

GAO

Testimony

For Release  
on Delivery  
Expected at  
2:00 p.m. EST  
Thursday  
March 12, 1987

**CHAMPUS Reform Initiative:  
Unresolved Issues**

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



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Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our recent report on the Department of Defense's (DOD's) plans to change the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS).<sup>1</sup> At the request of this Subcommittee, we have been monitoring DOD's development of changes to CHAMPUS, called the CHAMPUS Reform Initiative. Our work is not yet complete and will continue.

The changes planned for CHAMPUS are major. Instead of contracting only for the processing and payment of medical claims, the new program would also contract with private industry for the delivery of medical care to CHAMPUS beneficiaries.

The Initiative's objectives are very ambitious. They are to contain CHAMPUS costs for both the government and beneficiaries, increase beneficiary access to health care, improve coordination between CHAMPUS and the military treatment facilities, assure quality of care, and simplify CHAMPUS administrative procedures.

To achieve these objectives, DOD plans to use the following features:

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1DEFENSE HEALTH CARE: CHAMPUS Reform Initiative: Unresolved Issues (GAO/HRD-87-65BR, Mar. 4, 1987).

- competitive fixed-price contracts awarded to private sector health care providers to help contain costs;
- a voluntary enrollment system, called CHAMPUS Prime, to improve beneficiary access to care and simplify CHAMPUS administrative procedures;
- a health care finder mechanism to improve coordination between CHAMPUS military treatment facilities and beneficiaries;
- quality assurance standards that must be adhered to by contractors; and
- staff-sharing agreements whereby contractor staff would augment staff in military treatment facilities.

DOD originally planned nationwide implementation of the Initiative by the fall of 1987 using three large contracts. After receiving direction from the Congress to first demonstrate the Initiative's feasibility before implementing the changes nationwide, and after reviewing industry comments on its draft request for proposal, DOD revised its plans. The major revisions were:

- The Initiative would be phased in, and experience gained from the first phase would be reflected in later phases.
- The first phase would cover six states.
- Provisions beyond those in the draft request for proposal were made to reduce the contractors' financial risk if beneficiary utilization of program services was higher than expected.
- Provisions were included to ensure stability of medical care for beneficiaries should the demonstration fail.

#### ISSUES NEEDING RESOLUTION

I would now like to discuss what we believe are the key issues that DOD should resolve before it proceeds with nationwide implementation of the Initiative. While the Initiative may be based on sound premises, its ultimate success may be jeopardized if the issues we have identified are left unresolved. These issues include

- the possibility of cost increases,
- the potential adverse effects on beneficiary satisfaction, and

-- a potential increase in program complexity.

Program costs may increase  
under the Initiative

Although DOD believes that the Initiative will contain costs, it has not analyzed (1) the potential savings expected from the Initiative's cost-saving features, (2) the potential costs of making program improvements, or (3) the costs of implementing its various administrative requirements. Rather, DOD officials told us that they will rely on industry bids to determine whether the Initiative can achieve the objective of containing costs.

According to many industry comments on the Initiative, beneficiary utilization of the program may also increase because of the planned additional benefits and lower cost sharing by beneficiaries. Several companies also stated that the proposal contradicts the trend in the health industry to shift benefit costs to the beneficiary, especially when benefits are being enhanced. Increased utilization, increased benefits, and lower cost sharing by beneficiaries could result in higher costs to the government.

To protect contractors from unanticipated increases in utilization, DOD plans to revise the risk-sharing provisions in

Initiative contracts. DOD hopes to encourage potential contractors to submit more reasonable bids than they otherwise might if contractors were solely responsible for the costs of increased use of program services. However, this could shift substantial risk from the contractor to the government and may reduce DOD's ability to achieve one of the Initiative's principal objectives--containment of CHAMPUS costs.

It may also prove costly to implement the Initiative's innovative and complex features under fixed-price contracts. Under fixed-price contracts, if ambiguities in contract specifications must be clarified, the contractor is entitled to higher compensation for additional work required by the clarifications. These contract clarifications, called change orders, can result in substantial increases in the original contract price. Contracting officials we interviewed said that change orders are required more frequently in procurements, such as those contemplated under the Initiative, in which contract specifications are complex and innovative. They noted that the government is in a weak position when negotiating change order prices because it is responsible for ambiguities in the original specifications.

The Initiative may not increase beneficiary satisfaction

Turning now to the issue of beneficiary satisfaction, DOD states that CHAMPUS beneficiaries are dissatisfied with the current program because of beneficiary cost-sharing requirements, complex CHAMPUS procedures and problems in claims processing, and long delays in receipt of claim payments.

DOD expects the Initiative to improve beneficiary satisfaction, but information from both industry and beneficiary organizations raise concerns about whether this will occur. Industry perceives problems with some of the key features designed to increase beneficiary satisfaction, such as mechanisms to refer beneficiaries to providers, quality assurance systems, and contractor staff working in military treatment facilities. Beneficiary organizations are concerned about the disruptions in service that might be caused by such a major program restructuring and also that contractors will have a financial incentive to direct beneficiaries to lower cost contractor providers.

Program complexity may increase under the Initiative

The third issue I would like to address is that of program complexity. While the Initiative may reduce beneficiary problems

associated with the filing of claims, it requires contractors to implement a number of new program features while retaining essentially intact the current CHAMPUS features. Having these new features layered on top of the existing program creates the potential for increased program complexity for both contractors and beneficiaries. In addition to CHAMPUS Prime and the health care finder, new features include utilization review and quality control systems, contractor staff working in military treatment facilities, and a management information system. For beneficiaries not enrolling in the contractor's network of providers, all of the current requirements that DOD claims need correction, such as submission of claims and beneficiary cost sharing, would continue to apply.

In commenting on the draft request for proposal, a number of industry respondents expressed concerns that the Initiative's administrative requirements were excessive, overly restrictive, duplicative, and unclear. Industry as well as the military services have also expressed reservations about coordination of activities between the contractor and the military treatment facilities. Industry respondents stated that the coordination with military facilities envisioned under the Initiative would be difficult to achieve due to the issue of control and the complexity of the requirements. The services also want better clarification of the responsibilities and authorities of the contractor and the military facility commanders in the areas

requiring coordination. Each of the services has expressed concern about contractor management of the military direct care system.

DOD RECENTLY ISSUED  
REQUEST FOR PROPOSAL

Since issuing our briefing report, we have reviewed DOD's February 27, 1987, request for proposal for the Initiative's demonstration phase. This new request for proposal has addressed many of the concerns raised by industry respondents to DOD's draft request for proposal by permitting offerors more flexibility in designing systems to meet new program features. As discussed earlier, to address potential contractors' concerns about risk sharing, DOD has adjusted the risk-sharing provisions. It will also allow offerors to submit alternative cost proposals that DOD will consider if its own risk-sharing methodology does not elicit enough bids.

DEMONSTRATION PHASE NEEDS TO  
BE THOROUGHLY EVALUATED

We believe the issues discussed in our report remain substantially unaltered by DOD's recent action. We also believe that the Initiative's demonstration phase is critical and presents an excellent opportunity to assess these issues. Our past work involving evaluation of demonstration of risk-sharing

contracts with the private sector in the Medicare and Medicaid programs<sup>2,3</sup> has shown the need to proceed cautiously with the initial phases of complex undertakings.

DOD officials told us on February 24, 1987, that a methodology to evaluate the demonstration project has not yet been developed. Moreover, these officials could not estimate when such a methodology would be available. Because the Initiative may have significant effects on the military health care system and its beneficiaries, we believe that DOD should develop thorough evaluation criteria for the demonstration project at the earliest possible date.

In evaluating the demonstration, DOD should, at a minimum, determine the effects the Initiative has had on meeting DOD's objectives. For example, CHAMPUS now has the authority to reimburse hospitals using the same methodology that Medicare uses. In evaluating whether or not the CHAMPUS changes will result in cost containment, DOD's estimated savings of \$258 million annually that can already be attained under the existing program should be considered. The evaluation should also cover a

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<sup>2</sup>MEDICARE: Issues Raised by Florida Health Maintenance Organization Demonstrations (GAO/HRD-86-97, July 16, 1986).

<sup>3</sup>MEDICAID: Lessons Learned From Arizona's Prepaid Program (GAO/HRD-87-14, Mar. 6, 1987).

period of time sufficient to develop the information necessary to adequately assess the Initiative's effects.

RECOMMENDATIONS TO THE  
SECRETARY OF DEFENSE

In view of the many complexities and uncertainties involved in developing and implementing the Initiative, we recommended that the Secretary of Defense direct the Assistant Secretary of Defense (Health Affairs) to

- expeditiously develop a methodology for conducting a thorough evaluation of the Initiative's demonstration phase;
- assure that the Initiative's demonstration phase is of sufficient duration that issues such as those raised in our report and those that may arise during the demonstration can be thoroughly evaluated before DOD proceeds to subsequent phases of the Initiative; and
- inform the Congress promptly if DOD determines that the congressionally directed timetable (mid-1989) for nationwide implementation of the Initiative cannot be met because of the need for a more thorough demonstration phase and a subsequent evaluation of that phase.

This concludes my prepared remarks. We would be glad to answer any questions you have.