



United States
General Accounting Office
Washington, D.C. 20548

Health, Education and Human Services Division

B-276227

June 24, 1997

The Honorable William S. Cohen
The Secretary of Defense

Subject: TRICARE Administrative Prices in the Northwest Region May Be Too High

Dear Mr. Secretary:

The Department of Defense (DOD) initiated TRICARE—its nationwide managed health care program—to improve access for the military community while maintaining quality and controlling costs. This broad reform of DOD's \$15 billion health care system is changing the way it delivers services to 8.3 million beneficiaries. In authorizing the shift to managed care, the Congress directed that the cost of DOD's new TRICARE program be budget neutral—that is, costs not increase over what they would have been without the program.¹ To help achieve this goal, TRICARE managers are seeking opportunities to contain expenditures.

During the course of our work on TRICARE's managed care support contracts,² we observed that DOD did not take advantage of its contractual authority to adjust administrative support prices in the Northwest Region (Oregon, Washington, and part of Idaho) to correspond with a large health care price reduction. As a result, administrative support prices in the Northwest region may be up to an estimated \$25 million too high over the 5-year contract period.

BACKGROUND

Once negotiated, services to be provided under the TRICARE managed care support (MCS) contracts have fixed prices, including payments to providers for

¹The National Defense Authorization Acts for fiscal years 1994 and 1995 (P.L. 103-160 and P.L. 104-106, respectively).

²We plan to report shortly on DOD's overall management of TRICARE contract change orders.

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delivery of health care services, as well as administrative support items, such as marketing, enrollment, and claims processing. In these contracts, health care services and administrative support are separately itemized and priced. Though contract prices are fixed when the contract is signed, the contracts are designed to be modified to accommodate such unforeseen events as shifts in the population served, new medical technologies, or military hospital workload changes. The bid price adjustment (BPA) is a contract provision that establishes a means to amend the health care price to account for factors beyond the contractor's control.

Though the BPA provision in this contract does not apply to administrative support prices, provisions in the TRICARE MCS contracts allow for adjustments to administrative support prices that result from contract changes. These adjustments differ from the formal bid price adjustment process and are to be negotiated separately in accordance with Federal Acquisition Regulation (FAR) section 52.243-1, Changes—Fixed-Price. Also, the prices of health care and administrative support functions are not linked, so changes in health care prices would not automatically generate a change in administrative support prices, or vice versa.

FAR section 52.243-1 authorizes contracting officers to make changes within the general scope of the contract at any time. Paragraph 52.243-1 (b) states, "If any such change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price, delivery schedule, or both, and shall modify the contract." According to the TRICARE Support Office (TSO) official in charge of negotiating change orders, typical change orders to TRICARE contracts—those not part of the BPA process—are firm fixed price and include both health care and administrative support prices.

The purpose of our review was to determine if TRICARE managers had taken advantage of DOD's contractual authority to adjust administrative prices to correspond with a large health care price decrease. We interviewed officials from the Northwest Region Lead Agent, TSO, and Health Affairs. We performed our work between January and May 1997 in accordance with generally accepted government auditing standards.

ADMINISTRATIVE SUPPORT PRICES WERE NOT ADJUSTED TO REFLECT LOWER HEALTH CARE PRICES

The largest contract change to date in the Northwest Region (modification P00008, effective Feb. 1, 1995) reduced the health care price by a total of \$169 million (33 percent) over the five option periods (see table 1). The reduction was calculated to

reflect lower baseline population and military treatment facility utilization estimates.³ According to a TSO contracting officer, this modification was subject to the requirements in FAR section 52.243-1.

Table 1: Health Care Price Reduction in the Northwest Region

Option period	Original price	Revised price	Price decrease
1	\$89,933,251	\$65,767,312	\$24,165,939
2	95,388,048	66,268,546	29,119,502
3	104,565,875	69,203,221	35,362,654
4 and 5 ^a			
Total	\$518,216,649	\$348,967,544	\$169,249,105

Note: Table 1 includes only health care prices and does not reflect other contract items, such as administrative support and resource sharing, which were not affected by modification P00008.

^aTSO requested that we not publish annual prices for future option period 4 and 5.

Despite a 33-percent reduction in health care prices, TRICARE contracting officers, as we discuss later, did not propose a second action to reduce administrative support prices. For example, the administrative support price remained at \$18.9 million for the first option period. As a result, administrative support prices (as a percentage of total contract price) increased from 16 to 21 percent for the first option period. Similarly, the administrative cost percentage increased about 5 percent for each of the 5 option periods (see table 2).

³The purpose of modification P00008 was to determine a price for an earlier modification (P00003) that revised baseline population and military treatment facility utilization estimates using more recent data sources. The change took effect prior to the Mar. 1, 1995, start of health care delivery.

Table 2: Northwest Region Administrative Support Price as a Percentage of Original and Modified Contract Price

Option period	Administrative price	As a percentage of original price	As a percentage of modified price
1	\$18,914,180	16	21
2	19,085,071	16	21
3	19,432,740	15	20
4 and 5 ^a			

^aTSO requested that we not publish future option period prices. The percentage increase, however, remained constant at about 5 percent per year.

The increased proportion spent for administrative support in the Northwest Region is also the highest among TRICARE regions (see table 3).

Table 3: Administrative Support Price as a Percentage of Total Contract Price for Option Period 1^a

TRICARE MCS contract	Total contract price (in millions)	Administrative price (in millions)	Administrative percentage
Southwest	\$351.1	\$46.7	13
Golden Gate, Region 9, and Hawaii-Pacific	509.7	65.4	13
North Central and Desert States	446.6	64.2	14
Gulf South and Southeast	683.8	124.2	18
Northwest	92.0	18.9	21

Note: Data are as of the beginning of option period 1 for each contract (start dates differ for each contract and modifications can affect the total contract price).

^aThe total contract price for option period 1 includes prices for health care, administrative support, and other items such as resource sharing and start-up costs.

**TRICARE MCS CONTRACTS DO NOT
REQUIRE AUTOMATIC PRICE ADJUSTMENTS**

TRICARE MCS contracts do not require that health care price reductions automatically trigger a corresponding reduction in the administrative support prices, nor do contracts require the reasons administrative prices are not reduced be documented. Without such records, TSO contracting officers were unable to explain why a reduction in the Northwest Region's administrative support price was not proposed or why further analysis was not conducted to determine if a price reduction was warranted. Documentation supporting modification P00008 showed detailed analysis of health care prices but did not include an analysis of administrative support prices.

According to a DOD contractor hired to calculate the effects of contract modifications (independent of the MCS contractor), modification P00008 included changes in both the process and the resulting prices—but did not consider adjusting administrative prices. While administrative price adjustments are not part of the BPA process, administrative support price adjustments are not precluded under the FAR changes provisions. Because modification P00008 was issued under the authority of FAR section 52.243-1, it is a change order that allows TSO contracting officers to adjust administrative support prices.

**ADMINISTRATIVE SUPPORT PRICES AND
HEALTH CARE PRICES SHOULD BE LINKED**

While health care costs are not directly linked to administrative support costs in existing TRICARE MCS contracts, there is a clear relationship between the two. For example, such administrative cost elements as advertising and developing a utilization management program appear to be of a fixed cost nature, but administrative cost elements such as beneficiary enrollment, claims processing, and premium collection would vary depending, for example, on the number of beneficiaries. Since the contract was modified to reflect a smaller number of people to be served, resulting in lower utilization and fewer claims, it seems that there should be less administrative costs.

The Defense Contract Audit Agency (DCAA) and Lead Agent officials also told us that a 33-percent reduction in the health care price should have been accompanied by a reduction, perhaps proportionally smaller, in the administrative support price.⁴ Or, at

⁴DCAA is the cognizant audit agency for TRICARE MCS contracts. It audits administrative support costs in TRICARE bid proposals as well as contract modifications in excess of \$500,000.

a minimum, TSO contracting officers should have conducted further analysis to determine the extent to which an administrative support price reduction was warranted. TSO's analysis would most likely require a DCAA audit of the contractor's administrative expenditures.

Had TRICARE contracting officials applied the contractor's original administrative support rates to the reduced health care prices in modification P00008, administrative support prices might be as much as \$25 million less over the 5 years of the contract. This projection, moreover, is at the upper range of potential savings because administrative support costs would likely not decrease in the same proportion as health care costs. Savings could further decrease if the contractor could justify and negotiate higher administrative support prices. Nevertheless, renegotiating administrative support prices would not only give DOD valuable information on the true cost of administrative services in the Northwest Region, but also would ensure DOD pays fair and reasonable prices for these services.

The Principal Director for Health Services Financing, Office of the Assistant Secretary of Defense (Health Affairs), told us the office now recognizes that having all administrative prices fixed and unrelated to health care prices is a flaw in current TRICARE MCS contracts. To correct this shortcoming, the office plans to link administrative support and health care prices, based on variables such as claims volume, number of enrollees, or other indicators, in future MCS contracts. Regarding the large health care price reduction in the Northwest Region, Health Affairs officials said that TSO contracting officials should consider renegotiating the administrative support price.

According to a senior contractor official, the contractor also recognizes the need to have health care and administrative support prices linked. Furthermore, the contractor would not be opposed to reexamining the impact of modification P00008 on administrative support prices in the Northwest Region. He said, however, that savings resulting from this particular modification might be offset by increased administrative support costs in other areas such as claims processing.

CONCLUSIONS AND RECOMMENDATIONS

Because TRICARE contracting officers did not seek an administrative support price reduction to correspond with a 33-percent health care price reduction, DOD may be paying too much for administrative support services in the Northwest Region. To help ensure DOD pays fair and reasonable prices for administrative support in the Northwest Region, we recommend that you direct the Acting Assistant Secretary of Defense for Health Affairs to initiate action to determine the extent to which administrative support prices could be reduced as a result of the \$169 million health care price reduction in modification P00008.

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Similarly, to better match administrative support prices with workload, we support current Health Affairs efforts to develop contractual links between administrative support and health care workload and prices. We recommend that you consider incorporating such a requirement in future cycles of TRICARE MCS contracts and, to the extent possible, in contracts currently under negotiation in the Northeast, Mid-Atlantic, and Heartland regions where it would not compromise the competitive procurement process.

AGENCY COMMENTS

We obtained oral comments from Health Affairs officials. They generally agreed that administrative support prices should have been considered at the time of modification P00008 and could not comment further on why this did not occur. They also said that the evidence was convincing that they should revisit the regional contractor's administrative costs. But they said such other matters as resolving resource sharing and contract modification problems, negotiating current bid proposals, and developing the next cycle of TRICARE contracts now have their attention and likely would receive near-term priority over renegotiating the subject administrative costs. While we recognize that DOD officials must prioritize their work as appropriate, we note that the subject change is almost 2-1/2 years old and the passage of time tends to further complicate reaching an equitable settlement for both parties. DOD officials also made other technical comments that we incorporated where appropriate.

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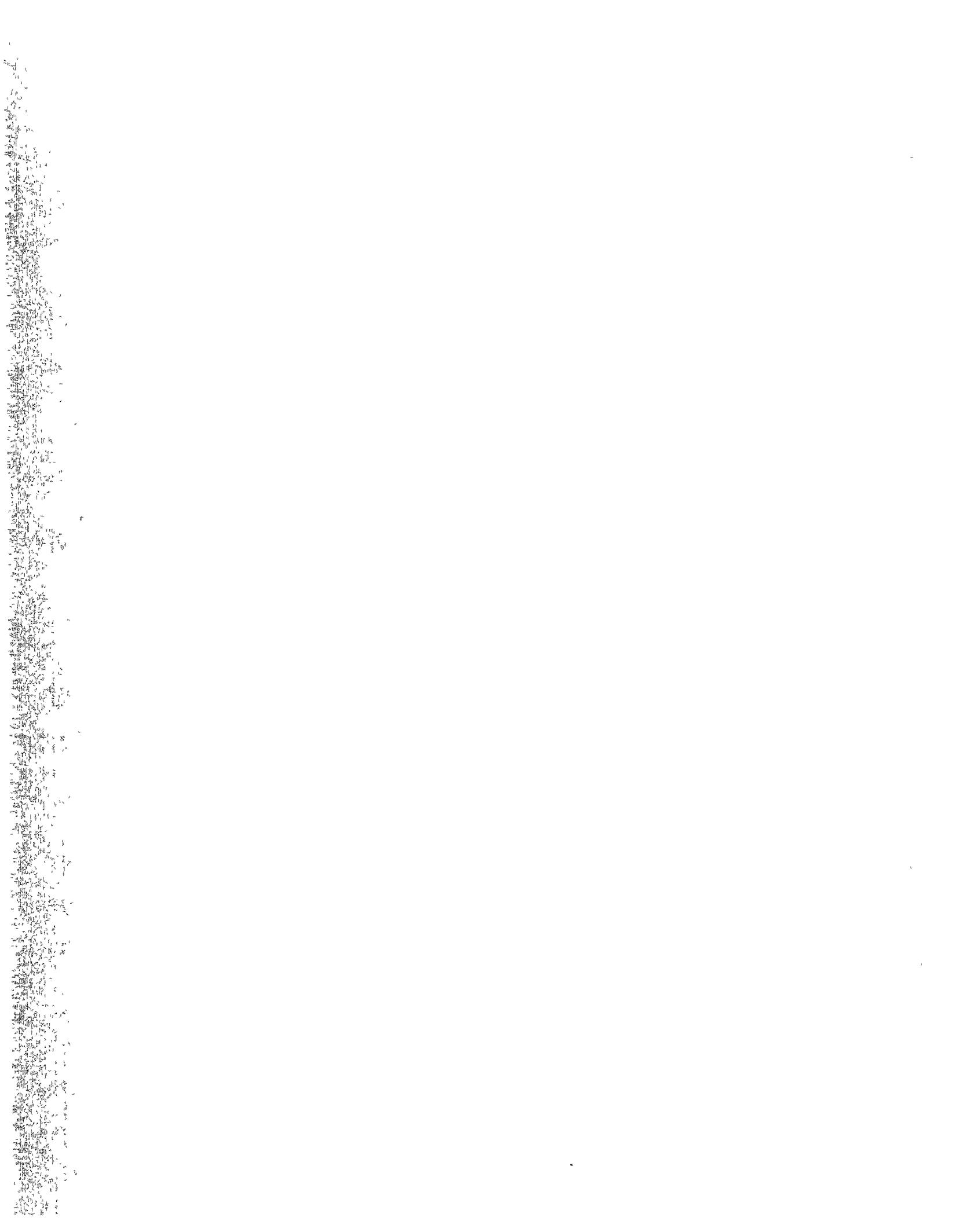
We would appreciate being apprised of your disposition of these matters. If you have any questions or would like to discuss the matters further, please call me at (202) 512-7111 or Dan Brier, Assistant Director, at (202) 512-6803.

Sincerely yours,



Stephen P. Backhus
Director, Veterans' Affairs and
Military Health Care Issues

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