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MILITARY HEALTH CARE

Savings to Champps From Using a Prospective Payment System



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Human Resources Division

B-240032

July 13, 1990

The Honorable Beverly B. Byron
Chairman, Subcommittee on Military Personnel
and Compensation
Committee on Armed Services
House of Representatives

The Honorable G.V. Montgomery
Chairman, Committee on Veterans' Affairs
House of Representatives

You requested that we obtain information on whether the prospective payment system used by the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS) was achieving its goal of saving money. You also asked that we determine the extent to which CHAMPUS was reimbursing hospitals in excess of the amounts that they billed CHAMPUS. The request resulted from an article in the October 1989 issue of DAV Magazine, published by the Disabled American Veterans, that told of cases in which CHAMPUS paid hospitals more than they billed. We briefed your staffs on the results of our work on April 10 and 13, 1990. This fact sheet summarizes and supplements the information presented at those briefings.

Background

Before fiscal year 1988, CHAMPUS paid hospitals their billed charges less disallowed items, such as unauthorized private rooms. On October 1, 1987, CHAMPUS implemented a prospective payment system, modeled after the Medicare system, in an effort to (1) reduce government health care costs and (2) provide an incentive for hospitals to reduce their operating costs. Conceptually, under the prospective payment system, the government's costs are reduced because hospitals are reimbursed based on their average costs rather than their billed charges. Hospitals, in turn, strive to reduce their operating costs because, under the payment system, they profit when payments exceed their costs and lose money when their costs exceed payments.

Under the prospective payment system, hospitals are paid predetermined rates for each patient. The rates are based on the costs of treating similar groupings of patients, referred to as diagnosis related groups (DRGs). DRGs are a result of dividing patients into groups based on their diagnosis, procedures performed, age, sex, and discharge status. In CHAMPUS there are 514 DRGs and an established payment rate for each. The rates represent the average costs, for an average length of stay, for

the group of procedures comprising a DRG. When CHAMPUS implemented DRGs, it changed beneficiary cost-sharing requirements so the beneficiaries would share in any savings. In no cases do beneficiaries pay more than they did under the previous billed-charge payment method.

Scope and Methodology

We obtained data on about 200,000 fiscal year 1989 CHAMPUS hospital claims filed in the 13-month period ending October 1989. These claims represented about 76 percent of the claims that were expected to be paid under DRGs for care provided in fiscal year 1989. We determined the number of claims where the DRG payments were both greater and less than billed charges. We also determined the effect of DRGs on total CHAMPUS expenditures by comparing fiscal year 1989 payments with estimates of what costs would have been under the previous payment system. We interviewed CHAMPUS officials responsible for administering the prospective payment system and obtained CHAMPUS statistical analyses on hospital payments and costs per hospital admission. Appendix I details our scope and methodology.

Results in Brief

CHAMPUS's prospective payment system has saved both the government and beneficiaries a substantial amount of money compared to what costs would have been under CHAMPUS's previous system of paying billed charges. For the claims we analyzed—about three-fourths of the expected fiscal year 1989 volume—the government saved about \$169 million, and beneficiaries saved about \$33 million.

Hospital billed charges (for the claims we analyzed) that would have been paid under the previous system were about \$647 million (\$550 million by the government and \$97 million by beneficiaries). Under DRGs, total payments were about \$445 million, a reduction of \$202 million, or 31 percent. The government paid \$381 million, and beneficiaries paid \$64 million. Projecting these cases to the entire fiscal year 1989, we estimate that government savings were about \$223 million and beneficiary savings were about \$43 million.

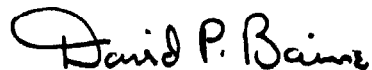
Taken as a whole, therefore, DRGs have been successful in reducing CHAMPUS costs per hospital admission. In fiscal year 1987, before DRGs, the cost per admission was \$3,056, and in fiscal year 1989, after DRGs, the cost was \$1,961.

Because they are based on average costs, some DRG-payment rates under the prospective payment system actually exceeded amounts that hospitals would have received for particular cases under the previous payment system. More specifically, about one-third of the fiscal year 1989 DRG payments exceeded hospital billed amounts. Conversely, two-thirds of the payments were for less than what the hospitals billed. Instances of payments overbilled and underbilled amounts occurred in nearly all 514 DRGs.

Appendix I contains details of the results of our work.

We discussed information in this fact sheet with officials in the Office of the Assistant Secretary of Defense (Health Affairs) and CHAMPUS. They agreed with the information presented. We are sending copies of this fact sheet to interested congressional committees and to the Secretary of Defense. We will also make copies available to others upon request.

If you have any questions concerning the contents of this fact sheet, please call me at (202) 275-6207. Other major contributors to this fact sheet are listed in appendix II.



David P. Baine
Director, Federal Health Care
Delivery Issues

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Abbreviations

CHAMPUS	Civilian Health and Medical Program of the Uniformed Services
DRG	diagnosis related group

Hospital Reimbursements Under CHAMPUS's Prospective Payment System

The Civilian Health and Medical Program of the Uniformed Services helps pay for medical care provided by civilian hospitals, physicians, and other civilian providers to dependents of active duty members, retirees and their dependents, and the dependents of deceased members of the uniformed services.¹ Medical care claims for services provided to these beneficiaries are paid by private organizations, referred to as fiscal intermediaries, under contract with the Department of Defense.

CHAMPUS Prospective Payment System

CHAMPUS implemented its prospective payment system effective for hospital admissions occurring on or after October 1, 1987, in an effort to (1) reduce government costs and (2) provide an incentive for hospitals to reduce their operating costs. Before the prospective payment system, CHAMPUS paid hospitals based on their billed charges less disallowed items, such as unauthorized private rooms and television sets. Under the prospective payment system, payment for hospitals' operating costs is based on prospectively determined rates applied on a per discharge basis using diagnosis related groups. DRGs divide hospital patients into groups based on their principal diagnosis, procedures performed, age, sex, and discharge status.

The DRG rate is an average rate for an average length of stay for the group of procedures comprising a DRG. Hospitals may keep the excess when their costs are less than the DRG amounts, but they must absorb the losses when their costs exceed the DRG amounts. The DRG amount (the government share plus beneficiary share) is payment in full for the inpatient services provided, and the hospital may not bill the beneficiary for the difference between billed charges and the DRG amount.

CHAMPUS's prospective payment system is modeled after Medicare's, which was implemented in 1983. While most of the DRG definitions in the CHAMPUS system are similar or identical to those in the Medicare system, the DRG rates are different because of differences in the two programs, particularly in the beneficiary population. Most Medicare beneficiaries are over age 65, while virtually all CHAMPUS beneficiaries are under 65. Also some services, notably obstetric and pediatric services, are nearly absent from Medicare but are a large part of CHAMPUS-paid services. CHAMPUS has 514 DRGs, while Medicare has 476. The difference is that

¹The uniformed services covered by CHAMPUS are the Air Force, Army, Marine Corps, Navy, Coast Guard, and Commissioned Corps of the Public Health Service and the National Oceanic and Atmospheric Administration.

CHAMPUS added 36 DRGs for neonatal claims and 2 for alcohol or drug abuse.

Cost-share requirements changed for retirees and dependents of retired and deceased personnel when CHAMPUS implemented the prospective payment system. The purpose of the change was to ensure that beneficiaries would also share in savings and that in no case would they pay more than they paid under the previous billed-charge system. Under the previous system, these beneficiaries paid 25 percent of the billed amount. Under the DRG system, they pay the lesser of (1) 25 percent of hospital billed charges or (2) a fixed charge per day of hospitalization. (The charge per day of hospitalization is adjusted annually; it was \$210 per day in fiscal year 1989 and \$235 per day in 1990.) Under no circumstances can the cost share exceed the DRG amount. Cost-share requirements for dependents of active duty members did not change under the DRG payment system. They continued to pay the greater of \$25 per hospital admission or \$8.05 (in fiscal year 1989) per day of hospitalization.

Some hospitals, including psychiatric hospitals, rehabilitation hospitals, and hospitals outside of the 50 states, are exempt from DRG-based payments, as are such services as heart and liver transplants. An estimated 74 percent of all fiscal year 1989 CHAMPUS hospital admissions were paid on the basis of DRGs, but less than one-half of total CHAMPUS (government) payments to hospitals were based on DRGs.² Total CHAMPUS hospital payments were estimated to be about \$1.1 billion, of which about \$468 million were based on DRGs.

How Hospital Payments Are Determined

Two factors determine the hospital payment: (1) the "weight" of the DRG into which the patient was classified and (2) the standard payment amount for the discharging hospital. The weight for a given DRG represents the national average for resources required to care for CHAMPUS patients in that DRG relative to the national average for resources required to treat all CHAMPUS patients. Thus, a patient in a DRG with a weight of 2.0 is expected to require about twice the amount of hospital resources to treat as an average CHAMPUS patient.

The DRG weight is multiplied by the discharging hospital's standard payment amount, which is the national average cost of treating a CHAMPUS

²Total fiscal year 1989 CHAMPUS payment and admissions data are estimates based on claims received as of October 1990, using CHAMPUS's estimating methodology. Estimates are necessary because health care providers and beneficiaries do not have to file claims for 2 years.

patient adjusted to reflect wage rates in the hospital's area and whether it is located in an urban or rural area. Since CHAMPUS does not collect actual cost data, it uses Medicare's method and data to reduce hospital billed amounts to costs—called a cost-to-charge ratio. This ratio is determined by Medicare based on audited reports filed by hospitals. Medicare's cost-to-charge ratio for fiscal year 1989 was 0.63 to 1; CHAMPUS adds 1 percent for bad debts, thereby making the CHAMPUS ratio 0.64 to 1 for fiscal year 1989. In other words, hospitals' billed amounts were reduced by 36 percent to arrive at their costs for fiscal year 1989. The payment determined in this manner is adjusted upward for teaching hospitals.

Peer Review Organizations

CHAMPUS established a peer review organization program in October 1988. The organization's function is to conduct utilization and quality reviews of services provided in hospitals for care covered by CHAMPUS DRGs. The purpose of the reviews is to ensure that patients are getting medically necessary and appropriate care and are not being discharged too early. The Department of Health and Human Services' Health Care Financing Administration has contracted with peer review organizations in each state. CHAMPUS uses the same peer review organizations that Medicare uses to do its reviews, but CHAMPUS has its own scope of work to add reviews specific to the CHAMPUS case mix and program requirements.

Objectives, Scope, and Methodology

The Chairman, Subcommittee on Military Personnel and Compensation, House Committee on Armed Services, and the Chairman, House Committee on Veterans' Affairs, asked us to determine (1) the effect of the CHAMPUS prospective payment system on total CHAMPUS costs and (2) the extent to which hospitals were being reimbursed in excess of their billed charges. The request was spurred by an article in the October 1989 issue of DAV Magazine, which questioned the payment policies of CHAMPUS under the DRG system. The article expressed concern about instances in which CHAMPUS reimbursed hospitals more than their billed charges.

We obtained computer tapes from the Office of CHAMPUS containing data from 200,500 claims for fiscal year 1989 hospital admissions paid between October 1, 1988, and October 31, 1989. Claims involving 497 of the 514 CHAMPUS DRGs were on the tapes. These were the most current data available at the time of our review, and the computer tapes contained about 76 percent of the hospital claims to be paid under DRGs that CHAMPUS expected to receive for fiscal year 1989.

To verify the accuracy of the data, we obtained copies of a random sample of 400 claims identified from the tapes. Our comparison of these claims to the computer tapes detected only minor errors that would not significantly affect the results of our analyses.

Using the data tapes, we obtained for each claim, the DRG amount, the hospital billed amount, other health insurance payments, the beneficiary payment (cost share), and the government-payment amount. We accumulated the data by DRG. The data enabled us to (1) compare, individually and in aggregate, payments under the DRG system with what they would have been under the previous billed-charge system and (2) determine the extent to which DRG payments exceeded billed charges.

We supplemented this work with statistical analyses and reports CHAMPUS prepared on DRG payments and costs per admission, which we discussed with officials responsible for administering the prospective payment system.

We met with officials from the Department of Health and Human Services' Health Care Financing Administration Region 8 (Denver) to obtain information on Medicare's DRG rates in the Denver metropolitan area in order to compare them with CHAMPUS's rates. We also attempted to obtain data on the number of Medicare claims with DRG amounts above and below billed charges. However, the officials said that they had no analysis of this kind.

We discussed the matters contained in this fact sheet with officials in the Office of the Assistant Secretary of Defense (Health Affairs) and CHAMPUS. They agreed with the information presented. Our work was conducted from December 1989 to May 1990 in accordance with generally accepted government auditing standards.

CHAMPUS's DRG System Has Resulted in Substantial Savings

Overall, the CHAMPUS prospective payment system has brought substantial savings to both the government and beneficiaries. DRGs have resulted in nearly one-third of hospital claims being paid in amounts that exceeded the billed amount, but two-thirds being paid in amounts that were less than what hospitals billed. Taken as a whole, therefore, DRGs have reduced costs per admission.

**Appendix I
Hospital Reimbursements Under CHAMPUS's
Prospective Payment System**

**Overall Savings Are
Nearly \$200 Million**

For the claims we examined—nearly three-fourths of the expected fiscal year 1989 volume—the government and beneficiaries paid about \$202 million less in fiscal year 1989 for hospital care under DRGs than they would have paid under the previous billed-charge payment system. Savings to the government were \$169.2 million, and cost-share savings to retirees and dependents of retired and deceased members were about \$33 million.

For two-thirds of the claims, the DRG amount was less than hospital billed charges; for the remaining one-third, DRG amounts exceeded billed charges. Table I.1 shows the savings resulting from CHAMPUS's prospective payment system for the claims we reviewed—about 76 percent of the DRG claims CHAMPUS expected to receive for fiscal year 1989.

**Table I.1: Fiscal Year 1989 Savings From
the CHAMPUS Prospective Payment
System**

Dollars in millions				
Category	Number of claims	Billed allowed amount ^a	DRG amount	Savings or additional costs (-)
DRG payment less than billed	130,433	\$555.3	\$278.9	\$276.4
DRG payment more than billed	62,587	91.5	149.1	-57.6
Subtotal	193,020	\$646.8	\$428.0^b	218.8
Claims paid entirely by other health insurance	7,480			3.2
Payments for capital and direct medical education costs ^d				-20.1
Total claims and savings	200,500			\$201.9
Projected savings for 100 percent of FY 1989 claims				\$266.0

^aDisallowed items were subtracted from billed amounts to be comparable with the previous billed-charge payment system.

^bOf the \$428.0 million, \$340.4 million was paid by the government. The remainder was paid by a combination of other health insurance and beneficiary cost shares.

^cSavings for claims that CHAMPUS would have paid a portion of under billed-charge system but because other health insurance paid more than the DRG amount, CHAMPUS had no payment liability.

^dFiscal year 1989 costs that CHAMPUS paid directly to hospitals. (These costs are not included in the DRG rates.)

Taken as a whole, therefore, the CHAMPUS DRG system has lowered the CHAMPUS cost per admission. In fiscal year 1989, before the DRG system was implemented, CHAMPUS's cost per admission was \$3,056. In fiscal year 1989, the cost was \$1,961.

Other Analyses of DRGs

We analyzed four other matters related to CHAMPUS DRGs:

- whether the sum of all payments made under each DRG was more or less than the sum of billed charges for that DRG;
- whether claims payments involving other health insurance parallel the overall DRG results;
- how CHAMPUS DRG amounts compare with Medicare DRG amounts; and
- whether CHAMPUS accurately determined payments for a number of claims provided us by the Disabled American Veterans on behalf of CHAMPUS beneficiaries.

Some DRGs Exceeded Billed Charges Overall

In the 193,020 claims we reviewed for which CHAMPUS had a payment liability, 475 CHAMPUS DRGs had total payments that were less than hospital billed charges. Conversely, 22 DRGs had total payments that exceeded billed charges. The total payments exceeding billed charges for these 22 DRGs ranged from \$78 to \$2,173,010. Only three DRGs had total payments that exceeded billed charges by more than \$100,000. Even within each of these 22 DRGs, some specific payments were less than the billed amount, while in others the payments exceeded billed charges. Table I.2 shows examples of payments exceeding billed charges.

Table I.2: Examples of DRG Payments in Excess of Billed Charges

DRG number	Number of claims	Billed charges	DRG payments	Difference
468	3,076	\$13,681,462	\$15,854,472	\$2,173,010
431	163	951,293	1,166,829	215,536
426	640	1,977,863	2,112,056	134,193
187	4	8,401	8,479	78
345	8	13,052	13,802	750

CHAMPUS instructed its peer review organizations to examine 50 percent of the claims involving DRG 468, "unrelated operating room procedures," to determine whether hospitals were using it appropriately. From October 1988 through March 1990, the peer review organizations reported that of the 997 claims reviewed for this DRG, 439 (44 percent) had been incorrectly classified. As a result, CHAMPUS is making arrangements for a 100-percent examination of claims involving this DRG.

Claims Involving Other Health Insurance

When a beneficiary has other health insurance, CHAMPUS will pay the difference between the other insurer's payment and the DRG amount. In some cases, the other insurer may have paid the entire billed charge, but CHAMPUS will still pay an additional amount—up to the DRG amount.

For the 13,683 claims involving other insurance where CHAMPUS made a payment, 3,591 had DRG payments of less than billed charges, but 10,092 had DRG payments that resulted in the hospital receiving, in total, more than the billed charges. (There were an additional 7,480 claims for which CHAMPUS had no payment liability because other health insurance paid more than the DRG amount.)

Unlike cases in which no other insurance was involved, the majority of claims with CHAMPUS payment and other health insurance resulted in most hospitals receiving more money than the billed amounts. As a result, as shown in table I.3, total DRG payments for claims involving other insurance were nearly \$3 million more than the billed charges.

Table I.3: DRG Payments on Claims Involving Other Health Insurance

Dollars in millions					
Category	No. of claims	Billed amount	Billed allowed amount	DRG amount	Savings or additional costs (-)
DRG payment less than billed	3,591	\$16.9	\$16.2	\$10.3	\$5.9
DRG payment more than billed	10,092	24.4	20.7	32.6	-11.9
Subtotal	13,683	\$41.3	\$36.9	\$42.9	-6.0
Plus claims paid entirely by other health insurance (and DRG rate was less than billed)	7,480				3.2
Total claims and savings (additional costs)	21,163				\$-2.8

The above data do not include cases where no claim was filed because other health insurance paid an amount equal to or greater than the CHAMPUS DRG rate. CHAMPUS officials told us that hospital officials know the CHAMPUS DRG rates for an admission, and they know that if other health insurance pays an amount equal to or greater than the CHAMPUS DRG rate, CHAMPUS has no obligation to pay. In such cases, CHAMPUS officials said, hospitals generally do not send claims to CHAMPUS. Based on the percentage of beneficiaries who had other health insurance in fiscal year 1987, we estimate as many as 17,671 claims may not have been sent to CHAMPUS for this reason.

Under a regulation effective July 1, 1990, CHAMPUS will pay only an amount that, combined with the other health insurance payment, equals the hospital's billed charges or the DRG amount, whichever is less. The new regulation was made to conform with a change made by Medicare, upon which the CHAMPUS system is modeled. CHAMPUS's rationale for the change was similar to Medicare's: CHAMPUS is supplemental to other health insurance, and therefore, the CHAMPUS payment should not result in total payment that would be made in the absence of CHAMPUS coverage. If this change had been in effect for the fiscal year 1989 claims we reviewed, CHAMPUS would have saved approximately \$8 million.

CHAMPUS DRG Rates
Generally Lower Than
Medicare Rates

Our comparison of CHAMPUS DRG rates with Medicare rates for the Denver area showed that CHAMPUS rates were generally lower. Specifically, for nonteaching hospitals, 280 CHAMPUS DRG amounts were less and 186 were more than Medicare's. Also the average DRG cost for treating CHAMPUS beneficiaries in fiscal year 1989 for a large urban area was \$2,812, compared to the Medicare large urban rate of \$3,215. That CHAMPUS rates are lower than Medicare seems reasonable, given that CHAMPUS beneficiaries are younger and generally have less costly illnesses than Medicare beneficiaries.

Accuracy of Payments

We asked CHAMPUS officials to examine a number of claims that were provided to us by the Disabled American Veterans and others on behalf of beneficiaries. The claims, 16 in all, amounting to billed charges of \$116,171, and DRG payments of \$71,223, represented instances where the DRG payment was generally more than the billed amount. CHAMPUS officials examined the claims to determine whether the payments were accurate. They found minor errors in two claims totaling \$342.

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