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United States General Accounting Office
Washington, DC 20548

June 30, 2003

The Honorable Lane Evans
Ranking Democratic Member
Committee on Veterans' Affairs
House of Representatives

Subject: *VA Health Care: Contract Labor Cost Analysis in RAND Study*

Dear Mr. Evans:

The Department of Veterans Affairs (VA) spent about $23 billion to provide health care to over 4 million veterans in fiscal year 2002. To provide this care, VA relied primarily on its own employees, totaling about 190,000. VA also used contract employees, sometimes referred to as contract labor, to provide these services. In response to the requirements of the Federal Activities Inventory Reform Act of 1998 (the FAIR Act),[1] VA compiled an inventory of more than 180,000 full-time equivalent (FTE) positions that it determined to be "health care commercial" in nature. This means that the work carried out in these positions is also done in the private sector and could potentially be done by contract labor.

As part of its management initiatives, the Office of Management and Budget (OMB) has emphasized that competition should be used to determine the most effective and efficient way to provide commercial services. The process used to make this determination—referred to as competitive sourcing—is established in OMB Circular A-76. This process generally provides for competition between the government and the private sector on the basis of costs or costs and other factors. OMB has established competitive sourcing FTE targets for federal agencies to achieve as part of OMB's management initiatives. In response to OMB's FTE target for VA, VA established a plan to complete studies of competitive sourcing of 55,000 positions by 2008.

[1]Pub.L. No. 105-270, 112 Stat. 2382. The FAIR Act requires federal agencies to submit an annual inventory to the Office of Management and Budget of all their activities performed by federal employees that are not inherently governmental functions, that is, they are commercial in nature. OMB has defined a commercial activity as one that "is a recurring service that could be performed by the private sector and is resourced, performed, and controlled by the agency through performance by government personnel, a contract, or a fee-for-service agreement." OMB Circular A-76, p. A-3, May 29, 2003.

RAND addressed limited aspects of the use of VA contract labor in a report that examined another subject.[2] In that report, RAND found that increased use of contract labor appeared to decrease the overall costs at VA health care facilities. However, the report's finding differed from the interim finding that RAND briefed your staff on earlier. In that briefing, RAND stated that contracting for labor could result in higher, rather than lower, VA health care facility costs. Because of this difference in RAND's findings and your ongoing concerns about the impact of using contract labor at VA, you asked us to (1) determine what data RAND used in its contract labor analysis, (2) explain why RAND's final and interim findings differed regarding the effect of using contract labor on facility costs, and (3) assess whether RAND's report finding provides an adequate basis for making competitive sourcing decisions.

To perform our work, we reviewed the RAND study; interviewed officials in VA's Resource Allocation and Analysis Office, which managed the RAND contract; and interviewed authors of the RAND study. We also reviewed VA data analyzed by RAND on contract labor costs to verify data in its report and to determine how contract labor was defined. In addition, we relied on our prior work on VA competitive sourcing.[3] We conducted our work from March 2003 through June 2003 in accordance with generally accepted government auditing standards.

Results in Brief

RAND used contract labor data provided by VA from its financial accounting system. These data were for contract labor costs, such as for laundry and dry cleaning, for each VA health care facility in fiscal year 2000. According to VA officials, the costs in these accounts are predominately for contract labor costs. However, an undetermined proportion of these costs could also be for costs other than contract labor.

Data refinements that RAND made explain most of the difference between RAND's report finding and interim finding on the effect of contract labor on VA facility costs, according to the study authors. In its report, RAND found that increasing contract labor was associated with decreasing VA health care facility costs. In its interim finding, RAND reported the opposite, namely that contract labor was associated with higher, not lower, VA health care facility costs. RAND study authors told us that the difference between their interim finding and their report finding resulted from certain

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[2]RAND, *An Analysis of Potential Adjustments to the Veterans Equitable Resource Allocation (VERA) System* (Santa Monica: California, 2003). The purpose of the study was to evaluate ways to improve the health care allocation formula--the Veterans Equitable Resource Allocation system--that VA uses to allocate resources to its 21 health care networks. Networks in turn allocate resources to their health care facilities. In this work, RAND examined factors that were associated with increased costs at the facility level.

[3]See Related GAO Products.

data and analytical refinements that they made during the course of their research and data validation work after the briefing. The most important refinement was to exclude the costs of medical resident stipends and benefits from the contract labor analysis in the report. RAND excluded these costs for the report because they are not funded through the VA health care resource allocation system that RAND was examining.

RAND's finding on contract labor does not provide an adequate basis for making competitive sourcing decisions. First, RAND's purpose was not to address this issue but instead to evaluate ways to improve VA's health care resource allocation system, according to the RAND study authors. For example, RAND did not examine the effect of using contract labor for each contract service even though the association with facility costs may vary by type of service. Second, VA contract labor data have limitations that may affect their usefulness for analysis of the relationship between use of contract labor and facility health care costs. One of these is that the data may include some nonlabor costs. In addition, the small proportion of VA labor costs that are for contract labor and the small variation across VA in the use of contract labor limit the usefulness of these data for examining the relationship between contract labor and facility costs, according to the RAND study authors.

In commenting on a draft of this report VA and RAND agreed with our findings.

Rand Used Contract Labor Data from VA's Financial Accounting System

RAND used contract labor data provided by VA from its financial accounting system. These data were for contract labor costs for each VA facility in fiscal year 2000. In this system, VA has a number of budget accounts for contracted services such as laundry and dry cleaning and professional charges for contract hospital and outpatient treatment. (See table 1.) RAND used these budget accounts to determine contract costs for fiscal year 2000. According to VA officials, the costs are predominately for contract labor costs. However, an undetermined proportion of these costs could also be for costs other than contract labor.

Table 1: VA Budget Accounts for Contract Labor Used by RAND

Budget account	Name of account
2513	Automated Data Processing (ADP) Maintenance Support
2514	Systems Programming
2520	Repair of Furniture and Equipment
2530	Storage of Household Goods
2535	Interior Decorating Services
2540	Laundry and Dry Cleaning Services
2542	Operating Services (elevator inspection, garbage disposal, pest control)
2543	Maintenance and Repair (roads, utility systems)
2544	ADP Equipment and Computer Maintenance Contracts
2553	Miscellaneous Contractual Services for Indigent Veterans
2560	Medical Care Contracts and Agreements with Institutions
2561	Fee Medical and Nursing, on station
2562	Fee Medical and Nursing, off station
2569	Emergency Treatment of Veterans
2570	Fee Dental, off station
2571	Fee Dental, on station
2575	Other Contract Hospitalization (non-VA, non-Sharing)
2576	Consultants and Attendings
2579	Scarce Medical Specialist Contracts
2580	Non-Medical Contracts and Agreements with Institutions
2581	Non-Medical Contracts and Agreements with Individuals
2586	Sharing Medical Resources
2590	VA/Department of Defense (DOD) Sharing Agreements
2598	Contract Hospital and Outpatient Treatment (physician and professional charges)

Source: VA.

Data Refinements Explain Most of the Difference Between Rand Report and Interim Findings Regarding the Effect of Contract Labor on Costs

Data refinements that RAND made explain most of the difference between RAND's report and interim findings on the effect of contract labor on VA facility costs, according to the study authors. In its report, RAND's finding regarding contract labor was that an increased use of contract labor results in lower VA health care facility costs. This finding differs from RAND's interim finding that contract labor was associated with higher, not lower, VA facility costs.

RAND study authors told us that the difference between the interim briefing and report findings resulted from certain data and analytical refinements that RAND did after the briefing. The authors stated that the major data refinement was to eliminate the costs of medical resident stipends and benefits from the contract labor cost measure in RAND's final analysis because these costs are not funded through the VA health care resource allocation system that RAND was examining. In fiscal year 2002, VA expenditures for medical resident stipends and benefits were about $383 million. The RAND study authors also told us that they made additional data edits to improve accuracy for the report and that these edits may also have contributed to differences in RAND's contract labor finding. The study authors told us that a third factor also

contributed to the difference between RAND's interim and report finding on contract labor. The authors stated that they analyzed contract labor's impact in combination with various measures of patient and health care facility characteristics. The interim and report findings differed because RAND used different combinations of these measures in its analysis of contract labor.

Rand's Report Finding on Contract Labor Does Not Provide an Adequate Basis for Making Competitive Sourcing Decisions

RAND's report finding on contract labor does not provide an adequate basis for making competitive sourcing decisions for several reasons. First, the study's purpose was not to evaluate competitive sourcing but instead to evaluate ways to improve VA's health care resource allocation system, according to the RAND study authors.[4] These authors said RAND did not intend this finding on contract labor to be used to determine whether contracting with the private sector is a cost-effective alternative to using government employees. For example, RAND did not examine each contract labor account to determine if contract labor for that service, such as laundry and dry cleaning, resulted in higher or lower facility costs. This is important because the effect on facility costs of using contract labor may vary by type of service contracted. RAND did not examine the effect of each service but instead used the total dollar amount of all contract labor services at each facility in its analysis.

In addition, VA contract labor data have limitations that may affect their usefulness for analysis of the relationship between use of contract labor and facility health care costs. One limitation is that the data may include some nonlabor costs and VA does not know the extent to which nonlabor costs may be included in these accounts. Another limitation is the relatively small proportion of VA labor costs that are for contracting, 5.2 percent, and the small variation in contract labor use across VA. This limits the ability to examine the association of contract labor with facility health care costs. The RAND authors told us that, because of the relatively small amount of labor contracted in VA and the relatively small amount of variation, VA should not make policy decisions based solely on these data. The proportion of contract labor costs varied by network ranging from 3.2 percent in Network 3 (Bronx) to 9.2 percent in Network 5 (Baltimore) in fiscal year 2000. (See table 2.) In fiscal year 2000, the amount of labor contracted totaled $619 million.

[4]See RAND 2003 for details on its analysis, including its examination of contract labor.

Table 2: VA Contract Labor Costs, Fiscal Year 2000

Network[a] (location)	Contract labor costs	Proportion of labor costs contracted
1 (Boston)	$32,632,215	5.2%
2 (Albany)	13,091,491	4.1%
3 (Bronx)	23,567,097	3.2%
4 (Pittsburgh)	35,810,445	6.0%
5 (Baltimore)	36,056,219	9.2%
6 (Durham)	22,864,024	4.1%
7 (Atlanta)	32,618,472	5.1%
8 (Bay Pines)	29,936,565	3.5%
9 (Nashville)	18,862,213	3.5%
10 (Cincinnati)	34,084,148	7.6%
11 (Ann Arbor)	19,468,111	3.9%
12 (Chicago)	32,513,913	5.0%
13 (Minneapolis)	15,824,709	4.7%
14 (Lincoln)	10,903,448	5.1%
15 (Kansas City)	22,413,093	5.1%
16 (Jackson)	43,792,398	4.8%
17 (Dallas)	24,552,854	4.8%
18 (Phoenix)	20,737,333	4.8%
19 (Denver)	23,645,796	7.9%
20 (Portland)	29,245,793	5.8%
21 (San Francisco)	44,718,978	7.5%
22 (Long Beach)	51,513,721	7.3%
National total	**$618,853,035**	**5.2%**

Sources: VA and RAND.

Note: At our request, RAND calculated the network proportion of contract labor costs by aggregating totals from VA health care facilities to the network level and dividing total contract labor costs by total labor costs. By contrast, the network proportion of contract labor costs in RAND's report represented the average of each facility's cost in the network. As a result, the numbers in this table differ somewhat from the numbers in that report.

[a]VA had 22 health care networks in fiscal year 2000. It combined networks 13 and 14 in fiscal year 2002 and currently has 21 health care networks.

Agency and Other Comments

We provided a draft of this report to VA and to RAND for comment. In oral comments, an official in VA's Office of Congressional and Legislative Affairs informed us that VA agreed with our findings. The RAND study authors told us that RAND agreed with our findings and they provided technical comments that we incorporated as appropriate.

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We are sending copies of this report to the Secretary of Veterans Affairs and others who are interested. We will make copies available to others upon request. In addition, the report is available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staff have questions about this report, please contact me at (202) 512-7101 or James C. Musselwhite at (202) 512-7259. Thomas A. Walke and Daniel Montinez made key contributions to this report.

Sincerely yours,

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

Related GAO Products

Department of Veterans Affairs: Key Management Challenges in Health and Disability Programs. GAO-03-756T. Washington, D.C.: May 8, 2003.

Major Management Challenges and Program Risks: Department of Veterans Affairs. GAO-03-110. Washington, D.C.: January 2003.

VA Laundry Service: Consolidations and Competitive Sourcing Could Save Millions. GAO-01-61. Washington, D.C.: November 30, 2000.

Inadequate Oversight of Laundry Facility at the Department of Veterans Affairs, Albany, New York, Medical Facility. GAO-01-207R. Washington, D.C.: November 30, 2000.

VA Health Care: Expanding Food Service Initiatives Could Save Millions. GAO-01-64. Washington, D.C: November 30, 2000.

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