Audit of the Hawai‘i Health Connector

A Report to the Governor and the Legislature of the State of Hawai‘i

Report No. 15-01
January 2015

THE AUDITOR
STATE OF HAWAI‘I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai‘i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.

7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.

8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.

9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai‘i’s laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

THE AUDITOR
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Audit of the Hawai‘i Health Connector

Report No. 15-01, January 2015

Inadequate planning and improper procurement led to an unsustainable Health Connector

Board of Directors' inadequate planning led to an unsustainable health exchange

The Hawai‘i Health Connector Board of Directors and management could not agree on what Hawai‘i's health insurance exchange could be or should be. The Connector board never made that fundamental decision but continued its work without a finalized strategic plan. As a result, the Connector is unsustainable due to high operating costs and Hawai‘i's unique market of uninsured—only 8 percent of the population, about 100,000 residents. The interim executive director concluded that even with substantial reductions to the estimated $15 million annual operating budget, the Connector would not be sustainable. It would have to dramatically increase fees on participating exchange plans or the State would need to assess a fee across the market to preserve services.

In addition, the Connector did not have IT staff to manage the project's development or monitor contracts, relying on vendors to self-report their progress. In addition, the board's ability to monitor its massive IT system's development progress was impaired by an uncooperative executive director who withheld information. Throughout the website development process, the board was largely unaware of the Connector's myriad problems.

Connector did not properly procure and administer its contracts and monitor costs, putting federal grants at risk

The Connector received $204.4 million in federal grants to support the planning and establishment of Hawai‘i's state-based health insurance exchange. We found the Connector did not properly procure or administer its contracts and circumvented its own procurement policies and procedures when hiring consultants. Contracts were awarded without following proper procedures to ensure competitive pricing and procurement documentation was disorganized or missing from most contract files. Many of the Connector's IT consultant contracts were amended numerous times and costs ballooned as the Connector continued to rely on their services.

The Connector receives almost all its funds from grants awarded by the federal government. Strict federal regulations govern the use of these moneys. We noted numerous questionable travel and entertainment costs as well as unsupported severance pay. These questionable costs may be disallowed by the funding agency, and noncompliance with federal regulations may result in repayment of amounts or suspension and termination of a federal grant.

Agency response

The Connector suggested minor technical changes to our report but generally agreed with our findings and recommendations.

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State of Hawai‘i

Hawai‘i enrolled only 14.8 percent of its expected 58,000 individuals between October 1, 2013, and April 19, 2014, ranking it 46th in the nation.

Recommendations

Responses

For the full text of this and other reports, visit our website: http://auditor.hawaii.gov/

Audit of the Hawai‘i Health Connector

A Report to the Governor and the Legislature of the State of Hawai‘i

Submitted by

THE AUDITOR
STATE OF HAWAI‘I

Report No. 15-01
January 2015

Foreword

This is a report on the audit of the Hawai‘i Health Connector. We conducted the audit pursuant to Section 435H-2(d), Hawai‘i Revised Statutes (HRS), which requires the Auditor to undertake annual audits of the Connector and submit the results to the Connector and the insurance commissioner.

We wish to express our appreciation for the cooperation and assistance extended by the officials and staff of the Hawai‘i Health Connector, the Legislature, and various State departments and individuals whom we contacted during the course of our audit.

Jan K. Yamane
Acting State Auditor

Table of Contents

List of Exhibits

Chapter 1
Introduction

This audit of the Hawai‘i Health Connector was conducted pursuant to Section 435H-2(d), Hawai‘i Revised Statutes (HRS), which requires the Auditor to undertake annual audits of the Connector and submit the results to the Connector and the insurance commissioner. Section 23-9, HRS, also requires that the Auditor submit all reports to the Legislature and governor.

Background on Federal Health Reform Law

On March 23, 2010, the *Patient Protection and Affordable Care Act* was signed into law. A week later, on March 31, 2010, the *Health Care and Education Act* was signed; together, the laws are referred to as the *Affordable Care Act* (ACA) or "federal health reform." The purpose of the ACA was to expand access to health insurance, increase consumer protections, emphasize prevention and wellness, improve quality and system performance, expand the health workforce, and curb rising health care costs. Key provisions in the ACA include:

- Requiring all individuals to have insurance, with some exceptions, such as financial hardship or religious beliefs;
- Requiring employers to provide insurance coverage for workers, or pay penalties, with exceptions for small businesses;
- Providing tax credits to certain small businesses that pay for specified costs of health insurance for their employees beginning in 2010;
- Expanding the federal Medicaid program to cover people with incomes below 133 percent of federal poverty guidelines; and
- Requiring insurance plans to cover young adults on parents' policies effective September 23, 2010.

Additional insurance reforms, which became effective January 1, 2014, included prohibiting most insurance plans from excluding people for preexisting conditions and discriminating based on health status.

The ACA required each state to establish a health exchange to allow consumers to compare health insurance options and enroll in coverage. States could establish one of three types of exchanges: (1) a state-based exchange; (2) a federally facilitated exchange; or (3) a state-federal

partnership exchange. States that opted to establish their own exchanges had to declare their intentions to the U.S. Department of Health and Human Services (DHHS) by December 14, 2012.

The ACA requires that consumers be able to access an exchange through a website, toll-free call center, or in person. Consumers must be able to shop for qualified health plans offered through an exchange. The exchange also determines eligibility for Medicaid and the Children's Health Insurance Program (CHIP) and for income-based subsidies (such as advance payment of premium tax credits and cost-sharing subsidies) to help pay for their coverage and determine their eligibility. Plan enrollments, income-based financial subsidies, and eligibility are determined via electronic transfer of eligibility information between state exchanges and federal and state agencies, and enrollment data between exchanges and insurers.

The ACA also implemented the Small Business Health Options Program (SHOP) exchanges for "small employers," which gives states the option of defining whether this includes employers with 50 or fewer employees, or 100 or fewer employees. SHOPs have responsibilities similar to individual exchanges, including collecting and verifying information from employers and employees, determining eligibility, and facilitating enrollment.

In 2014, most individuals were required to maintain minimum essential coverage for themselves and their dependents or pay a fine. The ACA also mandates employers with 50 or more full-time equivalent (FTE) employees provide health insurance for their full-time employees or pay a per-month assessment on their federal tax returns. Small businesses with fewer than 25 FTEs, average annual wages of less than $50,000, and who purchase health insurance for employees are eligible for a tax credit.

Pursuant to the ACA, the DHHS awarded planning and establishment grants to states for activities related to establishing exchanges. The DHHS empowered its Centers for Medicare & Medicaid Services (CMS) division to implement health care reform for the country. Two organizations within CMS, the Center for Consumer Information and Insurance Oversight (CCIIO) and the Center for Medicaid and CHIP Services (CMCS), implemented programs with state governments through the award of federal grants to realize this vision of health care reform.

The ACA gave DHHS authority to determine and renew grants if a state made sufficient progress toward establishing an exchange. No planning and establishment grant can be awarded after December 31, 2014, and exchanges must be self-sufficient by 2015. The initial open enrollment period was October 1, 2013, through March 31, 2014. Exchanges were

required to offer qualified individuals and small business with coverage effective January 1, 2014.

State innovation waivers

Section 1332 of the ACA provides, that beginning in 2017, states may apply for a waiver of up to five years for requirements relating to health plans, exchanges, cost-sharing reductions, premium subsidies, and individual and employer mandates. If a waiver is approved, DHHS must provide the state with the aggregate amount of tax credits and subsidies that would have been paid to residents of that state in the absence of a waiver. Finally, DHHS must determine whether a state's plan for a waiver will provide coverage that is at least as comprehensive as plans offered through exchanges, cover at least a comparable number of individuals as the ACA would, and not increase the federal deficit.

Hawai‘i Health Connector

Act 205, Session Laws of Hawai‘i (SLH) 2011, established Hawai‘i's health insurance exchange as the Hawai‘i Health Connector, codified as Chapter 435H, HRS. The Legislature noted Hawai‘i already has an overall healthier population, lower uninsured rates, and lower premium costs than other states because of its *Hawai‘i Prepaid Health Care Act* (PHCA), Chapter 393, HRS, which was enacted in 1974. The Legislature therefore expressed that Hawai‘i's health insurance exchange should work in tandem with the PHCA to preserve existing benefits, stating that Hawai‘i's people would be best served by a locally operated exchange. Act 205 also established an interim board of directors to propose legislation for implementing an exchange, and to ensure Hawai‘i's compliance with the ACA.

The Connector was established as a nonprofit corporation organized and governed by the *Hawai‘i Nonprofit Corporations Act*, Chapter 414D, HRS. The general purposes of the Connector are to:

- Facilitate the purchase and sale of qualified health plans and qualified dental plans;
- Connect consumers to the information necessary to make informed health care choices; and
- Enable consumers to purchase coverage and manage health and dental plans electronically.

The Connector's mission is to reduce the number of uninsured individuals in Hawai‘i by providing a health insurance exchange, conducting consumer education, and assisting individuals in gaining access to assistance programs, premium assistance tax credits, and cost-share reductions.

The Connector is also designed to serve as an information hub for all qualified health care plans, offer consumer assistance in a culturally and linguistically appropriate manner, and make plans available to qualified individuals and employers with effective dates on or before January 1, 2014.

In June 2012, Hawai‘i became the first state in the nation to declare its intent to operate a state-based health insurance exchange and was conditionally approved to do so by DHHS on January 3, 2013. The CCIIO approved funding for Hawai‘i to establish a state-based exchange or state-based marketplace before and after the conditional approval.

Hawai‘i chose to implement the ACA through two separate information technology (IT) systems: (1) the Connector's single web-based portal, HHIX, which performs both eligibility determinations and allows individuals to shop for and enroll in plans offered by the exchange; and (2) the State's Department of Human Services' (DHS) Medicaid eligibility system, called Kauhale On-line Eligibility Assistance (KOLEA), to replace its aging eligibility system and implement new ACA rules. Applicants who are eligible for subsidized coverage or who want to purchase unsubsidized plans enroll through HHIX; those eligible for Medicaid or CHIP are enrolled via DHS' KOLEA system.

Board of Directors

The Connector is governed by a board of directors composed of 15 members appointed by the governor. The law requires that the board's membership reflect geographic diversity and the diverse interests of stakeholders, including consumers, employers, insurers, and dental benefit providers. In addition, the directors of the commerce and consumer affairs, health, human services, and labor and industrial relations or their designees are ex officio, voting members of the board. Board members during the period of our audit included a representative from the business sector, a neighbor island healthcare provider, two healthcare consumers, three health insurers, a federally qualified healthcare provider, and representatives from labor management, a health information exchange, a Native Hawaiian organization, and the directors (or their designees) of the four state departments.

Board members serve staggered terms, with the exception of ex officio members, who serve during their entire term of office. The board elects from among its members a chair, vice chair, treasurer, and secretary. Board members serve without compensation but may be reimbursed for reasonable expenses to perform their duties. Federal regulations mandate that the Connector's governance policies include ethics, conflict of interest, accountability and transparency standards, and disclosure of financial interests. Based on its bylaws, the board is organized into five standing committees: Executive, Community Outreach, Audit and

Finance, Governance, and Human Resources. Exhibit 1.1 describes the committees.

Exhibit 1.1
Board of Directors Standing Committees

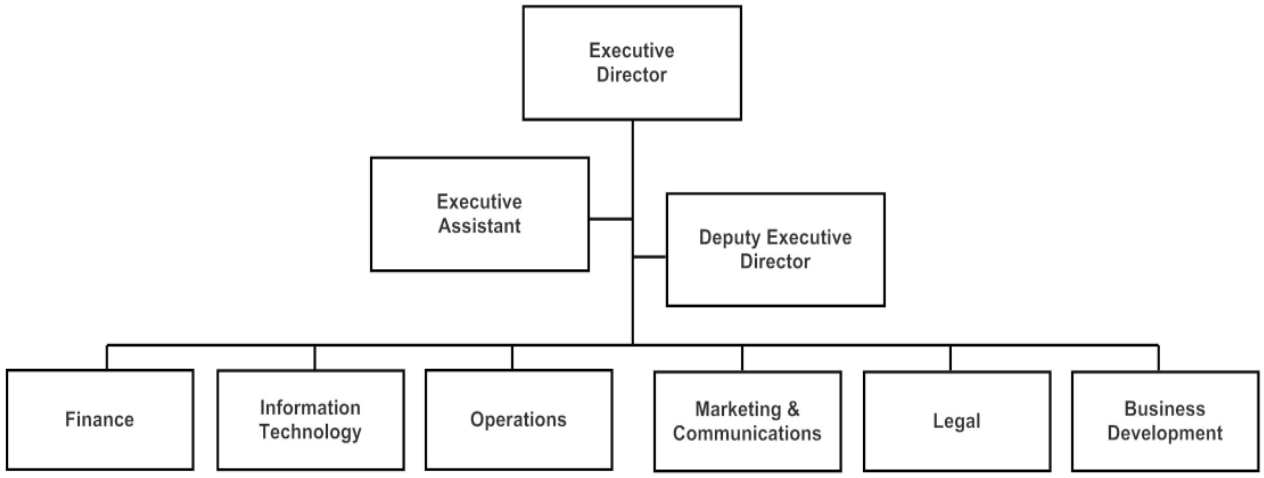
Committee	Responsibilities
Executive	Schedule board and committee meetings, evaluate performance of the executive director, and develop an annual strategic plan.
Community Outreach	Provide feedback on Connector's efforts and activities; bring forward discussion points from stakeholders; foster statewide inclusion, diversity and participation; and discuss methods for direct community and consumer feedback.
Audit and Finance	Select and evaluate external auditors; and review accounting practices, risk mitigation and potential fraud, financial statements, annual budget, related-party transactions, and internal controls.
Governance	Develop and review board skills matrix; establish process for selection of board officers; recommend committee membership, chairs, and charters; adjudicate conflicts of interest; and coordinate orientation and training of new directors, and continuing education of directors.
Human Resources	Develop and review personnel policies and procedures, compensation rate schedules, and employee benefits.

Source: Hawai'i Health Connector

Organization

The Connector is headed by an executive director appointed by the board and has 46 employees organized into six major functional areas: finance, information technology, operations, marketing and communications, legal, and business development. Exhibit 1.2 shows the Connector's organizational chart as of September 17, 2013.

Exhibit 1.2
Hawai‘i Health Connector Organizational Chart



Source: Hawai‘i Health Connector

Funding and expenses

Since its inception, the Hawai‘i insurance exchange effort has been funded by federal ACA grants to support the planning and establishment of exchanges and has been awarded a total of $205.3 million.[1] However, both federal and Hawai‘i laws require Hawai‘i’s health insurance exchange to be self-sustaining by 2015.

Two types of exchange grants were awarded to states—planning grants and exchange establishment grants. Planning grants to help states research and plan for exchanges were awarded to 49 states, the District of Columbia, and four territories. Hawai‘i received its $1 million planning grant on September 30, 2010. Exchange establishment grants are awarded in two levels: Level One grants are given to states that have made some progress using their planning funds and Level Two grants are made to states that are farther along in establishing an exchange. Hawai‘i has been awarded a total of $205.3 million in three increments of exchange establishment grants, as shown in Exhibit 1.3.

[1] Total grants awarded includes $1 million to the Department of Commerce and Consumer Affairs (DCCA) for research and planning. The Connector received a total of $204.4 million, was either awarded directly or as a subrecipient of DCCA.

Exhibit 1.3
ACA Grants to Hawai‘i, 2010–2013

Date of Grant	Type of Grant	Amount	Purpose
September 30, 2010	Planning	$1,000,000	Research and plan for exchange.
November 29, 2011	Level One	$14,440,144	Establish Hawai‘i Health Connector and web portal.
August 23, 2012	Level One	$61,815,492	Hire staff for outreach and public education, begin solicitation process for design and development of IT for individual and SHOP exchanges, and engage a quality assurance organization to help with a project management plan.
April 8, 2013	Level Two	$128,086,634	Fund staff, contract development and execution, infrastructure development, outreach and stakeholder strategies, training, and call center.
Total		**$205,342,270**	

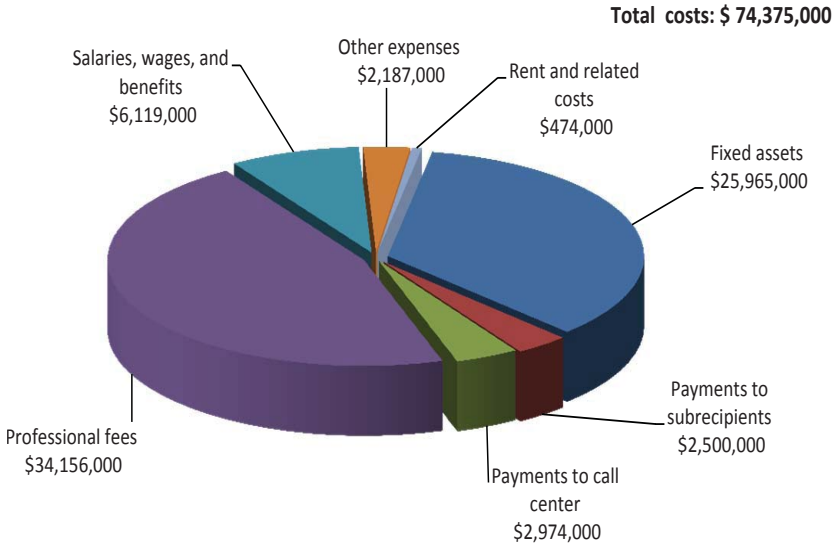
Source: Office of the Auditor

In accordance with its grant awards, the Connector was required to use the Level Two grant funds by April 7, 2014, and the second Level One grant funds before August 21, 2014. However, on April 16, 2014, CMS allowed the Connector to use its Level Two grant funds through April 7, 2015. On August 23, 2014, the Connector received another extension, allowing it to use its second Level One grant funds through August 21, 2015.

To generate revenues of its own, the Connector board approved an assessment of 2 percent against issuers on premiums sold via the individual portal beginning January 1, 2014, and on premiums sold via the SHOP portal beginning July 1, 2014.

As of March 31, 2014, the Connector had spent approximately $74.4 million. Exhibit 1.4 shows its major cost areas since inception in July 2011.

Exhibit 1.4
HHC Cumulative Costs from July 8, 2011 (Inception) to March 31, 2014



Source: Office of the Auditor

Chronology of the Connector's development

The Connector began assembling staff when the board hired an executive director in November 2011. In 2012, the Connector hired a consultant to help with planning its information technology system, submitted an Exchange Blueprint for approval by DHHS, and hired CGI Technologies and Solutions Inc. (CGI) to construct and maintain the online marketplace under a four-year, maximum amount $71.5 million contract.[2]

The Connector was structured to rely on contractors for services to help develop the HHIX. In addition to information technology services, the Connector also contracted with other vendors for human resources and payroll services, legal services, a call center, and marketing services. Additionally, the Connector provided grants to community organizations to participate in a program to reach and educate individuals about health insurance options.

The Connector was to debut its online marketplace on October 1, 2013, when the nationwide open enrollment period began. The Connector postponed the opening of its site because of concerns about poor performance and information security. When it did open on October 15, 2013, the exchange had only partial functionality. Instead of being able to apply for, select, and enroll in health insurance plans via

[2] The obligated contract amount was $53.5 million, which included $39.1 million for IT build deliverables and $14.4 million for three years of operations and maintenance.

the website in under an hour, applicants experienced numerous problems. During the first month of operation, only 257 individuals enrolled in health insurance policies via the Connector.

The Connector's original executive director resigned in December 2013 amid criticism of her management and was replaced on an interim basis by the governor's Affordable Care Act Implementation manager. In June 2014, a search began for a new executive director. During that time, three board members representing healthcare insurers also left the board due to expiration of terms and statutory changes to the composition of the board. In August 2014, the state's largest health insurer announced it would pull out of SHOP because it was spending too much time dealing with the Connector's technical problems. Beginning in January 2015, only one insurer will be left offering plans through SHOP.

State-Based Health Insurance Exchanges in Other States

Hawai'i is among 14 states and the District of Columbia that operate their own health insurance exchange. Thirty-six other states used a federally facilitated marketplace for the first open enrollment period, October 1, 2013, through March 31, 2014.

The federal government provided grant money to states and the District of Columbia to build their exchanges. Based on 58,000 potential enrollees, Hawai'i's total grants amounted to $3,540 per enrollee, as shown in Exhibit 1.5. This is the third highest per-enrollee amount given to a state-based exchanges.

Exhibit 1.5
Per-Enrollee Grant Funding for State-Based Exchanges

State	Total Grant Amount	Anticipated Number of Enrollees	Grant Dollars per Enrollee
1. Vermont	$168,124,081	45,000	$3,736
2. District of Columbia	$133,573,927	36,000	$3,710
3. Hawai‘i	$205,342,270	**58,000**	$3,540
4. Rhode Island	$105,305,029	70,000	$1,504
5. Oregon	$303,011,587	337,000	$899
6. Kentucky	$253,167,439	302,000	$838
7. Connecticut	$164,466,460	216,000	$761
8. Massachusetts	$180,067,775	259,000	$695
9. Washington	$266,026,060	507,000	$525
10. Minnesota	$155,020,465	298,000	$520
11. Maryland	$171,063,110	419,000	$408
12. Nevada	$90,773,768	249,000	$365
13. Colorado	$178,931,023	501,000	$357
14. New York	$429,065,407	1,264,000	$339
15. California	$1,065,212,950	3,291,000	$324

Source: Office of the Auditor based on Kaiser Family Foundation data

A Kaiser Family Foundation list of enrollments as a percentage of potential marketplace population shows Hawai‘i enrolled only 14.8 percent of its expected 58,000 individuals between October 1, 2013, and April 19, 2014, ranking it 46th in the nation. This was well below the national average of 28 percent enrollment. With 8,592 individuals enrolled, Hawai‘i ranks 14th out of 15 state-based exchanges for market penetration, as shown in Exhibit 1.6.

Exhibit 1.6
State-Based Exchanges' Market Penetration as of April 19, 2014

Rank	State	No. Individuals Who Selected a Marketplace Plan	Estimated Potential Enrollees (Market Penetration) Number	Percent
1	Vermont	38,048	45,000	84.6%
2	California	1,405,102	3,291,000	42.7%
3	Rhode Island	28,485	70,000	40.7%
4	Connecticut	79,192	216,000	36.7%
5	Washington	163,207	507,000	32.2%
6	District of Columbia *	10,714	36,000	29.8%
7	New York	370,451	1,264,000	29.3%
8	Kentucky	82,747	302,000	27.4%
9	Colorado	125,402	501,000	25.0%
10	Oregon	68,308	337,000	20.3%
11	Nevada	45,390	249,000	18.2%
12	Minnesota	48,495	298,000	16.3%
13	Maryland	67,757	419,000	16.2%
14	Hawai'i	8,592	58,000	14.8%
15	Massachusetts	31,695	259,000	12.2%
National average		**8,019,763**	**28,605,000**	**28.0%**

* Although the District of Columbia is not a state, it operates a "state-based" exchange.

Source: Office of the Auditor based on Kaiser Family Foundation data

An assessment that compared federal grant totals against number of enrollees on March 31 found Hawai'i's cost-per-enrollee of $23,899 was the highest in the country among 15 states operating their own exchanges. The analysis, performed by a former director of the Department of Health and Human Services' Office of Consumer Information and Insurance Oversight, found the national average for states running their own exchanges was $1,503.

Prior Audits

We have not conducted any prior audits of the Connector, but the Connector has undergone two financial audits to comply with federal Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, for the fiscal

years ended June 30, 2012 and 2013. These audits were conducted by independent certified public accounting firms.

The audit for the fiscal year ended June 30, 2012 reported the Connector had not accrued certain costs for legal and other professional services that totaled approximately $479,000 as of June 30, 2012; did not have formal policies and procedures governing the procurement process until May 2012; and did not have formal policies and procedures in place to ensure compliance with OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, or govern its cash management process.

There were no findings to report in the audit for the fiscal year ended June 30, 2013.

Objectives of the Audit

1. Assess the effectiveness of the Hawai‘i Health Connector Board of Directors’ governance and oversight over the Hawai‘i Health Connector and its information technology projects.

2. Assess whether the Connector is properly procuring its contractors, managing its contracts and grants, and monitoring costs for fraud and waste.

3. Make recommendations, as appropriate.

Scope and Methodology

Our audit focused on the Hawai‘i Health Connector’s efforts to develop and operate the State’s health insurance exchange as mandated by the federal *Affordable Care Act* and state law. We reviewed the Connector’s use of grant funds from its inception in July 2011 to the end of the first open enrollment period on March 31, 2014.

We conducted interviews with board members, office personnel, and other stakeholders. We reviewed sustainability and operating plans, budgets, organizational bylaws, meeting minutes, policies and procedures, operating reports, contracts, grant awards, and other relevant documents and records in order to assess the board and management’s oversight of the Connector and its business operations. We judgmentally selected items to review for compliance with applicable policies, procedures, agreements, and other relevant criteria.

Our work was performed from January 2014 to September 2014 and conducted pursuant to the Office of the Auditor’s *Manual of Guides* and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient,

appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Auditor's access to information

The Office of the Auditor has broad authority to access information. Section 23-5, HRS, gives the Auditor authority to examine and inspect all accounts, books, records, files, papers, documents and all financial affairs of every department, office, agency, and political subdivision of the State. Although the Connector was established by law as a Hawai'i nonprofit organization, Section 435H-2(d), HRS, requires the Connector to be audited annually by the Auditor who is specifically permitted to access, inspect, and make copies of any documents, papers, books, records, or other evidence pertinent to the Connector's budgets and operations. The Connector's bylaws also require an annual audit by the Auditor and specify the Connector shall permit the Auditor to have access to, inspect, and make copies of any relevant documents.

Our requests for information from the Connector followed our usual audit procedures. We routinely request preliminary information to plan and define our audit fieldwork. Such information may include organization charts, board minutes, operating plans, budget documents, and policies and procedures manuals. We interview staff, collect and analyze data, and review detailed documents including contracts, invoices, and other documents necessary to support our audit findings.

At the start of our audit, we encountered resistance from the former executive director, who was reluctant to share any information, claiming the Connector was a separate nonprofit organization and not an entity of the State. The Connector delayed producing requested data and documents and denied us direct and open access to Connector records and files. We were instructed to submit a request for specific files and told to wait for Connector staff to pull and review those files before allowing us access. Records requested were screened and released to us piecemeal. As a result, we had no assurance that documents were complete or in existence prior to our review. Obtaining items required numerous follow-up emails and telephone calls regarding undelivered, incomplete, and missing documents. We received documents up to two months after our initial requests, which significantly delayed our work. In some cases, requested files, reports, data, or invoices were not provided and we were unable to complete our audit procedures. The Connector's withholding of records from the Auditor contravenes the law and prevents the Auditor from carrying out her constitutional and statutory audit authority.

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Chapter 2
Inadequate Planning and Improper Procurement Led to an Unsustainable Health Connector

In 2011, the Legislature noted that Hawai‘i enjoys an overall healthier population, lower uninsured rates, and lower health insurance premium rates than the rest of the nation. This was primarily attributed to the *Hawai‘i Prepaid Health Care Act*, which since 1974 has mandated employer-provided health insurance for employees who work at least 20 hours per week. After the federal *Patient Protection and Affordable Care Act* (ACA) became law, Act 205, Session Laws of Hawai‘i (SLH) 2011, established the Hawai‘i Health Connector as the state's health insurance exchange. The ACA directed states to establish a health insurance exchange to allow consumers to compare health insurance options and enroll in coverage. States had the option of establishing a state-based exchange, having the federal government establish a federally facilitated exchange, or participating in a state-federal partnership. According to the Legislature and the Connector's interim executive director, the Legislature chose to establish a state-based exchange to avoid federal involvement and preserve the State's regulatory control of health care insurance policies.

The Connector could not enroll people by the federal government's deadline, and continues to struggle with full implementation. However, while full functionality is important, there are other concerns. The interim executive director estimated that the Connector's "high-expense system" costs $15 million a year to operate, yet the Connector expected to earn only $1 million in 2014. Federal grants for planning and establishment of exchanges ended on December 31, 2014, after which exchanges must be self-sustainable. According to the interim executive director, the Connector is nowhere near self-sustainability. If the Connector fails to become self-sufficient and a federal exchange is adopted, the State could lose important regulatory control of its health care insurance policies.

We also found the Connector did not properly procure and administer its contracts, and circumvented its procurement policies and procedures designed to ensure competitive pricing and monitor costs, which puts its federal grants at risk.

Summary of Findings

1. The Hawaii Health Connector Board of Directors' inadequate planning led to an unsustainable health exchange.

2. The Connector did not properly procure and administer its contracts and monitor costs, putting federal grants at risk.

Board's Inadequate Planning Led to an Unsustainable Connector

> We wanted to build a Ford Focus—something that will get you to the grocery store and back, and not much more. We figured that later we could add the power windows and automatic locks. This is not a Cadillac.
>
> — *CEO of Access Health CT, Connecticut's health insurance exchange, which has one of the highest enrollment rates in the country*

All nonprofit organizations must have a mission statement defining their reasons for existing; management and staff need to know what they do and why they are doing it. Without this knowledge, goals and objectives cannot be set and performance measurements cannot be put in place to gauge whether the organization is going where it needs to go. Work can begin, but without essential business-planning components to provide direction, in the end, the work may be useless.

The Connector's Board of Directors and management could not agree on what Hawai'i's health insurance exchange could or should be. Should the Connector be an affordable website that simply meets the core requirements of the ACA? Or was this an opportunity to leverage federal moneys to address multiple health care needs? The Connector board never made that fundamental decision but continued its work anyway.

Connecticut, which had a realistic plan for what could be implemented on such a tight deadline, built one of the most successful health insurance exchanges in the country—an exchange likened to a Ford Focus—that balanced functionality with feasibility and purpose. The Connector lacks such clarity, and now the State must support a health insurance exchange that does not work very well.

Board failed to develop strategic and sustainability plans to guide the organization's operations

Best practices indicate that strategic planning is paramount for any organization and is one of the key responsibilities of a nonprofit board. Board members must be involved extensively in the planning process, the creation of a written mission statement, and the creation and approval of the organization's strategic plan. This includes developing goals and objectives to achieve an organization's mission and vision and guide the organization's decisions and actions concerning the allocation of human and financial resources over the next three to five years. Financial sustainability needs to be at the core of planning and of establishing goals. Boards must also measure and evaluate an organization's progress in meeting its annual and long-term goals.

Many of the board members we interviewed acknowledged that the board failed to perform effective planning during the development of the Connector's strategic and sustainability plan. Although there were ongoing meetings and discussions regarding planning, these plans were never finalized. As a result, the board was unable to provide a sustainability plan when requested by the Legislature during hearings. The board was also unable to agree on what the Connector should be; or ensure it was managing for results and fulfilling its mission, as required by strategic planning; or ensure it was achieving self-sufficiency, as required by the ACA and Hawai‘i law.

Lack of strategic clarity and priorities contributed to organizational dysfunction

According to The Bridgespan Group, a nonprofit's "heart and soul" is its mission statement, which defines the organization's reason for being. While mission statements concentrate on the present and are designed in part to define an organization's purpose and primary objectives, a well-crafted one can also clarify an organization's markets and how it will serve them. More importantly, it can communicate a sense of direction to the entire organization. A vision statement defines an organization's purpose, it focuses on future goals and aspirations, and serves as a source of inspiration and motivation.

Board members reported that the lack of clarity on what the Connector could and should be led to disagreement on the board and suspicion between board members and staff. Besides organizational dysfunction, persistent disagreements contributed to the board's and staff's inability to agree on the Connector's future and resulted in some issues being "pushed down the road" instead of being resolved. Differences of opinion ranged from a board member believing the Connector was building a simple website to the executive director's vision of leveraging federal dollars to address Hawai‘i's various health needs.

Strategic plan was developed but never finalized

A strategic plan is used to define an organization's strategy, or direction, and make decisions on allocating limited resources to pursue the strategy. A strategic plan determines why a nonprofit exists (purpose, mission statement); where it wants to be (vision, values, and goals); how it is going to get there (strategies and action plans); what is needed (money, people, building, equipment, knowledge, etc.); and how to be sure it stays on track (evaluation).

Under its charter, the board's Executive Committee was to develop an annual strategic plan with other board members and the executive director. Board members noted there were efforts to develop a strategic plan, but regulations and events kept evolving, requiring revisions and retooling of the plan. The board devoted significant time to developing a strategic plan, but the plan was never finalized.

We asked the Connector for a copy of its strategic plan and sustainability plan. The Connector told us that each of the federally required sections for these plans was outlined in the exchange blueprint that was approved by CMS. In addition, some board members reported that the Connector's exchange blueprint served as a business plan in the absence of a strategic plan.

An exchange blueprint is different from a strategic plan and sustainability plan and has a different purpose. To receive the U.S. Department of Health and Human Services (DHHS) approval or conditional approval for a state-based exchange or a state partnership exchange and federal funding, states had to complete and submit an exchange blueprint that documents how their exchange met, or would meet, all legal and operational requirements associated with the model it chose to pursue. An exchange blueprint is structured around the activities a state must be able to perform in order to be approved as a state-based exchange or a state partnership within a federally facilitated exchange, consistent with the ACA and associated regulations. It lays out exchange activities, deadlines, strategies and processes, to guide the exchange's development.

As part of an exchange blueprint, a state must also demonstrate operational readiness to execute exchange activities. The DHHS uses the content of exchange blueprints to monitor states' performance in accomplishing the list of activities. States must attest to either completion or expected completion of exchange activities. DHHS may conduct on-site or virtual exchange assessments as part of its verification of an exchange's operational readiness.

For any organization, financial sustainability needs to be at the core of planning and establishing goals. An organization is only as effective as it

has resources to meet its purposes. Understanding resource implications involves aligning staff, infrastructure, and finances in a way that can support sustainable implementation. Providing adequate resources is, first and foremost, a board responsibility. If resources are not adequate, strategy or directions may have to be revised. This was especially the case for the Connector, since the ACA and Hawai‘i law require the exchange to be self-sustaining by January 1, 2015.

We found the Connector lacked formal plans for 2015, when it is supposed to attain self-sufficiency. The Connector's Exchange Blueprint did not include a realistic operating budget for 2015 needed to achieve sustainable operations. The Connector's revenue and expense models included in its Exchange Blueprint lacked specifics; instead, the models provided a range of estimates because a number of factors were still unclear, including eventual enrollment numbers. Where the Connector's estimated expense models were fairly accurate at $15.8 million, its estimated revenue range of between $15.9 million and $26.5 million per year was unrealistic, as the Connector expected to collect only $1 million in 2014 from fees. Although the board devoted time to developing strategic and sustainability plans, these issues were left unresolved.

Current model is unsustainable due to Connector's high operating costs and Hawai‘i's unique market

The Connector's interim executive director, who was in place from December 2013 to October 2014, acknowledged that Hawai‘i's state-based insurance exchange will not be sustainable beyond 2014. "We're not even close to breaking even," he told state lawmakers during a February 2014 hearing. According to him, the Connector needs $15 million a year to operate but expected to earn only $1 million in 2014 from a 2 percent fee on each insurance policy issued. During the first six months of enrollment, the Connector generated approximately $40,300 in fees—well below its targets. According to the interim executive director in testimony before the Legislature:

> We now have a very high-expense structure, we're looking at this integration [integrating technology functions with the state DHS Medicaid eligibility system] and whether it's feasible both technically and in terms of the business side of it.

The Connector's expensive structure is only one of its financial challenges. According to the State's insurance commissioner, Hawai‘i has a small pool of uninsured residents, the result of its *Prepaid Health Care Act*'s mandate for employer-provided health insurance. The commissioner and the interim executive director estimated that only 8 percent of Hawai‘i residents, about 100,000 people, are uninsured—a low number compared to other states. In addition, roughly half this group is expected to qualify for Medicaid, further shrinking the

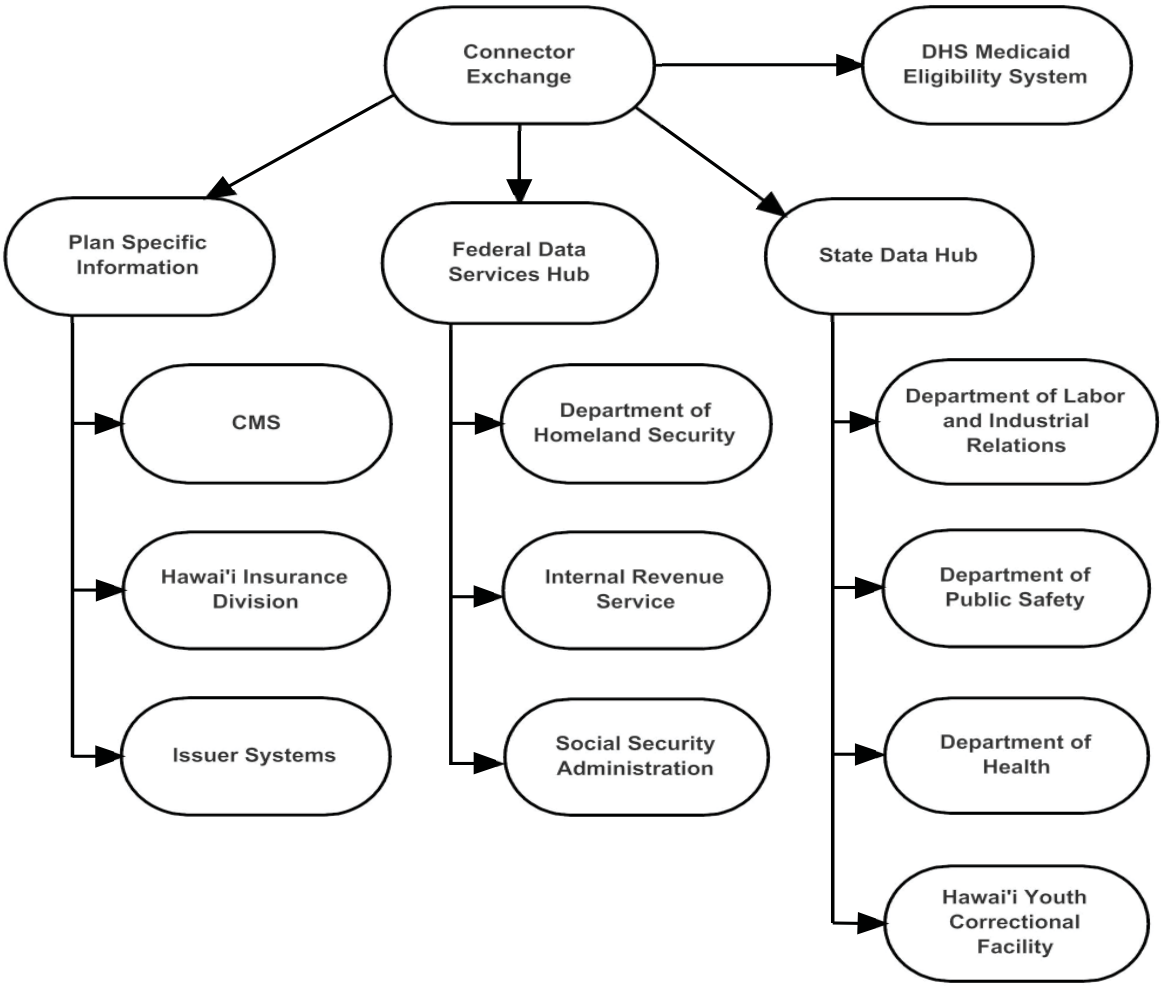
Connector's pool of potential customers. "There are not enough lives left to enroll at a volume that could sustain the Connector," said the interim executive director. "This is not an operational problem. It is a market problem." This important information about the size of its potential market should have been a foundation on which the Connector based its planning, development, and implementation efforts.

The interim executive director concluded that even with substantial reductions to its estimated $15 million annual operating budget, the Connector would not be sustainable. It would have to dramatically increase fees on participating exchange plans or the State would need to assess a fee across the market to preserve services.

Connector's complex exchange was designed without clear goals and objectives

Without clear goals, objectives, and a completed plan for financial sustainability, the interim board decided that the Connector's exchange would take a "no wrong door approach" featuring a web portal that could be accessed through multiple access points, or doors. The website would fulfill ACA requirements by enabling users to select and manage a private health insurance plan, but also offer real-time Medicaid eligibility verification as well as determine whether applicants qualified for advance premium tax credits and cost share reductions. The proposed system therefore needed to access and verify data from multiple computer systems, including the Department of Human Services' (DHS) Med-QUEST Division's eligibility system and the Federal Data Services Hub, the State Data Hub, and plan-specific information from various sources. Exhibit 2.1 illustrates the Connector's data sharing relationships.

Exhibit 2.1
Diagram of the Connector's Data Sharing Relationships



Source: Office of the Auditor

On November 1, 2012, the Connector signed a maximum $71.5 million four-year contract with CGI Technologies and Solutions Inc. (CGI) to design, develop, implement, host, operate, and maintain the Connector's proposed health insurance exchange. Enrollment in the exchange was to begin on October 1, 2013, and be fully operational by January 1, 2014, the ACA's deadlines.

The Connector blueprint's vague goals and objectives include building, designing, and implementing Hawai'i's exchange with input and support from key state agencies, small businesses, and individual consumers throughout the state; ensuring Hawai'i's exchange is attractive to and works for individual and small business consumers; and gathering feedback to be used in creating the exchange.

On March 22, 2013, the governor's ACA implementation coordinator, who later became the Connector's interim executive director, wrote a memo to the Connector board urging it to focus on launching a minimalist version of the exchange software that would satisfy core requirements of the ACA and Act 205, SLH 2011. He wrote:

> Because the October 1 deadline is fixed and the time to build a system is very short, any considerations about sustainability and future operations of the Connector that complicate or add risk to the timely launch should be set aside until after the launch.

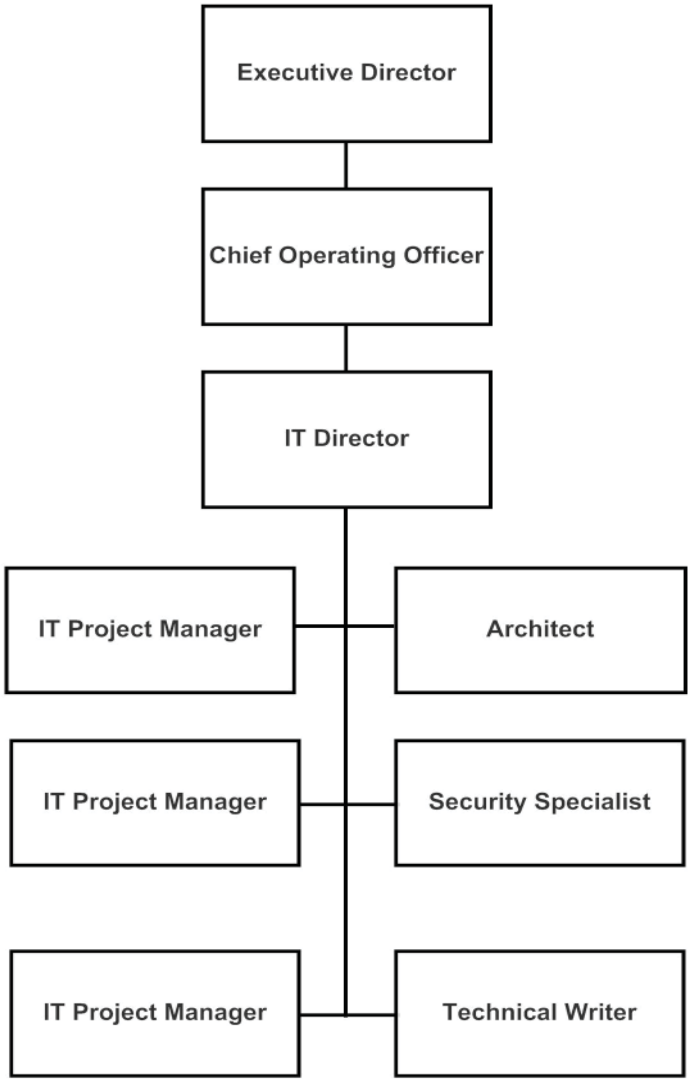
The implementation coordinator told us that the impetus for the memo was State ACA task force members' concern about whether the Connector was on schedule for an October 1, 2013, start. Although the task force had limited exposure to the Connector's operations, it observed that some basic organizational components were missing. The implementation coordinator told us that the Connector was trying to build something that was too complex.

Connector did not have staff to operate its health insurance exchange

CGI failed to deliver a functional exchange by the deadline of October 1, 2013. Following the delayed launch, the Connector's then-acting chief information officer (CIO) and senior advisor to the executive director conducted an analysis of the management of the IT development effort. Her January 2014 report noted a lack of clarity of roles and responsibilities and pointed out that the question of "Who is in charge?" was weighing heavily on the organization.

One of the report's conclusions was that the Connector needed to establish overall program management and project management functions to provide a single, unified point of contact and accountability. The Connector's IT organizational chart that was included in its November 2012 exchange blueprint listed only seven people: an IT director, three IT project managers, an architect, a security specialist, and a technical writer. The Connector did not have IT staff to manage the project's development or monitor contracts. According to the then-acting CIO and a board member, without management and monitoring functions, the Connector relied on vendors to self-report their progress. Exhibit 2.2 shows the Connector's IT organization as reflected in its November 2012 blueprint.

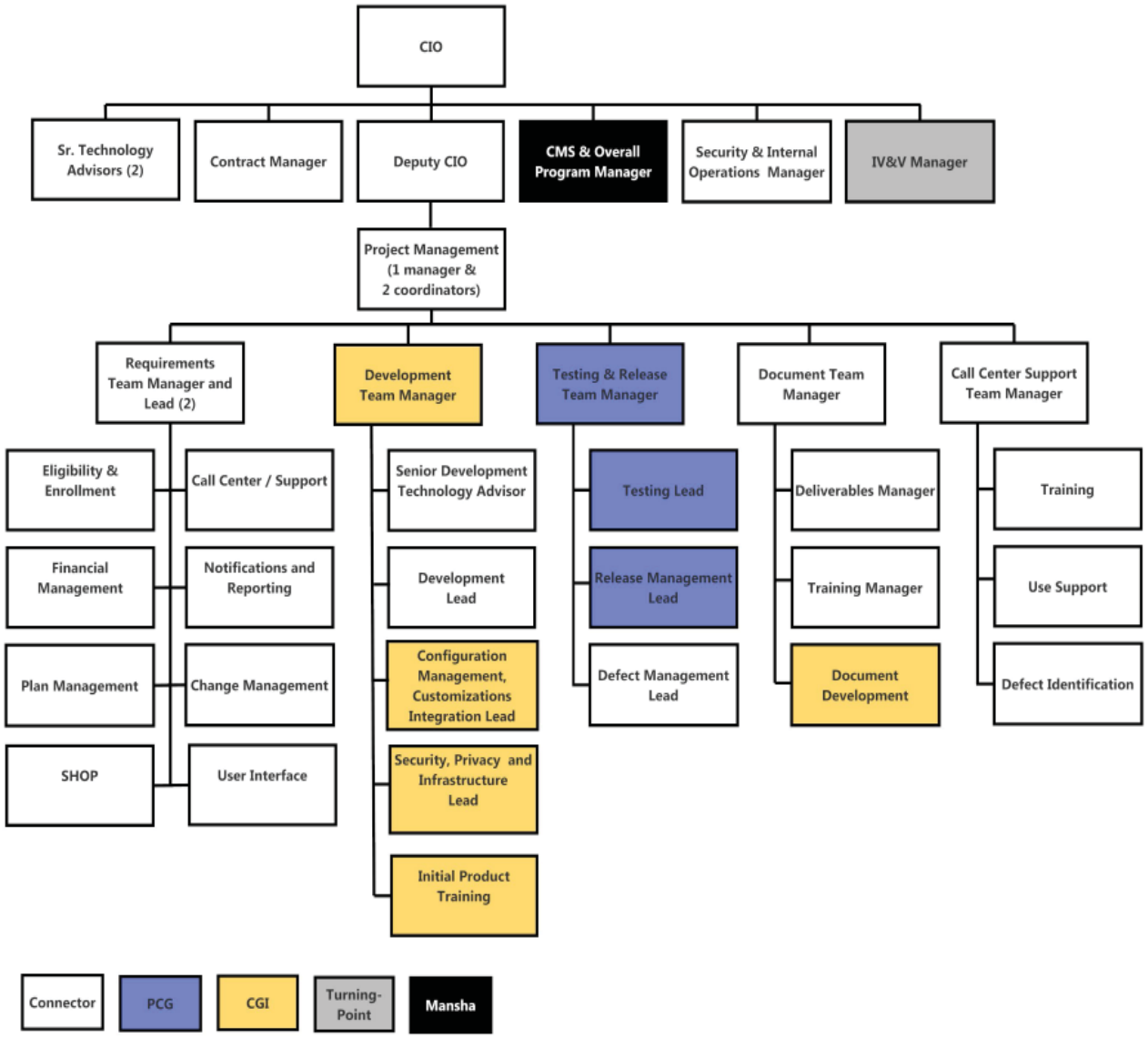
Exhibit 2.2
Hawai‘i Health Connector IT Organizational Chart Dated November 2012



Source: Hawai‘i Health Connector

In contrast, Exhibit 2.3 shows the IT organization that the then-acting CIO proposed in January 2014 to better manage the Connector's IT development effort. The then-acting CIO's report identified 14 key roles that "must be fulfilled at Connector." The new organizational chart also featured ten positions to be filled by consultants—a temporary solution.

Exhibit 2.3
Hawai‘i Health Connector IT Organizational Chart Proposed in January 2014



Source: Office of the Auditor and Hawai‘i Health Connector

Best practices call for a board, management, and others to identify risks and manage them through internal control systems (such as policies, procedures, control activities, and operational, financial, and compliance metrics), and for board members to be actively engaged and prepared to scrutinize management’s activities. We note that, based on job titles, neither the original nor the proposed IT organizational chart identified staff needed to operate the health insurance exchange system once implemented. According to the acting CIO and senior advisor to the executive director, the organization chart in the blueprint was not set up

to manage the custom build effort, it was intended for a commercial off-the-shelf (COTS) delivery and configuration management. Her proposed IT organizational chart was designed to manage the large IT development effort by including staff and consultants to manage the custom build effort. Without project and contract management infrastructure in place, the flow of information to the Connector's management was uneven at best, to non-existent at worst.

Denied information by executive director and staff, the board was unaware of the Connector's myriad problems

We found the board's ability to monitor its massive IT system's development progress was impaired by an uncooperative executive director who withheld information on the Connector's budget, certain PowerPoint presentations, and technology project progress reports.[11] Our review of board meeting minutes found the board made multiple requests to the former executive director for a copy of the Connector's budget over a four-month period before receiving it. The former chair of the board's Human Resources committee said she asked for staff compensation data but was denied. The board also requested copies of CMS' progress reviews and IT project progress reports, neither of which were provided until after the October 15th launch.

Some board members talked about problems receiving information from the Connector and the former executive director's distrust of insurers and State department directors. The Connector's chief operating officer said the former executive director was concerned that anything provided to the board would be leaked to the public and insurance companies. In addition, the former board chair said the former executive director did not know how to work with boards. Friction and distrust among board members and between the board and Connector staff grew so severe the Connector held a conflict resolution session to settle differences between the various factions.

The board did receive some information regarding IT progress, most notably a "dashboard" created in May 2013 by the Integrated Project Management Office (IPMO), which was formed to oversee integration of certain Connector and DHS systems. According to several board members, the IT progress reports the board received from the prior executive director, the prior State CIO, and the IPMO focused on reporting progress regarding interaction between the DHS system and the Connector system, not the overall IT project's progress. Reports either painted a rosy picture or failed to provide the level of detail the board desired.

[1] Known as independent verification and validation (IV&V) report.

The Connector received monthly independent verification and validation (IV&V) reports, compiled by a consultant hired to perform IV&V testing, that presented a review of issues facing the IT project. The reports identified high risks or risks indicative of conditions likely to have a severe negative effect on the project and which should be considered a top priority for remediation. The number of high risks documented in these reports ranged from 20 in May 2013 to 59 in December 2013.

Board members we spoke to did not recall receiving any IV&V reports or reports concerning IT problems. Several board members also questioned whether the project was on track. Concerns also came from outside the board: the state's largest health insurer sent a letter in early September 2013 questioning the adequacy of the IT system testing and whether enough time remained to correct problems before the scheduled October 1, 2013, launch date.

Management assured the board that the project was on track. Board members said they received assurances from the former executive director, prior State CIO, and the Connector's IPMO; and that they were given the impression the Connector would meet its target date and had workarounds and contingency measures in place.

On the morning of October 1, 2013, the then-board chair told us that he and several board members arrived at the Connector's office, ready to celebrate the launch of the online exchange. However, unable to find anyone at the office, they left. The next day, the then-board chair learned of the Connector's failure to launch the exchange via a radio news story. "We thought things were okay up until the morning of the launch," said the then-board chair. "We brought boxes of manapua for a celebration to an empty office. Then it hit—boom—that there were some real issues with IT. We all expected there would be some glitches, but not like what happened."

Connector Did Not Properly Procure and Administer Its Contracts and Monitor Costs, Putting Federal Grants at Risk

The Connector received $204.4 million in federal grants to support planning and establishing of Hawai'i's state-based health insurance exchange. It anticipated spending $177 million (approximately 86 percent), of its grant budget on consulting and contractual costs. We found the Connector did not properly procure or administer its contracts and circumvented its own procurement policies and procedures when hiring consultants. Contracts were awarded without following proper procedures to ensure competitive pricing, and procurement documentation was disorganized or missing from most contract files.

Connector circumvented its own procurement policies

The Connector's procurements were plagued by a lack of proper governance and internal controls over its procurement and contract management processes. Although the Connector was created as a nonprofit corporation—not subject to State procurement law and rules, to allow for greater flexibility—it did not adhere to its own procurement policy, which was designed to comply with federal procurement standards. The Connector's prior executive director misused her procurement authority and circumvented the Connector's procurement policies in hiring consultants, eliminating the open competition the policy was designed to ensure. Contract files were also missing required documentation. By not following its own procurement policy, the Connector cannot ensure it has received the best value for public funds spent. It also increases the risk of noncompliance with federal procurement requirements, exposing the Connector to a potential loss of federal funds.

Connector's procurement policy was designed to ensure compliance with federal standards

The Connector's procurement policy was developed to govern its purchases of equipment, goods, and services. The policy, effective January 1, 2012, was established to ensure that materials and services are obtained in an effective manner and in compliance with federal procurement standards. The policy requires all procurement transactions to be conducted in a manner that provides, to the maximum extent practical, open and free competition. It requires the Connector to prepare and file a cost or price analysis for every contract procurement. This means that, even if a bid appears to be a good value, the Connector should not make the purchase until a cost or price analysis has been performed, or other vendors also are given consideration. A cost analysis is the review and evaluation of each cost element to determine whether it is reasonable and allowable. A price analysis involves comparing market prices, including discounts listed in commercial catalogs, or recently submitted bids for similar services.

The Connector's policy includes five different methods of procurement: (1) procurements less than $1,000; (2) procurement by small purchase procedures ($1,000–$100,000); (3) procurement by competitive proposals (request for proposals); (4) procurement by noncompetitive proposals; and (5) procurement by sealed bids. Since the board only reviews and authorizes contracts over $100,000, the executive director decides the procurement method to be used.

A *small purchase* procedure is defined as a relatively simple and informal procurement method for securing services, supplies, or other property that do not cost more than $100,000. If the small purchase procedure is used, a price or rate quotation must be prepared for an adequate number

of qualified sources. *Competitive proposals* are where a request for proposals is advertised and more than one vendor submits a proposal, and either a fixed price contract or a cost reimbursement type contract is awarded. Generally, competitive proposals are used when conditions are not appropriate for sealed bids.

A n*oncompetitive proposal* is a procurement over $100,000 obtained through solicitation of a proposal from only one source (sole source), or after solicitation of a number of sources, competition is determined inadequate. If this procurement method is used, a cost analysis verifying the proposed cost data, projections of the data, and evaluation of the specific elements of costs and profits must be prepared. Procurement by noncompetitive proposal may be used only when awarding a contract that is infeasible under small purchase procedures, sealed bids, or competitive proposals, and one of the following applies: the item is available only from a single source; the public necessity or emergency for the requirement will not permit a delay resulting from competitive solicitation; the DHHS authorizes noncompetitive proposals; or, after solicitation of a number of sources, competition is determined inadequate. Procurement by *sealed bids* is defined as a process where bids are publicly advertised and a firm fixed contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming to the material terms and conditions of the invitation for bids, is the lowest price.

Although the Connector adopted a detailed procurement policy designed to conform to federal requirements, we found the Connector did not adhere to its own policy.

Prior executive director misused her authority by circumventing Connector's own procurement policies

Under the Connector's procurement policy, the executive director decides which procurement method to use. The violations we found reflect an attempt by the prior executive director to circumvent the Connector's policy in order to expedite hiring consultants. By not adhering to its own procurement policy, the Connector is unable to ensure it is receiving the best value for its use of public funds.

We reviewed the procurement of 15 professional services contracts, including three human resources contracts, ten IT contracts, one legal contract, and one marketing contract. Six contracts were procured via small purchase, four via competitive proposals, and five via noncompetitive proposals. Exhibit 2.4 shows the types of contracts we reviewed and how they were procured.

Exhibit 2.4
Procurement Method Used for 15 Professional Service Contracts

Type of Service	Procurement Method			Total
	Small Purchase	Competitive Proposals	Noncompetitive Proposal	
Human resources	1		2	3
Information technology	5	3	2	10
Legal		1		1
Marketing			1	1
Total	**6**	**4**	**5**	**15**

Source: Office of the Auditor

Of the 15 contracts we reviewed, only four were procured through competitive procurement. The remaining 11 were procured via noncompetitive methods, resulting in two having a set billing rate per period, two having an hourly billing rate with no ceiling, and seven having an hourly billing rate with a set ceiling. Ten contracts were procured as sole source procurements.

Most of the noncompetitive procurements violated the Connector's procurement policies and federal requirements for ensuring competitive pricing, which may have resulted in higher costs. For example, the Connector frequently hired consultants for less than $100,000 using small purchase procedures, which allowed it to quickly enter contracts without obtaining board approval, then later amended those contracts to request additional work and obtained token board approval. We found the six contracts procured using small purchase procedures (under $100,000) were amended 12 times and grew from a total value of $433,00 to $1,623,000—an increase of 275 percent.

The board is required by its procurement policy to review and authorize all contracts over $100,000, including amendments and multiple awards to the same vendor that exceed $100,000. We found that Connector staff did not obtain board approval for three of the six small purchase contracts reviewed that were amended to exceed $100,000 in aggregate.

Connector procurement policy also explicitly prohibits parceling, the practice of dividing the purchase of same, like, or related goods or services into several smaller purchases to evade procurement policy requirements. We found that two of the six small purchase contracts we reviewed appeared to be parceled. In those instances, within two months of being awarded, staff requested board approval to extend the contracts and increase fees for the same scope of work. Board members expressed frustration with this practice of contract extensions and fee increases,

indicating that the board had no recourse but to approve extension requests or risk delaying the projects.

The Connector's procurement policy also requires that when using the small purchase procedures method, a price quote must be prepared from an adequate number of qualified sources. We found only two of the six small purchases had evidence of price quotations from other sources in the contract files.

Similarly, we found problems with the procurement of the five noncompetitive proposals. The Connector procured these consultants from only one source, with the majority of the files citing public emergency as the reason for the noncompetitive solicitation. The Connector's procurement policy requires that in such instances a cost analysis be prepared, but we did not find evidence of such an analyses in any of the five noncompetitive proposals contracts we reviewed.

Connector did not properly monitor its procurement activities

We also found the board was not sufficiently involved in overseeing procurement activities to ensure compliance with the Connector's policy. According to best practices,[2] a board is ultimately responsible for setting the tone of an organization and ensuring an effective control framework is in place. Board minutes showed the Connector's board had not sufficiently implemented policies to monitor procurement, which would help ensure compliance with the Connector's policy and federal requirements.

Connector contract administrators are responsible for creating a written contract administration plan to monitor contractor conformance with terms, conditions, deliverables, budget, and specifications of a contract, which are filed in contract files with references. We found that nine of the 11 noncompetitively procured contracts we reviewed resulted in time and material (T&M) contracts. T&M contracts reimburse contractors for time spent and materials used; they are the least preferred type of contract for public procurements because they do not encourage efficiency and cause contracting agencies to bear more risk than in fixed price contracts. Fixed price contracts are more desirable because they reduce agencies' risk by shifting it to the contractor when there is adequate price competition. T&M contracts are thus generally used as a last resort when it is too difficult to accurately estimate the extent of work to be done. In such situations, agencies should determine that no other contract type is possible or suitable and establish a method to periodically oversee the work and ensure it is being conducted in the most cost-efficient way. However, we found no evidence in Connector

[2] The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Guidance on Monitoring Internal Control Systems.

contract files that contract oversight and administration were being done, since T&M contracts were not executed as a last resort and were not monitored methodically. By using T&M contracts that are not properly monitored, the Connector increased its risk of higher project costs and noncompliance with federal procurement requirements.

Procurement documentation was disorganized or missing from contract files

Connector procurement policy specifies the minimum documentation required for contract files and stipulates that all source documents (for example, receipts, purchase orders, invoices, bid materials, requests for proposals, etc.) be retained to ensure a clear and consistent audit trail is established. We found, however, that many of the required documents were missing or nonexistent. For instance, nine of 11 contract files were missing a cost or price analysis; three of four competitive contract files were missing evidence of the basis for the award cost or price; and five noncompetitive contract files were missing evidence of justification for lack of competition. In addition, we found no procedures or checklists to ensure that contract files include all required documentation or any evidence that contract files are independently reviewed for completeness.

The Connector also lacked documentation showing it complied with its procurement policy for evaluating vendor proposals. For procurements above $100,000, Connector policy requires that proposals be evaluated by independent committee members who objectively review each proposal. Bids or offers must be evaluated by a committee of at least three board members or appointees selected by the board. Evaluation results from each committee member (that is, a short list of vendors and final recommendation to award) must be documented and made part of the contract file. However, none of the four competitive procurement method contract files we reviewed contained evidence of the method for conducting technical evaluations of the proposals; three of the four did not identify the evaluation committee members or whether the committee was made up of at least three board members or board appointees; and none of the four contained signed declarations by evaluation committee members. In one instance, the board asked to participate in evaluating proposals for the exchange implementation project that resulted in the Connector's hiring CGI; however, Connector management denied this request. One of the contract files did not have vendor evaluation sheets from committee members.

Contracts were not monitored

Contract administrators are responsible for monitoring contracts to ensure contractors comply with contract terms, performance expectations are achieved, and any problems are identified and resolved. We found

that the Connector did not adequately monitor and evaluate its contracts, and identified numerous instances where the Connector did not follow its own contract administration procedures. By not adhering to these procedures, the Connector increases its risk of noncompliance with federal procurement requirements and exposes itself to potential loss of federal grant funds.

Of the 15 contract files we reviewed, many contract administration documents were missing or nonexistent. For example, none of the 15 files contained evidence of a contract administration plan; 12 did not show evidence of the approval and acceptance of deliverables; and none of the ten files for contracts that are no longer active contained contract closeout documents. A closeout checklist is required when closing out a contract; however, none of the contract files contained evidence of a checklist.

Control activities, one of the elements of internal controls, are the policies and procedures that help ensure management directives are carried out and necessary actions are taken to address risks to achieving of an entity's objectives. We found the Connector did not follow policies, processes, procedures, or forms for extending contracts that require evaluating a contractor's performance before a contract is extended. We also found no checklists in any of the 15 contract files that identify required contract administration documents nor evidence that the files were independently reviewed to ensure completeness.

Performance evaluation is another component of effective contract administration. National State Auditors Association best practices state that agencies should identify how contractor performance will be evaluated. Agencies should evaluate contractors' performance against a set of pre-established, standard criteria and retain this record of contract performance for future use. Monitoring should provide a basis for renewing contracts, imposing financial sanctions, or terminating contracts. However, we found no performance evaluations in any of the 15 contract files we reviewed. In fact, the six IT professional service contracts procured through small purchase procedures were amended and extended without evaluation of the contractor's past performance and four of the six lacked cost/price analysis for competitive evaluation. In addition, although contract administrators are responsible for monitoring contracts based on terms and deliverables, we found the Connector paid a contractor $16,300 in excess of its contractual total without any documentation or explanation in the files.

Managing project scope is another important part of contract administration. Controlling and managing the scope of work and any scope changes are critical to the success of a project. Scope changes can significantly impact cost, schedule, risks, and quality of an entire effort.

We found the Connector failed to document contract changes when the scope of work changed. The Connector's chief legal officer confirmed there were challenges in documenting all contract changes because of the continuous changes to the exchange and its shifting timelines. Although changes in scope of work resulted in different deliverables and revised roles and responsibilities, the legal officer acknowledged the contracts were not modified to reflect these changes. The Connector also failed to update contracts when product designs were revised.

Based on this extensive list of missing documents and contract administration functions that were not performed, we found that the Connector does not adequately monitor its contracts or evaluate its contractors. Without proper monitoring and oversight, public funds may be inefficiently expended, consultants may deliver unwanted services, and the Connector exposes itself to greater risks.

Connector's excessive contracting of core IT and legal services may have resulted in higher costs

Many of the Connector's IT consultant contracts were amended numerous times and ballooned in costs as the Connector continued to rely on their services. Legal services obtained from one Hawai'i firm were also used extensively, at a rate equivalent to five full-time employees, even though the Connector also maintained an in-house legal department. Given the magnitude of the Connector's mission and the $204.4 million in federal funding involved, the potential loss from fraud, waste, and abuse posed a significant risk. The Connector should have implemented enhanced oversight and monitoring of these contracts, especially since its grant applications reflected that it anticipated spending $177 million—approximately 87 percent of its $204.4 million grant budget—on consulting and contractual costs.

The federal Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Nonprofit Organizations*, specifies that costs must be reasonable for the performance of an award and allowable under these principles. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. Since the Connector did not properly procure and administer its contracts, some of its consultant contracts were not reasonable.

IT and related consultant contracts total exceeded $119 million

Many of the Connector's IT and related contracts were originally for smaller amounts and later expanded through multiple amendments, resulting in contracts significantly higher than originally contracted. Many were sole source contracts procured through noncompetitive methods. The Connector's IT and related contracts are listed in Exhibit 2.5.

Exhibit 2.5
Connector IT and Related Contracts

Vendor	Contract Amount
CGI Technologies and Solutions (CGI)	$74,230,091
Mansha	$22,032,987
Maximus	$12,015,050
Public Consulting Group (PCG)	$5,750,330
TurningPoint	$2,352,336
Department of Human Services	$1,166,690
Kataria	$680,000
Other (Enroll America, Freelantz, Mauldin)	$649,000
Brantigan	$375,000
Total	**$119,251,484**

Source: Office of the Auditor

Exhibit 2.6 lists nine contracts we reviewed that were amended, some numerous times, with significantly increased contract amounts.

Exhibit 2.6
IT and Related Consultant Contract Amendments

Vendor	Original Contract Amount	No. of Amendments	Final Contract Amount	Percentage Increase
PCG	$452,800	5	$5,100,330	1,026%
Brantigan	$50,000	5	$325,000	550%
Kataria	$90,000	3	$580,000	544%
Freelantz	$80,000	1	$300,000	275%
Mansha	$56,000	1	$168,000	200%
Mansha	$12,360,933	3	$21,864,987	77%
Kataria	$57,000	1	$100,000	75%
TurningPoint	$1,476,821	1	$2,352,336	59%
Mauldin	$100,000	1	$150,000	50%
Totals	**$14,723,554**	**21**	**$30,940,653**	**110%**

Source: Office of the Auditor

For example, Mansha, an IT consultant with a focus on healthcare industries, was originally awarded a sole-source contract of $56,000 to assist the Connector in preparing for a design review of its IT system. The Connector later increased the original contract to $168,000 and broadened Mansha's duties to include planning and laying the foundation for implementing an Integrated Program Management

Office (IPMO). Mansha provided the Connector two proposals for the IPMO work—a firm fixed price proposal for $12.4 million and a T&M proposal for $16.8 million, which appeared to be based on 17 people working 14 hours a day, six days a week, for one year. These proposals violated the Connector's procurement policy that precludes contractors who participate in creating solicitation documents from competing in those procurements. Mansha said its fixed price proposal of $12.4 million represented a "discount" from its T&M proposal. The Connector accepted Mansha's firm fixed price proposal after receiving board approval to proceed, even after the board expressed concerns about the cost of the $12.4 million contract, the number of consultants proposed, and the length of the contract. The Connector later amended Mansha's contract three more times to extend the time, change the scope of work, and add $9.5 million in fees—bringing the total contract to $21.9 million. The current State CIO acknowledged that Mansha's fees were not reasonable and that the electronic file system transfer between the State's Department of Human Services' (DHS) Medicaid eligibility system, called Kauhale On-line Eligibility Assistance (KOLEA), and the Connector's exchange software that Mansha was hired to implement does not work and would be difficult to fix.

In another example, in April 2012, PCG, a management consulting firm that primarily serves public-sector education, health, human services, and other clients, was awarded a $452,800, five-month IT contract for work on a proposal for IT design and specifications. Two months later, the PCG contract was increased by $54,400 to add work for policy advice and written analysis. Over a 21-month period, the contract was amended five times and increased to a total of approximately $5.1 million—more than a 1,000 percent increase. In January 2014, the Connector gave PCG another sole-source contract for $650,000 to provide pre-launch quality assurance testing.

In yet another example, Tom Brantigan, an independent consultant to the Connector, was originally awarded a sole source contract not to exceed $50,000 in August 2012 to participate as a member of the formal IT evaluation team in evaluating exchange proposals. A month later, Brantigan was awarded a second contract not to exceed $50,000 to assist in completing a blueprint with a specific focus on technology, privacy and security issues, policies and procedures, and safeguards. Over the next one and a half years, this second contract was amended five times and increased to a maximum fee of $325,000—an increase of 550 percent.

Hawai‘i law firm was paid $3.5 million for two and a half years of legal services

The Connector contracted with two law firms since 2011, costing approximately $4 million as of March 2014. One firm was paid the

majority of these fees, approximately $3.5 million over two and a half years from July 2011 through March 2014. Our review of invoices submitted to the Connector showed that services provided by the law firm ranged from general legal, regulatory, corporate matters, procurement, tax matters, among others, and totaled approximately 12,000 hours of billings. This equates to an average billing rate of roughly $292 per hour for 5.8 attorneys working full-time for a full year (assuming a 2,080 work hour per year or an 8-hour-work day for a full 260-work-day-year). The Connector paid for these legal services in spite of having its own in-house legal department consisting of four full-time personnel, including a chief legal officer and a staff attorney.

The overuse of legal counsel by the Connector did not go unnoticed by board members, who questioned the high cost of legal services. Board members noted that outside legal counsel should not sit in on every board meeting and requested that in-house counsel be used to reduce costs.

Questionable costs were paid using federal grant funds

With $204.4 million in federal ACA grant funding, the Connector must adhere to strict federal regulations related to costs and spending. Connector officials are responsible for ensuring that government-funded programs are achieving their objectives and desired outcomes, and that services are provided efficiently, effectively, and economically.

The Connector receives almost all its funds from grants awarded by the federal government. Strict federal regulations govern what these moneys can and cannot be used for. We reviewed a sample of selected disbursements and noted several questionable payments pursuant to OMB Circular A-122, *Cost Principles for Nonprofit Organizations*. These questionable costs may be disallowed by the funding agency, and noncompliance with federal regulations may result in repayment of amounts or suspension and termination of a federal grant. We found:

- One instance of severance pay of $46,250 paid to an employee not supported by an employment agreement or other documents to verify allowablility. Severance pay is allowable as required by an employer-employee agreement, an established policy, or by law. The Connector could not provide us with documentation to support the payment;

- Eleven instances totaling $12,771 where travel costs were not supported by documents showing the employee, purpose, and reason for the travel, and one other instance in the amount of $1,185 where the travel cost did not have supporting documentation showing an official business purpose. Travel costs are allowed for employees who are in travel status on official business of the nonprofit organization. Proper

documentation verifying official business is required for compliance with federal regulations;

- Fourteen instances totaling $2,615 paid for various questionable items, including meals and food costs paid other than during valid travel, promotional items purchased as giveaways at a fair, and party supplies. Meal costs not a part of valid travel are considered to be entertainment costs and are questionable. Costs of promotional items, gifts, and souvenirs are public relations costs that are not allowed and are considered questionable; and

- Two instances totaling $410 where invoices were not properly maintained to support purchases made. Federal regulations require maintenance of proper supporting documents for all costs charged to federal grants.

Conclusion

We found the Connector's Board of Directors should have noted numerous warning signs and exerted more vigorous effort in planning, oversight, and leadership of the Connector. The Connector had problems with its procurement and administration of contracts, and noncompliance with federal regulations may put grant funds at risk. The Connector missed the federal government's October 1, 2013, deadline for beginning enrollment, and continues to struggle with implementing its website's many features.

The Connector is not self-sustaining and Connector officials estimate operating expenses of approximately $15 million a year but expect to earn revenues of only $1 million in 2014. Under the *Patient Protection and Affordable Care Act*, all states are required to have a health insurance exchange that is either state-based, federally facilitated, or a state-federal partnership. If the Connector fails and a federal system is adopted, the State could lose important regulatory control of its health care insurance policies. The Connector needs to envision a health insurance exchange model that addresses Hawai'i's unique market place. Given the Connector's lack of self-sustainability, the Legislature needs to decide how best to support the health insurance exchange.

Recommendations

1. To ensure that Hawai'i's health insurance exchange works in tandem with the *Hawai'i Prepaid Health Care Act*, the Hawai'i Health Connector Board of Directors should:

    a. Develop a self-sustaining, state-based health insurance exchange as required by both federal and state law; and

b. Prepare an updated business plan, which includes business and financial models of a scaled-down Connector that includes:

i. Clear statements of the Connector's business mission, vision, goals, and objectives;

ii. Benchmarks and performance measures that can be used to track performance and make midcourse corrections;

iii. Plans for a downsized Connector that meets the core requirements of the *Affordable Care Act*;

iv. Updated enrollment numbers that reflect Hawai'i's true uninsured market;

v. Plans for IT functions that have been integrated with selected state agencies, resulting in reduced operating expenses;

vi. An analysis of Connector revenues based on updated enrollment numbers; and

vii. Estimates of increased fees and additional state funding necessary to support operations.

2. To ensure the health insurance exchange operates efficiently and effectively, Connector management should:

a. Address the circumvention of its procurement policies by:

i. Providing adequate time to properly plan its procurement of contracts under the competitive proposal (RFP) method to assure it receives the best value for the use of public funds;

ii. Training relevant personnel on its procurement policies and procedures and federal grant requirements;

iii. Ensuring all contracts adhere to requirements for board approval before proceeding with execution of contracts; and

iv. Establishing formal procedures to ensure the proper maintenance and completeness of contract files.

b. Address noncompliance with its contract administration policies by:

i. Appointing an authorized contract administrator at the time each contract is executed;

ii Implementing meaningful and measurable metrics to assess compliance with contract administration procedures;

iii. Revising contract administration policies and procedures to include contractor performance evaluation;

iv. Requiring contractor performance evaluation of all contracts and before any contract amendments are executed;

v. Training relevant personnel on contract administration procedures and federal grant requirements; and

vi. Monitoring payments to contractors to ensure payments are for valid work performed and do not exceed contract amounts.

Issue for Further Study

We encountered an area of concern that we were unable to follow up on and which we believe warrants further study. Specifically, we were unable to determine if fees paid to Mansha Consulting LLC (Mansha) were reasonable because the Connector did not provide us with all information requested.

We are concerned about the Mansha contract because the Connector entered into a sole source $12.4 million contract with Mansha to serve as systems integrator for the Connector system and the DHS system in the role of Integrated Project Management Office (IPMO) despite serious concerns raised by the board. Mansha provided the Connector with a time and material proposal for $16.8 million based on 17 people working 14 hours per day, six days per week, for one year. Mansha offered the Connector a 26 percent discount off its time and material proposal to $12.4 million if the Connector awarded the contract at the fixed fee price.

According to the proposal, Mansha would have a team of 17 people, to be composed of 11 Mansha employees and six subcontractor employees. Supporting documents indicate that Mansha did not provide anywhere

near the number of personnel it committed to, and the subcontractor was retained for only 3.5 months of the 12-month period.

Mansha's role changed after the Connector's system was launched on October 15, 2013. Mansha was hired to perform the role of IPMO when the State and the Connector entered into an Integrated Governance Agreement that created the IPMO function. In December 2013, the agreement was terminated, which should have terminated the IPMO agreement with Mansha. However, the Connector opted to retain Mansha and changed its role from IPMO to a new Project Management Office (PMO) and systems integrator for the Connector. This occurred despite Mansha's failure to successfully complete the electronic file system transfer work through the integration of the Connector system and the DHS system it was initially retained to perform. According to the current State CIO, the electronic file system transfer does not work and would be difficult to correct.

The Connector's acting CIO reported that Mansha's contract was renegotiated to reflect this new role. The acting CIO said Mansha's original rates were high because Mansha's chief executive officer factored in the risk of the unknown. The federal government also directed the Connector to reduce the monthly fees paid to Mansha following the second and third federal reviews. However, we were unable to verify whether the Connector complied with this directive or continued to pay Mansha a fixed monthly fee of $863,732 for the 11 months we reviewed, despite the change in scope of work, federal government directive to reduce Mansha's monthly fees, and renegotiation of fees by the Connector.

We requested information from the Connector to support the number of Mansha personnel and subcontractor personnel that actually worked on the IPMO by month for the period from April 2013 through April 2014. The Connector did not provide us with this information.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Hawai‘i Health Connector on January 16, 2015. A copy of the transmittal letter is included as Attachment 1. The Connector’s response, dated January 23, 2015, is included as Attachment 2.

The Connector expressed its appreciation for our thorough review of the Connector’s operations. The Connector generally agreed with our findings, con clusions, and recommendations and reported that it has already undertaken actions to address several of our recommendations, including implementing training, segregating duties, and providing better internal and external oversight and reporting of contracting activity.

The Connector suggested minor technical changes to our report for clarity, some of which we made.

ATTACHMENT 1

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

JAN K. YAMANE
Acting State Auditor

(808) 587-0800
FAX: (808) 587-0830

January 16, 2015

COPY

Mr. Jeffrey M. Kissel
Executive Director
Hawai'i Health Connector
201 Merchant Street, Suite 1810
Honolulu, Hawai'i 96813

Dear Mr. Kissel:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Audit of the Hawai'i Health Connector*. We ask that you telephone us by Tuesday, January 20, 2015, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit your original hard copy response to our office no later than 12 noon, Friday, January 23, 2015.

The Board members of the Hawai'i Health Connector, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Jan K. Yamane
Acting State Auditor

Enclosures

HAWAI'I HEALTH CONNECTOR

January 23, 2015

Ms. Jan Yamane
Acting State Auditor
State of Hawaii
Office of the Auditor
465 King Street, Room 500
Honolulu, HI 96813-2917

Dear Ms. Yamane,

The Board of Directors and Management of the Hawaii Health Connector "Connector" thanks the Auditor for its efforts on behalf of the Governor, Legislature and the people of the State of Hawaii for a thorough review of the Connector as set forth in the Draft Report to the Governor and Legislature of the State of Hawaii on the Audit of the Hawai'i Health Connector "Draft" as of September 2014 and submitted for review by the Connector on January 16, 2015.

As the Audit correctly observed, 2014 was the first full year of operations. The Connector opened to the public in late 2013. The Connector was challenged by a number of issues as the business; together with its complex Information Technology "IT" as was planned, developed and implemented. We acknowledge that the Connector operated in an environment where federal regulations changed at times daily or regulations\guidance was either not available, or properly communicated to the Board from our oversight agencies in Washington or by Connector Management.

This played a part in the significant errors in judgment, business practices, and procedures that were made. Planning and governance were not adequately emphasized as the Connector commenced activities. Instead there was a rush to implement the IT as a universal process solution for all of the functionality required under the ACA. The impact on the Connector was to delay implementation and cause an overall sense of frustration for prospective customers, the insurance community, and even its supporters in government and business.

That said, we also agree with the Auditor's conclusion that reads, in part, "If the Connector fails and a federal system is adopted the State could lose important regulatory control of its heath care policies."

We have reviewed the Draft document and are in general agreement with the factual content and conclusions as of September 30, 2014. Certain subsequent events have occurred and there are some technical issues that we wish to call to your attention as follows:

Connector Comments and Questions on Draft Report Content

The Connector has the following comments and/or questions regarding the following:

1. Chapter 1, page 6, Funding and Expenses

   In paragraph 1 of the "Funding and Expense" section of the Draft, the verbiage states that the Connector was awarded $205.3 million in grant funding. For the sake of good order we have reconciled the actual award from its components that total $204.4 million either directly or as a subrecipient of federal grants from the U.S. Department of Health and Human Services (DHHS). The following is a summary of the grant awards received by the Connector:

Grant Description	Award Amount	
Planning Grant (1)	$	54,321
1st Level One (2)		14,440,144
2nd Level One		61.815,492
Level Two		128,086,634
Total	$	204,396,591

   (1) Amount received as a subrecipient from the State of Hawaii DCCA.

   (2) Amount includes $10,197,249 directly awarded to Connector and $4,242,895 awarded to State of Hawaii DCCA and passed through to the Connector.

   The difference of $945,679 is related to the $1.0 million Planning Grant, which was not awarded to the Connector but instead by the State of Hawai'i. The Draft report refers to this $205.3 million award amount throughout the report sometimes referring to the funding being awarded to Hawai'i (which is technically accurate) and other times referring to the Connector as the recipient. The Connector staff requests that the references to the Connector awarded funding be modified to the correct amount.

2. Chapter 1, pages 7-8, Funding and Expenses

   Paragraph 3 includes total expenditures of $74.4 million from Inception through March 31, 2014. The Connector's internal records and Federal reporting through March 31, 2014 includes total expenditures of $75.2 million. The detail of these expenses are included in the below schedule and indicate the differences by the Draft expenditures categories included in Exhibit 1.4.

Expenditure Description	Per State Auditor Draft	Per Connector Planning*	1st Level 1 Grant**	2nd Level 1 Grant***	Level 2 Grant***	Total	Difference State Auditor Over(under) Connector
Salary, Wage, Benefits	6,119,000		1,549,931	4,154,267	382,766	6,086,964	32,036
Professional Expenses	34,156,000		3,752,574	15,128,542	15,355,059	34,236,175	(80,175)
Call Center	2,974,000		-	-	2,936,373	2,936,373	37,627
MAO	2,500,000		-	303,302	2,061,367	2,364,669	135,331
Fixed Assets	25,965,000		552,339	112,668	4,436	669,443	25,295,557
Intangible Assets	-		8,075,681	19,061,249	-	27,136,929	(27,136,929)
Rent and Related	474,000		93,801	141,771	200,152	435,723	38,277
Other Expenses	2,187,000	54,321	415,819	431,844	421,110	1,323,094	863,906
	74,375,000	54,321	14,440,144	39,333,642	21,361,263	75,189,370	(814,370)

* Per Connector general ledger detail
** Per CCIIO 1st Level 1 Grant Budget Report as of 3/31/14 plus grant funding received as subrecipient from State of Hawaii DCCA of $4,242,895
*** Per CCIIO 2nd Level 1 and Level 2 Grant Budget Reports as of 3/31/14.

3. Chapter 1, page 8, Chronology of Connector's Development

Paragraph 1 describes the contractual terms of the CGI contract as a four-year $71.5 million contract. The actual obligated contract value of the CGI contract on the execution date was $53.5 million, which includes the IT build deliverables ($39.1 million) and three years of maintenance and operations (M&O) ($14.4 million). The difference in the amounts are related to optional deliverables and M&O service periods that were not approved and are not considered obligated funding as presented in the Connector's federal, internal, or BOD financial reporting.

4. Chapter 1, page 10, State-Based Health Insurance Exchanges in Other States

Paragraph 2 includes the following language:

> *Overall, Hawai'i's cost-per-enrollee was the highest in the country, for the 15 jurisdictions operating their own exchanges at $23,899. The national average for jurisdictions running their own exchanges was $1,503.*

It appears that your computation of the $23,899 is based on the grant awards to Hawai'i of $205,340,208, not funding expended, and an enrollment total of 8,592 individual lives as of March 31, 2014. The early enrollment figures are not representative of the cost-per-enrollee as of that date. It appears that you are quoting information from a newspaper article, which is not necessarily based on facts. We request that this verbiage be removed from the report, as the information is incomplete, inaccurate, and misleading.

5. Chapter 2, page 13, Inadequate Planning and Improper Procurement Led to Unsustainable Health Connector

   Paragraph 2 includes the following language:

   > *... Federal grants for planning and establishment of exchanges ended on December 31, 2014, after which the exchanges must be self-sustainable.*

   The remaining balances of federal grant awards are available to the exchanges for reimbursement of DHHS CCIIO approved design, development, and implementation (DDI), establishment, and consumer assistance program expenses to be incurred after December 31, 2014. Federal grant funding is not available for direct M&O expenses after December 31, 2014. In fact, the Connector has received CCIIO approval to expend approximately $22.8 million of federal grant funding for certain non-IT related costs and approximately $2 million of DDI costs for the period January 1, 2015 through June 30, 2015. The Connector also expects to request approval for additional DDI costs of approximately $9.0 to $12.0 million for DDI expenditures to be incurred through fiscal year 2015.

6. Chapter 2, page 17, Inadequate Planning and Improper Procurement Led to Unsustainable Health Connector

   Paragraph 3 refers to the Connector generating approximately $40,300 in issuer fees for the first six months of the enrollment. Issuer fee revenue earned on individual insurance premiums for the first six months were $120,835 for the period January through June 2014. The Connector does not know where the Auditor's derived the reported amount.

7. Chapter 2, page 19, Inadequate Planning and Improper Procurement Led to Unsustainable Health Connector

   Paragraph 1 refers to the CGI contract as a four-year $71.5 million contract. Please see discussion in Item 3 above.

8. Chapter 2, page 24, Connector Did Not Properly Procure and Administer

   Paragraph refers to total Connector grant award as $205.3 million. The Connector's total federal grant awards total $204.4. Please see discussion in Item 1 above.

9. Chapter 2, page 31, Contracts Were Not Monitored.

   Paragraph refers to total Connector grant award as $205.3 million. The Connector's total federal grant awards total $204.4. Please see discussion in Item 1 above.

10. Chapter 2, page 32, Exhibit 2.5 Connector IT and Related Contracts

    The Contract amounts included in the Exhibit do not agree with the Connector's contract records as of March 31, 2014. Following is a list of the total contract amounts per vendor per the Connector's records as compared to the Draft report:

Vendor	Contract Amount: Auditor's Report	Contract Amount: Connector Records		Difference
CGI Technologies and Solutions	$74,230,091	$64,140,856		$10,089,235
Mansha Consulting	22,032,987	22,450,281	*	(417,294)
Maximus	12,015,050	11,379,370		635,680
Public Consulting Group	5,750,330	5,750,330		-
Turning Point	2,352,336	2,352,336		-
Hawaii DHS	1,166,690	1,166,690		-
Kataria Holdings LLC	680,000	680,000	*	-
Brantigan	375,000	325,000		50,000
				$10,357,621

*- Contract amounts do not include travel expenses.

11. Chapter 2, pages 32-33, Exhibit 2.6 IT and Related Contract Amendments

The PCG line item included in Exhibit 2.6 indicates that the original contract amount for PCG was $452,800, which is technically correct. Although the Connector believes it is important to note that the total RFP award to PCG was $1,393,025, which was the budget amount, approved by the Connector BOD before the RFP was awarded. Therefore, the fact that the Company chose to prepare contracts initially for smaller amounts until they reached the total RFP award was the administrative process followed by Connector legal support and not a procurement violation. In fact, a member of management of the Hawaii DCCA was the granting procurement officer for this RFP. The subsequent amended amounts added to the original RFP amounts were also properly documented and approved by the Connector BOD. Therefore, the Connector believes that Exhibit 2.6 should be modified to reflect these facts. The Connector can again make available the RFP documents and procurement documentation to support the above facts immediately upon request.

Paragraph 2 on page 33 refers to the PCG amendments and does not discuss the facts as provided in the paragraph above regarding the procurement and administration of the contract documents. The Connector believes that the lack of such clarification could be misleading to the readers of this report.

12. Chapter 2, page 34, Questionable Costs Were Paid Using Federal Grant Funds

Paragraph 3 on this page refers to total Connector grant award as $205.3 million. The Connector's total federal grant awards total $204.4. Please see discussion in Item 1 above.

13. Chapter 2, page 34, Questionable Costs Were Paid Using Federal Grant Funds, Severance Pay:

    Paragraph 5 on page 34 includes the following language:

    - *One instance of severance pay of $46,250 paid to an employee not supported by an employment agreement or other documents to verify allowability. Severance pay is allowable as required by employer-employee agreement, an established policy, or by law. The Connector could not provide us with documentation to support the payment;*

    The Connector believes the Auditors were provided the supporting documentation for this payment to include a copy of the employment agreement which covered the period which severance was paid after termination and the ability to review the confidential Separation and Release Agreement executed by the employee. The Connector can again make available these documents for the Auditor's review immediately upon request.

14. Chapter 2, pages 34-35, Questionable Costs Were Paid Using Federal Grant Funds

    Paragraph 6 on page 34 and paragraphs 1 and 2 on page 35 refer to certain travel, meal, promotional items, and other expenses that are questionable in the opinion of the Auditors. The Connector was not aware that the Auditors had questions on the allowability of or documentation associated with any invoices paid by the Connector and reviewed by the Auditors since neither the CFO nor the Finance staff were asked for further documentation or explanation on the hundreds of invoices provided to the Auditors. Therefore, the Connector requests the specific details associated with these alleged questionable costs in order to be able to properly respond to the Auditor's comments and to assess the cause of such findings, if found to be applicable.

    The Connector has established strictly enforced purchase and disbursement policies and procedures that were designed to specifically address the requirements mandated by OMB Circular A-122, *Cost Principles for Nonprofit Organizations* and the U.S. Department of Health and Human Services Grant Policy Statement. These policies and procedures were established and documented by the Finance leadership in late 2013 to ensure that all Connector expenditures are proper, allowable, are supported by complete documentation, and properly accounted for in the company's books and records. These policies and procedures include specific requirements for travel-related expenses.

    The Connector would also point out that it rejected application for reimbursement of travel and related expenses when the documentation or nature of the reimbursement request did not conform to the aforesaid policy. As discussed elsewhere herein, the Connector is conducting on-going investigations of unsubstantiated charges claimed by contractors.

Implemented Solutions

Much has changed at the Connector since the Auditor began working on this report in January 2014. An interim Executive Director addressed the crisis in the technology implementation by implementing appropriate procurement procedures to complete the build out of the IT systems. The Board, under the leadership of its current Chair, reorganized, implemented new procedures and controls and selected a new permanent Executive Director. The new Executive Director joined the organization on October 7, 2014 and immediately set to work with the full support of the Board to address a number of critical issues as follows:

- Developed a financial forecast to inform the Board, the Legislative Oversight Committee, and federal and state partners of the current needs of the Connector if present trends in costs and revenues continued.
- Changed the focus of the enrollment process from an IT web-based process to a customer assistance process, supported by an IT infrastructure, that continues to improve in functionality and performance as development work is completed.
- Immediately began working on a Strategic Plan and Sustainability Plan focused on a specific mission, vision, and value proposition of "harmonizing the Affordable Care Act with the provisions of Hawaii's Prepaid Healthcare Act of 1974."
    - That plan was completed, approved by the Board and submitted to the Legislature on time, as required by Act 233, on December 31, 2014.
    - The report itself also details the strategy for harmonizing the two regulatory and legislative protocols.
    - Owing to the sensitivities over prior spending practices, the report also provides a detailed set of financial statements identifying major areas of spending and revenue.
    - It goes on to list the aggregate amount paid to any contractor where total consideration was $500,000 or more.
- Stopped the unstructured IT functionality development and focused all IT efforts on making certain any further investment in IT systems and related interfaces remedied defects, improved reliably and the user facing points of contact. That process is continuing.
- Addressed areas of contention between the Connector and its state and federal partners by resolving open issues in contracts and operating agreements, reconciling amounts outstanding for payment of inter-agency sums, and continue to establish more transparent and open communication.
- Withheld payment, pending investigation, of sums claimed due and owing, but not properly supported by certain contractors.
- Engaged new IT resources supervised by Hawaii-based talent

- Greatly expanded oversight by both the Board and third party contractors including, weekly written reports to the Board and key stakeholders, updates by the Independent Validation and Verification contractor directly to the Board at each and every meeting.
- Established an open door policy to the public and the press.
- Provided the Legislative Oversight Committee with full and detailed progress reports in testimony delivered prior to the commencement of the legislative session.
- Finally, and most importantly managing the operations of the Connector to greatly improve the enrollment experience for our customers this year.

We are pleased to report that many of the audit recommendations either are in process or have already been implemented. The following list summarizes the status of the recommendations:

1. Provide for an "insurance exchange" that "works in tandem with the Hawaii Prepaid Healthcare Act"
    a. Develop a self-sustaining state based insurance exchange
        i. **The Connector is working with its Legislative Oversight Committee to develop a financing model similar to HEMIC that would ultimately fund the Connector on a temporary basis until it achieves a surplus, then use that surplus to fully repay the funding.**
    b. Prepare an updated business plan…addressing the 7 specific points outlined in the Audit Report.
        i. **A comprehensive Business and Sustainability plan together with a fully supported updated market analysis was submitted to the Legislature on December 31, 2014. A copy of the plan is available to the public on the Connector's web site.**
2. To insure the Connector "operates efficiently" it should address
    a. Procurement policies
        i. Provide adequate time for RFP processes
            1. **New policies and procedures are being adopted to fully document the actions of all procurements and make them available to independent third party validation and verification (IV&V) on a real time basis.**
        ii. Train personnel in procurement and grant processes
            1. **In addition to training, there have been process changes that reinforce segregation of duties in all procurement activities.**

iii. Requiring all contracts follow Board approval process

1. **Contracting activity is now reported to the Board in the weekly report, compliance with Board policy is the responsibility of the Procurement Manager, and reviewed and verified by the CFO and monitored by IV&V.**

iv. Formal procedures for maintenance of contract files

1. **This responsibility has been reassigned to the CFO's department. Procedures are under development but are already under examination by independent auditors and IV&V.**

b. Address certain "noncompliance with contract administration policies" in accordance with 7 recommendations

i. **We agree with each one of the recommendations. The Connector has already taken steps to implement them and has included third party supervision through IV&V to verify their continued observance.**

ii. **Full documentation of the procedures associated with these recommendations is underway, however, the Connector remains somewhat resource constrained and does not expect to complete the documentation process until the end of 2015.**

With respect to the "Issue for further study," the Board and Management shares the concern expressed by the Auditor. At the December meeting the Board authorized an independent investigation into the outstanding balance that the named contractor asserted was due, owing and unpaid as well as certain other matters. The federal agencies controlling the grant were notified appropriately, as were the members of the Legislative Oversight Committee.

The Board and Management are committed to improving the governance and business processes and will continue to work with the Auditor to assure satisfactory compliance.

Sincerely,

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Jeffrey M. Kissel
Executive Director