June 30, 2003

Health Care

Franchise Business Activity Contracts for Medical Services
(D-2003-113)

Department of Defense
Office of the Inspector General

Quality *Integrity* *Accountability*

Additional Copies

To obtain additional copies of this report, visit the Web site of the Inspector General of the Department of Defense at www.dodig.osd.mil/audit/reports or contact the Secondary Reports Distribution Unit of the Audit Followup and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or fax (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Audit Followup and Technical Support Directorate at (703) 604-8940 (DSN 664-8940) or fax (703) 604-8932. Ideas and requests can also be mailed to:

ODIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General of the Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-4704

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

FAR	Federal Acquisition Regulation
FBA	Franchise Business Activity
WHMC	Wilford Hall Medical Center
WRAMC	Walter Reed Army Medical Center

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

June 30, 2003

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (HEALTH AFFAIRS)
DIRECTOR, DEFENSE PROCUREMENT AND ACQUISITION POLICY

SUBJECT: Report on Franchise Business Activity Contracts for Medical Services (Report No. D-2003-113)

We are providing this report for information and use. This is the first of two reports on medical services contracts. We considered management comments from DoD and the Department of the Treasury 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 and left no unresolved issues. As a result of management comments received from the Office of Defense Procurement and Acquisition Policy, we deleted Recommendation 2. No additional comments are required.

We appreciate the courtesies extended to our staff. Questions should be directed to Mr. Scott J. Grady at (757) 872-4759 or Mr. Michael A. Joseph at (757) 872-4815 ext. 223. See Appendix B for the report distribution. The team members are listed inside the back cover.

David K. Steensma
Deputy Assistant Inspector General
for Auditing

cc:
Inspector General of the Department of the Treasury

Office of the Inspector General of the Department of Defense

Report No. D-2003-113 **June 30, 2003**
(Project No. D2002LF-0110)

Franchise Business Activity Contracts for Medical Services

Executive Summary

Who Should Read This Report and Why? Contract personnel responsible for procuring medical services and military and civilian health care professionals within the military health system should read this report. Those responsible for acquiring and providing medical services should be interested in the issue of acquiring medical services through the Department of the Treasury, Franchise Business Activity contracts.

Background. The Office of the Assistant Secretary of Defense (Health Affairs) exercises authority, direction, and control over the facilities, funding, personnel, programs, and other medical resources within DoD. TRICARE is a regionally managed health care program for active duty and retired members of the uniformed services, their families, and survivors. TRICARE brings together the health care resources of the Army, the Navy, and the Air Force and supplements them with networks of civilian health care professionals to improve access to high quality service while maintaining the capability to support military operations. To help fill needs that cannot be satisfied through medical facilities or through TRICARE contracts, the Military Departments issue non-TRICARE contracts. In 2002, DoD spent about $1.2 billion to acquire medical services through non-TRICARE contracts.

There are a variety of contractual methods available to medical facilities to fulfill their supplemental needs, such as the General Services Administration-managed Federal Supply Schedule contracts, Veteran's Administration contracts, local contracts with individuals or commercial organizations, and nationwide or regional contracts. The Franchise Business Activity provides another contractual method used by the military health system to fill medical service requirements.

The Department of the Treasury created the Franchise Business Activity to provide Federal organizations common financial and administrative support services on a reimbursable basis. DoD was not centrally monitoring the use of Franchise Business Activity contracts and could not provide information on how much was spent through the Franchise Business Activity. The Franchise Business Activity informed us that DoD spent about $19.1 million in FY 2002 on direct provider medical services such as doctors, nurses, and others working directly with beneficiaries.

Results. According to the Franchise Business Activity, in FY 2002, 19 DoD medical facilities acquired medical services using Franchise Business Activity contracts. The use of Franchise Business Activity contracts to acquire medical services may not be in the best interest of DoD medical facilities. We questioned:

- whether DoD medical facilities should use the Franchise Business Activity authority to acquire financial and administrative support services as a means to acquire medical services, and

- why DoD would acquire medical services through Franchise Business Activity contracts, considering that it has extensive medical service contracting capabilities of its own.

Also, the scope of work for one contract was so broad that medical contractors with lower-priced bids were considered technically inferior and not selected partly because prior experience was only in medically related labor categories. DoD may also be incurring unnecessary costs through surcharge fees ranging from $0.38 million to $1.9 million (for FY 2002). Further, according to the Navy, contracting for medical services through the Franchise Business Activity may expose the Government to unnecessary risk through potentially illegal and unenforceable contracts. The Assistant Secretary of Defense (Health Affairs) should determine whether it is appropriate for the military health system to use the Franchise Business Activity to acquire medical services. If determined to be appropriate, the Assistant Secretary should issue guidance on the use of Franchise Business Activity contracts.

Management Comments and Audit Response. The Assistant Secretary of Defense (Health Affairs) concurred with the finding and the intent of the recommendations. Guidance will be issued to the Military Departments indicating that there is no legal authority to use the Franchise Business Activity to enter into personal services contracts for health care services. The Assistant Secretary of Defense (Health Affairs) comments were responsive and additional comments are not required. As a result of management comments received from the Director, Defense Procurement and Acquisition Policy, we deleted the recommendation addressed to that office. We also clarified a citation for language taken from Senate Report 107-151. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

Table of Contents

Executive Summary i

Background 1

Objectives 2

Finding

Acquiring Medical Services Through Franchise Business Activity Contracts 3

Appendixes

A. Scope and Methodology 11
Prior Coverage 12
B. Report Distribution 13

Management Comments

Assistant Secretary of Defense (Health Affairs) 15
Defense Procurement and Acquisition Policy 17

Background

Military Health System. The Office of the Assistant Secretary of Defense (Health Affairs) exercises authority, direction, and control over the facilities, funding, personnel, programs, and other medical resources within DoD. Its responsibilities include establishing policies, procedures, and standards that govern DoD health care programs. The mission of the military health system is to enhance DoD and our Nation's security by providing health care support for the full range of military operations and sustaining the health of DoD health care beneficiaries.

TRICARE is a regionally managed health care program for active duty and retired members of the uniformed services, their families, and survivors. TRICARE brings together the health care resources of the Army, the Navy, and the Air Force and supplements them with networks of civilian health care professionals to provide improved access to high quality service while maintaining the capability to support military operations. To help fill needs that cannot be satisfied through DoD medical facility personnel or through TRICARE contracts, the Military Departments use non-TRICARE contracts. Those non-TRICARE contracts are used to acquire medical services, such as health care providers, laboratory testing services, and ancillary services. In 2002, DoD spent about $1.2 billion to acquire medical services through non-TRICARE contracts.

There are a variety of different contractual methods available to help DoD medical facilities fill their supplemental needs, such as the General Services Administration-managed Federal Supply Schedule contracts, Veterans Administration contracts, local contracts with individuals or commercial organizations, and nationwide or regional contracts. The Franchise Business Activity (FBA), within the Department of the Treasury, provides another contractual method used by the military health system to fill medical service requirements. Although DoD does not track the extent of medical services contracted through the FBA, FBA officials estimated that DoD spent about $19.1 million in FY 2002 on direct provider medical services. That amount does not include funds spent by the military health system or other DoD organizations for non-medical services or support.

FBA Contracts. The Government Management Reform Act of 1994, Public Law 103-356, section 2170, October 13, 1994, authorized six franchise fund pilot programs in different Executive departments. Public Law 104-208, "Omnibus Consolidated Appropriations Act of 1997," September 30, 1996, established the pilot fund for the Department of the Treasury, and Public Law 106-554, "Consolidated Appropriations Act of 2001," December 21, 2000, made the Treasury Department's pilot program permanent. The fund was established "for the maintenance and operation of such financial and administrative support services as the Secretary determines may be performed more advantageously as central services." As part of the franchise fund program, the Department of the Treasury created the FBA to provide Federal organizations common financial and administrative support services on a reimbursable basis.

To acquire medical services using an FBA contract, the DoD medical facilities enter into an interagency agreement with the FBA and place purchase calls or task orders against existing contracts between the FBA and a vendor. According to FBA officials, the surcharge for using its services varies by task order from 2 percent to 10 percent.

Military Department Medical Contracting Responsibilities. The DoD approach to acquiring supplemental medical services for their medical facilities is decentralized. The Army's Health Care Acquisition Activity is a headquarters directorate reporting to the Army Surgeon General and the Commanding General of the Army Medical Command. The Army Acquisition Activity provides medical service acquisition support to Army Components worldwide and oversight to seven regional contracting offices (two contracting centers and five contracting offices). However, it views its role as advisory in nature and gives Army medical facilities full autonomy to decide what contracting methods to use in filling their medical service requirements. The Naval Bureau of Medicine and Surgery delegates responsibility to contract for medical services to the Naval Medical Logistics Command and the Fleet Industrial Supply Center Norfolk, Philadelphia Detachment. However, Navy medical facilities maintain a limited degree of discretion in filling supplemental medical service requirements by contracting for medical services directly, up to their acquisition authority limit. The Air Force has a very decentralized approach toward contracting for supplemental medical services and generally leaves such contracting actions and decisions up to each medical facility and the base contracting office where the medical facility is located.

Objectives

The audit objective was to evaluate contracting agency and program office procedures for award and administration of medical service contracts, excluding TRICARE contracts, and to evaluate the management control program applicable to the audit objective. During the audit process, we learned that the Military Departments were acquiring health care services (for example, physicians, nurses, laboratory and pharmacy technicians) through FBA contracts. Because the use of FBA contracts is a relatively new method for acquiring medical services that could have a significant impact on the military health system, this report addresses the use of FBA contracts. Other issues regarding medical service contracts and the management control program will be discussed in a separate report. See Appendix A for a discussion of scope and methodology and prior coverage.

Acquiring Medical Services Through Franchise Business Activity Contracts

According to the FBA, 19 DoD organizations acquired medical services totaling about $19.1 million using FBA contracts in FY 2002. The use of FBA contracts to acquire medical services may not be in the best interest of DoD medical facilities. We question:

- whether DoD medical facilities should use FBA authority for acquiring financial and administrative support services to acquire medical services, and
- why DoD would acquire medical services through FBA contracts considering that it has extensive medical service contracting capabilities.

Also, the scope of work for one of the two FBA contracts reviewed was so broad that medical contractors with lower-priced bids were considered technically inferior and not selected partly because prior experience was only in medically related labor categories. DoD may also have been incurring unnecessary costs by paying surcharge fees on those FBA medical contracts. Additionally, the Naval Medical Logistics Command contends that using the FBA as a means for acquiring medical services may result in illegal and unenforceable contracts that place the medical facilities at unacceptable risk.

Use of FBA Contracts

All three Military Departments used FBA contracts to acquire medical services. None of the Military Departments could provide data concerning the extent to which they used FBA contracts. However, the FBA documented that 19 DoD medical facilities acquired medical services totaling about $19.1 million in FY 2002 through FBA contracts, as shown in the table.

FY 2002 DoD Medical Services Contracted Through FBA

	Number of Medical Facilities	Amount (in millions)
Army	10	$13.3
Navy	3	0.4
Air Force	6	5.4
Total	**19**	**$19.1**

We reviewed the use of FBA contracts at Walter Reed Army Medical Center (WRAMC) and the Air Force's Wilford Hall Medical Center (WHMC). We were not aware that the Navy was also acquiring medical services using FBA contracts until after we completed our fieldwork. Therefore, we did not review Navy use of FBA contracts at specific Navy medical facilties.

Appropriateness of Using the FBA to Acquire Medical Services

We question whether it is in the best interest of DoD to use FBA contracts to acquire medical services for several reasons. We believe that it may not have been appropriate for WRAMC and WHMC to acquire medical services using FBA authority to provide financial and administrative support services. Regardless of the appropriateness of using FBA contracting authority, we question why DoD would acquire medical services through FBA contracts when the military health system has extensive medical service contracting capabilities of its own. Also, the scope of work for one of the two FBA contracts reviewed was so broad that medical contractors with lower-priced bids were considered technically inferior and not selected partly because prior experience was only in medically related labor categories.

Use of FBA Authority to Provide Administrative Support Services in Procuring Medical Services. Public Law 104-208 provided funding for the FBA to procure financial and administrative support services that the Secretary of the Treasury determined may be more economical to procure as a centralized service. The legislative history of the provision suggests that the purpose of the funding was to increase competition and to reduce duplication and costs for administrative services (Senate Report No. 103-281). The FBA interpreted the phrase "administrative support services" to include procurement and contracting, thereby allowing it to procure any type of service, including medical.

The three Military Departments interpreted the FBA authority differently and took various approaches to acquiring medical services through the FBA. Although the Navy determined that FBA contracts should not be used to acquire medical services, the Army and the Air Force had not made similar department-wide decisions. Also, DoD had not issued guidance concerning the use of FBA contracts for acquiring medical services.

The Naval Medical Logistics Command determined that the FBA was not an appropriate means for acquiring medical services. In August 2000, the Navy Bureau of Medicine and Surgery Instruction 4283.1, "Health Care Contracting," was changed to prohibit Navy medical facilities from using FBA contracts to acquire medical services. We agree that the Navy position is prudent. However, through an FBA data call we identified three Navy medical facilities that used the FBA to acquire medical services. We received information from the FBA on Navy medical facilities using FBA contracts, and we provided that information to the Naval Medical Logistics Command.

The Army's WRAMC, North Atlantic Regional Medical Command, used the Economy Act to justify using FBA contracts to acquire medical services, which totaled about $6.9 million in FY 2002, and in effect, transferred its personal services contracting authority to the FBA. The Economy Act (sections 1535-1536, title 31, United States Code) provides that, under certain circumstances, an agency may place an order for goods or services within the same agency or with other agencies. According to the Federal Acquisition Regulation (FAR) 17.5, the Economy Act applies when more specific statutory authority (for example, sources with separate statutory authority such as Federal Supply Schedule contracts) does not exist and the goods or services cannot be obtained as conveniently or economically by contracting directly with a private source. Further, according to Army Medical Command personnel, the authority to enter into personal services contracts rests with the Commander of the medical facility who can, in turn, delegate that authority to the FBA. To issue a personal services contract through the FBA, the Army's North Atlantic Regional Medical Command issued a blanket task order and modified its interagency agreement with the FBA. Although the task order states that the FBA does not have personal services contract authority, the Army had, in effect, transferred its personal services contracting authority to the FBA.

The Air Force's WHMC took another approach to the use of FBA contracts. WHMC did not use the Economy Act to justify using the FBA to acquire medical services and did not transfer its personal services contracting authority to the FBA. Instead, WHMC used a non-personal services FBA contract to acquire about $4.4 million of medical services in FY 2002, even though those services were similar to, and integrated with, those provided by Government employees at the medical facility.

FBA officials stated that they do not have personal services contract authority. The FAR 37-104 normally requires the Federal Government to obtain employees by direct hire under procedures set forth in civil service law. The FAR states that obtaining personal services by contract circumvents those laws, unless Congress has specifically authorized acquisition of the services by contract. Personal services contracts are characterized by an employer-employee relationship. Section 1091, title 10, United States Code, provides DoD with statutory authority to enter into personal services contracts for health care providers. According to DoD Instruction 6025.5, "Personal Services Contracts for Health Care Providers," January 6, 1995, personal services contracts are the preferred type of contract when the services provided are similar to those provided by Government employees in Government facilities and when the services of Government workers and contractors will be largely integrated.

On its Web site, the FBA states that it can meet an agency's long-term needs, to include the crossing of fiscal years, and states that an agency may validly record a financial obligation at the time it enters into a binding interagency agreement with the FBA. Further, the Web site states that the FBA can bill the agency or medical facility before services are rendered, based on the estimate. Although our audit did not include an analysis of medical facility management of funds transferred to the FBA, Army Audit Agency Report A-2002-0562-IMH, "Management Controls for Reimbursable Orders, U.S. Army Garrison Fort Sam Houston," September 16, 2002, identified a potential funding violation at an Army medical facility that

used a FBA contract. The problem occurred when appropriated funds from one year were used for obligations in another fiscal year. The Army Command's Resource Management Office didn't complete transactions by closing out reimbursable orders issued to the FBA. Because the FBA operates a revolving fund, funds remaining on reimbursable orders were applied to the next period. The nature of the FBA revolving fund and the resulting potential for funding violations raises an additional concern regarding the appropriateness of contracting through the FBA.

DoD Capability to Contract for Medical Services. Regardless of whether DoD can properly use FBA authority to provide financial and administrative support services for acquiring medical services, we question why DoD would choose to do so, considering the extensive medical service contracting capability that exists in the military health system. According to TRICARE Management Activity officials, DoD spent about $8 billion in FY 2002 acquiring TRICARE medical services. In addition, DoD spent about $1.2 billion in FY 2002 acquiring non-TRICARE medical services. As previously mentioned, DoD has medical contracting organizations, such as the Army's Health Care Acquisition Activity and the Naval Medical Logistics Command, that provide contractual support to DoD medical facilities. Thus, contrary to one of the purposes for establishing the franchise fund program, we believe DoD use of the FBA to acquire medical services may result in a duplication of services. At the DoD medical facilities visited, the primary reason given for acquiring medical services through the FBA was convenience and timeliness. Considering the extensive DoD contracting capabilities, medical activities should be able to satisfy the contractual needs of its medical facilities without using the FBA.

Scope of the FBA Contract. The scope of work for one of the two FBA solicitations reviewed was so broad that medical contractors with lower-priced bids were considered technically inferior and not selected partly because prior experience was only in medically related labor categories. The FBA does not award separate contracts to fill the medical service requirements of DoD. Instead, the FBA issues task orders against its existing contracts. Although the solicitation process for the FBA contract used by WRAMC allowed contractors to bid on portions of the FBA contract (for example, only medical services), the process for awarding the FBA contract used by WHMC required the contractors to provide the entire range of services.

The FBA contract used by WHMC was an approximate $44 million, multi-year FBA contract that Federal agencies in 27 geographical regions could use to acquire a full range of services, including administrative, light industrial, medical, professional, and technical services. Non-medical services comprised more than half of the labor categories, which included accountants, computer specialists, engineers, inspectors, and personnel specialists. In the recommendation for award memorandum, the FBA considered four lower-priced bidders to be technically inferior and did not select them partly because prior performance was only in medically related fields. Two of those four bidders had provided non-FBA contract medical services to DoD, totaling at least $15 million annually in FYs 2000 and 2001. The bids from the medically oriented companies ranged from about $26 million to about $41 million, which was $18 million to $3 million below the winning bid of $44 million. Although it is the prerogative of the FBA

to select a contractor who is bidding on the entire range of services, we question why DoD would want to use a contracting vehicle that may eliminate qualified medical service contractors. Although technical ability to perform all solicited services is important, we believe that a contract that requires one contractor to provide such vastly different services does not necessarily result in the best value in price and technical ability for the DoD medical facilities.

Surcharges Paid. Contracting for medical services through the FBA may result in additional costs to DoD through surcharges. We attempted to determine the total amount of surcharges paid to the FBA in FY 2002 by WRAMC, WHMC and DoD. WRAMC, WHMC, and DoD could not provide that information. The WRAMC and the WHMC interagency agreements did not specify a surcharge percentage. When we asked FBA officials for the total amount of surcharges paid in FY 2002 by DoD (and by WRAMC and WHMC specifically), they stated that surcharges ranged from 2 percent to 10 percent and that exact amounts would not be provided because the information was proprietary. If DoD does not know the amount of surcharges paid, it is difficult to judge the cost-effectiveness of the contracting service provided by the FBA. Further, considering the volume of medical services contracted for by DoD, it seems illogical that the FBA should be able to acquire medical services more cost-effectively than DoD. Based on the FBA estimate of 2 percent to 10 percent, surcharges in FY 2002 for the $19.1 million medical services could have ranged from $0.38 million to $1.9 million.

Potential Risks to the Military Health System. Navy officials stated that using FBA contracts to acquire direct health care providers might result in illegal, unenforceable contracts that expose the medical facilities to unacceptable risk. According to the Legal Counsel, Naval Medical Logistics Command, the FBA exceeded its charter and acted outside statutory authority by marketing direct health care providers to Navy medical facilities. The Navy based its decision to prohibit the use of FBA contracts for acquiring medical services, in part, on the belief that the FBA lacks the authority to award personal services contracts. Also, Counsel, Naval Medical Logistics Command stated that the power to re-delegate authority must be specifically granted beforehand, and this was not done. The Counsel believes the issue is significant because only a contract which was properly awarded under Section 1091, title 10, United States Code, can trigger the medical malpractice protection provided under Section 1089, title 10, United States Code. The Counsel was also concerned that FBA contracts did not provide adequate procedures or definition of responsibilities for contract administration, increasing the likelihood of unacceptable performance levels and ineffective remedies. The matter is further complicated by the fact that the DoD medical facilities' privity of contract is with the FBA, rather than the health care professionals performing the services. That means the medical facility must work through the FBA rather than directly with the contractor to enforce the terms of the contract.

DoD Guidance

We believe that the Assistant Secretary of Defense (Health Affairs) should make a determination on the appropriateness of using FBA contracts to acquire medical services for the military health system. The determination should be based on a legal opinion regarding DoD use of FBA financial and administrative support service authority. Additionally the determination should consider the medical service contracting capability that exists in DoD. If the determination is made that the use of FBA contracts is appropriate for acquiring medical services, then the Assistant Secretary should issue guidance on the use of those contracts. Such guidance should cover, at a minimum:

- the use of annual appropriations for services provided in subsequent years,
- the appropriate type of contracting vehicle to use (personal or non-personal),
- the acceptable amount of surcharges and disclosure of surcharge amounts in the interagency agreements, and
- whether the military health system will be allowed to use FBA contracts that might exclude medical providers for their inability to provide non-medical services.

We will forward a copy of this report to the Department of the Treasury Inspector General's Office so that it can take any action it deems necessary concerning the interpretation of financial and administrative support services provided by the FBA.

Ongoing Review

We briefed the Director, Defense Procurement and Acquisition Policy on our concerns regarding the appropriateness of acquiring medical services through the FBA. The procurement officials stated that in accordance with section 824 of the National Defense Authorization Act for FY 2003, they are currently assessing the costs and benefits associated with using non-DoD agencies to satisfy contracting requirements in FY 2000 through FY 2002. Section 824 of the Act resulted from a provision in the Senate bill (S. 2514, section 815). When discussing that provision, the Senate Armed Services Committee expressed concern that DoD continues to order excessive quantities of products and services through contracts entered by other Federal agencies and departments whose personnel have, in many cases, less expertise in acquiring the specific products or services than DoD personnel (Senate Report 107-151, accompanying S. 2514). Section 824 of the Act requires DoD to determine the amount paid in surcharges for acquiring products and services under contracts entered by other Federal agencies, and whether these funds could be put to better use.

Management Comments on the Finding and Audit Response

The Director, Defense Procurement and Acquisition Policy expressed concern that in the draft to this report we incorrectly cited Section 824 of the National Defense Authorization Act for FY 2003 as containing specific language indicating that DoD is acquiring services from other Federal agencies with less expertise than in-house DoD personnel. That language was taken from committee language in Senate Report 107-151, discussing the Senate provision from which Section 824 was derived, and we have made appropriate corrections to the report.

Recommendations, Management Comments, and Audit Response

Deleted and Renumbered Recommendations. According to the Director, Defense Procurement and Acquisition Policy, Section 824 of the National Defense Authorization Act for FY 2003 requires summary-level data on the total amount paid during FYs 2000 through 2002 by DoD to other Federal agencies as fees, along with a determination of whether the total fees are excessive and a description of associated benefits received by DoD. The Act does not require DoD to review specific categories of products and services, such as medical services. Additionally, the Director stated that the Office of the Assistant Secretary of Defense (Health Affairs) is the appropriate organization for determining whether DoD should continue using FBA contracts to acquire medical services. Accordingly, the Director nonconcurred with Draft Recommendation 2. to include DoD acquisition of medical services through the FBA in the statutory review of interagency contracts required by the National Defense Authorization Act for FY 2003. As a result of the Director's comments, we have deleted Draft Recommendation 2. Draft Recommendations 1.a. and 1.b. have been renumbered as Recommendations 1. and 2., respectively.

We recommend that the Assistant Secretary of Defense (Health Affairs):

1. Determine whether the military health system should continue to use the Franchise Business Activity to acquire medical services for DoD. The determination should be based, in part, on a legal opinion regarding DoD use of Franchise Business Activity financial and administrative support service authority.

2. If the determination in Recommendation 1. is that DoD components may use the Franchise Business Activity contracts, the Assistant Secretary should coordinate with the Director, Defense Procurement and Acquisition Policy to issue guidance concerning the use of those contracts. The guidance, at a minimum, should discuss:

a. The use of annual appropriations for services performed in subsequent years.

b. The appropriate type of contracting vehicle to use (personal or non-personal).

c. The acceptable amount of surcharges and disclosure of surcharge amounts in the interagency agreements.

d. The use of Franchise Business Activity contracts that might exclude medical providers who do not provide non-medical services.

Management Comments. The Assistant Secretary of Defense (Health Affairs) concurred with the finding and recommendations. The Office of General Counsel, TRICARE Management Activity, in conjunction with the Office of General Counsel, DoD, issued a legal opinion stating that there is no legal authority to use the FBA to enter into personal services contracts to carry on health care responsibilities in military treatment facilities. Guidance will be issued to the Military Departments regarding use of the FBA.

Appendix A. Scope and Methodology

We queried the DoD Contract Action Reporting System to determine the overall scope of non-TRICARE medical service contracting throughout the Military Departments. To gain an understanding of how DoD medical facilities acquire medical services and to determine what guidance and controls exist regarding the use of FBA contracts, we visited and held discussions with personnel from the Army Medical Command, the Army Health Care Acquisition Activity, the Naval Medical Logistics Command, the Office of the Air Force Surgeon General, WRAMC, WHMC, and the FBA. We could not determine the extent to which DoD obtains medical services through the FBA because the contract actions were not reported in the DoD Contract Action Reporting System, and DoD did not know the extent to which FBA contracts were used. Thus, we relied on the FBA to estimate DoD funds spent to acquire medical services through FBA contracts. We also relied on the FBA to determine surcharge percentages paid, because the fees were not visible to DoD. Because the FBA is not a DoD Component and we did not have access to their supporting detail, we did not verify the accuracy of the estimates or the surcharge fee percentages.

We examined documents pertaining to two FBA contracts that were used by WRAMC and WHMC in FY 2002, to acquire about $6.9 million and $4.4 million respectively, for medical services. The documents in our review were dated January 6, 1995, through March 4, 2003. Specifically, we examined documents pertaining to the solicitation and award of FBA contracts and the interagency agreements established between the FBA and the two DoD medical facilities we reviewed. Additionally, we examined the blanket task order used by WRAMC. We reviewed 19 individual purchase calls, totaling about $0.9 million, placed against the blanket task order at WRAMC, and five task order requests, totaling about $2.2 million at WHMC, that were used to acquire health care providers, such as nurses and medical technicians. We were not aware that the Navy was using FBA contracts to acquire medical services until after we completed our fieldwork. Therefore, we did not review any Navy procurement using FBA contracts. We reviewed public laws, the FAR, and DoD and Military Department regulations relating to the acquisition of medical services and the use of FBA contracts. We did not review medical facility management of funds transferred to the FBA or the validity of contract payments made.

Our audit objective was to evaluate contracting agency and program office procedures for the award and administration of medical service contracts, excluding TRICARE contracts, and to evaluate the management control program applicable to the audit objective. During the audit process, we learned that the Military Departments were acquiring health care services (for example, physicians, nurses, laboratory and pharmacy technicians) through FBA contracts. Because the use of FBA contracts is a relatively new method of acquiring medical services that could have a significant impact on the Military Departments, this report addresses the use of FBA contracts. This audit was performed from April 2002 through April 2003 in accordance with generally accepted government auditing standards.

This audit report addresses management controls, but does not address management's self-evaluation related to procuring medical services through the FBA. Specifically, this report identifies a lack of clear policies and procedures related to contracting for medical services through the FBA. Recommendations 1. and 2., if implemented, will increase visibility of and strengthen management controls over the acquisition of medical services through franchise funds such as the FBA. Other issues regarding medical service contracts and management's overall self-evaluation related to procuring medical services will be evaluated in a subsequent summary report, including material weaknesses, if any.

Use of Computer-Processed Data. Although we used the DoD Contract Action Reporting System to determine the scope of medical contracting for supplemental medical care for the original audit objectives, we found that the system did not include FBA contracts. Although we used the Reporting System to estimate the scope of non-TRICARE medical services contract dollars, we did not base our audit conclusion on that data and, accordingly, did not validate its reliability. We did not use computer-processed data to form our audit conclusions about the use of FBA contracts.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management and the DoD Support Infrastructure Management high-risk areas.

Prior Coverage

During the last 5 years, the Army has issued one report on the use of FBA contracts to acquire medical services. Prior coverage concerning contracting will be provided in a separate report. Army reports can be accessed over the Internet at https://www.aaa.army.mil from certain domains.

Army

Army Audit Agency Report No. A-2002-0562-IMH, "Management Controls for Reimbursable Orders, U.S. Army Garrison Fort Sam Houston," September 16, 2002

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology and Logistics
  Director, Defense Procurement and Acquisition Policy
Under Secretary of Defense (Comptroller)/Chief Financial Officer
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense for Personnel and Readiness
Assistant Secretary of Defense (Health Affairs)
General Counsel

Department of the Army

Inspector General
Auditor General, Department of the Army
Surgeon General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy
Chief, Bureau of Medicine and Surgery

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force
Surgeon General, Department of the Air Force

Other Non-DoD Organizations

Office of Management and Budget, National Security Division
Inspector General, Department of the Treasury

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Assistant Secretary of Defense (Health Affairs) Comments

THE ASSISTANT SECRETARY OF DEFENSE

1200 DEFENSE PENTAGON
WASHINGTON, DC 20301-1200

HEALTH AFFAIRS

JUN 18 2003

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Response to Department of Defense Inspector General on Draft Audit Report, "Franchise Business Activity Contracts for Medical Services," D2002LF-0110

This is the Department of Defense (DoD) response to the recommendations in the DoD Inspector General (DoD IG) Draft Audit Report, "Audit of Medical Services Contracts," dated April 22, 2003 (Project No. D2002LF-0110) (attached).

Overall, we concur with the findings and recommendations of the draft report. The Office of General Counsel, TRICARE Management Activity (OGC, TMA), in conjunction with the OGC, DoD, has issued a legal opinion stating that there is no legal authority to use the Franchise Business Activity (FBA) to enter into personal services contracts to carry on health care responsibilities in Military Treatment Facilities (MTFs) (attached). The opinion further states that the use of the FBA to acquire other services, including non-personal services of health care providers for MTFs, should strictly comply with FAR Part 37 and the principles of Federal appropriation laws. Guidance will be issued to the Military Departments regarding the use of the FBA contracting vehicle.

Please feel free to direct any questions to my Project Officers on this effort, Ms. Suzanne Curtis (Functional) at (703) 681-1143 and Mr. Gunther Zimmerman (GAO/IG Liaison) at (703) 681-3492.

for William Winkenwerder Jr., MD

Attachments:
As stated

Final Report Reference

Agency Comments on Department of Defense Inspector General Draft Audit Report, "Franchise Business Activity Contracts for Medical Services," D2002lf-0110

Department of Defense Comments

RECOMMENDATION:

1. We recommend that the Assistant Secretary of Defense (Health Affairs) (ASD (HA)):

a. Determine whether the Military Health System (MHS) should continue to use the Franchise Business Activity (FBA) to acquire medical services for the Department of Defense (DoD). The determination should be based, in part, on a legal opinion regarding DoD use of FBA financial and administrative support service authority.

b. If the determination in Recommendation 1a is that DoD components may use the FBA contracts, that the Assistant Secretary should coordinate with the Director, Defense Procurement and Acquisition Policy, to issue guidance concerning the use of those contracts. The guidance, at a minimum, should discuss:

(1) The use of annual appropriations for services performed in subsequent years.
(2) The appropriate type of contracting vehicle to use (personal or non-personal).
(3) The acceptable amount of surcharges and disclosure of surcharge amounts in the interagency agreements.
(4) The use of FBA contracts that might exclude medical providers who do not provide non-medical services.

2. We recommend that the Director, Defense Procurement and Acquisition Policy include the DoD acquisition of medical services through the FBA in the statutory review of DoD interagency contracts as required by the National Defense Authorization Act for Fiscal Year 2003.

Renumbered as Recommendations 1. and 2.

Response to Recommendations 1a and 1b:

Concur. The TRICARE Management Activity Office of General Counsel (TMA OGC), in conjunction with DoD OGC, has issued a legal opinion stating that there is no legal authority to use the FBA to support health care responsibilities in DoD MTFs. Guidance will be issued to the Military Departments regarding the use of the FBA contracting vehicle.

Deleted

Response to Recommendation 2:

No comment. Defer to Director, Defense Procurement and Acquisition Policy.

Technical Changes:

None.

Defense Procurement and Acquisition Policy Comments

Final Report Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION, TECHNOLOGY AND LOGISTICS

June 2, 2003

DPAP/P

MEMORANDUM FOR DIRECTOR, READINESS AND LOGISTICS SUPPORT DIRECTORATE, DODIG

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS 6/6/03

SUBJECT: DoDIG Draft Report No. D2002LF-0110, Franchise Business Activity Contracts for Medical Services

This is in response to your request for my comments on the following recommendation contained in the subject draft audit report.

DoDIG Recommendation #2: We recommend that the Director, Defense Procurement and Acquisition Policy (DPAP) include the DoD acquisition of medical services through the Franchise Business Activity in the statutory review of DoD interagency contracts as required by the National Defense Authorization Act for FY 2003.

Deleted

DPAP Comments: Nonconcur. This recommendation incorrectly suggests that Section 824 of the National Defense Authorization Act for Fiscal Year 2003 (Pub. L. 107-314) requires a review of the appropriateness of DoD's acquiring specific categories of products and services through contracts with other Federal departments and agencies, such as medical services under the Department of Treasury's Franchise Business Activity. Section 824 actually requires the Department to provide a report to Congress of summary-level data on the total amount paid during FY 2000-2002 by DoD to other agencies as fees for the acquisition of all such products and services, together with a determination of whether that total is excessive and a description of the associated benefits received by DoD. In preparing this report, we considered all available data on DoD orders placed against other agencies' contracts during the three-year period from both the Defense Department Form 350 reports and the Federal Procurement Data System. Consistent with your Recommendations #1, we believe the Assistant Secretary of Defense (Health Affairs) is the appropriate office for determining whether the military health system should continue to use the Franchise Business Activity to acquire medical services for DoD.

Final Report Reference

Revised

We must also take exception to the following sentence contained in the Ongoing Review section (page 8) of your draft report: "According to the Authorization Act, DoD continues to order excessive quantities of products and services through contracts by other Federal agencies and departments with less expertise in acquiring the specific products or services than DoD personnel." Section 824 contains no value judgments about DoD's use of other agencies' contracts. It simply asks for data on total fees paid, together with a determination of whether that total is excessive and a description of associated benefits received by the Department.

The Section 824 report was provided to the House and Senate Armed Services Committees on May 16, 2003. It stated that the total fees paid by DoD averaged approximately one percent of the total dollars spent by the Department under other agencies' contracts during FY 2000-2002 and that we do not think these fees are excessive. The Section 824 report also noted that the General Services Administration, which accounts for approximately 93 percent of the total dollars that DoD spends under other agencies' contracts, will be lowering the fee for its Federal Supply Schedule contracts from the current one percent to 0.75 percent beginning in FY 2004.

I appreciate the opportunity to comment on this draft audit report. My point of contact is Mr. Christopher Werner at (703) 695-9764 or via e-mail: christopher.werner@osd.mil.

Deidre A. Lee
Director, Defense Procurement
and Acquisition Policy

Team Members

The Readiness and Logistics Support Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Shelton Young
Michael A. Joseph
Scott J. Grady
Dawn Borum
Robin Parrish
Elmer J. Smith
Eva Zahn
William Lanyi
Elizabeth L. N. Shifflett
Susann L. Cobb