Assess a fee on the qualified health plans (QHPs) offered by health insurance issuers through the health insurance exchange (exchange) that is reasonable and necessary to support the operations of the exchange.	↑	Established an initial fee of \$13.95 assessed on a per-member, per-month basis for individual QHPs sold through the exchange and created a similar fee structure for QHPs offered to small businesses. In its <i>Fiscal Year 2015–2016 Budget</i> , Covered California indicated that it will consider adjusting the fees, or plan assessments, based on enrollment.
Maintain enrollment and expenditures to ensure that expenditures do not exceed revenue, and institute appropriate measures to ensure fiscal solvency.	↑	Through its annual budget process, Covered California develops a budget to help ensure that it covers operating costs under a range of enrollment scenarios. Beginning in fiscal year 2013–14, its goal has been to maintain a three- to six-month reserve.

Sources: 42 United States Code, section 18031; 45 Code of Federal Regulations, part 155.160; California Government Code, section 100503; Covered California’s 2012 Financial Sustainability Plan; and Covered California’s *Fiscal Year 2015–2016 Budget*.

* Covered California must spend its remaining federal establishment grant funds by September 30, 2016. These funds can be used for establishment costs but cannot be used to support ongoing operations.

↑ = Progressing as expected.

According to Covered California’s 2015-16 budget, an increase in its plan assessments would require between nine and 18 months to have an impact on revenue. As explained by its chief financial officer, this delay would be necessary because an increase in the plan assessments must be approved by Covered California’s board and then presented during Covered California’s next round of negotiations with insurance issuers for the following plan year. Consequently, a plan assessment increase can take effect only on January 1 of the year following the next contract negotiation. According to Covered California’s *Health Insurance Companies and Plan Rates for 2016*, QHP premiums increased by an average of approximately 4 percent in 2015 and 2016; however, Covered California has not increased its plan assessments. For the

projections it includes in its 2015-16 budget, Covered California used its monthly plan assessments for the individual and small business markets of \$13.95 and \$18.60, respectively, as the basis for its projections through fiscal year 2018–19.

Covered California projects that its expenditures will decrease and level out over the next several years and that it will achieve a balance between its revenues and expenditures in fiscal year 2017–18. Specifically, its costs for the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) and for outreach, sales, and marketing represented 70 percent of Covered California’s expenditures in its fiscal year 2013–14 budget. In subsequent fiscal years expenditures for CalHEERS have decreased, and Covered California projects that expenditures for outreach, sales, and marketing will decrease for the current fiscal year. In its 2015–16 budget Covered California projects that these expenditures will continue to decrease through at least fiscal year 2016–17 as it becomes more established. Table 4 presents a breakdown of Covered California’s budgeted and actual expenditures for the last two fiscal years and its budgeted expenditures for fiscal year 2015–16.

Table 4
Covered California’s Budgeted and Actual Expenditures for Fiscal Years 2013–14 and 2014–15 and Budgeted Expenditures for Fiscal Year 2015–16

	FISCAL YEAR 2013–14		FISCAL YEAR 2014–15		FISCAL YEAR 2015–16
	BUDGET	ACTUAL*	BUDGET	ACTUAL*	BUDGET
Service centers†	\$64,732,239	\$79,031,302	\$97,022,224	\$96,836,382	\$100,103,078
California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS)	181,042,718	114,714,737	88,177,616	93,607,718	42,410,485
Outreach & sales, marketing‡	134,218,916	131,718,285	189,831,459	153,558,948	121,512,473
Plan management and evaluation	22,788,018	4,939,390	17,334,578	11,286,694	17,300,582
Administration	36,556,839	32,571,736	37,796,386	36,460,965	46,159,372
Other expenditures#	9,504,885	151,547	12,589,363	1,543,057	13,493,138
Total expenditures 	\$448,843,615	\$363,126,997	\$442,751,626	\$393,293,764	\$340,979,127

Sources: California State Auditor’s analysis of data obtained from Covered California’s data as maintained in the California Department of Finance’s California State Accounting and Reporting System; *Covered California Policy and Action Items*, dated June 19, 2014; Covered California’s *Fiscal Year 2015–2016 Budget*, dated June 30, 2015; and budget reconciliation documents provided by Covered California.

* These amounts exclude prior year expenditures for each fiscal year and any pass-through payments to issuers of qualified health plans (QHPs) and insurance agents.

† Covered California’s service centers are staffed by representatives who assist both consumers and certified enrollment representatives with understanding health plan options, determining eligibility for subsidies and tax credits, and enrolling consumers in QHPs.

‡ For fiscal year 2013–14 this expenditure was listed as “Enrollment Activities,” whereas for fiscal years 2014–15 and 2015–16, it was listed as “Outreach & sales, marketing.”

For fiscal year 2013–14 these budgeted amounts are for Covered California for Small Business (CCSB). For fiscal years 2014–15 and 2015–16 these budgeted amounts are for statewide general administrative costs and strategic initiatives. However, according to Covered California the actual expenditures for these categories are reported in different categories. Specifically, the actual expenditures for CCSB are included in the “Outreach & sales, marketing” actual column. In addition, Covered California stated while the actual expenditures for statewide general administrative costs remain in this category, the actual expenditures for the strategic initiatives are reported within the appropriate organizational category.

|| These totals do not include reimbursements or CalHEERS cost-sharing.

State law requires Covered California to establish and maintain a prudent reserve and as of January 1, 2016, it requires Covered California to reduce plan assessments during a subsequent fiscal year if, at the end of any fiscal year, the reserve is equal to or more than Covered California's operating budget for the subsequent fiscal year. As shown earlier in Table 2 on page 13, Covered California projects that it will end fiscal year 2015–16 with approximately seven months of operating funds in its reserve, and it will have nearly six months in its reserve as of the end of fiscal year 2016–17. As expressed in its 2015–16 budget, one of Covered California's guiding financial principles is to maintain a reserve that is sufficient to cover its financial obligations and allow for time to adjust revenue and expenditures in the event of an unanticipated event. The chief financial officer stated that Covered California's board has established a target reserve of three to six months of operating expenditures rather than a one-year reserve—the maximum state law allows. He explained that building a larger reserve would be possible but at the expense of increasing the plan assessments, which would increase the premiums paid by enrollees in QHPs.

The chief financial officer also stated that the targeted reserve of three to six months would allow Covered California sufficient time to make adjustments to revenue or expenditures in order to maintain solvency. For example, most, if not all, of Covered California's contracts allow it the flexibility to cancel them with 30 days' notice and according to its 2015–16 budget, over \$200 million of its expenditures are for contracts. However, he acknowledged that a thorough review of the contracts would be necessary to determine which ones could be canceled. In addition, he stated that if a significant revenue change were to surface, Covered California would evaluate the magnitude of that change and develop plans to resolve the resulting issues. These plans might include initiating adjustments to the plan assessments charged to QHP issuers, reducing discretionary expenditures, and reducing contract expenditures. Further, he said that Covered California would consider a hiring freeze, terminating temporary employees, or reducing vacant positions.

Were Covered California to undertake such a large reduction in expenditures in such a brief period of time, it might not be adequately prepared to respond effectively to the market conditions that necessitated those expenditure reductions.

Were Covered California to undertake such a large reduction in expenditures in such a brief period of time, it might not be adequately prepared to respond effectively to the market conditions that necessitated those expenditure reductions. For example, Covered California could find that it is without the funds necessary to undertake additional marketing efforts that might be necessary to increase enrollment and, in turn, to increase revenues. Despite these risks and the fact that it is now nearing completion of its third open enrollment period, Covered California has not completed a formal analysis of the adequacy of its reserve level. Nonetheless, Covered California has conducted some work in this area, such as a review

of a reduction in enrollment countered with adjustments to plan assessments and expenditures. When we inquired about this, the chief financial officer stated that as Covered California gathers more data over time on expenditure trends and revenues, it will continue to fine-tune its reserve requirement estimates. Specifically, he explained that the data from 2014 and 2015 would not be indicative of typical business cycles and reserve requirements; thus, using these data would likely lead to overestimating the reserve. He stated that although 2016 data should be more reflective of future years' business cycles, it would be premature to establish the reserve using only one year of data. Covered California would like to use data for 2016 and 2017 to prepare a formal reserve analysis soon after December 2017.

However, we believe that Covered California can conduct a meaningful, formal analysis to determine an adequate reserve level with the data available following this third open enrollment period, which was scheduled to end on January 31, 2016. In addition, to ensure that the most recent data are incorporated into its analysis, Covered California should update the analysis periodically. Covered California's financial plans are highly dependent upon its enrollment projections, which in turn largely rely on its limited experience from its first two open enrollment periods. If Covered California does not enroll as many consumers as its fiscal year 2015–16 budget projects, its revenues will suffer. Further, increasing its revenues by adjusting its plan assessments could take nine to 18 months, as described earlier. To better position itself to ensure its financial sustainability in this scenario, Covered California could formally analyze the steps it would take to ensure that its reserve is adequate to cover its operating expenditures. For instance, as part of this analysis, it could identify the contracts it would eliminate to reduce its expenditures. Although Covered California has done some work in this area, we believe it could benefit from a formal analysis related to its reserve level to ensure it maintains its financial solvency if enrollment significantly decreases. Consequently, financial sustainability continues to be an area of risk that will need to be closely monitored.

Financial sustainability continues to be an area of risk that will need to be closely monitored.

It Is Too Early To Tell Whether Enrollment Projections Accurately Reflect the Market

To ensure Covered California's financial sustainability, our July 2013 report recommended that it conduct regular reviews of enrollment, as well as other factors, and make prompt adjustments to its financial sustainability plan as necessary. During our current audit, we found that Covered California has annually updated its enrollment projections. For its fiscal year 2015–16 budget, Covered California primarily based these enrollment projections on prior

Summary of Covered California's Six Key Assumptions Used to Forecast Enrollment

Enrollment of the subsidy-eligible population: Proportion of the population eligible for federal subsidies that has enrolled in the exchange.

Effectuation rate: Proportion of enrollees who completed an application, selected a qualified health plan, and paid at least their first month's premium.

Monthly enrollment rate during special enrollment: Average number of new monthly enrollments in Covered California for qualifying events, such as loss of coverage from loss of employer-provided insurance or loss of coverage under the California Medical Assistance Program.

Monthly disenrollment rate: Proportion of current effectuated enrollees terminated each month.

Nonrenewal rate: Proportion of enrollees who did not renew or were found ineligible for renewal.

Subsidized and unsubsidized enrollments: Ratio of subsidy-eligible enrollees to enrollees not eligible for subsidies.

Source: Covered California's *Fiscal Year 2015-2016 Budget*, as of June 30, 2015.

year or other recent data, as well as the California Simulation of Insurance Markets.³ However, as Covered California has acknowledged, a number of potential developments could lead to more or less enrollment and revenue than anticipated. In fact, Covered California stated that the biggest uncertainty in its forecasts is the pace at which the population eligible for federal subsidies on health insurance (subsidy-eligible population) enrolls in QHPs through Covered California. Thus, future enrollment is uncertain, and Covered California's limited operational history suggests that its enrollment projections are an area of risk that it will need to carefully monitor in order to ensure its financial sustainability.

Covered California used six key assumptions to determine its multiyear enrollment projections. Using these assumptions, Covered California developed a range of enrollment estimates—from low to high, which show continued enrollment growth through fiscal year 2018–19. The text box describes Covered California's six key forecasting assumptions.

One of Covered California's key assumptions is the proportion of the subsidy-eligible population that has enrolled in health insurance through the exchange. Covered California used external estimates and participation in similar programs, such as the Healthy Families program, to arrive at low, medium, and high alternatives for this assumption in its forecast. Covered California forecasts that by 2018 it will enroll 75 percent—the medium alternative—of those who are eligible for subsidies and do not already have coverage. According to Covered California's 2015–16 budget, the California Simulation of Insurance Markets model estimates the subsidy-eligible population in California to be approximately 2.5 million, increasing to 2.7 million by 2017.

Another of Covered California's key assumptions is the monthly enrollment rate during special enrollment, which consists of individuals who enroll outside of the open enrollment period because of qualifying events, such as the loss of employer-provided

³ The California Simulation of Insurance Markets model, a joint project of the University of California, Los Angeles, Center for Health Policy Research and the University of California, Berkeley, Center for Labor Research and Education, is designed to estimate the impacts of elements of the Patient Protection and Affordable Care Act on employer decisions to offer insurance coverage and individual decisions to obtain coverage in California.

insurance or the loss of Medi-Cal coverage.⁴ Although an average of 31,000 special enrollments occurred each month from June 2014 through November 2014, Covered California used a conservative assumption of 25,000 new monthly special enrollments for its projection, in part because the actual month-to-month pace slowed noticeably after July 2014.

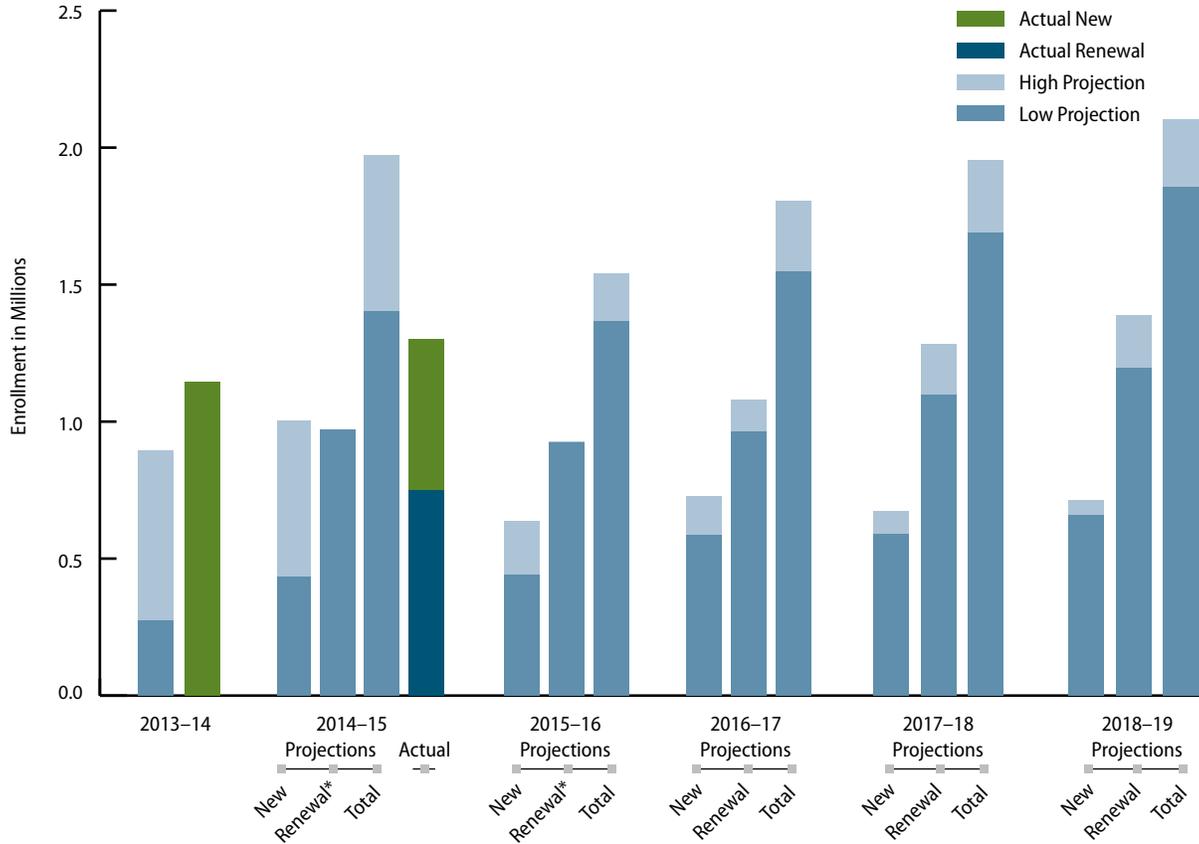
A third assumption that Covered California used is its *effectuation rate*, which is the proportion of enrollees who completed an application, selected a QHP, and paid at least their first month's premium. Covered California based its effectuation rate for subsequent years on the actual effectuation rate of those who enrolled in 2014, which was approximately 80 percent for those enrolled during open enrollment and approximately 75 percent for those enrolled outside of the open enrollment period. Using this data, Covered California projected an 80 percent effectuation rate during open enrollment and a 75 percent effectuation rate during special enrollment.

Covered California bases its budgets on its medium enrollment projections. According to its 2015-16 budget, individuals from the subsidy-eligible population made up 83 percent of its 2014 enrollment; therefore, Covered California's revenues are primarily dependent on the number of individuals it enrolls from this subpopulation of Californians. As shown in Figure 1 on the following page, in fiscal year 2013-14, the year of its first open enrollment period, Covered California exceeded its high projection of roughly 894,000 by enrolling more than 1.1 million consumers. For its second open enrollment period, Covered California's enrollment, including renewals, was nearly 1.3 million, falling slightly short of its low projection of 1.4 million and well below its high projection of nearly 2 million. As of September 30, 2015, Covered California had roughly 1.3 million consumers enrolled in the exchange. Its third open enrollment period began on November 1, 2015, and continued through January 31, 2016.

Covered California's revenues are primarily dependent on the number of individuals it enrolls from the subsidy-eligible population of Californians.

⁴ Open enrollment is a designated period during which all eligible consumers may apply for health coverage.

Figure 1
Covered California's Projected and Actual Enrollment
Fiscal Years 2013–14 to 2018–19



Sources: Covered California's Request for Approval of Proposed FY 2013–14 Budget; Covered California Policy and Action Items, June 19, 2014; Fiscal Year 2015–2016 Budget; and data provided by Covered California.

Note: Data for actual enrollment consist of consumers who effectuated, which means they completed an application, selected a qualified health plan, and paid at least their first month's premium.

* Covered California did not include distinct renewal data in its projections. Therefore, we arrived at its renewal data by subtracting nonrenewals and disenrollments from its beginning effectuated enrollment. The fact that its high projections for these fiscal years contained much larger numbers of disenrollments than its low projections was primarily responsible for reducing the high renewal projections that we calculated for these fiscal years to below the level of its low renewal projections.

Covered California Evaluates and Modifies Its Marketing Approach to More Effectively Reach Eligible Program Participants

Covered California's marketing division develops and executes marketing campaigns promoting the products and services offered through the State's exchange. Under state law Covered California is required to market and publicize the availability of health care coverage and federal subsidies through the exchange. To satisfy this requirement and to target key populations and ensure a positive effect on enrollment, the marketing division has adjusted its marketing strategy for each open enrollment period to reach consumers eligible for health insurance. Table 5 summarizes how Covered California's key marketing strategies have evolved for each of the three enrollment periods based on its evaluations of enrollment and survey data.

For the first open enrollment period, the marketing division focused on educating consumers throughout the State about the exchange. According to documentation regarding its marketing campaign, Covered California’s objective was to establish a media presence to generate awareness about the exchange and reach the subsidy-eligible population. To accomplish this objective, its marketing campaign included television advertisements that promoted the benefits of enrolling in a health plan through Covered California and newspaper advertisements regarding sources of more information about available plans and services such as a toll-free phone number and website. The advertisements emphasized that Covered California provides financial assistance for those who need help with their monthly insurance bills and that nobody can be denied coverage because of a preexisting condition.

Table 5
Summary of Selected Key Marketing Strategies by Enrollment Period

	ENROLLMENT PERIOD ONE	ENROLLMENT PERIOD TWO	ENROLLMENT PERIOD THREE
Marketing expenditures (Dollars in millions)	\$74	\$67.5	\$60.8*
Selected marketing strategies	<ul style="list-style-type: none"> Allocate the media plan budget based on the percentage of the uninsured population in different areas of the State, with adjustments made to account for media costs. Advertise in as many as eight different languages depending on the area, using different forms of media channels, such as television, radio, print, and digital. Raise awareness of Covered California and how to access information regarding affordable health coverage. 	<ul style="list-style-type: none"> Increase awareness and enhance the image of Covered California, with particular focus on Hispanic and African American segments, while building loyalty among current enrollees. Promote messages through media channels frequently accessed by members of the non native English-speaking communities, including Hispanic and Asian population segments, as well as the African American and lesbian, gay, bisexual, and transgender communities. Use social media to remind consumers of open enrollment dates, and direct mail to describe the benefits of membership to current enrollees. 	<ul style="list-style-type: none"> Market to a population that more closely aligns with the core target age of 25 through 54, and reallocate the media budget to increase digital advertising and revise its radio advertising strategy. Outreach to the Hispanic market statewide with enhanced direct mail in areas with a high concentration of Hispanics. Planned use of innovative technology to advertise to specific market groups instantly.
Total enrollment by period [†]	1,395,929	1,408,362	Not available as of December 2015

Sources: Various documents, including those related to its marketing campaigns and expenditures, provided by Covered California and selected executive director reports to Covered California’s board of directors.

Note: The enrollment periods include designated open enrollment periods, during which all eligible consumers may apply for health coverage, and special enrollment periods, during which consumers with certain qualifying life events, such as loss of health insurance or marriage, may apply.

* Enrollment periods one and two include actual marketing expenditures according to Covered California’s financial documents. For enrollment period three we present its marketing budget because, as of December 2015, all expenditures had not yet occurred.

† Enrollment figures include those consumers who selected a plan and enrolled during open enrollment periods, but who may or may not have made a payment to maintain insurance. These amounts do not include enrollees who signed up during special enrollment periods. These amounts are distinguishable from those in Figure 1, which include only those consumers who enrolled during open and special enrollment periods and paid their first month’s premium.

According to documents related to its marketing campaign for the first open enrollment period, Covered California designated roughly half of its marketing budget to the Los Angeles market, which includes San Bernardino and Orange counties.

According to documents related to its marketing campaign for the first open enrollment period, Covered California designated roughly half of its marketing budget to the Los Angeles market, which includes San Bernardino and Orange counties. Covered California designated the remainder of the marketing budget across the additional 11 marketing areas in the State, including San Francisco–Oakland–San Jose, Sacramento–Stockton–Modesto, San Diego, and Fresno–Visalia, with an emphasis on the type of media it determined to be most effective to reach the target populations it identified.

To determine the effectiveness of the strategies it used to inform consumers about its products and services, and to increase enrollment following the first open enrollment period, Covered California evaluated data, such as demographic data, regarding the consumers enrolled in QHPs. Further, it analyzed survey data regarding public awareness of Covered California and consumers' overall experience with the exchange. According to the director of marketing, Covered California relied on these data to determine whether its marketing efforts were effective in enrolling consumers in QHPs.

Covered California used consumer enrollment data during and after the first open enrollment period to develop future targeted marketing campaigns. It determined that enrollment among Hispanic and African American consumers during the first three months of the first open enrollment period was significantly lower than its projections for that period. Although enrollment figures for these consumers eventually increased by the end of the first open enrollment period, Covered California focused its efforts for the second open enrollment period in part, toward underrepresented segments of the population, including the Hispanic and African American populations, to better ensure that they were aware of the opportunities to acquire health insurance. For example, Covered California used local platforms such as community newspapers and television advertisements specific to those communities to reach the underinsured in these target populations. According to Covered California's available enrollment data, the percentage of new Hispanic and African American enrollees increased in 2015 from the previous year.

In addition, during and following the first open enrollment period, Covered California surveyed or interviewed enrolled consumers; members of its outreach community, such as its service center representatives and enrollment counselors; and uninsured consumers to identify barriers to enrollment and to adjust its marketing strategy. For example, it conducted interviews to gauge consumer attitudes toward health insurance, awareness of Covered California, and barriers to obtaining health insurance through

Covered California. The results indicated that, although consumers were generally aware of Covered California, many indicated that they would not enroll because they were confused about how Covered California works and were concerned about not being able to afford insurance. Further, based on interviews with enrollment counselors, Covered California learned that the biggest barriers to enrollment of Hispanic consumers were confusion surrounding the program, technological barriers, and cost.

Covered California's second open enrollment marketing campaign included an advertising approach aimed at addressing the results of these surveys and interviews. Specifically, this campaign included advertisements containing testimonials from actual enrollees discussing positive experiences, such as cost savings and peace of mind, from enrolling in QHPs. In addition, Covered California encouraged consumers to seek free, in-person enrollment assistance or to visit its multilanguage website to obtain additional information. In March 2015, after the close of the second open enrollment period, one of Covered California's consultants conducted focus groups of uninsured consumers in select areas to understand key barriers and motivators for enrolling in a health insurance plan, among other factors. The results the consultant reported indicated that, although nearly all participants had heard of Covered California, those who had looked into it had not found what they considered an affordable plan. In addition, some had negative experiences with the website and, as a result, had not returned. The consultant also reported that almost all focus group participants wanted health insurance but were resigned to the idea that they could not currently afford to enroll in a plan.

Following the second open enrollment period, Covered California used survey data to inform its marketing strategies moving forward. In particular, it contracted with the National Opinion Research Center (NORC) at the University of Chicago to conduct market research and evaluation. NORC surveyed approximately 2,200 California residents during March through May of 2015. The purpose of the survey was to assess recent changes in public knowledge, attitudes, and behaviors related to purchasing health insurance and the effectiveness of Covered California's marketing and outreach campaigns. The resulting report, released in October 2015, reached two important conclusions that affected Covered California's marketing strategy. It indicated that overall consumer awareness of Covered California rose from 12 percent in 2013 to 85 percent in 2015. The report also stated that 72 percent of respondents who purchased a health plan through Covered California indicated that financial assistance was an extremely important motivator in obtaining insurance. Further, the survey closely examined respondents' knowledge of the availability of financial assistance for lower income groups and the tax penalty for not having minimum essential coverage. According to the report

After the close of the second open enrollment period, a consultant reported that although nearly all participants had heard of Covered California, those who had looked into it had not found what they considered an affordable plan.

Because of a moderate level of awareness of the subsidy, Covered California runs the risk that some uninsured individuals may decline health care coverage because of the cost, even though they may qualify for financial assistance.

the results showed that 64 percent of the uninsured population were aware of the subsidy in 2015. As a result of this moderate level of awareness of the subsidy, Covered California runs the risk that some uninsured individuals may decline health care coverage because of the cost, even though they may qualify for financial assistance.

Covered California has taken steps to address the report's findings in its marketing campaign for the third open enrollment period. According to its director of marketing, in addition to facilitating retention and renewal of existing members, Covered California's goals include attracting new enrollees who are unsure about how to enroll or are unaware of the available federal subsidies. To accomplish these goals Covered California is promoting radio and television advertisements to inform general and Hispanic audiences that most uninsured Californians can receive financial assistance to pay for insurance, and that four out of five consumers who receive their insurance through Covered California have received financial assistance. In addition, Covered California's English and non-English language advertisements include notice of a deadline to enroll to avoid a tax penalty. Although it anticipates that this effort will increase awareness of the subsidy and tax penalties, according to the director of marketing, Covered California plans to reevaluate both enrollment and awareness data following the third open enrollment period to determine whether its efforts were effective.

Covered California Has Established a Network of Entities to Help Strengthen Its Outreach Efforts

Covered California's outreach and sales division reviews the performance of certified enrollment representatives (enrollment representatives) and provides numerous resources and service center support to the entities that educate and enroll program participants. Under federal requirements the exchange must conduct outreach and education activities that meet specified standards to inform consumers about the exchange and insurance affordability programs to encourage participation. Similarly, state law requires Covered California to conduct public education actions to raise awareness of the availability of QHPs and to conduct outreach activities to assist enrollees. In our July 2013 report we concluded that Covered California's planned outreach efforts were extensive and appeared to satisfy federal and state requirements. Covered California has established a network of enrollment representatives, consisting of entities and individuals that educate consumers on, and enroll them in, QHPs and Medi-Cal. As shown in Table 6 enrollment representatives include certified application entities and counselors as well as certified insurance agents.

Table 6
Summary of the Types and Responsibilities of Covered California's Certified Enrollment Representatives

TYPE OF CERTIFIED ENROLLMENT REPRESENTATIVE (ENROLLMENT REPRESENTATIVE)	NUMBER OF ENROLLMENT REPRESENTATIVES AS OF NOVEMBER 2015	RESPONSIBILITY	FISCAL YEAR ENROLLMENT REPRESENTATIVES BEGAN WORK
Certified application entity or certified application counselor	340 certified application entities, 1,797 certified application counselors	A public or private entity designated by Covered California to certify its staff members or volunteers as certified application counselors that provide information to consumers about the full range of qualified health plans (QHP) options and insurance affordability programs for which they are eligible, assist them in applying for coverage, and facilitate enrollment of eligible individuals in QHPs and insurance affordability programs.	2015–16
Certified insurance agent	14,037	Agents, certified by Covered California to transact in the individual and Small Business Health Options Program exchanges, now called Covered California for Small Business.	2013–14
In-person assister (certified enrollment entity and certified enrollment counselors)	Program discontinued	Staff at entities, such as nonprofit community organizations, faith-based organizations, or local government agencies, whose responsibilities include maintaining expertise in eligibility, enrollment, and program specifications; providing information and services in a fair, accurate, and impartial manner; and facilitating consumers' selection of a QHP.	2013–14*
Navigator	68 contractors and an additional 64 subcontractors	Entities, receiving grant funding to perform services for consumers, that demonstrate an existing relationship or could readily establish relationships with employers and employees, consumers, or self-employed individuals likely to be eligible for enrollment. These groups include community and consumer-focused nonprofit groups, trade and professional associations, and state or local human services agencies. The navigator's responsibilities include maintaining expertise in eligibility, enrollment, and program specifications and facilitating consumers' selection of a QHP.	2014–15
Plan-based enroller	11 QHP issuers, and 1,602 plan-based enrollers	Staff employed or contracted by a QHP issuer to provide enrollment assistance to consumers. The enrollers' responsibilities include maintaining an expertise in eligibility enrollment and program specifications, providing information and services to consumers, informing consumers of the availability of other QHP products offered through the exchange, and facilitating enrollment in QHPs.	2013–14

Sources: Documentation and information provided by Covered California; 45 Code of Federal Regulations, parts 155.205(d), 155.210, 155.215, 155.220, and 155.225; 10 California Code of Regulations, sections 6652, 6654, 6664, 6702, 6710, 6800, and 6802.

* Covered California used the in-person assister program, which compensated enrollment representatives for each person enrolled in the program, to help enroll as many consumers as possible during the first two enrollment periods. The certified application entity and certified application counselor program took over the role of the in-person assister program beginning in fiscal year 2015–16. This role is administered by local entities whose mission it is to provide services to people without being paid an incentive for their efforts.

The outreach and sales division generates reports from CalHEERS to review the performance of enrollment representatives. It uses this information to determine gaps in services and to identify new outreach opportunities to increase enrollment during future enrollment periods. For example, the outreach and sales division generates certain detailed reports to better inform local enrollment representatives during their planning processes. Using these reports, enrollment representatives can quickly identify consumers

Many navigators fell short of reaching the enrollment goals outlined in their grant agreements.

who began working with a team member but who never enrolled. The enrollment representatives can use this information to contact those consumers and continue to discuss enrollment options.

The outreach and sales division uses other reports to better assess overall program performance and make necessary changes that can help enrollment representatives in better serving consumers. For example, Covered California modified the structure of its navigator program, described in Table 6 on the previous page, from an incentive-based grant program during fiscal year 2014–15 to a block grant program for fiscal year 2015–16, after evaluating the program's milestones and enrollment data. Covered California began the navigator grant program shortly before the beginning of the second open enrollment period, using its operational funds and not federal establishment funds, in accordance with the Patient Protection and Affordable Care Act. We reviewed data Covered California collected that specifies each grant recipient's target goals for new effectuated enrollments (enrollment goals) and whether those goals were reached during the grant award period, which included the second open enrollment period. According to these data, many navigators fell short of reaching the enrollment goals outlined in their grant agreements.

Specifically, according to the grant agreements for the first award period of October 1, 2014, through June 30, 2015, each navigator received an initial payment, or 25 percent of its total grant award, for achieving the milestone of submitting a strategic work plan and campaign strategy to Covered California. The grant agreements further specify that the navigators would receive subsequent payments whenever they achieved 25, 75, or 100 percent of their enrollment goals and satisfied certain reporting requirements. However, many navigators failed to reach their enrollment goals. Of the 65 entities awarded navigator grants, only 10 met or exceeded 100 percent of their enrollment goals, and seven achieved only 75 percent of their goals. Of the remaining 48 navigators that fell short of achieving 75 percent of their enrollment goals, 20 did not even attain 25 percent of the goals. As a result, many navigators were in jeopardy of not receiving additional grant payments since they were not achieving the enrollment goals specified in their grant agreements.

In January 2015 Covered California's executive director indicated during a presentation to the board that navigators were spending much of their time helping consumers renew and enroll in health plans. The former acting deputy director of Covered California's outreach and sales division told us that the support many navigators were providing to consumers was more extensive than anticipated, particularly for non-native English speakers. As a result, in January 2015 Covered California's board approved a one-time

payment modification of the grant agreements to base payments on the number of consumers who enroll in a plan while assisted by a navigator rather than on effectuated enrollment, the number of consumers who enroll in a plan and make their first monthly payment. The former acting deputy director of the outreach and sales division stated that this change alone would allow navigators to attain the next payment. She also explained that those who still fell short of the revised enrollment goals could demonstrate progress and achievement of goals through a narrative report to receive grant funding.

After the second open enrollment period, Covered California evaluated the results of the navigator program and modified its approach to funding navigators. Specifically, at an April 2015 board meeting, the former acting deputy director of the outreach and sales division asserted that these entities are key contributors to the effort to provide outreach, education, enrollment and renewal assistance, and post-enrollment support, implying that the navigators' compensation should reflect this effort. Subsequently, the board approved changes to the navigator grant program for the third open enrollment period so that it operates in a manner similar to a traditional block grant program by paying navigators in equal installments on an established schedule. Navigator grantee payments are now not based solely on achieving actual enrollment and renewal goals but are also based on the work they perform related to consumer outreach, education, enrollment, renewal assistance, and post-enrollment support on behalf of Covered California. As a result, navigators can earn the full installment amount without reaching their enrollment goals, provided their work in these other areas has been satisfactorily documented in their progress reports and approved by Covered California.

As a result of these changes, Covered California's new navigator agreements, which have a duration that includes the third open enrollment period, require additional accountability measures. In addition to the monthly performance reporting previously required, the new grant agreements require information pertaining to performance and quality assurance. This added information includes the number of consumers assisted or enrolled by demographic category, successful educational and enrollment strategies, and any barriers or technical difficulties preventing navigators from meeting their enrollment or renewal goals. According to a manager in the navigator grant program, Covered California will finalize its evaluation of the success of the navigator program under the new funding format at the conclusion of the third open enrollment period, and it will make necessary modifications to help grant recipients better deliver services to consumers. This evaluation should help inform any necessary changes to the navigator program.

After the second open enrollment period, Covered California evaluated the results of the navigator program and modified its approach to funding navigators.

The outreach and sales division also routinely informs the enrollment representatives of new developments and strategies to help generate additional enrollments or renewals. To assist in this effort, the outreach and sales division provides numerous webinars to keep enrollment representatives informed of ways to promote their business and provide effective service to consumers. Covered California also provides its enrollment representatives, which include certified insurance agents, with online access to webinars and information about the open enrollment and renewal process as well as electronic agent briefings that describe pertinent information, such as reminders, and available resources. Moreover, Covered California established service centers to help ensure that all enrollment representatives have their enrollment questions answered.

Finally, the outreach and sales division is using geographic information software (GIS) to further inform Covered California's outreach efforts. As of November 2015 using GIS technology, the outreach and sales division had created and allowed regional sales staff and community partners to access a map book displaying the estimated remaining subsidy-eligible population. The map book hones in on certain regions within the State's eight sales areas and provides overlaid, color-coded information about estimated subsidy-eligible populations and the location of enrollment representatives in the region. The map book enables regional sales staff and local enrollment representatives to identify underserved areas with high levels of uninsured consumers who qualify for the federal subsidy. A manager within the outreach and sales division stated that, by tracking the enrollments made by enrollment representatives before and after they began using this tool, Covered California intends to evaluate the effectiveness of the map book and establish best practices for enrollment representatives.

Recommendations

Covered California should continue to monitor its plan for financial sustainability and revise the plan accordingly as factors change. Further, it should complete a formal analysis of the adequacy of its reserve level by December 31, 2016, and update this analysis as needed, so that it is prepared if it does not meet its revenue projections and needs to increase its funding or decrease its expenditures to maintain financial solvency. This formal analysis should identify those contracts it could quickly eliminate, among other actions it would take, in the event of a shortfall in revenues.

Covered California should continue to regularly review its enrollment projections and update the projections as needed to help ensure its financial sustainability.

Chapter 2

COVERED CALIFORNIA'S SOLE-SOURCE CONTRACTING PRACTICES NEED TO BE IMPROVED, AND CALHEERS NEEDS CONTINUED OVERSIGHT

Chapter Summary

Covered California needs to improve its contracting practices to ensure the integrity of the process it uses in awarding sole-source contracts. In reviewing sole-source contracts, we found that nine out of 40 justifications were insufficient. Specifically, we found that two of its contracts were missing justifications, and the remaining seven failed to assert either *timeliness* or *unique expertise* as the basis for sole-sourcing the contracts. Covered California's policy, which was approved by its board of directors (board) and in place during our review, permitted the use of sole-source contracts when timeliness or unique expertise may be required. In some instances the justifications asserted reasons that the board had not approved for using a noncompetitive procurement process. In other instances the justifications failed to explain why Covered California was using a sole-source contract at all. Rather, the justifications explained the reasons for the respective services and why the selected vendor was qualified to provide them.

Our review also identified concerns with Covered California's board-adopted policy itself, particularly in light of the new requirement that Covered California's contract manual be substantially similar to the *State Contracting Manual*. Specifically, Covered California's policy referenced generic terms such as *timeliness* and *unique expertise* as justification for using a sole-source contract. We believe that these terms are overly broad and are not substantially similar to the *State Contracting Manual*. Without competitively bidding such contracts, Covered California cannot be assured that the contractor it hires is the most qualified or cost-effective vendor.

Further, the aggressive schedule and rapid design, development, and implementation of the California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS), although resulting in a functional system, has required trade-offs that in some cases present longer-term risks to system maintainability. Without independent verification and validation (IV&V) oversight, our information technology (IT) expert believes certain system issues may go unidentified or unresolved, resulting in long-term cost and schedule implications.

Covered California Often Did Not Adequately Justify Its Use of Sole-Source Contracts

State law requires Covered California to establish and use a competitive process to award contracts, and it also provides Covered California with broad statutory authority to establish its own procurement and contracting policy. In December 2011 the board adopted a procurement policy, updated in February 2013 and in place during our review, that provided Covered California the flexibility to use standard state procurement methods such as leveraged procurement agreements, (which allow departments to buy directly from suppliers through existing competitively bid contracts and agreements) or to use its own competitive contracting methods. However, Covered California's board-adopted policy also included a noncompetitive process that allows Covered California to use sole-source contracts when *timeliness* or *unique expertise* may be required. In addition, the board-adopted policy stated that the use of sole-source contracts should be justified in writing.

During fiscal years 2012–13 through 2014–15 Covered California did not consistently follow the part of its board-adopted policy that addresses noncompetitive procurements.

During fiscal years 2012–13 through 2014–15 Covered California did not consistently follow the part of its board-adopted policy that addressed noncompetitive procurements. We reviewed the justifications for 20 of Covered California's sole-source contracts and another 20 applicable amendments to those contracts, for a total of 40 justifications. Our review found that nine of the 40 justifications were insufficient according to the board-adopted policy. Specifically, Covered California was missing two justifications altogether—one for an original contract and another for an amendment; the remaining seven justifications—five for original contracts and two for amendments—failed to assert either timeliness or unique expertise as the basis for sole-sourcing these contracts. In two instances the justifications asserted other nonboard approved reasons for using a noncompetitive procurement process. In other instances the justifications failed to explain why a sole-source contract was being used at all. Rather, the justifications explained only the reasons Covered California needed the respective contract or amendment and why the selected contractor was qualified to provide the services, none of which were reasons covered in the board-adopted policy for justifying a noncompetitive process.

For example, Covered California did not sufficiently justify the use of a noncompetitive procurement method with respect to Covered California's largest sole-source contract (and the third largest contract overall): a contract for marketing and outreach services with Weber Shandwick for nearly \$134 million, as shown in Table 7. In December 2011 Covered California released a solicitation for a variety of marketing and outreach services, to which it received 13 proposals. Covered California executed the contract, ultimately worth over

\$28 million, with Ogilvy Public Relations Worldwide (Ogilvy) in April 2012. Covered California’s director of marketing reported that Ogilvy executed the first two phases of the marketing plan, which laid the foundation for Covered California’s advertising campaign. She explained that at that time, Covered California decided another vendor would be better suited to carry out the advertising campaign. As a result, Covered California executed a sole-source contract with Weber Shandwick in May 2013. Covered California initially awarded the contract on the basis that (1) Weber Shandwick had submitted the second best proposal for the solicitation that led to awarding the contract to Ogilvy, (2) the services were needed, and (3) the vendor was qualified. However, none of these reasons were appropriate justifications for using a sole-source procurement method under the board-adopted policy. Instead, Covered California determined that, having excluded Ogilvy, Weber Shandwick remained the best value. However, the scope of the Weber Shandwick contract was more focused on the implementation of the advertising campaign, whereas the scope of the Ogilvy contract was initially centered on creating a marketing plan, and it later developed and implemented a public relations plan.

Table 7
Covered California’s 10 Largest Contracts by Final Dollar Amount
From July 1, 2012, Through June 30, 2015

	ORIGINAL CONTRACT AMOUNT	FINAL CONTRACT AMOUNT, INCLUDING AMENDMENTS	FISCAL YEAR ORIGINALLY AWARDED	VENDOR	PROCUREMENT TYPE	SCOPE OF WORK (TOTAL CONTRACT TERM IN YEARS*)
1	\$294,038,767	\$423,711,058	2012–13	California Health and Human Services Agency	Interagency agreement	California Healthcare Eligibility, Enrollment, and Retention System (CalHEERS) project management (2.75)
2	157,000,000	157,000,000	2014–15	Campbell Ewald Company	Competitive	Advertising and marketing campaign (3)
3	98,694,500	133,915,722	2012–13	Weber Shandwick	Sole-source	Marketing and publicity (2.25)
4	50,037,142	61,098,334	2012–13	Pinnacle Claims Management, Inc.	Competitive	Small Business Health Options Program administration (3.5)
5	36,613,862	52,499,973	2012–13	California Department of Social Services	Interagency agreement	CalHEERS reimbursement (3.25)
6	25,398,647	33,754,425	2012–13	Contra Costa County	Competitive	Provide additional service center (4.5)
7	813,600	33,594,509	2013–14	Richard Heath and Associates, Inc.	Sole-source	Outreach and education grant (4)
8	9,800,000	23,700,000	2014–15	Faneuil, Inc.	Competitive	Call center support and data entry (0.75)
9	6,716,000	16,784,000	2013–14	California Department of Social Services	Interagency agreement	Review appeals of applicant eligibility (2.75)
10	9,145,400	16,369,720	2013–14	K/P Corporation	Competitive	Develop and disseminate print materials (3)

Source: California State Auditor’s review and analysis of all contracts awarded during fiscal years 2012–13 through 2014–15.

Note: Includes amendments awarded before August 2015.

* Contract term rounded to nearest quarter of a year.

We believe Covered California did not sufficiently justify using a noncompetitive procurement process as its board-adopted policy outlined.

Covered California amended the Weber Shandwick contract twice using the noncompetitive procurement method in both instances. Neither of the justifications for the amendments cited the reasons that were included in the board's adopted policy as a basis for avoiding a competitive process. Rather, the amendment justifications only indicated that the services were needed and that Weber Shandwick was qualified to provide the needed services. Finally, in March 2015 when Weber Shandwick's \$134 million contract neared expiration, Covered California sought competitive bids for a vendor to undertake a new advertising and marketing campaign. Although Weber Shandwick submitted a proposal for the new advertising and marketing campaign, Covered California determined that another contractor, Campbell Ewald Company, was the best value for that bid. When we brought this to the attention of Covered California, the marketing director stated that it takes anywhere from six months to one year to competitively bid a marketing contract and there was not enough time to competitively bid for a marketing contract after Ogilvy. In addition, she stated that Weber Shandwick did an outstanding job on Covered California's behalf in terms of quick turnaround, quality of work, and cost-efficiencies. The term of the contract began in May 2013 and by September 2013, she stated, Weber Shandwick had a comprehensive campaign on air to launch the first open enrollment of Covered California. Nevertheless, as we stated earlier, we believe Covered California did not sufficiently justify using a noncompetitive procurement process as its board-adopted policy outlined.

We also question the validity of three additional justifications. Specifically, although Covered California asserted either timeliness or unique expertise as the basis for using the noncompetitive procurement process, in these three instances available documentation suggests that either the vendor was not unique or that Covered California had sufficient time to use a competitive procurement method. As noted previously, in April 2012 Covered California executed a contract with Ogilvy to provide marketing and outreach services. Richard Heath and Associates, Inc. (Richard Heath) became a subcontractor to Ogilvy for this contract. The original Ogilvy contract was set to expire in October 2013. In late September 2013 Covered California executed a sole-source contract with Richard Heath for more than \$813,000 for the purpose of supporting, training, and managing the Outreach and Education Grant, In-Person Assister, and Navigator Grant Programs. Covered California then amended the Ogilvy contract by removing, among other things, the corresponding portions related to these grant programs. Three days after it removed these items from the Ogilvy contract, which was 18 days after awarding Richard Heath's original contract, Covered California amended the contract with Richard Heath to increase the contract total to

just over \$44 million—again without using a competitive process. As of January 2016 the contract totaled nearly \$37 million after a subsequent amendment lowered the total contract amount.⁵

Covered California justified the original Richard Heath contract and the subsequent first amendment on the basis that the sole-source contract was necessary because of the severe time constraints it was facing. However, we question this justification in light of the fact that Covered California had the time and capacity to seek competitive bids for these services. As previously indicated, when Covered California executed the contract with Ogilvy, it was aware that the contract would expire in October 2013. Further, in its justification to use a sole-source contract with Richard Heath, it stated that during the first year of the contract with Ogilvy, which began in March 2012, Covered California determined that it needed a different vendor to provide services related to Ogilvy's marketing plan. This acknowledgement indicates that Covered California was aware that it needed another contract by or before March 2013; thus, it could have begun a competitive procurement process and successfully awarded a contract by October, when the Ogilvy contract was set to expire. Considering the size of the contract award and that Covered California had time to competitively bid the contract, we believe it was paramount for Covered California to ensure that it awarded this contract using a method that offered the best opportunity for selecting the most qualified vendor at the most competitive cost.

In response to our review, the assistant general counsel noted that the federal requirements for the outreach program and all its components were new and complex. He also stated that conducting a competitive procurement process for the outreach services that Richard Heath had already performed for over a year under the Ogilvy contract would have been more costly than awarding the contract to Richard Heath, as a new contractor would have had to expend additional time and resources to get up to speed on the program. Covered California believes awarding a sole-source contract to Richard Heath for these services was the best value. He further noted that by the time Covered California realized it needed a direct contract with Richard Heath, there was not enough time to competitively bid the contract and have the contractor certify and support the enrollment personnel in advance of open enrollment. Even with using a noncompetitively bid contract, the Richard Heath contract was only executed one week before the start of the first open enrollment period. He stated that for these reasons Covered California followed its board-adopted policy, which allowed the use of noncompetitively bid contracts under these conditions. Regardless of the assistant general counsel's rationale, we still question the justification used in this instance. Covered California was aware as early as April 2012 that

Considering the size of the contract award and that Covered California had time to competitively bid the contract, we believe it was paramount for Covered California to ensure that it awarded this contract using a method that offered the best opportunity for selecting the most qualified vendor at the most competitive cost.

⁵ The contract total here differs from the total in Table 7 because the table information is as of August 2015.

outreach services were needed and it knew the federal requirements for the outreach program were new and complex; we therefore believe it could have competitively bid for these services earlier.

In addition, we found that in April 2014 the board granted Covered California staff the authority to enter into a competitive procurement process for a vendor to develop and implement a data analytics program. About five months later, Covered California awarded a \$540,000 sole-source contract to Equanim Technologies, Inc. (Equanim) to perform lead responsibility over the request for proposal process, oversee the competitive process to be used in selecting the vendor to develop and implement the data analytics program, and to manage the project. In its justification Covered California indicated, in part, that the competitive procurement process was unnecessary because the selected project management vendor was uniquely qualified and had to begin work immediately. However, we question whether the project management vendor was unique, that is, that it was the only vendor that could provide the type of project management services Covered California wanted to procure. In fact, many vendors provide project management services. Further, in Covered California's justification for a noncompetitive procurement process, it also claimed that time was of the essence. However, we believe that Covered California should have been aware of the complexity of the data analytics program when it requested approval to competitively bid for that program and, therefore, had the time to also competitively bid for the project management services. Covered California's delay is not an acceptable reason to use a sole-source contract. Using such justifications as the basis for entering into sole-source contracts undermines the integrity of the competitive procurement process.

The assistant general counsel stated that Covered California needed specific expertise in creating and implementing the data analytics program in order to support its statutory charge to be a driver of the health care quality improvement goals laid out in the Patient Protection and Affordable Care Act. He explained that it needed a project management vendor that had unique experience in this area. Specifically, he stated that because Equanim had successfully assisted other state agencies in getting similar programs up and running, Covered California believed Equanim had the unique expertise that justified the sole-source contract. Additionally, he noted that if Covered California had competitively bid these services, its ability to operationalize the data analytics program and deliver critical data to inform policy decisions would have been jeopardized. However, we believe Covered California could have identified the need for a project management vendor earlier in the process. Further, although Equanim had assisted other state agencies by providing project management services for data analytics programs, this experience does not make it the only vendor available to provide such services.

Although Equanim had assisted other state agencies by providing project management services for data analytics programs, this experience does not make it the only vendor available to provide such services.

As shown in Table 8, over the last three fiscal years, the total number of sole-source contracts Covered California has used has decreased each year. The assistant general counsel stated that Covered California faced many challenges at the inception of the exchange because it was a newly created public entity. He stated that it had no office, no employees, no technology platform, and only about two years to implement the largest health care reform legislation since the creation of Medicare. He explained that the exchange could not have been successfully implemented without using sole-source contracts. However, as we pointed out previously, we identified certain instances where Covered California had time to competitively bid certain services and because it did not, it lacks assurance that the contractor was the most qualified or cost-effective vendor. In April 2015 Covered California implemented a *noncompetitive bid justification form* to provide more specific guidance on the information that staff requesting a sole-source contract need to include in their justifications. Our review of the form found that using it could contribute to adequately justifying the need for sole-source contracts.

Table 8
Covered California Contracts Awarded July 1, 2012, Through June 30, 2015
(Dollars in Thousands)

PROCUREMENT TYPE	FISCAL YEAR 2012-13		FISCAL YEAR 2013-14		FISCAL YEAR 2014-15		TOTAL	
	NUMBER OF CONTRACTS	TOTAL DOLLAR AMOUNT						
Competitive								
Competitive	76	\$149,080	52	\$28,195	105	\$226,991	233	\$404,266
Leveraged procurement agreement*	15	3,329	17	1,688	12	2,938	44	7,960
Noncompetitive								
Interagency agreement	14	377,583	28	(2,540)	8	1,172	50	376,215
Nonmonetary contracts†	2	-	7	-	10	-	19	-
Sole-source	27	147,958	24	40,825	13	10,053	64	198,836
Exempt‡	8	68	14	1,133	17	1,321	39	2,522
Grand Total	142	\$678,018	142	\$69,306	166	\$242,501	450	\$989,799

Sources: *State Contracting Manual*, Covered California's draft procurement manual, California State Auditor's review and analysis of all contracts awarded in fiscal years 2012-13 through 2014-15.

Note: Includes amendments awarded before August 2015.

* Leveraged procurement agreements allow departments to buy directly from suppliers through existing competitively bid contracts and agreements; under certain circumstances these contracts may be exempt from bidding.

† As defined by Covered California, these types of agreements are created to protect the State's interests to complete a project or comply with regulations but do not require the exchange of funds. These agreements, such as memorandums of understanding, are not subject to normal procurement processes.

‡ As defined by the California Department of General Services, contracts exempt from bidding include those for legal services and contracts with other public entities or with a certified small business.

As of June 24, 2015, state law requires Covered California to adopt a contract manual that is substantially similar to the State Contracting Manual.

Covered California Needs to Improve Its Noncompetitive Procurement Policy

As previously noted, while state law requires Covered California to establish and use a competitive process to award contracts, it also provides Covered California with broad statutory authority to establish its own procurement and contracting policy. For example, state law exempts Covered California from certain contracting requirements, such as obtaining approval from the California Department of General Services (General Services) before entering into a contract. However, as of June 24, 2015, state law requires Covered California to adopt a contract manual that is substantially similar to the *State Contracting Manual*.

Contrary to the board-adopted policy in place during our review, which permitted Covered California to use the noncompetitive procurement process when timeliness or unique expertise may be required, the *State Contracting Manual* allows for the use of a noncompetitive process in two types of situations: when there is an emergency where immediate acquisition is necessary for the protection of the public health, welfare, or safety; or when the acquisition of goods and services are the only goods and services that meet the State's need and no known competition exists. Our review identified concerns with the board-adopted policy in light of the new requirement that Covered California's contract manual be substantially similar to the *State Contracting Manual*. The board-adopted policy used generic terms such as *timeliness* and *unique expertise* as justification for using a sole-source contract. We believe that these terms are overly broad and are not substantially similar to the *State Contracting Manual*. The term *timeliness* does not restrict the use of a sole-source contract to those instances where there is an emergency. Further, the term *unique expertise* does not restrict the use of a sole-source contract to those instances when only one vendor with the requisite qualifications is available to complete the needed work.

Covered California's procurement manual has been revised in its draft form numerous times and the manager within its business services branch and contracts section indicated that Covered California's staff has been using it since the inception of the exchange. In our review of the November 2015 draft manual, we found that it includes criteria that allow for a sole-source contact in circumstances other than those that the *State Contracting Manual* permits. Specifically, in addition to allowing for the use of a sole-source contract when there is an emergency or when only one vendor with the requisite qualifications is available, the draft procurement manual allowed the use of a noncompetitive process when "the services are urgently needed to fulfill Covered California's obligations or mission." After bringing this to the attention of Covered California,

staff made subsequent changes to the draft procurement manual to address our concerns. Covered California's draft procurement manual was adopted by the board in January 2016 and takes the place of the 2011 board-adopted policy. Our review of the January 2016 board-adopted procurement manual found that it is substantially similar to the *State Contracting Manual* as state law requires.

Although Covered California was required to comply with the board-adopted policy in place during our review, we found an instance in which its staff followed the draft procurement manual instead of the board-adopted policy. Specifically, the board-adopted policy suggests a written justification is necessary for all sole-source contracts regardless of the amount. However, the October 2013 draft procurement manual and all subsequent draft versions allow staff to award sole-source contracts for less than \$25,000 without a written justification. Our review included one sole-source contract that was less than \$25,000 and, contrary to the board-adopted policy, no written justification was provided. Covered California staff explained that they were following the draft procurement manual, not the board-adopted policy. Similarly, the assistant general counsel stated that the draft procurement manual served as Covered California's formal contract amendment policy. Inconsistent policies and procedures regarding its procurement processes further affect Covered California's ability to comply with state laws.

We found an instance in which Covered California's staff followed the draft procurement manual instead of the board-adopted policy.

Covered California's Contracts Database Is Inaccurate, Hindering Its Ability to Keep Adequate Records of Its Contracts

Covered California's database of the contracts that it has awarded suffers from inconsistent and inaccurate information. According to the chief of business services, Covered California uses this database as its internal tracking tool and to provide quarterly reports to the board. However, although Covered California has written desk procedures for entering information into its database, we found errors in the data provided. These problems occur, in part, because staff enter contract information inconsistently and adequate review does not occur to ensure accurate entry as called for by Covered California's desk procedures. For instance, we found that some contracts were categorized under an incorrect procurement type, such as contracts labeled as exempt from bidding when they were competitively bid. In addition, we noted a contract in the database for \$130,000 that, according to the contracts manager, was never executed.

Because of our concerns regarding the accuracy of the information in this database, we recreated three years of data using Covered California's hard-copy contract files and discovered a significant

We determined that the award values of 75 individual contracts had been incorrectly recorded in the database. The value of 44 contracts was understated by about \$11.7 million, and the value of 31 contracts was overstated by roughly \$32.2 million.

number of errors. Our results indicated that Covered California had entered into 449 contracts valued at just less than \$990 million during fiscal years 2012–13 through 2014–15. However, we determined that the award values of 75 individual contracts had been incorrectly recorded in the database. Specifically, the value of 44 contracts was understated by about \$11.7 million, and the value of 31 contracts was overstated by roughly \$32.2 million with a net discrepancy of about \$20.5 million. In one instance, Covered California's database shows a contract with Pinnacle Claims Management, Inc., for almost \$65 million, but we determined that this contract was actually worth \$61 million. Because state and federal law require Covered California to keep an accurate accounting of all activities, receipts, and expenditures, and because the contracts database is used as the central information system for its contract management activities, it is essential that Covered California follow its procedures to ensure the database's accuracy.

CalHEERS Needs Continued Oversight

The aggressive schedule and rapid design, development, and implementation of CalHEERS, although resulting in a functional system, has required trade-offs that present longer-term risks to system maintainability in some cases. According to federal regulations, each state is to develop, for all applicable state health subsidy programs, a secure electronic interface for the exchange of data that allows a consumer's eligibility to be determined for all health care programs based on a single application. Covered California entered into a contract with a systems developer in 2012 to provide design, development, implementation, and maintenance services for CalHEERS, which supports the maintenance, operations, and on-going business of Covered California. CalHEERS is also one of the systems that supports the same functions for the California Department of Health Care Services. The system also interfaces, or communicates electronically, with an array of federal, state, and private entities. This communication involves sharing sensitive data that are used for potential eligibility for other programs, such as CalFresh and California Work Opportunities and Responsibility to Kids. Given that the continuing development and maintenance activities for the system are anticipated to occur until 2017, CalHEERS must receive adequate technical oversight in order to identify risks and issues that threaten system viability and to ensure such risks and issues are adequately resolved.

To assist the CalHEERS project by ensuring that deficiencies are detected and corrected as early as possible, Covered California contracted with a system expert to evaluate every aspect of the design, development, and implementation phase and to provide

monthly IV&V reports. These reports assess the strengths and weaknesses of the project and include recommendations for correcting the findings and risks identified. We had our IT expert review the six most recent IV&V reports for the periods covering August 2014 through January 2015, the month the final report was issued (the IV&V contract with Covered California expired in February 2015). According to our IT expert, although the IV&V reports do not suggest that the CalHEERS project is deficient, the risks identified in the reports are significant and may pose threats to system maintainability moving forward. For example, the IV&V consultant identified concerns over the ability to isolate and easily correct defects in order to cost-effectively maximize the productive life of the system. This type of risk represents a challenge to the future ability of the system to readily expand its capacity in users served or increased transaction volumes.

According to the project director of CalHEERS, decisions were made to prioritize certain system fixes, based on the risk they presented, at specific times in an effort to meet project release deadlines. According to the chief of the CalHEERS project management office, the management team established a quality assurance team in July 2014 to undertake activities focusing on continual improvement of processes and products, among other issues. However, as of November 2015, this team was still working through a list of issues that may affect system functionality that, according to its documentation, CalHEERS plans to address through future releases. As a result, the risks related to the underlying system issues have not been fully mitigated.

According to the project director, the project management team is actively considering whether an IV&V skill set is needed going forward. Our IT expert believes that given the size and technical complexity of the project, as well as the significant number of maintenance items and change orders that remain outstanding, the project should reinstitute IV&V services as soon as practical. In fact, he explained that the CalHEERS project should maintain IV&V services until the size and frequency of significant modifications greatly diminish. The IV&V processes determine whether the development products of a given system activity conform to the requirements of that activity and whether the product satisfies its intended use and user needs. Tasks involved in making this determination may include the analysis, evaluation, review, inspection, assessment, and testing of products. Our IT expert believes that effectively implemented IV&V services will assist the CalHEERS project with technical oversight, inform decisions about system development processes, and identify the implications of any technical trade-offs that the system builder might make or propose.

Our IT expert believes that effectively implemented IV&V services will assist the CalHEERS project with technical oversight, inform decisions about system development processes, and identify the implications of any technical trade-offs that the system builder might make or propose.

Selected Significant Risks to the CalHEERS System as of a July 2015 Independent Project Oversight Consultant Report

- Continued loss of skilled contractor staff in key positions, which has affected the release schedule and quality of deliverables.
- A delay in or partial implementation of change requests, which could increase project costs.
- A struggle to enforce the change management process to ensure that the new functionality added to a release has the appropriate design document approval and provides an assessment of when it is best to add a change without affecting other changes.

Source: July 2015 independent project oversight consultant report.

Covered California also entered into a contract with the Office of Systems Integration—an office within the California Health and Human Services Agency (Health and Human Services)—for project management and quality assurance services. Health and Human Services entered into a memorandum of understanding with the California Department of Technology for independent project oversight (IPO) to provide additional advice and consulting on the management of the project during the design, development, and implementation phase. Our IT expert reviewed six of the IPO reports for February through July 2015. The reports include updates on project releases of a list of overdue action items, a summary of the status of recent project deliverables, and a description of pending and resolved risks. The text box gives examples of the unresolved risks that are most significant to completing the system within the approved schedule. The IPO consultant's reports indicate

whether the CalHEERS project team has taken steps to address them. The July 2015 report, the last issued by the IPO consultant, identified outstanding risks that still need to be addressed. However, according to the chief of the CalHEERS project management office, as of January 2016 IPO services have ended because the project met its milestones and moved into the operations and maintenance phase.

Our IT expert indicated that the necessity of IPO diminishes as a project evolves from development to ongoing operations. As a consequence, he suggested there is a reduced need for IPO and he said that it might be reasonably terminated. He indicated that the size and complexity of the system and the ongoing effort to enhance it, however, suggest that quality assurance processes remain key to the efforts to maintain the project. Although CalHEERS has moved into operations and maintenance mode, the level of development activity remains high; thus, our IT expert suggests IV&V be continued. According to the project director, the CalHEERS project management office has instituted a number of processes in recent months to address issues in the IPO reports and it continues to prioritize improvements to the system based upon severity and risk to the project. Nevertheless, our IT expert indicated that the most critical risks regarding the system architecture and management, if not mitigated, could compromise system functionality. Without adequate oversight at this point in the project, specifically from an IV&V standpoint, these system issues may go unidentified or unresolved, resulting in long-term cost and schedule implications for the ongoing maintenance of CalHEERS.

Covered California Has Created a Process to Monitor, Recertify, and Decertify Qualified Health Plans As Federal Law Requires

Federal regulations require state health insurance exchanges to monitor QHP issuers for their demonstration of ongoing compliance with certification requirements. In addition, the exchanges must establish a process for recertifying QHPs that includes a review of general certification criteria, and they must create a process for decertifying QHPs that meets federal requirements. Similarly, state law requires the board to implement procedures for recertifying and decertifying QHPs that are consistent with guidelines from the U.S. Secretary of Health and Human Services. Our July 2013 report noted that Covered California correctly prioritized the QHP certification process over other considerations and that this process ensured that the QHPs selected for sale through the exchange would, among other requirements, provide essential health benefits and be available for Covered California's first open enrollment in October 2013.

Moving forward, however, we recommended in that 2013 report that Covered California develop a plan and procedures for monitoring, recertifying, and decertifying QHPs, or it would risk not complying with federal requirements. Our current review found that Covered California has developed these procedures in addition to its comprehensive, multistep certification process for QHPs that are sold through the exchange. Specifically, we reviewed QHPs for three of the largest insurance issuers and for one small issuer and found that Covered California appropriately monitored these QHPs using data the issuers provided. These data include numerous measures of quality and network management. Covered California uses the data to develop performance scores and customer service metrics, and to determine the extent to which issuers are paying health care providers based on the quality and outcomes of their services. Table 9 on the following page shows the federal requirements for QHPs that we determined Covered California has satisfied.

Further, Covered California's annual recertification process results in an extensive review of QHPs' compliance with state and federal requirements. Covered California annually recertifies QHPs, even though federal regulations do not specify how often they must be recertified. Covered California's contracts with QHP issuers are detailed, lengthy documents that result in an extensive recertification process. According to Covered California's general counsel, its recertification process requires the issuer to demonstrate why its QHPs should be recertified and may take the issuer months to perform. Based on our review of selected contracts between Covered California and QHP issuers, we determined that these contracts incorporate applicable

Our current review found that Covered California has developed procedures for monitoring, recertifying, and decertifying QHPs.

federal regulations. The general counsel also noted that Covered California's annual recertification process is, in effect, another mechanism for monitoring QHPs for compliance with federal and state requirements. Therefore, we believe the annual frequency and extensive nature of this recertification process is reasonable, considering that Covered California is using the process as a component of its monitoring activities.

Table 9
Covered California's Compliance With Key Federal and State Requirements for Qualified Health Plans

REQUIREMENTS FOR COVERED CALIFORNIA	PROGRESS TOWARD COMPLETION, JULY 2013*	PROGRESS TOWARD COMPLETION, FEBRUARY 2016	STEPS COVERED CALIFORNIA HAS TAKEN
Federal			
Establish and complete a process for certifying qualified health plans (QHPs).	✓	Previously completed	Established a QHP certification process and, for each plan year, has selected issuers to offer QHPs through the health insurance exchange.
Monitor QHP issuers for ongoing compliance with certification requirements.	↑	✓	Monitors QHP issuers monthly using issuer metrics and annually via the recertification process.
Establish a process for recertifying and decertifying QHPs.	✗	✓	Established a process and an application for recertification and a process template for decertification of QHPs.
State			
In each region of the State, provide a choice of QHPs at each of the five federally specified coverage levels.	✓	Previously completed	Each region of the State has a choice of QHPs at each of the five federally specified coverage levels.

Sources: 45 Code of Federal Regulations, part 155; California Government Code, section 100503; and California State Auditor's analysis of documents obtained from Covered California.

✓ = Completed.

↑ = Progressing as expected.

✗ = Yet to begin.

* We most recently reported on the progress of Covered California in our July 2013 report—*New High-Risk Entity: Covered California Appears Ready to Operate California's First Statewide Health Insurance Exchange, but Critical Work and Some Concerns Remain*, Report 2013-602.

Covered California has also developed a decertification procedure, which consists of a series of action steps across its program areas, and it followed this decertification procedure for one QHP issuer in July 2014. Specifically, the issuer of the QHP withdrew from the exchange because it chose to no longer offer the same plans both through and outside of Covered California. We reviewed Covered California's application of its decertification procedure for this issuer's QHPs and found that it was consistent with federal regulations.

Recommendations

To comply with state law, Covered California should ensure that its staff comply with the changes to its recently-adopted procurement manual that incorporate contracting policies and procedures that are substantially similar to the provisions contained in the *State Contracting Manual*.

Before executing any sole-source contracts, Covered California should adequately document the necessity for using a noncompetitive process in its written justifications and, in doing so, demonstrate valid reasons for not competitively bidding the services.

Covered California should improve its project management of contracts to ensure that it allows adequate time so it can use the competitive bidding process as appropriate.

Covered California needs to develop a process by June 2016 to ensure that it accurately enters information regarding its contracts into its contract database.

To ensure that CalHEERS does not face delays and cost overruns in the implementation of planned releases, Covered California should immediately contract with an independent party for IV&V services to highlight and address potential risks going forward.

We conducted this audit under the authority vested in the California State Auditor by section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: February 16, 2016

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.



January 27, 2016

Elaine M. Howle*
California State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Subject: Covered California Response to State Draft Audit Report 2015-605

Dear Ms. Howle:

As Covered California nears the end of its third open enrollment period, it continues to expand on its efforts to improve the health of all Californians by ensuring their access to affordable, high quality care. While we have made great strides in our efforts to implement the Affordable Care Act, we also recognize that work remains to be done. The California State Auditor's (CSA) report entitled *High Risk – Covered California It Must Ensure Its Financial Sustainability Moving Forward, and Its Use of Sole-Source Contracts Needs Improvement* offers Covered California recommendations on areas for improvement. We agree that these areas are important and have taken them seriously since the establishment of Covered California. With regard to the specific recommendations, we have already undertaken efforts to address. For example, in the area of financial management, Covered California has conducted informal analyses and stress-testing of expenditures, revenue and reserve requirements. With respect to CalHEERS, in addition to utilizing an Independent Verification and Validation vendor during our critical, formative years, we have established a quality assurance team, a user acceptance testing program and engaged an independent expert in cost analysis. We recognize that our work in these areas is not complete and we appreciate CSA's suggested recommendation for further refinement.

Covered California would like to thank the CSA staff for their hard work and for their assistance during this audit. Similar to the oversight of Covered California by its contracted, independent auditors and by federal agencies such as the Office of Inspector General and the Centers for Medicare and Medicaid Services, we find the

* California State Auditor's comments begin on page 51.

January 27, 2016
Page 2

additional input from our State Auditor to be critical to the future success of California's Health Benefit Exchange. If you have any questions, please contact Jennifer Lum, Audit Coordinator at (916) 228-8276.

Sincerely,



Peter V. Lee
Executive Director

cc: Board of Directors, Covered California

Enclosure

Covered California Response to State Auditor Report 2015-605

Chapter 1

Recommendation No. 1

Covered California should continue to monitor its plan for financial sustainability and revise it accordingly as factors change. Further, it should complete a formal analysis of the adequacy of its reserve level by December 31, 2016, and update this analysis as needed, so that it is prepared in the event that it does not meet its revenue projections and needs to increase its funding or decrease its expenditures to maintain its financial solvency. This formal analysis should include an identification of those contracts it could quickly eliminate, among other actions it would take, in the event of a shortfall in revenues.

Response

Covered California agrees with this recommendation. It has built budget planning, expenditure and revenue monitoring into its day-to-day activities and will continue to perform these functions. We will conduct a formal analysis of the reserve and will incorporate the results into our existing forecasting and stress testing.

Recommendation No. 2

Covered California should continue to conduct regular reviews of its enrollment projections and update the projections as needed to help ensure its financial sustainability.

Response

Covered California agrees with this recommendation. Covered California currently reviews enrollment projections on a monthly basis and revisits the forecast on a quarterly basis and will continue to do so.

Chapter 2

Recommendation No. 3

To comply with state law, by April 2016, Covered California's board should adopt a procurement manual incorporating contracting policies and procedures that are substantially similar to the provisions contained in the *State Contracting Manual*. Specifically, it should expressly limit its use of sole-source contracts to only those situations authorized by the *State Contracting Manual*.

Response

The California Health Benefit Exchange Board adopted the Covered California *Procurement and Contract Manual* during the Board meeting on January 21, 2016. The contracting policies and procedures contained in the Covered California *Procurement and Contract Manual*, including those pertaining to non-competitive bidding, are substantially similar to those contained in the *State Contracting Manual*.

Covered California Response to State Auditor Report 2015-605

Recommendation No. 4

Before executing any sole-source contracts, Covered California should adequately document the necessity for using a noncompetitive process in its written justifications and, in doing so, demonstrate valid reasons for not competitively bidding the services.

Response

- ② The Covered California *Procurement and Contract Manual* adopted by the California Health Benefit Exchange Board on January 21, 2016 requires a written justification for all non-competitively bid contracts of \$25,000 and above. Covered California has developed a noncompetitive bid justification form which was further refined in April 2015 to provide more specific guidance for staff to use when preparing a justification supporting a sole-source contract.

Recommendation No. 5

Covered California should improve its project management of contracts to ensure it allows adequate time to use the competitive bidding process as appropriate.

Response

- ③ Covered California implemented a process in 2015 where program staff receive advance notice of contracts which are set to expire within the next six months. This notice affords staff sufficient time to consult with contract management staff on the appropriate contracting method necessary to continue or procure the services needed. Covered California will continue to improve on this process.

Recommendation No. 6

Covered California needs to develop a process by June 2016 to ensure it accurately enters information regarding its contracts into its database.

Response

Covered California agrees that it should implement a quality assurance process to ensure the database is accurate. Although the contract database is primarily an internal tool for the contracts unit, because it is used for other purposes, Covered California, as a result of this audit, has developed a process to ensure inaccurate information is corrected and accurate information is entered into the database moving forward.

Recommendation No. 7

To ensure that CalHEERS does not face delays and cost overruns in the implementation of the planned releases, Covered California should immediately contract with an independent party for IV&V services to highlight and address potential risks going forward.

Covered California Response to State Auditor Report 2015-605

Response

We concur with the recommendation that Covered California perform IV&V services. However, we believe that such services can adequately and competently be performed by a mix of both civil service staff and independent contractors. In 2012, Covered California issued a competitive solicitation and awarded a contract to an independent vendor to perform IV&V services. This independent contractor performed the IV&V services from 2012 until 2015. Effective 2015, Covered California began transitioning the performance of IV&V services to a combination of internal staff and external entities. For example, Covered California established a quality assurance team that includes both external quality assurance consultants and state staff. In 2015/2016, Covered California also entered into a contract with an expert in cost estimation to perform independent verification of costs for change requests. Further, the CalHEERS project will formally transition to the Office of Systems Integration on July 1, 2016, pending approval of the Governor's Budget, which will allow independent oversight by a separate state agency.

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Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM COVERED CALIFORNIA

To provide clarity and perspective, we are commenting on Covered California's response to our audit. The numbers below corresponds to the numbers we have placed in the margin of Covered California's response.

During the course of our audit work, Covered California informed us that it anticipated that its draft procurement manual would be presented to its board of directors (board) for approval in February 2016. However, as indicated in Covered California's response, the board adopted the draft procurement manual at its meeting on January 21, 2016, which was the first day of Covered California's official review of our draft report. As a result, we modified the text in our report on pages 3, 36, and 37 to reflect the board's action. Additionally, we revised our recommendation on pages 4 and 43 to clarify that Covered California should ensure that its staff comply with the changes to its board's recently-adopted procurement manual.

①

Although Covered California's recent board-adopted procurement manual requires a written justification for all noncompetitively bid contracts of \$25,000 and above, it will be important for Covered California to ensure that its staff adequately document the necessity for using a noncompetitive process in its written justification. Further, on page 35 we acknowledge that Covered California implemented a *noncompetitive bid justification form*, as it indicates in its response, to provide more specific guidance on the information that staff requesting a sole-source contract need to include in their justifications. Also, on page 35 we conclude that our review of the form found that using it could contribute to adequately justifying the need for sole-source contracts.

②

Despite our numerous discussions with Covered California, it never informed us of the process described in its response that it asserts was implemented in 2015 by which staff receive advance notice of contracts which are set to expire within the next six months. We look forward to Covered California's 60-day response to further explain and provide evidence of this process.

③

We are concerned about Covered California's belief that it can adequately and competently perform independent verification & validation (IV&V) services by using a mix of both its civil service staff and independent contractors. Specifically, industry standards require the responsibility for the IV&V effort to be vested in an organization that is separate from the development

④

and program management organizations. However, as stated on page 40, Covered California contracted with the Office of Systems Integration (OSI) for project management and quality assurance services. Further, this is the first time Covered California has mentioned the potential transition of the California Healthcare Eligibility, Enrollment, and Retention System project to the OSI, and it is unclear to us how this transition will address our recommendation. Nevertheless, we stand by our recommendation that IV&V services are still needed and should be contracted for immediately.