THE DEPUTY SECRETARY OF VETERANS AFFAIRS
WASHINGTON

June 7, 2005

The Honorable Lane Evans
Ranking Democratic Member
Committee on Veterans' Affairs
U. S. House of Representatives
Washington, DC 20515

Dear Congressman Evans:

This is in response to your letter of April 13, 2005, co-signed by Congressman Ted Strickland requesting more detail on the Department of Veterans Affairs' (VA) achievement of management efficiencies. Secretary R. James Nicholson asked me to respond to you on his behalf. The Department takes very seriously the enormous responsibility of ensuring the timely delivery of high-quality benefits and services to America's deserving veterans, as well as providing sound stewardship of the taxpayer dollars entrusted to this Department.

Consistent with practices used at other Federal departments, VA does not budget to a "total savings baseline." Instead, our budget reflects savings that are achieved through multiple approaches. VA managers seek to implement best practices, incorporate knowledge from lessons learned, and improve business strategies to minimize costs wherever possible, while at the same time maximize revenue collections.

While VA aims to maximize savings in all of the Department's operations, particular emphasis is placed on taking advantage of the many opportunities to reduce costs in health care delivery. VA has been publicly recognized for its success in employing more effective means of procuring drugs and using a national drug formulary. Substantial savings have resulted from our aggressive efforts to secure better drug prices through volume drug purchases and better-managed drug utilization. For example, VA negotiated a price reduction in January 2005 for allergy medicine administered through the nose and achieved a price reduction from more than $38 dollars per bottle to less than $8 a bottle, a savings of 80 percent. In another instance, a recently-awarded contract for Angiotensin Receptor Blockers resulted in cost savings of over $30 million. These are just two examples of the many negotiated savings that VA has successfully implemented.

VA has also partnered with the Department of Defense to achieve savings in areas of medical imaging, purchases of expensive medical technology, and volume purchases, and we are continually examining ways to expand these efforts. In addition, VA has been actively involved in energy management of fuel oil consumption that resulted in a 32 percent reduction in usage in 2004, at an estimated savings of $3 million. In the area of vehicle fleet management, VA raised its average mileage per gallon, resulting in estimated savings of $2 million last year. There are many other examples of VA's success in achieving ongoing savings.

The Honorable Lane Evans

VA treats more patients, more efficiently, than any other medical care system in the world. While focusing on the need to pursue efficiencies and reduce costs, VA has always made the quality of patient care our highest priority. The Department's health care sets the national standard of excellence for the health care industry. VA continues to exceed the performance of private sector and Medicare providers for all 15 health care quality indicators for which comparable data are available. These indicators include cancer screening for early detection, and immunization for influenza and pneumonia. In addition, they cover disease management measures such as compliance with accepted clinical guidelines in managing diabetes, heart disease, hypertensive disease, and mental health. These preventative care strategies help patients avoid more serious and costly health problems.

While it is neither possible nor desirable to construct an arbitrary baseline of savings, it is clear that VA continues to reap significant savings. This has been documented not only by our own internal assessments, but has been validated by the Government Accountability Office (GAO) in their recent study of management efficiencies at VA which is enclosed. The $590 million in management efficiencies discussed in the FY 2006 budget represents less than a 2 percent improvement in cost savings that VA projects to realize through the many efforts already underway. Private industry has reflected a 3 to 4 percent improvement in productivity in the past few years.

The Department remains confident that VA's dedicated staff can achieve a standard comparable to that of businesses throughout the country, even though our official estimates reflect a more modest level of efficiencies. VA's successful track record in achieving management efficiencies is undeniable, as the recent GAO report confirms. I have every confidence in VA's ability to continue to achieve cost savings in the future that will enhance the Department's position as a model of excellence in health care delivery.

I trust that this information satisfactorily addresses your concerns. A similar letter has been sent to Congressman Strickland.

Sincerely yours,

Gordon H. Mansfield

Enclosure

GAO
Accountability • Integrity • Reliability
United States Government Accountability Office
Washington, DC 20548

March 2, 2005

The Honorable Christopher Bond
Chairman
The Honorable Barbara Mikulski
Ranking Minority Member
Subcommittee on VA/HUD-Independent Agencies
Committee on Appropriations
United States Senate

The Honorable James Walsh
Chairman
The Honorable Chet Edwards
Ranking Minority Member
Subcommittee on Military Quality of Life and Veterans Affairs,
and Related Agencies
Committee on Appropriations
House of Representatives

Subject: Budget Justification Issue Papers on Fiscal Year 2006, Department of Veterans Affairs' Medical Care Collections Fund and Management Efficiencies

To assist you in this year's Department of Veterans Affairs' (VA) budget deliberations, we are providing three issue papers on the Medical Care Collections Fund (MCCF) and one on management efficiencies. The information contained in these issue papers is for the use of the VA/HUD- Independent Agencies Subcommittee of the Committee on Appropriations, United States Senate and the Military Quality of Life and Veterans Affairs, and Related Agencies Subcommittee of the Committee on Appropriations, House of Representatives.

The overall objective of budget justification reviews is to provide objective analysis of the President's proposed budget and identify potential reductions, rescissions, restrictions, or realignments. For our review of VA's MCCF, we submit issue papers that provide analyses of revenue collected from third-party insurers along with estimates of the amount of first-party debt satisfied by third-party revenue. Both of these issues should be considered when evaluating VA's request for new budget authority, as should our analysis of VA's estimated MCCF increase between fiscal years 2005 and 2006. We also provide an issue paper on the likelihood that VA can achieve significant management efficiencies in fiscal year 2006.

In conducting this work, we followed generally accepted government auditing standards except that we did not test the reliability and validity of the data used to

calculate these estimates nor did we test internal controls or compliance with legal and regulatory requirements related to the management of this program. We provided a draft of this report to VA for comment. The Deputy Secretary of Veterans Affairs provided written comments, which have been incorporated where appropriate. (VA's comments are reprinted in enclosure V.)

If you or your staff have any questions about this report, please call me at (202) 512-7101 or Michael T. Blair, Jr., at (404) 679-1944. Cherie Starck and Cynthia Forbes were key contributors to this report.

Sincerely yours,

Cynthia Bascetta

Cynthia A. Bascetta
Director, Health Care—Veterans'
Health and Benefits Issues

Enclosures - 5

Enclosure I

Estimates of Third-Party Insurance Collections

The Veterans' Health-Care Amendments of 1986 authorized VA to collect payments from private health insurers (third-party insurers) for the cost of treating veterans for nonservice-connected disabilities. The Balanced Budget Act of 1997 established a new fund in the U.S. Treasury—the Department of Veterans Affairs' Medical Care Collections Fund (MCCF)—and authorized VA to use funds from this account to supplement its medical care appropriations.[1] As a result of improved operating processes and systems, VA has increased total collections from third-party insurers from $540 million in fiscal year 2001 to $960 million in fiscal year 2004.

Based on VA's past experience, its estimate that it will collect $1.175 billion in third-party revenue in fiscal year 2006 appears achievable. Our analysis is based on information about VA's initiatives to increase revenues from collections and its past collection experience. The initiatives include procedures to improve insurance identification, verification, and billing, as well as other business office operations such as submitting electronic claims. With regard to its past collection experience, VA's actual collections for third-party revenue were 167 percent of its fiscal year 2002 estimate, 152 percent of its fiscal year 2003 estimate, and 87 percent of its fiscal year 2004 estimate. Based on VA's ongoing efforts to increase collections, we believe the opportunity exists for it to further increase overall collections.

Agency Comments and Our Evaluation

In its comments on our draft, VA stated that information we provided on the "collections to billings rate" was partly influenced by the fact that not all billings are collectible. In the draft that was sent to VA, we made the point that VA's collection rate, as described in its budget submission documents, increased from 31 to 41 percent from fiscal year 2001 to fiscal year 2004—an indication that VA's initiatives have resulted in increased collection activity. We believe the information we provide on actual collections for third party revenues sufficiently supports our position that VA is likely to collect $1.175 billion in third-party revenue in fiscal year 2006.

[1] 38 U.S.C. §1729A(c)(1)(A).

Enclosure II

Estimate of First-Party Debt Satisfied by Third-Party Revenue

VA uses revenue collected from third-party insurers to satisfy veterans' (or first-party) copayment debt,[2] which reduces the amount that could be available to supplement medical care appropriations. GAO has been on record for many years advocating that this practice be discontinued.[3] In its 2006 budget, VA has proposed discontinuing this practice and estimated that as a result it will be able to supplement its medical care appropriations by about $30 million. VA calculated this estimate by inflating total first-party revenue by roughly 20 percent—VA's estimate of the percentage of veterans in priority groups 7 and 8 that are privately insured.

We agree with VA's proposal but estimate that this change would make available at least $120 million in funds, rather than VA's estimate of $30 million. Moreover, we believe our estimate is conservative because it excludes amounts from certain priority groups. For example, our estimate excludes veterans in priority groups 2, 3, 4, and 6 because we did not have a basis for determining what percentage of these veterans contribute to first-party revenue. To calculate our estimate we applied the percentage of veterans from priority groups 5, 7, and 8 with private health insurance coverage in fiscal year 2002 to the corresponding amounts of first-party collections in fiscal year 2003, as shown in table 1.

Table 1. Estimated First-Party Debt Satisfied by Third-Party Revenue, Fiscal Year 2003

Priority group	Actual reported first-party revenue[a] (dollars)	Veterans covered by private insurance[b] (percent)	Projected first-party revenue (dollars)	Estimated first-party debt satisfied with third-party revenue (dollars)
5	203,413,592	9	223,531,420	20,117,828
7	26,035,628	16	30,994,795	4,959,167
8	302,469,668	24	397,986,405	95,516,737
Total	531,918,888		652,512,620	120,593,732

[a] Source: VA Chief Business Office.

[b] Source: 2002 Veterans Health Administration Survey of Veteran Enrollees' Health and Reliance Upon VA.

In addition, neither VA's nor GAO's estimates include the savings that would result from eliminating the cost of administrative staff time dedicated to the process involved with satisfying first-party debt with third-party revenue. VA cannot specify the total amount of administrative time spent on this process throughout its health system, but in 2004, 17 of the VA's 21 network officials stated that considerable administrative time was dedicated to satisfying first-party debt with third-party revenue. For example, one official estimated that the medical facilities in his network used approximately 11 full-time equivalent staff on this process.

[2] In 1986, Congress authorized VA to establish copayments from veterans for nonservice-connected medical care.

[3] See GAO, *VA Health Care: Guidance Needed for Determining the Cost to Collect from Veterans and Private Health Insurers*, GAO-04-938 (Washington, D.C: July 21, 2004) and *VA Medical Care: Increasing Recoveries From Private Health Insurers Will Prove Difficult*, GAO/HEHS-98-4 (Washington, D.C.: Oct. 17, 1997).

Enclosure II

Agency Comments and Our Evaluation

In its comments on our draft, VA stated that due to the limited time it had to review the report, it cannot concur with the higher amount we estimate could be saved through the first-party offset proposal. We believe after VA sufficiently reviews our methodology it will concur our estimate is conservative.

Enclosure III

Analysis of the MCCF Increase from Fiscal Year 2005 to 2006

Whether VA will be able to increase its collections by $636 million in fiscal year 2006 depends largely on enactment of legislation. Over 90 percent of the expected increase in the MCCF between fiscal years 2005 and 2006 is tied to new legislative proposals and increased third-party collections. Two-thirds of this increase ($424 million) depends on approval from Congress for VA to assess an annual enrollment fee and increase pharmacy copayments for veterans in priority groups 7 and 8.[4] An additional one-fourth of this increase requires VA to increase third-party collections (see table 2). As discussed in enclosure I, we believe the opportunity exists for VA to increase its overall collections.

Table 2. Analysis of MCCF Increase between Fiscal Years 2005 and 2006 (Dollars in Thousands)

Source of MCCF difference	FY 2005 (dollars)	FY 2006 (dollars)	Difference	
			Dollars	Percent
First-party collections	131	166	35[a]	26.7
Third-party collections	1,018	1,175	157	15.4
Pharmacy copayments	722	773	51	7.0
FY 2006 legislative proposal				
Enrollment fee	–	248	248	–
Pharmacy copayment increase (7 and 8)	–	176	176	–
All other MCCF	82	51	(31)	(37.8)
Total receipts and collections	1,953	2,589	636	32.6

Source: The President's Fiscal Year 2006 Budget for the Department of Veterans Affairs, page 893.

[a]$30 million is due to the elimination of first-party offset and $5 million is due to increased collections.

[4]This annual enrollment fee would be $250 and pharmacy copayments would increase from $7 to $15 for a 30-day supply of drugs.

Enclosure IV

Estimates of Management Efficiencies

VA estimates that fiscal year 2006 management efficiencies will result in savings of $590 million. VA plans to achieve these savings through continued standardization in the procurement of pharmaceuticals and medical supplies, as well as through other operational efficiencies such as inventory management. VA's Business Oversight Board is focusing on procurement reform and, to date, 50 of 65 procurement reforms recommended by the Secretary's Procurement Reform Task Force have been implemented. For example, in 2004, VA and DOD increased the number of joint pharmacy contracts. In addition, to increase efficiencies when purchasing medical and surgical supplies, VA and DOD are in the process of converting DOD's Distribution and Pricing Agreements to VA's Federal Supply Schedule (FSS). The conversion will result in a single federal pricing catalog that will be searchable and available on-line for use by both departments.

Based on VA's past experience, its 2006 estimate of $590 million in management savings appears achievable. Our analysis is based on prior work by GAO and VA's Office of Inspector General (IG) in the area of VA procurement[5] and past savings experience. While GAO and the IG reported that VA's efforts to standardize procurement saved hundreds of millions of dollars, both also concluded that more could be saved through increased resource sharing, especially in the areas of medical services and joint procurement of medical and surgical supplies. In fact, VA's actual savings exceeded its estimates in fiscal years 2003 and 2004 by 98 percent and 2 percent, respectively (see table 3).

Table 3: VA's Actual and Estimated Management Efficiencies for Each Fiscal Year, Fiscal Year 2003 through 2006 (Dollars in Thousands)

Total savings/cost avoidance	FY 2003 Actual	FY 2004 Actual	FY 2005 Estimate	FY 2006 Estimate
Standardization of pharmaceuticals	396,100	360,100	188,529	327,153
Standardization of other supplies, materials, Equipment, and inventory management	73,839	137,452	71,962	124,876
Administrative consolidations, VA/DOD sharing, competitive courcing, and other	157,407	151,866	79,509	137,971
Total	627,346	649,418		
Estimate	316,392	633,608	340,000	590,000
Percent of actual savings above estimated savings	98	2		

Source: VHA Budget Office.

[5] See GAO, *Best Practices: Using Spend Analysis to Help Agencies Take a More Strategic Approach to Procurement,* GAO-04-870 (Washington, D.C.: Sept. 16, 2004), *Contract Management: Further Efforts Needed to Sustain VA's Progress in Purchasing Medical Products and Services,* GAO-04-718 (Washington, D.C.: June 22, 2004), *VA and DOD Health Care: Factors Contributing to Reduced Pharmacy Costs and Continuing Challenges,* GAO-02-969T (Washington, D.C.: July 22, 2002), and *VA and Defense Health Care: Potential Exists for Savings through Joint Purchasing of Medical and Surgical Supplies,* GAO-02-872T (Washington, D.C.: June 26, 2002), Department of Veterans Affairs, Office of Inspector General, *Audit of VA Medical Center Procurement of Medical, Prosthetic and Miscellaneous Operating Supplies,* Report Number 02-01481-118 (Washington, D.C.: Mar. 31, 2004) and Department of Veterans Affairs, Office of Inspector General, *Evaluation of VA's Purchasing Practices,* Report Number 01-01855-75 (Washington, D.C.: May 15, 2001).

Enclosure V

THE DEPUTY SECRETARY OF VETERANS AFFAIRS
WASHINGTON

March 2, 2005

Ms. Cynthia Bascetta
Director, Health Care–
Veterans Health and Benefits Issues
U. S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Bascetta:

The Department of Veterans Affairs (VA) has reviewed the Government Accountability Office's (GAO) draft review on **Budget Justification Issue Papers on Fiscal Year 2006, Department of Veterans Affairs' Medical Care Collections Fund.** VA appreciates the opportunity to comment on the draft report. Due to the limited time we had to review the report, we cannot concur with your higher estimate of savings related to the first party debt offset proposal. In addition, the collections to billings rate of 41 percent is partly influenced by the fact that not all billings are collectible. For example, when the billings are adjusted for Medicare amounts that cannot be collected the rate is 75 percent for the first quarter of FY 2005. VA remains committed and will conduct a thorough review of the data and provide a detailed response at a later date.

VA appreciates the opportunity to comment on your report.

Sincerely yours,

Gordon H. Mansfield