A Special Performance Audit

State Workers' Insurance Fund

January 2012

Jack Wagner, Auditor General

Pennsylvania Department of the Auditor General
Bureau of Special Performance Audits

January 31, 2012

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania
Harrisburg, Pennsylvania 17120

The Honorable Julia K. Hearthway
Chairwoman
State Workers' Insurance Board
Harrisburg, Pennsylvania 17120

Dear Governor Corbett and Chairwoman Hearthway:

Enclosed is our special performance audit report of the State Workers' Insurance Fund (also referred to as SWIF). The report covers the period of January 1, 2007, through August 2, 2011, with updates through December 2011 as noted.

We conducted this audit under the authority of Pennsylvania's Fiscal Code and in accordance with generally accepted government auditing standards. Those auditing standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained does indeed provide a reasonable basis for our findings and conclusions based on our audit objectives.

Our special performance audit of SWIF was conducted as part of the Auditor General's focus on state government agencies' adherence to the requirements of the state's procurement process, the nature of the state contracts made with private vendors, and the amounts paid to these vendors. Our report focuses on two contracts: (1) SWIF's contract with MedRisk, Inc., for medical bill review and repricing services and for preferred provider organization and panel development services; and (2) SWIF's contract to implement, support, maintain, and enhance software for a new automated system.

The audit report presents 8 findings and 17 recommendations. Overall, as we note in the "Results in Brief" section of the report, SWIF made changes to the MedRisk contract in ways that were unfair to other vendors; SWIF failed to provide sufficient oversight of MedRisk's activities; and SWIF created a conflict of interest and the potential for fraud under the MedRisk contract. We also found that SWIF exercised poor contract management and weak oversight related to its contract for a new automated system.

Chief among our recommendations is that SWIF should prepare a cost/benefit analysis to determine if SWIF should continue to contract out medical bill review and repricing services, and if SWIF chooses to continue to outsource these services, as currently provided by MedRisk, then SWIF should immediately issue a new request for proposals that more accurately reflects the actual work to be performed by the vendor. To avoid a conflict of interest and the potential for fraud, we recommended that SWIF should not allow MedRisk to review and reprice its own in-network bills; rather, SWIF should use its own in-house staff (who also perform bill review duties) to process MedRisk's in-network bills. If SWIF believes it makes the most sense for MedRisk to process its in-network providers' bills, we recommended that SWIF must establish internal controls to ensure that conflict of interest and the potential for fraud are eliminated.

Our report includes the entire written response from SWIF, along with our evaluation of that response. In that evaluation, we state that we continue to assert that a conflict of interest and the potential for fraud are matters in need of a thorough review. As a result, we are forwarding this report to the Office of Attorney General for its evaluation of whether any provision of law has been violated and to take any actions it deems necessary.

Finally, while SWIF officials attribute the decisions and activities described in our findings to previous SWIF management teams, it is the current management team's responsibility for taking appropriate actions immediately. We trust that you will direct SWIF to follow our recommendations to ensure accountability and cost effectiveness in SWIF's operations.

Sincerely,

JACK WAGNER
Auditor General

Enclosure

cc: The Honorable Robert M. McCord, Member, State Workers' Insurance Board
The Honorable Michael F. Consedine, Member, State Workers' Insurance Board
Elizabeth A. Crum, Deputy Secretary for Compensation and Insurance,
Pennsylvania Department of Labor and Industry
Brian Nixon, Director, State Workers' Insurance Fund

State Workers' Insurance Fund

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

Table of Contents

Table of Contents

State Workers' Insurance Fund

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

Table of Contents, continued

State Workers' Insurance Fund

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

Results in Brief

In this special performance audit of the State Workers' Insurance Fund (which we refer to as SWIF), we selected two contracts on which to focus: (1) SWIF's contract with MedRisk, Inc., for medical bill review and repricing services and for Preferred Provider Organization (PPO) and panel development services; and (2) SWIF's contract to implement, support, maintain, and enhance software for a new automated system.

We found that SWIF made changes to the MedRisk contract which were unfair to other vendors; SWIF failed to provide sufficient oversight of MedRisk's activities; and SWIF created a conflict of interest and the potential for fraud under the MedRisk contract. We also found that SWIF exercised poor contract management and weak oversight of its contract for a new automated system.

Our findings cover calendar years 2007, 2008, 2009, and 2010, and 2011 through the end of our audit work in August.

Overall, we developed eight findings and present 17 recommendations, summarized as follows:

MedRisk contract (pages 21-52)

Finding One: *After contracting with MedRisk, SWIF eased various important provisions so much – and without following the state's Procurement Handbook – that the procurement process was unfair to other vendors who might have bid lower and ultimately performed better.*

This finding outlines three ways in which SWIF altered the requirements for contracted services *after* awarding the contract to MedRisk. SWIF's changes lowered MedRisk's expenses significantly and also put other vendors at a competitive disadvantage. SWIF also made changes to the contract without written change orders or contract

amendments, thus not complying with DGS' *Procurement Handbook*.

To address Finding One, we recommend that SWIF should (1) immediately issue a new request for proposals that more accurately reflects the actual work to be performed by the vendor, should SWIF choose to continue to outsource the services currently provided by MedRisk; and (2) comply with DGS' *Procurement Handbook* and implement contract amendments and change orders when modifying pertinent terms and conditions of its contracts.

Finding Two: *SWIF paid MedRisk more than $2.5 million to perform medical bill review and repricing services while SWIF continued to perform the same duties itself.*

This finding presents three points which call into question SWIF's decision to contract out medical bill review and repricing services. Specifically, SWIF already had employees on staff who performed these services and who *continue* to perform these services; SWIF already had the technical capability to perform medical bill review and repricing services; and SWIF was unable to justify its determination of a need to hire a contractor to perform these services.

To address Finding Two, we recommend that SWIF should prepare a cost/benefit analysis on contracting out medical bill review and repricing services and should use this analysis in helping to determine if SWIF should continue to outsource these services.

Finding Three: *SWIF paid MedRisk almost $1.4 million between January and August 2009 without holding MedRisk fully accountable for its contracted work and without providing sufficient oversight.*

This finding describes SWIF's leniency in enforcing the terms of the contract for an eight-month period and the problems associated with such leniency. For example, SWIF did not

monitor MedRisk's error rates and turnaround time, thus jeopardizing the timeliness and accuracy of its bill processing operations. SWIF also allowed MedRisk to delay conducting customer satisfaction surveys and renewed the contract with MedRisk with no knowledge of how well SWIF's policyholders and claimants were being served.

To address Finding Three, we recommend that SWIF should (1) not allow any contractor to begin work until SWIF can fully monitor its work; and (2) ensure that it exercises its rights regarding non-compliance with the terms and conditions of the contract, and should require immediate corrective actions.

Finding Four: *SWIF paid providers $2.5 million in interest because it didn't pay them within 30 days as required.*

In Finding Four we discuss the financial costs of SWIF's lack of oversight regarding MedRisk's timely processing of bills. SWIF's inadequate monitoring resulted in interest payments on late bills, as well as missed opportunities for SWIF to recoup some of the interest paid by imposing penalties on MedRisk for exceeding the required bill processing turnaround time.

To address Finding Four, we recommend that SWIF should (1) keep track of all interest paid as a result of MedRisk's actions versus interest paid due to SWIF's actions; (2) immediately take corrective action to enforce the provision of the contract requiring MedRisk to process bills within 10 working days rather than continuing to allow for a monthly average of 10 days; and (3) monitor MedRisk's timely processing of medical bills more intensely, including conducting a more detailed review of MedRisk's monthly turnaround time reports to ensure that the information presented in the reports is accurate and that the calculation of the turnaround time is more precise.

Finding Five: *SWIF created a conflict of interest and the potential for fraud by allowing MedRisk to process its own in-network bills and by failing to ensure that MedRisk does not intentionally delay the processing of those bills.*

This finding details the problems inherent in SWIF allowing MedRisk to process its own in-network bills. First, this arrangement created possibilities for MedRisk to incorrectly apply provider discounts to bills. Also, because SWIF did not adequately monitor MedRisk's bill processing, SWIF did not ensure that MedRisk did not intentionally delay the process in order to retain in-network interest payments for itself.

To address Finding Five, we recommend that SWIF should (1) not allow MedRisk to review and reprice its own in-network bills due to a conflict of interest and the potential for fraud, and should use its own in-house staff (who also perform bill review duties) to process MedRisk's in-network bills; and (2) establish internal controls to ensure that proper discounts are applied and that MedRisk cannot intentionally delay processing the bills, if SWIF believes it makes the most sense for MedRisk to process its in-network providers' bills.

Finding Six: *SWIF extended its contract with MedRisk even though MedRisk fell $800,000 short in meeting its guaranteed trauma bill savings over two years.*

In Finding Six we describe MedRisk's two distinct guaranteed savings amounts, one for trauma bills and the other for non-trauma bills. MedRisk failed to meet its 17 percent trauma bill savings guarantee to SWIF in 21 months of a 24-month period, falling short by $800,000.

To address Finding Six, we recommend that SWIF should, with the cooperation of MedRisk, amend the contract with MedRisk to require MedRisk to reimburse SWIF for any shortfalls in meeting MedRisk's trauma bill savings guarantee.

Finding Seven: *SWIF allowed MedRisk to underperform in establishing "provider panels" that save SWIF money.*

This finding describes the contractual requirement that makes MedRisk responsible for establishing provider panels on behalf of SWIF policyholders, and points out that SWIF has seen only

a small number of new panels formed as a result of MedRisk's work.

To address Finding Seven, we recommend that SWIF should, with the cooperation of MedRisk, amend the contract to develop a performance measure with regard to panel development, including a financial penalty against the fees paid to MedRisk for guaranteed savings if the goal is not met.

SWIF's automated PowerComp software system (pages 53-62)

Finding Eight: *Between 2000 and 2011, SWIF spent at least $73.7 million for an automated system plagued by problems resulting from, or worsened by, SWIF's poor contract management and weak oversight—problems suggesting that SWIF may not be capable of managing the system's planned replacement.*

In Finding Eight we detail how SWIF's transition to a new automated system took several years longer than anticipated, consequently sending the project millions of dollars over the anticipated cost. We discuss SWIF's failures to negotiate financial penalty provisions into its contract to cover implementation delays, to anticipate various obstacles, and to assign project accountability to one person or position. We also discuss SWIF's underestimation of implementation costs, which were 230 percent higher than projected.

To address Finding Eight, we recommend that—in future changes to its computer program system and/or information technology process—SWIF should (1) negotiate the option for punitive financial penalties for the vendor's failure to meet established milestones and deadlines; (2) establish definitive accountability measures and give these committees which oversee future changes the ability to enforce contract clauses, such as the aforementioned provisions; (3) consider designating a high-level staff person as a true project manager,

giving that person the authority to make decisions and the sole responsibility of overseeing the project to completion on time and on budget; (4) have future contracts for changes to its computer program system and/or information technology processes carefully reviewed by members of the Department of Labor and Industry's and/or DGS' legal staff who are familiar with information technology contracts, or consider consulting with the Office of Administration's Office for Information Technology or an independent contractor for assistance in information technology contracting. Further, SWIF officials should ensure that they understand the ramifications of proprietary language in future information technology contracts, learn from the mistakes made in implementing PowerComp, and avoid making similar mistakes in a future project. In other words, SWIF should not move forward until it can do so based on lessons learned.

Response from the State Workers' Insurance Fund

SWIF's response to our findings and recommendations and our evaluation of that response are presented on pages 68-77.

State Workers' Insurance Fund

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

Introduction

Creation of the State Workers' Insurance Fund; workers' compensation insurance mandatory

The State Workers' Insurance Fund (which we refer to as SWIF) was established in 1915[1] by the Pennsylvania Workers' Compensation Act[2] and operates within the Pennsylvania Department of Labor and Industry. The purpose of SWIF is to provide a guaranteed workers' compensation insurance option to Pennsylvania businesses since the Workers' Compensation Act mandates that every employer[3] must carry workers' compensation insurance.[4]

This requirement applies to Pennsylvania employers that employ one or more workers (even if all the workers are family members), regardless of whether the employees are part-time or full-time. Employers who do not have workers' compensation insurance may be subject to lawsuits by employees and to criminal prosecution by the commonwealth.

While many businesses acquire workers' compensation insurance through private insurance carriers, these private carriers may choose not to insure certain applicants, such as new businesses, sole proprietors, or businesses deemed by the insurance industry to have a high risk of injury (e.g., roofing, construction, or trucking). However, SWIF is required by law to provide coverage to all employers regardless of the level of risk involved. For this reason, SWIF is sometimes referred to as the insurer of last resort.

---

[1] The fund created by Act 338 of 1915 (77 P.S. § 221) was continued through Act 57 of 1996.
[2] 77 P.S. § 2604. Hereinafter, we refer to the Pennsylvania Workers' Compensation Act as the Workers' Compensation Act.
[3] Exemptions to this requirement include people covered under other workers' compensation acts, such as railroad workers, longshoremen, and federal employees; domestic servants; agricultural workers who work less than 30 days or earn less than $1,200 in a calendar year from one employer; and employees who have requested and been granted exemption due to religious beliefs or their executive status in certain corporations.
[4] 77 P.S. § 301.

Employees are covered for workers' compensation benefits the first day of employment

Workers' compensation insurance provides medical and wage-loss benefits to compensate employees who are injured, contract a disease, or have a condition worsen as a result of employment. Additionally, benefits for work-related deaths are paid to an employee's survivors. The insurance does not compensate for pain and suffering and does not provide job security in the event of an injury.

Medical benefits to treat the work-related injury or illness of an employee include the following:

- Services rendered by physicians or other health care providers, including chiropractors
- Reasonable surgical and medical services needed
- Hospital treatment, services, and supplies
- Prescription medicines
- Orthopedic appliances and supplies

Injured employees are free to choose their own physicians or health care providers unless the employer has posted a list of six or more physicians or health care providers, known as a "panel of providers." If the employer has posted a panel of providers, the employee is required to visit one of them for initial treatment, and must continue treatment with that provider (or another on the posted list) for a period of 90 days following the first visit. After the 90 days, the employee may seek treatment with the physician or health care provider of the employee's choice.

Wage-loss benefits are paid if the disability resulting from the work-related injury or illness lasts longer than seven calendar days. These benefits are equal to approximately two-thirds of an employee's average weekly gross wage, up to a weekly maximum. During 2010, the wage-loss weekly maximum was $845; during 2011, it was $858. An employee can receive up

to this maximum amount regardless of whether the disability is temporary or permanent.

For a temporary disability, an employee receives wage-loss benefits only for the duration of the disability. For a permanent *partial* disability, an employee receives wage-loss benefit payments up to 500 weeks.[5] For a permanent *total* disability, there is no maximum payment period.

SWIF organization: staffing and governance

SWIF is an enterprise fund[6] within the Pennsylvania Department of Labor and Industry. SWIF's director reports to the Deputy Secretary for Compensation and Insurance within the Department of Labor and Industry. SWIF is headquartered in Scranton and has offices in seven other locations: Erie, Harrisburg, Johnstown, Philadelphia, Pittsburgh, Pottsville, and Sunbury. Each office provides full claims processing and policyholder services.

SWIF had 323 employees as of December 2011.

The three-member State Workers' Insurance Board[7] (SWIB, or the Board) oversees the operations of SWIF and includes the Secretary of Labor and Industry, who acts as the chairperson, the State Treasurer, and the Insurance Commissioner.

Key responsibilities of the Board include the following:

- Preparing and publishing a schedule of premiums or rates of insurance for employers.[8]

[5] The 500 weeks do not have to be consecutive.
[6] An "enterprise fund" provides goods or services to the public for fees that make the entity self-supporting. Also, it should be emphasized that SWIF is not an independent agency; it falls directly under the Department of Labor and Industry.
[7] 77 P.S. § 2602.
[8] 77 P.S. §§ 2606, 2607.

- Retaining the services of a certified actuary to conduct an annual independent actuarial study of the fund.[9]
- Keeping an accurate account of the money paid in employer premiums and of income from the investment of premiums.[10]
- Making all necessary contracts for supplying medical, hospital, and surgical services.[11]

The Board also appoints a five-member advisory council, with one member representing each of the following:

- The Pennsylvania Chamber of Business and Industry or its successor organization.
- The American Federation of Labor – Congress of Industrial Organizations (AFL-CIO) or its successor organization.
- Employers who have policies through SWIF with premiums of $5,000 or less annually.
- Employers who have policies through SWIF with premiums of more than $5,000 annually.
- The State Workers' Insurance Board (this person also serves as chair of the advisory council).[12]

Advisory council members serve for two years and are compensated only for reasonable expenses incurred in the performance of their duties.[13] The advisory council has the power to do the following:

- Commission an actuarial study of the State Workers' Insurance Fund no more than once a year. (This actuarial study is different from the annual actuarial study listed as one of the Board's duties.)
- Review any actuarial studies of the fund commissioned by the Board.

[9] 77 P.S. § 2611(b).
[10] 77 P.S. § 2611(c).
[11] 77 P.S. § 2613.
[12] 77 P.S. § 2603(b).
[13] 77 P.S. §§ 2603(c), (d).

- Request and receive from the Board copies of or access to audits of the State Workers' Insurance Fund.
- Recommend to the Board annually the amount of surplus in the State Workers' Insurance Fund, if any, which is "safely distributable."[14]
- Request assistance from the Board as necessary to fulfill the advisory council's statutory obligations.[15]

The members of the Board and the advisory council receive no compensation; however, they are entitled to be reimbursed for certain expenses incurred in performing their duties.[16]

SWIF statistics:
annual written premiums and number of policyholders

SWIF is the largest workers' compensation insurance carrier in Pennsylvania. SWIF's number of policyholders for the past four calendar years and the amount of premiums paid by those policyholders are shown in the table below.

Calendar year	Written premium	Policyholders
2007	$371,239,000	51,077
2008	$276,020,000	47,335
2009	$213,688,000	30,012
2010	$162,172,000	26,846

Most of SWIF's revenues come from the premiums, but SWIF also earns income from its investments. Together, these two sources of revenue must cover SWIF's payment of workers' compensation insurance claims as well as its operating expenses. However, in recent years, expenses of SWIF have exceeded its revenue, and SWIF has been operating at a loss.

[14] "'Safely distributable' means amounts which are distributable without jeopardizing the ability of the State Workers' Insurance Fund to satisfy its present and future legal obligations to subscribers." *See* 77 P.S. § 2601.
[15] 77 P.S. § 1503(e).
[16] 77 P.S. § 2603(d). An examination of Board members' reimbursed expenses was outside the scope of this audit.

As the table above shows, the number of SWIF's policyholders has been decreasing; therefore, the premium rates paid by current policyholders may have to be adjusted to cover operating losses.

Objectives and scope of this special performance audit

The overall objective of this special performance audit was to evaluate selected contracts in effect during the calendar years 2007, 2008, 2009, 2010, and through the end of our audit work in August 2011.

We selected two contracts on which to focus: (1) SWIF's contract with MedRisk, Inc., for medical bill review and repricing services and for Preferred Provider Organization (PPO) and panel development services; and (2) SWIF's contract to implement, support, maintain, and enhance software for a new automated system.

A more detailed description of our objectives and scope, including why we selected these two contracts, along with our methodology, are provided in Appendix A of this report.

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

Background

Understanding the nature and profile of the MedRisk contract

(Background to accompany Findings 1 to 7)

In 2008, SWIF entered into a contract with Pennsylvania-based MedRisk, Inc., a claims services and medical management company (which we will refer to as MedRisk).[17] The term of the initial contract was from May 1, 2008, through April 30, 2011. In February 2011, SWIF extended the contract for one year, making the contract effective through April 30, 2012.

This contract outsourced several functions critical to SWIF's operations. Generally speaking, these functions included reviewing and repricing medical bills, and establishing discounted rates for medical services provided to injured workers. Each of these functions is explained in the following sections.

Medical bill review and repricing: what do these services entail?

When an injured worker is treated by a health care provider,[18] the provider sends the bill for services to the employer's workers' compensation insurance company, which for many businesses is SWIF.

When SWIF receives these medical bills, the bills must be reviewed before they can be processed for payment. SWIF's contract with MedRisk requires that MedRisk review these

[17] MedRisk is headquartered near Philadelphia in King of Prussia.

[18] The Workers' Compensation Act defines "health care provider" as "any person, corporation, facility or institution licensed, or otherwise authorized, by the Commonwealth to provide health care services, including but not limited to, any physician, coordinated care organization, hospital, health care facility, dentist, nurse, optometrist, podiatrist, physical therapist, psychologist, chiropractor, or pharmacist, and an officer, employee or agent of the person acting in the course and scope of employment or agency related to health care services." *See* 77 P.S. § 29. Throughout this report, we use the term "provider" simply to represent any of these health care providers.

provider bills on behalf of SWIF. This review includes the following:

- Determining whether services reported on bills are related to—and appropriate for—the work injury suffered by the worker.
- Determining whether the services are properly coded on bills.
- Determining whether billed amounts are correct.
- Ensuring that duplicate bills for the same service are not paid.

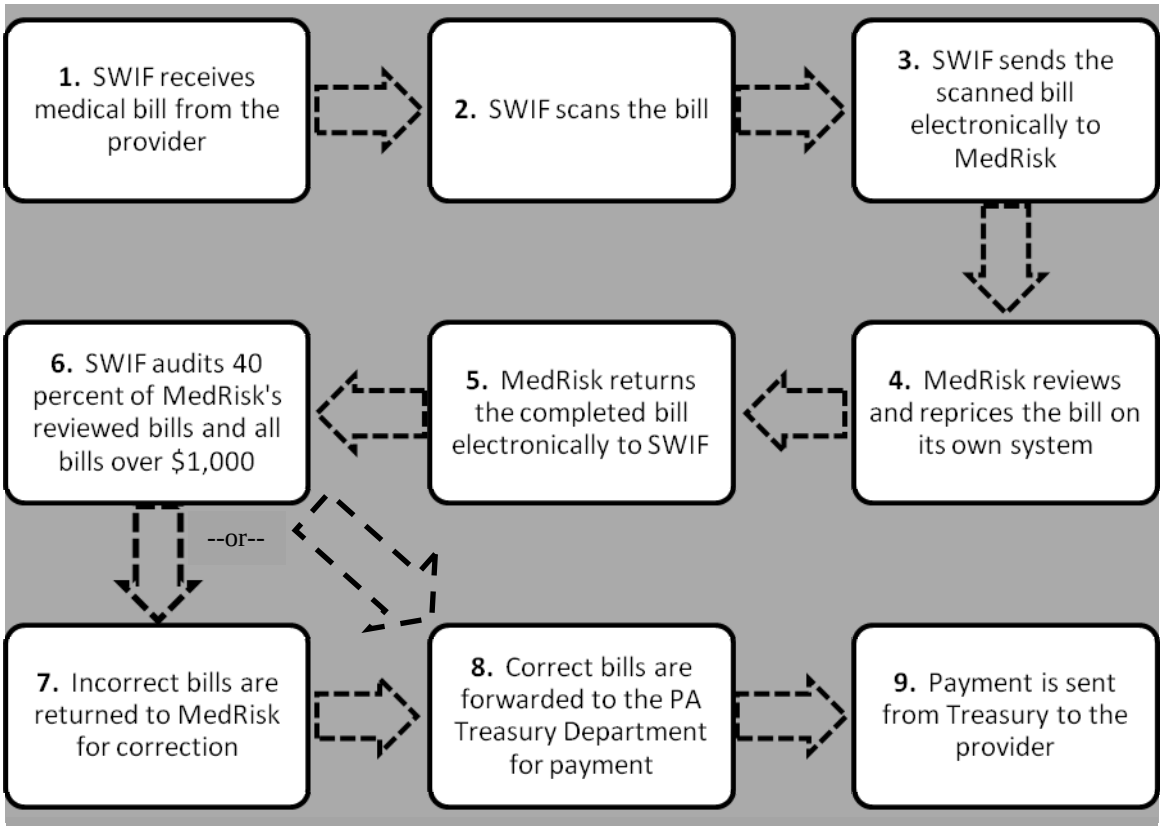
MedRisk is also required to ensure that the amounts charged by providers do not exceed fee schedule amounts established for workers' compensation payments under the Pennsylvania Workers' Compensation Act.[19] (We will refer to the fee schedule as the "workers' compensation fee schedule.")

Finally, MedRisk determines if any negotiated provider discounts should be applied to the bills and, if so, "reprices" the bills accordingly. (We discuss this concept in the next section.)

MedRisk returns the reviewed and repriced bills to SWIF, where SWIF staff conducts audits of MedRisk's work and submits the approved medical bills to the Pennsylvania Treasury Department, who pays the providers.

The chart on the next page shows the flow of a medical bill under MedRisk's contract with SWIF.

[19] *See* 77 P.S. §§ 411-682. These fee schedule amounts are determined by a formula and are based on the Medicare fee schedule.



How medical bills are moved through SWIF

To save money for SWIF, MedRisk negotiates with providers to discount the rates they charge

The other major component of SWIF's contract with MedRisk requires MedRisk to establish discounted rates that medical services providers charge SWIF for the services they provide to injured workers. The intent of these discounts is to save SWIF money.

The savings occur because SWIF pays the providers lower amounts than those established under the workers'

compensation fee schedule. Prior to the implementation of the MedRisk contract, SWIF generally paid all providers according to the workers' compensation fee schedule.

MedRisk achieves these discounts by administering a preferred provider organization, or PPO, which is a group of providers who have agreed to accept reduced fees for services rendered. As part of its contract with SWIF, MedRisk is responsible for negotiating the discounted PPO fees. If providers who render services are not members of the PPO, MedRisk negotiates with them individually for discounts.[20]

While SWIF benefits by paying for services at discounted rates, SWIF is not part of the rate negotiations. Negotiating and contracting for such discounts is strictly between MedRisk and the providers.

How much did SWIF pay MedRisk?

The contract between SWIF and MedRisk is not a fixed-price contract. Rather, MedRisk is paid based on the work it does for SWIF. From January 2009 (when MedRisk began to invoice SWIF) through the end of December 2010, SWIF paid MedRisk a total of $4,897,125 for services rendered.

We will discuss this $4.9 million total in four parts:

1. Payments to MedRisk for medical bills processed.
2. Payments to MedRisk based on the savings MedRisk obtained for SWIF through provider discounts (whether PPO providers or other providers).
3. Other payments associated with the contract, including a one-time reimbursement for start-up costs.

[20] Providers generally join PPOs and agree to accept discounted rates because they expect that the volume of patients will increase since patients often are referred to other doctors within the PPO. Providers expect that the increase in volume will compensate for the reduced fee rates.

4. Deductions, including penalties for substandard performance.

Payments for medical bill processing. SWIF pays MedRisk for medical bill processing on a per-unit basis. This per-unit fee varies depending on the type of medical bill processed.

For each "Part A"[21] medical bill processed, MedRisk receives $25. Generally, Part A bills are those for inpatient care in hospitals, skilled nursing facilities, hospice, and home health care.

For each line of every "Part B" medical bill processed, MedRisk receives 95 cents. Generally, Part B bills are those for outpatient care, doctor services, physical or occupational therapists, and additional home health care not covered under Part A. SWIF also pays MedRisk the Part B rate for processing pharmacy bills.

MedRisk invoiced SWIF for more than $2.5 million for bill processing services performed in calendar years 2009 and 2010, as shown in the chart below.

Year	Total bills processed	Amount invoiced by MedRisk
2009	241,305	$1,267,270
2010	240,323	$1,238,493
Total	**481,628**	**$2,505,763**

Payments based on savings achieved through discounts. In its response to the request for proposals that resulted in its contract, MedRisk guaranteed[22] it could save SWIF 7 percent on non-trauma medical bill costs through discounts MedRisk would negotiate with providers. In other words, MedRisk

[21] The "Part A" and "Part B" bills referenced in this section correspond to those same "Part A" and "Part B" services allowed in the Medicare program.

[22] The word "guarantee" was included in MedRisk's cost submittal with regard to savings in its response to the request for proposal. The request for proposals required all bidders to "set forth the percentage of savings that the Offeror guarantees SWIF."

guaranteed it would reduce medical providers' fees by 7 percent for non-trauma services. For example, if the workers' compensation fee schedule listed a $1,000 fee for a particular non-trauma service, MedRisk guaranteed it would negotiate a $70 discount, meaning the provider would bill SWIF $930 rather than $1,000.

If MedRisk generates savings greater than its guaranteed 7 percent, SWIF would pay MedRisk—according to the contract—a percentage of that additional savings. Continuing with the preceding example, if SWIF was guaranteed to see a $70 discount but instead saw a $100 discount because MedRisk did better than its guarantee, SWIF would pay MedRisk a portion of the additional $30 in savings (percentages vary as shown in the table below).

For trauma bills, which are generally higher than non-trauma bills, MedRisk guarantees SWIF a savings of 17 percent (i.e., 17 percent less than the fees listed on the workers' compensation fee schedule). This 17 percent guarantee exceeds the savings that SWIF said it formerly achieved (prior to contracting with MedRisk) when in-house staff negotiated trauma bill discounts averaging about 10 percent.[23]

The percentage that MedRisk receives is based on the actual savings according to the following tiers:

[23] The request for proposals (through a question and responses section) stated that trauma savings had to be 10 percent over the guaranteed savings. With MedRisk guaranteeing 7 percent savings, this means MedRisk's trauma savings guarantee amounted to 17 percent. SWIF officials confirmed this 17 percent figure during a December 10, 2010, meeting.

Pennsylvania Department of the Auditor General
Jack Wagner, Auditor General
January 2012

SWIF pays MedRisk for saving more money than it guaranteed to save

Additional annual savings on medical bills (beyond the savings *guaranteed* by MedRisk)	**Commonwealth pays MedRisk this portion of additional savings**
Up to $5 million	40 percent
$5 million to $10 million	45 percent
$10 million to $15 million	50 percent
Over $15 million	55 percent

The table below shows how much SWIF paid to MedRisk for additional annual savings on medical bills (beyond the savings guaranteed by MedRisk).

Year	**Commonwealth paid MedRisk this amount for its portion of additional savings**
2009	$ 950,082
2010	$1,483,732
Total	**$2,433,814**

Other payments. SWIF also paid MedRisk a one-time payment of $85,000 for MedRisk's part in establishing computer interfaces that would allow MedRisk's computer system to work with SWIF's automated system and software. (We discuss this computer issue further in Finding One.)

SWIF also reimbursed MedRisk for postage as provided for in the contract. Postage amounted to $71,896 for the two-year period.

Deductions. As of December 2010, SWIF deducted penalties of $121,359 from its payments to MedRisk for lateness and accuracy issues. (Lateness and accuracy are discussed in more detail in Findings Four and Five, respectively.)

SWIF also deducted a total of $77,989 from its payments to MedRisk for adjustments to medical bills that MedRisk processed in prior months. SWIF and MedRisk refer to these adjustments as "reconciliations," and they are reflected on MedRisk's monthly invoices.

Total payments made to MedRisk. In summary, SWIF paid $4.9 million to MedRisk in calendar years 2009 and 2010 as shown in the next table.

SWIF payments to MedRisk
January 2009 through December 2010

Category	Amount paid/deducted
Bill processing fees	$2,505,763
Split of PPO/discount savings	2,433,814
One-time payment for interface	85,000
Postage	71,896
Penalties for timeliness and accuracy	(121,359)
Reconciliations	(77,989)
Total	**$4,897,125**

More background: The Department of the Auditor General previously investigated SWIF for rejecting vendor proposals prior to contracting with MedRisk

The Department of Labor and Industry and SWIF first issued a request for proposals for the implementation and administration of a statewide PPO in 2004. The purpose of this request was to contract with a vendor that would develop a PPO for SWIF because SWIF was the only workers' compensation insurance carrier in the Commonwealth of Pennsylvania that did not have a PPO. The purpose of the PPO was to provide a network of medical care providers who would

provide medical care services to SWIF claimants at reduced costs.

This 2004 request for proposals did not result in SWIF's selecting a vendor. SWIF's former director stated that the evaluation committee exercised its option to reject all the proposals submitted because the committee believed that the proposals were lacking in quality and were thin on details.

The Department of Labor and Industry issued a second request for proposals for PPO services in July 2005. Again, the evaluation committee exercised its option to reject all of the proposals.

The Department of Labor and Industry and SWIF issued a third request for proposals in October 2005. This time, SWIF was seeking a vendor who would not only form a PPO but also would provide medical bill review services, which would include data entry and repricing for medical bills. Nine vendors submitted proposals, and, again, the evaluation committee rejected them all. According to SWIF's former director, some of those proposals were strong in the PPO area but weak in the repricing area, and vice versa.

At this point, the Department of General Services took over the procurement process and, on July 21, 2006, issued a fourth request for proposals, this time resulting in the selection of MedRisk.

In April 2008, our Office of Special Investigations released a report about SWIF and its use of contractors.[24] In that report, among other findings, we were critical of SWIF for not properly documenting why it rejected all proposals that resulted from its first three requests for the services it was seeking.

[24] The Department of the Auditor General's Office of Special Investigations issued a report, *Special Investigation of the State Workers' Insurance Fund, Emergency Procurements*, dated April 2008 which included the finding that SWIF violated the state's *Procurement Handbook* by using emergency contractors for extended periods of time without the awarding of a contract through the request for proposals process.

Audit Information Limitation

Generally accepted government auditing standards require us to report any audit limitations.[25] During the course of this audit, SWIF and the Pennsylvania Department of General Services (DGS) did not provide sufficient evidence to allow us to determine if MedRisk was selected in compliance with the provisions of the Commonwealth Procurement Code. Because the procurement of MedRisk was handled by DGS, SWIF officials would answer very few questions in regard to the contract procurement and selection process. As a result, we sent an information request to DGS on October 25, 2010.

In short, although DGS provided a response to each of our questions, we found the answers to be largely inadequate for purposes of evaluating the selection process. For example, regarding our requests for various documents related to the procurement of MedRisk, DGS provided us with a "detailed master scoring sheet" which DGS officials stated they created based on the original scoring sheets.

This master scoring sheet was provided to us in lieu of the original, individual scoring sheets we had requested, and it was limited in its usefulness since original scoring sheets often contain notes and other information which could be helpful in evaluating the procurement process. Further, without the individual scoring sheets, we were not able to ascertain the accuracy of the master scoring sheet.

Therefore, the master scoring sheet did not provide enough detail to allow us to adequately assess the scoring of the seven bidders and the contractor selection process.

[25] Section 8.11 of Government Auditing Standards (July 2007 Revision) states, "auditors should describe the scope of the work performed and any limitations, including issues that would be relevant to likely users, so that they could reasonably interpret the findings, conclusions, and recommendations in the report without being misled. Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials of access to certain records or individuals."

We also asked DGS to provide us with documentation evidencing that it had performed due diligence during the bidding process which resulted in the selection of MedRisk. DGS provided us with a memorandum in which it recommended that MedRisk be selected for contract negotiations. While this memorandum stated MedRisk's qualifications, DGS did not provide any documentation showing that it verified these qualifications. Furthermore, DGS stated that it would provide us with no further documentation.

Due to the limited amount of information provided to us by both SWIF and the Department of General Services regarding the procurement and selection process of the MedRisk contract, we were unable to conclude on whether the MedRisk vendor was selected appropriately.

Understanding the nature and profile of SWIF's automated PowerComp software system

(Background to accompany Finding 8)

In the late 1990s, SWIF determined it would undergo a modernization project by which an automated system would process and pay medical claims. At the time, even though SWIF had a computer system known as PICS—the Pennsylvania Insurance Compensation System—that system required SWIF staff to spend significant amounts of time and manpower on manual procedures to process and pay claims.

According to current SWIF officials, management in those prior years did not have the experience needed to handle the procurements related to a project of the magnitude of SWIF's modernization project. Accordingly, SWIF contracted with a consulting firm to develop an information technology strategic plan, including how SWIF could use such technology to improve its business processes.

Subsequently, in September 2000, SWIF began the official procurement process with a request for quotations seeking a vendor to develop and implement a workers' compensation insurance computer system. The request document said that SWIF was looking "to meet anticipated workload growth, increased customer service demands, and to position itself as a leading provider in the workers' compensation market." SWIF's ultimate selection would be based on the vendor's proposed cost, the vendor's qualifications, and the vendor's ability to understand and meet SWIF's needs.

Of the five responding vendors, SWIF selected the one offering a software called PowerComp, a trademarked workers' compensation software which we refer to throughout this report as the "software." The choice was made based on SWIF's assessment that the product was the only one that could address all phases of the workers' compensation business: work management, policyholder services, and claims management—including a claims-management component for processing medical bills.

SWIF officials had further confidence in the software because it was used by other states, including Arizona, Kentucky, Louisiana, and South Carolina. Furthermore, SWIF officials said they had observed a demonstration of the software and that it was a "robust" product.

Our audit focused on issues related to the contract between SWIF and the software vendor because the software was the core of the modernization project. However, we note here that SWIF also contracted with eight other information technology vendors to assist in the modernization project.[26]

[26] SWIF's contracts with these other vendors were for technical expertise, hardware, or software, and were in effect at various times between 2000 and 2008.

Software costs far exceeded expectations

In September 2000, soon after choosing the software vendor, SWIF began planning for the complicated conversion from the old system to the new one; however, SWIF did not actually contract with the vendor until May 30, 2003—almost three years later. SWIF officials told us that it took three years to negotiate the contract because the vendor turned out to be very difficult to work with. Even so, SWIF believed the software vendor still had the best product, and SWIF also recognized its own financial investment, having spent three years planning and laying the groundwork for the software's implementation.

The contract with the software vendor required SWIF to pay the vendor $1.7 million for software development services and would remain in effect either until June 30, 2004, or until the new system was implemented, whichever came first. However, despite what the contract said, SWIF extended the contract until the new system was implemented in June 2005—a full year later.

Since June 2005, SWIF has continued to contract for support, maintenance, and enhancement of the software/system, either with the original vendor or its successors through several acquisitions,[27] and with other vendors as well.

Overall, from 2000 through November 2011, SWIF spent at least $73.7 million to implement, support, maintain, and enhance its software/automated system.

The $73.7 million can be broken down into two parts: $34.9 million from 2000 through 2005 for implementation, and $38.8 million from 2005 through 2011 for support, maintenance, and enhancement.

[27] SWIF initially contracted with Information Engineering, which was doing business as Taliant. In 2005, Taliant was acquired by World Group, which formed InsureWorx. InsureWorx was bought by Fiserv in 2006 and was renamed StoneRiver in 2009.

SWIF was unaware of the true cost of the software/system until during this audit when we found various errors and missing information in SWIF's related documentation. During the course of our work, SWIF (1) acknowledged that it had not adequately maintained cost-related information and (2) adjusted the total software/system cost to include an additional $8.5 million (which is included in our total of nearly $74 million).

Finding One

After contracting with MedRisk, SWIF eased various important provisions so much – and without following the state's *Procurement Handbook* – that the procurement process was unfair to other vendors who might have bid lower and ultimately performed better.

The request for proposals, or RFP, which resulted in SWIF's contract with MedRisk contained numerous detailed terms and conditions for vendors to consider and address in their responses. The RFP became part of SWIF's contract with MedRisk.[28]

During the course of our audit, we found that SWIF—*after* awarding the contract and over time—altered the requirements for contracted services and lowered MedRisk's expenses significantly. Thus, the requirements in the awarded contract eventually did not closely resemble those that the other bidders thought would apply to them.

Based on the simple but critical issue of fairness that underlies the state's *Procurement Handbook*,[29] SWIF's changes put other vendors at a competitive disadvantage. If the six other bidders had known that the requirements would be altered so much, not only might those bidders have submitted different bids based on the altered requirements, but other vendors might have bid on the contract as well. Overall, SWIF could have potentially received lower and/or more responsive bids from vendors who might have been better qualified, and who might have

[28] The RFP was incorporated by reference into clause 1 of the MedRisk contract as follows: "The Contractor shall, in accordance with the terms and conditions of this Contract, provide Preferred Provider Organizations and Comprehensive Medical Bill Review Services more fully defined in the RFP, to L&I, State Workers' Insurance Fund."

[29] The common standard of procurement in Pennsylvania is to provide for "a level playing field for those who want to compete for Commonwealth contracts." *See* DGS' *Procurement Handbook*, Part I, Chapter 13.

ultimately performed more efficiently and effectively than MedRisk.

In the sections below, we address three of the most significant changes that occurred.

1. **SWIF took over the majority of work and expense in establishing computer system interfaces.**

   What did the RFP ask? The RFP required the vendor "to work with SWIF to develop, test and implement" three computer system interfaces required to carry out medical bill review and repricing services. These interfaces were necessary to allow SWIF's computer system and the vendor's computer system to communicate with each other so that medical bills and other information could be electronically transferred between the two systems.

   According to the RFP, the vendor was responsible for building and implementing the outbound interfaces to SWIF, for accepting and processing SWIF's data within the vendor's own system, and for any data transformations or conversions necessary in the exporting of data to SWIF.

   What changed after the contract was awarded? After contract implementation, SWIF did not require MedRisk to comply fully with the requirements outlined in the contract. SWIF defended the change by saying that, while MedRisk made the required modifications to its own computer system, SWIF did not permit MedRisk to modify SWIF's computer system because SWIF's software vendor expressed "intellectual property concerns." SWIF thus allowed that software vendor to develop the interfaces instead of MedRisk.

   What are our concerns? SWIF paid its software vendor more than $916,000 to complete the required modifications to SWIF's computer system. At the same time, SWIF paid

MedRisk the full $85,000 that it had bid to complete all the interface work as described in the contract.[30] Thus, in total, SWIF paid more than $1 million for interface work that MedRisk bid only $85,000 to complete.

SWIF should have consulted with the software vendor prior to or during the RFP process and recognized that the software vendor would not allow another vendor to perform major components of the interface work. SWIF could have then ensured that the actual extent of the work was reflected in the RFP.

2. SWIF absorbed all responsibilities and costs related to receiving and scanning medical bills.

What did the RFP ask? The RFP required the vendor to receive medical bills directly from SWIF and/or providers, and also required the vendor to scan all paper medical bills and provider notes. The RFP outlined strict image quality requirements for scanning density, document preparation, and indexing of bills.

The RFP stated that vendors would not be reimbursed directly for any costs related to scanning and imaging services. The RFP also stated that SWIF would audit a sample of all scanned documents and assess liquidated damages against the vendor for failing to meet image quality requirements.

What changed after the contract was awarded? SWIF eliminated the scanning and imaging requirements just described, choosing instead to receive, scan, and image all medical bills and provider notes itself, after which it forwards the scanned and imaged documents electronically to MedRisk.

[30] When we questioned SWIF officials why they still paid MedRisk $85,000 for MedRisk's work, they conceded that they had initially questioned the payment as well but recognized that MedRisk still had to make modifications to its computer system as part of the interfaces. They stated that staff from the Governor's Office of Administration's Office of Information Technology reviewed the work done by MedRisk and had confirmed that the $85,000 payment was justified.

As a result of the change, SWIF absorbed the expenses related to scanning and imaging services that MedRisk would have provided. MedRisk's expenses were therefore lowered.

SWIF explained that rather than incurring shipping costs to send the bills to MedRisk or training the medical providers to send bills to MedRisk, it made the most sense for SWIF to use existing resources to scan the bills in-house and then forward the electronic bills to MedRisk.

What are our concerns? The vendors who responded to the RFP likely built in the costs for providing scanning and imaging services as part of the per-unit costs proposed for medical bill review services. Other vendors may have found the scanning and imaging requirements to be too cumbersome and opted not to respond to the RFP at all. A representative for one potential vendor confirmed to us that the vendor opted not to bid based on these requirements. That vendor even filed a bid protest due in part to the requirement to receive bills directly from providers, which the vendor claimed was not permitted by the Workers' Compensation Act; however, this bid protest was denied by the Department of General Services.

Again, SWIF should have recognized prior to or during the RFP process that it made more sense for SWIF to perform these services. Ultimately, SWIF gave MedRisk a break—i.e., lower expenses—that other vendors had not anticipated when considering responding to the RFP.

3. SWIF did not enforce financial penalties to the extent outlined in the contract.

What did the RFP ask? Because the RFP outlined several types of penalties that SWIF could impose for certain areas of poor performance, vendors were asked to understand that good performance was expected and that poor performance would come with penalties. These penalties included the following:

- For lateness in transferring data to SWIF (past 5 p.m. daily), SWIF could penalize the vendor **$15,000 a day** for each incident.

- For failing to meet any of three standards applicable to error ratios on medical bills, SWIF could penalize the vendor up to 20 percent[31] of that month's processing fees for each standard (for a maximum possible 60 percent with three standards).

- For failing to meet image quality requirements, SWIF could assess liquidated damages according to a calculated monthly "failure rate."[32]

What changed after the contract was awarded? SWIF imposed penalties loosely or not at all. Three examples:

- To make its operations purportedly more efficient, SWIF made the data file transfer deadline earlier—moving it from 5 p.m. to noon. MedRisk agreed to the new requirement (in a "verbal agreement," according to SWIF). Despite this agreement, SWIF has elected not to impose the financial penalty on MedRisk even though MedRisk has been late at least eight times through November 2010.

- SWIF combined all three error rate penalties into one error ratio standard, thereby reducing the maximum possible penalty from 60 percent to 20 percent by giving up the ability to compound damages for different types of errors.

[31] For the first month in which the vendor exceeds any error ratio standard, the vendor must provide a written corrective action plan; for the second consecutive month, for each error ratio standard exceeded, the vendor may be penalized 10 percent of its processing fees for that month; for the third consecutive month, for each error ratio standard exceeded, the vendor may be penalized 20 percent of the processing fees for that month; furthermore, SWIF may terminate the vendor's contract for cause.

[32] Specifically, the RFP stated that "SWIF will multiply the percentage of image failures by the number of pages scanned by the [vendor] in the past 30 business days to calculate an audited failure rate. SWIF will multiply the audited failure rate by $0.15 to calculate the liquidated damages…."

- As discussed earlier, SWIF eliminated the scanning requirements and thus gave up the ability to assess penalties (in addition to giving MedRisk less work.)

What are our concerns? Bidders, including those capable of meeting every deadline and performing according to standards, might still have been discouraged by the amount and severity of potential penalties. Not only is the change unfair to potential vendors who might have otherwise bid on the contract, but the change also sends a message to MedRisk that performance requirements are not all that important.

SWIF changed the requirements without contract amendments or change orders

Pennsylvania's *Procurement Handbook* requires a contract amendment for any change to the terms, conditions, requirements, or costs (increases/decreases) of a contract, except for change orders.[33] The handbook also requires the issuance of change orders under certain circumstances. Change orders are essentially notices to contractors of a change to the terms of the contract, e.g., a renewal, extension, or alteration to services.[34]

Given these requirements, we examined the extent to which SWIF amended the contract or issued any change orders for each of the contract changes discussed above. We found that SWIF did not comply with the requirements of Pennsylvania's *Procurement Handbook* because it did not implement any amendments or change orders to the contract even though many of the changes made by SWIF required such actions.

For example, SWIF's decisions regarding computer system interfaces constituted a material change to the terms and conditions of the contract; therefore, SWIF should have

[33] DGS' *Procurement Handbook*, Part I, Chapter 32, "Contract Changes," Section A.
[34] *Ibid.*

amended the contract. SWIF should have also implemented a change order since SWIF's actions altered the services within the scope of the contract, resulting in lowered costs to MedRisk. Likewise, SWIF's decision to absorb all responsibilities and costs related to receiving and scanning medical bills required both a contract amendment and a change order for the same reasons.

While SWIF officials indicated to us that they believed contract amendments and/or changes were not needed, we disagree.

Although we found that many of the changes made to the contract were not in SWIF's and taxpayers' best interests, SWIF was nonetheless required to make these changes in accordance with the *Procurement Handbook*. Even if the handbook does not specify consequences for non-compliance with requirements related to contract changes, it is critical for SWIF to comply with such requirements since written contract amendments serve to protect SWIF against any future potential contract disputes with MedRisk concerning the terms and conditions of the contract.

Further, the vital importance of formalizing changes to the contract, which ensures the delineation of responsibilities between SWIF and MedRisk, is apparent. The fact that SWIF did not formalize contract changes is an indicator of the haphazard manner in which SWIF has administered this contract, which we discuss throughout this report.

Additionally, SWIF extended the contract with MedRisk without documenting any changes to the original terms and conditions. Because SWIF altered the contractual requirements so significantly—and because of MedRisk's poor performance (as discussed later in this report)—SWIF should not extend its contract with MedRisk when it expires on April 30, 2012. If SWIF chooses to continue to outsource the services provided by MedRisk, SWIF should immediately issue a new RFP that

more accurately reflects the actual work to be performed by the vendor.

Summary and Recommendations

Once SWIF finalized the contract with MedRisk and began to use MedRisk's services, SWIF changed several terms of that contract without written change orders or contract amendments, thus not complying with DGS' *Procurement Handbook*. For example, SWIF incurred over $1 million in expenses for developing computer interfaces so that MedRisk's computer could communicate with SWIF's system. These interfaces, according to the contract, were supposed to be developed by MedRisk.

If other vendors had known that the terms and conditions of the contract could be altered, those vendors who did not bid on the contract could have chosen to bid on it, and those vendors who did bid on it could have altered their terms and prices. In either case, other vendors who were equally qualified and potentially less expensive could have possibly been selected instead of MedRisk.

SWIF chose to alter the requirements for contracted services significantly and even extended the contract with MedRisk for another year without formalizing any of the changed practices with a contract amendment or change order. As a result, SWIF not only may be criticized for favoritism towards MedRisk but also puts itself at risk for potential future contract disputes regarding the terms and conditions of the contract.

Recommendations

1. If SWIF chooses to continue to outsource the services currently provided by MedRisk, SWIF should immediately issue a new RFP that more accurately reflects the actual work to be performed by the vendor.

2. SWIF should comply with DGS' *Procurement Handbook* and implement contract amendments and change orders when modifying pertinent terms and conditions of its contracts.

Finding Two

SWIF paid MedRisk more than $2.5 million to perform medical bill review and repricing services while SWIF continued to perform the same duties itself.

Throughout our audit, we found it difficult to see the advantages of SWIF's decision to contract out medical bill review and repricing services. SWIF paid MedRisk more than $2.5 million for these services in 2009 and 2010 combined. And, while SWIF already had the technology to perform medical bill review and repricing services in-house, SWIF paid more than $1 million to establish computer interfaces with MedRisk so that MedRisk could perform these services.

SWIF already had employees on staff performing medical bill review and repricing services

As part of SWIF's contract with MedRisk, MedRisk performs medical bill review and repricing services for SWIF. Prior to SWIF's contract with MedRisk, SWIF had 17 employees who performed medical bill review and repricing services. Once SWIF entered into its contract with MedRisk, SWIF kept the 17 employees without significantly changing their duties. While SWIF did move those employees into other areas within SWIF, the employees still devote most of their time to medical bill review activities.[35]

- SWIF kept approximately half of the employees on medical bill review duties to work with bills that involve extenuating circumstances such as legal issues. These employees also handle bills for surveillance and case management.

[35] SWIF officials stated that the original in-house positions are not being refilled as employees quit or retire.

- SWIF sent the remaining employees to SWIF's Control Unit which audits MedRisk's work. SWIF officials said that the Control Unit checks all medical bills processed by MedRisk that total over $1,000. The Control Unit also reviews 40 percent of all bills totaling under $1,000 that are processed by MedRisk. We found that SWIF's auditing of more than 40 percent of the bills was excessive since MedRisk—after a shaky start—has generally maintained an error ratio of less than 3 percent. SWIF's continued review of so many bills when the error rate has dropped so significantly gives the appearance that SWIF is giving "busy work" to the former employees.

Overall, SWIF has paid MedRisk more than $2.5 million for medical bill review and repricing services while continuing to pay over $1.7 million for in-house salaries and benefits for the same services.

SWIF already had the technical capability to perform medical bill review and repricing services

Prior to the MedRisk contract, SWIF's own computer system was customized to include the software SWIF needed to perform medical bill review and repricing services. Nonetheless, SWIF contracted out these services to MedRisk.

In contracting these services to MedRisk, SWIF spent approximately $1 million to establish interfaces between SWIF's software and MedRisk's software. This $1 million cost included over $915,000 paid to SWIF's software vendor and $85,000 paid to MedRisk for MedRisk's role in establishing the interfaces.

SWIF could not justify its contracting out for these services

When we questioned SWIF on the need to hire a contractor for medical bill review and repricing services, SWIF officials stated that a former Secretary of the Department of Labor and Industry "made the determination that SWIF could achieve greater efficiency and eliminate a backlog[36] of unpaid medical bills [by contracting out these services]."

When we asked SWIF officials for documentation related to this determination, such as a cost/benefit analysis or another type of study to show that the outsourcing of medical bill review and repricing services was in the best interest of SWIF and taxpayers, SWIF officials were unable to provide us with any such documentation.[37]

Although SWIF was able to alleviate its backlog of bills, State Workers' Insurance Board meeting minutes indicate that the elimination of the backlog was due more to SWIF's use of overtime for its own employees rather than to the implementation of the MedRisk contract. In fact, the board's meeting minutes indicate that the implementation of the MedRisk contract actually created another backlog of several thousand bills in 2009.

Summary and Recommendation

For 2009 and 2010 combined, SWIF paid MedRisk more than $2.5 million for medical bill review and repricing services. In addition, SWIF paid more than $1 million to establish

[36] SWIF officials told us that, prior to its contract with MedRisk, SWIF had developed a substantial backlog in processing medical bills due to an increase in business and a resulting increase in claims. SWIF officials said that they tried different strategies to alleviate the backlog, such as using emergency contractors and authorizing overtime, before finally deciding to contract out its medical bill review and repricing services.

[37] We subsequently discovered information indicating that SWIF had in fact conducted two cost/benefit analyses related to the outsourcing of medical bill review and repricing services. Upon our request, SWIF officials provided us with two undated cost/benefit analyses. SWIF officials told us that these documents "were not considered as part of the decision-making process [by the former Secretary of Labor and Industry]," and "were prepared in anticipation of a union grievance related to the outsourcing of these processes." Further, SWIF officials stated that the documents "were prepared after the RFP was posted."

computer interfaces with MedRisk so that MedRisk could process medical bills for SWIF.

In the meantime, SWIF already had staff and the technological capabilities to perform medical bill review and repricing services in-house. SWIF could not provide an adequate explanation or any documentation showing the benefits of outsourcing these services for its own benefit and the sake of taxpayers.

With a $3.5 million investment in MedRisk for medical bill review and repricing services through December 31, 2010, SWIF should assure its policyholders and claimants that a contract for these services is necessary.

Recommendation

3. SWIF should prepare a cost/benefit analysis on contracting out medical bill review and repricing services and should use this analysis in helping to determine if SWIF should continue to outsource these services.

Finding Three

SWIF paid MedRisk almost $1.4 million between January and August 2009 without holding MedRisk fully accountable for its contracted work and without providing sufficient oversight.

MedRisk began to perform work and to invoice SWIF for its work in January 2009. But, according to SWIF officials, it wasn't until eight months later (September 8, 2009) that "full implementation" of the MedRisk contract occurred. That was the date on which the computer interfaces between SWIF's software and MedRisk's computer system were completed.[38]

SWIF officials justified the January 2009 start of invoicing by explaining that MedRisk was able to perform work prior to "full implementation" of the contract since medical bill data could be entered manually. Indeed, MedRisk processed 154,631 medical bills between January 2009 and August 2009, the period prior to full implementation. During that same period, MedRisk also performed work related to other major contract requirements, including administering a PPO for SWIF and negotiating other discounts with medical providers.

SWIF paid MedRisk almost $1.4 million for services performed in these eight months.

While it may seem reasonable that SWIF permitted MedRisk to begin performing its duties as soon as possible, the problem is that SWIF was too lenient in enforcing the terms of the contract during this period. SWIF's leniency jeopardized the timeliness and accuracy of bill processing operations.

[38] The actual term of the contract between SWIF and MedRisk was for three years, from May 1, 2008, through April 30, 2011.

SWIF did not monitor MedRisk's error rates and turnaround time for eight months

The contract requires that MedRisk submit monthly error rate and turnaround time reports to SWIF. In this way, SWIF can monitor MedRisk's performance in reviewing and repricing medical bills.

When we asked SWIF to provide us required error rate and turnaround time reports for January through August 2009,[39] SWIF officials did not have this information. The officials also stated that the error rate reports for this time period were not useful since the computer systems between SWIF and MedRisk were not fully integrated.

Whatever the rationale, SWIF did not monitor MedRisk's performance related to error rates and turnaround time prior to the full implementation date of September 8, 2009. Furthermore, from January through August 2009, SWIF's Control Unit audited only bills over $1,000 and did not audit a sample of bills under that amount.

SWIF's limited auditing is especially troublesome because the first calculated error rate, in September 2009, was over 50 percent.

We were unable to quantify the real financial impact of SWIF's lack of oversight. Nevertheless, it is reasonable to believe that MedRisk's error rates from January through August 2009 did not differ significantly from that first reported rate of 50 percent.

High error rates cost SWIF money because they slow down the processing time (SWIF must pay 10 percent interest on payments made to providers after 30 days). High error rates

[39] As part of our audit work, we attempted to analyze MedRisk's monthly error rate and turnaround time reports for a full two-year period, from January 2009 through December 2010. Additional information regarding these reports is located in Finding Four.

also cost SWIF money because they lead to erroneous payments to providers.

Without monitoring MedRisk's performance and without conducting more audits, SWIF could not determine if MedRisk was meeting the timeliness and error rate standards established in the contract. In short, SWIF simply did not know if MedRisk was meeting certain contract requirements critical to SWIF operations.

SWIF allowed MedRisk to delay other services

The contract between SWIF and MedRisk also required MedRisk to conduct policyholder and claimant satisfaction surveys after the end of the first contract year. These surveys can provide SWIF with feedback regarding MedRisk's performance as seen through the eyes of policyholders and claimants.

Because MedRisk began to perform medical bill review and repricing services in January 2009, we expected that MedRisk would have conducted these surveys as soon after December 31, 2009, as possible.

Instead, we found that because SWIF officials considered full implementation of the contract to be September 2009, SWIF did not require MedRisk to implement the survey requirement until the first quarter of 2011.

By delaying these surveys until the first quarter of 2011, SWIF made its February 2011 decision to extend MedRisk's contract with little or no knowledge of MedRisk's performance as seen through the eyes of SWIF's policyholders and claimants.

Summary and Recommendations

For the eight months of January through August 2009, SWIF did not hold MedRisk accountable to the performance measures established in the contract. While the contract went into effect May 1, 2008, SWIF claimed that the actual "full implementation" date was not until September 8, 2009, when SWIF's and MedRisk's computer systems became compatible.

While it is understandable that SWIF wanted to try to use the services of MedRisk as soon as possible, SWIF took on inherent risk in allowing the contractor to process bills for eight months without any monitoring of performance. By not monitoring MedRisk's performance, SWIF could not assure policyholders and claimants that medical bills were processed accurately and timely.

At the same time, SWIF allowed MedRisk to delay, by over a year, the customer surveys it is required to conduct with policyholders and claimants. Thus, in renewing MedRisk's contract for another year, SWIF did so with little information about how well or how poorly its policyholders or claimants were being served.

Recommendations

4. SWIF should not allow any contractor to begin work until SWIF can fully monitor its work.

5. SWIF should ensure that it exercises its rights regarding non-compliance with the terms and conditions of the contract, and should require immediate corrective actions.

Finding Four

SWIF paid providers $2.5 million in interest because it didn't pay them within 30 days as required.

State regulations require that SWIF pay 10 percent interest to medical providers on bills not paid within 30 days of receipt.[40] In calendar years 2009 and 2010, SWIF paid approximately $2.5 million in interest to medical providers because it didn't pay them within the 30 days.

SWIF is responsible for paying this interest regardless of whether SWIF or MedRisk caused the delay in bill processing.

Because both SWIF employees and MedRisk employees process medical bills (see Finding Two), we asked SWIF officials how much of the $2.5 million in interest was due to MedRisk's work. SWIF officials stated that SWIF tracks interest on late bills only in total, and that it would be "almost impossible" to separate out the bills which were paid late due to MedRisk.[41]

As a result, we were unable to determine how much of the $2.5 million in interest was attributable to delays caused by MedRisk as opposed to SWIF. Even so, our audit work indicates that MedRisk processed a significant number of late bills for SWIF, and that SWIF's lack of monitoring MedRisk's bill processing activities contributed to this lateness.

[40] The Pennsylvania Workers' Compensation regulations at 34 Pa.Code § 127.210(a) require that "[i]f an insurer fails to pay the entire bill within 30 days of receipt of the required bills and medical reports, interest shall accrue on the due and unpaid balance at 10% per annum…."

[41] SWIF officials told us that they do track interest paid by SWIF as a result of fee reviews submitted to the Bureau of Workers' Compensation by those providers in the PPO that MedRisk administers. Interest resulting from fee reviews amounted to $19,761 on 1,429 bills from January 2009 through December 2010.

MedRisk took longer than 10 days to process nearly 25 percent of medical bills

The contract requires that MedRisk review, process, and submit all bills to SWIF for payment within 10 working days of the date that MedRisk receives the bill from SWIF. This requirement is necessary to ensure that SWIF has ample time to process the reviewed and repriced bills from MedRisk and submit the bills to the Treasury Department for payment within 30 calendar days.

Despite this requirement, we found that between September 2009 and December 2010, MedRisk took longer than 10 days to review and reprice 90,302 bills, representing 24.4 percent of all bills it processed during that time period.[42]

While the number of bills processed beyond the required 10 days was significant, the contract with MedRisk does not allow SWIF to charge penalties for the number of bills processed beyond 10 days. Rather, the contract holds MedRisk accountable to an average of 10 working days for all bills processed in each month. (This monthly average is referred to as "turnaround time.") If the average turnaround time exceeds the 10-day limit for any monthly period, SWIF may penalize MedRisk financially by deducting a percentage of MedRisk's monthly bill processing fees.[43]

[42] We requested from SWIF all of MedRisk's monthly turnaround time reports from January 2009 to December 2010; however, SWIF officials provided us with turnaround time reports only from September 2009 through December 2010, stating that the reports were not produced until "full implementation" in September 2009. (See Finding Three for more information on "full implementation.")

[43] For the first month in which MedRisk exceeds the l0-day average, MedRisk may be penalized 10 percent of its processing fees for that month. For the second and subsequent consecutive month(s) in which MedRisk exceeds the 10-day average, MedRisk may be penalized 20 percent of the processing fees for that month; furthermore, SWIF may terminate MedRisk's contract for cause.

As of the end of December 2010, MedRisk had exceeded the average monthly turnaround time requirement in 4 of the 16 months we reviewed, as follows:

Month	Monthly average turnaround time
September 2010	11.63 days
October 2010	14.86 days
November 2010	11.74 days
December 2010	10.44 days

SWIF imposed penalties totaling $74,889 against MedRisk for exceeding the turnaround time in those four months.

While SWIF held MedRisk to the terms of the contract in imposing these penalties, the $75,000 contrasts starkly to the $2.5 million SWIF paid out in interest for late payments.

When we asked SWIF if it has considered amending the contract so that it could take into account the number of late bills, SWIF officials responded that, as long as MedRisk's average processing time stays under 10 working days, then SWIF is comfortable because that still gives SWIF enough time to pay the bills within 30 calendar days. This reasoning is flawed, however, when we consider that (1) SWIF paid $2.5 million in interest on late bills in a two-year period and (2) SWIF cannot determine if it was its own delays or MedRisk's delays that led to the late payments.

SWIF did not adequately review MedRisk's turnaround time reports to ensure that the monthly average is accurate

Even though SWIF officials stated they are "comfortable" with having MedRisk report its turnaround time as a monthly average, we found that further analysis was needed. Specifically, we analyzed MedRisk's monthly reports to determine if the reports were accurate and thus useful for

SWIF. This determination is important since the information on the turnaround time reports is self-reported by MedRisk and—as we explain within this section—is not thoroughly checked by SWIF.

In conducting this analysis, we noted that these reports contained incongruities that lead to questions about the validity of the data and the calculated average monthly turnaround time. For example:

- Three of the monthly reports showed a processing time of 0.00 days for some medical bills, with the export date (i.e., the date MedRisk returned the reviewed bill to SWIF) reported as preceding the import date (i.e., the date SWIF initially sent the bill to MedRisk for review).

- Each of the reports contained hundreds of duplicate entries.

Either of the preceding types of occurrences could skew the average monthly turnaround time which MedRisk reports to SWIF:

- With regard to the 0.00 days processing time, SWIF officials said they consulted MedRisk on the issue after we brought it to SWIF's attention, and MedRisk reported back to SWIF that due to an "import issue," MedRisk staff went into the system and changed the date manually. Such an action caused us to have additional concerns—that is, the potential for MedRisk to change dates at any time within the turnaround time reports to manipulate the turnaround times to MedRisk's advantage.

- Regarding the hundreds of duplicate entries on the turnaround time reports, SWIF officials explained that the duplicates were due to reconsiderations which

occurred when MedRisk denied a bill and the provider returned the bill to MedRisk (through SWIF) for a second review.

The biggest problem we found, however, was that SWIF officials themselves were not aware of the issues within the turnaround time reports until we asked about them. This lack of awareness is yet another indicator of SWIF's weak oversight.

SWIF officials said that they review MedRisk's turnaround time reports by selecting a few line items from the reports to see if they match the information on MedRisk's computer system.[44] But by looking at only a small number of items, SWIF did not make sure that the information MedRisk provided was reliable, especially since this information is self-reported by MedRisk and can be manually changed by MedRisk.

SWIF's inadequate monitoring did not ensure that MedRisk processed bills in a timely manner and resulted in interest payments on late bills and missed opportunities for SWIF to recoup some of the interest paid by imposing penalties on MedRisk for exceeding the required turnaround time.

Summary and Recommendations

SWIF has paid $2.5 million in interest as a result of making late payments to providers. SWIF could not break out what portion of this $2.5 million was attributable to MedRisk's actions versus what portion was a result of SWIF's actions. Regardless, it is fair to say that MedRisk cost SWIF money in interest payments since MedRisk processes a substantial portion of SWIF's medical bills.

SWIF's oversight is once again called into question. SWIF did not adequately monitor MedRisk to ensure it processed as many bills as possible in a timely manner to avoid SWIF

[44] MedRisk uses a system called CLAIMExpert®, which SWIF officials stated is an online system that tracks the routing of SWIF's medical bills after they are received at MedRisk.

having to make interest payments on late bills. SWIF also didn't adequately review monthly turnaround time reports, meaning that SWIF was not aware of the extent to which MedRisk took longer than 10 days to process so many bills.

Recommendations

6. SWIF should keep track of all interest paid as a result of MedRisk's actions versus interest paid due to SWIF's actions.

7. SWIF should immediately take corrective action to enforce the provision of the contract requiring MedRisk to process bills within 10 working days rather than continuing to allow for a monthly average of 10 days.

8. SWIF should monitor MedRisk's timely processing of medical bills more intensely, including conducting a more detailed review of MedRisk's monthly turnaround time reports to ensure that the information presented in the reports is accurate and that the calculation of the turnaround time is more precise.

Finding Five

SWIF created a conflict of interest and the potential for fraud by allowing MedRisk to process its own in-network bills and by failing to ensure that MedRisk does not intentionally delay the processing of those bills.

When non-PPO providers treat injured workers employed by SWIF-insured businesses, SWIF pays those providers directly. MedRisk still plays a role in the process, however, by reviewing and repricing the providers' bills.

MedRisk also reviews and reprices the bills of providers who are part of its own PPO. These providers are called MedRisk's in-network providers. However, in allowing MedRisk to review and reprice bills from its own network, SWIF has created a conflict of interest and the potential for fraud.

- **SWIF provided little oversight when allowing MedRisk to review and reprice medical bills from its own in-network providers**

  SWIF has created a conflict of interest by allowing MedRisk to review and reprice its own in-network bills. The problem leads to a potential for fraud because SWIF only partially checked MedRisk's work. Specifically, SWIF checked only to see that a bill for services from an in-network provider did not exceed the workers' compensation fee schedule amount. If it did not exceed that amount, SWIF paid MedRisk, who was responsible for paying its in-network providers directly.

  SWIF did *not* check to see whether or not MedRisk had applied the correct provider discount to the bill. Such a check was not necessary, according to SWIF officials. According to the officials, SWIF "is not party" to payments between MedRisk and its in-network providers and thus has

no interest in ensuring whether MedRisk pays its providers correctly.

SWIF officials also noted that, because MedRisk receives a portion of any savings in excess of its guaranteed amounts (as we explained previously), MedRisk has an incentive to apply the correct discounts.

We find that SWIF's "incentive" reasoning is flawed. Specifically, because SWIF doesn't check, MedRisk has an equal incentive to apply *incorrect* discounts to its in-network provider bills. For example, if MedRisk has negotiated a discount of 25 percent with an in-network provider and the bill is $100, MedRisk owes its in-network provider $75 after MedRisk receives its payment from SWIF. However, if MedRisk *were to apply a discount of 10 percent* to the same $100 bill, MedRisk could receive a $90 payment from SWIF, pay $75 to the in-network provider as agreed, and keep the extra $15.

- **SWIF could not ensure that MedRisk did not intentionally delay the processing of MedRisk's in-network providers' bills in order to collect interest on late payments**

  If either SWIF or MedRisk takes longer than 30 days to process bills from providers, those providers are then supposed to receive 10 percent interest as we previously explained. SWIF officials confirmed that any interest paid due to lateness on bills from MedRisk's *in-network* providers is paid directly to MedRisk, who then is supposed to forward that interest onto its providers.

  SWIF has created another conflict of interest by paying MedRisk directly for interest on late bills. This conflict leads to another potential for fraud because MedRisk can pay a provider directly for the medical bill within 30 days, regardless of when the bill is processed, and then

purposefully delay forwarding that bill to SWIF for payment (i.e., reimbursement to MedRisk) so that the bill appears—at least to SWIF—late enough to earn interest.

For example, MedRisk receives a bill from an in-network provider and pays that in-network provider immediately for that bill. For simplicity in this example, the provider is paid $100.

However, MedRisk can delay reviewing, repricing, and forwarding that bill to SWIF so that the bill does not get processed for payment until after the 30-day requirement has elapsed. SWIF must pay 10 percent interest on this late bill ($10 on our $100 example). SWIF makes payments directly to MedRisk for MedRisk's in-network providers, including both the provider fee and the interest payment.

In this example, MedRisk would receive $110, and with this payment MedRisk has been reimbursed the $100 it paid to the provider plus it gets to keep the $10 interest payment since the provider did not receive a late payment.

As a result, MedRisk actually benefits financially from delayed bill processing due to the fact that MedRisk itself receives the 10 percent interest payment from SWIF on late in-network bills.

When we asked SWIF officials what actions SWIF takes to ensure that MedRisk does not intentionally delay bills, SWIF officials stated that MedRisk is penalized for exceeding a 10-day average monthly turnaround time.

However, we believe that the contractual penalties for lateness may not be severe enough to deter fraud. For example, as of December 2010, MedRisk was penalized a total of $74,889 for exceeding the required 10-day average monthly turnaround time in four separate months. If we compare this amount to the total interest paid on late bills

by SWIF in 2009 and 2010 (almost $2.5 million), the $74,889 seems minimal.

Therefore, we do not believe that the penalties for lateness as described in the contract are sufficient to preclude MedRisk or any vendor from intentionally delaying bill processing in order to receive interest payments on late bills.

Summary and Recommendations

SWIF allows MedRisk to review and reprice its own in-network bills, which has created a conflict of interest and the potential for fraud. This arrangement creates possibilities for MedRisk to incorrectly apply provider discounts to bills. Also, SWIF does not monitor the extent to which MedRisk intentionally delays processing bills so that it can collect interest. Such monitoring is necessary to ensure that MedRisk is not retaining those interest payments for itself. There is a real potential for MedRisk to deliberately delay processing its in-network providers' bills, creating another possibility for fraud.

Recommendations

9. SWIF should not allow MedRisk to review and reprice its own in-network bills due to a conflict of interest and the potential for fraud. SWIF should use its own in-house staff (who also perform bill review duties) to process MedRisk's in-network bills.

10. If SWIF believes it makes the most sense for MedRisk to process its in-network providers' bills, then SWIF must establish internal controls to ensure that proper discounts are applied and that MedRisk cannot intentionally delay processing the bills.

Finding Six

SWIF extended its contract with MedRisk even though MedRisk fell $800,000 short in meeting its guaranteed trauma bill savings over two years.

MedRisk guaranteed that it would save SWIF money on SWIF's medical bill costs by negotiating discounts with providers who perform medical services for SWIF claimants.[45]

As we explained previously, MedRisk guaranteed SWIF two distinct savings amounts: (1) for non-trauma bills, a 7 percent savings on the fees listed on the workers' compensation fee schedule; and (2) for trauma bills, a 17 percent savings on the fees listed on the workers' compensation fee schedule.

SWIF officials told us that, prior to the MedRisk contract, trauma bills were negotiated by nurses on staff at SWIF, and the average savings generated by these in-house negotiations was approximately 10 percent on the fees listed on the workers' compensation fee schedule. As a result, the request for proposals instructed vendors to use a 10 percent savings amount as the baseline when proposing their trauma savings guarantees. MedRisk guaranteed to exceed this 10 percent baseline savings by 7 percent, thus establishing its total trauma bill savings guarantee of 17 percent.

The contract provides that SWIF and MedRisk will split any savings that MedRisk generates above the amounts guaranteed by MedRisk. (Details regarding the split of savings are discussed on pages 11 to 13.)

The contract also states that if MedRisk "fails to deliver the savings guaranteed in its proposal after a reasonable amount of time, SWIF may find [MedRisk] in default of its obligations and [MedRisk] could face termination of the contract and

[45] MedRisk stated its guaranteed savings in the cost proposal section of its response to the RFP.

debarment[46] by the Commonwealth." The contract does not require that MedRisk reimburse SWIF for any unmet portion of the guarantees.

We found that MedRisk failed to meet its 17 percent savings guarantee for trauma bills by nearly $800,000 in calendar years 2009 and 2010 combined, with an average savings of 13 percent on the fees listed on the workers' compensation fee schedule.[47] In fact, MedRisk met its trauma bill savings guarantee in only three months of the twenty-four month period.

MedRisk's failure to meet the trauma savings guarantee is significant because savings guarantees were an important part of the bid evaluation process. The request for proposals stated that the guaranteed savings amount "is considered material and important and will be relied upon during the proposal evaluation process." The request for proposals also cited "cost"—which included the guaranteed savings amount—as the most important weighted factor used in evaluating proposals.

Because MedRisk proposed the highest guaranteed savings amounts of all seven vendors who bid on the contract, MedRisk received the highest score in the "guaranteed savings" category of the bid evaluation process. MedRisk's savings guarantees were therefore integral to MedRisk being awarded the contract.

Although MedRisk has substantially failed to meet the trauma portion of the savings guarantee, SWIF has taken no actions to terminate its contract with MedRisk as a result of MedRisk's failure. In fact, in February 2011, SWIF extended its contract

[46] Part I, Chapter 16 of DGS' *Procurement Handbook* allows a head of a purchasing agency to "debar" a contractor "after reasonable notice to the contractor involved and reasonable opportunity for the contractor to be heard, from consideration for the award of Commonwealth contracts" based on substantial evidence.
[47] MedRisk's invoices show that MedRisk met and exceeded its 7 percent savings guarantee to SWIF for *non-trauma* bills during calendar years 2009 and 2010, with an average savings of 12 percent.

with MedRisk for one year, making the contract effective through April 30, 2012.

Summary and Recommendation

MedRisk's savings guarantees are intended to assure SWIF that MedRisk will achieve a specific level of savings for SWIF by negotiating discounts with medical providers. MedRisk guaranteed SWIF a 7 percent savings on non-trauma bills and a 17 percent savings on trauma bills.

MedRisk fell $800,000 short of meeting its trauma bill savings guarantee to SWIF in 2009 and 2010 combined; in fact, during the two-year period, MedRisk met its trauma bill savings guarantee in only three individual months. SWIF should have been able to count on MedRisk achieving this savings since MedRisk "guaranteed" it to SWIF.

The contract does not require that MedRisk reimburse SWIF for any unmet portion of the savings guarantees. Rather, the contract allows for the termination of MedRisk for failing to meet its savings guarantees. Even so, SWIF chose instead to extend its contract with MedRisk for another year even though MedRisk substantially failed to achieve the trauma bill savings that MedRisk guaranteed to SWIF.

Recommendation

11. Given that MedRisk has consistently and substantially failed to meet its trauma bill savings guarantee, SWIF, with the cooperation of MedRisk, should amend the contract with MedRisk to require MedRisk to reimburse SWIF for any shortfalls in meeting MedRisk's trauma bill savings guarantee.

Finding Seven

SWIF allowed MedRisk to underperform in establishing "provider panels" that save SWIF money.

In addition to providing medical bill review and repricing services and negotiating provider discounts, MedRisk is also responsible for establishing provider panels on behalf of SWIF's policyholders.

A provider panel is a list of at least six healthcare providers, at least three of which must be physicians. When an employer posts a provider panel in the workplace, injured employees must seek treatment for their work-related injuries with one of the designated providers for 90 days from the date of the first visit.[48]

According to SWIF officials, policyholders' use of provider panels saves money for SWIF (and in turn the policyholders). These savings occur because an injured worker's medical costs are controlled for 90 days while the worker is being seen by panel physicians.

SWIF does not directly compensate MedRisk for its panel development work. Rather, the financial benefit to MedRisk for providing this service comes when injured employees visit panel providers with whom MedRisk has established a discounted rate; MedRisk then receives from SWIF a percentage of any savings generated above the amount MedRisk guaranteed to SWIF.

[48] The Pennsylvania Workers' Compensation regulations at 34 Pa. Code § 127.751(a) give each employer the right to establish provider panels, but does not require employers to do so.

MedRisk has underperformed in establishing provider panels

Prior to SWIF's contract with MedRisk, approximately three percent of SWIF's policyholders had already established provider panels. These panels were established either with SWIF's assistance or by policyholders independently.

SWIF officials told us that as of December 10, 2010, due to MedRisk's efforts, 1,071 additional panels were officially posted by policyholders. Thus, with a total policyholder count of 26,846 in 2010, only about four percent of SWIF policyholders posted panels. Or stated another way, there has been only a one percent increase in panel development as a result of MedRisk's work.

SWIF officials told us they want to see more provider panels posted. However, when we asked if SWIF had set a goal for MedRisk regarding the number of panels MedRisk should establish, officials stated that they had not. They said there is no contractual requirement for MedRisk to perform better.

Summary and Recommendation

SWIF has contracted for panel development services, but has seen only a small number of new panels formed as a result of MedRisk's work. SWIF did not set any goals for MedRisk, nor did the contract penalize MedRisk for underperformance. As such, SWIF is currently underserved by MedRisk with regard to panel development.

Recommendation

12. SWIF, with the cooperation of MedRisk, should amend the contract to develop a performance measure with regard to panel development, including a financial penalty against the fees paid to MedRisk for guaranteed savings if the goal is not met.

Finding Eight

Between 2000 and 2011, SWIF spent at least $73.7 million for an automated system plagued by problems resulting from, or worsened by, SWIF's poor contract management and weak oversight—problems suggesting that SWIF may not be capable of managing the system's planned replacement.

According to the initial contract with the winning software vendor, that vendor was responsible for the following:

1. Customizing the software to meet SWIF's specific needs.
2. Installing the software.
3. Assisting SWIF in converting all data from the old system and transferring it to the new one.
4. Providing training to the SWIF staff.

Three- to five-year delay in the new automated system's startup

Even before the software could be installed to make the new automated system operational, SWIF had to prepare to transfer all its data from the existing computer system. Therefore, in September 2000, and before the software contract could be signed, SWIF began laying the groundwork for the transfer, assisted by the winning software vendor and some of the other information technology vendors.

SWIF acknowledged that it had not anticipated that the customization, installation, and conversion would be as complicated or lengthy as it turned out to be. For example, although SWIF expected that the new automated system would

be fully operational and in use by March 2002, the data by then was not ready to be transferred from the old system.

In May 2003, with the signing of the contract with the software vendor, SWIF was closer to the software installation and data transfer. Both SWIF and the vendor agreed that the new automated system would be operational by February 17, 2004, but still two years behind SWIF's original expected date of March 2002.

The anticipated "operational" date of February 2004 came and went, and the implementation of the software/system continued. Ultimately, SWIF did not "go live" with its new automated system until June 1, 2005—five years after the software vendor had been chosen and more than three years after SWIF originally projected.

By all accounts, the modernization project and its related software/system implementation were massive undertakings. SWIF was apparently unprepared or inexperienced—or both—to deal with project management issues and contract matters in ways that might have improved and hastened the new software/system's implementation. Examples follow:

- **SWIF did not negotiate financial penalty provisions into its contract to cover implementation delays.**

  The contract between SWIF and the software vendor included only one clause related to implementation delays. That clause allowed SWIF to withhold payment to the vendor, but only until certain milestones were met, and without financial deductions.

  Thus, despite the one-year expiration written into the initial contract, SWIF extended it four times for 60- to 90-day intervals through May 31, 2005, when installation was finally completed. SWIF paid the vendor $4.7 million during these extensions—$4.7 million over and above the

original $1.7 million that SWIF paid for the installation that both parties had previously agreed would occur in 2004.

- **SWIF had not anticipated various obstacles.**

  Some of the implementation obstacles faced by SWIF were related to changes beyond its control. For example, SWIF could not have predicted the need to address implementation issues based on internal organizational restructuring, or changes to existing workers' compensation law.

  There were other obstacles, however, that SWIF should have anticipated and/or managed better. For example, SWIF should have anticipated the complexity associated with customizing the new software/system to meet SWIF's needs for reviewing and repricing medical bills, or the numerous interfaces (i.e., the sharing of data) required to communicate not only within SWIF but also with other state agencies who provide or use SWIF data. In addition, SWIF did not anticipate the need for extensive discussions with representatives of its unionized workforce prior to moving staff and changing their duties, or the need for converting far more data than normal as business grew but software implementation lagged. Finally, SWIF could have chosen to implement its new system sooner, but in phases, rather than implementing the entire system at once, which took longer.

- **SWIF did not assign project accountability to any one position or person.**

  Although we found an organizational chart from 2002 that designated a SWIF management official as "project manager" for the modernization project, we found no evidence that this project manager had any decision-making authority or was in any way directly responsible for ensuring the timely and cost-effective completion of the new automated system.

We also learned that SWIF created at least two groups to oversee the modernization project. In 2001 and 2002, a "Change Control Board" of SWIF management officials met weekly to address implementation problems and to discuss how to move implementation forward. In mid-2003, an ad-hoc committee of SWIF management officials, an information technology consultant, and the software vendor was formed to review the status of the project's implementation. The committee initially met several times weekly and later (in January 2005) became the "Steering Committee," charged with watching over the Change Control Board and keeping the modernization project on track.

SWIF officials have told us that, in addition to SWIF management, Department of Labor and Industry officials at the highest level were keenly aware of the delays as well, and that top officials discussed how best to move forward—including whether or not to discontinue the project altogether. Regarding discussions about that latter option, such discussions resulted in SWIF's determination that a change in course would be no less expensive than the course already being taken—meaning that the modernization project would continue using the software/system already selected.

Overall, it is thus clear that SWIF and top Department of Labor and Industry officials were aware of the modernization project and the problems with its implementation. But those officials were simultaneously responsible for many other responsibilities as well, while the modernization project's "project manager" was a project manager in name only. Just as best practices dictate, that position should have had clear responsibility for success of the project, with authority to lead, make timely decisions, and hold people accountable.[49] Instead, no one person was accountable.

[49] *Best Practices in Project Management*, prepared by Energy Facility Contractors Group (EFCOG) and

- **SWIF underestimated implementation costs, which were 230 percent more than projected.**

  SWIF had initially projected in September 2000 that the cost to implement the automated system would total $10.6 million; SWIF anticipated paying $4.8 million to the software vendor and $5.8 million to other vendors.

  However, by the time the system went live in 2005, the total cost of implementation had swelled to $34.9 million, with SWIF paying $17.6 million to the software vendor and $17.3 million to the other vendors. Specifically, SWIF's final cost to implement its automated system was $24.4 million more than initially projected, or 230 percent higher.

  Regarding the $17.6 million that SWIF paid to the software vendor only, this amount included the $1.7 million and $4.7 million paid to the software vendor for the 2003 contract and contract extensions, respectively, as well as $9.4 million for transitioning from the Pennsylvania Insurance Compensation System, $700,000 for the software license, and $1.1 million for services related to the implementation.

The impact of SWIF's inexperience goes beyond implementation

As we noted earlier, SWIF officials reported that the software vendor was difficult to work with even before the contract was signed. SWIF officials also told us of problems that followed the software's actual implementation when the vendor protested SWIF's intended procurement of another contractor to support, maintain, and enhance the software. The original

National Laboratory Directors Council (NLDC), states: "One of the key selection factors is the leadership abilities of the [project manager]. Among these is the ability to lead a team, create a positive environment, manage relationships, make timely decisions, and hold people accountable." This report, dated January 18, 2010, is located at http://www.efcog.org/wg/pm/docs/archive/omc/Contractor%20Best%20Practices%20in%20Project%20Management%20Final.pdf. Accessed on October 27, 2011.

software vendor protested SWIF's action, saying SWIF would be violating provisions of the licensing agreement. Thus ensued a three-year legal battle in Commonwealth Court between SWIF and the software vendor; the battle ended in 2008 when the two parties negotiated a maintenance contract giving SWIF limited rights to use other vendors—in conjunction with the software vendor—to provide maintenance and support services for the software.

SWIF's inexperience clearly played a role in this matter. SWIF officials stated that, at the signing of the original contract, they were aware the software was proprietary. However, at the same time, SWIF officials made a seemingly contradictory—or even naive—statement that they were unaware that the software vendor would not allow SWIF to use anyone other than its own employees to provide support or maintenance. In other words, SWIF was aware that the software was proprietary, but unaware that the vendor would take "proprietary" to such extremes.

Whether or not SWIF fully understood what it was doing when signing the 2003 contract with its proprietary provisions, SWIF had nonetheless locked itself into a long-term relationship with the software vendor—a commitment that continues until SWIF stops using the software.

For this reason, since June 2005, SWIF has entered into a series of six contracts with the software vendor to provide related support, maintenance, and enhancements. SWIF's most recent contract—the one signed following the legal battle—remains in effect through November 2011, with options to extend the contract for two additional one-year terms through November 2012 and 2013.

In total, SWIF will have spent $38.8 million from 2005 through November 2011 for support, maintenance, and enhancement of the system—i.e., $24.8 million to the software vendor and $14 million to other vendors.

Past practices raise serious questions about SWIF's ability to manage the system's replacement

SWIF's current contract with the software vendor will terminate at some point between now and November 2013, meaning that SWIF must decide whether (1) to continue maintaining the current automated system and thus offer the software vendor yet another contract or (2) to seek another vendor to provide an entirely new computer system.

SWIF officials have told us they plan to replace the software because, at ten years old, it is outdated despite the enhancements made by the vendor over that time period.

The officials have also said that SWIF must become more web-oriented in order to provide better service to claimants and policyholders. For example, even though potential policyholders can access a workers' compensation application online, they cannot complete the process in that manner as SWIF would like. Instead, potential customers must print an application or obtain one from a district office, and then mail or hand-deliver it to SWIF's offices.

SWIF would also like to offer other service opportunities online, such as the ability to file claims electronically much the way unemployment compensation claims can be done through another program administered by the Department of Labor and Industry.

With those improvements in mind, SWIF began in March 2008 to seek information on the related software products and customizations. According to SWIF officials, there is no one product that offers policy and claims functions together. In other words, if SWIF moves forward and continues to find that no product aligns precisely with SWIF's typical business processes, then SWIF is once again facing a situation similar to the one encountered previously: the need for significant customization.

SWIF officials acknowledged that in hindsight, SWIF might have done things differently regarding the modernization project and the software/system implementation; as a result, SWIF officials have indicated they are moving forward with plans to replace the software/system based on lessons learned, such as asking software vendors questions about Internet technology, intellectual property, proprietary limitations, and the use of other vendors for support and maintenance. It is imperative that SWIF uses these lessons learned and improves its project oversight in an effort to avoid the problems, delays, and cost overruns that plagued SWIF with the current software/system.

Summary and Recommendations

In the late 1990s, SWIF decided to undertake a modernization project that would automate the system by which SWIF processed and paid medical claims. By the end of 2000, SWIF had selected the only software product that could address all phases of the workers' compensation business and began the transition to the new software/system. SWIF anticipated completing the new system in March 2002 at a cost of $10.6 million; however, SWIF's new system went live on June 1, 2005—more than three years later—at a cost of $34.9 million, which was **230 percent** higher than initially projected.

SWIF's transition to the automated system and implementation of the software was complex and plagued by problems resulting from—or possibly worsened by—SWIF's poor contract management and weak oversight. These issues, along with SWIF's lack of preparation or inexperience—or both—may have impeded the implementation and led to the modernization project taking several years longer than anticipated, and consequently sending the project millions of dollars over the anticipated cost.

Since June 2005, SWIF has continued to contract with the software vendor to provide support, maintenance, and enhancements related to the system. SWIF's most recent contract remains in effect through November 2011, with

options to extend the contract for two additional one-year terms through November 2012 and 2013.

Overall—from 2000 through November 2011, SWIF spent at least $73.7 million to implement, support, maintain, and enhance its automated system, which SWIF is now working to replace. As SWIF moves forward with plans to seek a vendor to provide a new web-oriented system that could offer customers self-service opportunities, SWIF must take action to manage the new system's implementation and costs based on lessons learned.

Recommendations

13. In future contracts for changes to its computer program system and/or information technology processes, SWIF should negotiate the option for punitive financial penalties for the vendor's failure to meet established milestones and deadlines.

14. When creating committees to oversee future changes to its computer program system and/or information technology processes, SWIF should establish definitive accountability measures and give these committees the ability to enforce contract clauses, such as the aforementioned provisions.

15. For future changes to its computer program system and/or information technology processes, SWIF should consider designating a high-level staff person as a true project manager, giving that person the authority to make decisions and the sole responsibility of overseeing the project to completion on time and on budget.

16. SWIF should have future contracts for changes to its computer program system and/or information technology processes carefully reviewed by members of the Department of Labor and Industry's and/or DGS' legal staff who are familiar with information technology contracts, or consider consulting with the Office of

Administration's Office for Information Technology or an independent contractor for assistance in information technology contracting. Further, SWIF officials should ensure that they understand the ramifications of proprietary language in future information technology contracts.

17. Prior to embarking on any new system development project, SWIF should learn from the mistakes made in implementing PowerComp and avoid making similar mistakes in a future project. In other words, SWIF should not move forward until it can do so based on lessons learned.

Appendix A

Objectives, Scope, and Methodology

The Department of the Auditor General conducted this special performance audit in order to provide an independent assessment of contracts entered into by or on behalf of SWIF. Furthermore, we conducted this audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Objectives

Our special performance audit of SWIF was conducted as part of the Auditor General's focus on state government agencies' adherence to the requirements of the state's procurement process, the nature of the state contracts made with private vendors, and the amount of taxpayers' dollars paid to these vendors. The audit also served as a check on SWIF's procurement use of contractors following a previous investigation of SWIF conducted by this department.[50]

Our overall objective for this audit was to evaluate contracts entered into by or on behalf of SWIF. We selected two contracts on which to focus for our audit.

The first SWIF contract we selected was for medical bill review and repricing services and for Preferred Provider Organization (PPO) and panel development services. We selected this contract because the services provided are integral to SWIF's functions.

[50] In April 2008, the Department of the Auditor General's Office of Special Investigations released a report outlining four findings that resulted from an investigation which followed complaints related to SWIF's procurement process and extended use of emergency contractors for medical bill repricing services.

The second contract we selected was for the implementation, support, maintenance, and enhancement of SWIF's software and automated system. We selected this contract because of the impact the software/system has on all of SWIF's business processes and because of the large dollar amount spent.

Our objectives in regard to these two contracts were as follows:

1. What types of services were procured under these contracts and what were the results and benefits of procuring these services?

2. Did SWIF adhere to the Commonwealth procurement laws, policies, and *Procurement Handbook* throughout the procurement process?

3. Did SWIF ensure proper oversight and monitoring of contractor selection and contractor performance?

Scope

This special performance audit report presents information for the period of January 1, 2007, through August 2, 2011, unless otherwise indicated.

Methodology

To address our audit objectives, we performed the following procedures:

- Conducted interviews with key officials of SWIF

- Reviewed and analyzed pertinent laws, guidelines, policies, and procedures, including the Workers' Compensation Act, the Procurement Code, and the *Procurement Handbook*

- Reviewed Department of Labor and Industry annual reports for the years ended December 31, 2006, through December 31, 2009

- Reviewed a list of SWIF's contracts in effect between January 1, 2007, and May 18, 2010

- Reviewed minutes from meetings of the State Workers' Insurance Board and the advisory council to the Board

- Reviewed previous financial audits of SWIF conducted by the Department of the Auditor General's former Bureau of Federal Audits, and met regularly with auditors from that bureau to coordinate efforts and share information[51]

- Reviewed the April 2008 report on SWIF, along with related working papers, from the Department of the Auditor General's Office of Special Investigations (OSI), and met with OSI staff to obtain additional background information

- Reviewed the request for proposals for medical bill review and repricing services and for Preferred Provider Organization (PPO) and panel development services, along with MedRisk's response to the request for proposals

- Reviewed SWIF's contract with MedRisk, including all attachments

- Requested and reviewed information from both SWIF and the Pennsylvania Department of General Services[52] pertaining to the procurement process which resulted in the contract with MedRisk

[51] The Department of the Auditor General's Bureau of State and Federal Audits (formerly the Bureau of Federal Audits) conducts annual audits on SWIF's financial statements. The most recent audit, released on October 20, 2011, covered years ended December 31, 2008 and 2009.

[52] See page 16 for discussion on limited information provided by the Department of General Services.

- Reviewed and analyzed MedRisk's monthly invoices submitted to SWIF from January 2009 through December 2010, along with SWIF payments made to MedRisk for the same time period

- Reviewed and analyzed information pertaining to MedRisk's compliance with contractual obligations related to bill scanning and imaging; data file transfers; 10-day average monthly processing time requirements; and bill processing error rate and accuracy requirements

- Reviewed and analyzed information pertaining to interest payments made by SWIF due to late bill processing and as a result of fee reviews conducted by the Bureau of Workers' Compensation

- Reviewed and analyzed information pertaining to MedRisk's PPO and other provider discount services, as well as panel development services

- Reviewed documents (i.e., the request for quotes, chosen vendor's response to the request for quotes, and contract) pertaining to the procurement of the software in 2003, as well as subsequent amendments to the contract

- Reviewed the 2008 contract between SWIF and the software vendor

- Analyzed and tested purchase orders, SAP screen shots, and invoices supporting all of SWIF's reported expenses from 2000 through 2010 to implement, support, maintain, and enhance the software/system

- Reviewed documents related to SWIF's monitoring and oversight of the implementation, support, maintenance, and enhancement of the software/system

- Reviewed documents pertaining to SWIF's efforts to replace the software/system in 2008

Findings and Recommendations

We developed 8 findings and we present 17 recommendations to address the issues we identified. We will follow up within the next 12 to 24 months to determine the status of our findings and recommendations.

Our expectation is that the findings presented herein will improve SWIF's contracting processes and will provide a framework for corrective action where necessary.

Response from SWIF with evaluation from the Department of the Auditor General

SWIF's full response to this audit report is reproduced on the following pages.

First, however, in accordance with generally accepted government auditing standards, we include here an evaluation of the comments that SWIF has provided.

Our evaluation of SWIF's comments

We emphasize that, overall, SWIF did not address several important matters that we have identified and discussed in our report.

For example, in Finding Five we state that SWIF created a conflict of interest and the potential for fraud by failing to provide proper oversight of MedRisk. While SWIF agreed that additional internal controls should be established to ensure proper payment of provider invoices, we continue to assert that a conflict of interest and the potential for fraud are matters in need of a thorough review.

As a result, we will forward this report to the Office of Attorney General for its evaluation of whether any provision of law has been violated and to take any actions it deems necessary.

We also note that—although SWIF officials state that SWIF has realized $21.5 million in net savings over the life of its contract with MedRisk—this savings could have been much greater had SWIF better managed its contract with MedRisk, or even performed certain services in-house. If SWIF extends the MedRisk contract for another year after April 30, 2012, SWIF should put contract amendments and/or written change orders in place as we recommended in this report.

Further, we continue to recommend that SWIF evaluate and document the need to outsource medical bill review and repricing services, and—if SWIF determines these services should continue to be outsourced—SWIF should begin the

contract rebidding process as soon as possible to ensure that the flawed RFP resulting in the current contract with MedRisk will not continue to impair SWIF's ongoing operations.

Finally, while SWIF officials attribute the decisions and activities described in our findings to previous SWIF management teams, it is the current management team's responsibility for taking appropriate actions immediately.

COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF LABOR AND INDUSTRY
HARRISBURG, PENNSYLVANIA 17120

THE SECRETARY

December 19, 2011

The Honorable Jack Wagner
Auditor General
Room 229 Finance Building
Harrisburg, PA 17120

Re: Special Performance Audit of the State Workers' Insurance Fund for the period from January 1, 2007 to present

Dear Auditor General Wagner:

The State Workers Insurance Fund (SWIF) is pleased to have this opportunity to respond to statements and findings in the Auditor General's report of its Special Performance Audit.

At the outset, it should be noted that the contract with MedRisk has produced net savings of $21.5 million over the life of the contract – all of which acts to the benefit of policyholders at SWIF and helps to insure the financial stability of the fund. Indeed, these savings have assisted in minimizing premiums for the policyholders, while simultaneously providing workers compensation insurance protection for employees of policyholders. It should also be noted that this report covers activities at SWIF which pre-date the current management team. We are confident that new management will produce additional benefits for policyholders.

Finding One

After contracting with MedRisk, SWIF eased various important provisions so much—and without following the state's Procurement Handbook—that the procurement process was unfair to other vendors who might have bid lower and ultimately performed better.

1. **SWIF took over the majority of the work and expense in establishing computer systems interfaces.**

Response: The RFP development, review and contract award to MedRisk was handled by the Department of General Services. SWIF was not consulted as to the possibility of programming constraints due to the "intellectual property concerns". During this time, the Department of Labor & Industry was in litigation with StoneRiver concerning intellectual property rights of all things associated with the PowerComp® system. As part of the settlement of that litigation, StoneRiver and SWIF entered into a contract that provided that third-parties could have only very limited access to StoneRiver's intellectual property and only under certain limited

circumstances. As a result, MedRisk was unable to perform any modifications to the PowerComp® system. The payment of $85,000 was originally protested by SWIF staff, but the expense was paid at the direction and approval of the Office of Information Technology (OIT). Said approval was given after review of a detailed invoice reflecting the effort by MedRisk to develop necessary components of the interface. Development work by MedRisk was necessary for MedRisk to receive the data in its ClaimExpert® system.

2. **SWIF absorbed all responsibilities and cost related to receiving and scanning medical bills.**

Response: During the implementation of the medical bill processing portion of the contract, SWIF management determined that it was operationally more efficient to maintain the scanning of bills. This would also allow SWIF to control the start of the bill processing cycle, which is important because, pursuant to the Workers' Compensation Act, any carrier must pay interest on a medical bill that is not paid within 30 days. It was SWIF's strong belief that numerous bills would continue to be submitted to SWIF, negating any benefit to SWIF of having MedRisk perform scanning. This conclusion was reached after the contract was awarded and executed. Preparing an amendment to the contract to reflect this decision did not create any advantage for MedRisk in the procurement process, nor would it have allowed other offerors any opportunity to revise their proposals.

3. **SWIF did not enforce financial penalties to the extent outlined in the contact.**

Response:
-Lateness of data. SWIF responded to Information Request #6, question 22, wherein the Office of Information Technology verbally requested MedRisk to agree to transfer the daily data file to SWIF by noon each day, so SWIF could automate the import of this file. MedRisk agreed to this with the understanding the language of the contract would still stand and no penalty would be assessed, unless the file arrived after 5 pm. As responded to in Information Request #6, question 19, no fines have been assessed as there have not been any files received after 5 pm, as per the contract terms and conditions.

-SWIF's medical bill audit process was based on established system workflows and policies and procedures in place for the auditing of SWIF'S in-house payment of medical bills. It was SWIF's intent to use these same policies and procedures to audit medical bills as processed by MedRisk. Extensive system changes would be required to PowerComp®, to include tracking by incorrect dollars paid, as well as dollar total value of incorrectly denied bills. By continuing to track the number of errors in total, for incorrectly paid bills and errors in data entry, SWIF made it twice as difficult for MedRisk to maintain an error ratio of under 3%.

-SWIF did impose liquidated damages pursuant to the contract on 4 occasions, totaling $46,470.53 for errors in data entry. SWIF also imposed liquidated damages pursuant to the contract on 6 occasions, totaling $99,189.53 for timeliness of processed bills, resulting in a total of $145,660.06 in liquidated damages collected by SWIF. SWIF has consistently enforced the damage provisions of the contract when warranted.

-Image quality requirement was no longer enforceable when then-SWIF management decided, for operational efficiency, to scan medical bills received.

Due to SWIF's limited involvement in the development and issuance of this RFP, these changes to contract requirements were operationally necessary. SWIF agrees these issues should be considered in the development of any future RFP.

Finding Two

SWIF paid MedRisk more than $2.5 million to perform medical bill review and repricing services while SWIF continued to perform the same duties itself.

Response: As discussed in several meetings with representatives of the Pennsylvania Department of Auditor General, the decision to outsource the payment of SWIF's medical bills was made by the former Secretary of Labor and Industry in conjunction with the Office of Administration. Of note is the fact that for the period SWIF paid $2.5 million in medical bill repricing services SWIF realized net savings of $10.8 million. Additionally, a limited number of SWIF staff remained in SWIF's Medical Bill Unit to continue to process medical bills that SWIF had anticipated would fall out of the normal claim cycle. Prior to execution of the contract with MedRisk, SWIF's medical bill unit consisted of 20 employees, and after implementation of the contract, the unit consisted of 10 employees. SWIF also transferred staff to its Control Unit to continue to audit medical bills at the level outlined in the contract to assure proper compliance on behalf of its claimants and policyholders. SWIF staff did not continue to perform the same duties that were contracted to MedRisk. Staff was utilized to audit MedRisk's performance or to process only those bills that could not be processed by MedRisk. Through attrition and transfers to other positions, the number of staff was significantly reduced.

Recommendation 3: SWIF should prepare a cost/benefit analysis on contracting out medical bill review and repricing services and should use this analysis in helping determine if SWIF should continue to outsource these services.

Response: SWIF agrees that any future RFP for these services should include a cost benefit analysis. It should be noted that for January 2009 to October 2011 SWIF realized $21.5 million in net savings due to the implementation of the MedRisk contract.

Finding Three

SWIF paid MedRisk almost $1.4 million between January and August 2009 without holding MedRisk fully accountable for its contracted work and without providing sufficient oversight.

Response: SWIF was under strict instructions from the former Secretary of Labor and Industry that implementation was to occur by January 1, 2009. This implementation was before completion of the interface necessary to allow bills processed by MedRisk to be systematically processed into PowerComp®. Due to the unavailability of these processes, it was necessary for

SWIF to manually review and input bills that were repriced by MedRisk. SWIF also made a management decision to only review bills over $1,000 due to the involvement of SWIF Medical bill payers in the manual processing of bills for the period, as well as limited personnel available in SWIF's Control Unit. Due to the manual input on SWIF's part to process bills, it was not possible to track errors to MedRisk and hold MedRisk solely accountable. Furthermore, the medical bill reviewers were instructed to review all manually inputted bills for proper payment, effectively creating an audit trail.

Upon full implementation, the error percentage for September 2009 of 50% was due to two types of errors related to information required by SWIF for management reporting purposes. These errors did not result in additional or incorrect dollar amounts paid to providers. The error ratio with the removal of these two error types resulted in an error ratio of 1.67%. However, as per the terms of the contract SWIF held MedRisk accountable for all errors. It should also be noted that during the period prior to full implementation of January 2009 to August 2009, SWIF realized $5.2 million in savings. As of October 2011 SWIF has realized $21.5 million dollars in savings from January 2009.

Finding Four

SWIF paid providers $2.5 million in interest because it didn't pay them within 30 days as required.

Response: The largest portion of the $2.5 million in interest was the result of a backlog of medical bills at SWIF that accrued prior to the implementation of the MedRisk contract. The tracking of the interest paid due to MedRisk action was not possible due to the manual processing required at SWIF. SWIF has on several occasions requested the return of interest for those bills processed beyond 30 days by MedRisk. SWIF continues to negotiate with MedRisk for the return of interest payments and/or a credit to SWIF for bills that MedRisk delayed processing. The statement found on page 42, that "the biggest problem we found however, was that SWIF officials themselves were not aware of the issues within the turnaround time reports until we asked them" is not accurate. SWIF officials were aware of the issue of bills with a zero day turn around time, but not the specific bills questioned, due to the fact the specific bills identified were not part of the bills sampled during the monthly review. SWIF first raised the issues of zero days on the timeliness report during the initial development of the report with MedRisk on March 18, 2009 thru an email requesting an explanation to this issue. SWIF received a response with explanation on March 18, 2009, in which MedRisk clarified that certain bills are processed and returned to SWIF on the same day that they are received by MedRisk, therefore creating a zero day turnaround time. SWIF continues to monitor both the timeliness of bills paid as well as interest associated with bills over 30 days.

Medical bill interest on bills over 30 days has dropped significantly during the time frame prior to the MedRisk contract to current period. Because the Workers' Compensation Act requires the payment of interest on all bills paid past 30 days, any workers' compensation carrier will be required to pay interest in some circumstances, such as bills that are the subject of litigation. SWIF continues to take all reasonable steps to reduce interest payments. The total interest payments by year, listed below, demonstrate the reduction in interest payments.

2008 - $1,841,214
2009 - $1,789,029
2010 – $679,031
Thru November 2011 - $548,135

Finding Five

SWIF created a conflict of interest and the potential for fraud by allowing MedRisk to process its own in-network bills and by failing to ensure that MedRisk does not intentionally delay the processing of those bills.

Recommendation 9: SWIF should not allow MedRisk to reprice its own in-network bills due to a conflict of interest and the potential for fraud. SWIF should use its own in-house staff (who also perform bill review duties) to process MedRisk's in-network bills.

SWIF believes it is in its best interest to allow MedRisk to process its in-network bills to achieve increased savings. As required by the contract, SWIF receives a percentage of savings below fee schedule. From January 2009 to October 2011 MedRisk has produced $28.5 million in gross savings below fee schedule through network provider discounts.

Recommendation 10: If SWIF believes it makes the most sense for MedRisk to process its in-network providers' bills, then SWIF must establish internal controls to ensure that the proper discounts are applied and that MedRisk cannot intentionally delay processing the bills.

SWIF agrees that additional internal controls should be put into place to review the proper payment of these invoices. As stated in response to finding two, SWIF transferred staff to its Control Unit to continue to audit medical bills at the level outlined in the contract in order to assure proper compliance on behalf of its claimants and policyholders. Beyond SWIF internal controls, the in-network providers would also provide oversight of MedRisk processed bills for individual contracts. Again, SWIF continues to negotiate with MedRisk for the return of interest payments made by SWIF to MedRisk and/or a credit to SWIF for such interest payments.

Finding Six

SWIF extended its contract with MedRisk even though MedRisk fell $800,000 short in meeting its guaranteed trauma bill savings over two years.

The cost proposal spreadsheet prepared by the Office of Administration included in the RFP required an overall guaranteed savings percentage. The MedRisk response insured a guaranteed saving of 7%. The trauma guaranteed saving of 17% is used in the calculation of the monthly PPO savings fee payable to MedRisk. For the month of September 2009 the reduction to the PPO fee due to MedRisk was $21,000. In total SWIF's PPO fees paid to MedRisk were reduced by $415,000 for 2009 and 2010. MedRisk achieved savings above the guarantee of 7% for both the beginning of contract (January 2009) and full implementation

(September 2009) at point of renewal. At the point of renewal (April 1, 2011) SWIF had realized net savings of $17 million. Through October 2011 SWIF has realized net savings of $21.5 million. Based on the savings realized through the contract, SWIF would have been irresponsible to terminate the agreement based only on the trauma savings.

Finding Seven

SWIF allowed MedRisk to underperform in establishing "provider panels" that saved SWIF money.

Response: The current contract does not include a guaranteed level of performance in terms of development of provider panels. SWIF agrees that any future RFP for the establishment of provider panels should include performance measurements and financial penalties for performance not meeting these measurements. SWIF continues to work with MedRisk on this issue and has secured a commitment to review and improve the panel development process.

Finding Eight

Between 2000 and 2011, SWIF spent at least $73.7 million for an automated system plagued by problems resulting from, or worsened by, SWIF's poor contract management and weak oversight—problems suggesting that SWIF may not be capable of managing the system's planned replacement.

Response: The appearance of poor contract management or weak oversight is, in large part, the result of unavailability of SWIF personnel or records, as the period from 2000 to 2007 fell outside the scope of this audit. OIT management in place during the time frame of 2000 to 2007 is no longer available to comment on the events of this time period. However, there is an inherent cost in developing, maintaining and enhancing any information technology system and SWIF will incur such costs, as would any carrier, as a requirement of conducting its business of writing policies and handling claims.

The replacement of the system due to its age is the standard system lifetime amortization for Department systems. Further, the system is built on an outdated client-server based technology. The enhancements that were made to PowerComp® were functional in nature and necessary to meet the business needs of SWIF. The enhancements did not address or impact the core technology upon which the system is built.

Further, it is not accurate to state that a replacement system will necessarily require significant customization. The lack of a single product that offers policy and claims functions together does not dictate a need for significant customization. SWIF will continue to review all available options for a replacement system for PowerComp® to determine a solution that is most advantageous to the Commonwealth.

This finding also assumes that SWIF has determined that it will purchase another commercial, off-the-shelf product to replace PowerComp®. No such decision has been made. Additionally, SWIF has not foreclosed the possibility of reviewing its business processes, nor has it

necessarily determined that any customizations to a new system would be aligned to business process rather than functionality. SWIF will seek a solution that best aligns system functionality with SWIF's needs.

Recommendation 13: In future contracts for changes to its computer program system and/or information technology processes, SWIF should negotiate the option for punitive financial penalties for the vendor's failure to meet established milestones and deadlines.

Response: Agreed.

Recommendation 14: When creating committees to oversee future changes to its computer program system and/or information technology processes SWIF should establish definitive accountability measures and give these committees the ability to enforce contact clauses, such as the aforementioned provisions.

Response: Agreed.

Recommendation 15: For future changes to its computer program system and/or information technology processes, SWIF should consider designating a high level staff person as a true project manager, giving that person the authority to make decisions and the sole responsibility of overseeing the project to completion on time and on budget.

Response: Agreed.

Recommendation 16: SWIF should have future contracts for changes to its computer program system and/or information technology process carefully reviewed by members of the Department of Labor and Industry's and/or DGS legal staff who are familiar with information technology contract, or considering consulting with the Office of Administration's Office for Information Technology or an independent contractor for assistance in information technology contracting. Further, SWIF officials should ensure that they understand the ramifications of proprietary language in future information technology contacts.

Response: Agreed.

Recommendation 17: Prior to embarking on any new system development project, SWIF should learn from the mistakes made in implementing PowerComp® and avoid making similar mistakes in a future project. In other words, SWIF should not move forward until it can do so based on lessons learned.

Response: Agreed.

Again, I appreciate the opportunity to respond to your proposed findings and to provide additional information. I believe that SWIF provides significant benefits to its policy holders and to injured workers, and that the cost savings achieved are important to ensuring and improving the financial stability of the fund. SWIF will continue its important mission to provide workers' compensation coverage for Pennsylvania employers and benefits to injured workers in the Commonwealth.

Sincerely,

Julia K. Hearthway

cc: Elizabeth Crum, Deputy Secretary for Compensation and Insurance
Terence Singer, Deputy Secretary for Administration
Brian Nixon, Director, State Workers' Insurance Fund
Arthur F. McNulty, Chief Counsel

Audit Report Distribution List

This report was distributed to the following individuals upon its release:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

The Honorable Julia K. Hearthway
Secretary of Labor and Industry
Commonwealth of Pennsylvania

The Honorable Kelly Powell Logan
Secretary of Administration
Commonwealth of Pennsylvania

The Honorable Robert M. McCord
State Treasurer
Commonwealth of Pennsylvania

The Honorable Linda Kelly
Attorney General
Commonwealth of Pennsylvania

The Honorable Michael F. Consedine
Insurance Commissioner
Commonwealth of Pennsylvania

The Honorable Sheri L. Phillips
Secretary of General Services
Commonwealth of Pennsylvania

Elizabeth A. Crum
Deputy Secretary for Compensation and Insurance
Pennsylvania Department of Labor and Industry

Anna Maria Kiehl
Chief Accounting Officer
Office of Comptroller Operations
Office of the Budget

Brian Nixon
Director
State Workers' Insurance Fund
Pennsylvania Department of Labor and Industry

Richard Cardamone
Director
Bureau of Commonwealth Accounting
Office of Comptroller Operations
Office of the Budget

This report is a matter of public record and is accessible at www.auditorgen.state.pa.us or by contacting the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, Pennsylvania 17120. Telephone: 717-787-1381.