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U.S. DEPARTMENT OF VETERANS AFFAIRS
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
COMMITTEE ON VETERANS' AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES
HEARING ON
PURCHASING PERSPECTIVE:
VA'S PROSTHETICS PARADOX
MAY 30, 2012**

Chairman Johnson, Ranking Member Donnelly, and Members of the Subcommittee, thank you for the opportunity to discuss the results of two recent Office of Inspector General (OIG) reports dealing with prosthetic contracting and supply issues.¹ Based on the Committee's interest in how VA obtains prosthetic limbs and oversees its prosthetic supplies, we conducted audits of how VA acquires prosthetic limbs and manages its prosthetics inventory. I am accompanied by Mr. Nick Dahl, Director of the OIG's Bedford Office of Audits and Evaluations and Mr. Kent Wrathall, Director of the OIG's Atlanta Office of Audits and Evaluations.

Before we discuss the results of our audits, let me make one thing clear: the OIG believes veterans should be able to receive the limbs that their clinicians determine are the best for them whether the source is VA or commercial vendors. Our audits focused on the effectiveness of VA's acquisition and contract administration practices. We did not examine nor do we offer an opinion on whether VA labs are a preferred source of prosthetic limbs rather than contract vendors based on cost comparisons or other factors.

BACKGROUND

The Veterans Health Administration (VHA) defines prosthetics as all aids, devices, parts or accessories which patients require to replace, support, or substitute for impaired or missing anatomical parts of the body. The items include artificial limbs, terminal devices, stump socks, braces, hearing aids and batteries, cosmetic facial or body restorations, optical devices, manual or motorized wheelchairs, orthopedic shoes, and similar items.² VA maintains an inventory for most prosthetics items. However, for some prosthetic items, such as artificial limbs, VA Medical Centers (VAMCs) do not maintain inventories and instead order these items, as needed, for individual patients. From fiscal year (FY) 2007 through FY 2011, VHA's prosthetic costs increased from \$1.0 billion to \$1.8 billion.

¹ *Veterans Health Administration – Audit of the Management and Acquisition of Prosthetic Limbs*, March 8, 2012, and *Veterans Health Administration – Audit of Prosthetics Supply Inventory Management*, March 30, 2012.

² VHA Handbook 1173.1, *Eligibility*, November 2, 2000.

VA uses two automated inventory systems to manage prosthetic inventories. VHA's Prosthetic and Sensory Aids Service (PSAS) uses the Prosthetic Inventory Package (PIP) to manage the majority of prosthetic inventories. Supply Processing and Distribution (SPD) Service uses the Generic Inventory Package (GIP) to manage prosthetic supplies stored in Surgery Service.

Three VA organizations have responsibilities related to prosthetic inventory management. PSAS develops policies and procedures for providing prosthetics to veterans. VHA's Procurement and Logistics Office (P&LO) provides VAMCs logistics support and monitors compliance with inventory management policies and procedures. VA's Office of Acquisition, Logistics, and Construction supports VAMCs in acquiring and managing supplies and offers training to VA's acquisition professionals. All three organizations need to work together to provide the leadership and coordinated support needed to manage VA's prosthetic supplies.

AUDIT OF THE MANAGEMENT AND ACQUISITION OF PROSTHETIC LIMBS

In this report, we evaluated VHA's management and acquisition practices used to procure prosthetic limbs, and examined the costs paid for prosthetic limbs. Overpayments for prosthetic limbs were a systemic issue at all 21 Veterans Integrated Service Networks (VISNs). Overall, we identified opportunities for VHA to: (1) improve controls to avoid overpaying for prosthetic limbs, (2) improve contract negotiations to obtain the best value for prosthetic limbs purchased from contract vendors, and (3) identify and assess the adequacy of in-house prosthetic limb fabrication capabilities to be better positioned to make decisions on the effectiveness of its labs.

Improved Internal Controls Needed

We reported VHA's PSAS needed to strengthen payment controls for prosthetic limbs to minimize the risk of overpayments. We identified overpayments in 23 percent of all the transactions paid in FY 2010. VHA overpaid vendors about \$2.2 million of the \$49.3 million spent on prosthetic limbs in FY 2010. VHA could continue to overpay for prosthetic limbs by about \$8.6 million over the next 4 years if it does not take action to strengthen controls. On average, VHA overpaid about \$2,350 for each of these prosthetic payments. Overpayments generally occurred because VHA paid vendor invoices that included charges in excess of prices agreed to in the vendors' contracts with VA. Strengthening controls to ensure invoices submitted by vendors are consistent with contract terms should and can be accomplished without compromising the quality of the prosthetic limbs provided to veterans.

At the four VISNs we visited (VISN 1, 8, 12, and 15³), we found that Contracting Officer's Technical Representatives (COTRs) either did not conduct reviews of prosthetic limb invoices or conducted only limited reviews of invoices. Instead, Prosthetic Purchasing Agents were reviewing vendor quotes, creating purchase orders, and reviewing invoices prior to making final payments. This is contrary to the Government Accountability Office's *Standards for Internal Controls in Federal*

³ VISN 1 – New England Healthcare System; VISN 8 – VA Sunshine Healthcare Network; VISN 12 – VA Great Lakes Health Care System; and VISN 15 – VA Heartland Network.

Government that requires key duties and responsibilities be divided to reduce the risk of error or fraud. VHA should ensure responsibility for determining compliance with contract terms and for processing payments is kept separate to better ensure proper segregation of duties. Further, while Prosthetic Purchasing Agents at the four VISNs reported conducting reviews to ensure invoice prices matched Medicare pricing and appropriate vendor discounts, results of our audit revealed these reviews were not effective in preventing overpayments.

Due to the frequency of overpayments, immediate attention is needed to prevent future overpayments and to recover current overpayments. By strengthening internal controls over payments for prosthetic limbs and properly separating duties, PSAS staff have the opportunity to improve their acquisition practices and provide better stewardship of funds.

Actions Needed To Ensure the Best Value When Procuring Prosthetic Limbs

We found that VISN Contracting Officers were not always negotiating to obtain better discount rates with vendors and some items were purchased without specific pricing guidance from either the P&LO or PSAS. Without negotiating for the best discount rates obtainable, VHA cannot be assured it receives the best value for the funds it spends to procure prosthetic limbs. We noted that while strengthening acquisition practices to ensure contracting officers consistently negotiate better discount rates should result in lower costs, it should in no way compromise the quality of prosthetic limbs procured.

We also reported VA paid almost \$800,000 for about 400 prosthetic limb items using “not otherwise classified” (NOC) codes in FY 2010. NOC codes are used by VA to classify items that have not yet been classified or priced by Medicare. While this may not be a significant amount in aggregate, the prices paid for individual items that have not yet been classified can be significant. For example, absent pricing guidance VA was paying about \$13,700 for a type of Helix joint before it was classified. Once the item was classified, the price dropped to about \$4,300. To avoid situations like this, we reported VHA needed to develop guidance to help VISN staff determine reasonable prices for items that Medicare has yet to classify and price.

Improved Prosthetic Limb Fabrication and Acquisition Practices Needed

We did not identify information that showed either how many limbs specific VHA labs could fabricate or how many limbs they should be fabricating. PSAS management did not know the current production capabilities of their labs and could not ensure labs were operating efficiently. VHA guidance states that PSAS should periodically conduct an evaluation to ensure prosthetic labs are operating as effectively and economically as possible. We found that PSAS suspended their review of labs in January 2011 after reviewing only 9 of 21 VISNs. Because reviews of all VISNs were not conducted, PSAS was unaware of its in-house fabrication capabilities and management does not know if labs are operating as effectively and efficiently as possible.

We also reported VISN prosthetic officials did not always identify the appropriate number of contractors needed to provide prosthetic limbs to veterans. VHA guidance recommends three to five vendors receive contract awards depending on the geographic area and workload volume. However, three of four VISN Prosthetic Managers interviewed were under the assumption they were to award contracts to all vendors who responded to their solicitation, provided those vendors met VA's criteria to qualify as a contract vendor. The VHA guidance conflicted with prosthetic limb contract guidance that states maximum flexibility be given to individual medical centers to determine the number of contracts required to meet their needs.

Due to the inconsistencies in the guidance, differing procurement practices existed among the four VISNs visited. Three of the four VISNs did not identify an appropriate number of contract vendors and VISN Contracting Officers made awards to nearly all vendors that submitted proposals, many of which were located in the same general areas. As a result, overlaps and gaps in service existed and VISN contracting staff may have been performing unnecessary contract work. Additionally, VHA could not be assured the decision to make contract awards was effectively aligned with workload volume or with what individual medical centers required to meet their needs in serving patients.

We reported VHA lacked the information to know whether its prosthetic limb fabrication and acquisition practices are working as effectively and economically as possible. By evaluating fabrication and acquisition practices, PSAS will be in a better position to know the current capabilities of its labs and to make decisions regarding the number of contracts needed to provide services to veterans in each VISN.

Use of VA's Electronic Contract Management System (eCMS) Needs To Improve

Use of eCMS is mandatory for all procurement actions valued at \$25,000 or more. We found that VHA's contracting officers did not consistently use eCMS to document contract awards to prosthetic limb vendors, which was consistent with the findings from our recent audit of VISN contracts.⁴ Nearly all of the eCMS contract files for awards made to vendors at the four VISNs visited were missing key acquisition documentation.

Missing documentation included evidence of required contract oversight reviews and determinations of responsibility of the prospective contractors through a check of the Excluded Parties List System. Further, contract invoices were not included in eCMS. As a result, we could not readily verify whether a COTR had reviewed vendor invoices prior to certification to ensure they accurately reflected that goods received were in accordance with contract requirements, including prices charged. The lack of documentation in eCMS adversely affects management's ability to readily assess the quality, timeliness, and administration of contracts.

⁴ *Veterans Health Administration – Audit of Veterans Integrated Service Network Contracts*, December 1, 2011. This audit examined whether VHA's new contract oversight structure and review processes were effective in improving VISN procurement practices. Despite the new contract oversight structure, we still identified recurring systemic deficiencies associated with acquisition planning, contract award, and contract administration.

Recommendations

We made eight recommendations to the Under Secretary of Health. They include strengthening controls over the process for reviewing vendor quotes, purchase orders, and verification of invoices and costs charged by prosthetic limb vendors. In conjunction with this, we recommended VHA take collection action to recover the \$2.2 million overpaid to vendors. We also made recommendations to ensure contracting officers conduct price negotiations to obtain the best value for prosthetic limb items and for PSAS to assess the capabilities of VHA's prosthetic labs.

The Under Secretary for Health agreed with our recommendations and presented an action plan. VHA reported that, as part of the reorganization of P&LO, contracting officers or delegated ordering officers will place prosthetic orders above the micro-purchase threshold of \$3,000. VHA indicated this change will properly separate acquisition duties for reviewing vendor quotes, purchase orders, and invoices received from prosthetic limb vendors. VHA told us that their Service Area Organization offices will review every prosthetic limb contract to ensure price negotiations have occurred. These controls are critical for VA to receive the best value for prosthetic limbs. It is too early to measure the effectiveness of these changes, however we will follow-up as appropriate.

AUDIT OF VHA'S PROSTHETICS INVENTORY MANAGEMENT

This report provides a comprehensive perspective of the suitability of VHA's prosthetic supply management policies. In assessing VAMC prosthetic inventory management, VHA agreed that inventories maintained above the 30-day level would be considered excessive unless there was evidence VAMCs needed a higher inventory level to meet replenishment and safety requirements. VHA also agreed prosthetic inventory levels of 7 days or less would create a risk of supply shortages.

We found VHA needs to strengthen VAMC management of prosthetic supply inventories to avoid disruption to patients, to avoid spending funds on excess supplies, and to minimize risks related to supply shortages. Further, because of weak inventory management practices, losses associated with diversion could go undetected. VHA needs to improve the completeness of its inventory information and standardize annual physical inventory requirements.

Inventory Systems Are Not Integrated

VAMC Inventory Managers need real-time information from VA's Integrated Funds Distribution, Control Point Activity, Accounting, and Procurement System (IFCAP) and its Computerized Patient Record System (CPRS) to keep PIP quantities accurate and manage prosthetic inventories effectively. However, VHA's PIP does not integrate with IFCAP and CPRS. As a result, when warehouse staff record received supplies in IFCAP and when clinical staff record used supplies in CPRS, PIP is not automatically updated. Consequently, staff must manually record all supplies received and used in PIP. This work is labor-intensive and reduces the time staff have to actively manage supply inventories, and introduces errors into these systems.

Inefficiencies from Using Two Inventory Systems

VHA policies require VAMCs to use PIP to manage prosthetic supplies and GIP to manage surgical device implants (SDIs). VAMCs use of two inventory systems caused staff confusion about the responsibility for managing SDI inventories and created inefficiencies in managing SDIs stored in Surgery Service closets, crash carts, and operating rooms. As a result, VAMCs did not use either PIP or GIP to manage about 7,000 (28 percent) of 25,000 SDIs. The estimated inventory value for these items was almost \$8 million. By replacing PIP and GIP with one automated modern inventory system, VHA can help VAMCs manage these inventories and avoid excess prosthetic inventories and shortages.

Inadequate Staff Training

Inadequate training was a major cause of VAMCs accumulating excess inventory and experiencing supply shortages. VHA's *Inventory Management Handbook* requires staff receive training from qualified instructors on basic inventory management principles, practices, and techniques on how to use PIP and GIP effectively. However, staff at the six VAMCs we visited had not received training from qualified instructors.⁵ Because staff did not receive adequate training, they did not consistently apply basic inventory management practices and techniques.

VHA requires VAMCs to complete annual wall-to-wall inventories of quantities on hand with inventory accuracy rates of at least 90 percent. However, none of the six VAMCs we audited had the required documentation of completed physical inventories. VAMCs' failure to consistently complete and document physical inventories was also a contributing cause of reporting inaccurate quantities on hand. When VAMCs do not keep quantities on hand current, the automated inventory systems cannot accurately track item demand, which VAMCs must know in order to establish reasonable stock levels.

Insufficient Oversight

Insufficient VHA Central Office and VISN oversight contributed to VAMCs maintaining excess inventory and supply shortages. VHA's *Inventory Management Handbook* states that GIP will be the source of reported inventory data and lists seven performance metrics VAMCs must report every month. However, because the Handbook does not specifically require VAMCs to extract performance metric data from PIP, VAMCs did not report the required performance metrics for prosthetic inventories.

In addition, VHA's Handbook does not sufficiently define the role of VISN prosthetic representatives' (VPRs) inventory oversight responsibilities. The VPRs, who had jurisdiction over the audited VAMCs, stated they conducted VAMC site visits. However, the frequency of the site visits varied from quarterly to annually and during the site visits VPRs did not consistently perform a complete assessment of prosthetic supply inventory management.

⁵ VA Medical Centers in Decatur, Georgia; Indianapolis, Indiana; Northampton, Massachusetts; Nashville and Murfreesboro, Tennessee; Salem, Virginia; and Clarksburg, West Virginia.

VHA Handbook Inadequacies

Although VHA's *Inventory Management Handbook* provided a reasonable foundation for VAMC management of prosthetic supplies, the Handbook needed more guidance to ensure VAMCs do not accumulate excess supplies or experience supply shortages. We identified several Handbook inadequacies VHA must improve to help ensure VAMCs maintain reasonable inventory levels. For example, the Handbook did not have clear guidance on establishing normal, reorder, and emergency stock levels or timeliness standards for recording supplies received and used in PIP and GIP. A comprehensive and clear Handbook is an essential VHA control to ensure proper stewardship and accountability of VAMC prosthetic inventories.

Recommendations

Our second report made 10 recommendations to the Under Secretary of Health. They include requiring VISN and VAMC Directors to eliminate excess prosthetic inventories and avoid prosthetic shortages, developing a plan to implement a modern inventory system, and strengthening management of prosthetic supply inventories. In addition, we recommended VHA officials collaborate with the Executive Director, Office of Acquisition, Logistics, and Construction, to develop a training and certification program for prosthetic supply inventory managers. The Under Secretary for Health agreed with our recommendations and presented an action plan. We will follow-up as appropriate.

CONCLUSION

VA needs to improve contract administration and inventory management practices. Improvements in contract administration and inventory management will help ensure more funds are available for prosthetic care in VA. We expect VA to follow through on its commitment to replace the current inventory systems.

By strengthening internal controls, VA will reduce the financial risks associated with unused prosthetic supply inventories and waste. Until VHA strengthens the management and acquisition practices used to procure prosthetic limbs, VA will not have sufficient assurance that its practices are as effective and economical as possible.

Chairman Johnson, thank you for the opportunity to discuss our work. We would be pleased to answer any questions that you or other members of the Subcommittee may have.