

GAO

Report to the Chairman and Ranking
Minority Member, Subcommittee on
Military Personnel, Committee on
Armed Services, House of
Representatives

April 2001

DEFENSE HEALTH CARE

Continued
Management Focus
Key to Settling
TRICARE Change
Orders Quickly



G A O

Accountability * Integrity * Reliability

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Abbreviations

ADP	automated data processing
BPA	Bid Price Adjustment
CNA	Center for Naval Analysis
COTS	Change Order Tracking System
DHP	Defense Health Program
DLA	Defense Logistics Agency
DOD	Department of Defense
IGCE	independent government cost estimate
IPT	Integrated Program Team
IS	information systems
MCS	managed care support
REA	Request for Equitable Adjustment
TMA	TRICARE Management Activity



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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

April 30, 2001

The Honorable John M. McHugh
Chairman
The Honorable Martin T. Meehan
Ranking Minority Member
Subcommittee on Military Personnel
Committee on Armed Services
House of Representatives

Under TRICARE, the Department of Defense's (DOD) managed care program, military-operated hospitals and clinics are supplemented by contracted civilian services. To date, DOD has awarded seven managed care support (MCS) contracts to administer health care in 11 geographic regions. Since the inception of TRICARE, DOD has made numerous modifications to these contracts via contract change orders. These changes were made for a variety of reasons, such as the addition of new benefits or changes in administrative processes. In recent years, DOD's management of the change order process has resulted in a large backlog of outstanding change orders. The cost associated with this backlog as well as its growth has been an ongoing source of congressional concern. Until recently, DOD directed its MCS contractors to implement change orders prior to negotiation and payment. Therefore, DOD's backlog of unsettled changes orders generally consists of change orders for which the MCS contractors have not received payment. Because DOD's estimates for change order costs have typically been lower than MCS contractors' proposed costs, the unsettled change orders could represent a significant future liability for the Defense Health Program (DHP) if they are settled at higher amounts than DOD estimated.

In July 1997, we reported that DOD was taking steps to improve its change order process, and we recommended that DOD continue providing the high-level management attention it had recently begun to use to implement change order process improvements.¹ However, the backlog continued to grow. On July 1, 2000, DOD began a short-term initiative to negotiate and pay for all of its outstanding change orders. In addition, DOD has begun to use a new process for issuing and settling change orders.

¹*Defense Health Care: Actions Under Way to Address Many TRICARE Contract Change Order Problems* (GAO/HEHS-97-141, July 14, 1997).

Your Subcommittee raised questions about whether the change order process had, in fact, improved and about DOD's ability to effectively manage the MCS contracts. Specifically, you asked us to update the 1997 report and provide information on (1) the status of the change order backlog and whether DOD reduced it, (2) factors that contributed to the growth of the backlog, and (3) DOD's new change order process.

To address these objectives, we analyzed data from DOD's Change Order Tracking System and interviewed officials of DOD's TRICARE Management Activity (TMA), which solicits, awards, and oversees the MCS contracts. We also met with the MCS contractors to obtain their views on problems with change orders and potential process modifications. We did our work from July 2000 through March 2001 in accordance with generally accepted government auditing standards. (For a further description of our scope and methodology, see app. I.)

Results in Brief

As of June 30, 2000, TMA's backlog of unsettled change orders had more than doubled—from 223 to 562—since our July 1997 report. Despite TMA's concurrence with our earlier recommendation to continue providing high-level management attention to needed process improvements, TMA management did not remain consistently focused on the change order process. Furthermore, the initiatives it implemented had limited effectiveness in reducing the backlog. On July 1, 2000, TMA initiated a short-term, ambitious effort to eliminate the backlog by making the settlement of change orders a management priority both internally and with the MCS contractors. By February 2001, TMA had eliminated most of the backlog, which resulted in settlements of about \$900 million for current and prior fiscal years. This short-term effort, while successful, was prompted by the need to prepare for sweeping program changes, including expanded benefits for retired military beneficiaries who are Medicare-eligible, legislated by the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398). Because the total cost of these settlements had not been included in the current-year defense budget, these costs contributed to about \$500 million of the overall DHP funding shortfall for fiscal year 2001, which TMA estimates at \$1.4 billion.

TMA had issued 1,091 change orders to its TRICARE contracts as of June 30, 2000—more than triple the amount we reported in July 1997. However, because the pace of settlements lagged far behind the number of change orders issued, TMA's backlog continued to grow. Because the change order process involves a number of sequential tasks, recurring delays with steps in this sequence (such as cost proposal submissions by MCS

contractors and reviews by TMA), slowed the overall process and ultimately, payments to the MCS contractors. By June 30, 2000, TMA had met its goal to settle change orders within 180 days of issuance less than 20 percent of the time. TMA's staffing problems further impeded its ability to settle change orders in a timely manner. For instance, TMA had a major reorganization and staff reduction under the 1997 Defense Reform Initiative. In addition, TMA had problems with the high turnover of its Contract Management staff, who are responsible for issuing and settling change orders. The resulting knowledge gaps and reduced resources left TMA unable to make significant progress in settling change orders to eliminate the backlog.

Recently, TMA began using a new change order process requiring potential changes to be reviewed, approved, and prioritized by senior-level TMA and military services officials. Furthermore, change order costs are to be negotiated and settled before changes are implemented. TMA officials told us that the new approval and prioritization process for new changes will help control the number of change orders issued by ensuring that all the changes issued are necessary and that the most important changes are implemented first, based on the availability of funds. In addition, negotiating and settling change orders before implementation will help TMA ensure that sufficient funding is available to pay for the changes, which will help it avoid future funding shortfalls. However, it is premature to evaluate the effectiveness of this process because TMA has not yet issued any change orders under it. Given TMA's past experience with change order initiatives, it is imperative that TMA closely monitor its new process.

We are recommending that the Secretary of Defense ensure that the new change order process receives the consistent high-level management attention necessary to succeed and, as part of this effort, monitor the new process and take corrective actions if problems, such as a growing backlog, develop. We requested comments from DOD, but none were provided.

Background

DOD's primary medical mission is to maintain the health of its 1.6 million active duty service personnel and to provide health care for them during military operations. DOD also offers health care to 6.7 million nonactive duty beneficiaries, including dependents of active duty personnel, military retirees, and dependents of retirees. Under TRICARE, DOD provides health care to its eligible beneficiaries through military-operated hospitals and clinics worldwide and supplements this care with civilian providers.

DOD contracts with MCS contractors to administer its TRICARE program on a regional basis. The MCS contractors' responsibilities include claims processing, customer service, and developing and maintaining an adequate network of civilian providers.

Since 1994, DOD has awarded seven MCS contracts covering the 11 TRICARE regions. These contracts were awarded for a base period and 5 option years.² (See table 1.) Four of the MCS contracts have used all of the option years and three of these have been extended for an additional 2 years. A fourth contract's extension is under way. TMA anticipates that all of its MCS contracts will eventually be extended.

Table 1: MCS Contractors, Regions, and Date of Initial Award

MCS Contractor	Region name and number	Date of initial award
Health Net Federal Services ^a	Northwest/11	September 1994
Health Net Federal Services	Southwest/6	April 1995
Health Net Federal Services	Golden Gate, Southern California, and Pacific/9, 10, and 12	August 1995
Humana Military Healthcare Services	Southeast and Gulf South/3 and 4	November 1995
TriWest Healthcare Alliance	Central/(formerly 7 and 8)	June 1996
Anthem Alliance ^b	Mid-Atlantic and Heartland/2 and 5	September 1997
Sierra Military Healthcare Services	Northeast/1	September 1997

^aHealth Net Federal Services, formerly Foundation Health Federal Services, changed its name in February 2001.

^bIn April 2001, DOD announced that Humana Military Healthcare Services acquired Anthem Alliance and will assume responsibility for the Mid-Atlantic and Heartland Regions.

Source: TMA.

TMA, within DOD's Office of the Assistant Secretary of Defense (Health Affairs), is responsible for administering the MCS contracts. TMA's contracting officers have the ultimate responsibility for contract administration, including the issuance of change orders. Contracting

²The base period, which varies by contract, consists of a transition period, ranging from 6-9 months, and the early months of health care delivery.

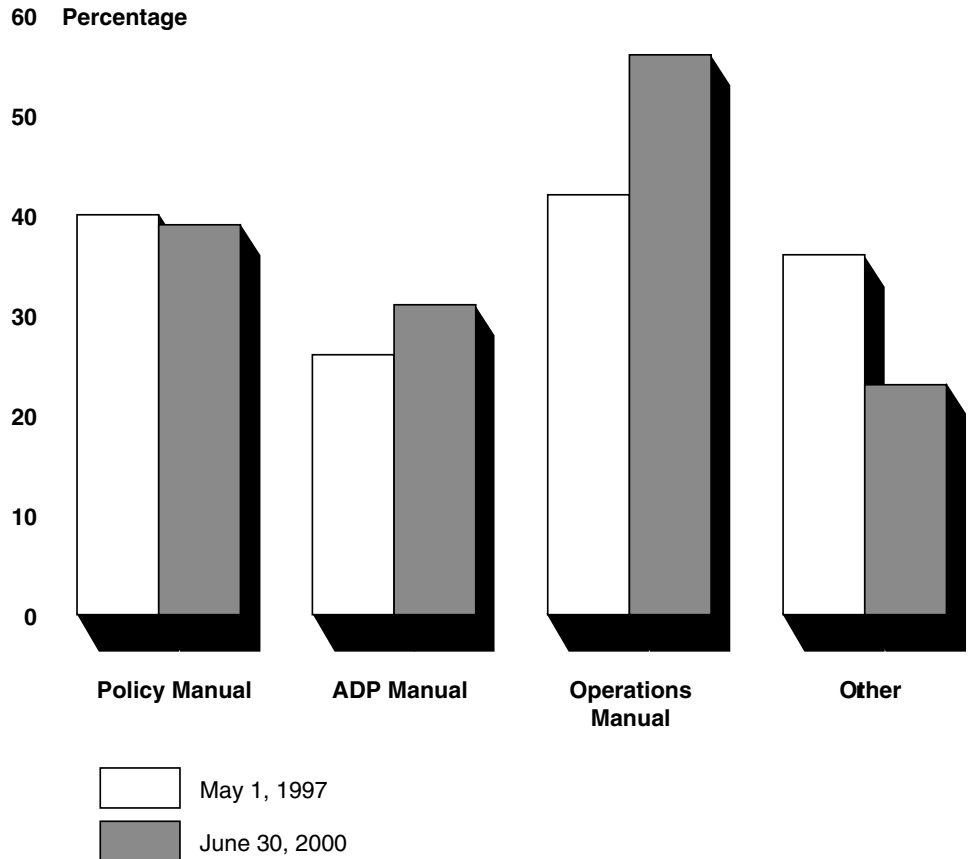
officers are assigned to each MCS contract and are supported by other TMA staff as well as by the Lead Agents.³

Change orders may result from new laws or regulations, or from DOD initiatives. The most recent data available, which were in our 1997 report, showed that one-third of all TRICARE change orders resulted from new laws or regulations, while the remaining two-thirds were self-initiated. TMA officials told us that they were unable to provide updated statistics for our current review because the data are maintained by several different departments and would require significant effort to compile.

Most changes are incorporated into the MCS contracts by issuing the change order as an amendment to the applicable TRICARE program manual: the *Policy Manual*, the *Automated Data Processing (ADP) Manual*, or the *Operations Manual*. Policy changes include the authorization of new benefits or changes in the administration or payment of current benefits. ADP changes involve modifications to how data are created, maintained, or reported, as well as changes to systems requirements. Operations changes include those involving the administration of the TRICARE program, such as revisions to home health care billing procedures. Changes can also be classified as “multiple,” meaning they involve modifying two or more of the manuals. Changes classified as “other” fall outside these categories. Examples of such changes are the authorization of travel costs incurred by the MCS contractors for government training and orders directing MCS contractors to report information about ongoing provider fraud investigations. Similar to our 1997 report, we found that as of June 30, 2000, the *Operations Manual* was modified most frequently, followed by the *Policy Manual*, as shown in figure 1.

³An administrative organization called a Lead Agent is designated for each of the TRICARE regions to coordinate health care provided by all military treatment facilities in the region. Lead Agents can issue change orders that are small in scope. However, we included in our review only those change orders issued by TMA.

Figure 1: Percentage of Change Orders by TRICARE Manual, May 1, 1997, and June 30, 2000



Note: The percentage for each year total more than 100 percent because some change orders modified more than one manual. In May 1997, 30 percent of change orders affected multiple manuals, and in June 2000, 35 percent of change orders affected more than one manual.

Source: TMA's Change Order Tracking System.

Most change orders affect all of the MCS contracts. For example, if TMA issues a change to the TRICARE program, such as a new benefit, all of the MCS contracts must be changed. Each change order, even for the same change, has to be negotiated separately with each MCS contractor because the cost of the change can vary by geographic region and the number of beneficiaries a contract covers.

The Federal Acquisition Regulation, the Defense Federal Acquisition Regulation Supplement, and other internal DOD guidance set forth the requirements governing the administration of change orders. The

requirements include time frames within which contractors should submit cost proposals to the government as well as guidance as to the time frames within which change orders should be settled.

All change orders have been issued by TMA as unilateral changes, which means that they were implemented before their costs were negotiated and settled. The process of issuing and settling change orders involved many steps. When a change was identified for the TRICARE program, TMA defined its requirements, solicited comments about the change from the MCS contractors, and obtained an independent government cost estimate (IGCE), which was used to obligate, or set aside, funds for the change order. Then, the change orders were issued to the MCS contractors for implementation. MCS contractors were asked to submit a cost proposal within 60 days. When it received the proposal, TMA performed technical reviews and cost analyses of the information and then negotiated with the MCS contractor to determine the final price. Change order settlements can result in payments to the MCS contractors, savings to TMA, or no cost to either party. TMA's goal for settling change orders is 180 days from issuance.

TMA is also responsible for formulating the DHP budget request, which encompasses costs for MCS contracts, including change orders. TMA prepares both a current-year budget and a budget for the Future Years Defense Plan, which represents the estimated appropriation needs for the budget years for which funds are being requested and at least 4 years after. TMA also maintains the accounting system used to obligate and disburse funds for change orders.

Change Order Backlog Recently Reduced

In our July 1997 report we cited a series of actions TMA had under way to address change order problems and reduce the backlog, such as hiring a management consulting firm to recommend improvements. In that report, we recommended that TMA continue providing high-level management attention to implement needed improvements to the process. However, TMA's actions failed to make a measurable improvement to the process, and by June 30, 2000, the number of unsettled change orders had peaked at 562—more than double what it had been at the time of our previous report. Realizing that they had to “clear the books” in order to prepare for sweeping program changes that would result from the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398), TMA officials began an ambitious effort on July 1, 2000, to eliminate the backlog by the end of the calendar year. As of February 2001, TMA's change order backlog totaled 121—a reduction of 78 percent in 7 months.

To reach this goal within the short time frame, TMA modified its normal change order process, negotiating with its MCS contractors about \$900 million in global settlements for the current and prior fiscal years that included change orders as well as other contract adjustments. Because the total cost of these settlements had not been included in the current-year defense budget, these costs contributed to about \$500 million of the overall DHP funding shortfall for fiscal year 2001, which TMA estimates at \$1.4 billion.

Past Initiatives Had Limited Effectiveness

According to our 1997 report, the initiatives TMA was implementing to address change order problems included engaging a consulting firm to prepare IGCEs for individual change orders, establishing a new requirement that all proposed change orders be reviewed and approved by Health Affairs before issuance, and hiring a management consulting firm to review and recommend improvements to the process. In that report, we stated that while it was too soon to determine the effectiveness of these efforts, they could bring needed discipline to the system by helping to ensure the need for, cost of, and timely settlement of change orders. However, for a variety of reasons that included a major staff reorganization and reduction, TMA management did not remain consistently focused on change order improvements, and these initiatives either were not fully implemented or had limited success. Furthermore, TMA did not always have data available to measure the impact of these specific initiatives on the change order process. (See app. II for a list of the initiatives and their outcomes.) These initiatives notwithstanding, between July 1997 and June 30, 2000, the backlog more than doubled to 562 (see table 2) although the percent of unsettled change orders decreased from 62 percent to 52 percent.

Table 2: TRICARE Change Orders by MCS Contractor, Region, and Settlement Status on May 1, 1997, and on June 30, 2000

MCS Contractor/region	Status of all change orders on May 1, 1997 ^a			Status of all change orders on June 30, 2000		
	Settled	Unsettled	Total	Settled	Unsettled	Total
Health Net Federal Services/11	56	56	112	138	76	214
Health Net Federal Services/6	30	46	76	104	78	182
Health Net Federal Services/9, 10, and 12	29	47	76	104	80	184
Humana/3 and 4	19	52	71	85	82	167
TriWest/Central (formerly 7 and 8)	0	22	22	56	72	128
Anthem/2 and 5 ^b				29	72	107
Sierra Military Healthcare Services/1 ^b				13	96	109
Total	134	223	357	529	562	1,091

^aData from GAO/HEHS-97-141, July 14, 1997.

^bThese contracts had not been awarded on May 1, 1997.

Source: TMA's Change Order Tracking System.

Change Order Backlog Mostly Eliminated Under Recent Settlement Effort

On July 1, 2000, TMA initiated an ambitious, short-term effort, referred to as Mobilization, to settle its 562 open change orders as well as other contract adjustments by the end of the calendar year.⁴ TMA officials stated that clearing the backlog was necessary in order to prepare for changes mandated in the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) that would result in significant program changes, including expanded health care and pharmacy benefits for military retirees who are age 65 and older. In addition, TMA officials recognized that they needed to reimburse MCS contractors for implementing past change orders that had not been negotiated and paid. To help achieve this goal, TMA increased the technical support for its

⁴TMA's initiative also included the settlement of all outstanding Requests for Equitable Adjustment (REA), claims, and Bid Price Adjustments (BPA). REAs are submitted by MCS contractors to redress unforeseen changes in contract conditions that subsequently increased their expenses. Claims usually result from the inability of TMA and the MCS contractor to agree on an REA. BPAs are regularly scheduled reviews of the operating conditions of the contract, with subsequent adjustments to the contract price, which may either increase or decrease the contract price.

Contract Management staff by using 14 staff on contract from the Center for Naval Analysis (CNA), who were originally slated to analyze and evaluate the proposals submitted in response to TMA's solicitations for the next round of TRICARE contracts, which had been postponed. These additional staff were used primarily to help with change order proposal reviews by providing technical and pricing expertise. TMA also hired an information systems consulting firm to help review proposals and increased the numbers of other contracted staff who support Contract Management.

TMA worked with its MCS contractors to make this initiative a priority by setting deadlines for the cost proposal submissions, which are needed to negotiate and settle the change orders. TMA officials soon realized, however, that reviewing and negotiating individual change orders would be too time-consuming to meet its 6-month goal. To expedite negotiations, TMA sent a team of contract staff to each MCS contractor to negotiate global settlements, which included all change orders that had not yet been settled under this effort, as well as REAs, claims, and other outstanding contract adjustments. As of February 8, 2001, TMA had completed payments to four of its five MCS contractors and had made partial payments to the fifth MCS contractor.⁵ Through this effort, TMA settled all but 71 change orders. According to TMA, some change orders were not settled under this effort because it lacked information or disagreed with the MCS contractors about settlement terms. The 71 change orders, combined with the 50 change orders issued after July 1, 2000, resulted in a backlog of 121 by February 2001.

Amounts Budgeted for Change Orders Insufficient to Cover Negotiated Settlement Costs

As of February 2001, TMA estimated a DHP funding shortfall of about \$1.4 billion for fiscal year 2001. This shortfall amount includes about \$500 million of the negotiated settlement amounts from TMA's Mobilization initiative as well as other DHP requirements, such as the direct care system of military treatment facilities and the National Mail Order Pharmacy.⁶ TMA officials indicated that this shortfall would have to be

⁵As of April 16, 2001, TMA had completed payments to the fifth MCS contractor for all but 5 of the change orders that were negotiated during this effort.

⁶TMA's funding shortfall estimate of \$1.4 billion includes costs associated with the MCS contract settlements as well as other MCS contract costs; other private sector care benefits, such as the National Mail Order Pharmacy; the direct care system; and statutory requirements, including start-up costs for some of the new benefits for beneficiaries, who are age 65 and older.

satisfied through either an emergency supplemental budget request for fiscal year 2001 or a reprogramming of DOD funds. Negotiated settlements from the Mobilization initiative totaled about \$900 million for current and prior fiscal years.⁷ However, it is not possible to identify the amounts related specifically to change orders for each of the MCS contracts because the change orders and other contract adjustments were jointly settled. Furthermore, the total cost of this effort is difficult to determine because the settlements also affected future-year costs.⁸ TMA officials stated that future-year cost estimates will be included in the President's Budget for Fiscal Year 2002.

In 1997 we reported that TMA was not budgeting separately for change orders, and we cautioned that settling TRICARE's backlog of change orders could be very costly. We noted that the MCS contractors' estimates to settle only a portion of the open change orders at the time totaled \$423 million, yet TMA estimated that settling all open change orders would cost \$38 million. At the time of our 1997 report, TMA officials told us that they were developing a methodology to include change order costs in their budget. That methodology, developed in 1998 and first employed in fiscal year 1999, was to use 3 percent of TMA's annual adjusted MCS contract costs as an estimated budget for change orders. Using this methodology, the amount in the fiscal year 2001 budget for change orders is approximately \$90 million. However, since TMA has negotiated settlement amounts for most of its change order backlog and has a clearer picture of change order costs, TMA officials plan to review the adequacy of the 3 percent budget estimate.

Many Factors Contributed to the Change Order Backlog

The high volume of change orders issued and the consistently slow pace of settlements allowed the backlog to grow. Although TMA's goal is to settle change orders within 180 days after issuance, it had met this goal less than 20 percent of the time as of June 30, 2000. In July 1997 we reported an average settlement time of 340 days and an average age per unsettled change order of 273 days. By June 30, 2000, both averages had increased: settlement time had risen to 499 days and the age of unsettled change

⁷This amount does not include settlements for some claims, which are still being negotiated. Also, these settlements affected BPA amounts for current and prior fiscal years. These additional amounts have yet to be finalized.

⁸Future-year costs increased, in part, because the settlements included changes to health care costs and factors used in BPAs.

orders reached 547 days—1½ years. Settlement delays occurred because of the slow submissions of cost proposals by the MCS contractors, the subsequent slow reviews of the proposals by TMA, and TMA’s periodic problems with obtaining funds for payment. TMA contract staffing shortages and high turnover further impeded the process.

TMA Continued to Issue Hundreds of Change Orders

As of May 1, 1997, TMA had issued 357 change orders to its TRICARE contracts, with an average of 71 per contract; as of June 30, 2000, change orders totaled 1,091 and averaged 156 per contract. Since our 1997 report, TMA awarded two additional MCS contracts, whose change orders resulted in a 25 percent increase to the overall number issued. Table 3 compares the number of change orders issued for each TRICARE contract and region for these time periods.

Table 3: TRICARE Change Orders Issued by MCS Contractor and Region as of May 1, 1997, and June 30, 2000

MCS Contractor/region	All changes issued as of May 1, 1997 ^a	All changes issued as of June 30, 2000
Health Net Federal Services/11	112	214
Health Net Federal Services/6	76	182
Health Net Federal Services/9, 10, and 12	76	184
Humana/3 and 4	71	167
TriWest/Central (formerly 7 and 8)	22	128
Anthem/2 and 5 ^b		107
Sierra Military Healthcare Services/1 ^b		109
Total	357	1,091

^aData from GAO/HEHS-97-141, July 14, 1997.

^bThese contracts had not been awarded on May 1, 1997.

Source: TMA’s Change Order Tracking System.

Figure 2 shows that the rate of issuance for change orders since May 1, 1997, has varied substantially by month. The number of change orders issued each month from May 1, 1997, through June 30, 2000, varied from a low of 3 during July 1998 to a high of 80 during September 1998. An average of 19 change orders were issued each month during this time period.

Figure 2: Change Orders Issued by Month, May 1997 - June 2000



Source: TMA's Change Order Tracking System.

Process Impediments and Staffing Problems Allowed the Backlog to Grow

The change order process has consisted of sequential steps, such as the submission of cost proposals by the MCS contractors, the subsequent proposal reviews by TMA, and ultimately, payment by TMA, if needed, for settlement. Delays in completing these steps slowed settlements. Furthermore, long-standing contract staffing problems, including both limited numbers and high turnover, diminished the contract staff's overall knowledge base and impeded its ability to handle the heavy workload.

Slow Proposal Submissions

To begin the change order negotiation and settlement process, TMA must receive an adequate cost proposal from the MCS contractor. TMA asks MCS contractors to submit a cost proposal within 60 days from receipt of the change order, but TMA does not often receive them within this time frame. As of June 30, 2000, TMA had not received proposals for 381 of the 562 unsettled change orders (68 percent)—90 percent of which were older than 60 days. In addition, we found that it took an average of about 9 months from change order issuance to proposal submission. One of the most common reasons MCS contractors cited for slow proposal submission was that they believe TMA does not always provide sufficient specifications for them to appropriately price out the costs of the changes. We cited this same problem in our 1997 report. As a result, MCS contractors said that during the implementation of the change they must spend time clarifying the details and scope of the change. One MCS

contractor told us that TMA's insufficient specifications leaves many items open to contractor interpretation, and therefore the MCS contractor's efforts and corresponding costs sometimes vary significantly from TMA's expectations.

Another reason some contractors gave us for slow proposal submissions is the time it takes to collect relevant data for determining the total cost of the change. This process involves obtaining information from various internal departments, which can include systems and actuarial personnel, as well as from subcontractors, such as those used in processing health care claims. Also, two of the MCS contractors stated that if the benefit is new and unique, they prefer to gather actual costs because it is hard to predict the extent to which beneficiaries will use the benefit. Another factor that delays proposal preparation is TMA's issuance of additional changes to previous unsettled change orders.⁹ This complicates proposal preparation because it is difficult to determine where to assign costs—to the original or to the subsequent change.

Slow Proposal Reviews

In order to meet TMA's goal to settle change orders in 180 days, it has 120 days after proposals are submitted to review, negotiate, and settle them. However, as of June 30, 2000, the average time between proposal submission and settlement was 295 days. A number of factors contributed to this delay. One was that when a proposal is received, the TMA contracting officer may need to obtain multiple cost evaluations, including health care, information systems (IS), operations, and possibly a Defense Contract Audit Agency audit.¹⁰ These evaluations usually are not performed by TMA's Contract Management staff but by consultants or other TMA staff. The logistics of obtaining timely evaluations from these different sources can be time-consuming, and negotiations cannot proceed until the appropriate evaluations are complete.¹¹

An audit or review that results in the revision of a proposal also adds to the settlement time. Furthermore, as time passes, data in the proposal may

⁹TMA does not maintain data showing the frequency with which this occurs. TMA officials estimated that about half of their large dollar change orders, those over \$500,000, fall into this category (about 5 percent of all change orders).

¹⁰TMA asks the Defense Contract Audit Agency to audit all proposals over \$500,000 and others upon the request of the TMA contracting officer.

¹¹TMA has not maintained data on the difficulties or time spent in obtaining proposal reviews.

need to be updated. There is no standard length of time for which a proposal is considered current, and either TMA or the MCS contractor may initiate these updates. MCS contractors also may choose to revise their proposals if additional information becomes available that affects the cost of the change order.

If TMA determines that a proposal is inadequate, the MCS contractor must make the necessary changes and resubmit it for review. According to TMA, an adequate proposal must meet the requirements of the Federal Acquisition Regulation. TMA told us that some of the more common reasons a proposal must be revised are that it does not provide sufficient detail on costs and that it does not include adequate supporting documentation. TMA officials said they rarely issue formal notices of inadequacy and prefer to resolve problems informally in a collaborative approach. As a result, even though TMA officials told us that proposals are frequently inadequate, they have not maintained statistics to demonstrate this.

TMA officials acknowledged that contract staff exercise a fair amount of judgment in determining the adequacy of a proposal. For example, one contracting officer may find a proposal adequate, while another, who prefers more detailed cost data, may not. This can be a problem for MCS contractors if the TMA contract official they work with changes. One MCS contractor expressed frustration when proposals it submitted were initially considered adequate, then inadequate, and then adequate again, as their TMA contracting officer changed. Another MCS contractor told us it generally experienced an influx of inadequate proposals when new and inexperienced TMA staff were assigned to its contract. Once these staff became familiar with the MCS contractor's proposal format, fewer proposals were returned as inadequate.

Insufficient Funding Delays Payment

All of the MCS contractors told us that once they and TMA agreed upon a payment amount, there was sometimes a lengthy delay before they received the official settlement paperwork allowing them to bill TMA. As a result, the change order backlog can include change orders that have been negotiated but not paid. Although TMA does not maintain statistics showing the length of time between negotiation and payment, MCS contractors told us that in some instances they waited many months after negotiation to receive the final settlement paperwork. For example, one MCS contractor waited 9 months for settlement paperwork, and another said it waited 6 months.

TMA officials acknowledged that one of the primary reasons for delays has been insufficient funding. After negotiation, TMA officials prepare settlement paperwork and coordinate with Resource Management staff, who perform budgeting and accounting functions, to determine whether adequate funding is available. If it is not, TMA must wait until additional funding is obtained before sending paperwork to the MCS contractor. Delays also can occur if there is a problem with any of the numerous steps that must be completed in sequence after negotiation before the MCS contractor can be paid. Once TMA determines it has adequate funding, it sends the settlement paperwork to the MCS contractor for signature. The MCS contractor signs and returns the paperwork to TMA, where it is signed and returned to the MCS contractor, who may then bill TMA. TMA officials told us that they are required to pay the bill within 30 days of receipt.

Staffing Problems

In 1997, TMA officials stated that the backlog was caused in part by a shortage of staff as well as TMA's decision to allocate existing resources to the higher priority work of awarding the TRICARE contracts. Until recently, TMA officials continued to cite staff shortages as a problem contributing to the growth of the change order backlog. These officials stated that the continuation of this shortage was partially due to the Defense Reform Initiative that began in late 1997 and resulted in both a reorganization and an overall staff reduction of about 20 percent. TMA also had difficulty obtaining staff with certain areas of expertise needed to review MCS contractors' proposals. For example, TMA did not have adequately trained staff who were dedicated to perform information systems technical evaluations of proposals for approximately 1½ years from January 1999 to June 2000.¹² Without these evaluations, proposals with IS data could not be satisfactorily negotiated and settled. To avoid future staffing difficulties, TMA officials told us that they intend to retain some of the contracted staff who assisted them with Mobilization. In addition, TMA is currently conducting an internal assessment of current and future workload requirements to better align its resources, which could affect staffing levels. Therefore, TMA officials told us that they are not sure how many contracted staff will be used in the future.

Another problem was the turnover among TMA's contract staff—with staff both leaving and shifting among contracts. TMA officials stated that staff

¹²An IS technical evaluation would be used to determine whether the costs incurred by the MCS contractor in making systems changes were appropriate.

turnover is primarily due to staff shortages, which results in more work being distributed among fewer staff, leading to burnout. TMA officials stated that their experienced contract staff are highly marketable and can readily obtain other jobs for higher pay. Turnover of contract staff has been a long-standing problem for TMA. A 1998 Defense Logistics Agency (DLA) procurement management review of contracting activities at TMA reported that since January 1995, the turnover of contracting staff was high—about 33 percent over 3 years—and morale was low. The DLA report stated that these problems were due, in part, to staff burnout resulting from the change to managed care contracts, the sometimes hectic work pace, and the lack of program managers to make decisions and focus priorities. TMA concurred with the findings in that report.

The DLA report also said that contract staff need a minimum of 18 months of TRICARE experience to properly learn about MCS contracts. Therefore, high turnover of contract staff compromises the overall knowledge level about contracts as well as the specific business operations of the MCS contractors, which can delay change order settlements. For example, a few of the MCS contractors said that by the time they reached final negotiations, the TMA contract staff they initially worked with were no longer there, and they had to spend time educating the new staff about past actions on the change order.

Effectiveness of New Change Management Process Unknown

In May 1999, TMA began revising the change order process with the goals of reducing the backlog and facilitating the effective management of future change orders. The resulting streamlined Change Management Process is intended to address the fundamental problems with change orders, such as controlling the number issued by ensuring that the changes are necessary and by making certain that money is available to fund them. The new process includes the creation of the Change Management Board, an executive-level body charged with reviewing, approving, and prioritizing new changes. Although the Change Management Board began meeting in January 2000, it is premature to evaluate the effectiveness of the new process because no change orders have yet been issued under it.

Under the revised process, TMA's Program Executive Officer assigns each potential change order to a Program Manager, who is responsible for all activities associated with it.¹³ The Program Manager's initial task is to

¹³The Chief Operating Officer for TMA serves as the Program Executive Officer.

determine whether the potential change is “operational” or “significant.” Operational changes are those that cost less than \$500,000 per MCS contract and include administrative modifications, such as annual updates of provider reimbursement rates, ADP system updates, and routine modifications such as the clarification of current requirements. Operational changes are not reviewed by the Change Management Board for approval and proceed directly to negotiation and implementation.

Significant changes include benefits that represent a major program shift or changes with a financial impact over \$500,000. For such changes, the Program Manager establishes an Integrated Program Team (IPT) consisting of a cross-section of personnel including senior TMA, military services, and Lead Agent officials and others as needed. The IPT is responsible for determining specifically how a new change will be implemented and for estimating the cost of implementation to the MCS contracts, if applicable. Although the amount of time needed to determine these details may vary, TMA officials estimate that the IPT’s portion of the process could take 6 to 12 months. Within this time period, the IPTs have specific milestones to meet, such as receiving approval of an implementation plan from the Change Management Board.

The Change Management Board is composed of senior officials of both TMA and the Armed Services.¹⁴ The Board reviews proposed changes and determines which ones will become change orders. Approved changes are prioritized for negotiation and implementation on the basis of their importance and the availability of funds. Some approved changes will be delayed if funding is not available and thus may be included in the next year’s budget. For example, the Board may approve 20 change orders with total estimated costs of \$34 million. However, if only \$20 million is available to fund these changes, only changes with the highest priority will be implemented immediately.

TMA’s new Change Management Process allows for change orders to be issued either unilaterally, as they were previously, or bilaterally, which means that the changes are negotiated before implementation. TMA’s goal is to issue all of its contract changes bilaterally. As with the previous

¹⁴Members of the Change Management Board include the Program Executive Officer, who serves as the Chairperson; the Deputy Surgeons General; the Deputy Director of Medical Readiness, Joint Chiefs of Staff; the Director of Resource Management; the Director of Acquisition Management and Support; and the Director of Information Management, Technology and Reengineering.

process, contract changes issued bilaterally must have an adequate proposal with the requisite reviews before negotiations begin. Because the entire bilateral process may take over a year, any delays with proposal submissions and reviews would delay not only settlement but also implementation. To avoid such delays, in the new Change Management Process, TMA and MCS contractor officials will work together to develop the proposal, eliminating the more time-consuming consecutive steps of proposal submission and review.¹⁵ When possible, TMA plans to have negotiation teams that can be deployed to the MCS contractors' locations to jointly develop proposals and negotiate costs, with the goal of leaving with signed bilateral agreements.

Changes now going through the new process include one for the National Enrollment Database, which is to be issued bilaterally; TMA expects it to be issued in spring 2001. Twenty-three other changes are pending approval by the Board and will not be considered until funding is available. These include the expansion of the mammography benefit and elimination of the preauthorization requirement for beneficiaries with other health insurance. In addition, the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) contained mandates that resulted in 22 changes not yet in the process, including the elimination of copayments for family members under TRICARE Prime as well as the extension of TRICARE Prime Remote for family members.¹⁶ Other mandates in this act include the recently added benefits for military retirees who are Medicare-eligible—TRICARE Senior Pharmacy and TRICARE for Life, both of which will be issued bilaterally. These 46 changes, when applied to all seven contracts, could create a total of 322 change orders.¹⁷

According to TMA officials, potential advantages of the new process include better control over the volume of change orders issued by prioritizing approved changes for issuance. In addition, TMA should be able to better manage its financial resources by issuing changes bilaterally

¹⁵TMA calls this streamlined step Alpha Contracting.

¹⁶TRICARE Prime is DOD's managed care program. TRICARE Prime Remote provides active duty members with a specialized version of TRICARE Prime when they are assigned to duty stations in areas not served by the military health care system.

¹⁷TMA officials indicated that because some of the mandated changes are outside the scope of the current MCS contracts, they may use a different contracting mechanism to change the contracts, such as sole-source requests for proposal.

because it will know the costs of changes before implementation and can ensure that funds will be available to pay for them. Potential benefits to contractors include better-defined specifications and assurance of timely payments.

Although the bilateral process appears to be a step in the right direction, it may not work for some changes because sufficient lead-time may not be available. For example, congressionally mandated changes may have implementation dates that this process cannot meet because the amount of lead-time will not be sufficient. According to TMA, the unilateral change order process can still be used under such time constraints.

Conclusions

As of June 30, 2000, the number of change orders issued had almost tripled, while the number of unsettled change orders had more than doubled since our last report. Although we recommended in that report that DOD devote high-level attention to managing improvements to the change order process, this was not consistently done. As a result, until recently, none of TMA's numerous initiatives effected much improvement to the process or reduced the backlog. The current small backlog is the result of a recent concerted effort, not better management over time. TMA's new Change Management Process appears to address many of TMA's problems with change orders by controlling the volume of issuance, using a more collaborative negotiation process, and settling costs before implementation. However, past initiatives that appeared promising ultimately delivered little in terms of preventing or reducing the backlog. The high volume of change orders soon to enter the new Change Management Process makes it imperative that TMA management closely monitor the process to prevent future backlogs.

Recommendation for Executive Action

We recommend that the Secretary of Defense direct the Assistant Secretary of Defense (Health Affairs) to monitor the new Change Management Process on a continuous basis and take immediate corrective action if problems, such as a growing backlog, are identified.

Agency Comments and Our Response

We requested comments from DOD, but none were provided.

We are sending copies of this report to the Honorable Donald H. Rumsfeld, Secretary of Defense, and relevant congressional committees. Please contact me on (202) 512-7101 if you or your staff have any questions concerning this report. Another GAO contact and staff acknowledgments are listed in appendix III.

A handwritten signature in black ink that reads "Stephen P. Backhus". The signature is written in a cursive style with a large, prominent 'S' at the beginning.

Stephen P. Backhus
Director, Health Care—Veterans' and
Military Health Care Issues

Appendix I: Scope and Methodology

Our objectives were to update the 1997 report and provide information on (1) the status of the change order backlog and whether DOD reduced it, (2) factors that contributed to the growth of the backlog, and (3) DOD's new change order process.

To provide information on the status of the change order backlog and whether DOD reduced it, we analyzed a copy of TMA's Change Order Tracking System (COTS) dated January 8, 2001. This file contains data about all change orders that have been issued by TMA to the five MCS contractors. With this database, we identified change orders that had been issued and settled on August 1, 1996, May 1, 1999, and June 30, 2000. We also used this database to identify the number of change orders issued since May 1, 1997, the number that had an independent government cost estimate (IGCE), and the average number of days between change order issuance and proposal submission. We compared these data with the corresponding data from our 1997 report to assess the difference.

We also interviewed and obtained documentation from TMA about its prior initiatives to address change order problems, its Mobilization effort, the funding shortfall, and the number of unsettled change orders as of February 2001. We also assessed how TMA estimates, budgets, and accounts for change orders by obtaining studies and supporting documentation used to estimate costs, tracing estimated costs to the budget, and reviewing accounting data from fiscal year 1997 through fiscal year 2000. In addition, we interviewed and obtained documentation from each of the five MCS contractors about prior initiatives to address change order problems, and the Mobilization effort. We also interviewed and obtained supporting documentation from the TMA consultant who prepares budget estimates and IGCEs.

To provide information on factors that contributed to the previous growth of the backlog, we used the January 8, 2001, COTS database to calculate the

- average amount of time needed to finalize all change orders settled by June 30, 2000;
- average age of unsettled change orders as of June 30, 2000;
- number of change orders issued each month between May 1, 1997, and June 30, 2000;
- number of proposals that had been submitted as of June 30, 2000;
- average amount of time from change order issuance to proposal submission;

- average number of days between proposal submission and change order settlement as of June 30, 2000; and
- number of change orders issued since May 1997 that had an IGCE.

We compared these data with the corresponding data from our 1997 report to assess the difference.

We also interviewed and obtained documentation from TMA about the number of change orders issued, the pace of settlements, the process TMA uses to settle change orders, factors affecting the pace of proposal review, and reasons why payments to MCS contractors are delayed. In addition, we interviewed the five MCS contractors about how they process change orders, factors affecting the timeliness of proposal submission, and delayed payments from TMA. We met with officials of the Defense Contract Audit Agency and Defense Contract Management Agency to determine their roles in the change order process.

We were not able to determine whether change orders resulted from new laws or regulations or whether they were self-initiated because TMA does not regularly maintain these data. TMA officials stated that they were unable to provide this information in time for this report because the data are filed in several different departments and would require significant effort to compile.

To provide information on DOD's new change order process, we interviewed officials from TMA and obtained documentation that described this new process. We also discussed the new process with each of the MCS contractors to obtain their views. We did our work from July 2000 through March 2001 in accordance with generally accepted government auditing standards.

Appendix II: Prior Initiatives to Address Change Order Problems and Their Outcomes

At the time we issued our 1997 report, TMA had begun numerous efforts to improve the change order process and expedite settlements.¹ These initiatives and their outcomes include the following:

- TMA assembled a team of contract specialists in August 1996 to expedite the settlement of change orders for all MCS contracts. TMA told us that the team was focused on reducing the change order backlog to a manageable and consistent level—a goal of 100 to 150 open change orders—by early 1999. However, by May 1999, when the team was disbanded, the backlog had grown from 197 to 408 change orders. TMA officials explained that this approach did not work for several reasons, including staff shortages.
- In November 1996, TMA engaged a consulting firm to prepare independent government cost estimates (IGCE) for new change orders instead of making “guesstimates” or basing cost estimates on contractors’ informal estimates. While this was a needed improvement, it was not expected to have an impact on the timeliness of the process since the IGCE is obtained before the change order is issued. Since our 1997 report, approximately 90 percent of the change orders issued had an IGCE. IGCEs are an important financial management tool because they serve as the basis for determining the amount of funds to be obligated for the change orders. Inaccurate estimates could result in either the underobligation of funds, which would result in the need for additional funding, or overobligation, which would unnecessarily obligate funds that could be used for another DHP program activity. According to TMA’s consultant who prepared the estimates, differences between IGCEs and proposal amounts occur for many reasons. For example, the MCS contractors may use different actuarial assumptions than TMA’s consultant. Differences can also result from the time delay between the preparation of the IGCE, which is developed shortly before the change order is issued, and the contractor’s proposal, which may be developed many months later and include actual costs. As of June 30, 2000, we found that it took an average of about 9 months from issuance to proposal submission. TMA’s analysis found that IGCEs were generally lower than both the MCS contractors’ proposed costs and settlement amounts.
- In March 1997, TMA established a new requirement that all proposed change orders be reviewed and approved by Health Affairs before issuance. The review was to evaluate each order’s effects on the health

¹*Defense Health Care: Actions Under Way to Address Many TRICARE Contract Change Order Problems* (GAO/HEHS-97-141, July 14, 1997).

care system, its costs, and the availability of funds. In short, the Deputy Assistant Secretary, Health Services Financing, was to evaluate the need for each change order and decide whether to implement it. However, under the reorganization prompted by the Defense Reform Initiative, this responsibility was transferred to the Director of Military Health Systems Operations, who created a Change Management Board consisting of senior Service and TMA officials. Although TMA officials said that the Board reviewed and approved change orders before issuance, they could not provide us data to assess the impact of these reviews on the numbers of change orders issued.

- In March 1997, TMA hired a management consulting firm to review and recommend improvements to TMA's change order process, specifically, ways to help reduce the current backlog and to prevent future backlogs. However, after reviewing a draft of the firm's report, TMA officials discontinued the study because they were already aware of the consultant's principal finding—that the change order problems were caused by high volume and a lack of discipline within the process. Nevertheless, some of TMA's subsequent initiatives mirrored the report's recommendations, such as the use of predetermined milestones and the establishment of a centralized review board to evaluate changes before they are issued.
- TMA notified contractors to begin submitting overdue (beyond the 60-day post-issuance requirement) proposals for low-cost or no-cost change orders. Contractors were told that proposals not received within 30 days could be unilaterally settled by TMA, meaning that TMA would pay the price it deemed appropriate. TMA officials told us that they periodically prompted MCS contractors to submit cost proposals for particular change orders and that the MCS contractors responded, obviating the need for TMA to settle any change orders unilaterally. However, these officials did not have data to illustrate the outcome of this and similar initiatives.
- When we issued our July 1997 report, TMA was developing provisional payment procedures, which were implemented in January 1998. These procedures allow MCS contractors to bill TMA on a monthly basis for costs incurred to implement changes, which is contingent upon the receipt of an adequate cost proposal. TMA makes provisional payments at the lesser of 100 percent of incurred contractor costs or up to 75 percent of the amount TMA has obligated for the change. If incurred costs are greater than obligated amounts, TMA requests a Defense Contract Audit Agency audit to validate the additional costs. TMA will then pay up to 75 percent of the validated costs. Despite TMA's effort to pay contractors in a more timely manner, MCS contractors told us that the provisional payment process is cumbersome and slow, especially when their incurred costs are greater than TMA's funded amounts. TMA officials said that the biggest

**Appendix II: Prior Initiatives to Address
Change Order Problems and Their Outcomes**

obstacle to MCS contractors' receipt of provisional payments is the submission of an adequate proposal.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Michael T. Blair, Jr., (404) 679-1944

Staff Acknowledgments

Bonnie Anderson, Mario Artesiano, Rathi Bose, Cynthia Forbes, Linda Garrison, Elizabeth T. Morrison, and Dayna K. Shah made key contributions to this report.

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