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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

MANPOWER AND WELFARE
DIVISION

March 22, 1974

Mr. James B. Cardwell
Commissioner of Social Security
Department of Health, Education,
and Welfare

Dear Mr. Cardwell·

The General Accounting Office has reviewed the methods used to reimburse the Southern California region of the Kaiser Foundation Health Plan, Inc under part B of the Medicare program. Kaiser is a Group Practice Prepayment Plan (GPPP) which has elected to deal directly with SSA

These direct dealing GPPPs are required to submit year-end cost reports showing the cost of services furnished to Medicare patients based on either "reasonable costs" or "reasonable charges " The Kaiser Health Plan elected the "reasonable charge" option and was therefore eligible to receive reimbursement for financial requirements in excess of allowable costs if such charges were equally shared by other non-Medicare GPPP members This additional payment was called the "equalization factor."

In February 1973, we provided SSA and the Kaiser Health Plan for their advance comments, copies of a draft report to the Secretary of HEW entitled "Impact of Organizational Relationships in Payments to Health Maintenance Organizations." After considering Kaiser's comments of March 16, 1973, and SSA's comments of May 7, 1973, we have decided not to issue the proposed report to the Secretary.

The purpose of this report is to advise you of certain payments to the Southern California region of the Kaiser Health Plan which appeared to us inconsistent with the SSA reimbursement instructions (GPPP Manual) for direct dealing GPPPs and which had not been questioned in prior HEW or subcontracted audits These questionable payments--which totaled about $35,000 of the $4.3 million in Medicare reimbursement to the Health Plan in calendar year 1970--have been discussed with SSA and Kaiser officials. Our findings and the related pertinent comments are summarized below.

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COST OF HOUSE CALL SERVICES

About 85 percent of the Medicare reimbursements to the Health Plan represented payments to the Southern California Permanente Medical Group--an independent partnership of physicians--which through a contractual relationship with the Health Plan provide professional services to Health Plan members

Included in the payments to the Medical Group were certain amounts for physicians making house calls to Health Plan members. We noted that for 1970 the Health Plan used a cost base of about $597,000 for computing Medicare's share of the costs for the house call benefit, and a cost base of about $301,000 for charging non-Medicare members The effect of this variance was to increase Medicare reimbursement by about $21,000

Kaiser officials advised us that the Medicare cost base represented budgeted estimates initially used to establish the basic payment to the Medical Group whereas the non-Medicare cost base essentially represented the actual charges to members for house call services The officials acknowledged, however, that the disparities between estimated and actual charges for the house call benefit made the Medicare cost computation invalid and refunded $70,695 to SSA for the cost reporting periods from July 1, 1966, through December 30, 1970 In addition, the Health Plan reduced costs claimed for 1971--but not yet allowed by SSA--by $22,415 as a result of its recalculations of the Medicare cost basis for house call services

COST OF SERVICES TO NON-MEMBERS

According to section 314 of SSA's GPPP Manual, GPPPs are required to reduce their total costs by such income as is realized from fees charged for rendering medical services to nonplan members--or by the cost of rendering such services, if such costs are determinable. The Manual further provided that services furnished to Medicare non-members on a fee basis are to be reimbursed on a reasonable charge basis by the applicable area carrier

Under the contract between the Health Plan and the Medical Group, the basic payment to the Medical Group was to be reduced by non-member revenues received, but the Medical Group was to be paid 22 percent of such net non-member revenue realized in excess of $500,000 For 1970, this payment for services to non-members was about $114,000 and because it was not excluded in calculating Medicare reimbursement had the effect of increasing Medicare payments to the Health Plan by about $8,000.

Health Plan officials advised us that it has been the practice in the Southern California region to pay the Medical Group an additional amount related to the care of non-member patients in recognition of the additional costs incurred and as an incentive for the Medical Group to identify and collect all of the revenues to which the Health Plan was entitled. Health Plan officials advised us that the Plan was conforming to SSA instructions by considering this additional payment the same as any other contract payment to the Medical Group which is reimbursable by Medicare.

In our view, the SSA instructions provide that the revenues (or if determinable, the cost) for treating non-members are to be excluded from a GPPP's reimbursable costs and any arrangement by which a GPPP distributes or otherwise disposes of such non-member revenue should not serve to defeat the purpose of such instructions.

SSA officials advised us that they would instruct their auditors to look into this matter to determine the Health Plan's compliance with the SSA instructions

APPLICATION OF "TIME FACTOR" TO HEALTH PLAN ADMINISTRATIVE COSTS

Generally, GPPP costs are allocated between Medicare and non-Medicare members on the basis of the number of services provided. However, because aged patients require more physicians' time for a particular service than younger patients, SSA instructions permit GPPPs to increase the actual number of services provided to Medicare patients by a "time factor" of 20 percent or of a percentage based on actual experience The Kaiser Health Plan has been using the standard 20 percent rate.

Section 306 4 of the GPPP Manual states, however, that the time factor will not be allowed in allocating indirect administrative costs. Indirect administrative costs--as distinguished from direct administrative costs closely associated with physician services--are defined as those costs not directly associated with providing medical care such as salaries of officers, executives and general office personnel, travel, legal and auditing fees, and telephone and telegraph expenses.

We noted that the time factor was used in allocating to Medicare virtually all the payments to the Medical Group even though the payment included such administrative costs as data processing and accounting service costs and executive and administrative salaries. In addition, in 1970 the Health Plan included $629,000 of its own regional office administrative expenses in the costs allocated to Medicare based on the 20 percent time factor. The use of the time factor in allocating the Health Plan regional office administrative costs increased the Medicare reimbursement in 1970 by about $6,000.

According to Health Plan officials, the regional office administrative costs which were allocated to Medicare using the time factor represented the costs of services the office performed which directly contributed to the delivery of physicians' services On the other hand, Health Plan officials have also asserted that the Health Plan is independent of the Medical Group, that their relationship is primarily contractual, and that they are not organizations which are related by ownership or control.

In our opinion, the SSA instructions have attempted to distinguish between those administrative costs which could be directly related to providing medical care such as clinical supplies and maintenance of the clinics and those costs where such a direct relationship to physicians' services is not readily apparent. In view of the asserted distinct and independent relationship between the Health Plan and the Medical Group, it seems to us that the Health Plan's regional office costs which included such functions as overall management, consumer and governmental relations, financial planning, and legal affairs should be allocated to the Medicare program as an indirect administrative cost and not subject to the time factor

SSA officials advised us that they would instruct their auditors to look into this matter further.

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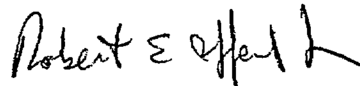
We would appreciate your advice on the action taken or planned with respect to the matters discussed in this report. Copies of this report are being furnished to the Assistant Secretary, Comptroller, and the Director of the HEW Audit Agency.

Sincerely yours,



Robert E. Iffert, Jr.
Assistant Director