December 30, 2017

Diana Dooley, Secretary
California Health and Human Services Agency
1600 9th Street #460
Sacramento, CA 95814

Dear Ms. Diana Dooley,

In accordance with the State Leadership Accountability Act (SLAA), the State Department of Health Care Services submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2017.

Should you have any questions please contact Ginny Veneracion-Alunan, Chief, Internal Audits, at (916) 650-0272, Ginny.Veneracion-Alunan@dhcs.ca.gov.

BACKGROUND

The mission of DHCS is to provide Californians with access to affordable, integrated, high-quality health care, including medical, dental, mental health, substance use treatment services, and long-term care. The vision of DHCS is to preserve and improve the overall health and well-being of all Californians. DHCS strives to ensure that Californians have access to quality health care services that are delivered effectively and efficiently. DHCS’ programs integrate all spectrums of care primarily via Medi-Cal, California’s Medicaid program.

The Federal Centers for Medicare and Medicaid Services has designated DHCS as the Single State Agency responsible for administering Medi-Cal, a federal/state partnership providing, coordinating, and delivering important health care services to nearly 14 million Californians at an annual cost that exceeds $100 billion; making it the largest Medicaid program in the nation. Approximately one-third of Californians receive health care services financed or organized by DHCS, making DHCS the largest health care purchaser in the state. The Affordable Care Act expanded eligibility for Medi-Cal to adults without children, and parent and caretaker relatives with incomes up to 138 percent of the federal poverty level. This expansion and other enrollment changes since 2013 have increased Medi-Cal enrollment by 5 million Californians.

In addition to Medi-Cal, DHCS offers programs to special populations such as:

- Low-income and seriously ill children and adults with specific genetic diseases.
- Californians in rural areas and to underserved populations.
- Community mental health services and substance use disorder services funded by federal block grants and the Mental Health Services Act.
- Public health prevention and treatment programs.

DHCS received federal approval in 2015 for California’s 1115 waiver renewal, called Medi-Cal 2020. The five-year waiver through 2020 works to transform the way Medi-Cal provides services to its members, while improving quality of care, access, and efficiency.

To integrate the DHCS mission, vision, core values, and goals, in 2015 DHCS’ executive staff updated the 2013-2018 Strategic Plan, a roadmap to achieve DHCS’ short-term and long-term objectives. The Strategic Plan outlines appropriate strategies that will help DHCS capitalize on upcoming changes to health care
delivery, while allowing DHCS to maximize its efficiency and positive impact on the health care system. The Strategic Plan defines three main constituencies – the people DHCS serves, the public, and DHCS employees. The commitments in the Strategic Plan support DHCS’ dedication to enhancing the consumer experience, improving health outcomes, lowering the cost of care, fostering a positive work environment, and adhering to DHCS’ core values of integrity, service, accountability, and innovation.

DHCS’ executive staff works diligently to instill the Core Values in its employees performing the day-to-day operations. DHCS demonstrates its commitment to the Core Values with the implementation of online “Dashboards” and its Stakeholder Engagement Initiative to increase transparency and improve communications with providers, partners, advocates, and the public.

**ONGOING MONITORING**

As the head of State Department of Health Care Services, Jennifer Kent, Director, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

**Executive Monitoring Sponsor(s)**

The executive monitoring sponsor responsibilities include facilitating and verifying that the State Department of Health Care Services internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Erika Sperbeck, Chief Deputy Director, Policy & Program Support.

**Monitoring Activities**

DHCS provides continuous and ongoing monitoring efforts to address DHCS’ risks. All levels of management are involved in evaluating and monitoring ongoing risks, while strengthening internal controls, in order to detect and mitigate risks timely. Senior executive management meet daily and executive staff meet bi-weekly to discuss global issues including risks and mitigating controls. A mandatory, quarterly DHCS Managers and Supervisors meeting is sponsored by the DHCS Director. The Week Ahead Report (WAR), which reports critical and sensitive issues to the California Health and Human Services Agency, contains vital information that is also disseminated to DHCS employees in the form of administrative memos and newsletters to keep employees abreast of recent developments and updates to departmental policies. Additionally, Internal Audits (IA) monitors the ongoing status of audit findings’ Corrective Action Plans (CAPs) through full implementation, and is rolling out a CAPs reporting plan for division management.

**Addressing Vulnerabilities**

DHCS coordinates identification and management of vulnerabilities utilizing the Institute of Internal Auditors Three Lines of Defense model. The model is an integrated risk management framework through which DHCS responds to risks and assigns responsibility for action. Executive management guides the risk management framework that includes consideration of risk in business decisions to accomplish DHCS strategic and operational objectives.

DHCS executive management discuss priorities including any escalated risks or emerging vulnerabilities at a daily senior management meeting, and at a bi-weekly executive staff meeting. Risks and controls are discussed and vetted, then business decisions are transformed into actionable plans that are communicated to programmatic leaders. The business unit managers and process owners, DHCS’ first line of defense, are then assigned the responsibility to address the risks as the ultimate risk owners. These risk owners establish operational procedures and controls to mitigate risks. Actions
and tasks are then executed to comply with statutory requirements and prevent noncompliance from recurring in the future. Ongoing program assessments are produced and reviewed internally, then submitted to executive staff. Compliance units (within program areas), the second line of defense, provide oversight and enhanced risk mitigation functions. For instance, compliance units perform program monitoring reviews with a formalized escalation process. Internal Audits (IA), the third line of defense, provides objective assurance on the adequacy and effectiveness of controls and risk management procedures. IA conducts independent, risk-based evaluations of DHCS programs. The three lines of defense all play an important role in addressing vulnerabilities in the program as well as monitoring progress toward mitigating risks. DHCS executive leaders ultimately set the “tone for the organization” by driving responsibility and accountability organization-wide.

**COMMUNICATION**

In collaboration with IA, executive management communicates monitoring roles, internal control activities, and results throughout DHCS. In these communications, management assigns the internal control responsibilities to appropriate staff. Further, to enable staff to perform key roles in achieving business objectives, addressing risks and supporting the internal control system, DHCS management communicates relevant information and expectations down and across established reporting lines. For example, DHCS management selects appropriate methods for internal communication, as follows: electronic newsletters; direct email, new employee orientation, and onboarding plans; online and live employee training; presentations at staff meetings; resource manuals; standard operating procedures and requirements; signage; and one-on-one meetings (for specific issues). Additionally, employees can access the DHCS Strategic Plan and organizational goals, its Core Values and Professional Standards and various employee toolkits posted on the DHCS intranet. Finally, the DHCS Director holds mandatory meetings for all DHCS supervisors and managers on a quarterly basis to discuss current issues and priorities.

**ONGOING MONITORING COMPLIANCE**

The State Department of Health Care Services has implemented and documented the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the State Department of Health Care Services systems of controls and monitoring.

**RISK ASSESSMENT PROCESS**

The following personnel were involved in the State Department of Health Care Services risk assessment process: Executive Management, and Middle Management.

**Risk Identification**

DHCS performed the risk assessment in accordance with the Committee of Sponsoring Organizations of the Treadway Commission’s (COSO) Internal Control – Integrated Framework (2013). IA facilitated the department-wide risk assessment process and evaluation of controls. In January 2016, IA communicated to executive management the 2017 SLAA requirements and risk assessment information. IA provided all Division Chiefs with a Risk and Control Self-Assessment (RCSA) Questionnaire to identify their program area objectives and their related risk and mitigating control(s). IA reviewed the RCSA responses to identify self-reported risks and prepared a populated Risk Control Matrix (RCM). IA facilitated the focused risk discussions to identify and categorize top risks using the Department of Finance (DOF) risk catalog. As applicable, IA researched the relevant internal and
external audit results and evaluated the CAPs. Further, Deputy Directors and Division Chiefs developed the risk statements following DOF guidelines.

Risk Ranking
Deputy Directors then rated each risk based on the likelihood, impact, and velocity using a high (3), medium (2), and low (1) rating scale, which IA used to calculate risk scores. Risks from Deputy Directors’ and Division Chiefs’ program areas were reviewed by their respective Chief Deputy Directors before the meeting with the Director, who provided final determination of DHCS’ highest rated risks including its related mitigating controls.

RISKS AND CONTROLS

Risk: Reporting -External-Information Communicated—Adequacy, Accuracy, Interpretation, Timeliness
The risk of incorrectly reporting on state, federal, and other special funding.
Caused by insufficient internal and external communication.
Results in potential over and under spending (Medi-Cal Local Assistance), loss of credibility, and negative publicity.

Control A
Programs conduct monthly meetings in order to create an avenue for collaboration between Divisions and cut down on inaccurate dissemination of information internally.

Control B
Increased administrative controls including reconciliation and documented policies and procedures mitigate potential errors of when and how to communicate internally and externally, in order to obtain and disseminate accurate information and reduce associated fiscal management issues.

Control C
Quality review processes are in place to make certain that all statistics created by DHCS and utilized in reports and/or disseminated to the public are adequate, accurate, and properly defined to facilitate decisions made with the best available information.

Risk: Operations -External-Fraud, Theft, Waste, Misconduct, Vandalism
As the Medi-Cal program continues to expand in both size and complexity, the likelihood of fraud, waste, and abuse (FWA) increases.

This is caused by Medi-Cal program complexity sometimes hindering program integrity efforts and insufficient resources and technology available to properly monitor the program and quickly react to the changing landscape of fraud schemes.

As a result, there may be improper payments.

Control A
Implementation of new technologies such as expanded data analytics that help identify and keep pace with evolving fraud schemes.
To prevent, detect and control Medi-Cal FWA, DHCS has placed a strong emphasis on Medi-Cal program integrity over the past decade.

**Control B**
Issuance of defined and up-to-date policy guidance by upper level management ensure that staff correctly interpret policies surrounding potential threats due to fraud, waste, and abuse, as well as raise staff awareness of how to correctly identify and address these issues when encountered.

**Control C**
Enhanced provider enrollment, reenrollments, and monitoring.

**Control D**
Outreach and education efforts help minimize potential threats of FWA by instilling knowledge in staff that helps them correctly identify the threats and provide the ability to act quickly on this knowledge.

**Control E**
Quality review processes and written policies and procedures reinforce the identification of threats that are directly applicable to specific areas (e.g., recognizing fraudulent applications and claims in advance of payments).

**Control F**
Review an average of 180 million annual fee for service claims processed electronically to ensure compliance with program requirements.

**Risk: Operations - Internal - New System Implementation (Other Than F1$Cal)**  
Associated risks related to new system implementation to modernize mission-critical systems, such as the California Medicaid Management Information System (CA-MMIS) and the upgrade to the Enhanced Medi-Cal Budget Estimate Redesign (EMBER) system, which may result in potential system failure.

The CA-MMIS project will replace the existing legacy system and aims to adopt a user-centered, iterative, and modular approach to the design, development and implementation of system modules. The EMBER system, utilized to produce the Medi-Cal Local Assistance Estimate, has exceeded its technical support, which makes the system increasingly less compatible with newer software and unable to receive ongoing software updates.

As a result of new system implementation, there is potential for operational processing delays, and reporting inaccuracies. A successful system upgrade would enhance system stability and improve flexibility making it more adaptable to changes in the Medi-Cal program. Additionally, these upgrades will allow for future system enhancements to the system to provide estimates that are more accurate with increased transparency and reporting capabilities.

**Control A**
Strengthened administrative controls including technical analysis for the systems modernization efforts, as well as system development life cycle controls. In addition, all new systems projects require executive sponsorship to certify that the project is appropriately prioritized by DHCS to maintain appropriate attention, resources and time management.
RISK: OPERATIONS -INTERNAL-TECHNOLOGY—COMPATIBILITY
The risk of DHCS’ continued reliance on outdated information technology (IT) applications creates programmatic challenges and compatibility issues with IT infrastructure of state, federal, and local partners in the provision of health and human services for the citizens of California.

DHCS continues to utilize an IT platform that is over 40 years old and these legacy systems were not designed for the current workload or scope needed.

The maintenance of these outdated legacy applications is costly based on the development of workarounds, reliance on external consultants, and delays in meeting real time data needs. As a result of these outdated applications, there is potential loss of information, convoluted or inaccurate information being disseminated throughout the department, inefficient use of departmental resources, poor quality of care, insufficient oversight, and barriers to access to care. Further, if these outdated applications are not replaced, systems may fail, thereby negatively affecting operations of key public service systems.

CONTROL A
Systems development life cycle controls and continued communication, including workgroups and meetings, between the software developers and staff that utilize the current systems help to mitigate potential implementation issues. These controls ensure that all possible issues with the new systems are addressed before implementation occurs, and that outdated systems which are still in use are adequately maintained until they can be replaced.

RISK: COMPLIANCE-EXTERNAL-COMPLEXITY OR DYNAMIC NATURE OF LAWS OR REGULATIONS
Given the important role Medi-Cal plays in providing health coverage to approximately one-third of Californians—and some of our most vulnerable residents—DHCS and the state face the risk of major Medicaid policy changes at the federal level (differing from the state view), and the uncertainty surrounding Medicaid funding.

Caused by a new federal administration with different priorities.

As a result, there are potential changes in the current scope of the Medi-Cal program, potential reductions in federal funding which comprises the majority of program spending, and repercussions to the many vulnerable Californians who qualify for social programs.

CONTROL A
An established Federal Legislation and Regulations Tracker, maintained by the Director’s Office, monitors changes that impact DHCS. Leadership review is required to provide feedback to DHCS’ State Medicaid Director.

CONTROL B
Regular meetings and communication helps DHCS stay informed about Congressional actions or varying interpretations of federal laws and regulations. DHCS also sends out stakeholder notifications as warranted in order to make sure that external parties that may be affected by the changing federal landscape are aware of potential changes in advance so that they have the ability to prepare for them.

RISK: OPERATIONS -EXTERNAL-STAFF—RECRUITMENT, RETENTION, STAFFING LEVELS
The risk of the inability to recruit and retain a highly-qualified workforce.

Caused by retirement and competing positions with more attractive pay.
Results in the loss of competent and knowledgeable staff, reduction in workforce skills needed to accomplish our mission, lack of backup for absent staff, missed deadlines, and an overworked and overstressed workforce. Additionally, DHCS’ staffing levels are negatively impacted by loss of institutional knowledge due to staffing turnover and inability to hire qualified replacements.

**CONTROL A**
DHCS has committed to increase administrative controls which include: well-developed onboarding processes; management approved procedural manuals for all staff; cross-training of staff; opportunities for training classes offered by the Strategic Planning and Workforce Development Branch; the Leadership Academy; Analyst Certification Program; and DHCS Academy.

**CONTROL B**
Staff are offered flexible work schedules and coordinated wellness activities. Teamwork strategies and promotional opportunities to create long-term incentives for retention and skills development are in progress.

**CONTROL C**
When possible, DHCS creates hiring incentives for new staff in order to draw more qualified applicants for posted positions.

**RISK: OPERATIONS - EXTERNAL-FUNDING—SOURCES, LEVELS**
The risk of heavy reliance on non-guaranteed federal and state funds, and vulnerability to reduction or discontinuance of funding sources.

Caused by non-compliance with complex and dynamic program changes and regulatory requirements.

Could result in reduction in benefits and Medicaid program changes.

**CONTROL A**
DHCS ensures compliance with legislative and regulatory requirements through established departmental processes for program changes, by division, with executive management project sponsors.

**CONTROL B**
Senior executive management meets daily and executive staff meet bi-weekly to discuss DHCS priorities. DHCS has implemented a continual oversight and monitoring process to ensure efforts are prioritized to address the most critical functions. DHCS works effectively and efficiently in collaboration with beneficiaries, providers, and stakeholders to encourage participation and achieve optimal resolution. Additional funding is sought via the state budget process to increase the resources available to administer DHCS’ programs.

**CONCLUSION**
The State Department of Health Care Services strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.
Jennifer Kent, Director

CC: California Legislature [Senate (2), Assembly (1)]
    California State Auditor
    California State Library
    California State Controller
    Director of California Department of Finance
    Secretary of California Government Operations Agency