
COMMONWEALTH OF PENNSYLVANIA



**A SPECIAL INVESTIGATION OF THE
STATE WORKERS' INSURANCE FUND,
Emergency Procurements**

April 2008

JACK WAGNER, AUDITOR GENERAL
PENNSYLVANIA DEPARTMENT OF THE AUDITOR GENERAL

April 17, 2008

The Honorable Sandi Vito
Acting Secretary
DEPARTMENT OF LABOR AND INDUSTRY
1700 Labor and Industry Building
Harrisburg, Pennsylvania 17120

Dear Acting Secretary Vito:

The Department of the Auditor General has conducted an investigation of the State Workers' Insurance Fund ("SWIF"), an enterprise fund within the Department of Labor and Industry ("DLI"). Specifically, we investigated SWIF's extended use of emergency contractors without the awarding of a permanent contract through the Request for Proposal ("RFP") process.

Although this investigation was initiated in response to a complaint from an unsuccessful bidder who had alleged numerous procurement law violations by SWIF, I want to emphasize that our findings and recommendations are intended to address systemic issues that exist beyond this particular complaint. I also want to emphasize that we are not questioning whether there was an emergency that justified SWIF's initial decision to use emergency contractors, but rather how SWIF went about procuring such services.

During the course of our investigation, we found the following:

- SWIF violated state procurement guidelines by using emergency contractors for extended periods of time without the awarding of a contract through the RFP process;
- SWIF may have paid fees to emergency contractors that were greater than the fees proposed by the complainant;
- SWIF made two emergency procurements for services without preparing the required supporting documentation; and

- DLI and SWIF rejected all proposals submitted in response to a third RFP without documenting the reasons for the rejections in the contract file as required.

Additional concerns are discussed at the end of this report, including several recommendations to the Pennsylvania Department of General Services regarding procurement policies and procedures under the responsibility of that agency.

We have included DLI's response to a draft copy of this report, followed by our comments on the response. We commend the staff of DLI and SWIF for their cooperation and assistance with this investigation. We encourage you, in your roles both as Acting Secretary of Labor and Industry and as Acting Chair of the State Workers' Insurance Board, to carefully review the matters set forth in this report and implement the recommended corrective actions. The Department of the Auditor General will follow-up at the appropriate time to determine whether our recommendations have been implemented.

This report is a public document and its distribution is not limited. Additional copies may be obtained through the Department's website, www.auditorgen.state.pa.us.

Sincerely,

/S/

JACK WAGNER
Auditor General

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EXECUTIVE SUMMARY

FINDINGS	RECOMMENDATIONS
<u>FINDING I:</u> The State Workers' Insurance Fund ("SWIF") Violated State Procurement Guidelines By Using Emergency Contractors For Extended Periods Of Time Without The Awarding Of A Contract Through The Request For Proposal ("RFP") Process.	We recommend that the Department of Labor and Industry ("DLI") and SWIF: <ul style="list-style-type: none">• Limit their use of emergency contractors to 90 days with a possible 90-day extension if such an extension is needed to secure the services of a qualified vendor through the RFP process; and• Ensure that their use of emergency contractors, when appropriate, does not result in the exclusion of disadvantaged or minority- or women-owned business enterprises from consideration for participation in such contracts.
<u>FINDING II:</u> SWIF May Have Paid Fees To Emergency Contractors That Were Greater Than The Fees Proposed By The Complainant.	We recommend that DLI and SWIF refrain from the extended use of emergency contractors and attempt to contract for services at lower costs through the RFP process.
<u>FINDING III:</u> SWIF Made Two Emergency Procurements For Services Without Preparing The Required Supporting Documentation.	We recommend that DLI and SWIF prepare the Emergency Procurement Approval Request form for all future uses of emergency contractors.
<u>FINDING IV:</u> DLI And SWIF Rejected All Proposals Submitted In Response To A Third RFP Without Documenting The Reasons For The Rejections In The Contract File As Required.	We recommend that DLI and SWIF: <ul style="list-style-type: none">• Ensure that, in the future, the reasons for the rejections of all proposals are placed in the contract file;• Provide written notification to each unsuccessful bidder of the reasons for such rejections, including information about that bidder's scores on the various elements contained in the evaluation

	<p>checklist and the bidder's ranking in comparison to other bidders; and</p> <ul style="list-style-type: none"> • Re-evaluate their RFP policies and requirements in order to minimize the number of cancellations and rejections because such actions result in the loss of time, effort, and money by both the Commonwealth and the prospective vendors.
<p align="center">ADDITIONAL CONCERNS</p>	
<p>The complainant sought assurance that SWIF would not use or distribute any technical information contained in its response to the third RFP at issue. We determined that SWIF does not use proprietary or technical information obtained from vendors' proposals for its own purposes, although it is entitled to do so. We have no recommendations relative to this issue.</p>	
<p>The scope of this investigation required a review of certain procurement policies and procedures under the responsibility of the Pennsylvania Department of General Services ("DGS"). Therefore, we recommend that DGS:</p> <ul style="list-style-type: none"> • Limit the use of emergency contractors by state agencies to 90 days with a possible 90-day extension if such an extension is needed to secure the services of a qualified vendor through the RFP process, and ensure that the use of emergency contractors, when appropriate, does not result in the exclusion of disadvantaged or minority- or women-owned business enterprises from consideration for participation in Commonwealth contracts; • Require state agencies to use the Emergency Procurement Approval Request form and to include cost and basis information on the form; • Conduct investigative reviews of the awarding of all emergency contracts by agencies subject to DGS' procurement guidelines; and • Monitor all situations in which an Invitation for Bid or RFP is cancelled or all bids or proposals are rejected in order to ensure that such action is justified and in the best interest of the Commonwealth. 	

BACKGROUND AND INTRODUCTION

The State Workers' Insurance Fund ("SWIF") is an enterprise fund within the Pennsylvania Department of Labor and Industry ("DLI").¹ It is administered by the State Workers' Insurance Board, which consists of the Secretary of DLI, who serves as chair of the board, the Insurance Commissioner, and the State Treasurer. It is managed on a day-to-day basis by a Director, who reports to DLI's Deputy Secretary for Compensation and Insurance.

SWIF was established by law to provide a quality workers' compensation program for Pennsylvania businesses that choose SWIF to meet their required obligations under the Pennsylvania Workers' Compensation Act, and to contribute to a progressive, stable workers' compensation market in Pennsylvania.²

SWIF is the largest provider of workers' compensation insurance in the Commonwealth of Pennsylvania, and it controls 15-18% of this market. SWIF is headquartered in Scranton, Pennsylvania, and has offices in seven other Pennsylvania cities. According to SWIF's website, SWIF had 429 employees as of January 2008.³

The following table summarizes SWIF's business activities for the years 2003 through 2007, the most recent data available:⁴

TABLE 1
SWIF Business Summary, 2003-2007

YEAR	AMOUNT OF WRITTEN PREMIUMS
2003	\$301,166,000
2004	\$385,385,000
2005	\$425,000,000
2006	\$398,952,000
2007	\$360,582,000
TOTAL	\$1,871,085,000

¹ Please note that the Department of the Auditor General recently released its cyclical financial audit of SWIF for the 2005 and 2006 calendar years. The audit report, dated December 11, 2007, included a finding that SWIF did not comply with statutory limits for equity investments and an observation that SWIF should improve its procedures for the monthly reconciliation of long-term investments. The investigation discussed in the present report was conducted as a separate engagement.

² 77 P.S. § 2601 *et seq.*

³ SWIF website, www.dli.state.pa.us/swif, "Frequently Asked Questions (FAQ)" (last modified on Feb. 29, 2008), accessed by OSI on April 7, 2008.

⁴ SWIF website, www.dli.state.pa.us/swif, "Frequently Asked Questions (FAQ)" (modification dates Jan. 2, 2007 and Feb. 29, 2008), accessed by OSI on June 20, 2007 and April 7, 2008, respectively; OSI interview of SWIF Director, September 12, 2006.

In May 2006, the Department of the Auditor General (“Department”) received a complaint from an unsuccessful bidder alleging numerous procurement law violations relating to SWIF. The complainant⁵ also provided OSI with copy of its letter dated March 14, 2006, to DLI’s Deputy Secretary for Compensation and Insurance, which the complainant characterized as a “formal complaint” regarding SWIF’s Request for Proposal (“RFP”) #SWIF 02-2005.⁶ The formal complaint contained the following allegations:

- SWIF issued three RFPs in an attempt to secure a vendor for provider panel preparation,⁷ Preferred Provider Organization⁸ network access, and/or repricing services.
- The first RFP (SWIF #01-04) resulted in no vendor being selected (“RFP 1”). This document does not contain a date of issuance.
- The second RFP (SWIF #01-05), issued in June 2005, was withdrawn by SWIF on September 7, 2005, a week before its due date (“RFP 2”).
- The third, more comprehensive RFP (SWIF #02-2005) was issued by SWIF on October 31, 2005, and was due December 8, 2005 (“RFP 3”).
- SWIF issued a letter to all vendors on February 3, 2006, exercising its right to reject all bids submitted in response to RFP 3.

The complainant also provided a copy of DLI’s response dated April 20, 2006, from SWIF’s Deputy Chief Counsel.

The Department’s Office of Special Investigations (“OSI”) commenced this investigation on June 12, 2006. OSI conducted several interviews of the complainant, who provided various documents, including the following:⁹

⁵ For the sake of simplicity, this report uses the term “complainant” to refer to *both* the individual who sent the Department a complaint *and* the limited liability company that this individual owns and operates. The business itself was the unsuccessful bidder in response to SWIF’s third request for proposal.

⁶ As indicated in the bullets below, this is referred to as “RFP 3” throughout this report.

⁷ RFP #SWIF 01-05 defines a “panel of physicians” as a list of at least six designated health care providers, no more than four of whom may be a coordinated care organization and no fewer than three of whom shall be physicians.

⁸ A Preferred Provider Organization (“PPO”) is a group system of health care organized by an insurance company. Physicians, health care providers of all types, hospitals, and clinics sign contracts with the PPO system to provide care to its insured people. These medical providers accept the PPO’s fee schedule and guidelines for its managed medical care.

⁹ During the course of this investigation, OSI examined several documents that referenced RFP #SWIF 03-2005, including the documents listed in the first and second bullets below. During a telephone conversation on December 14, 2006, DLI’s Audit Coordinator stated that any reference to RFP #SWIF 03-2005 is a typographical error and the correct number is RFP #SWIF 02-2005 – i.e., RFP 3. The Audit Coordinator stated that there was no RFP #SWIF 03-2005.

- Complainant's Technical Submittal in Response to RFP 3;
- Complainant's Cost Submittal in Response to RFP 3;
- Copies of certificates recognizing the complainant as a Disadvantaged Business Enterprise ("DBE") and a Woman-Owned Business Enterprise ("WBE"); and
- Copies of various e-mail messages, Right-to-Know Law Request Forms and responses, and other correspondence between complainant and officials at the Pennsylvania Department of General Services' ("DGS").

In addition to analyzing the records provided by the complainant, OSI's investigative actions included the following:

- Interviewing DGS' Deputy Secretary and Special Advisor to the Governor for Minority, Women-Owned and Disadvantaged Business Development ("DGS Deputy Secretary");
- Reviewing the Commonwealth Procurement Code¹⁰ and DGS' *Commonwealth of Pennsylvania Procurement Handbook* ("Handbook");¹¹
- Interviewing SWIF's Administrative Manager;
- Interviewing SWIF's Director;
- Analyzing copies of relevant business records and correspondence provided by DLI; and
- Reviewing RFP 1, RFP 2, and RFP 3.

This investigation covered five allegations made by the complainant about SWIF's procurement process and use of contractors, and resulted in four findings relative to DLI and SWIF. Additional concerns are discussed at the end of this report, including several recommendations to DGS regarding procurement policies and procedures under the responsibility of that agency.

A draft copy of this report was provided to DLI for its review and comment. DLI's response is included at the end of this report, followed by this Department's comments on the response.¹²

¹⁰ 62 Pa.C.S. § 101 *et seq.*

¹¹ The *Handbook* is available at www.dgs.state.pa.us – click on "Procurement" at the top of DGS' home page and then on "Procurement Handbook" on the left side of the "Bureau of Procurement" page. It was first posted on December 7, 2005. The "Procurement Handbook" page states, "The [hard-copy] version of the Procurement Handbook is no longer available. The online handbook, which is accessible from the left side of this page, will be the only version of the Commonwealth's official Procurement documentation." With the exception of SWIF's rejection of all bids submitted in response to RFP 3, all activities covered by this investigation occurred under the prior (hard-copy) version of the *Handbook*. However, for purposes of this report, there are no significant differences between the two versions of the document unless otherwise noted.

¹² A draft copy of this report was first provided to DLI under cover of correspondence dated October 29, 2007, to which DLI submitted a response dated November 29, 2007. OSI then revised the draft report to address certain issues raised in DLI's response. On March 4, 2008, representatives of OSI met with representatives of DLI to explain those revisions, present a second draft report, and request a response to the second draft. OSI wanted to give DLI the opportunity to revise its response based on the changes that were made and also give the Acting Secretary of DLI the opportunity to respond to the report

FINDINGS AND RECOMMENDATIONS

**FINDING I: SWIF Violated State Procurement Guidelines By Using
Emergency Contractors For Extended Periods Of Time Without
The Awarding Of A Contract Through The Request For Proposal
Process.**

The complainant submitted Right-To-Know-Law Request Forms to DLI dated December 6, 2005, and February 24, 2006, to which DLI responded by correspondence dated December 16, 2005, and March 6, 2006, respectively. In response to the complainant's requests, DLI provided copies of the following documents:

- an e-mail message dated March 12, 2005, from SWIF's Administrative Manager to a DGS official in which the Administrative Manager requested EPOS¹³ to contract out the payment of medical bills for a 90-day period, with the option for a second 90-day period to follow if needed;
- an e-mail message dated March 14, 2005, from the DGS official approving the emergency procurement immediately for 90 days and approving an additional 90 days if required;
- an e-mail message dated September 30, 2005, from SWIF's Administrative Manager to a DGS official in which the Administrative Manager requested permission to extend the use of two emergency contractors for an additional nine months; and
- an e-mail message dated October 3, 2005, which authorized the nine-month extension.

SWIF used the services of two emergency contractors for medical bill repricing services:

1. Emergency Contractor #1:

SWIF Purchase Order ("PO") # 4500210792 for medical bill repricing dated March 19, 2005, listing a delivery date of March 28, 2005, stated the following: "EPOS approved by DGS to allow for the payment of SWIF's medical bills for a 90 day period with an option to extend for a 2nd 90 day period through 9/28/05 at SWIF's discretion."

as she saw appropriate, rather than rely on her predecessor's response. DLI submitted its revised response on March 21, 2008.

¹³ DLI's Audit Coordinator stated that "EPOS" is the plural of "EPO," which is an acronym for "Emergency Purchase Order."

SWIF PO # 4500246478 for medical bill repricing dated July 28, 2005, listing a delivery date of August 1, 2005, stated the following: “SWIF to exercise renewal option for 90 day period for the payment of SWIF’s medical bills. Contracting period through October 31, 2005.”

SWIF PO # 4500272628 for medical bill repricing dated October 28, 2005, listing a delivery date of November 1, 2005, stated the following: “Extension of EPOS (4500246478) for 9 months per attached DGS approval. Contract period 11/1/05 through 7/31/06.”

2. Emergency Contractor #2:

SWIF PO # 4500210794 for medical bill repricing dated March 19, 2005, listing a delivery date of March 28, 2005, stated the following: “EPOS approved by DGS to allow for the payment of SWIF’s medical bills for a 90 day period with an option to extend for a 2nd 90 day period through 9/28/05 at SWIF’s discretion.”

SWIF PO # 4500246492 for medical bill repricing dated July 28, 2005, listing a delivery date of August 1, 2005, stated the following: “SWIF to exercise renewal option for 90 day period for the payment of SWIF’s medical bills. (Original PO 4500210794). Contract period through October 31, 2005.”

SWIF PO # 4500272634 for medical bill repricing dated October 28, 2005, listing a delivery date of November 1, 2005, stated the following: “Extension of EPOS (4500246492) for 9 months per attached DGS approval. Contract period 11/1/05 through 7/31/06.”

Records (listings of Medicaid Part A and Part B bills submitted by month) provided by DLI indicate that Emergency Contractor #1 was still involved in medical bill repricing for SWIF as of September 2006, and Emergency Contractor #2 was still involved in medical bill repricing for SWIF as of October 2006.

The Commonwealth Procurement Code, a state law originally enacted in 1998, includes the following provision with regard to emergency procurements:

The head of a purchasing agency may make or authorize others to make an emergency procurement when there exists a threat to public health, welfare or safety or circumstances outside the control of the agency create an urgency of need which does not permit the delay involved in using more formal competitive methods. Whenever practical, in the case of a procurement of a supply, at least two bids shall be solicited. A written determination of the basis for the emergency and for the selection of the particular contractor shall be included in the contract file.¹⁴

¹⁴ 62 Pa.C.S. § 516.

Based on this law, the *Handbook* includes the following instructions regarding emergency procurements:

1. Conditions for Use. The head of a purchasing agency may make or authorize others to make an emergency procurement when:

- a. A threat to public health, welfare, or safety exists.
- b. Circumstances outside the control of the agency create an urgency of need which does not permit the delay involved in using more formal, competitive methods.

2. Selection Process. Whenever practical, in the case of a procurement of a supply, at least two bids shall be solicited.

3. Preapproval. All emergency procurements which exceed \$5,000 must be preapproved by DGS unless the agency can establish that because of the nature or time of the emergency, proper DGS officials were not available or that time would not permit prior contact with the department.

4. Written Determination. A written determination of the basis for the emergency and for the selection of the particular contractor shall be sent to DGS and included in the contract file. A form for the agency to use in preparation of the written determination is provided in the Appendix of Forms.

5. Record Listing. The purchasing agency shall maintain a record listing of all emergency contracts for a minimum period of three years from the date of final payment under the contract. The record shall contain:

- a. Each contractor's name.
- b. The amount and type of each contract.
- c. A listing of the supplies, services, or construction procured under the contract.¹⁵

The *Handbook* does not address the issue of time limits relative to the use of emergency contractors as opposed to the RFP process.

DGS' website contains a section titled "Frequently Asked Questions On the Procurement Code and Policy," which states the following:

¹⁵ Pennsylvania Department of General Services, *Pennsylvania Procurement Handbook Online*, Part I, Chapter 6, Section F ("*Handbook*") (last modified on April 1, 2008), accessed by OSI on June 20, 2007 and again on April 7, 2008.

Q. HOW LONG ARE DGS APPROVED EMERGENCY PURCHASES OF SERVICES GOOD FOR? (5/10/2001)

A. Unless it is spelled out at the time of the request, then basically they are good for 90 days. (60 to 90 days will be the normal [sic]).¹⁶

Purchase Orders provided by DLI to OSI indicate that SWIF, with the approval of DGS, used two emergency contractors for the period of March 28, 2005, through July 31, 2006, a total of 16 months. In addition, records of bills submitted by month indicate that Emergency Contractor #1 worked as an emergency contractor through at least September 2006, totaling 18 months. These records also indicate that Emergency Contractor #2 worked as an emergency contractor through at least October 2006, totaling 19 months.

The complainant told OSI that it had contacted SWIF's Deputy Chief Counsel in April 2005 by telephone in an attempt to determine SWIF's reasoning for awarding emergency contracts to Emergency Contractor #1 and Emergency Contractor #2. According to the complainant, the Deputy Chief Counsel told the complainant that this was a three-month contract with a possible three-month extension and SWIF could not utilize these vendors past September 30, 2005. The Deputy Chief Counsel indicated that SWIF must secure a vendor through the official bid process should SWIF need to extend the services past September 30, 2005. The complainant told OSI that it has no record of this telephone conversation.

During an interview on August 25, 2006, OSI asked SWIF's Administrative Manager to explain why DLI and SWIF failed to select a qualified contractor through the RFP process at a time when it was using emergency contractors. The Administrative Manager stated that SWIF officials felt that the proposal responses were not satisfactory to the needs of SWIF because of price, quality, or both. During an interview on September 12, 2006, SWIF's Director was asked the same question by OSI and responded that no permanent contractor was selected because no quality proposals were submitted.

OSI interviewed the DGS Deputy Secretary on July 20, 2006. OSI advised him that the complainant had provided OSI with copies of several e-mail messages that had been sent between him and the complainant. OSI asked the DGS Deputy Secretary to explain why DLI and SWIF had failed to select a contractor through the RFP process at a time when SWIF was using emergency contractors. The DGS Deputy Secretary stated that SWIF's use of two emergency contractors for at least 15 months from April 2005 through July 2006 was "out-of-the-ordinary." He also stated that he did not know why SWIF avoided the use of RFPs to hire a contractor, but he believed that the transfer of this issue to DGS would correct this situation.

In a February 4, 2006 e-mail message from the DGS Deputy Secretary to the complainant, the DGS Deputy Secretary stated that he had planned to meet with DLI

¹⁶ DGS website, www.dgsweb.state.pa.us/comod/FAQs/FAQS_All.asp, "Frequently Asked Questions On the Procurement Code and Policy," accessed on July 24, 2007 and again on April 7, 2008.

about the RFP. However, he told OSI that he did not meet with DLI, but he believes that he may have spoken to DLI's Deputy Secretary for Compensation and Insurance about this issue. The DGS Deputy Secretary told OSI that he had spoken internally with the Secretary of DGS, and that both he and the Secretary recognized that there were "problems" with the SWIF emergency contracts and RFPs and "how they were being administered." The DGS Deputy Secretary told OSI that he and the DGS Secretary agreed that they should try to place SWIF's RFP process under the control of DGS.

In a February 28, 2006 e-mail message to the complainant, the DGS Deputy Secretary stated that "DGS is extremely dissatisfied with the way [DLI] has handled this contract, and we are taking steps to try to assume responsibility or oversight of the contract." He told OSI that his source for this information was DGS' Special Assistant to the Deputy Secretary for Procurement. In this same e-mail message, the DGS Deputy Secretary stated that DGS had tried to gain control of this contract. He told OSI that DGS did not gain control of this contract, but this matter was under the control of the Governor's Office of Administration with input from DGS.

DGS issued RFP # DGS-CN-00020848 on July 21, 2006 on behalf of DLI and SWIF. This RFP was issued for Preferred Provider Organizations and Comprehensive Medical Bill Review Services.

The complainant filed objections to the RFP pursuant to applicable statutes in the form of a "bid protest." DGS dismissed the bid protest on or about September 21, 2006. The complainant subsequently filed a lawsuit in the Commonwealth Court of Pennsylvania in which it requested a reversal of DGS' dismissal of the bid protest. After the Commonwealth Court affirmed the dismissal, the complainant asked the Supreme Court of Pennsylvania to hear an appeal of the lower court's decision. That request appears to be still pending as of the date of this report.

Finally, we note that the complainant also alleged that the emergency procurements failed to consider interested firms' status as disadvantaged or minority- or women-owned business enterprises ("DBEs" and "MWBEs") and that, unlike its firm, the two emergency contractors did not have such status. During this investigation, we learned that, unlike a traditional RFP procurement, an emergency procurement is not required to take into account a firm's DBE/MWBE status. However, we also learned, during an interview with the DGS Deputy Secretary on July 20, 2006, that the Governor's goal is to have 10% of all Commonwealth contractors classified as DBEs or MWBEs and that the then-current percentage was 7.2%. Therefore, we are concerned that the use of non-DBE/MWBE emergency contractors for periods considerably beyond the norm may prevent the Commonwealth from increasing its percentage of DBE/MWBE contractors.

Conclusions and Recommendation:

We are not questioning whether or not there was an emergency that justified SWIF's initial decision to use emergency contractors. However, we do question SWIF's use of two emergency contractors for periods of 18 months and 19 months, respectively, and SWIF's failure to secure the services of a qualified vendor through the RFP process. DLI and SWIF explained the use of emergency contractors for these extended time periods on the grounds that no quality proposals were received in response to RFP 3. It is our conclusion that SWIF's use of these emergency contractors was excessively long and that the extended use of the emergency contractors violated the guidelines for the use of emergency contractors. Our conclusion is supported by the statements of and e-mails from the DGS Deputy Secretary, guidelines provided on DGS' website, and the fact that DGS increased its role in this RFP process in July 2006.

We recommend that DLI and SWIF limit their use of emergency contractors to 90 days with a possible 90-day extension if such an extension is needed to secure the services of a qualified vendor through the RFP process. We also recommend that DLI and SWIF ensure that their use of emergency contractors, when appropriate, does not result in the exclusion of DBEs or MWBEs from consideration for participation in such contracts.

FINDING II: SWIF May Have Paid Fees To Emergency Contractors That Were Greater Than The Fees Proposed By The Complainant.

Medicare Part A ("Part A") helps cover inpatient care in hospitals, critical access hospitals, and skilled nursing facilities (not custodial or long-term care), while Medicare Part B ("Part B") covers medical services such as doctors' services, outpatient care, and other medical services that Part A does not cover. We found that SWIF may have paid Part B repricing per line fees to the emergency contractors that were greater than the fees proposed in the complainant's response to RFP 3.

Emergency Contractor # 1 -- Payments

SWIF PO # 4500272628, dated October 28, 2005, is an extension of PO # 4500246478 for Emergency Contractor # 1 for the period of November 1, 2005, through July 31, 2006. This purchase order indicates that SWIF paid this contractor according to the following schedule:

TABLE 2
Emergency Contractor # 1 Payment Schedule

TYPE OF BILL	PAYMENT AMOUNT
Part A	\$30.00 per bill
Part B	\$1.00 per line
Duplicate / flawed bills	\$5.00 per bill

Records provided by SWIF indicate that Emergency Contractor # 1 submitted (or "entered," in SWIF terminology) the following numbers of bills during the period of March 2005 through September 2006:

TABLE 3
***Number of Bills Submitted by Emergency Contractor # 1,
March 2005 through September 2006***

TYPE OF BILL	NUMBER SUBMITTED
Part A	24,648
Part B	274,303
Total	298,951

SWIF's Administrative Manager provided a handwritten summary schedule to OSI in August 2006. This summary schedule indicated that SWIF paid Emergency Contractor # 1 a total of \$1,071,903 during the period of March 28, 2005 through July 31, 2006.

Emergency Contractor # 2 -- Payments

SWIF PO # 4500272634, dated October 28, 2005, is an extension of PO # 4500246492 for Emergency Contractor # 2 for the period of October 1, 2005 through July 31, 2006. This PO indicates that SWIF paid Emergency Contractor # 2 according to the following schedule:

TABLE 4
Emergency Contractor # 2 Payment Schedule

TYPE OF BILL	PAYMENT AMOUNT
Part A	\$30.00 per bill
Part B	\$1.00 per line
Duplicate / flawed bills	\$5.00 per bill

Records provided by SWIF indicate that Emergency Contractor # 2 submitted the following numbers of bills during the period of March 2005 through September 2006:

TABLE 5
***Number of Bills Submitted by Emergency Contractor # 2,
March 2005 through September 2006***

TYPE OF BILL	NUMBER SUBMITTED
Part A	36,817
Part B	593,318
Total	630,135

SWIF's Administrative Manager provided a handwritten summary schedule to OSI in August 2006. This summary schedule indicated that SWIF paid Emergency Contractor # 2 a total of \$1,907,280 during the period of March 28, 2005 through July 31, 2006.

Conclusion and Recommendations:

Evidence obtained by OSI from SWIF's Administrative Manager indicates that SWIF made the following payments to the two emergency contractors during the period of March 28, 2005 through July 31, 2006:

TABLE 6
SWIF Payments to Emergency Contractors,
March 28, 2005 through July 31, 2006

TYPE OF BILL	AMOUNT
Part A	\$1,662,480
Part B	\$1,316,973
Total (Part A and B)	\$2,979,453

The Part B payments are based on the emergency purchase order price of \$1.00 per line, meaning that the emergency contractors were paid for 1,316,973 lines on Part B bills. Our computation does not factor in payments for duplicate or flawed bills because, in response to our request for the average number of bills handled per week by the emergency contractors, SWIF did not provide any data regarding the number of duplicate or flawed bills.

The complainant's response to RFP 3 included a Cost Submittal in which it proposed a fee of \$.85 per line for both Part A and Part B bills. This savings of \$.15 per line on Part B bills may have saved SWIF and the Commonwealth a total of \$197,546. We acknowledge that this is a cost comparison analysis only and this analysis does not consider the quality of services provided by the emergency contractors or the quality of services that would have been provided by the complainant. We also acknowledge that we cannot directly compare fees with regard to Medicaid Part A repricing because those fees are paid on a per-bill basis, as opposed to per-line as with Part B, yet the complainant had submitted its proposal for both Part A and B on a per-line basis.

The above data indicate that the use of the RFP process may have resulted in the saving of significant amounts to SWIF and the Commonwealth. However, the comparison does not support the complainant's claim that the emergency contractors were paid three times the market value for services provided.

This investigation was not intended as a complete financial audit of SWIF's payments to the emergency contractors, but we do question DLI's and SWIF's payments of significant amounts to two emergency contractors for periods of 18 and 19 months, respectively, when at least one vendor had submitted a proposal that offered – and, apparently, may have actually resulted in – lower cost for the same service, at least with regard to Part B work.

We recommend that DLI and SWIF refrain from the extended use of emergency contractors and attempt to contract for services at lower costs through the RFP process.

FINDING III: SWIF Made Two Emergency Procurements For Services Without Preparing The Required Supporting Documentation.

As discussed in Finding I, the complainant provided OSI with a copy of a Right-to-Know Law Request Form, dated February 24, 2006, which it had submitted to DLI. This form specifically requested that DLI provide it with:

1. A copy of the “Emergency Purchase; Confirmation Memo” which SWIF submitted to the DGS to secure emergency contracts for both [Emergency Contractor #1] and [Emergency Contractor #2] for repricing services effective April 1, 2005.

The Emergency Purchase; Confirmation Memorandum (“Memorandum”) was required for the awarding of emergency contracts at the time of the procurements at issue. This form required the following information:

- Basis for the emergency;
- Identity of the emergency contractor;
- Price of emergency supplies or services; and
- Basis for selection of the emergency contractor.

The complainant wanted to review the Memoranda because they should have indicated the amounts being paid by SWIF to Emergency Contractor #1 and Emergency Contractor #2.

The complainant also provided OSI with a copy of DLI’s letter, dated March 6, 2006, in response to the Right-to-Know Law Request. This letter listed all 11 items that the complainant had requested, and indicated that 9 of the items requested were not being provided for various reasons. This response letter indicated that the first item on the request list, which was the Memorandum, would be provided to the complainant.

However, the complainant told OSI that the response did not include copies of any Memoranda. The complainant said that it had contacted a representative of DLI, who stated that the response included all documents on file relative to these two emergency contracts. The complainant concluded, as a result of the contact with this DLI representative and the information in the response letter, that Memoranda were never completed and that these documents do not exist.

As discussed in Finding I, both the Commonwealth Procurement Code and the *Handbook* require that a written determination of the basis for an emergency procurement and for the selection of the particular contractor must be included in the contract file. The *Handbook* provides a form for agencies to use in order to prepare the written determination. Under the version of the *Handbook* in effect during the events under investigation, the form was the Emergency Purchase; Confirmation Memorandum. Under the current version of the *Handbook*, that form is called the Emergency

Procurement (“EP”) Approval Request form.¹⁷ Both forms require the same types of information to justify the use of an emergency procurement.

During an interview with OSI on August 25, 2006, SWIF’s Administrative Manager stated that he was directed by DLI’s Deputy Secretary for Compensation and Insurance to request permission from DGS for the use of two emergency contractors to assist SWIF with its medical bill backlog. SWIF’s Administrative Manager stated that he did not prepare a Memorandum relative to this emergency purchase request because he was not told to do so by any of the approving officials at DGS. The Administrative Manager stated that he was familiar with both the Memorandum and the instructions in the *Handbook* relative to this document. However, the Administrative Manager stated that he considered his e-mail request dated March 12, 2005, relative to the use of emergency contractors to be an acceptable substitute for the Memorandum. A copy of this e-mail message, dated March 12, 2005, originating with SWIF’s Administrative Manager, was provided to OSI by the complainant.

During an interview with OSI on September 12, 2006, SWIF’s Director stated that she was not aware of anyone at SWIF completing a Memorandum relative to this emergency request. The Director stated that she did not know why a Memorandum was not completed. The SWIF Director stated that and she did not know who at SWIF would have been responsible for completing and submitting the Memorandum. Significantly, she further stated that she was not familiar with the requirement to file a Memorandum or the information required on a Memorandum.

By letter dated October 4, 2006, OSI requested that DLI provide copies of certain documents relative to this investigation, including all Memoranda which SWIF submitted to DGS to secure emergency contracts for both Emergency Contractor #1 and Emergency Contractor #2 for repricing services effective April 5, 2005, or thereafter.

By letter dated November 22, 2006, SWIF’s Deputy Chief Counsel responded as follows:

As of this date, this information has not been provided to me. I will check with SWIF to see if such information exists and either the DLI Audit Coordinator or I will advise you. Please note that there are no contracts with [Emergency Contractor #1] or [Emergency Contractor #2] since these were emergency procurements.

DLI’s Audit Coordinator provided OSI with a second letter dated December 22, 2006, in order to address the outstanding items from the November 22, 2006, letter. DLI provided only copies of eight e-mail messages written between SWIF’s Administrative Manager and a DGS representative during the period of March 12, 2005 through June 30, 2006 relative to the emergency contracts. DLI was not able to provide a copy of a Memorandum to OSI because no such document had been prepared by SWIF.

¹⁷ This form is numbered by DGS’ Bureau of Procurement as “BOP-004, Rev. 09/25/2006.”

Conclusions and Recommendations:

SWIF's actions violated the requirements of the *Handbook* by failing to prepare Memoranda relative to the hiring of two emergency contractors. DLI and SWIF have taken the position that e-mail messages between SWIF's Scranton headquarters and DGS in Harrisburg are a suitable substitute for the required supporting documentation for emergency procurements, which, at least in this case, were not prepared by SWIF.

We recognize the fact that the e-mail messages do include the basis for the emergency and that at least one of the e-mail messages does identify the two emergency contractors. However, other than including the statement that SWIF is planning to use two vendors that are skilled in paying medical bills, the e-mail messages state nothing about the basis for the selection of the emergency contractors or about the price of using emergency contractors – information which was required by the Memorandum.

We recommend that DLI and SWIF prepare the new Emergency Procurement Approval Request form for all future uses of emergency contractors. A sample form can be found in the "Procurement Forms" section of DGS' website. The online versions of the form and *Handbook*¹⁸ have replaced the hard-copy versions, which are no longer available.¹⁹

¹⁸ www.dgs.state.pa.us – click on "Procurement" at the top of DGS' home page and then on "Procurement Forms" or "Procurement Handbook" on the left side of the "Bureau of Procurement" page (accessed by OSI on July 26, 2007 and again on April 7, 2008).

¹⁹ See footnote 11 for explanation.

FINDING IV: DLI And SWIF Rejected All Proposals Submitted In Response To A Third RFP Without Documenting The Reasons For The Rejections In The Contract File As Required.

RFP 3 requested bid responses for the following three services:

1. Medical bill review/repricing services;
2. Preferred Provider Organization access; and
3. Provider panel development.

On February 3, 2006, SWIF's Director issued a letter to all vendors that had responded to RFP 3, including the complainant, informing them that SWIF was exercising its right to reject all bids submitted in response to RFP 3. The letter did not cite any reasons for this decision.

The Commonwealth Procurement Code provides the following with regard to cancelling and rejecting Invitations for Bids ("IFBs") and RFPs:

An invitation for bids, a request for proposals or other solicitation may be canceled, or any or all bids or proposals may be rejected, at any time prior to the time a contract is executed by all parties when it is in the best interests of the Commonwealth. Bids may be rejected in part when specified in the solicitation. The reasons for the cancellation or rejection shall be made part of the contract file.²⁰

Similarly, the *Handbook* states the following with regard to cancelling and rejecting IFBs and RFPs:

A. Cancellation of an IFB or RFP or rejection of all bids or proposals usually involves the loss of time, effort, and money spent by the Commonwealth and the bidder or offeror in carrying activities in the procurement process up to the point of cancellation or rejection.

B. An IFB, RFP, or other solicitation may be cancelled or any and all bids or proposals may be rejected, at any time prior to the time a contract is executed by all parties, when it is in the best interest of the Commonwealth. Bids may be rejected in part when specified in the solicitation.

C. All IFBs, RFPs, or other solicitation should reserve to the Commonwealth the right to reject any or all bids or proposals, in whole or in part, when it is in the best interests of the Commonwealth.

D. The reasons for the cancellation of an IFB, RFP, or other solicitation and the reasons for the rejection of all bids or proposals must be made a

²⁰ 62 Pa.C.S. § 521.

part of the contract file. The reasons stated for the cancellation or rejection must show that the cancellation was based upon the sound judgment of the Commonwealth and not arbitrary or capricious or an abuse of discretion.²¹

SWIF's Administrative Manager told OSI that he did not know why all responses to this proposal were rejected, but SWIF's Director would be able to answer this question. The Administrative Manager stated that each vendor who responded to this RFP received a letter of explanation relative to the reasons for the rejection of the proposals, and that the Director would be able to provide a copy of this letter.

The Administrative Manager stated that he was aware that the *Handbook* states that the reasons for the cancellation of an IFB, RFP, or other solicitation and the reasons for the rejection of all bids or proposals must be made a part of the contract file.

SWIF's Director told OSI that DLI issued RFP 3 on October 31, 2005, and DLI rejected all proposals relative to this RFP on February 3, 2006. The Director stated that the purpose of RFP 3 was to develop a PPO for SWIF and to contract with a vendor for medical bill review which would include data entry and re-pricing for network medical bills. She defined a "network bill" as a bill submitted by a medical care provider belonging to SWIF's PPO. She stated that this medical bill review process would require the successful vendor to interface with Power Comp, SWIF's new software. She stated that non-network bills would be handled internally by SWIF.

The Director stated that the acceptance of a proposal relative to RFP 3 would have eliminated the need for the emergency contractors, and the medical bill backlog would have been eliminated.

The Director stated that nine vendors submitted proposals relative to RFP 3. The Director stated that all of these proposals were rejected because they were all unsatisfactory in some way and were thin on details. For example, some proposals were strong in the PPO area and weak in the medical bill review area, and vice-versa.

The Director stated that she had personally drafted the letter of rejection that was sent to all vendors that submitted proposals in response to RFP 3. She stated that this letter told the vendors that all proposals were being rejected without any explanation or reason for the rejection of the proposals. She stated that she wrote this letter under the direction of SWIF's Deputy Chief Counsel, who had instructed that the letter only had to state that no proposals were being accepted without including any explanation or reason for this action.

OSI told SWIF's Director that the *Handbook* states that the reasons for the cancellation of an IFB, RFP, or other solicitation and the reasons for the rejection of all bids or proposals must be made part of the contract file. The Director replied that she did not know if this information was included in the contract file, but she would attempt to find out.

²¹ *Handbook*, Part I, Chapter 26 (last modified July 20, 2007).

OSI asked SWIF's Director why DLI and SWIF failed to select a contractor through the RFP process at a time when SWIF was using emergency contractors. The Director replied that no contractor was selected through the RFP process because no quality proposals were submitted.

By letter dated October 4, 2006, OSI requested that DLI provide OSI with RFP contract files listing the reasons for the rejection of all proposals relative to RFP 1 and RFP 3 and the withdrawal of RFP 2. By letter dated November 22, 2006, DLI responded that "it is the understanding of the Deputy Chief Counsel, Department of Labor and Industry, that these memoranda have not been prepared."

A second DLI response letter dated December 22, 2006, contained the following statement:

Though formal letters were not placed in the RFP contract files as required by Chapter 26 of the Commonwealth Procurement Handbook, the reason that each solicitation was withdrawn was that the proposals were lacking in quality and did not provide the range of services that SWIF was looking for. In the case of the RFP that was withdrawn, it was due to a decision to rewrite portions of the RFP. Soon thereafter, [DGS] took over the process from [DLI].

Relative to RFP 3, DLI provided to OSI a handwritten evaluation summary sheet for four reviewers (A, B, C, and D) and seven vendors (1-9) which we have summarized in Table 7.

TABLE 7
Evaluation Summary Sheet for RFP 3

VENDOR	A POINTS	B POINTS	C POINTS	D POINTS	AVERAGE POINTS
1	51.00	53.00	51.50	53.50	52.25
2 <i>Emergency Contractor #1</i>	54.00	48.00	48.00	46.50	49.13
3 <i>Emergency Contractor #2</i>	42.00	39.50	43.00	42.00	41.63
4	36.00	38.75	40.00	39.50	38.56
5 <i>Complainant</i>	34.50	40.00	38.00	37.80	37.58
6	38.00	31.75	33.50	34.50	34.44
7	30.00	31.00	33.00	31.00	31.25
8	No data	No data	No data	No data	N/A
9	No data	No data	No data	No data	N/A

This evaluation summary sheet lists evaluation points for the two emergency contractors used by SWIF, shown as Vendors 2 and 3 in Table 7. It also indicates that the two emergency contractors would not have been qualified to be selected through the RFP process if that process had been used.

The evaluation summary sheet indicates that the complainant was ranked fifth out of seven respondents, and was ranked more than 14 points behind the respondent that was ranked first.

DLI also provided copies of nine evaluation checklists prepared by SWIF's Director. These evaluation checklists list 28 elements of evaluation in the following areas:

- Statement of the problem;
- Management summary;
- Work plan;
- Prior experience; and
- Personnel qualifications.

In her response letter to OSI dated November 22, 2006, the SWIF's Deputy Chief Counsel stated the following relative to the request for RFP evaluation committee checklists, evaluation committee reports, evaluation committee recommendations, and evaluation committee work papers:

Enclosed is information about [RFP 1] and [RFP 3]. I am concerned that this information is not complete. For example, with respect to [RFP 3], I seem to have only evaluation checklists completed by the SWIF Director. I will ask SWIF to gather any more documents it may have in this regard and either the Audit Coordinator or I will advise you. I do not have any information with respect to [RFP 2]. I assume that is because this RFP was withdrawn. I will confirm this with SWIF and either the Audit Coordinator or I will advise you.

In the response letter dated December 22, 2006, DLI's Audit Coordinator stated the following:

All of the information regarding this process that SWIF was able to access has been forwarded to you. Some of the evaluations were inadvertently not maintained. Please note that there were no proposals received for [RFP 2] as it was withdrawn prior to the receipt of proposals.

The SWIF Director's evaluation checklist for the highest-rated RFP respondent (Vendor 1 in Table 7), which was not selected, is summarized in the following table:

TABLE 8
Vendor 1 Evaluation Checklist Summary
For SWIF Director (Evaluator)

EVALUATION AREA	MAXIMUM POINTS	VENDOR ONE POINTS	VENDOR 1 PERCENTAGE
Statement of Problem	5	5.0	100.0%
Management Summary	8	6.0	75.0%
Work Plan	15	14.5	96.6%
Prior Experience	18	14.0	77.7%
Personnel Qualifications	17	14.0	82.3%
Totals	63	53.5	84.9%

This evaluation checklist information is included for the purpose of showing that a percentage score of 84.9% was not considered satisfactory for acceptance by DLI and SWIF.

Conclusions and Recommendations:

DLI admitted in the letters to OSI dated November 22, 2006, and December 22, 2006, that it did not prepare the required memoranda explaining the reasons for the rejection of the RFPs, and that these memoranda were not placed in the contract files as required by the Commonwealth Procurement Code and the *Handbook*. DLI has also admitted to “inadvertently” failing to maintain certain RFP evaluation forms, and expressed concern over the fact that this information was incomplete.

We question DLI’s and SWIF’s failure to place the reasons for the rejection of all proposals submitted in response to RFP 3 in the contract file. We also question the rejection of all proposals on the bases that they all were “lacking in quality and did not provide the range of services that SWIF was looking for.” The rejection of all proposals involves the loss of time, effort, and money by both the Commonwealth and the prospective vendors, and such action should require more specific reasons and explanations.

In addition, we question SWIF’s inconsistency in rejecting all proposals submitted in response to RFP 3, including proposals submitted by both emergency contractors used by SWIF for extended periods of time. We question why vendors that were hired as emergency contractors, without any formal bidding process, were not qualified to be selected through the RFP process, and were paid almost \$3 million for the period of March 28, 2005 through July 31, 2006. We must also question why a vendor that received an evaluation score of 84.9% of the total possible score was not considered acceptable to DLI and SWIF.

We recommend that DLI and SWIF ensure that, in the future, the reasons for the rejections of all proposals are placed in the contract file as required. We also recommend that they provide written notification to each unsuccessful bidder of the reasons for such rejections, including information about that bidder's scores on the various elements contained in the evaluation checklist and the bidder's ranking in comparison to other bidders. Finally, we recommend that DLI and SWIF re-evaluate their RFP policies and requirements in order to minimize the number of cancellations and rejections because such actions result in the loss of time, effort, and money by both the Commonwealth and the prospective vendors.

ADDITIONAL CONCERNS

Technical Information Contained In Response To RFP 3

The complainant stated that it had sought reimbursement from SWIF for the time and expense in preparing a bid response to RFP 3, and the return of its proposal with assurance that SWIF not use or distribute the information contained in the proposal. The complainant stated that it was aware, at the time that it had submitted the bid proposal, that the RFP specifically stated that SWIF had the right to use any and all information obtained through the RFP process. However, the complainant stated that it wanted this information returned for the following reasons:

- The complainant theorized that SWIF never wanted to award a contract to it, and SWIF rejected all bids in order to continue to use the emergency contract vendors.
- The information provided by the complainant could be used by SWIF in dealing with vendors more favorable to SWIF, particularly in the area of the development of provider panels. The complainant stated that SWIF does not want to involve itself in the development of provider panels.
- The information provided by the complainant could be used by SWIF in implementing its new repricing software to the extent that it would not need the services offered by it.

By letter dated April 20, 2006, SWIF's Deputy Chief Counsel responded to the complainant's formal complaint letter dated March 14, 2006. The last paragraph of this response letter read as follows:

Third, you ask that [DLI] either make restitution to the vendors which submitted proposals in response to the RFP, to reimburse them for their time and expense in preparing the proposals, or to return the proposal submitted by [you] with written assurance that SWIF will not use or distribute the information contained in that proposal. As you note in your letter, the RFP specifically states that if [DLI] rejects all of the proposals, it has the right to use any and all information derived through the RFP process. See Section 1.17 of the RFP. You even state that, in hindsight, you should have objected to this clause when you submitted your proposal. Finally, Section 1.7 of the RFP states that [DLI] is not liable for any cost incurred by vendors prior to the issuance of a contract.

SWIF did not return the complainant's proposal.

SWIF's Administrative Manager told OSI that state law and RFP language allow SWIF to use technical information or trade secrets obtained from proposals that were not selected. However, the Administrative Manager stated that SWIF does not use proprietary or technical information obtained from vendors' proposals for its own purposes. The Administrative Manager stated that such action could be considered to be copyright infringement.

We did not find any evidence to contradict SWIF's Administrative Manager's statement concerning this issue. In addition, the ranking of the complainant's response to RFP 3 as fifth out of seven respondents (see Table 7 in Finding IV) suggests that SWIF may have no use for any of the technical information included in the complainant's response. We have no recommendations relative to this issue.

Observations Relative To DGS Responsibilities

This investigation was initiated and completed as the result of allegations made by the complainant against DLI and SWIF. However, the scope of this investigation required OSI to review certain procurement policies and procedures under the responsibility of DGS. Therefore, based on our findings, we recommend that DGS:

- Limit the use of emergency contractors by state agencies to 90 days with a possible 90-day extension if such an extension is needed to secure the services of a qualified vendor through the RFP process, and ensure that the use of emergency contractors, when appropriate, does not result in the exclusion of DBEs or MWBEs from consideration for participation in Commonwealth contracts;
- Require state agencies to use the Emergency Procurement Approval Request form, which replaced the Emergency Purchase; Confirmation Memoranda form, and to include cost and basis information on this form;
- Conduct investigative reviews of the awarding of all emergency contracts by agencies subject to DGS' procurement guidelines; and
- Monitor all situations in which an IFB or RFP is cancelled or all bids or proposals are rejected in order to ensure that such action is justified and in the best interest of the Commonwealth because, as stated in the *Handbook*, such action "usually involves the loss of time, effort, and money by the Commonwealth and contractor in carrying the procurement process up to the point of cancellation."²²

²² *Handbook*, Part I, Chapter 26, Paragraph A.

DEPARTMENT OF LABOR AND INDUSTRY'S RESPONSE TO DRAFT REPORT²³



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March 21, 2008

Jeffery H. Gribb, Director
Office of Special Investigations
Commonwealth of Pennsylvania
Department of the Auditor General
327 Finance Building
Harrisburg, PA 17120-0018

**RE: Response to Draft Report on Department of Labor and Industry,
State Workers' Insurance Fund Emergency Procurements**

Dear Mr. Gribb:

Attached is the Department of Labor and Industry's, State Workers' Insurance Fund's (SWIF's) revised formal response to the above-referenced Revised Draft Report. It is respectfully requested that this formal response be attached in its entirety to the Auditor General's final report.

SWIF's formal response addresses each draft finding and recommendation at length. The major points of the response are that:

- The Department of Labor and Industry and SWIF typically do not use emergency procurements for extended lengths of time, but given the possibility of monetary penalties for late bill paying and the complicated nature of the RFP, the use of the emergency procurement process was necessary.
- SWIF received approval from the Department of General Services (DGS) for the emergency procurements and thus, did not violate state procurement law or guidelines;
- SWIF complied with requirements of DGS' Disadvantaged Business (DB) program in the RFP process. However, whenever possible, SWIF will endeavor to use DB's for its emergency procurements.

The Department does not and will not use extended emergency procurements whenever an RFP is possible. However, the complicated nature of the service sought combined with the

²³ Please note that DLI is responding to a revised draft of this report, as explained in footnote 12. In addition, please note that, in the interest of space, we have omitted the exhibits to DLI's response, which consist of 23 pages of e-mails between SWIF and DGS, including multiple copies of many of the e-mails, in support of DLI's response to Finding III of the draft report. OSI had already reviewed and considered those e-mails during the course of this investigation.

L&I Response to Auditor General
Re: SWIF Emergency Procurement
March 21, 2008
Page 2

potential costs to our premium holders required use of an emergency vendor in this instance. SWIF has complied with applicable DGS and Commonwealth procurement procedures for emergency procurements. Moreover, extended use of emergency vendors is not a systemic issue within the Department or SWIF.

Thank you for the opportunity to respond to the Revised Draft Report.

Very truly yours,



Sandi Vito

SV/

Attachment

cc: Gregory C. Fajt, Chief of Staff, Governor's Office
Naomi Wyatt, Secretary of Administration
James P. Creedon, Secretary of General Services
Barbara Adams, General Counsel
Elizabeth Crum, Deputy Secretary for Compensation and Insurance
Roger H. Caffier, Chief Counsel
Curtis Topper, Deputy Secretary for Procurement, DGS
Coletta Railing, L&I Audit Coordinator

**Department of Labor & Industry
State Workers' Insurance Fund
Response to Revised Draft Report on
Emergency Procurements**

Finding I and Recommendation

The Auditor General states that the State Workers' Insurance Fund (SWIF) violated state procurement guidelines by using emergency vendors for extended periods of time without awarding contracts through a request for proposal (RFP) process. The Auditor General recommends that the Department and SWIF limit their uses of emergency vendors to 90 days with a possible 90-day extension if such an extension is needed to secure the services of a qualified vendor through the RFP process. The Auditor General also recommends that SWIF ensure that its use of emergency vendors, when appropriate, does not result in the exclusion of disadvantaged and minority-/women-owned business enterprises (collectively "DB") from participating in these contracts.

SWIF's Response

The Department and SWIF respectfully disagree with the Auditor General's finding that SWIF violated state procurement law or guidelines. Significantly, the Department of General Services (DGS) reviewed and approved these emergency procurements, which SWIF properly utilized. (See, Exhibits A and B). Neither the Commonwealth Procurement Code nor the Procurement Handbook sets a time limit for emergency procurements.

The Department and SWIF agree that emergency vendors should be used only in limited and special circumstances and for limited periods of time. The Department elected to use emergency vendors to provide medical bill paying services due to a lengthy backlog in payment of SWIF medical bills. Staff levels at the time were insufficient to provide timely processing of bills. These bills were for medical services received by injured workers whose employers had insured their workers' compensation liability through SWIF. This problem was caused by a number of factors including a huge increase in the number of medical bills submitted to SWIF, and SWIF adapting to a new computer system, which was still undergoing some post-implementation corrective programming. It was absolutely vital that SWIF timely pay these bills. If these bills were not paid on a prompt basis as required by the Pennsylvania Workers' Compensation Act, SWIF could incur substantial monetary penalties. 77 P.S. §§ 531(5), 971(b), 991(b). Also, medical providers who were not timely paid may have refused to render future services to injured workers.

Based on this need, the Department selected vendors that possessed expertise and experience in paying medical bills for other Commonwealth workers' compensation programs, and were already set up to work with the Department of Treasury, who issues the checks to providers. As a result of the use of emergency vendors, SWIF was able to eliminate the medical bill backlog, avoid substantial statutory monetary penalties and ensure that injured workers continued to receive necessary medical treatment for work related injuries.

The Department's practice is to use emergency vendors for a limited period of time and, under normal circumstances, it adheres to the best practice suggestions found in DGS's web site under

the “Frequently Asked Questions” (FAQ)”, which states that “basically [emergency contracts] are good for 90 days.”

There are no statutory or regulatory time limits on emergency procurements.

While the Department agrees that limiting the use of emergency vendors to 90 days with a possible 90-day extension is preferable, the special and complicated circumstances of issuing the RFP for the selection of a vendor to provide medical bill-paying services necessitated utilization of emergency vendors for longer periods of time.

The Procurement Code and the Handbook do not set time limits on the use of emergency procurements. Significantly, the Auditor General recognizes this in his Revised Draft Report, which cites the pertinent Section of the Procurement Code (62 Pa. C.S.A. 516) and an outdated version of the Procurement Handbook.¹ (Revised Draft Report, p. 12) The only “authority” to which the Revised Draft Report cites in support of its conclusion that the Department “violated state procurement guidelines” is the “Frequently Asked Question” (FAQ): “HOW LONG ARE DGS APPROVED EMERGENCY PURCHASES OF SERVICES GOOD FOR?” The response relied upon by the Auditor General states, “Unless it is spelled out at the time of the request, then basically they are good for 90 days. (60 to 90 will be the normal [sic]).” (Revised Draft Report, p. 13) This FAQ appears only on DGS’s website; it is not in the Handbook. As cited in the Auditor General’s revised report, DGS approved the extension of the emergency contract.

Therefore, the Department and SWIF did not violate procurement law or guidelines.

Although SWIF complies with and supports all DB requirements and goals, there are no DB requirements in connection with emergency procurements.

With respect to the second recommendation, SWIF agrees that all agencies should fully comply with the DB program. However, it disputes the remainder of this finding. The Department and SWIF strongly support and comply with all applicable DB requirements in the procurement process.

The Auditor General acknowledges that unlike a traditional RFP, there is no DB requirement for emergency procurements. (Revised Draft Report, p. 14) However, the Revised Draft Report expresses concern that the use of emergency procurements beyond three to six months could prevent the Commonwealth from increasing its usage of DB-eligible vendors to the Administration’s goal of 10%. As noted above, the Department and SWIF support and follow DB requirements. SWIF’s use of emergency procurements under the stated circumstances here was necessary and justified. The emergency vendors utilized had a system in place with Treasury to allow them to begin services immediately. In the subsequent RFP process, all DB requirements were followed.

Finding II and Recommendations

The Auditor General contends that SWIF may have paid fees under the emergency procurements that were greater than the fees proposed by complainant. The Auditor General recommends that

¹ The current provisions with respect to Emergency Procurements of Services are set forth at Part 3, Chapter 60, of the Procurement Handbook.

SWIF refrain from the extended use of emergency procurements and attempt to use the RFP process to secure lower costs.

SWIF's Response

Again, the Department agrees that the RFP process should be utilized whenever possible to secure lower costs. In fact, through the RFP process, an appropriate vendor was selected, resulting in guaranteed savings of \$7.5 million to SWIF. SWIF takes its fiduciary responsibility to its policyholders very seriously and constantly strives to achieve efficiencies and cost savings through best business practices. The Department strongly disagrees that it would have paid greater fees under the emergency procurement than it would have with the complainant.

The conclusion that SWIF paid higher fees is entirely speculative.

There is no evidence that SWIF paid more to the emergency vendor than to the complainant. First, the Auditor General does not consider what SWIF would have paid complainant for paying Part A bills. As noted above, Part A bills were paid on the basis of the bill and Part B bills were paid on the basis of the number of lines per bill. Second, the Revised Draft Report itself recognizes several problems with its findings. (Revised Draft Report, p. 18) It recognizes that it does not factor in payments for duplicate or flawed bills.² SWIF chose the two vendors to perform the services under emergency procurements because of their ability to quickly implement and assist with payment of the medical bills. Both vendors possessed expertise and experience in paying medical bills for other Commonwealth workers' compensation programs, and were already set up to work with the Department of Treasury, who issues the checks to providers.

The Department and SWIF believe that the emergency procurement was the appropriate decision at the time and ultimately saved SWIF the cost of monetary penalties that would have been incurred if the medical bill paying backlog had not been addressed.

The Auditor General recommends that SWIF refrain from extended use of emergency procurements and that SWIF attempt to contract for services at lower costs through the RFP process. The Department responded to the first part of this recommendation in connection with Finding I, above. With respect to the second part of this recommendation, it is, of course, the Department's and SWIF's intent to always secure quality services at the lowest possible price. The Department and SWIF are already in compliance with the second part of this recommendation.

Finding III and Recommendation

The Auditor General contends that SWIF made two emergency procurements for services without preparing the proper supporting documentation. The Auditor General recommends that,

² The Revised Draft Report (p. 18) states that SWIF did not provide any requested data to the Auditor General regarding duplicate or flawed bills. SWIF is not aware that it had received any such specific written request. However, SWIF did provide the average number of medical bills handled per week by each of the emergency contractors in response to a request dated October 4, 2006, and information pertaining to amounts of fines, penalties and interest paid by SWIF during each of the years 2003, 2004, 2005 and 2006 relative to the medical bill backlog.

going forward, the Department and SWIF use the emergency procurement approval request form.

SWIF's Response

SWIF agrees that it should, and it currently does, use the emergency procurement approval request form.

These emergency procurements were initially requested and approved by DGS during the period from March 12, 2005 through October 3, 2005 via e-mail. The Revised Draft Report faults SWIF for not preparing an "Emergency Purchase; Confirmation Memorandum" in connection with the emergency procurements. The Procurement Handbook in effect at the time these emergency procurements were requested and approved did require a Confirmation Memorandum to be prepared after an emergency procurement was initially requested by an agency and approved by DGS. Although SWIF did not prepare a confirmation memorandum, it did provide proper documentation and did have appropriate approval via e-mail. Attached collectively as Exhibits A and B are e-mails between SWIF and DGS with respect to SWIF's requests to enter into the two emergency procurements, and extend those emergency procurements, and DGS's approval of these requests.

The Department and SWIF are in compliance with the procedure for emergency procurements that came into effect in September, 2006. The Department and SWIF seek approval for all emergency procurements using the "Emergency Procurement (EP) Approval Request form (Form BOP-004, Rev. 09/25/2006). Accordingly, the Department and SWIF are already in conformance and agree with the Auditor General's recommendation that the Department and SWIF use the Emergency Procurement (EP) Approval Request form.

Finding IV and Recommendations

The Auditor General contends that the Department and SWIF did not properly note in the contract file the reason that all proposals submitted in response to the third RFP were rejected. The Auditor General recommends that the reasons for rejections of all proposals be placed in the contract file, that the Department and SWIF provide written notification to each unsuccessful bidder of the reason for their rejection, and that the Department and SWIF re-evaluate their RFP policies and requirements in order to minimize the number of cancellations and rejections.

SWIF's Response

SWIF rarely cancels or rejects all RFP vendor proposals.

Although the Procurement Code gives the Commonwealth the right to cancel or reject all proposals submitted in response to RFPs (62 Pa. C.S.A. 521), the Department and SWIF agree that this should be avoided if at all possible. Toward that end, it is not the Department's and SWIF's practice to cancel, or reject all proposals submitted in response to RFPs. The PPO/medical bill payment RFPs were anomalies due to the complexities inherent in the substantive, technical and technological components.³

³ The Auditor General notes that the complainant filed a protest in connection with the current and fourth RFP issued by the Office of Administration and DGS. (Revised Draft Report, p. 14) The only protest filed in connection

The Department and SWIF apparently did not note in the contract file the reason that all proposals submitted in the response to the third RFP were rejected. The Department and SWIF will take action to assure compliance with this requirement in accordance with the Auditor General's first recommendation under this Finding.

SWIF has complied with the Handbook in notifying unsuccessful bidders.

The Auditor General next recommends that the Department and SWIF "provide written notification to each unsuccessful bidder of the reasons for such rejections, including information about that bidder's scores on the various elements contained in the evaluation checklist and the bidder's ranking in comparison to other bidders." The Department and SWIF disagree with and strongly object to this recommendation.

The Procurement Handbook sets forth specific requirements in this regard. Part 1, Chapter 6, Section B (9) requires that selected and non-selected offerors be notified when an offeror has been selected for contract negotiations. It does not require that any other information be given. Part 1, Chapter 6, Section B (10) (pertaining to debriefings) very specifically sets forth what information may be given to an offeror who requests a debriefing. It provides that an offeror be "advised of the position of the offeror's proposal in relation to the proposals submitted by other offerors in each of the criteria for selection." It specifically does not require that an offeror be advised of its scores on the various elements included in the evaluation checklist. Indeed, it has long been DGS policy that an offeror not be advised of the points assigned to the various components of the evaluation criteria. The Department and SWIF have complied and will continue to comply with these Handbook requirements.

The Department and SWIF appreciate the opportunity to respond to this Revised Draft Report.

with this RFP was filed by Premier Comp Solutions, LLC. DGS dismissed this protest and the complainant appealed this dismissal to Commonwealth Court. On October 10, 2007, the Commonwealth Court affirmed DGS's dismissal of the protest. *Premier Comp Solutions, LLC v. DGS and L&I*, (No. 1902 C.D. 2006; Pa. Cmwlth.) Premier Comp is seeking allowance of appeal from the Pennsylvania Supreme Court.

DEPARTMENT OF THE AUDITOR GENERAL'S COMMENTS ON DEPARTMENT OF LABOR AND INDUSTRY'S RESPONSE TO DRAFT REPORT

We appreciate DLI's detailed response to a draft copy of this report. In preparing to comment on that response, we have carefully reviewed the evidence gathered in the investigation and reconsidered all of our findings and recommendations beyond the reconsideration that had already occurred before we prepared and submitted a second draft for management response.²⁴ DLI, SWIF, and DGS should carefully review the matters set forth in this final report and implement the recommended corrective actions. The Department of the Auditor General will follow-up at the appropriate time to determine whether our recommendations have been implemented.

With regard to DLI's specific responses each of the findings in our report, we comment as follows:

Finding I (violation of state procurement guidelines):

We are encouraged by DLI's acknowledgement that emergency vendors should be used only in limited and special circumstances and for limited periods of time and that all agencies should fully comply with the DBE/MWBE program. To that end, we hope that DLI and SWIF fully implement the recommendations that we present in connection with this finding.

We want to emphasize that we are not questioning whether or not there was an emergency that justified SWIF's initial decision to use emergency contractors. However, we do question how SWIF went about procuring such services.

DLI states that there are no time limits for emergency procurements. While we agree that neither the Procurement Code nor the *Commonwealth of Pennsylvania Procurement Handbook*²⁵ expressly impose time limits for emergency procurements, guidance provided on DGS' website clearly states that "[u]nless it is spelled out at the time of the request, then basically [DGS-approved emergency procurements] are good for 90 days. (60 to 90 days will be the normal [sic])."²⁶

²⁴ See footnote 12.

²⁵ Contrary to DLI's statement that we relied on an outdated version of the *Handbook* during this investigation, it is important to understand that we used the appropriate version of the *Handbook*. This was explained in the draft report. See footnote 11 of this final report.

²⁶ DGS website, www.dgsweb.state.pa.us/comod/FAQs/FAQS_All.asp, "Frequently Asked Questions On the Procurement Code and Policy," accessed by OSI on July 24, 2007, and again on April 7, 2008.

Therefore, because SWIF's original request for use of emergency contractors specified 90 *days* with an option for an extension of a second 90-*day* period, and the DGS website refers to the period of 60 to 90 *days* as the norm for emergency procurements, we maintain our position that the use of emergency contractors for periods of 18 and 19 *months* is excessive. Furthermore, we further disagree that the e-mail correspondence between SWIF and DGS justified this extended use of emergency contractors. We also note that DLI's response does not address our concern that the use of non-DBE/MWBE emergency contractors for periods considerably beyond the norm may prevent the Commonwealth from increasing its percentage of DBE/MWBE contractors.

Finding II (excessive fees paid to emergency contractors):

We are encouraged by DLI's acknowledgement that the RFP process is an important tool in securing quality services for the lowest costs. To that end, we hope that DLI and SWIF fully implement the recommendation that we present in connection with this finding.

DLI disputes the calculations that led to our conclusion. As explained in the finding, we simply compared the actual fees paid for Medicaid Part B repricing to the emergency contracts with the Medicaid Part B fees proposed by the complainant. We did not, and could not, factor in other variables such as duplicate bills, flawed bills, or service quality, for the reasons already explained in the finding. Nor did we, or could we, directly compare fees with regard to Medicaid Part A repricing because those fees are paid on a per-bill basis, as opposed to per-line as with Part B, yet the complainant had submitted its proposal for both Part A and B on a per-line basis.

Based on the data provided in Tables 3 and 5 in the finding, it is clear that Part B bills comprised over 93% of the total number of bills submitted by the emergency contractors. Therefore, any possible excessive fees paid to the complainant for Part A bills would be unlikely to have significantly reduced the cost savings gained by the complainant's lower fees for Part B bills.

Regardless, we had already qualified the language used in our conclusion to state that SWIF *may have* paid fees to emergency contractors that were greater than the fees proposed by the complainant. Yet our recommendation does not change, nor does our concern about DLI's and SWIF's payments of significant amounts to two emergency contractors for periods of 18 and 19 months, respectively, when at least one vendor had submitted a proposal that offered – and, apparently, may have actually resulted in – lower cost for the same service, at least with regard to Part B work.

Finding III (lack of supporting documentation):

We are encouraged by DLI's acknowledgement that emergency procurements must be approved based on the required supporting documentation and we commend DLI for its commitment to implement the recommendation that we present in connection with this finding.

DLI states that, although the required form was not used in connection with the emergency procurements at issue, e-mail correspondence between SWIF and DGS constituted appropriate documentation and approval. However, DLI does not address the fact that the e-mails do not include all of the information required by the form, nor does DLI address the statement by SWIF's Director that she was unfamiliar with the requirement to file the form or the information to be included on the form.

Finding IV (failing to make reasons for rejections part of contract file):

We are encouraged by DLI's acknowledgement that the cancellation or rejection of proposals submitted in response to RFPs should be avoided and that the reasons for the rejection of all proposals submitted in response to RFP 3 were not placed in the contract file as required. We commend DLI for its commitment to ensure that, in the future, the reasons for the rejections of all proposals are placed in the contract file. However, we stand by our other recommendation that, as a matter of best practice even if it exceeds the requirements of the *Handbook*, additional information should be provided to unsuccessful bidders.

DISTRIBUTION LIST

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