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RELEASED 4/20/78

Use of Grant Funds by the Sacramento Foundation. HRD-78-62;
B-164031(3). March 6, 1978. 7 pp.

Report to Sen. Henry M. Jackson, Chairman, Senate Committee on
Governmental Affairs: Permanent Subcommittee on Investigations;
by Elmer B. Staats, Comptroller General.

Issue Area: Health Programs: Compliance With Financing Laws and
Regulations (1207); Health Programs: Reimbursement Policies
and Utilization Controls (1208).

Contact: Human Resources Div.

Budget Function: Health: General Health Financing Assistance
(555).

Organization Concerned: Department of Health, Education, and
Welfare.

Congressional Relevance: Senate Committee on Governmental
Affairs: Permanent Subcommittee on Investigations. Sen.
Henry M. Jackson.

Authority: Social Security Amendments of 1972 (P.L. 94-182).
P.L. 94-549.

The Foundation Community Health Plan of the Medical
Care Foundation of Sacramento was reviewed to determine: (1) if
the Federal Government had recovered Medicaid funds paid to the
Foundation as recommended in previous reports; and (2) if the
State of California should refund Federal Government grant funds
paid to the Foundation as part of a rate-setting demonstration
study. As of December 1977, HEW had not attempted to recoup
funds from California based on 1975 recommendations on fiscal
years 1973 and 1974 Foundation activities. HEW had not recovered
the Federal share of the \$1.6 million in per capita rates, and
the issue remained unresolved. The State failed to justify
paying rates to the Foundation exceeding those that would
normally have been paid to a prepaid health plan. The law is not
specific on how extensively the Foundation had to participate in
the rate-setting study; HEW's grant to the State only required
the Foundation to provide data to the State. Because the
Foundation provided the data, there are no grounds on which to
demand repayment from California for its payment of
demonstration grant funds to the Foundation. (RBS)



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

RELEASED
4/16/78

MAR 6 1978

B-164031(3)

The Honorable Henry M. Jackson
Chairman, Permanent Subcommittee on
Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This letter responds to your request for information relating to the Foundation Community Health Plan of the Medical Care Foundation of Sacramento (Foundation). Specifically, we were asked to determine

- if the Federal Government has recovered Medicaid funds paid to the Foundation as recommended in our previous reports and
- if the State of California should refund Federal Government grant funds paid to the Foundation as part of a prepaid health plan rate-setting demonstration study.

We made our review at the Department of Health, Education, and Welfare (HEW), HEW's San Francisco Regional Office, the California Department of Health, and the Foundation. We reviewed program records and interviewed HEW, State, and Foundation officials.

As requested by your office, we did not obtain written comments on this report. However, we discussed our observations with HEW, State, and Foundation officials.

HEW HAS NOT RECOVERED FUNDS
AS WE RECOMMENDED

We have issued two reports dealing, in part, with the Foundation:

"Better Controls Needed for Health Maintenance Organizations Under Medicaid in California,"
B-164031(3), September 10, 1974, and

HRD-78-62
(106122)

"Deficiencies in Determining Payments to Prepaid Health Plans Under California's Medicaid Program," MWD-76-15, August 2, 1975.

Our 1974 report evaluated California's use of prepaid health plans. The report contained many findings and recommendations relating to various aspects of the prepaid plan program, including weak procedures for determining reimbursements to prepaid plans. The report noted that the Foundation was paid per capita rates which exceeded those normally paid to a prepaid plan.

In our 1975 report we explained in more detail the deficiencies in California's prepaid health plan rate-setting mechanism and also discussed the rates paid to the Foundation. We reported that California had negotiated monthly per capita rates with the Foundation for fiscal years 1973 and 1974 which exceeded actual per capita fee-for-service costs in the same counties by \$4.3 million. Both Federal and State regulations prohibit paying prepaid plans more than the same services would cost under the fee-for-service system.

According to the State, the Foundation was paid rates exceeding fee-for-service costs because it had suffered adverse selection. That is, Medicaid recipients, who had chosen to enroll in the Foundation's Plan, were sicker, and thus more costly to care for, than Medicaid recipients who remained in the fee-for-service system. If this contention had been true, paying the Foundation at higher rates would have been appropriate under both Federal and State regulations. However, when we examined the data the State used to determine adverse selection, we concluded that the data did not justify that conclusion. Therefore, we recommended that HEW recoup from California the Federal share of excessive payments to the Foundation.

State and Foundation officials agreed that the higher rates had not been justified. However, Foundation officials believed their data did indicate that adverse selection had occurred. They said that an additional actuarial study, including State data on the fee-for-service system, was needed to prove that adverse selection had taken place.

As of December 1977, HEW had not attempted to recoup funds from California based on our 1975 recommendation on fiscal year 1973 and 1974 Foundation activities. However, HEW did inform the State that it was going to recoup the Federal share of overpayments to the Foundation as reported by the California Auditor General. The Auditor General had reported in June 1975 that the State had paid the Foundation capitation rates exceeding the per capita average fee-for-service cost upper limit without the actuarial support required by State law. The Auditor General estimated that during calendar year 1974, the Foundation had received excessive payments of \$1.6 million. As of December 1977, HEW had not recovered the Federal share of the \$1.6 million, and the issue was still unresolved.

CALIFORNIA'S PREPAID HEALTH PLAN
DEMONSTRATION PROJECT

In February 1976, HEW awarded a demonstration project grant to California to develop a rate-setting methodology for prepaid health plans and a model quality assessment and cost control system for use by State Medicaid agencies. A purpose of the grant was to determine if the Foundation had suffered adverse selection. HEW said that this grant would fulfill the intent of many of the recommendations in our 1974 and 1975 reports on California's prepaid health plan program. Background on the Foundation's involvement in this grant follows.

During negotiations for a prepaid plan contract for July 1975 to June 1976, the Foundation told the State it would need a monthly per capita rate of \$30.31 for Medicaid recipients in the Aid to Families with Dependent Children (AFDC) category. The State countered that, because of the State and Federal fee-for-service upper limit on prepaid plan payments, it could pay the Foundation no more than \$25.62 per AFDC recipient. The Foundation asserted that it had no intention of contracting with the State at rates below those computed by its actuary and would cease doing business with the State if it could not obtain a satisfactory rate.

Since the State would not pay the Foundation at rates exceeding the fee-for-service upper limit, a contract was negotiated which provided for State payments of \$25.62 to

the Foundation for AFDC eligibles plus a provision for Federal payment for an additional \$4.69, contingent on the award of a grant by HEW to the State. Failure of the Federal Government to award the grant to the State for payment of the supplemental capitation rates and development of a rate-setting methodology would result in cancellation of the State's contract with the Foundation. Payments under the additional capitation rate provision were to be applied retroactively to July 1, 1975, and were to continue until June 30, 1976, when the State's rate of \$25.62 could be adjusted to reflect the capitation rate which would result from the rate-setting study segment of the grant.

The State anticipated that the HEW grant would be awarded under authority of section 222 of the Social Security amendments of 1972 (Public Law 92-603) which provide for Medicaid demonstration grants. However, section 222 did not permit HEW to include, as part of the grant, funds for retroactive payments.

On December 31, 1975, an amendment to section 222 became law (section 107 of Public Law 94-182) and allowed retroactive payments under section 222 if certain requirements were met. Senate Report 94-549, in explaining the amendment, states that it

"would remove a technical barrier to the Secretary's approval of a grant to the Sacramento Medical Care Foundation which is aimed at obtaining data to assist [HEW] in developing appropriate reimbursement mechanisms for health maintenance organizations."

On February 9, 1976, HEW approved a \$5.2 million grant to California. The grant had four major objectives, including developing an actuarially sound rate-setting mechanism for prepaid health plans. The grant period runs until November 1979, and as of January 23, 1978, \$3.4 million of the grant had been paid to the State.

Of the \$3.4 million given the State, \$1,107,426.25 was paid to the Foundation on April 16, 1976, and represented retroactive capitation payments above the State capitation rate. Additional payments to the Foundation, totaling \$180,776.05, were made for May and June 1976. From July 1975 to June 1976, capitation payments from grant funds totaled about \$1.3 million. Effective July 1, 1976, the

Foundation canceled its contract with the State because the maximum (\$28.48) the State was willing to pay the Foundation for the year beginning July 1, 1976, was \$9.33 per eligible person a month less than the Foundation would accept (\$37.81). Under the grant provisions, grant funds could not be used for extra capitation payments after June 30, 1976.

RESULTS OF THE FOUNDATION'S PORTION
OF DEMONSTRATION GRANT

On July 27, 1977, the State submitted to HEW a study of alleged adverse selection in the Medicaid population covered by the Foundation.

The State concluded that payments to the Foundation for Medicaid eligibles during 1974 were not higher than Medicaid costs would have been under the fee-for-service system. This conclusion was based on the fact that the Foundation experienced higher use of some types of services than their use under the fee-for-service system. Therefore, the State determined that it did not have to repay the Federal share of per capita payments to the Foundation which exceeded average per capita fee-for-service costs.

We have analyzed the State's study and, in our opinion, the report does not substantiate a determination that the Foundation suffered adverse selection. We believe that the methodology used by the State could not reasonably support such a conclusion. Greater use of medical services does not necessarily imply greater need for such services because use is affected, in part, by the utilization control and reimbursement practices of the payer. It is not surprising that, when the State works backward from actual cost and utilization data, it finds support for the adverse selection theory because the whole premise of its study becomes self-fulfilling. The State assumed that Foundation utilization controls were as effective as those for the fee-for-service program, and therefore, the Foundation was no more susceptible to overuse than was the fee-for-service program. However, utilization differences can be due to subtle differences in utilization control and the reimbursement methods for health practitioners.

We also noted several other problems in the study:

- The study results are sensitive to the correlation of the paid claims and number of eligibles data, and the study admits to flaws in this data.
- For hospital use, the primary unit studied should have been total days of hospitalization rather than number of admissions.
- The analysis of utilization by age and sex should have been presented in the report. A preliminary report on the study which was provided to us stated that adverse selection could not be supported by age and sex analysis.

As previously discussed, our 1975 report pointed out that the State's 1973 study justifying higher payments because the Foundation had experienced adverse selection could not be substantiated. In view of the State's failure to justify payment rates higher than those customarily used for prepaid plans, we recommended that HEW recoup Federal sharing payments to the Foundation which exceed the limit established by Federal regulations.

In our view, when a State deviates from its established procedures and negotiates higher per capita rates for one plan than those that would customarily be used for other plans, the burden for justifying the higher rates rests with the State. In our opinion, California's July 1977 study fails this test.

As of February 1, 1978, HEW had not formally evaluated the State's report or taken a position on it.

CALIFORNIA'S PAYMENT OF GRANT FUNDS TO THE FOUNDATION

The law allowing retroactive demonstration grant payments to the Foundation requires that such payments only be made in connection with a rate-setting methodology study but does not define the extent of participation in the study necessary to qualify for the funds.

HEW's grant to the State only requires the Foundation to give data to the State for the rate-setting study to qualify for the extra Federal capitation payments. Also, the State's contract with the Foundation contains only one

requirement relating to the rate-setting study--that the Foundation give data to the State. The Foundation did provide the required data to the State. Therefore, the Foundation met the conditions of the grant and thereby met the conditions of the law.

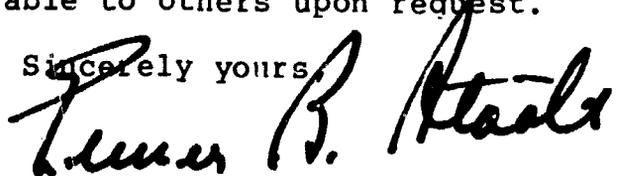
CONCLUSION

The State has, in our opinion, failed to justify paying rates to the Foundation exceeding those that would normally have been paid to a prepaid health plan. We believe the burden of justification rests with the State when it decides to deviate from regular procedures and regulations, and the State has failed to meet this burden. Accordingly, we believe HEW should implement our prior recommendation and recoup the Federal share of all excess payments made to the Foundation through fiscal year 1975.

The law is not specific on how extensively the Foundation had to participate in the rate-setting study, and HEW's grant to the State and the State's contract with the Foundation only required the Foundation to give data to the State. Because the Foundation did give data to the State, we see no grounds on which to demand repayment from California for its payment of demonstration grant funds to the Foundation.

We trust this information satisfactorily answers your request. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James B. Stacks".

Comptroller General
of the United States