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September 14, 1999

The Honorable Christopher S. (Kit) Bond
Chairman, Subcommittee on VA, HUD,
and Independent Agencies
Committee on Appropriations
United States Senate

Subject: Veterans' Health Care: Fiscal Year 2000 Budget

Dear Mr. Chairman:

The President's fiscal year 2000 budget estimates total obligations of $18.4 billion for the health care system operated by the Veterans Health Administration (VHA), within the Department of Veterans Affairs (VA). This includes a $17.3 billion current appropriation request and $1.1 billion in other available budget authority, primarily consisting of cost recoveries for medical care provided to insured veterans.

This budget also assumes that VHA will reduce operating costs by $1.1 billion by implementing management efficiency initiatives. Such savings will, in effect, offset the need for additional appropriated funds. Over the past several months, however, we and others, including veterans' service organizations, have questioned whether VHA can achieve that level of efficiency savings.[1]

In late July, the Director of the Office of Management and Budget (OMB) informed you that VHA's spending needs are greater than were expected when the President's fiscal year 2000 budget was prepared. Currently, VHA estimates the additional spending needs to be about $600 million. As a result, VHA would need management efficiency savings of $1.7 billion, additional appropriated funds in that amount, or a combination of efficiency savings and appropriated funds.

The OMB Director informed you that he intends to amend VHA's fiscal year 2000 budget for veterans' medical care by requesting an additional $900 million in appropriated funds.[2] As you requested, we examined VHA's plans to spend the additional $900 million requested for veterans' medical care and the likelihood of VHA's achieving its proposed management efficiency savings. To develop the information for this letter, we interviewed VHA headquarters officials and reviewed records, including the President's budget and supporting documents.

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[1]See Veterans' Affairs: Progress and Challenges in Transforming Health Care (GAO/T-HEHS-99-109, Apr. 15, 1999).

[2]The Director also stated that he wants to amend VHA's budget for construction activities by adding $100 million in appropriated funds. This includes $35 million to conduct market-based studies that we recommended as a means of facilitating needed realignment of VHA's capital assets.

In summary, VHA intends to spend an additional $900 million appropriation for expenditures that were originally to be financed through management efficiency savings. More specifically, about $800 million is to fund payroll increases, inflation, and other mandatory rate changes, such as for property rentals. VHA would use the remaining $100 million to enhance its extended care services. This, in effect, leaves $800 million of VHA's spending plan–primarily for service enhancements–to be offset by efficiency savings.

Although VHA can achieve significant management efficiency savings in fiscal year 2000, an $800 million savings target seems unlikely. Our assessment indicates that VHA has identified a wide array of efficiency initiatives that, if implemented in a timely manner, could yield about $600 million of savings in fiscal year 2000. These initiatives include, for example, shifting veterans' care to more appropriate settings or reengineering clinical and administrative processes–actions that in the past afforded VHA the opportunity to provide the same or higher-quality services at lower costs.

As we have previously reported, beyond the savings that VHA can achieve by implementing initiatives it has already identified, we believe a realignment of VHA's capital assets is critical to its continued ability to realize significant savings that could be reinvested to enhance medical care for veterans. Therefore, it seems essential that VHA carry out its commitment to systematically assess its major health care delivery markets as quickly as possible.

BACKGROUND

Over the past six decades, VHA's health care system has grown into our nation's largest direct provider of health care, serving veterans at more than 600 locations nationwide. VHA's system has focused primarily on hospital care, using technology and specialized medicine. It has not keep pace, however, with a rapidly changing health care industry, especially the rise of managed care practices.

In October 1995, VHA began to transform its system from a hospital operator to a health care provider that relies on community-based, integrated networks of VHA and non-VHA providers to meet veterans' needs more efficiently and effectively. In doing so, VHA created 22 regional networks to make basic budgetary, planning, and operating decisions for veterans living within defined geographical areas.

In October 1996, the Congress furnished tools that VHA said were key to a successful transformation. These included new eligibility rules that permit VHA to provide medical care in the most appropriate settings and expanded authority to purchase services from private providers.

In January 1997, VHA proposed a 5-year plan to operate within a fixed annual appropriation of $17 billion through fiscal year 2002. To accomplish this, VHA planned to reduce per patient costs by 30 percent while increasing the number of patients served by 20 percent and its reducing reliance on appropriations by 10 percent.

As VHA requested, the Congress also authorized VHA to retain all collections from third parties, copayments, per diems, and certain torts beginning July 1, 1997. VHA may spend these funds in the year collected or any subsequent year to supplement appropriations available to meet veterans' health care needs.

VHA made significant progress toward transforming itself during fiscal years 1996 to 1998. VHA enhanced benefits and served additional veterans each year while realizing a revenue surplus of $496 million as of September 30, 1998.[3] This surplus resulted primarily from management initiatives that have significantly enhanced the efficiency and effectiveness of VHA's health care delivery system.

In VHA's fiscal year 2000 budget planning, its 22 networks identified 451 management initiatives that they estimated could reduce operating costs by almost $1.2 billion. VHA told us that these will be implemented, as VHA deems appropriate, to achieve fiscal year 2000 spending objectives.

VHA'S PLANS TO SPEND ADDITIONAL FUNDS

VHA's fiscal year 2000 budget is intended to serve 3.65 million veterans, an increase of 54,000 over fiscal year 1999. VHA originally estimated that it could achieve this goal with a current appropriation of $17.3 billion, other available budget authority of $1.1 billion, and reduced operating costs of $1.1 billion, to be realized through management efficiency initiatives.

VHA's original spending plan estimated that $863 million of the efficiency savings would be required to maintain the current service level. This involved primarily payroll increases for existing employees, inflation, and other mandatory rate changes, such as for property rentals and state veterans' home programs. An additional $296 million of savings was targeted to enhance services for veterans with Hepatitis C ($136 million), veterans needing extended care services ($106 million), and homeless veterans ($40 million), and other services ($14 million).

On July 26, 1999, OMB's Director informed you that VHA's spending needs are greater than were expected when the President's fiscal year 2000 budget was prepared. He cited several factors, including the treatment of 400,000 veterans who were newly enrolled in VHA's system.

VHA has identified increased spending needs of about $600 million. Of this, VHA attributes $366 million to higher-than-expected price increases for and use of pharmaceuticals and prosthetic appliances.[4] In this regard, several network directors commented to us that they are experiencing increased demand from veterans whose care is primarily paid elsewhere but who obtain from VHA the specialty care and services not covered by their private insurance or Medicare, such as pharmaceuticals, eyeglasses, and hearing aids.

VHA's revised spending plan also includes an additional $210 million to enhance veterans' services, including additional Hepatitis C treatments, expanded services for women veterans and patients in state veterans' homes, and reduced waiting times. In addition,

[3]VHA's original fiscal year 2000 budget estimated that $280 million of this surplus would be used in fiscal year 1999 and the rest in fiscal year 2000 as part of its estimated $1.1 billion in other available budget authority.

[4]An estimated $132 million is inflation-related and $234 million relates to increased usage.

VHA plans to spend $34 million to enhance its revenue collection processes, which may ultimately lead to higher medical care cost recoveries.[5]

As OMB's Director previously informed you, he will request $900 million in additional appropriations, leaving $800 million to be offset by management efficiency savings. VHA expects to use $800 million of the additional funding to finance payroll increases for existing employees and inflation. The remaining $100 million will be used to enhance extended care services. The $800 million of efficiency savings is to be used to finance (1) $200 million of VHA's originally planned spending, primarily for Hepatitis C treatments and medical care for homeless veterans, and (2) VHA's newly identified spending needs of $600 million.[6]

VHA'S LIKEHOOD OF ACHIEVING MANAGEMENT EFFICIENCIES

Our assessment of the VHA networks' 451 management initiatives, totaling an estimated $1.2 billion, indicates that proposed actions could be divided into two broad categories: (1) cost savings that could be achieved while providing the same or higher-quality service and (2) cost savings that could result in diminished service quality or unreasonable service delays. We included in the second category 176 initiatives such as across-the-board reductions in workforce or overtime, termination of services to new or current veterans, lengthening of waiting times, and closures of community outpatient clinics. In total, these initiatives account for about $600 million of estimated savings.

In contrast, we found that 275 proposed initiatives appear to be consistent with the goals and objectives of VHA's ongoing transformation. These initiatives appear to be comparable to, in many instances, actions that in the past have afforded VHA the opportunity to provide the same or higher-quality services at lower costs. These initiatives include actions that would continue to shift care to appropriate levels, reengineer health care delivery processes, and defer capital investments for equipment and nonrecurring maintenance. These initiatives, if implemented in a timely manner, could yield about $600 million in savings.

Shifting Care to Appropriate Levels

A major objective of VHA's transformation is to shift the focus of its health care system from inpatient settings to less costly outpatient settings. Advances in medical technologies and practices afford VHA significant opportunities to achieve this objective. VHA's 22 networks proposed initiatives that would shift veterans' care to more appropriate levels and reduce excessive hospitalizations or medications. VHA's networks estimated that these initiatives could result in efficiency savings of $90 million annually.

Nine networks, for example, proposed initiatives that could reduce unnecessary hospital use. VHA's networks have, in the past, used comparable initiatives to identify patients who can be served more cost-effectively in alternatives to inpatient settings, including many chronically and terminally ill patients who can be treated at home rather than in a hospital.

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[5]Enclosure I summarizes VHA's original and revised spending plan, based on costs to maintain current services and enhance targeted services in fiscal year 2000.

[6] Enclosure II summarizes VHA's costs to maintain current services and enhance targeted services, based on the administration's forthcoming appropriation request of $900 million and management efficiencies of $800 million.

Also, 10 networks advanced proposals to improve the safety, effectiveness, and efficiency of drug prescription practices. Several networks, for example, plan to implement "polypharmacy" reviews to identify veterans who may be taking combinations of drugs that could be unsafe, duplicative, or needlessly costly.

Reengineering Clinical and Administrative Processes

VHA's transformation has, in the past, realized significant efficiency savings as a result of reengineering clinical and administrative processes. Twenty networks have proposed additional initiatives that would continue the reengineering efforts, including modernizing, standardizing, and consolidating processes. In addition, networks identified opportunities to increase efficiency through outsourcing. Networks estimated that efforts such as these could lead to an estimated $400 million in savings.

Nearly all networks developed proposals to modernize processes. Seven, for example, proposed advanced food preparation and delivery methods. Moreover, two proposed to modernize pharmacy operations through automation, while two others cited telemedicine as a means to improve efficiency.

Half of the networks advanced proposals to standardize processes. Seven, for example, had proposals involving the uniform procurement of prosthetics, pharmaceuticals, and supplies. Additionally, four identified such efficiencies as bulk purchasing, standardizing laboratory processes, and standardizing laboratory equipment. Nationally, VHA plans to reduce its prosthetics costs by at least 10 percent through such means as standardized purchasing processes.

Virtually every network based proposals for efficiency improvements on consolidations of administrative, support, or clinical processes. For example, networks said they could consolidate laboratories, laundry operations, food services, pharmacy operations and drug procurement, and various administrative activities.

Several networks included outsourcing options as a means of generating efficiency savings. Four networks, for example, identified such facility support services as housekeeping and fire fighting, as well as a variety of clinical and administrative services.

Deferring Capital Investments

Twelve networks proposed shifting about $110 million of maintenance and equipment funds to the direct delivery of medical care for veterans in fiscal year 2000. This represents about 15 percent of the maintenance and equipment funds that VHA has available in fiscal year 2000.

As previously noted, VHA has requested an additional $35 million to assess service delivery markets. These assessments, as we recommended, should include a determination of veterans' health care needs, a survey of existing assets, and an evaluation of alternatives for meeting veterans' needs in the most cost-effective manner. This should provide opportunities, beyond fiscal year 2000, to significantly reduce the amount of funds used to

operate and maintain unneeded or inefficient health care delivery locations and to reinvest such savings to enhance care provided to veterans.

Until such assessments are completed, networks appear to lack critical information needed to make difficult decisions concerning the efficient use of maintenance and equipment funds. Deferring some capital investments until the market-based studies are completed could result in a more efficient use of such funds.

CONCLUSIONS

If VHA's revised spending plan for fiscal year 2000 is to be implemented, offsetting a significant portion through management efficiencies seems desirable. It is difficult, however, to estimate with certainty what level of savings VHA will ultimately realize in fiscal year 2000. It seems optimistic, though, to assume that VHA's efficiency savings will reach the $800 million that its revised spending plan currently envisions. Our assessment of VHA's identified management initiatives indicates that potential savings could yield about $600 million in fiscal year 2000 if initiatives are implemented in a timely manner.

Thus, it seems inevitable that VHA will need to reduce the level of planned spending or increase the amount of appropriated funds requested if its revised spending plan is to be fully implemented. Such changes, however, depend on the estimated savings level that VHA can achieve. For example, if VHA can achieve $600 million in efficiency savings, then it would require an additional $200 million above the forthcoming $900 million appropriation request. If a lower or higher savings level is assumed, appropriations or planned service enhancements would have to be adjusted accordingly.

Over the longer term, VHA's continued ability to realize significant efficiency savings and improve services to veterans is inextricably linked to a successful realignment of its capital assets. In this regard, it seems essential that VHA use the $35 million as planned to conduct needed market assessments. Directing VHA to do so may provide additional assurance that such assessments will be completed in a timely manner.

AGENCY COMMENTS

VHA's Chief Network Officer and Chief Financial Officer reviewed a draft of this correspondence and concurred with its conclusions. Moreover, they agreed that the contents provide an objective analysis of VHA's revised spending plan for fiscal year 2000 and the likelihood of achieving proposed management efficiency savings.

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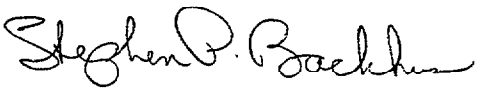
Copies of this letter are being sent to the Honorable Barbara A. Mikulski, Ranking Minority Member, Subcommittee on VA, HUD, and Independent Agencies, Senate Committee on Appropriations; the Honorable Bob Stump, Chairman, and the Honorable Lane Evans, Ranking Minority Member, House Committee on Veterans' Affairs; the Honorable Arlen Specter, Chairman, and the Honorable John D. Rockefeller IV, Ranking Minority Member, Senate Committee on Veterans' Affairs; the Honorable James T. Walsh, Chairman, and the Honorable Allan B. Mollohan, Ranking Minority Member, Subcommittee on VA, HUD, and Independent Agencies, House Committee on Appropriations; and the Honorable Togo West, Secretary of Veterans Affairs. Copies will be made available to others on request.

Paul Reynolds, Fred Caison, and Dawn Shorey developed information contained in this letter. If you have any questions, please contact me at (202) 512-7101 or Mr. Reynolds at (202) 512-7109.

Sincerely yours,



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

Enclosures - 2

SUMMARY OF VHA'S ORIGINAL AND REVISED FY 2000 SPENDING PLAN

Dollars in millions

	Maintain service level	Enhance service level	Total
VHA's original spending plan[a]			
Payroll for existing employees	$563		$563
Inflation and other rate changes	267		267
State home changes	25	$7	32
CHAMPVA		7	7
National archive storage	3		3
Real property rental	3		3
Costs for additional calendar day in FY2000	2		2
HR Link$ (personnel and payroll system replacement)	1		1
Hepatitis C		136	136
Extended care		106	106
Homeless initiatives		40	40
Subtotal	$863	$296	$1,159[b]
Revised spending plan			
Pharmaceuticals[c]	110	90	200
Prosthetic appliances[d]	22	144	166
Increased hepatitis treatment[e]		43	43
Improved revenue collection process[f]		34	34
Services for women veterans[g]		23	23
State home pharmaceuticals[h]		18	18
Initiatives to reduce waiting times[i]		75	75
Subtotal	$131	$428	$560
Total	**$994**	**$724**	**$1,718**

Notes: Numbers represent increases over the fiscal year 1999 budget base.

Totals may not add because of rounding.

[a]VA, FY 2000 Budget Submission, Medical Programs, Volume 2 of 6 (Feb. 1999), pp. 2-67 .

[b]Includes $14 million in other budget authority.

[c]An additional cost of $200 million is anticipated as a result of inflation and increased usage. Of this, $110 million is attributable to price increases that are higher than the rate used in VHA's original budget submission. The remaining $90 million is to provide new drug treatment regimes for 150,000 veterans.

[d]An additional cost of $166 million is anticipated as a result of inflation and increased usage. Of this, $22 million is attributable to price increases that are higher than the rate used in VHA's original budget submission. The remaining $144 million is to pay for increased use of prosthetic appliances, including eyeglasses and hearing aids, for 240,000 veterans.

[e]An additional $43 million and 132 FTEs are anticipated to evaluate and treat veterans for the Hepatitis C virus, based on a higher estimate of Hepatitis C prevalence among veterans than the estimate used for VHA's original budget submission. The additional resources will enable VHA to screen approximately 179,000 veterans and provide initial treatment to an additional 3,000.

[f]An additional cost of $34 million and 193 FTEs are planned for improving compliance with reporting requirements in order to increase revenue collections. Additional FTEs will enable VHA to evaluate current compliance and train employees on the requirements for third-party reimbursements.

[g]An additional cost of $23 million and 131 FTEs is anticipated in order to provide maternity care for 4,100 women veterans.

[h]An additional cost of $18 million is anticipated, as a result of a policy change, to provide medications for veterans in state homes. Previously, VHA's policy was to withhold state nursing home per diems when veterans in state homes received medications from VHA. VHA estimates that medications will need to be provided to about 8,500 veterans, who had previously received medications from the state homes.

[i]An additional cost of $75 million and 750 FTEs, primarily clinical staff, are planned for implementing initiatives to reduce the time periods veterans must wait to receive VHA care.

SUMMARY OF POTENTIAL FUNDING SOURCES FOR VHA'S REVISED SPENDING PLAN

Dollars in millions

	Additional appropriation requested	Required management efficiencies
Maintain current services		
Payroll increase	$533	$30
Inflation and other rate changes	267	132[a]
State home changes VA share of cost		25
National archive storage		3
Real property rental		3
Cost for additional calendar day in FY 2000		2
HR Link$ (personnel and payroll system replacement)		1
Subtotal	$800	$194
Enhance service level		
Hepatitis C		179
Extended care	100	6
Homeless initiatives		40
Pharmaceuticals		90
Prosthetic appliances		144
Improved revenue collection process		34
Services for women veterans		23
State home pharmaceuticals		18
State home change (workload)		7
CHAMPVA		7
Initiatives to reduce waiting times		75
Subtotal	$100	$623
Total	**$900**	**$818**

Note: Totals may not add because of rounding.

[a]Cost increase attributable to higher-than-expected prices for pharmaceuticals and prosthetic appliances.

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