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Acronyms

DCAA	Defense Contract Audit Agency
FAR	Federal Acquisition Regulation
IG	Inspector General
REA	Request for Equitable Adjustment



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

September 21, 2007

MEMORANDUM FOR DIRECTOR, TRICARE MANAGEMENT ACTIVITY

SUBJECT: Report on Hotline Allegations Concerning TRICARE's Actions on a Request for Equitable Adjustment (Report No. D-2007-6-008)

We are providing this report for your information and use. We performed this review in response to a Defense Hotline complaint. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Meredith Long-Morin at (703) 604-8739 (DSN 664-8739), meredith.morin@dodig.mil.

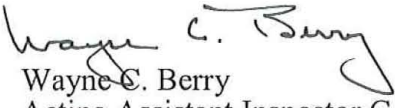

Wayne C. Berry
Acting Assistant Inspector General
Audit Policy and Oversight

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Hotline Allegations Concerning TRICARE's Actions on a Request for Equitable Adjustment

Results In Brief

What We Did

We reviewed a Defense Hotline allegation that (1) TRICARE “knowingly” and “falsely” reported to the DoD Inspector General that the TRICARE contracting officer had sustained \$21 million in costs questioned by the Defense Contract Audit Agency in its audit of a request for equitable adjustment and that (2) the contracting officer did not prepare a negotiation memorandum covering the actions he took on the \$21 million in costs questioned by the Defense Contract Audit Agency.

What We Found

We did not substantiate the first allegation, but we substantiated the second. TRICARE inaccurately reported the sustained questioned costs, but our review disclosed no evidence that TRICARE knowingly overstated them in its reporting to the DoD Inspector General. We substantiated that the contracting officer failed to prepare negotiation memorandums for two equitable adjustments worth a combined \$160 million. As a result, there is no written explanation concerning the actions the contracting officer took on the Defense Contract Audit Agency questioned costs, or on the recommendations obtained from a consulting firm and the TRICARE Assistant General Counsel. The contracting officer also failed to (1) respond to a Defense Contract Audit Agency request for a copy of the negotiation memorandum, (2) obtain a required Board of Review approval; and (3) obtain a required legal review until 19 months after he issued his entitlement

determination and paid out millions in interim payments.

What We Recommend

TRICARE should review the last 3 years of contract modifications that exceed \$500,000 to verify that the contract files include adequate negotiation memorandums and all required approvals. In addition, TRICARE should evaluate its current controls for ensuring that contracting officers obtain the required approvals before taking a pricing action. TRICARE needs to take appropriate corrective actions based on the results of these reviews and furnish a copy of the results to the DoD Inspector General.

Management Comments

In responding to the June 19, 2007 draft of this report, the TRICARE Deputy Director concurred with the recommendations.

Introduction

Objective

We conducted this review to determine the validity of allegations received by the DoD Hotline concerning actions by the TRICARE Management Activity on a request for equitable adjustment (REA) submitted by Humana Military Healthcare Services, Inc. (Humana). We also reviewed the actions that TRICARE took on a similar REA submitted by TriWest, Inc., which was not a part of the DoD Hotline allegations. See Appendix A for details regarding our scope and methodology.

Background

TRICARE Management Activity (TRICARE). The mission of TRICARE is to manage the DoD medical and dental programs for current and retired members of the uniformed services, their dependents, and other beneficiaries. TRICARE delivers healthcare services through regional healthcare contractors, including Humana and TriWest. The TRICARE Acquisition Management and Support Directorate, located in Aurora, Colorado, is responsible for awarding and administering regional healthcare contracts for TRICARE.

Humana REA. Under Contract No. MDA906-96-C-0002, Humana provided healthcare services to eligible beneficiaries in TRICARE Regions 3 and 4. In March 1997, Humana and its subcontractors—Blue Cross and Blue Shield of South Carolina, and Managed Prescription Service—submitted a \$61 million REA. Humana requested the equitable adjustment based on its projection of receiving significantly more healthcare claims than the Government had estimated in its Request for Proposal. Between 1998 and 2000, Humana and its subcontractors submitted several revised REAs, ranging from \$89 million to \$96 million.

TriWest REA. In September 1999, TRICARE received a similar \$79 million REA from TriWest, Inc., which provided healthcare services in TRICARE Regions 7 and 8 under Contract No. MDA906-96-C-0004. Like Humana, TriWest requested an equitable adjustment based on its projection of significantly higher healthcare claims than the Government had estimated in its Request for Proposal.

Entitlement Determination. In November 1997, 8 months after receiving the first Humana REA, the TRICARE contracting officer issued a determination that the contractor was entitled to an equitable adjustment for the increase in the volume of healthcare claims. Although the contracts were firm-fixed-price, the contracting officer concluded that the contractor should be compensated through an equitable adjustment because he believed the Government's Request for Proposal was vague and ambiguous. While the entitlement determination did not establish the final amount of equitable adjustment, it was used as the basis for providing interim payments to the contractor, pending a final negotiated settlement.

Defense Contract Audit Agency (DCAA). DCAA provides audit and financial advisory services to all DoD Components, including TRICARE. DCAA issues audit reports resulting from several types of audits of Government contractor proposals and contracts. As requested by TRICARE, DCAA audited the Humana and TriWest REAs. In Audit Report No. 1621-97K17200003, October 20, 1998, DCAA questioned \$21 million of the \$96 million Humana REA; DCAA later reduced the questioned amount to \$16 million after reviewing one of the revised Humana REAs for \$90.6 million. In Audit Report No. 3901-1998AI7200003-S1, November 3, 1999, DCAA questioned \$14 million of the \$79 million TriWest REA.

Contract Modification. In August 2000, Humana submitted its final REA for \$89 million. In February 2001, TRICARE accepted it and executed a contract modification that increased the contract value by \$89 million. TRICARE also executed a contract modification that increased the TriWest contract value by \$71 million.

Findings

A. Inaccurate Reporting of Questioned Costs Sustained

We did not substantiate the allegation that, in the information it submitted to the DoD Inspector General (IG), TRICARE “knowingly” and “falsely” reported sustaining¹ the entire \$21 million in DCAA-questioned costs associated with the Humana REA. Although TRICARE inaccurately reported the sustained costs associated with the Humana REA, our review disclosed no evidence that TRICARE knowingly overstated the sustained questioned costs in reporting them to DoD IG. TRICARE has since revised its procedures for reporting audit information and now requires approval of documentation supporting the resolution and disposition of audit reports. These actions should help ensure the accuracy of future reporting to DoD IG.

Requirement for Reporting the Status of Audit Reports. DoD Directive 7640.2, “Policy for Follow-up on Contract Audit Reports,” dated February 12, 1988, prescribes DoD policy and procedures for the resolution and disposition of contract audit reports. Resolution of an audit report is achieved when the contracting officer determines a course of action on the audit findings, and disposition is generally achieved when the contracting officer carries out the action either through a negotiated settlement or a final decision under the Disputes Clause.

DoD Directive 7640.2 requires that all DoD Components, including TRICARE, report on the status of resolution and disposition actions to DoD IG semiannually.

¹ A contracting officer sustains questioned costs by upholding the determination of the auditor (in this case, DCAA) and not reimbursing the contractor for the questioned costs.

For dispositioned audits, Components must include the amount of questioned costs they sustained. DoD IG includes a summary of the status reports for all DoD Components in its Semiannual Report to Congress.

Reporting on the Humana Equitable Adjustment. TRICARE did not accurately report the amount of questioned costs it sustained on the Humana equitable adjustment. TRICARE reported to DoD IG that the contracting officer had sustained the entire \$21 million questioned by DCAA in Audit Report No. 1621-97K17200003, October 20, 1998. Although we could not determine the exact amount of sustained questioned costs because of the lack of a negotiation memorandum, we did determine that the maximum amount the contracting officer could have sustained was \$1.6 million, which is the difference between the \$90.6 million Humana REA last audited by DCAA and the \$89 million negotiated agreement. As a result, TRICARE overstated the sustained questioned costs by a minimum of \$19.4 million (\$21 million less \$1.6 million) in its reporting to DoD IG.

However, our review of the contract file, and interviews of current and former TRICARE employees, did not disclose any evidence that TRICARE had “knowingly” overstated the sustained questioned costs reported to DoD IG.

Reporting on the TriWest Equitable Adjustment. TRICARE could have accurately reported the amount of questioned costs associated with the TriWest equitable adjustment that it sustained, but the failure of the contracting officer to prepare a negotiation memorandum prevented us from verifying the accuracy of the reporting. TRICARE reported to DoD IG that the contracting officer had sustained \$8.3 million of the \$14 million that DCAA questioned in Audit Report No. 3901-1998A17200003-S1, which is the maximum amount that the contracting officer could have sustained (the \$78.9 million TriWest REA less the \$70.6 million negotiated agreement).

TRICARE Procedures. In 2002, TRICARE added a procedure that requires contracting officers to provide the TRICARE Contract Audit Follow-Up Monitor with documentation supporting the disposition of all audit reports. In Report No. D-2007-6-002, October 11, 2006, we also recommended that TRICARE implement a process to test the adequacy of documentation supporting the disposition of audit reports before reporting them as dispositioned. (See Recommendation 6.) In a May 24, 2007, response, TRICARE stated that it had revised its procedures to require approval of documentation supporting the resolution and disposition of audit reports. If properly implemented, the revised procedures should help TRICARE provide accurate audit information to DoD IG. DoD IG plans to review the revised procedures and verify their implementation. Subject to the results of the DoD IG review and verification, we have no new recommendation for this finding.

B. Failure To Prepare Negotiation Memorandums

We substantiated the allegation that the contracting officer did not prepare a negotiation memorandum for the \$89 million Humana equitable adjustment. The same contracting officer also did not prepare a negotiation memorandum for the \$71 million TriWest equitable adjustment. Both the Federal Acquisition Regulation (FAR) and DoD Directive 7640.2 require the preparation of a negotiation memorandum. The contracting officer received field pricing findings and recommendations from DCAA, a consulting firm, and a TRICARE Assistant General Counsel, but without the negotiation memorandum, there are no documents that adequately explain the extent to which the contracting officer considered the recommendations in the negotiated agreement. The contracting officer also improperly ignored a DCAA request for a copy of the negotiation memorandum; failed to obtain Board of Review approval that would have disclosed the absence of the negotiation memorandums; and did not obtain the required legal review of the equitable adjustments until 19 months after making his entitlement determination and paying millions of dollars in interim payments.

Negotiation Memorandum Requirements. FAR 15.406-3(a) states that contracting officers shall document the principal elements of the negotiated agreement in the contract file. FAR 15.406-3(a)(7) requires that the negotiation memorandum document a summary of the field pricing assistance recommendations and the reasons for any pertinent variances from them. Paragraph 6.5 of DoD Directive 7640.2 requires contracting officers to prepare a memorandum covering the disposition of all audit reports.

Negotiation Memorandums for the Humana and TriWest Equitable Adjustments. The TRICARE contract files for the Humana and TriWest equitable adjustments did not contain negotiation memorandums. As a result, the contract files have no written record that demonstrates the fairness or reasonableness of the \$89 million negotiated agreement with Humana, or of the \$71 million negotiated agreement with TriWest. We spoke to the contracting officer responsible for the Humana and TriWest REAs, who acknowledged that negotiation memorandums were either not prepared or lost. He stated that, at that time, he was starting a new position as Office Chief and apparently forgot to prepare the memorandums. In his current position as Office Chief, he supervises a team of 10 employees, including contracting officers and contract specialists. Judging from his actions during this time, we are concerned that his team may not be preparing negotiation memorandums in accordance with the FAR and DoD Directive 7640.2.

The negotiation memorandum is a critical part of the contract file because it serves as the primary means of demonstrating the reasonableness of the negotiated price and compliance with applicable laws and regulations. It also serves to protect the Government's interests in the event of future disputes.

DCAA Audit Reports. Without negotiation memorandums, there is no explanation as to why the contracting officer did not sustain at least \$20.8 million in DCAA-questioned costs, including \$14.8 million and \$6 million for the Humana and TriWest REAs, respectively. The \$14.8 million amount for the Humana REA is the difference between the DCAA revised questioned costs of \$16.4 million and the maximum sustained questioned costs of \$1.6 million. The \$6 million amount for the TriWest REA is the difference between the DCAA-questioned costs of \$14.3 million and the maximum sustained amount of \$8.3 million. DCAA questioned the costs because the Humana and TriWest REAs did not adequately demonstrate that the costs directly resulted from the increase in healthcare claims.

Consultant Review. TRICARE hired Kennell and Associates, Inc., a healthcare consulting firm, to review and provide comments on the Humana and TriWest REA proposals. In August 1999, Kennell and Associates made several recommendations for saving the Government between \$35 million and \$52 million of the \$96 million Humana REA proposal, and between \$36 million and \$44 million of the \$79 million TriWest REA proposal. The two most significant recommendations included upholding the DCAA-questioned costs and making the contractor responsible for a portion of the costs associated with the increase in healthcare claims. However, the contract file does not indicate the extent to which the recommendations were incorporated in the negotiated agreement.

Legal Review. In a June 14, 1999, memorandum to the contracting officer, an Assistant General Counsel for TRICARE provided a legal opinion on the REAs. Although the Assistant General Counsel concurred with the contracting officer's November 1997 entitlement determination, he expressed some of the same concerns on the amount of entitlement as those reported by DCAA and the consulting firm. The Assistant General Counsel stated that the contractor should bear some of the costs associated with the increased volume in claims. In addition, the Assistant General Counsel stated that some of the cost elements, such as system development costs, did not appear to have a direct relationship to the increase in claims volume. However, according to Humana's final REA and the negotiated agreement, the contracting officer reimbursed \$3,446,145 of the \$3,808,077 (90 percent) in proposed system development costs. The contract file does not include a negotiation memorandum or other documentation to explain the reasonableness of this action.

In addition, the contracting officer did not obtain the legal opinion until 19 months after rendering his November 1997 entitlement determination and making interim payments to the contractors. Between November 1997 and May 1999, TRICARE paid Humana \$19 million in interim payments before obtaining written legal concurrence from the Assistant General Counsel. Paragraph 1.601-90(4) of the TRICARE Acquisition Manual, January 2001, requires a legal review prior to executing contract modifications exceeding \$500,000, which the modifications for providing interim payments to Humana and TriWest did. Although the Assistant General Counsel subsequently agreed with the contracting officer's entitlement determination, the contracting officer exposed the Government to significant financial

risk by making the determination and paying out millions of dollars in interim payments before obtaining legal concurrence.

Board of Review. The contracting officer did not obtain approval from the Board of Review on the Humana and TriWest contract modifications as TRICARE procedures required. A Board of Review comprising key senior TRICARE contracting officials was convened periodically to provide management oversight of all significant contract actions. It served to ensure that significant contract actions complied with applicable laws and regulations and that all documents necessary to fully support the amount of the award were prepared. In requesting Board of Review approval, the contracting officer was required to prepare a package of documents, including the negotiation memorandum, that were necessary to fully support the action. A Board of Review of the Humana and TriWest equitable adjustments would have prevented the contracting officer from issuing the equitable adjustments without having negotiation memorandums in the contract files. TRICARE should have controls in place that preclude contracting officers from executing actions without obtaining the required oversight reviews.

DCAA Request for Negotiation Memorandum. FAR 15.406-3(b) required that the contracting officer furnish a copy of the Humana and TriWest negotiation memorandums to DCAA. The contracting officer told us that DCAA requested a copy of the memorandums shortly after he executed the Humana contract modification in February 2001. The contracting officer stated that he first realized that a negotiation memorandum was not in the contract file when DCAA requested a copy of it. The contracting officer said he intentionally ignored the DCAA request, in part because of advice he received from his supervisor, the Director of Acquisition Management and Support. The Director of Acquisition Management and Support denies being told about the missing negotiation memorandums and denies providing such advice.

Recommendations and Management Comments

Recommendations. We recommend that the Director, Acquisition Management and Support Division:

1. Review contract modifications greater than \$500,000 that were executed in the last 3 years by the Office Chief and his team to determine whether the contract files include a negotiation memorandum that complies with the requirements of Federal Acquisition Regulation 15.406-3 and DoD Directive 7640.2.

2. Review the current management controls for ensuring that, before executing a pricing action, the TRICARE contracting officer includes in the contract file the required reviews and approvals and explanations for deviating from any field pricing recommendations.

3. Take appropriate corrective actions based on the results of Recommendations 1. and 2. to:

a. Reinforce to the Office Chief and his team the importance of preparing negotiation memorandums.

b. Improve the management controls for obtaining the required reviews and approvals and for explaining any deviation from field pricing findings and recommendations.

4. Provide the results of Recommendations 1. through 3. to the DoD Office of the Assistant Inspector General for Audit Policy and Oversight.

Management Comments. The Deputy Director, TRICARE Management Activity concurred to the recommendations. TRICARE is conducting a review of contract modifications, providing updated training on negotiation memorandums, and ensuring that all policies and procedures are adequate. TRICARE anticipates completing the actions by November 30, 2007.

Appendix A. Scope and Methodology

We evaluated records maintained by TRICARE in Aurora, Colorado, to determine the validity of the Hotline allegations. With assistance from the Defense Criminal Investigative Service, we interviewed current and former TRICARE managers and employees at Aurora. Specifically, we

- determined the applicable standards, public law, DoD regulations, directives, and instructions;
- reviewed TRICARE contract files related to the Humana and TriWest REAs, prepared in both hard copy and electronic format;
- interviewed current and former TRICARE employees and managers having direct involvement with the Humana and TriWest REAs or the TRICARE contract audit follow-up system; and
- obtained supporting documentation from the DCAA Financial Liaison Auditor assigned to the TRICARE Aurora, Colorado, facility.

We performed this review from July 2005 through June 2007. We suspended the project for 1 year within this timeframe to address other projects.

Use of Computer-Processed Data. We did not rely on any computer-processed data as part of our review. TRICARE uses a Web-based eTools system that maintains data on the status of actions taken to resolve contract audit report findings and recommendations. However, we verified the eTools data used in our review to source documents.

Prior Coverage. In the last 5 years, DoD IG issued one other report involving TRICARE's actions on DCAA audit reports. DoD IG Report No. D-2007-6-002, "Hotline Allegations Concerning the TRICARE Contract Award for the Audit of Capital and Direct Medical Education Costs," October 11, 2006, reported that TRICARE's award of a contract to Tichenor and Associates, Inc., did not comply with portions of the FAR. In addition, the incentive fee terms under the contract did not properly consider the overpayments that DCAA identified, resulting in Tichenor and Associates, LLP receiving additional incentive fees of up to \$4.7 million. Among the recommendations, TRICARE agreed to require the approval of documentation supporting the disposition of audit reports.

Appendix B. Report Distribution

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Chief of Healthcare Plan Operations
Director, Acquisition Management and Support Division
Director, Defense Contract Audit Agency
Branch Manager, Defense Contract Audit Agency, Chesapeake Bay Branch Office
Financial Liaison Auditor, TRICARE Management Activity (Contracts), Aurora

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Deputy Director TRICARE Management Activity Comments



TRICARE
MANAGEMENT
ACTIVITY

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE HEALTH AFFAIRS

SKYLINE FIVE, SUITE 810, 5111 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041-3206


AUG 23 2007

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Draft of a Proposed Report, Hotline Allegations Concerning TRICARE's
Actions on a Request for Equitable Adjustment (Project No. D2005-
DIPOAI-0226.000)

We have reviewed the recommendations in the Draft Report and concur with them. We have conducted a review, as recommended, and are analyzing the results. We will be providing updated training to personnel regarding negotiation memorandums and will ensure all policies and procedures are adequate and provide appropriate guidance. It is anticipated that all actions will be completed by November 30. We will report on the completion of these efforts in response to the final report.

My point of contact is Mr. John Meeker, Director, Acquisition Management and Support. Mr. Meeker can be reached at (303) 676-3991.


Elder Granger
Major General, MC, USA
Deputy Director

Attachments:
As stated



Inspector General Department of Defense