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Potential Expansion of the  
CHAMPUS Reform Initiative

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Before the  
Subcommittee on Military Personnel and  
Compensation, Committee on Armed Services  
House of Representatives

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**SUMMARY**

At the request of the Subcommittee on Military Personnel and Compensation, House Committee on Armed Services, GAO examined two issues related to the Department of Defense's CHAMPUS Reform Initiative demonstration project:

- The progress made in overcoming problems encountered with implementation of the Initiative in California and Hawaii.
- The adequacy of the support for expanding the Initiative into Arizona, Nevada, and New Mexico.

To their credit, DOD and Foundation Health Corporation, DOD's principal contractor, have made substantial improvements in claims processing, resource sharing efforts, and financial management over this past year.

GAO believes, however, that a decision regarding the expansion of the Initiative should be delayed until there is more convincing evidence that the Initiative is saving money--a key DOD element for judging its success. Estimates made thus far suggest that while CHAMPUS costs are being contained in California and Hawaii, it is not possible to directly link lower-than-expected CHAMPUS costs to the Initiative itself. The studies made by DOD's consultants suggest that more analysis be done before such a linkage can be established. A delay in DOD's decision to expand the Initiative would also permit it to determine whether Foundation's progress under the contract is being sustained.

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Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to present our views on (1) the progress made in implementing the CHAMPUS Reform Initiative demonstration project in California and Hawaii and (2) the Department of Defense's plans for expanding the Initiative into Arizona, Nevada, and New Mexico. Our views are based on many discussions with program officials over this past year as well as our review of documentation prepared by DOD, its consultants, and the prime contractor for the Initiative, Foundation Health Corporation.

As we have stated in previous testimony, the Initiative is a complex undertaking that could have a significant impact on the way health care is provided to military beneficiaries for years to come. The concept of managed care in DOD is a worthy endeavor that needs to be fully tested and given a fair chance to succeed.

Since its beginning in 1988, the Initiative has had its share of difficulties, as this Subcommittee is well aware, and we and others have pointed out areas needing improvement. Just one year ago in testimony before this Subcommittee, we discussed the seriousness of the claims processing and financial problems facing Foundation. At that time, we suggested that the demonstration project not be expanded until DOD could satisfy

itself, and the Congress, with valid documentation that the project was a viable and workable endeavor.

DOD believes that the Initiative is succeeding and accomplishing its principal objectives--containing CHAMPUS costs and improving beneficiary care--and, therefore, is seeking to expand the project into three more states as permitted under its contract with Foundation.

I would like to summarize our views on DOD's position. To their credit, DOD and Foundation have made substantial improvements in claims processing, resource sharing efforts, and financial management over this past year. No longer is Foundation's financial health in serious jeopardy, and last month, for the first time, some significant parts of its claims processing efforts met contract standards. Resource sharing agreements are steadily increasing.

It is less clear that the Initiative is saving money. Studies done thus far suggest that CHAMPUS claims costs are lower in California and Hawaii than it is estimated they would have been, considering historical trends and CHAMPUS cost increases elsewhere. However, it is not yet possible to directly link the lower costs to the Initiative. The studies suggest that more analysis be performed before such a linkage can be established. Additional analyses are expected to be available from the RAND

Corporation later this year. We believe DOD's decision on expansion should await the results of these analyses as to whether the project has produced savings. This would also permit DOD to determine whether Foundation's progress regarding the operational aspects of the Initiative are being sustained.

### BACKGROUND

The Initiative, a managed care demonstration project in California and Hawaii, began delivering services on August 1, 1988. Its primary goal is to improve basic health care services for military beneficiaries while containing CHAMPUS costs. The Initiative provides three options to CHAMPUS beneficiaries:

- CHAMPUS Prime--a program requiring enrollment by beneficiaries to receive, at little cost, all of their civilian-provided care from the contractor-established provider network. As of November 1989, about 60,000 people were enrolled in CHAMPUS Prime.
  
- CHAMPUS Extra--a program not requiring beneficiary enrollment but offering care provided by the contractor network at reduced costs to beneficiaries.

-- Standard CHAMPUS--regular CHAMPUS benefits continue to be available to beneficiaries who do not have the opportunity or choose not to participate in either CHAMPUS Prime or Extra.

Through January 1990, DOD had paid Foundation about \$742 million under the Initiative contract. The contract may run through January 1993. Its total costs are estimated to be over \$3 billion if all option periods are exercised.

Last year, the House Committee on Armed Services directed that no expansion occur until the later of February 1, 1992, or when the Secretary of Defense certifies to the Congress that the contractor is sufficiently able to perform. In a December 1989 report to the Congress, DOD stated that the contract permitted expansion to Arizona, New Mexico, and Nevada on or after February 1, 1990. The report noted, however, that because of concerns over previous contractor claims processing problems and fiscal stability, expansion would not take place on that date. This was so that the Congress would have ample time to review the Initiative's progress and DOD could provide the Congress a detailed implementation plan for expansion.

## PROGRESS MADE IN OVERCOMING PROBLEMS

As you know, Madam Chairman, last year DOD seriously considered terminating its contract with Foundation because of several significant problems hampering the Initiative. However, since May 1989 there has been marked improvement in Foundation's performance, and DOD recently exercised a 1-year option period extending the Initiative through January 1991. I would like to highlight these improvements now.

### Claims Processing Has Improved

Foundation and its subcontractor, Electronic Data Systems, have made substantial improvements in claims processing operations. In fact, last month was the first month that DOD did not withhold funds from Foundation due to noncompliance with contract standards. Foundation is processing at least 92.5 percent of its managed care claims within 30 days of receipt. Its backlog of claims has decreased from about 214,000 (an 89-day supply) in mid-May 1989 to about 69,000 (an 11-day supply) in early March 1990--a reduction of about 68 percent in the number of claims backlogged. With respect to Standard CHAMPUS, Foundation's subcontractor, Blue Cross of Washington and Alaska, continues to achieve compliance with contract standards.

Despite these improvements, some shortcomings remain in the claims processing system, including inadequate servicing of provider and beneficiary inquiries, and the absence of certain management information system reports. DOD officials have told us that before authorizing expansion of the Initiative to the other three states, they will require that these problems be resolved and that Foundation be able to handle additional workload without adverse effects on current or future services.

#### Resource Sharing Efforts Have Increased

As of March 12, 1990, Foundation had implemented 39 resource sharing agreements, 37 more than last April. Several other agreements are being negotiated and designed. (Resource sharing allows Foundation to refer beneficiaries to local military facilities and augment the staff and other resources of those facilities to help reduce the costs of treating the beneficiaries.) The current agreements cover a broad range of specialties, including mental health, primary care, obstetrics, gynecology, pediatrics, and cardiology.

Resource sharing is a vital feature of the Initiative. As the number of agreements increases, the capabilities of military treatment facilities increase, resulting in reduced costs for treating beneficiaries. There are likely to be many more



potential sharing opportunities; therefore, continued attention needs to be given to securing such agreements.

#### Foundation's Financial Condition Has Improved

The financial condition of Foundation has improved since April 1989. At that time, the Defense Contract Audit Agency stated that Foundation's financial condition might endanger performance on the Initiative contract. As a result, DOD took several steps to protect government funds. In January 1990, the Agency reported that the potential for financial jeopardy in Foundation's current fiscal year was remote, but that Foundation's long-term financial viability continued to be a concern. DOD attributed Foundation's improved financial position to (1) divestiture of unprofitable managed care companies, (2) concentration on the Initiative and managed care in California and Hawaii, (3) better management overall, and (4) favorable refinancing of a substantial bank loan.

Additional protection of government funds may also result from Foundation's creation (on Feb. 1, 1990) of a new subsidiary company responsible for the Initiative. DOD believes the formation of the new firm will help insulate the Initiative from adverse financial problems associated with Foundation because the Initiative's accounts and activities are separate from those of the parent company.

## POTENTIAL EXPANSION OF THE INITIATIVE

As you know, Madam Chairman, a key principle DOD has consistently cited regarding the Initiative is that "... the demonstration should continue if the actual price is likely to remain below what CHAMPUS would have cost without the Reform Initiative." DOD's position regarding expansion is that, because the project is saving money and is otherwise successful in California and Hawaii, expansion of the Initiative should take place soon.

For reasons I will elaborate on momentarily, we believe the savings estimates are qualified to such an extent that it is not possible to directly associate lower costs to the Initiative and more information is needed to make such a linkage.

### Savings Estimates Are Unconvincing

DOD has obtained the results of three studies to help it judge whether the Initiative is saving money. Each study shows CHAMPUS claims costs to have been lower than what they would have been without any changes to the military health care system, including CHAMPUS. However, the studies also suggest that more analysis should be performed before estimated savings can appropriately be linked to the Initiative.

A January 1990 RAND Corporation study compared total claims for services provided in April, May, and June 1988 (before the Initiative began) with claims for services rendered during the same 3 months in 1989 (early in the Initiative). RAND reported a decrease in claims costs of \$10 million (9 percent) between these two periods but an overall increase in total costs of \$5 million (4.6 percent) due to a large increase in administrative costs. It estimated that costs would have increased 22 percent over the same period without the Initiative. The RAND findings are qualified with the following statement:

"We must stress that the cost differences observed during the demonstration may not necessarily be attributable to the CRI. The current analysis has several serious limitations, e.g., the periods tested were very short; the CRI program initially had severe operational problems; our cost estimates have potential sources of error; cost data were inadequate to support estimates of CRI effects; and the analysis is based only on very early data. In short, we can definitively say very little about the causes for the decreases in claims payments. Separating the effects of the CRI from the many other changes occurring in the military health service system and the health care system more generally will require additional data and much more extensive analysis."

An official of the RAND Corporation informed us that it will soon begin a more detailed collection and analysis of claims data to more clearly determine the effect that the Initiative has had on CHAMPUS costs. The results of this effort are expected to be available later this year.

Using estimated cost data provided in a November 1989 report by the consulting firm of Lewin/ICF, DOD estimated savings of

from \$15 million to \$27 million during the first 6 months of the Initiative by studying changes in CHAMPUS costs in similar states during the same period. The report calls attention to the difficulty in identifying the specific reasons for changes in CHAMPUS costs because of the way these costs change with changes in military hospital workloads.

A third study, by the firm of William M. Mercer Meidenger Hansen, Inc., made actuarial projections of what CHAMPUS costs would have been had the Initiative not been in place. Its comparisons were based on historical CHAMPUS expenditure trends for California and Hawaii. The firm provided a range of estimates--from a \$16 million savings to a \$2 million cost increase for the first 6 months of the Initiative. For the second six months of the Initiative, the firm estimated savings of \$16 million to \$37 million.

The report explains that the estimates vary substantially with even small differences in assumptions about the size of the population served or the cost to serve each beneficiary.

None of these reports' qualifications or assumptions lead to a conclusion that a particular estimate is wrong. However, they suggest that clear indications of lower costs, or linkages of lower costs to the Initiative itself, have not yet been made and that more extensive study is warranted.

## CONCLUSION

In conclusion, Madam Chairman, we commend DOD and Foundation for the substantial improvements made over this past year in several areas. If such progress continues, the Initiative will receive the fair test it deserves.

However, one of DOD's primary guiding principles is that for the Initiative to be deemed successful, the costs should be less than what CHAMPUS would have cost without it. We believe that expansion should be contingent on convincing evidence that the Initiative has done that.

We realize that the process of determining whether savings exist will require estimates and that there will be difficulty isolating whether the Initiative is the reason for the savings. However, the estimates that have been made to date are too qualified to conclude that the Initiative is saving money.

Madam Chairman, we believe that DOD should obtain more conclusive evidence that estimates of savings are attributable to the Initiative. This should be done soon to allow sufficient time for testing in the other three states. The current contract expires in January 1993, and both DOD and Foundation must do substantial preparatory work before the delivery of services to additional beneficiaries. Expansion efforts would probably have

to begin in early 1991 to adequately test an expanded Initiative under the current contract.

The more refined RAND estimate later this year should be helpful in clarifying the extent to which the Initiative is reducing CHAMPUS costs. We believe a decision regarding the expansion of the project should not be made until the results of RAND's analyses are available. Delaying the decision would also give DOD the opportunity to determine whether Foundation's progress under the contract is being sustained.

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This concludes my prepared statement. We will be glad to answer any questions you or other members of the Subcommittee may have.