Audit & Ethics Branch

Directed Audit of First Canadian Health's Service Contract

2003-731

Final Report

July 08, 2004

Overview

Audit Qualifications

The Audit and Ethics Branch, Public Works & Government Services Canada undertook an audit of the First Canadian Health's service contract with the Crown, at the direction of its Deputy Minister. Management's overriding need for timely information necessitated a significantly compressed audit timeline. As a result, the audit examined only the most material activities and the areas of highest risk associated with the FCH Health Information and Claims Processing System contract.

Audit Objectives

The Audit objectives were to determine the extent to which:

1. The procurement complies with Government Contracts Regulations, central agency policies/guidelines, and departmental policies/guidelines/practices, thereby reflecting prudence and probity;
2. Public Works & Government Services Canada's (PWGSC) management and staff exercised due diligence in discharging their procurement, contract management and oversight responsibilities;
3. Roles and responsibilities of contract administration activities were clearly defined and understood, thereby contributing to a successful management of the contract according to time, cost and performance; and
4. Key management activities and related systems and controls ensure due regard to efficiency, effectiveness and economy.

Audit Scope

The Audit scope:

- Focused on procurement and management practices from the time of requisition in 1996 to December 2003; [Appendix B – Contract Milestones)
- Included a complete review of key procurement and contract administration documents from PWGSC's records; and
- A limited review of Health Canada's (HC) contract administration records, excluding financial information.

Audit Methodology

In order to meet the objectives of the audit, the following activities were performed:

- Engagement of a contracting expert to undertake a detailed review of contract documents;
- Conduct of interviews in PWGSC;
- Review and preparation of an inventory of all procurement and contract administration documents in PWGSC's records;
- Analysis and development of audit findings and conclusions; and
- Briefing on audit findings, in January 2004, to contracting officers and senior management responsible for the procurement.

Background

Background on

Health Canada's

First Nations and Inuit Health Branch

Non-Insured Health Benefits Program

(NIHB)

First Nations & Inuit Health

- The First Nations and Inuit health services, provided by Health Canada, constitute one of five departmental business lines and account for 50.1% of Health Canada's net planned spending for 2003-2004. (HC 2003-04 Estimates, Part III –Report on Plans and Priorities)

- The First Nations and Inuit Health Business line carries out its mandate through the following three programs:
  - community-based health promotion and prevention programs on reserves and in Inuit communities;
  - primary care and emergency services on reserves in remote and isolated areas where no provincial services are readily available; and
  - non-insured health benefits (NIHB) to First Nations and Inuit people regardless of residence in Canada. (HC 2003-04 Estimates)

NIHB Program

- Non-Insured Health Benefits program (NIHB) is delivered by the First Nations and Inuit Health Branch (FNIHB) in Health Canada.
- The NIHB program provides health-related goods and services not provided through other private or provincial/territorial health insurance plans for the purposes of maintaining health, preventing disease, diagnosing or treating an illness, injury or disability.
- Benefits include pharmacy (prescription and over-the-counter drugs and medical supplies/equipment), dental services, glasses and other vision care aids and services, transportation to access medically required services; health care premiums in Alberta and British Columbia; and other health care services including crisis intervention mental health counselling. (NIHB - 2001/02 Annual Report)
- As of 2001/02, the NIHB program provided services to approximately 721,000 registered Indians, Inuit and Innu individuals.

NIHB Program

- NIHB expenditures for 2001/02 increased by 9% from the previous year ($627.8M compared to $575.9M) as a result of several factors including:
  - First Nations and Inuit population growth rate of 3% per year, more than double the Canadian rate;
  - an increase in eligible clients accessing benefits;
  - the rising costs of benefits;
  - provincial health care reform;
  - the delisting of NIHB clients from provincial and territorial extended health care services; and
  - de-insurance of a number of services previously covered by public funding. (NIHB - 2001/02 Annual Report)

NIHB Program

- Health Canada has a long term objective to refocus the federal role and to support the transition of control and management of health services for First Nations and Inuit to the individual bands or communities.
- In 1997, HC estimated that the majority of the bands in Canada would independently manage their own health services in the future. As of January 2002, however only 70% of eligible First Nations and Inuit communities had taken on some limited degree of responsibility for managing their community health programs. (Closing the Gaps in Aboriginal Health)
- As well, HC estimated that 50% of the bands would opt-out of the NIHB program. HC undertook several pilots to test management and delivery options for the transfer of NIHB. Currently, only 1 out of 600 communities has taken over some of the responsibilities for processing claims for pharmaceutical, dental service, and medical supplies and equipment. This represents 6,000 people.

NIHB Program

- Until 1987, the payments for the NIHB program were administered manually by HC.
- In 1987, a two-year contract, with an option to renew, was awarded to Ontario Blue Cross to develop and implement an automated dental claims processing system. [*]
- In 1990, PWGSC, acting as contracting authority on behalf of Health Canada, awarded a contract to Ontario Blue Cross to develop, operate, and maintain an automated Health Information and Claims Processing System (HICPS) for drug, medical, and dental claims. Later Ontario Blue Cross was reorganized as Liberty Health. Due to initial development problems, HICPS was not fully operational until 1995. The initial contract was $42.5M over 6 years. The final costs were $67.8M, which included extension costs of approximately $2M for services until November 30, 1998. [*]

Background

Re-tendering of HICPS service contract

results in contract with

First Canadian Health Management Corporation Inc.

(FCH)

FCH – new HICPS Contract

- In 1996, PWGSC, acting as contracting authority on behalf of HC, initiated the re-tendering process for a new HICPS contract. The typical life-cycle activities of a PWGSC Procurement were followed by the Contracting officers. (Appendix F - Procurement Activities)
- The new HICPS contract was to provide for five years of claims processing service, commencing on July 1, 1998, with options for two two-year extensions, for a maximum of 9 years of claims processing.
- The new national automated HICPS was to provide services for the drugs, medical supplies and equipment, and dental components on the NIHB program, but other benefits such as vision care and medical transportation were not included.
- To compensate for the assumption that First Nation and Inuit bands or communities would opt-out of the NIHB program, HC decreased the estimate of claims processing volumes of the new HICPS contract by 5% per year. (Statement of Requirements document – SOR - Appendix 6)

FCH - Set-Aside Provision

- Under the government's Procurement Strategy for Aboriginal Business a Set-aside provision, which restricts the procurement to qualified aboriginal suppliers, applies to all contracts that serve a primarily aboriginal population (at least 80%) and that are worth more than $5K, where operational requirements, best value, prudence and probity, and sound contracting management can be assured. It is intended to boost economic development in aboriginal communities as a means to self-sufficiency and self-government.
- The new HICPS contract was considered to be a candidate and the contracting process was subject to the Set-Aside provision that limited the bidding to Aboriginal businesses.
- An Aboriginal firm had to certify: 51% ownership and control; at least 33% of employees were Aboriginal persons; and any subcontractors engaged would satisfy the set-aside provisions.
- Prior to award and during the life of the contract, the firm's certification can be subject to an audit to confirm their status.

FCH - HICPS Contract

- Seven proposals were received on June 1997; three bids met the technical requirements; and a newly created joint venture between the Tribal Councils Investment Group of Manitoba Limited, and Aetna Health Management Canada Inc., was selected as the lowest price, technically compliant bidder.
- The First Canadian Health Management Corporation Inc. (FCH) HICPS service contract was awarded on October 16, 1997, for $45.7 million over a five year period, with options of $14.6 million, on average, for each of the two two-year extensions.
- Although the contract's claims processing service was to commence on July 1, 1998, due to technical issues, the start date was deferred until December 01, 1998.

FCH - HICPS Contract

- FCH contracted, and paid a service fee, to its partner, Aetna, and later with related parties and subcontractors to deliver the HICPS services. The arrangements negotiated between FCH and its affiliates were not consistent with the rates or services that FCH had contracted with the Crown. For example: for certain claim lines, FCH paid higher processing rates than those provided in the HICPS contract; and FCH paid for returned claims for which it was not compensated.
  (Appendix A - Organization changes , Appendix D - Financial Statements)

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FCH Contract

- By June 2003, PWGSC was aware that the FCH contract, scheduled to end November 30, 2003, had exceeded the $45.7M award value by an excess of $17M.
- At the current rate of expenditure, the $74.9M expenditure approval for 5 years plus two two-year options is projected to more than double, if all option years are completed.
- On August 14, 1998, HC's Project Management stated the critical importance of HICPS as: "As First Nations and Inuit Health Branch's primary duty is to ensure the health and safety of its clients, it cannot run the risk of being without a fully functional HICPS as this could result in a client being denied services in a life and death situation."

FCH

For further information on the FCH HICPS contract refer to Appendices:

A FCH organizational changes – overview of corporate relationships in 1997 and 2000.

B HICPS Milestones – contracting milestones from 1996 to 2003.

C Analysis of Volume comparison of SOR to actual.

D Financial Statements of FCH and related companies.

E Health Expenditures Statistics in Canada and NIHB.

F Typical activities in the life-cycle of a procurement.

Audit

Audit of

PWGSC's Procurement and

Contract Management Responsibilities

for First Canadian Health's

Service Contract

Audit Findings – FCH Contract

Objective #1 –Compliance, Prudence, Probity

Statement of Requirements (SOR):

- The SOR clauses for the Management Arrangement identified HC as solely responsible for contracting, policy, design, development, operations, and maintenance issues. This limited PWGSC's contracting authority.
- The SOR clauses for Liquidated Damages and Right to Negotiate Penalties and Compensation Arrangements were not referenced in the main contract document. This did not ensure that all parties understood when a penalty applies and how much a liquidated damage should be.
- The SOR 'Invoice' clause indicates "Holdbacks where applicable." This conflicts with the Method of Payment clause in the contract that states full payment for work performed.

Audit Findings

- The SOR restricts PWGSC's effectiveness to ensure that Canada shall not be liable for the cost of any change or modification until the cost has been incorporated into the contract. As well, it conflicts with the contract General Conditions 9676, Article 4, that confirms that no design change or modifications to the work shall be binding unless incorporated into the contract by a written amendment executed by the Minister of PWGSC and the Contractor.
- The SOR clauses on HC's rights to audit and the reference in the main contract document are unclear as to which department should conduct the annual audit of the fixed cost component of the rates per benefit line.
- The SOR does not identify the requirement for a zero-balance account for Receiver General payments to providers. As well, it is unclear as to the process for verifying the accuracy of request for funds that are transferred to the flow-through account.

Audit Findings

Contract Document:

- The contract states that the first priority of documents is “the written agreement between the parties”. As it was never defined in the contract, this vague contract terminology led to confusion among the parties.
- No reference is made, in the contract, to the date of the SOR nor was the SOR attached as a supporting contract document; [*]

- The contract contains no provision for providing a copy of invoices to PWGSC. This is not in accordance with Article 13 GC9676. [*] (SM 6E.507).
- No rational on file as to why a letter of amendment was used instead of the formal amendment form (SM 11.03.8) to exercise the first two year option.

Audit Findings

Objective #2 – Due Diligence

Contract Management:

- PWGSC could not assure that the contract condition for Security Requirements was implemented at all times. This increases the risk of non-compliance with the requirements for Privacy of Information and transfer of data across provincial boundaries and Canada/USA borders.
- Contract Bonding requirements, in place for the life of the contract, were not verified by PWGSC. This was particularly important in managing the risks associated with Aetna severing its partnership arrangement with FCH in 1999/2000, as well as providing financial protection to the Crown for the term of the contract.
- Technical and non-technical modifications to the contract, FCH's proposal, and the SOR, that were undertaken with the agreement of HC, have not been actioned by PWGSC as amendments to the contract. [*]

Audit Findings

- Contract terms such as Volume Adjustment and Contract tools such as an independent audit of all elements of actual costs incurred by the contractor have not been applied by PWGSC throughout the life of the contract. [*]
- [*], PWGSC did not confirm that the contractor met its obligation in the operation of a Receiver General zero-balance accounts. [*]
- PWGSC did not ensure receipt of regular financial reporting.

Objective # 3 – Roles and Responsibilities

- There was a lack of clear understanding of the roles and responsibilities of PWGSC and HC which resulted in confusion and uncertainty by the contractor as to whom it should deal with.

Audit Findings

- It is the responsibility of Indian & Northern Affairs Canada to verify a contractor's compliance to the Set-Aside provision of the Aboriginal Procurement Policy. Post-award audits are performed by Consulting & Audit Canada (CAC) on a random basis, however where PWGSC contracting officers believe it to be necessary an audit of the contractor's continued status may be requested of INAC. (SM 9L.350)
- As early as Oct. 1997, PWGSC informed all parties that it must be copied on all decision documents and minutes of meetings, but this failed to occur. As well, PWGSC was not invited to attend all meetings.
- The PWGSC Contracting Officer turnover, of at least five officers, has complicated the transfer of knowledge and limited the comprehension of all issues in this complex multi-year procurement.
- A close daily relationship between HC and FCH resulted in commitments and agreements of which PWGSC was not aware.

Audit Findings

Objective #4 – Systems/ Controls- due regard to 3Es

- PWGSC did not ensure that appropriate risk considerations and controls were put in place given HICPS's previous contract history, and potential for abuse and fraud as evidenced in the Royal Canadian Mounted Police's investigation of pharmacies billing for prescriptions that were never dispensed (July 1998) and Indian and Northern Affairs Canada's audit of the lack of controls on Certification of Indian Status cards (January 2004). In November 2003, CAC was contracted by PWGSC to audit FCH's expenditures for claim lines, flow-through, discretionary projects, and toll-free charges. CAC, within its scope, did not report any major issues.
- There was no evidence that, prior to contracting, PWGSC received the benefit of advice and information that HC had received from consultants/experts on HICPS. This information could have been used to reduce the risks in contract administration.

Audit Findings

- PWGSC's contracting officer and managers acted quickly to identify the urgency and ratification issues to Treasury Board, once they were aware of the overpayment of the contract.
- Incomplete and unaudited financial information limit the ability of PWGSC to attest to the validity of FCH's claims of [*].
- PWGSC's high volume of procurements limit the level of attention that contracting officers can dedicate to projects such as HICPS.

Audit Conclusions

- Acceptance of the SOR terms and conditions restricted PWGSC's effectiveness to protect the liability of the Crown. As well, clauses that could have been incorporated into the contract by PWGSC to clarify and mitigate issues of performance, penalties and modifications to the SOR were not done.
- Contract conditions such as Security, Bonding, and Set-Aside Provision were not consistently managed by PWGSC throughout the life of the contract.
- [*] , PWGSC should have requested that an annual examination of all elements of costs be undertaken, which should have included a review of financial transactions between related entities.
- Lack of financial information undermined PWGSC's efforts to fully demonstrate due diligence in contract management and decision making.
- PWGSC's, and the client's, contract management roles and responsibilities need to be clearly defined and understood by all parties to the contract.
- As PWGSC played a minor role in administering the contract with FCH, it could not ensure that PWGSC's senior management were aware and advised of potential issues.

Audit Recommendations

The audit recommends that the ADM, Acquisition should:

- Consider incorporating [*] ;

- Amend the FCH contract to:
  - Clearly identify PWGSC's procurement roles and responsibilities. This will ensure that future negotiations and decisions are identified and supported in the contract documents;
  - Require the submission of financial information to PWGSC, which will enable the department to track commitments of monies against the contract;
- Undertake an annual audit of the FCH contract, as permitted in the contract terms and conditions, which includes a review of financial transactions between all related entities, in order to provide assurance that the Crown has received services in accordance with the contract and to monitor [*] of FCH;

Audit Recommendations

- Ensure that FCH complies with the Personal Information Protection and Electronic Documents Act and that there are contractual clauses in place to ensure that the privacy rights of users of HICPS are addressed;
- Ensure that FCH complies with contract conditions such as security, bonding, and Set-Aside provision throughout the life of the contract;

Future Contracts:

- Use knowledge gained from prior contracts in the identification and assessment of contractual risks, as well as the advice from authoritative sources to ensure that appropriate controls are applied in the future;
- Assess its current contract management capacity, and if necessary enhance this capacity through the application of additional contract management resources for future acquisitions; and
- Thoroughly develop and formally document PWGSC and Client's roles and responsibilities for complex and/or high-value contracts.

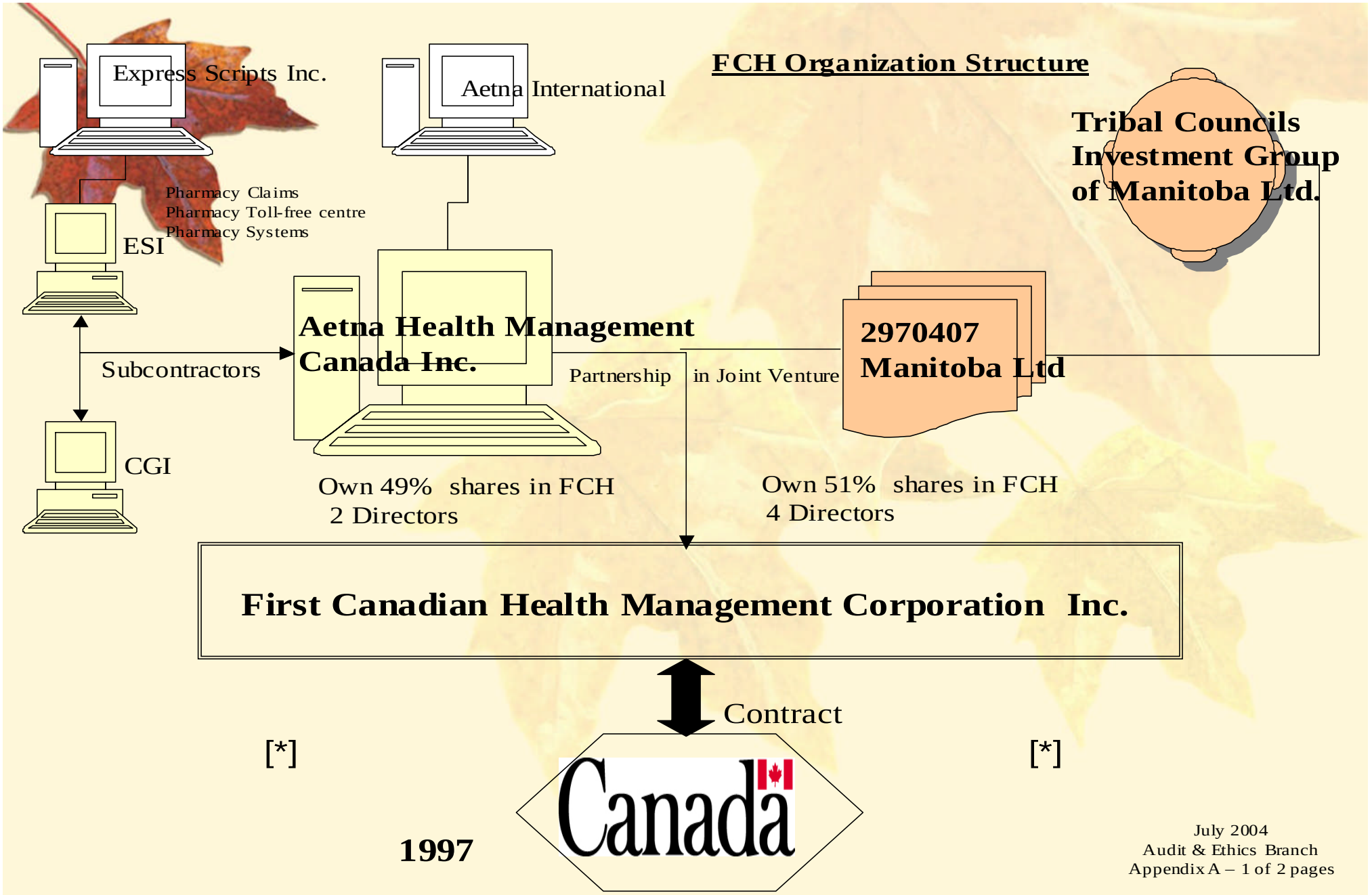
Lessons Learned

PWGSC Contracting Officers should:

- Prior to transfer of an active contract file, document all issues and provide all essential information to any new Contracting Officer who will assume responsibility for the file;
- Adhere more closely to SACC Manual clauses and ensure that deviations from such clauses are justified and documented in the contract files;
- Question any unusual or inappropriate items incorporated into the Statement of Requirements;
- Ensure that Client Program Managers understand all aspects of the contracting and approval process;
- Maintain contract management control from a financial point of view by ensuring receipt of invoices or financial summaries;

Lessons Learned

- Formally assess all risks before defining PWGSC's role in the verification of invoices for sensitive, high-profile, high-dollar value service contracts that contain other aspects such as; system enhancements; design changes; audit of rates; and liquidated damages in the form of penalties and holdbacks;
- For complex and/or high-value contracts, incorporate the appropriate clauses and procedures into the contract that designate PWGSC as a participant in the Design process and/or as Task Authority for changes and modifications including cost negotiation involvement;
- Thoroughly explain critical sections of the General Conditions and the significance of the relevant contract clauses to Clients, as well as Contractors, particularly with those dealing with the Crown for the first time; and
- Structure standard reporting to senior management on all sensitive, high-dollar procurements.



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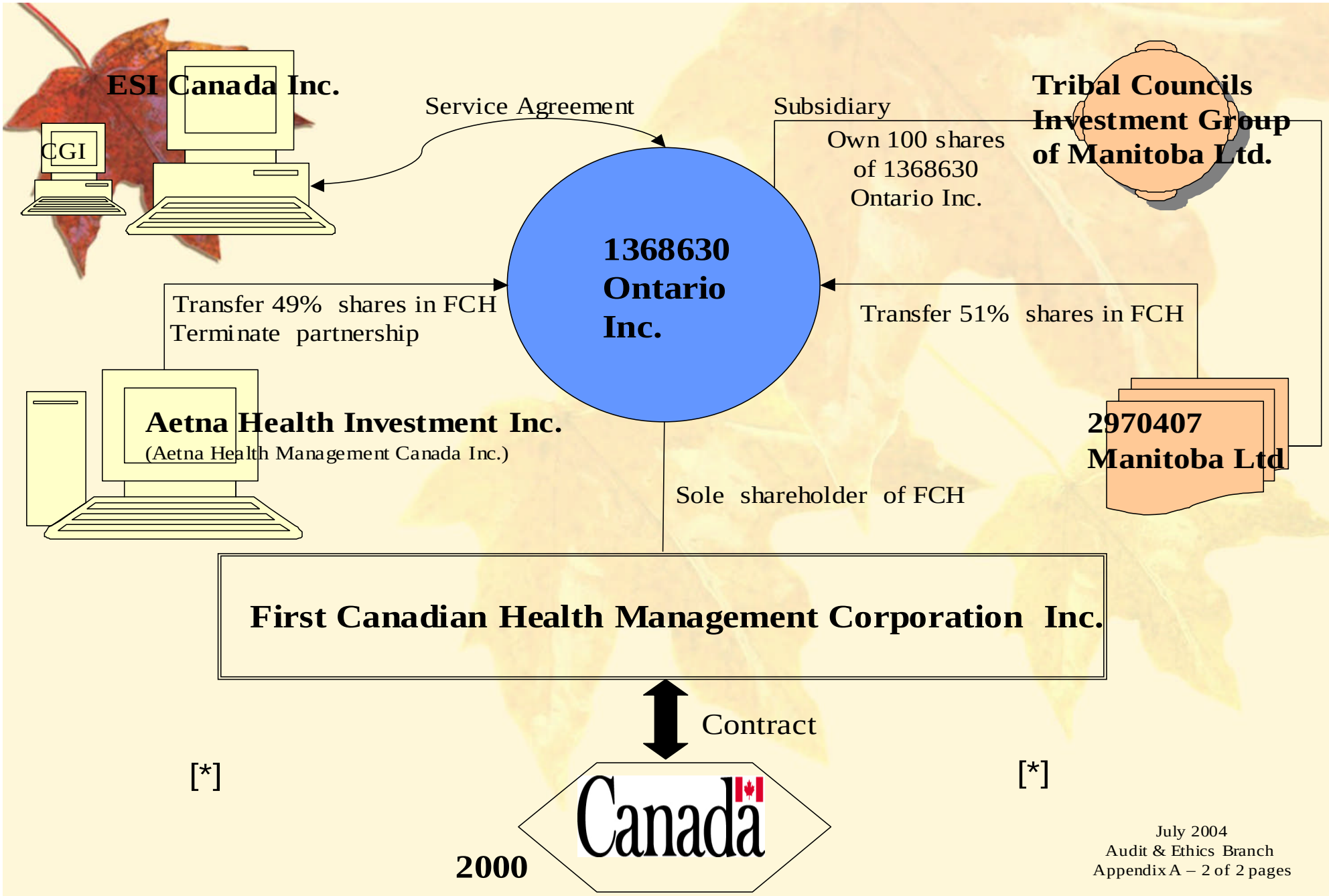

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Contract Milestones

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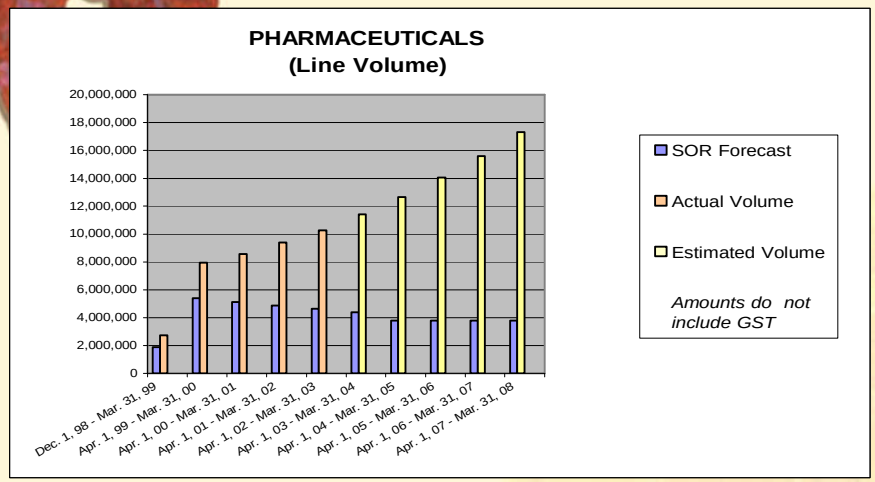
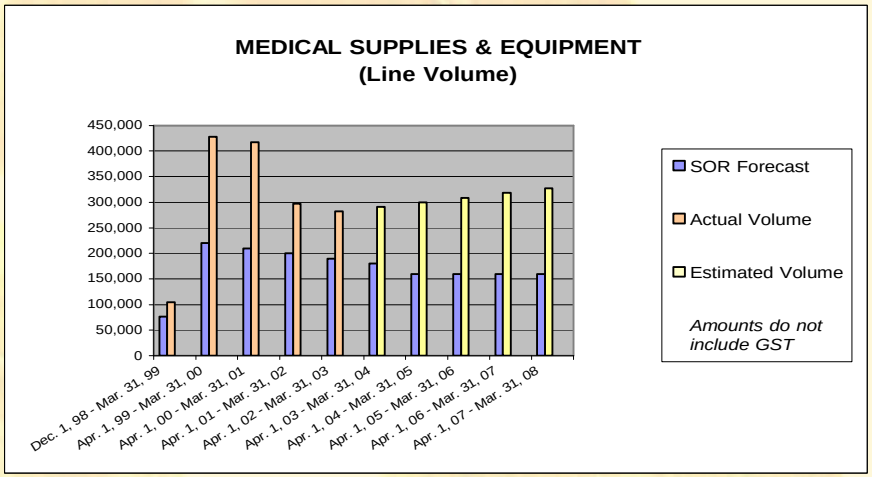
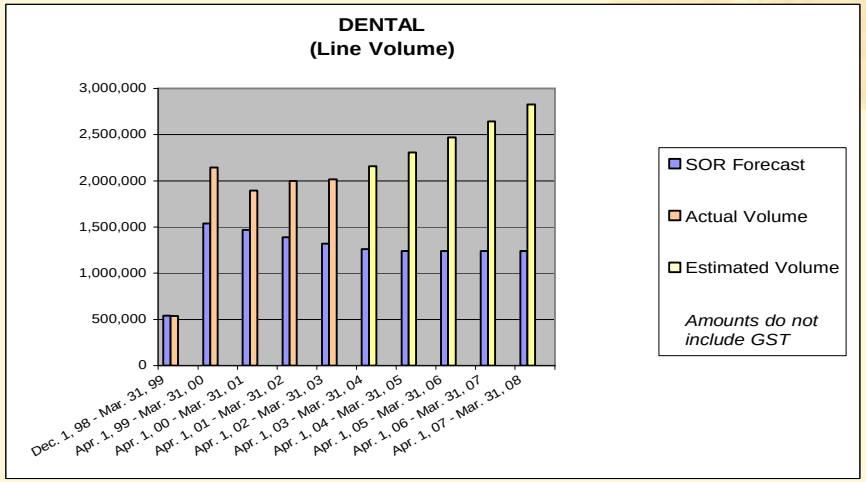
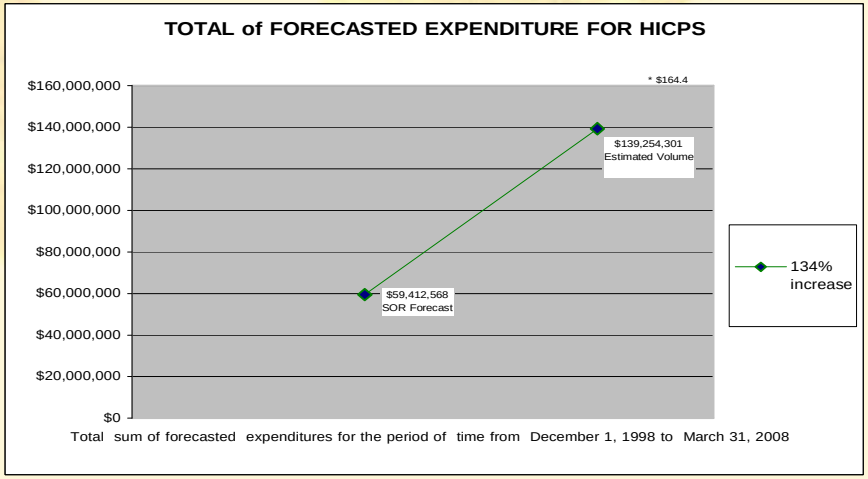
Analysis of Volume comparison of SOR to actual









Financial Statements of FCH and related companies

FCH and related parties transactions						
ASSETS						
Cash Accounts Receivable GST Receivable Income tax receivable Prepaid Expenses Deposits Investment in FCH Capital Assets	[*]	[*]	[*]	[*]	[*]	[*]
TOTAL ASSETS						
LIABILITIES						
Bank Indebtedness Accounts Payable & Accrued Liabilities GST Payable Future Income taxes payable Income Tax Payable Deferred Taxes Payable Note Payable Due to Related Parties						
TOTAL LIABILITIES						
SHAREHOLDERS EQUITY						
Share Capital Contributed Surplus Retained Earnings (Deficit)						
TOTAL EQUITY						
TOTAL LIABILITIES AND EQUITY						

Health-Care in Canada

Prescription Drugs

In 1975, prescriptive drug costs made up a relatively stable share of about 6% of health care spending. But by the mid-1980s, that share had begun a steady climb and, by 2001 the share had doubled to 12%.

1997	Cost of Prescription drugs per Canadian is $148.
2000/2001	NIHB Pharmacy costs per capita is $312.
2001/2002	NIHB Pharmacy costs per capita is $335.

Expanding use of prescription drugs and home care has reduced the reliance on more expensive hospital care and is part of changing trends in how health care services are delivered.

Expenses for drugs, dental, and vision care paid by private sources such as insurance companies or out-of-pocket.

2000	Costs per Canadian is $900. (30% of total health care costs per person)
2000/2001	NIHB costs for such expenses is $512/capita. (total population is 706K)
2002	Costs per Canadian is $1,000. (28% of total health care costs/ person)
2001/2002	NIHB costs for such expenses is $552/capita. (total population is 721K)

(Sources: Building on Values by R. Romanow, Nov. 2002; Health Care in Canada produced by the Canadian Institute for Health Information; Health Canada – NIHB Program Annual Report 2001/02)

PWGSC Procurement Activities

Typical activities in the life-cycle of a PWGSC Procurement.

- Establish Performance Monitoring Approach (Request for proposal).
- Ongoing Monitoring of Time, Cost and Performance.
- Resolution of Disputes and Problems.
- Management of Amendments, contract options and renewals.
- Cost Administration.
- File Maintenance.
- Close-out.