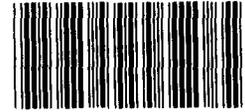


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**IMPLEMENTATION OF THE
CHAMPUS REFORM INITIATIVE**

Statement of
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Before the
Subcommittee on Manpower and Personnel,
Committee on the Armed Services
United States Senate



SUMMARY

At the request of the Chairman, Subcommittee on Manpower and Personnel, Senate Committee on Armed Services, GAO surveyed the problems encountered during the implementation of DOD's CHAMPUS Reform Initiative (CRI). Despite the problems, there have been significant achievements under the Initiative. The program's enrollment now includes over 35,000 beneficiaries and an extensive network of providers--with 80 percent of the network's physicians certified in their medical specialties.

In its testimony GAO states that:

- A significant problem encountered is that Foundation Health Corporation, the contractor for CRI, has a large volume of unpaid claims to health care providers. As of mid-May 1989, the backlog consisted of 214,000 claims, of which about 70 percent were in noncompliance with the contract standard--that is, over 30 days old. To help resolve claims processing deficiencies, Foundation has hired Electronic Data Systems Federal Corporation, a nationwide contractor with expertise in claims processing systems.
- The role of the Office of CHAMPUS in implementing the Initiative has been limited even though that Office has considerable expertise and experience in dealing with contractor claims processing and information systems problems. A much broader role for OCHAMPUS in the administration of CRI is currently under consideration by DOD.
- Because of concerns regarding Foundation's financial difficulties, DOD has taken steps to protect government funds and seek additional assurances as a condition for exercising Option III on August 1, 1989.
- A major feature of CRI--the sharing of contractor resources with local military treatment facilities--has not materialized because the incentive for Foundation to establish such a feature was removed during DOD's negotiations of the final contract. A recent contract modification was devised to resolve this matter. To date, there are seven sharing agreements, with others expected in the near future.

GAO believes, as others do, that some of the problems experienced might have been mitigated if additional developmental time had been permitted before the operational aspects of the contract began. GAO suggests that plans to expand CRI into other geographic areas be delayed until DOD can satisfy itself and the Congress that CRI is a viable and workable endeavor.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of work requested by this Subcommittee which sought information on the problems encountered during the implementation of the CHAMPUS Reform Initiative (CRI). Most of the information we will be presenting comes from documentation prepared by DOD personnel concerning various aspects of the Department's relationship with CRI's prime contractor--Foundation Health Corporation (Foundation)--and from our discussions with DOD and contractor officials.

Before presenting the results of our work, I would like to make a few general comments about CRI. As you know, CRI is a complex undertaking that could have a significant impact on the way health care is provided to military beneficiaries for years to come. Both DOD and the RAND Corporation--with whom DOD has contracted for an evaluation of the Initiative--have expressed the view that it is premature to make judgments concerning the Initiative's overall effectiveness. We agree with that view.

Nevertheless, today's hearing is timely because in the next two months, DOD will be facing a decision on whether to extend the Initiative for another 6 months as called for in the contract. As

you know, DOD's last decision to extend the contract was contingent on Foundation's agreeing to numerous conditions, including several designed to improve administration of its claims processing and management information systems and provide more protection of government funds.

In a moment we will discuss several problems that have been encountered in the early stages of the Initiative's implementation. However, it is important to note that there have also been significant achievements. Over 35,000 CHAMPUS beneficiaries have enrolled in CRI, and the contractor has established an extensive network of providers consisting of over 9,300 health care professionals and 117 hospitals. About 80 percent of the network's physicians are board-certified in their medical specialties.

BACKGROUND

In November 1986, DOD reported to the Congress that it planned to award separate contracts for a demonstration project to reform CHAMPUS in three geographic areas--Florida and Georgia, North Carolina and South Carolina, and California and Hawaii. However, DOD received only one bid in response to its request for proposals --Foundation's response to the request for proposals for the California/Hawaii area.

After protracted negotiations, DOD awarded a contract to Foundation to conduct the CRI demonstration project in California and Hawaii. As shown below, the contract, which was effective on February 1, 1988, provided for a 6-month developmental phase-in period followed by a series of six option periods for contract operations.

Development (February - July 1988)

Operations:

Option 1 (August 1988 - January 1989)

Option 2 (February 1989 - July 1989)

Option 3 (August 1989 - January 1990)

Option 4 (February 1990 - January 1991)

Option 5 (February 1991 - January 1992)

Option 6 (February 1992 - January 1993)

The contract is estimated to amount to over \$3 billion over 5 years if all the option periods are exercised. Through April 1989, DOD had paid Foundation about \$365 million under the contract. If the project proves successful, the contract allows it to be expanded into Arizona, Nevada, and New Mexico.

Beneficiaries receive health care provided by three companies under subcontract with Foundation--Foundation Health Plan (a

subsidiary of Foundation), Partners Health Plan, and Queens Health Care Plan. Under a separate subcontract with Foundation, Blue Cross of Washington/Alaska processes claims for care to beneficiaries who choose to remain in the basic CHAMPUS program.

In general, CRI provides three options to CHAMPUS beneficiaries:

- CHAMPUS Prime - a program requiring enrollment by beneficiaries to receive--at minimal cost--all of their civilian-provided care from the contractor-established provider network.

- CHAMPUS Extra - a program not requiring beneficiary enrollment but offering care provided by the contractor network at reduced costs to the 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.

IMPLEMENTATION PROBLEMS

AFFECTING CRI

As you may know, Mr. Chairman, we reported¹ to the Subcommittee on Military Personnel and Compensation of the House Committee on Armed Services that industry representatives expressed concern that the implementation schedule was too ambitious and would not allow time for adequate contractor development of necessary support systems to meet the Initiative's requirements. Industry was also concerned that management information system requirements had not been adequately specified. As we discuss below, these early concerns were well founded.

Claims Processing

System Inadequate

Since CRI operations began on August 1, 1988, Foundation has experienced a great deal of difficulty in processing claims from providers. As a result of its inability to process claims on a timely basis, Foundation entered into a contract with Electronic Data Systems Federal Corporation (EDS) to develop a processing system for its provider claims. The EDS system began claims processing operations in mid-April 1989--just 3-1/2 months before DOD must decide whether to exercise the next contract option. The

¹Defense Health Care: CHAMPUS Reform Initiative: Unresolved Issues (GAO/HRD-87-65BR, Mar. 4, 1987).

effectiveness of the EDS-developed system in reducing Foundation's backlog of provider claims is not yet known. However, EDS estimates that between now and June 23, the backlog will be reduced by 30 percent and that it will be able to process over twice the volume of incoming claims.

Since the contract's inception, Foundation has had five management reorganizations that have involved key personnel realignments, the most recent occurring on March 17, 1989. Several of these changes have involved realignments of positions and hiring of individuals to address the management information and claims processing system difficulties encountered by the contractor.

Foundation has had many complaints from providers concerning late payments or no payments. As of May 12, 1989, Foundation reported that there were more than 214,000 unprocessed claims in inventory. The contract calls for no claims to be over 30 days old. However, more than 150,000 of these claims--or about 70 percent--were over 30 days old. If EDS's estimates are correct, the backlog of unprocessed claims will be reduced to 150,000 by June 23, 1989 and 57 percent will be over 30 days old. According to DOD, EDS has begun processing a greater volume of claims than it receives each week.

Because it has been unable to settle claims timely,

Foundation has, until recently, made partial payments to providers. Subsequent to the EDS claims processing system becoming operational full payments were begun. A plan for reconciling interim payments with pending claims is being implemented.

The inadequacies of Foundation's claims processing and management information systems are well documented. As early as March 1988, the contracting officer noted that the delay in the development of a claims processing system was the most significant problem facing the CRI implementation. In June 1988, DOD conducted a benchmark test² of Foundation's systems' ability to process claims in a timely and effective manner and to produce the data needed to adequately monitor the contractor's performance. The test showed evidence of major system development and programming problems, which prompted DOD to schedule a comprehensive evaluation in July 1988.

The July evaluation confirmed the existence of serious deficiencies in information systems support, but DOD believed that the system met the minimal requirements for an August 1, 1988, initiation of CRI's operation. At the same time, DOD decided to monitor Foundation's development efforts more closely. Between

²An evaluation that assures the government that a system is working and ready to perform in accordance with contract requirements and that indicates what "fine-tuning" remains to be done.

September 1988 and February 1989, when the contract was extended, DOD increased its monitoring of Foundation's progress. A site visit conducted by DOD in mid-September 1988 found:

"the Foundation Health Corporation's MIS [management information system] support to CRI operations and management [is] deficient in every aspect and at every organizational level...Neither the nature and scope of MIS problems nor FHC's [Foundation Health Corporation] efforts and plans for resolving them had been fully or effectively communicated to the Health Plans or the government. The inadequate MIS support adversely impacts every area of CRI from marketing and enrollment, to network expansion, to provision of managed care, to processing of claims. Since poor or inadequate functioning in any of these areas can adversely impact on each of the others, unsatisfactory performance in MIS jeopardizes continuation of the entire project."

DOD has expressed frustration over Foundation's lack of responsiveness to demands for contract compliance. In large part, DOD attributes this problem to the fact that the CRI contract is Foundation's first contract with DOD.

To address all aspects of improving its claims processing operations, Foundation entered into a contract with EDS, an experienced nationwide claims administrator. EDS's responsibility

is to provide the hardware and software required to comply with the contract. In mid-April 1989, EDS began processing in-system claims for CRI. Final system modifications are scheduled for completion on August 15, 1989.

OCHAMPUS Role in CRI

Implementation Limited

Notwithstanding the substantial experience of many of its staff in dealing with CHAMPUS fiscal intermediaries and claims processing issues, the Office of CHAMPUS (OCHAMPUS) has played only a limited role in overseeing the implementation of Foundation's claims processing and management information systems. It is not possible to say with certainty that the problems encountered in the Initiative's implementation would have been reduced had OCHAMPUS been granted policy and operational authority of these aspects of Foundation's operations.

From the outset of this project, responsibility and authority for developing and implementing CRI has been in the Office of the Assistant Secretary of Defense (Health Affairs). The role of OCHAMPUS--as one of several organizations within that office--has generally been one of providing technical assistance and support. OCHAMPUS could not direct or influence Foundation to take corrective actions on any aspect of the development or

implementation of its claims processing or management information systems.

OCHAMPUS documents reflect that, on several occasions before DOD's decision to contract with Foundation, it pointed out to Health Affairs the risks involved in carrying out such a large-scale health care procurement with the complexities of the Initiative. OCHAMPUS noted the problems that were historically encountered in the first months of a fiscal intermediary contract and, among other things, recommended that the implementation phase be 1 year rather than the 6 months ultimately decided upon.

Our examination of CRI documents shows that OCHAMPUS repeatedly reported to Health Affairs the floundering efforts of Foundation to develop and implement a workable claims processing system, during both the developmental and the operational phases of the project. For example, in a March 23, 1988, report of a visit to Foundation, OCHAMPUS stated that the development of the claims processing system was behind schedule and that it might not be operational by August 1, 1988. Another report dated May 20, 1988, stated that no claims processing system existed at Foundation. As we indicated earlier, notwithstanding these and subsequent concerns regarding Foundation's system development efforts, DOD believed Foundation's system met the minimum requirements for the August 1, 1988, initiation of operations.

The role of OCHAMPUS in this Initiative was further reduced in March 1989. In a memorandum to the Director, OCHAMPUS, the Assistant Secretary stated that he had decided to give OCHAMPUS oversight responsibility for out-of-system (standard CHAMPUS) CRI claims processing activities. Another Health Affairs office--the Directorate of Program Implementation and Operations--was given responsibility for monitoring and directing Foundation's in-system claims activities. However, DOD officials told us on May 22, 1989 that a greater CRI role for OCHAMPUS is now under active consideration. Possible changes in responsibilities include (1) the contract administration function; (2) monitoring in-system claims operations; and (3) the assignment of a limited number of OCHAMPUS staff to provide on-site advice at the contractors' location. DOD officials explained that an expanded role for OCHAMPUS was always envisioned once the implementation of CRI became more routine. These probable changes appear reasonable to us since OCHAMPUS has a wealth of experience with standard out-of-system claims and knowledge of contract administration involving other fiscal intermediaries.

Foundation's Financial Condition

DOD has noted in several reports, dating back to September 1988, significant concern regarding the financial condition of Foundation. Because of this concern, DOD advised the contractor in early January 1989 that a decision to exercise the second option on February 1, 1989, could not be made unless significant progress was

made in resolving DOD's concerns regarding protection of government funds. As a result, an agreement was reached to modify the contract payment schedule so payments are more closely linked to Foundation's performance (i.e., prompt claims payment). Also the contract was modified so that Foundation would pay government funds into segregated escrow accounts at the plan level. The latter modification requires that government funds be kept in accounts separate from other corporate funds and that DOD approval must be given before funds are released from those accounts. DOD officials told us as a condition for exercising the next contract option, DOD will require other changes intended to provide additional protection of government funds.

Mr. Chairman, much of the data regarding Foundation's financial condition are of a proprietary nature. These data are being continuously examined by the Defense Contract Audit Agency, which has designated much of them "For Official Use Only." Because of these factors, we suggest that if the Committee wishes to pursue issues relating to Foundation's financial condition, these discussions be the subject of a closed hearing or briefing by DOD representatives familiar with this situation.

Substantial Progress
on Resource Sharing Lacking

One of the cornerstones of CRI was the idea of allowing the contractor to refer military beneficiaries to local military treatment facilities and augment the staff and other resources of those facilities to help reduce the costs of treating those beneficiaries. The purpose of the resource sharing was to give the contractor, operating under a fixed price contract, incentives to maximize the use of less costly military facilities and reduce government costs paid for care in the civilian sector.

During DOD's and Foundation's negotiation of the final contract provisions for the Initiative, the originally intended incentives for contractor resource sharing with military treatment facilities were removed. Accordingly, the sharing program has not lived up to its original expectations. According to DOD officials, a recent contract modification should help resolve this matter. Currently, Foundation has seven sharing agreements (5 more than before the contract modification) and expects to have 20 such agreements by July 31, 1989. There are numerous other proposals under consideration.

CONCLUSION

Mr. Chairman, CRI's implementation in California and Hawaii has been significantly hampered by difficulties encountered in Foundation's claims processing operations. These difficulties have consumed a great deal of time and attention on the part of both DOD and Foundation. The hiring of EDS holds the promise of resolving the problem associated with claims processing. However, additional questions remain regarding the contractor's financial condition. In retrospect, we believe, as others do, that some of the problems experienced might have been mitigated if additional developmental time had been permitted before the operational aspects of the contract began.

Looking to the future, we suggest that plans to expand CRI into other geographic areas be delayed until DOD can satisfy itself and the Congress, with valid documentation, that CRI is a viable and workable endeavor.

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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.