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**STUDY BY THE STAFF
OF THE
U.S. GENERAL ACCOUNTING OFFICE**

Relationships Between
Nonprofit Prepaid Health
Plans With California
Medicaid Contracts And
For Profit Entities
Affiliated with Them



This study outlines the relationship between nonprofit, prepaid health plans and for profit entities affiliated with them. Affiliated entities are those connected with the plan by common directors, officers, and/or owners. The study also outlines the flow of funds from the prepaid plans to the affiliated entities under contractual agreements.

HRD-77-4

NOV. 1, 1976

PREFACE


This staff study was prepared in response to a request of June 1, 1976, from the Acting Chairman, Permanent Subcommittee on Investigations, Senate Committee on Government Operations, for information on the corporate structures of certain prepaid health plans (PHPs) with contracts to provide medical services to Medicaid recipients in California. Specifically, the request asked for

- the names of the officers and directors of five listed PHPs;
- the names of the officers, directors, and shareholders (if possible) of the firms which subcontracted with these PHPs; and
- the percentage of these PHPs' gross receipts which flow to each subcontractor.

We prepared charts, included in the body of this staff study, which provide this information. (See chs. 2 through 6.)

The information on the PHPs and their subcontractors was obtained primarily from documents given to us by these entities. The documents included contracts, subcontracts, financial reports, and accounting records. We did not attempt to verify the information contained in these documents. Some of the financial data had been audited by independent accounting firms. The financial data that had been audited is identified in either the charts or the accompanying written material. The Chairman also asked us to determine the extent to which the California Department of Health (the State's Medicaid Agency) and the Department of Health, Education, and Welfare (HEW) had enforced their regulations regarding approval of PHP subcontracts. This information is provided in chapter 7.

As requested by the Chairman's office, we did not obtain comments on the information included in this staff study from HEW, the California Department of Health, or the five PHPs.


Gregory J. Ahart
Director
Human Resources Division

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ABBREVIATIONS

AFDC aid to families with dependent children
AHCP American Health Care Plan, Inc.
CMS Consolidated Medical Systems, Ltd.
CPI consumer price index
FHP Family Health Program, Inc.
HEW Department of Health, Education, and Welfare
HHS Harbor Health Services
HMO Health Maintenance Organization
OHC Omni-Rx Health Care, Inc.
PHP prepaid health plan

CHAPTER 1

INTRODUCTION

In 1967 the California State Legislature authorized the California Department of Health (the State agency) to undertake pilot projects to explore the feasibility of different methods of providing health care services and to determine the most efficient manner of providing such services. From 1968 through 1971, the State agency awarded several contracts for these projects to determine whether prepayment plans with medical group practices could provide efficient and economical health care services under Medicaid. The State's preliminary evaluations of these projects indicated that such an approach was feasible and that significant cost savings could be achieved. The State Legislature then authorized the use of prepaid health plans (PHPs) by the Medicaid program.

STATE LAWS RELATING TO PREPAID HEALTH PLANS

The Medi-Cal Reform Act, passed by California in 1971, provided for contracting with groups of medical providers to supply services on a prepaid basis to Medicaid recipients. The law stipulated that PHPs would provide or arrange for health care services for persons who voluntarily enroll and are eligible for California's public assistance programs. In turn, the State pays PHPs a fixed monthly premium per enrollee for providing health care services.

The California Legislature consolidated all prepaid health-related statutes into a new chapter of the State's Welfare and Institutions Code by enacting the Waxman-Duffy Prepaid Health Plan Act, effective July 1, 1973. The Waxman-Duffy Act defined a PHP as:

"* * * any carrier or association of providers of medical and health services who agree with the [California] Department of Health to furnish directly or indirectly health services to [Medicaid] beneficiaries on a predetermined periodic rate basis."

Carriers, as defined by the act, include private insurance companies, medical societies, associations of insurers, nonprofit hospital service plans, county hospital systems, and profit or nonprofit persons or organizations.

The Waxman-Duffy Act specified that a PHP must provide, as a minimum, the following health care benefits

- physician services,
- hospital inpatient and outpatient services,
- laboratory and X-ray services,
- prescription drugs, and
- skilled nursing home care.

The legislature's intent in creating PHPs, as defined in the Waxman-Duffy Act, was to

- encourage the development of more efficient delivery of health care to Medicaid recipients,
- reduce the inflationary costs of health care,
- improve the quality of medical services to eligible enrollees, and
- reduce the administrative costs of operating Medicaid.

PHPs, in order to operate in California, must also meet the requirements of the State Knox-Mills Health Plan Act, enacted in 1970, which covers all entities providing prepaid health care to residents of California. This act established tangible net equity requirements for organizations operating as PHPs which ranged from \$10,000 for plans serving 2,500 or fewer families to \$30,000 for those serving over 5,500 families. Additional reserves were required if PHPs provided more than 10 percent of their services on a fee-for-service basis with noncontracting providers. The Knox-Mills Act prohibited PHPs from expending an excessive amount of their premium revenue for administrative costs.

In 1974, the California Legislature amended the Knox-Mills Act to impose additional requirements and prohibitions on PHPs. The amendments increased the tangible net equity requirement for plans serving more than 10,000 families. Plans serving from 10,001 to 20,000 families must have \$40,000 in tangible net equity. This requirement increases on a sliding scale to \$370,000 for plans serving more than 500,000 families. The act also provided the State Attorney General with access to the books and records of PHPs and any maintained for them by management firms.

In 1975, the California Legislature amended the State's Welfare and Institutions Code, which governs the Medicaid program, to place additional requirements on the PHP program. These amendments provided that:

1. Each PHP subcontract must require the subcontractor to make all of its books and records relating to the subcontract available to the State agency.
2. PHP subcontracts are public records as well as the names of the subcontractors' officers and stockholders.
3. Financial reports which the PHPs are required to file with the State agency are public records.

STATE MEDICAID PHP CONTRACT PROVISIONS
RELATING TO SUBCONTRACTING

The State's Medicaid PHP contracts require PHPs to submit to the State agency for prior approval all subcontracts for health care, management, marketing, or support services. Subcontracts with associated companies 1/ must provide the

1/An associated company is defined in the PHP contracts as:

"* * *a company or person that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, the PHP."

Control is defined as:

"* * *the possession, directly or indirectly, of the power to direct or cause the direction of the management of the policies of a PHP, whether such power is exercised through one or more intermediary companies, alone, in conjunction with, or pursuant to an agreement, and whether such power is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, contract, or any other direct or indirect means."

As used in this study, the term "affiliated firms" is analogous to associated companies.

State with access to the books and records of the subcontractor relating to the subcontract and require the subcontractor to provide, when requested, financial reports relevant to the disposition of funds paid to the subcontractor. The PHP contracts also require that the PHP have an annual audit performed by an independent certified accounting firm and that the audit report fully disclose the organizational relationship(s) between the PHP and the associated company(ies) contracting with the PHP as well as an analysis of payments to each associated company by type of service rendered.

HEW REGULATIONS RELATING TO PHPS

HEW regulations in effect prior to August 1975 provided little guidance on contracting with PHFs. These regulations required that (1) the State specify the amount of the premium, the services covered, and the term of the contract, (2) the premium payment fully discharged the State from responsibility for the costs of the covered services, (3) the premium amount and/or covered services be periodically renegotiated, and (4) the State require the PHP to maintain and provide such records and reports necessary for the State to meet Federal reporting requirements. The State, in order to obtain Federal sharing, had to pay PHP premiums which did not exceed the cost of providing the same services under the fee-for-service system. Prior approval by HEW of PHP contracts was not required.

These regulations were revised, effective August 9, 1975, to place a number of new requirements on States that contract with PHFs. These new requirements included such things as control over PHP enrollment and disenrollment practices, that services be available on a 24-hour, 7-day-a-week emergency basis, internal grievance procedures, and a medical record-keeping system. The regulations also expanded the access to records requirements by stipulating that the State and HEW have the right to inspect and evaluate the quality, appropriateness, and timeliness of services provided and audit and inspect any books and records of the PHP which relate to the contract. The State also had to provide HEW with the actuarial basis for the premium determination and HEW required prior approval of contracts with expected values over \$100,000.

PRIOR GAO REPORTS OF CALIFORNIA'S MEDICAID PHP PROGRAM

GAO issued two reports to the Chairman, Committee on Finance, United States Senate, on California's Medicaid PHP program. The reports were:

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

--Deficiencies in Determining Payments to Prepaid Health Plans Under California's Medicaid Program, MWD-76-15, August 29, 1975.

These reports contained a number of recommendations designed to improve the use of PHPs under Medicaid.

SCOPE OF STUDY

As requested, we studied the following five PHPs:

- Consolidated Medical Systems, Ltd. (CMS);
- Harbor Health Services (HHS);
- Omni-Rx Health Care, Inc. (OHC);
- Family Health Program, Inc. (FHP); and
- American Health Care Plan, Inc. (AHCP).

We examined the contracts between the State and the PHPs and documents relating to the PHPs' subcontracts. Documents provided to us by the PHPs and/or the subcontractors included such material as the subcontracts, financial reports and accounting records of the PHPs and their subcontractors, and articles of incorporation and partnership agreements of the PHPs and their subcontractors. We did not attempt to verify the information provided by the PHPs and their subcontractors.

We also reviewed applicable HEW regulations, State laws and regulations, and interviewed officials of HEW, the State agency, and the five PHPs.

CHAPTER 2

CONSOLIDATED MEDICAL SYSTEMS, LTD.

Consolidated Medical Systems, Ltd. (CMS) is a nonprofit, tax exempt PHP which receives about 93 percent of its revenues from the State to provide services to Medicaid recipients. CMS contracts with affiliated firms for virtually all the services required by its Medicaid contract.

HMO International is the for profit firm under whose umbrella CMS and its affiliated contractors operate. HMO International, in a letter to us dated July 16, 1976, stated:

"In 1971 the State of California Department of Health (then the Department of Health Care Services) began accepting applications for contracts to provide [Medicaid] benefits on a prepaid basis, and HMOI [HMO International] inquired of the Department whether HMOI, a for-profit lay corporation, could be considered for such a contract. The Department indicated that it preferred to contract with a nonprofit corporation under the prepaid [Medicaid] program, and this preference was so strong that HMOI abandoned its efforts to apply for such a contract itself. Instead, HMOI sponsored the incorporation of CMS, Ltd. HMOI's directors were the incorporators and first members and directors of CMS, Ltd. HMOI's senior officers became the officers of CMS, Ltd. HMOI paid the legal, accounting and incorporation filing fees to incorporate CMS, Ltd. HMOI loaned CMS, Ltd. \$30,000 evidenced by CMS, Ltd.'s subordinated promissory note bearing 6% interest in order to permit CMS, Ltd. to meet legal tangible net equity requirements under the California statute then governing prepaid health care contractors. HMOI paid other expenses of CMS, Ltd. without reimbursement. After CMS, Ltd.'s organization, capitalization and registration under the [Knox-Mills] statute, HMOI prepared CMS, Ltd.'s application for a prepaid [Medicaid] contract which was subsequently accepted."

CMS is affiliated with several organizations which, because of common management, common ownership, and mutual operational dependence, operate under the umbrella of a "health maintenance organization." The following legal

entities are included in the "health maintenance organization": (1) CMS; (2) HMO International and subsidiaries; (3) California Medical Group Health Plan Inc., a professional medical corporation; and (4) California Medical Group, a professional medical partnership. There is no parent-subsidiary relationship among the four entities. The entities, however, are considered affiliates because of common ownership and/or common management. CMS and its affiliates are mutually dependent upon each other for their operations. To enable the various organizations to maintain separate identities, there are various written and oral contracts between the entities. Three individuals owning 97 percent of California Medical Group and 97 percent of California Medical Group Health Plan also own approximately 30 percent of HMO International and are represented on the board of directors of other entities including CMS.

In April 1976, HMO International entered into an agreement, subject to approval of its shareholders, under which it would buy the California Medical Group from its four partners and the California Medical Group Health Plan from its four owners (the same individuals). The contemplated end result of the reorganization would be that the for profit California Medical Group Health Plan would be the organization which would, as a subsidiary of HMO International, contract with the State. CMS and the California Medical Group would be dissolved and their functions assumed by California Medical Group Health Plan.

CHART I--CMS's CORPORATE INTERRELATIONSHIP WITH
AFFILIATES AND SUBSIDIARIES, INCLUDING BOARD OF
DIRECTORS AND PRINCIPAL OFFICERS

All of the firms shown on Chart I are affiliated because of common directors, officers, and/or owners. HMO International is the principal entity with control over the other firms. CMS is contractually tied to the other firms except in the following four cases:

--Health Incorporated has no direct ties to CMS but is a corporate shell which was to be used by HMO International for qualification as an HMO under the Health Maintenance Organization Act of 1973 (P.L. 93-222).

--Coastal Insurance Company no longer has contractual ties with CMS and is under conservatorship. At one time, this firm provided insurance to CMS' medical providers.

--Metromed Health Plan, Inc. has no contractual ties with CMS. It is a nonprofit firm organized in New York to provide prepaid health care. It was organized by one of the founders of CMS and HMO International and recently received a \$1 million grant from HEW under the HMO Act. Under the planned reorganization of HMO International (discussed on p. 7), Metromed would no longer be an affiliated firm.

--HMO Systems has no contractual ties with CMS. It is a wholly owned subsidiary of HMO International which was to be used to qualify under the HMO Act.

**CORPORATE INTERI
INCLUDING BOARD O**

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ANGUS A SCOT
RICHARD H KE
DAVID M MOLL
RICHARD H KE
DAVID M MOLL
ANGUS A SCOT
RICHARD H KE

HEALTH INCORPORATED, STATE OF CALIFORNIA
NOT FOR PROFIT
DIRECTORS
ANGUS A SCOTT
JERRY D WHITACRE
OFFICERS
ELLIOT R WOLFF, GENERAL COUNSEL AND SECRETARY
ROBERT BUNKER, TREASURER

DIRECT
NORMAN L J
RICHARD H I
DONALD K K
BORIS B LEV
ANGUS A SCI
OFFICE
ANGUS A SCI
JERRY WHIT
ELLIOT R W
STUART E K
MARY ANN W
CONNIE ZAST
WALTER S L
ANTHONY AF
STAN ARONO
RICHARD SIM
ROBERT SUN

CALIFORNIA MEDICAL GROUP HEALTH PLAN, INC. (CMGHP)
AN INDEPENDENTLY OWNED CORPORATION
DIRECTORS
DONALD K KELLY, MD 32 1/3%
BORIS B LEVIN MD 32 1/3%
DAVID M MOLL, MD 32 1/3%
OFFICERS
DAVID M MOLL MD (SEE ABOVE)
BORIS B LEVIN MD (SEE ABOVE)
MARY ANN WICKES 0
ALBERTO HIDALGO, MD 3%

OFFIC
DONALD K
KENNETH W
SULANNE D
OPER
RE

AFFILIATE OF HMO INTL

COASTAL INSURANCE COMPANY (CIC)
WHOLLY OWNED SUBSIDIARY OF HMO INTL
(INACTIVE UNDER CONSERVATORSHIP)
DIRECTORS
STUART E KAISER JR
ANGUS A SCOTT
JERRY WHITACRE
OFFICERS
ANGUS A SCOTT PRESIDENT
STUART E KAISER JR VICE PRESIDENT
ELLIOT R WOLFF SECRETARY
ROBERT BUNKER TREASURER

AFFILIATE OF HMO INTL

PHARMACEUTIX INC. (PC)
WHOLLY OWNED SUBSIDIARY OF HMO INTL
DIRECTORS
STUART E KAISER JR
ANGUS A SCOTT
JERRY WHITACRE
OFFICERS
JERRY WHITACRE PRESIDENT
ELLIOT R WOLFF SECRETARY
ANGUS A SCOTT VICE PRESIDENT
ROBERT BUNKER TREASURER

1
M
S
A
J
A
E
P

**WITH AFFILIATES AND SUBSIDIARIES
PRINCIPAL OFFICERS AND OWNERSHIP**

ICAL SYSTEMS LTD (CMS LTD)	
NUMBER OF DIRECTORS	70 021
NUMBER OF SHARES OWNED (HMO INTERNATIONAL)	
MEMBERS	
OFFICERS	
VEP	
ICER	

ATIONAL (HMOI)	
PROFIT	NUMBER OF SHARES OWNED (OUTSTANDING SHARES - 1,085,052)
	124 743
	133,142
	250
IT	3,500

HEALTH PLAN INC.	
MARK-NOT FOR PROFIT	NUMBER OF SHARES OWNED (HMO INTERNATIONAL)
TREASURER	200
DRM HSM 550-11	
FROM DHEW	

CALIFORNIA MEDICAL GROUP (CMG)	
A PARTNERSHIP	
PARTNERS	PERCENTAGE OWNERSHIP
ALBERTO HIDALGO MD	3%
DONALD K KELLY MD	32 1/3%
BORIS B LEVIN MD	32 1/3%
DAVID M MOLL, MD	32 1/3%

OF HMO INTL	
NT CORPORATION (MMC)	
OF HMO INTL	
PRESIDENT	
SECRETARY	
TREASURER	

AFFILIATE OF HMO INTL	
HMO SYSTEMS INC.	
WHOLLY OWNED SUBSIDIARY OF HMO INTL INAC, IVE CORPORATION INTENDS TO QUALIFY UNDER P L 93-272	
DIRECTORS	
STUART E KAISER JR	
DAVID M MOLL MD	
ANGUS A SCOTT	
OFFICERS	
ANGUS A SCOTT	PRESIDENT
ANTHONY A ARMINIO	VICE-PRESIDENT
STUART E KAISER JR	VICE-PRESIDENT
DAVID M MOLL MD	MEDICAL DIRECTOR
ELLIOT H WOLFF	SECRETARY
ROBERT BUNKER	TREASURER

AFFILIATE OF HMO INTL	
COASTAL INSURANCE (BURMUDA) LIMITED	
119,993 of 120,000 SHARES OWNED BY HMO INTL	
DIRECTORS	
STUART E KAISER, JR	
ANGUS A SCOTT	
ELLIOT R WOLFF	
DAVID B VAUGHAN	
CHARLES T COLLIS	
OFFICERS	
ANGUS A SCOTT	PRESIDENT
STUART E KAISER JR	VICE-PRESIDENT
DAVID B VAUGHAN	VICE-PRESIDENT
ELLIOT R WOLFF	SECRETARY
ROBERT BUNKER	TREASURER

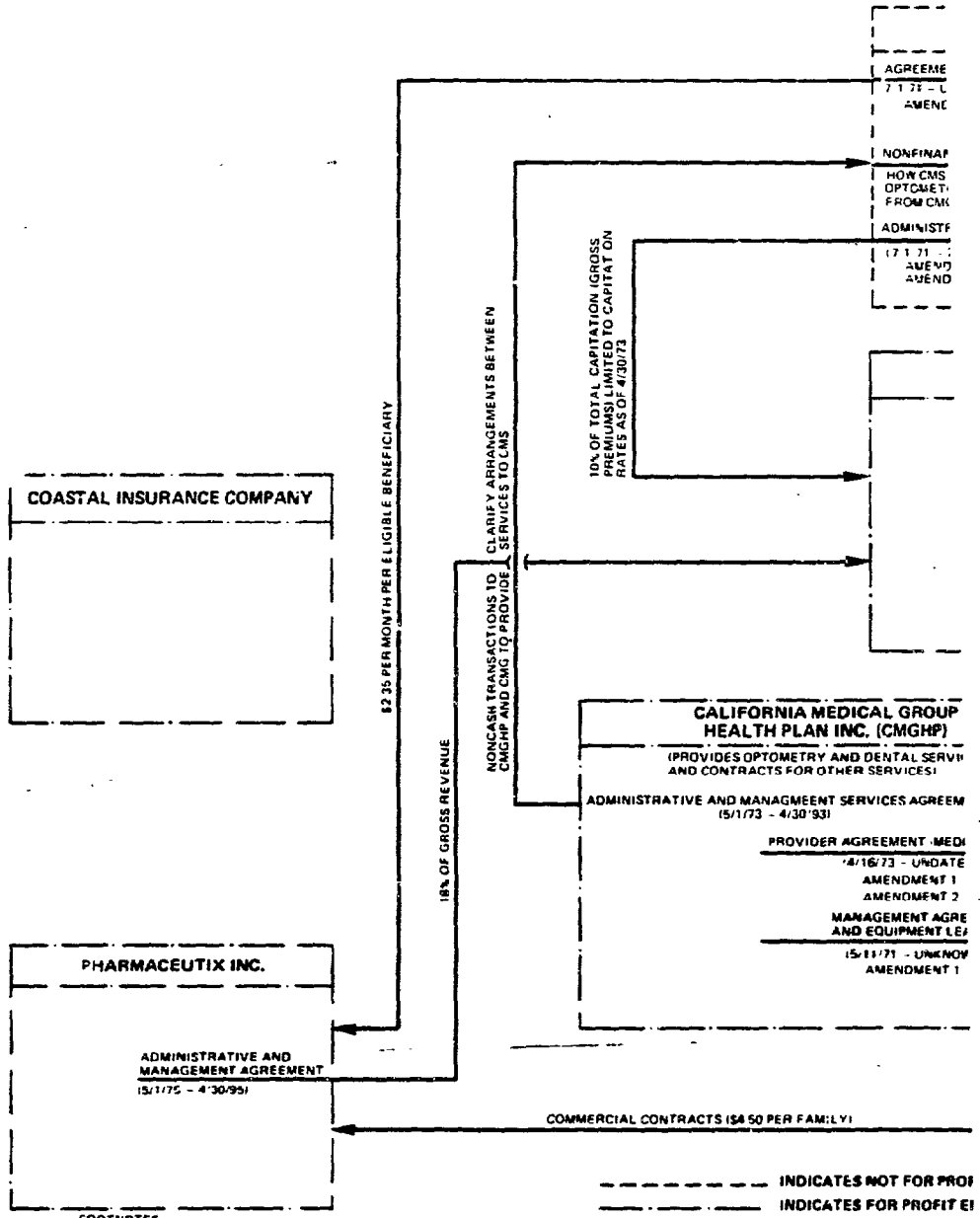
NOT FOR PROFIT ENTITIES
FOR PROFIT ENTITIES

CHART II--CMS'S INTERCOMPANY AGREEMENTS

This chart depicts the contractual ties between CMS and affiliated firms. These ties are quite complex with funds flowing through several affiliated firms in some instances. In fact, the contractual obligations became so complex, two clarifying agreements were needed to interpret the relationships.

The chart shows that HMO International provides CMS with administrative and management services, Pharmaceutix provides drugs, and the California Medical Group is responsible, either directly or indirectly, for providing all other medical services. The California Medical Group contracts with Medicalab Management Corporation for laboratory and X-ray services and Coastal Insurance (Bermuda) Limited for malpractice insurance. California Medical Group Health Plan provides optometrist and dental services.

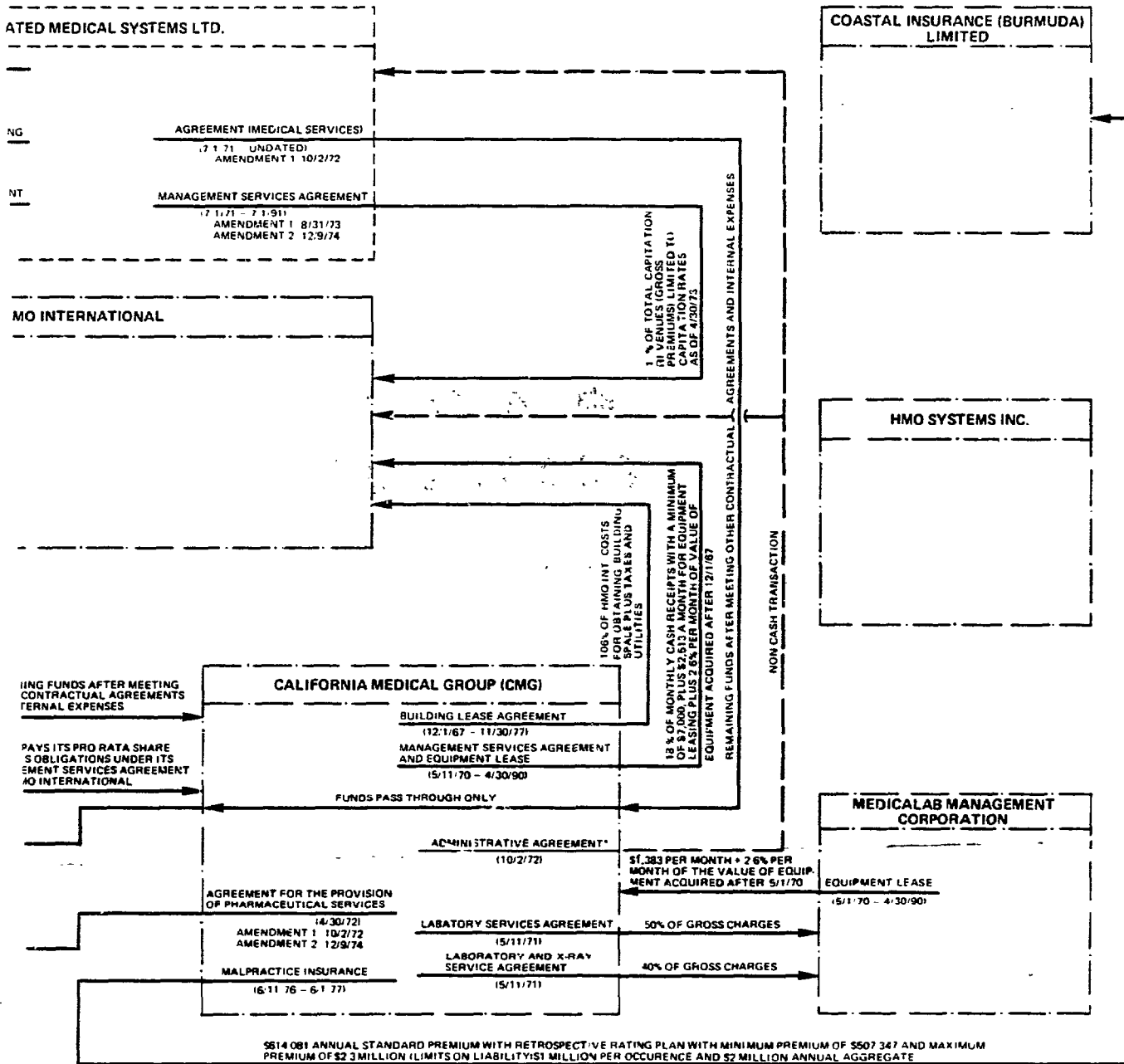
CMS, Pharmaceutix, California Medical Group, and California Medical Group Health Plan all contract with HMO International for administrative and management services for a percentage of their revenues.



FOOTNOTES
 *MEMORANDUM OF INTERPRETATION AND CLARIFICATION AND AGREEMENT 10-2-72
 THIS AGREEMENT CLARIFIES AGREEMENTS #3,9,2,2

--- INDICATES NOT FOR PROFIT
 ——— INDICATES FOR PROFIT
 → ← ARROWS INDICATE DIRECTION

COMPANY AGREEMENTS

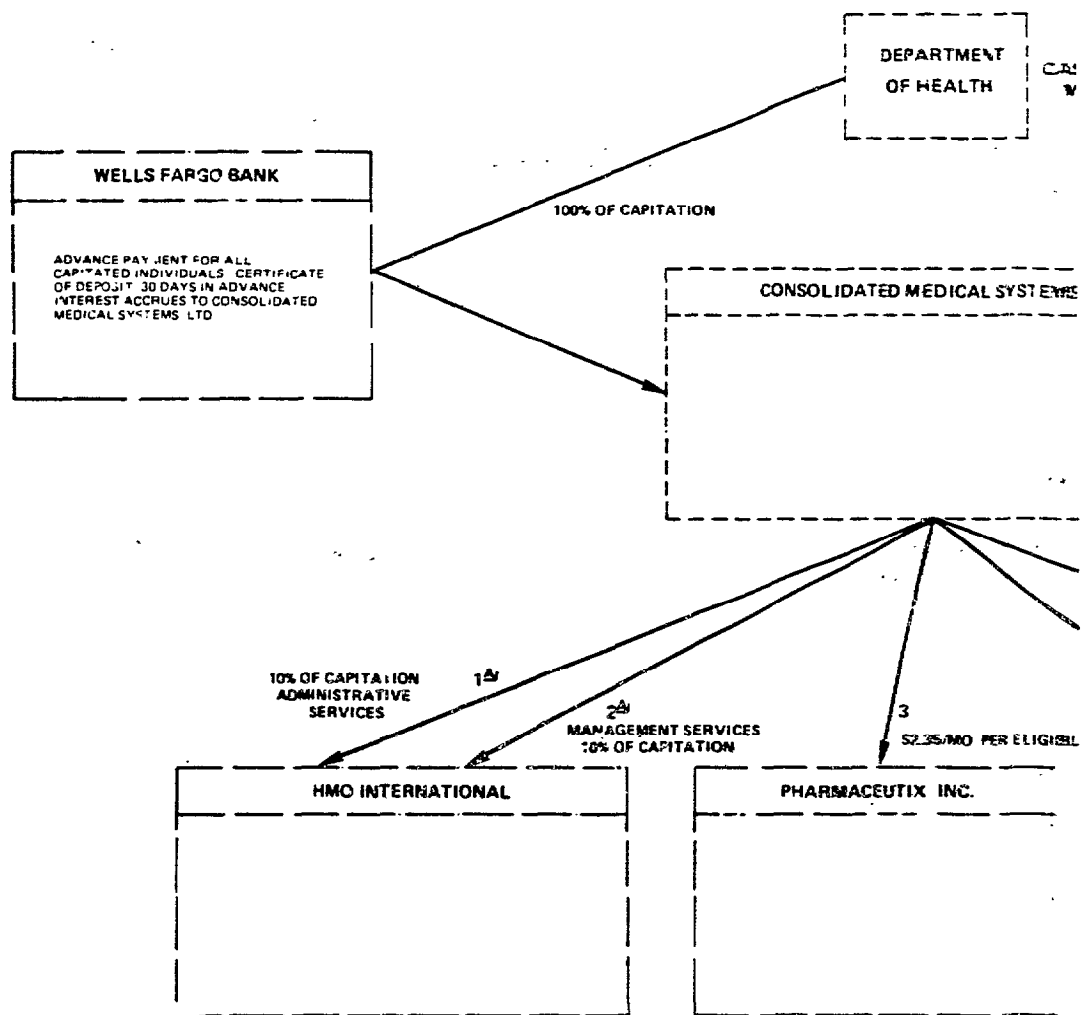


SS14 081 ANNUAL STANDARD PREMIUM WITH RETROSPECTIVE RATING PLAN WITH MINIMUM PREMIUM OF \$507,347 AND MAXIMUM PREMIUM OF \$23 MILLION (LIMITS ON LIABILITY) \$1 MILLION PER OCCURRENCE AND \$2 MILLION ANNUAL AGGREGATE

CHART III--CMS'S SIMPLIFIED CASH FLOW IN
MEDICAID CAPITATION PROGRAM

Chart III shows that about 5 percent of the Medicaid funds received by CMS is retained for internal expenses and the remainder flows to affiliated for profit firms.

SIMPLIFIED C.A.S

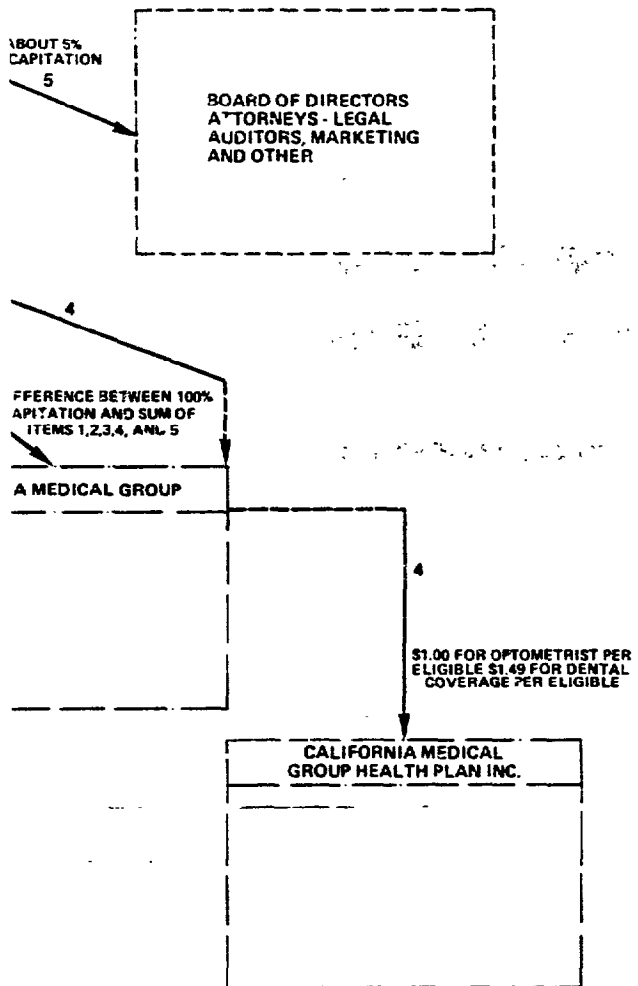


1A PAYMENTS TO HMO INTERNATIONAL ARE LIMITED TO 10% OF THE PER CAPITA PREMIUM RATES IN EFFECT FOR CMS AS OF 4/30/73. INCREASES IN PER CAPITA PREMIUMS AFTER THAT DATE DID NOT RESULT IN INCREASED PAYMENTS TO HMO INTERNATIONAL.

----- INDICATES NOT FOR PROFIT
 _____ INDICATES FOR PROFIT
 —————> ARROWS INDICATE DIRECTION FUNDS FLOW

DICAID CAPITATION PROGRAM

N



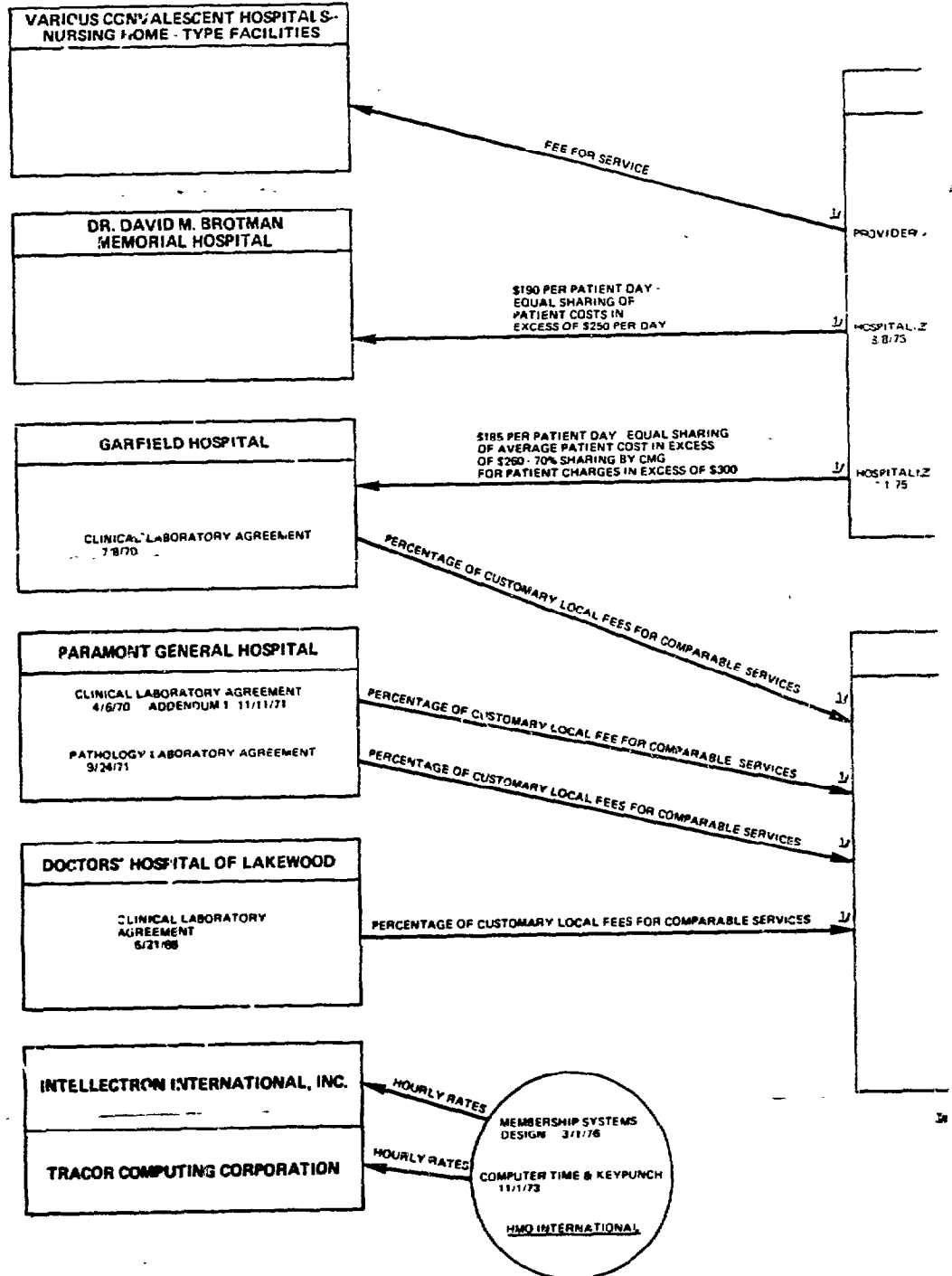
EXPLANATIONS:	
1	<p>TEN PERCENT OF GROSS PREMIUMS RECEIVED BY CMS LTD FROM STATE OF CALIFORNIA</p> <p>HMO TO PROVIDE COMPLETE ADMINISTRATIVE SERVICE TO CMS LTD HMO TO PROVIDE PERSONNEL FACILITIES AND EQUIPMENT AT HMO'S PRINCIPLE OFFICE HMO TO PROVIDE ACCOUNTING AUDITING BOOKKEEPING AND FINANCIAL ADVISORY SERVICES HMO TO MAINTAIN ALL OF CMS LTD RECORDS FORMS FOR SUBCONTRACTING ESTABLISH DISTRIBUTE AND MAINTAIN SYSTEM MANUALS HMO TO INSPECT APPROVE DISAPPROVE PROVIDERS</p>
2	<p>TEN PERCENT OF GROSS PREMIUMS RECEIVED BY CMS LTD FROM STATE OF CALIFORNIA</p> <p>HMO TO PROVIDE COMPLETE MANAGEMENT SERVICES TO CMS LTD A NEGOTIATION & RENEGOTIATION OF STATE CONTRACT B ORGANIZATION, EVALUATION AND SUPERVISION OF THE STRUCTURE OF THE SERVICES CMS IS REQUIRED TO PROVIDE C COORDINATION AND LIASON D SELECTION AND IMPLEMENTATION OF PROCEDURES FOR THE ENROLLMENT OF ELIGIBLE BENEFICIARIES E PLANNING AND PROJECTION OF POTENTIAL AREAS OF GROWTH F ANY MANAGEMENT FUNCTIONS CMS MAY NEED</p>
3	<p>\$2.35/MONTH PER ELIGIBLE ENROLLED BENEFICIARY</p> <p>PHARMACEUTIX TO FURNISH PREMISES WHERE THE PROFESSION OF PHARMACY IS PRACTICED PHARMACEUTIX TO OPERATE PHARMACIES AND EMPLOY PHARMACISTS PHARMACEUTIX TO MAINTAIN MALPRACTICE LIABILITY AND WORKMEN'S COMPENSATION INSURANCE</p>
4	<p>\$2.49/MONTH PER ELIGIBLE ENROLLED BENEFICIARIES</p> <p>CAPITATION FOR OPTOMETRY AND DENTAL COVERAGE PAID TO CALIFORNIA MEDICAL GROUP HEALTH PLAN INC</p>
5	<p>ABOUT 5% OF GROSS PREMIUM RECEIVED BY CMS LTD FROM STATE OF CALIFORNIA</p> <p>TO COVER ATTORNEYS' LEGAL FEES AUDITORS MARKETING AND OTHER RELATED EXPENSES</p>
6	<p>DIFFERENCE BETWEEN 100% CAPITATION AND THE SUM OF 1, 2, 3, 4, AND 5 ABOVE</p> <p>CALIFORNIA MEDICAL GROUP (CMG) TO PROVIDE THE FOLLOWING SERVICES TO ENROLLES AT 19 LOCATIONS 1) OUT PATIENT SERVICES 2) OUT PATIENT LABORATORY AND X-RAY SERVICES 3) EYEGLASSES 4) 24 HOUR EMERGENCY SERVICES 5) HOME HEALTH CARE SERVICES 6) PROSTHETICS AND ORTHOTIC DEVICES 7) HEARING AID AND DURABLE EQUIPMENT 8) HOSPITAL AND NURSING HOME INPATIENT SERVICES</p>

CHART IV--CMS'S AGREEMENTS WITH PROVIDERS--
BASIS FOR REIMBURSEMENT

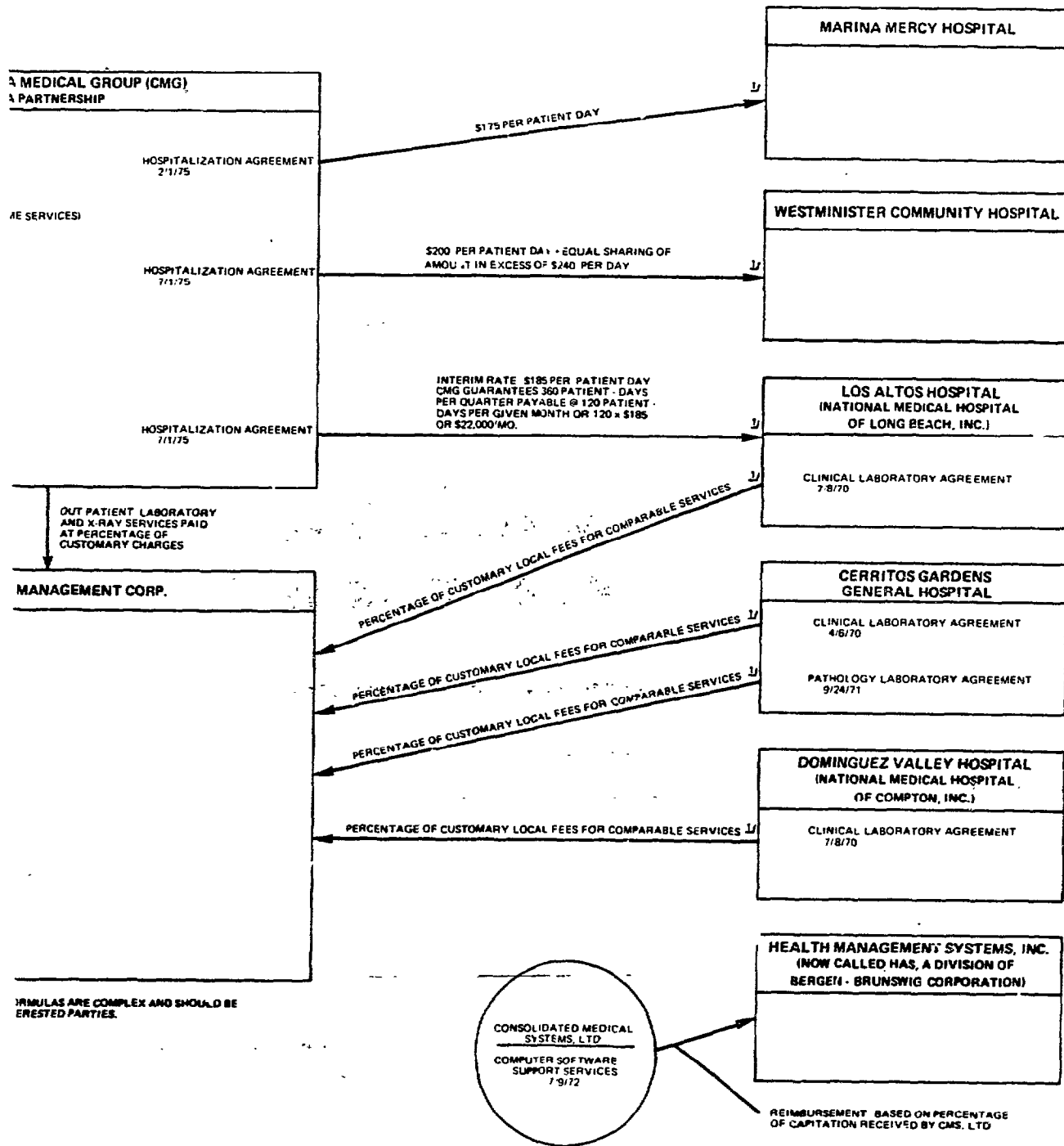
As shown by Chart II, CMS contracts with the California Medical Group for all health services except for prescription drugs, optometrist, and dental services. Chart IV shows how the California Medical Group contracts for the services it does not directly provide. None of the providers are affiliated firms except for Medicalab Management Corp., which has a direct contract for outpatient laboratory and X-ray services and indirectly provides inpatient laboratory and X-ray services through contracts with some of the hospitals the California Medical Group contracts with.

Chart IV also shows how CMS receives computer services.

AGREEMENTS WITH



PROVIDERS – BASIS FOR REIMBURSEMENT



FORMULAS ARE COMPLEX AND SHOULD BE REFERRED TO THE APPROPRIATE PARTIES.

CHART V--CMS' AND AFFILIATED FIRMS' REVENUE AND EXPENSES FOR THE YEAR ENDING APRIL 30, 1976 (UNAUDITED)

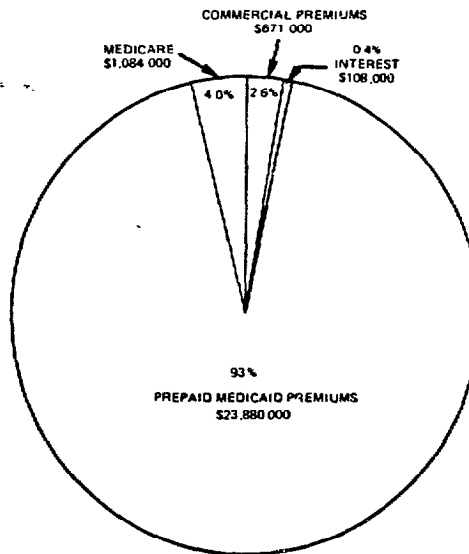
Chart V depicts the revenues and expenses of CMS and affiliated firms. The data was provided by CMS and/or the affiliated firms and was not verified by us. The data had not been audited by an independent accounting firm.

All of CMS's revenue was used to cover its internal costs and contractual obligations. Profits of the affiliated firms ranged from less than 0.1 percent of revenues for the California Medical Group Health Plan to 18.5 percent for HMO International. Coastal Insurance (Bermuda) Limited set aside 97.7 percent of its revenue as a premium reserve.

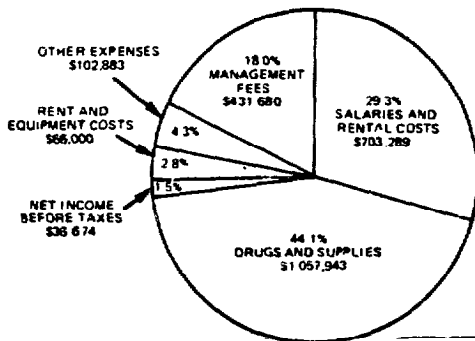
While these affiliated firms have revenues from sources other than CMS, CMS's payments to its affiliates represent substantial percentages of their total revenues. Pharmaceutix received about 73 percent of its total revenues from CMS. HMO International received about 41 percent of its total revenues from CMS directly and received additional funds indirectly from CMS through its management agreements with other affiliates which contract with CMS. The California Medical Group obtained about 68 percent of its total revenues from CMS and California Medical Group Health Plan about 17 percent. Coastal Insurance (Bermuda) received all of its premium revenues from the California Medical Group and thus, indirectly got about 68 percent of its revenues from CMS. Finally, Medicalab Management Corporation obtained about 24 percent of its income from CMS through its contract with the California Medical Group and additional funds from CMS through contracts with hospitals that contract with the California Medical Group.

REVENUE

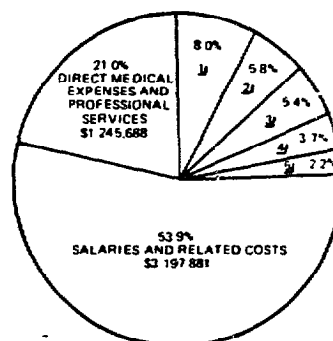
REVENUES
TOTAL REVENUES: \$25,743,000



PHARMACEUTIX INC.
TOTAL REVENUE: \$2,398,468



MEDICALAB MANAGEMENT CORP.
TOTAL REVENUE: \$5,928,643



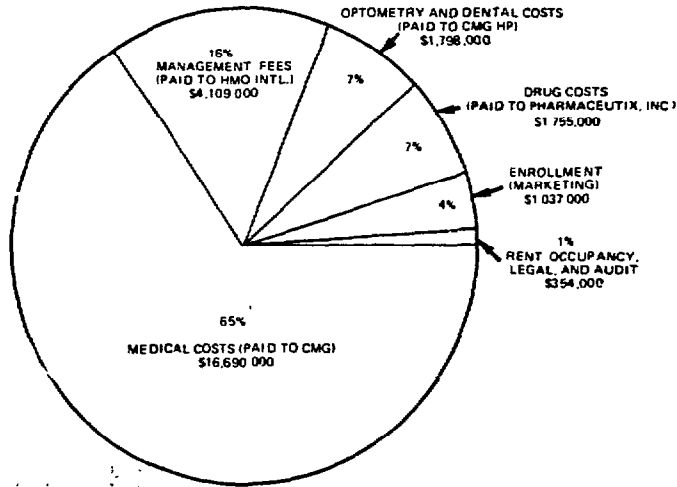
COASTAL

0.8%
NET INCOME BEFORE TAX
\$2,814

8.0%	NET INCOME BEFORE TAXES	\$476,058
5.8%	INTER COMPANY RENT AND INSURANCE EXPENSES	\$345,569
5.4%	RENT AND OCCUPANCY	\$317,977
3.7%	OTHER EXPENSES	\$216,847
2.2%	PROFESSIONAL OUTSIDE SERVICES	\$128,623

**EXPENSES FOR CMS LTD. AND AFFILIATES
ENDED APRIL 30, 1976
(AUDITED)**

EXPENSES
TOTAL EXPENSES: \$25,743,000



JA) LIMITED
16

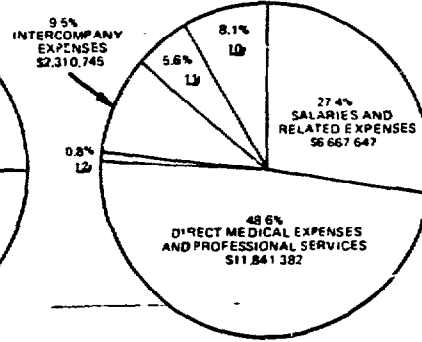
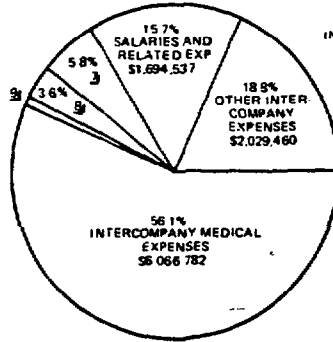
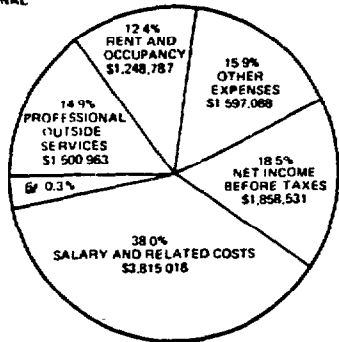
HMO INTERNATIONAL
TOTAL REVENUE: \$10,048,347

CALIFORNIA MEDICAL GROUP HEALTH PLAN
TOTAL REVENUE: \$10,817,221

CALIFORNIA MEDICAL GROUP
TOTAL REVENUE: \$24,364,945

MEDICAL PROFESSIONAL SERVICES
\$4,286

ON
TICE



INTERCOMPANY EXPENSES \$ 27,982
 DIRECT MEDICAL AND MEDICAL PROFESSIONAL SERVICES \$834,725
 PROFESSIONAL OUTSIDE SERVICES \$391,518
 AND OTHER EXPENSES \$ 199
 NET INCOME BEFORE TAXES

10/ 8.1% RENT AND OCCUPANCY \$1,980,230
 11/ 5.6% OTHER EXPENSES \$1,363,417
 12/ 0.8% NET INCOME BEFORE TAXES \$ 201,524

COMPENSATION RECEIVED BY DIRECTORS AND OFFICERS
OF CMS AND AFFILIATED FIRMS

The following table lists the compensation received during the period May 1, 1975, through April 30, 1976, by the directors and officers of CMS and affiliated firms paid by HMO International and its affiliates.

<u>Name</u>	<u>Position</u>	<u>HMOI</u>	<u>Affiliates of HMOI</u>	<u>Total</u>
Angus A. Scott	President, HMO International and Pres. & Chief Exec., CMS	\$ 64,235	\$ 2,822	\$ 67,057
Jerry Whitacre	Vice President, HMO International	59,746	-	59,746
Elliot Wolff	Vice President, HMO International	37,540	a/11,650	49,190
Stuart Kaiser, Jr.	Vice President, HMO International	43,158	-	43,158
Mary Ann Wickes	Vice President, HMO International	42,496	-	42,496
Connie Zastoupil	Vice President, HMO International	33,516	a/3,731	37,247
Walter Losk	Vice President, HMO International	39,562	-	39,562
Anthony Armino	Senior Vice President, HMO International	33,996	-	33,996
Robert Bunker	Treasurer	35,901	-	35,901
Bob Jensen	Not known	6,163	-	6,163
Dave Burowsky (note b)	Not known	17,000	-	17,000
Donald Kelly, MD	Former President, HMO International Member, Board of Directors, HMO International	121,750	c/38,246	159,996
Norman Jones	Member, Board of Directors, HMO International	6,839	-	6,839
John Penland (note d)	Former President, HMO International	231,868	-	231,868
Richard Keatinge	Member, Board of Directors, CMS MGT Corporation	-	3,500	3,500
Alex Aronoff	Former President--Medicalab	55,730	-	55,730
David Moll, MD	Partner, California Medical Group	-	c/90,996	90,996
Alberto Hidalgo, MD	Partner, California Medical Group	-	c/82,831	82,831
Boris Levin, MD	Partner, California Medical Group	-	c/93,996	93,996
Robert Daniels	Not known	-	9,595	9,595

a/Entire salary will be paid by HMO International in FY 1977.

b/Also received \$17,100 for legal services and \$6,893 for travel expenses.

c/These amounts consist of salaries and indirect remuneration from California Medical Group, a partnership. These amounts do not include distributive shares in partnership profits, if any. (We did not get the information necessary to determine profit distribution).

California Medical Group Partners:

Donald Kelly, MD Alberto Hidalgo, MD
David Moll, MD Boris Levin, MD

d/Employment terminated 9/30/76. The compensation includes termination pay of \$160,000.

CHAPTER 3

HARBOR HEALTH SERVICES

Harbor Health Services (HHS) is a nonprofit, tax exempt PHP. All of HHS's revenues received for providing health care come from the capitation paid by the State for Medicaid eligibles which amounted to about \$3,816,000 in fiscal year 1976. HHS had about 10,000 Medicaid enrollees as of June 30, 1976.

In a letter to us, dated July 29, 1976, HHS said that it:

"* * *deemed it necessary to become a non-profit corporation because it was believed it was the only method by which it could obtain a [Medicaid] Contract with the State of California.

"Though the Knox-Mills Health Plan Act did not specifically forbid profit making corporations from providing health care, it was our understanding that the Attorney General's interpretation was that no profit corporation, other than a professional corporation, could contract with the State. Therefore, HARBOR, as well as most other plans, found it necessary to go the non-profit route."

HHS, because of common ownership or interlocking management, is affiliated with Totalcare, a general partnership of two partnerships--Healthcon and Med-Con. Healthcon partners are also the two partners of Family Medical Group, HHS principal provider, and the partners of Medical Group of Compton Physicians and Surgeons Hospital. The latter partnership owns the buildings leased by Family Medical Group and the now inactive Compton Physicians and Surgeons Hospital where most of HHS's inpatient hospital care had been provided.

We were told by HHS officials that Family Medical Group provided the initial financing of HHS with a loan of about \$85,000. Family Medical Group was established in 1958.

CHART VI--HHS'S CORPORATE INTERRELATIONSHIP WITH AFFILIATES--
BOARD OF DIRECTORS, PRINCIPAL OFFICERS, AND OWNERSHIPS

This chart presents the boards of directors, officers, and/or owners of HHS and affiliated firms. As shown by the chart, all of these firms are connected through common principals.

**CORPORATE
BOARD OF DIRECTORS**

DIRECTORS	
MURIEL SIEGAL	
LAWRENCE RUCH	
VICTOR MASTRON	
RONALD RUNCIMAN	
MICHAEL JESKIN	
DOROTHY MAST	
ZOLA SIEGAL	
PRINCIPAL OFFICERS	
VICTOR MASTRON	
RONALD RUNCIMAN	
ZOLA SIEGAL	
MURIEL SIEGAL	
LAWRENCE RUCH	
DOROTHY MAST	
MICHAEL JESKIN	

A

FAMILY MEDICAL GROUP, INC.	
PARTNERS	OWNERSHIP
VICTOR MASTRON MD	50%
RONALD RUNCIMAN MD	50%

E

HEALTHCON	
A PARTNERSHIP	
PARTNERS	OWNERSHIP
MURIEL SIEGAL	55%
ZOLA SIEGAL	25
LAWRENCE RUCH	10
MICHAEL JESKIN	10

----- INDICATES NOT FOR PROFIT ENTITIES
 _____ INDICATES FOR PROFIT ENTITIES

**RELATIONSHIP WITH AFFILIATES
MEDICAL OFFICERS AND OWNERSHIP**

ALTH SERVICE	
PROFIT CORPORATION	
OFFICERS	
FOR PROFIT AFFILIATED ORGANIZATIONS ASSOCIATED WITH	
(B E)	
(A B C D F G)	
(A, B, C, D, F, G)	
(B E)	
(NONE)	
(G)	
(B E)	
MANAGERIAL DIRECTOR	(SEE ABOVE)
PHYSICIAN DIRECTOR	
ADMINISTRATIVE DIRECTOR	
MANAGERIAL SECTOR DEVELOPMENT	
LEGAL COUNSEL	
UNITY RELATIONS COORDINATOR	
COMMUNITY RELATIONS COORDINATOR	

C

COMPTON PHYSICIANS AND SURGEONS HOSPITAL	
INACTIVE AS OF JULY 1976	
OWNERS	SHARE
VICTOR MASTRON MD	13
RONALD RUNCIMAN MD	13
HENRY COWAN	19
JOHN FRANKS	19
FAMILY MEDICAL GROUP	19

CARE	
OWNERSHIP	
25%	
25%	
27.5%	
12.5%	
5%	
5%	

D

MEDICAL GROUP OF COMPTON PHYSICIANS AND SURGEONS HOSPITAL	
PARTNERS	OWNERSHIP
VICTOR MASTRON MD	50%
RONALD RUNCIMAN MD	50%

F

MED-CON	
A PARTNERSHIP	
PARTNERS	OWNERSHIP
VICTOR MASTRON MD	50%
RONALD RUNCIMAN MD	50%

G

9836 S. ATLANTIC BLVD.	
(OWNERSHIP OF BUILDING)	
OWNERS	
VICTOR MASTRON MD	
RONALD RUNCIMAN MD	
JOAN RUNCIMAN	

CHART VII--HHS'S INTERCOMPANY AGREEMENTS

Chart VII shows the contractual agreements between HHS and its affiliated firms. HHS contracts with these firms for virtually all of the services required by its Medicaid contract. The Medicaid capitation funds tend to flow from HHS to firms owned by the principals of HHS. The exception is HHS's contracts for medical services with unaffiliated medical groups which is illustrated on Chart VIII. These other medical groups serve about 65 percent of HHS's Medicaid enrollees and received about 50 percent of HHS's Medicaid capitation receipts in July 1976.

COMPTON PHYSICIANS AND SURGEONS HOSPITAL
(INACTIVE AS OF JULY, 1976)

MONTHLY FEE OF 7.32% OF FIRST \$231,000 PLUS VARIOUS PERCENTAGES OF ADDITIONAL CAPITATION REVENUES

ADMINISTRATIVE SE
1.15.75 - UNDATED
AMENDMENT 1 5/13
AMENDMENT 2 UNDATED
NEW AGREEMENT TO
PLUS COST AS COMPI

HEALTHCON
A PARTNERSHIP
AGREEMENT
PARTNERS
12-731

--- INDICATES NOT FOR PROFIT ENTITIES
--- INDICATES FOR PROFIT ENTITIES
---> ARROWS INDICATE DIRECTION FUNDUS FI

KEY AGREEMENTS

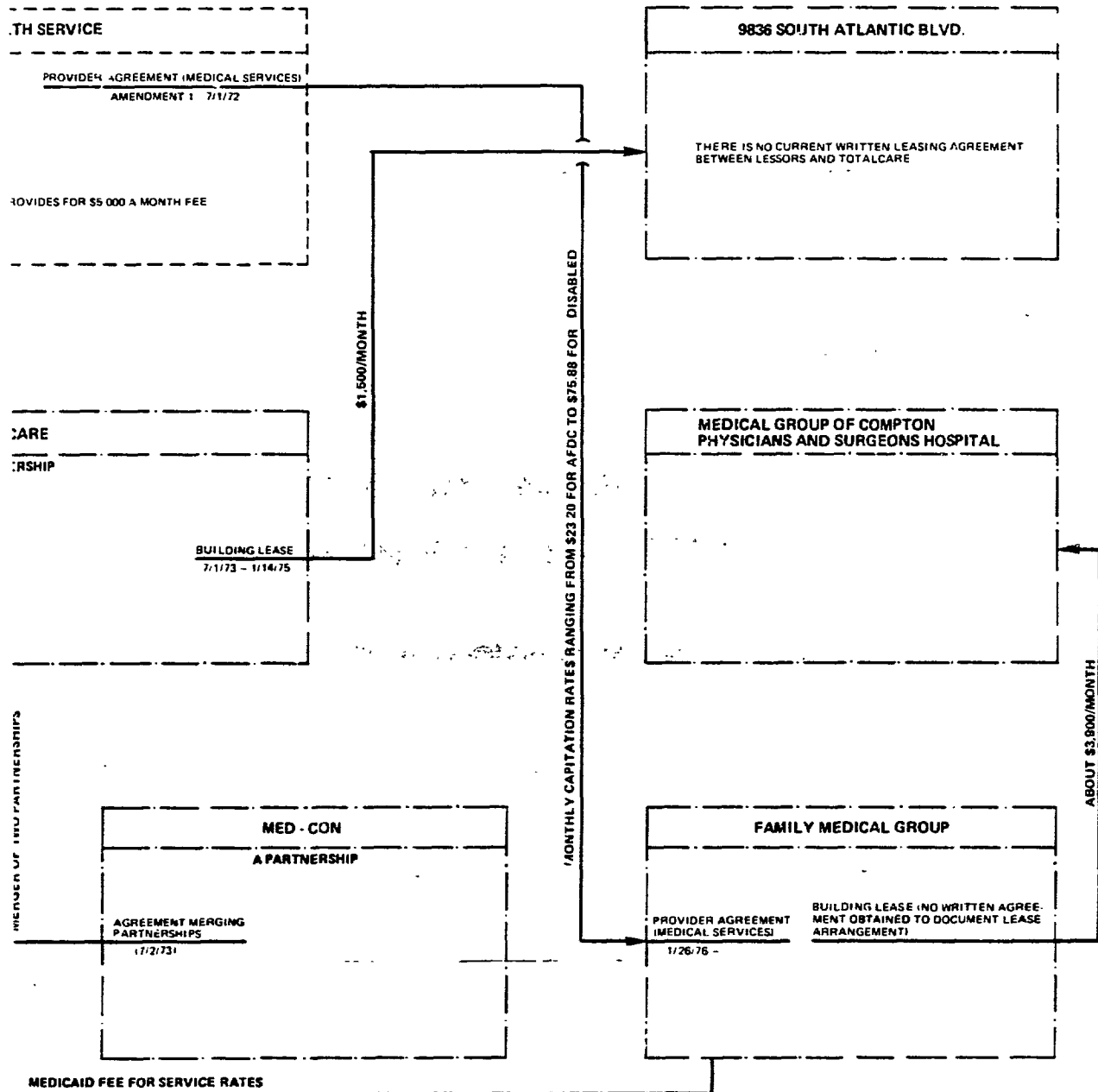
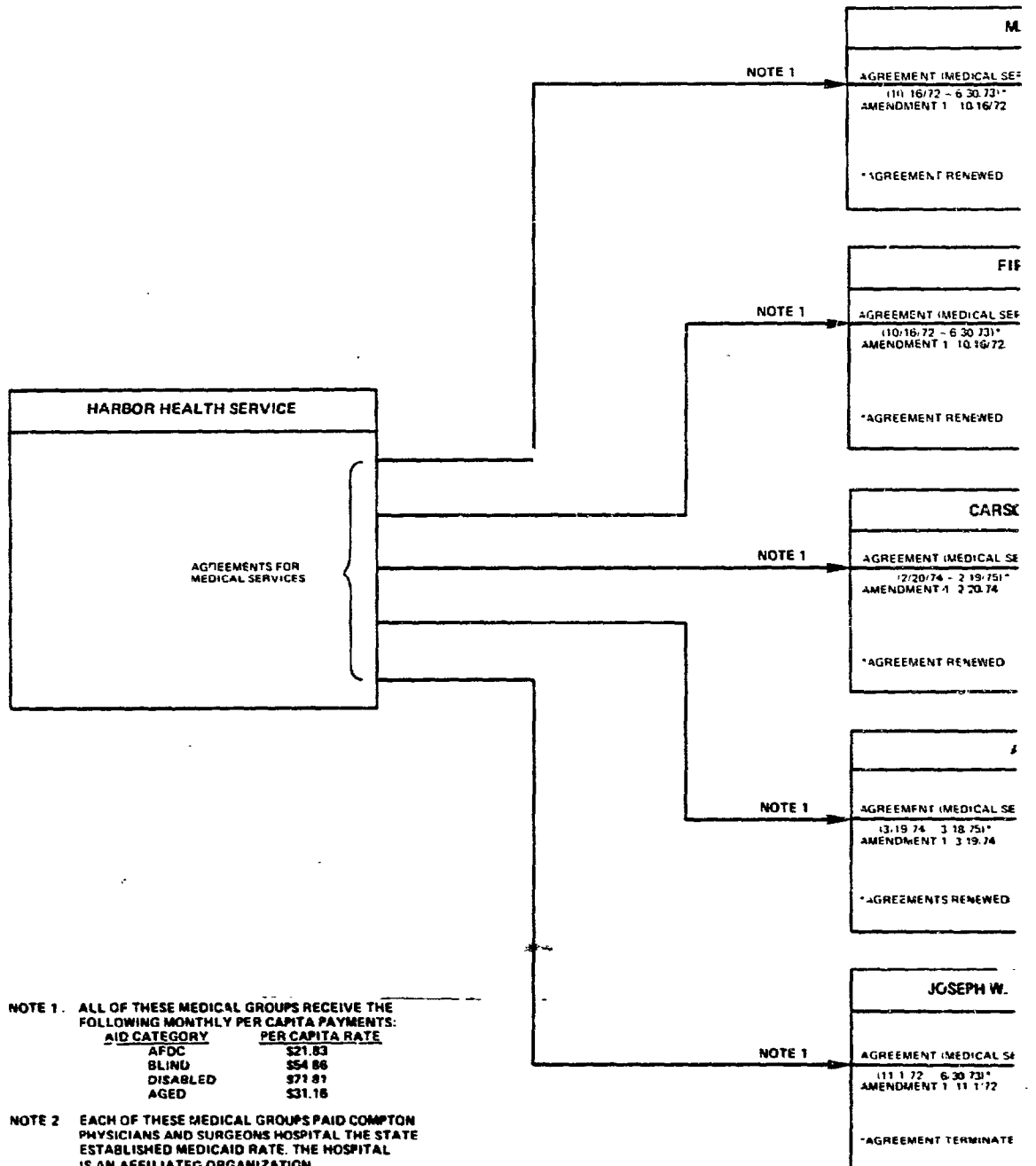


CHART VIII--HHS'S AGREEMENTS WITH UNAFFILIATED PROVIDERS

Chart VIII depicts HHS's contracts for medical services with unaffiliated medical groups. HHS pays these medical groups a per capita rate for providing medical services. HHS pays these unaffiliated groups less per person than it pays Family Medical Group, its affiliated medical group. The differences range from \$1.37 per aid to families with dependent children (AFDC) eligible to \$4.08 per disabled eligible. Also, 3 of the unaffiliated medical groups contracted with Compton Physicians and Surgeons Hospital, an affiliated firm, for hospital services.

AGREEMENTS V



ATED PROVIDERS

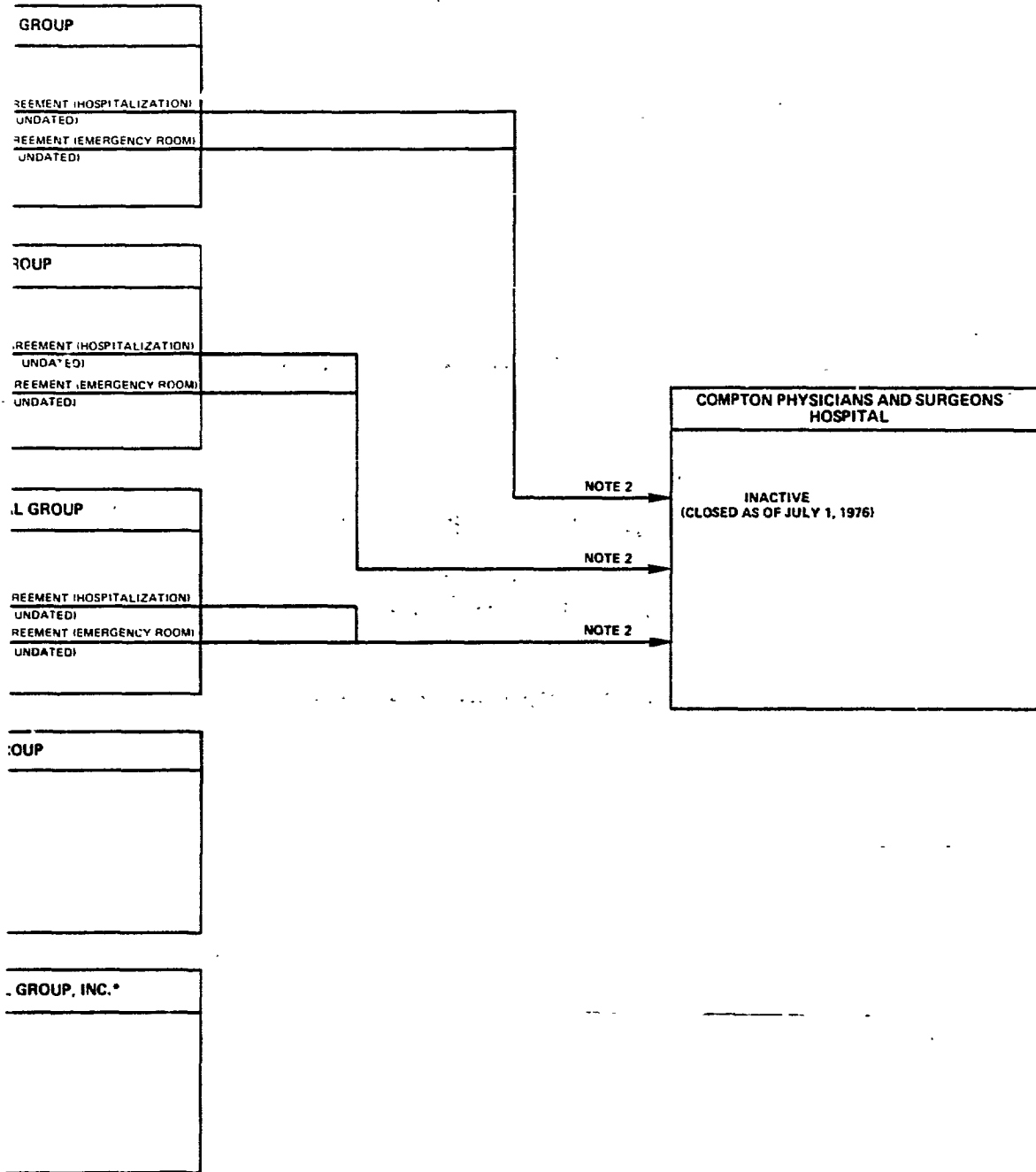


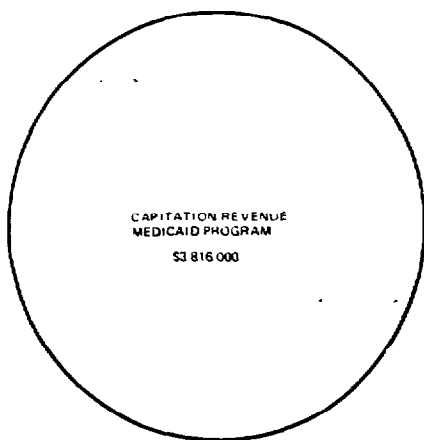
CHART IX--HHS'S AND AFFILIATES' REVENUES AND EXPENSES (UNAUDITED)

This chart shows the revenues and expenses of HHS and its affiliated firms. Interest revenues of HHS have been excluded. The data was not verified by us or audited by an independent accounting firm.

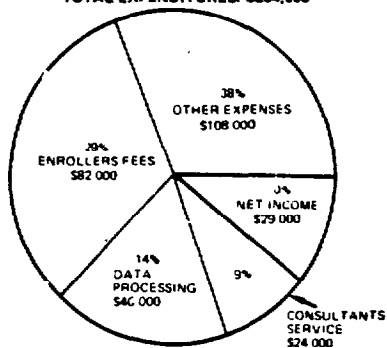
The Medical Group of Compton Physicians and Surgeons Hospital had a net income of 29 percent of revenues and Totalcare and Family Medical Group had before tax profits of 10 percent and 7 percent, respectively. Compton Physicians and Surgeons Hospital had a 6 percent loss and data was not available for the other affiliate.

HARBOR HEALTH SERVICE
FY ENDING JUNE 30, 1976

REVENUES \$3,816,000

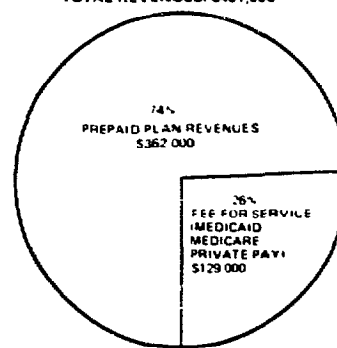


TOTAL CARE
SIX MONTH PERIOD ENDING JUNE 30, 1976 TOTAL REVENUE
ALL FROM HARBOR HEALTH SERVICE \$283,000
TOTAL EXPENDITURES: \$254,000



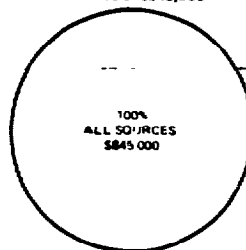
FAMILY MEDICA
FOUR MONTH PERIOD EN

TOTAL REVENUES: \$491,000

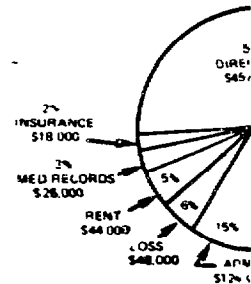


COMPTON PHYSICIANS AND SURGEONS HOSPITAL
(YEAR ENDING 8/31/75) (CLOSED IN JULY 1976)

REVENUE: \$845,000

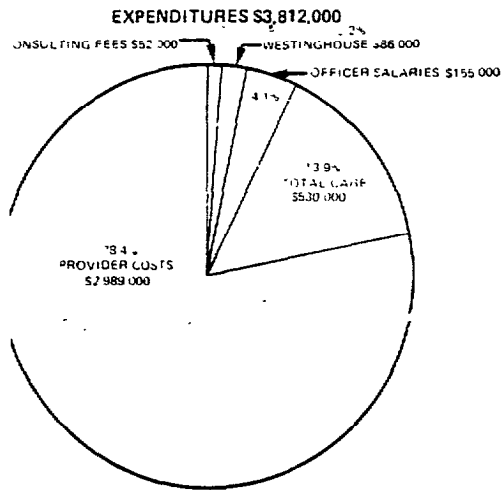


EXPENDITURE

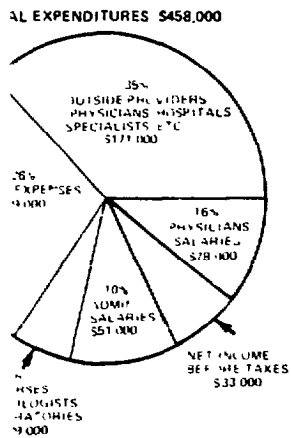
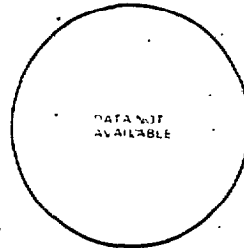


EXPENSES

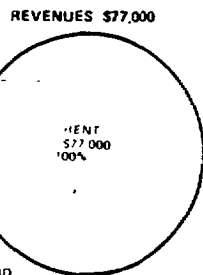
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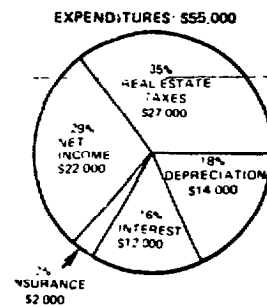
9836 SOUTH ATLANTIC BLVD
SOUTH GATE, CALIFORNIA
BUILDING OWNERS: DR. MASTRON & DR. RUNCIMAN
ACQUISITION COST REAL PROPERTY \$165,000
ANNUAL RENT \$18,000



MEDICAL GROUP OF COMPTON PHYSICIANS & SURGEONS HOSPITAL
YEAR ENDING DECEMBER 31, 1975



COMPTON PHYSICIANS & SURGEONS HOSP BLDG AND FAMILY MEDICAL GROUP BLDG



REMUNERATION OF PRINCIPAL OFFICIALS

The following table lists the annual salaries as of July 1976 of the principal officials of HHS.

<u>Names and titles</u>	<u>Salary (notes a and b)</u>
Victor Mastron, M.D.--Director, Secretary, Medical Director	\$60,000
Ronald Runciman, M.D.--Director, Treasurer, Health Educator	20,000
Zola Siegal--Director, Executive Director	20,000
Muriel Siegal--Director, President, Private Sector Developer	20,000
Lawrence Ruck--Director, Vice President, Legal Counsel	20,000
Dorothy Mastron--Director, Community Relations Coordinator	8,400
Michael Jeskin--Director, Public Relations Coordinator	8,400
Joan Runciman--Director	0

a/Does not include partnership salaries and/or income distributions, if any.

b/No payments for services provided as a member of the board of directors of HHS.

CHAPTER 4

OMNI-RX HEALTH CARE, INC.

Omni-Rx Health Care, Inc. (OHC) is a non-profit, tax exempt corporation which receives 100 percent of its medical revenues from its Medicaid PHP contract. OHC had about 10,700 Medicaid enrollees as of July 1976. Omni-Rx Health Systems is the for profit public corporation which controls OHC through common directors and officers. Omni-Rx Systems also controls many of OHC's for profit subcontractors through common directors, officers, and/or owners.

We asked OHC to outline its purpose, organization, and relationship with Omni-Rx Systems. In a letter to us, dated July 21, 1976, OHC said that in December 1972 Omni-Rx Systems decided to enter the prepaid health plan field. Omni-Rx Systems believed that the Knox-Mills Act required PHPs to be organized as non-profit firms. Therefore, OHC was created as a non-profit corporation and entered contracts to provide all of the services and functions required by its PHP contract. Omni-Rx Systems, because it had the financial capability, provided management services to OHC and the for profit medical groups connected to Omni-Rx Systems provided medical care to OHC enrollees. The letter went on to say that these inter-company arrangements require nine separate sets of accounting books and records which greatly add to the expenses and complexity of the accounting functions.

Omni-Rx Systems is a public company organized in July 1971 for the purpose of consolidating into a corporation various business entities involved in and related to the health care field. Essentially, Omni-Rx Systems is a management company providing logistical support services of a management and administrative nature such as personnel, supplies, equipment, facilities, data processing, billing and collections. Omni-Rx Systems also provides, through its divisions, ancillary services such as pharmaceutical, laboratory testing, neurodiagnostic testing, and cardiopulmonary testing. These services are primarily provided to two medical group partnerships, who provide services to Medicaid enrollees, fee-for-service patients, and patients covered by workmen's compensation.

There is no parent-subsidiary relationship between the medical group practices, OHC, and Omni-Rx Systems. The entities, however, can be considered affiliated firms because of common ownership and/or common management.

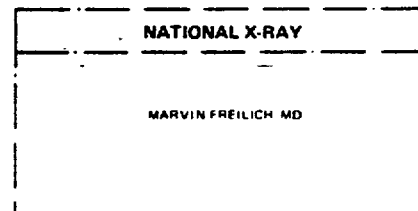
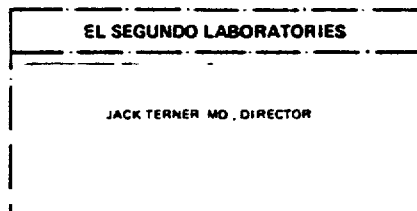
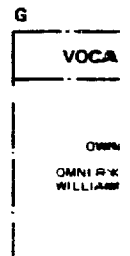
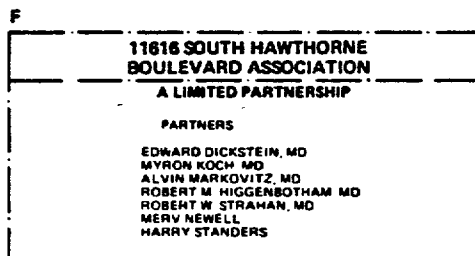
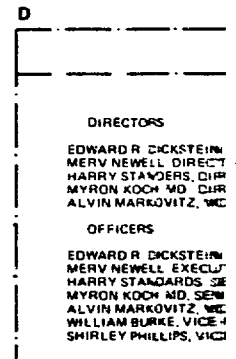
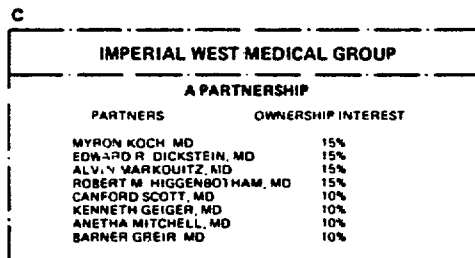
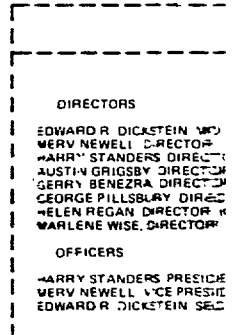
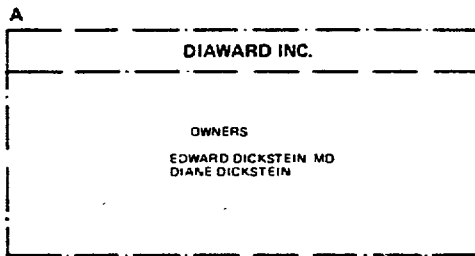
CHART X--OHC's CORPORATE INTERRELATIONSHIP WITH
AFFILIATES, SUBSIDIARIES, AND ANCILLARY DIVISIONS--
BOARD OF DIRECTORS, PRINCIPAL OFFICERS, AND STOCK
OWNERSHIPS

Chart X shows that Omni-Rx Systems has control over OHC since most of the directors and officers of Omni-Rx Systems are also the directors and/or officers of OHC. The chart also shows the owners of the affiliated firms. All of the affiliated firms have contracts with OHC or subcontracts with OHC contractors except for Vocational Rehabilitation Associates. The chart also shows the ancillary divisions of Omni-Rx Systems, all of which contract with OHC except for Cardiopulmonary Testing.

Partners who own 100 percent of one medical group partnership and 45 percent of the other medical group partnership also own about 50 percent of Omni-Rx Systems. Partners of the medical groups also are represented on the board of directors and act as officers of OHC and Omni-Rx Systems.

CORPORATE INTERRELATIONSHIP

BOARD OF DIRECTORS, P.F.



ERS AND STOCK OWNERSHIPS

ARE INC.
 CORPORATION
 ORGANIZATIONS ASSOCIATED WITH
 (A, B, C, D, E, F, G, H)
 (D, F, G, H)
 (NONE)
 (NONE)
 (NONE)
 (NONE)
 (SEE ABOVE)
 (SEE ABOVE)
 (SEE ABOVE)

B
AV-EL MEDICAL BUILDING
 OWNERSHIP
 OWNERS
 EDWARD R. DICKSTEIN, MD
 MYRON KOCH, MD
 ALVIN MARKOVITZ, MD
 ANN MARKOVITZ

SYSTEMS
 CORPORATION
 STOCK OWNERSHIP *
 (HARD) 139,844 SHARES
 20,000 SHARES
 28,298 SHARES
 133,145 SHARES
 68,239 SHARES

E
AV-EL MEDICAL GROUP
 A PARTNERSHIP
 PARTNERS OWNERSHIP INTEREST
 EDWARD R. DICKSTEIN, MD 33 1/3 %
 ALVIN MARKOVITZ, MD 33 1/3 %
 MYRON KOCH, MD 33 1/3 %

ENDING : 685,653
 COMMON ASSOCIATES
 MEMBERSHIP
 OWNERSHIP INTEREST
 75%
 25%

H
HAWTHORNE MEDICAL BUILDING
 A PARTNERSHIP
 PARTNERS
 ALVIN MARKOVITZ, MD
 ANN MARKOVITZ
 EDWARD R. DICKSTEIN, MD
 MYRON KOCH, MD
 MERV NEWELL
 HARRY STANDARDS

EX HEALTH SYSTEMS

CY INC.
 DIRECTOR

NEURODIAGNOSTIC MEDICAL SERVICE
 KENNETH GEIGER MD CHIEF

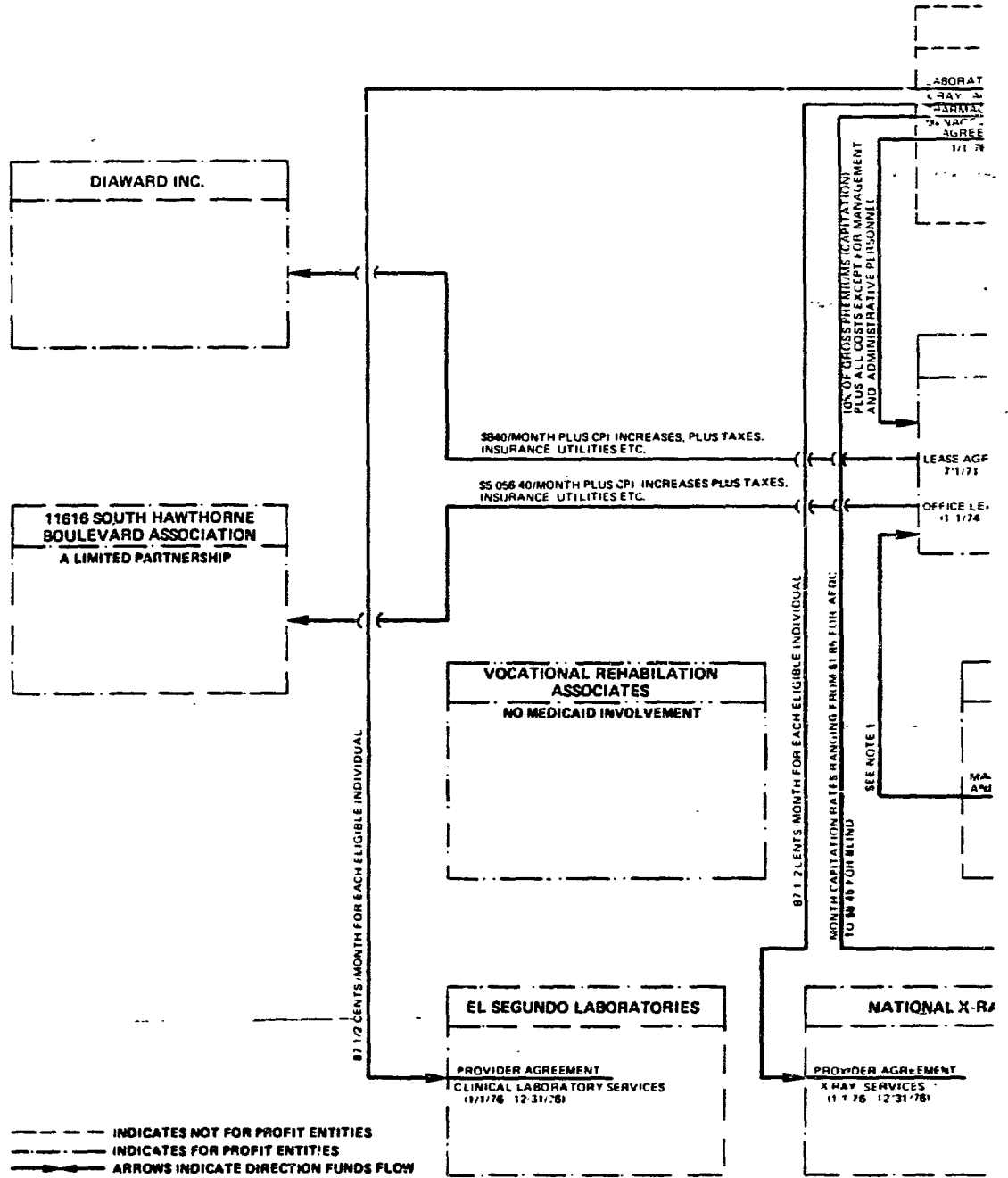
CARDIOPULMONARY TESTING
 ALVIN MARKOVITZ MD
 EDWARD R. DICKSTEIN MD

FOR PROFIT ENTITIES
 PROFIT ENTITIES

CHART XI--OHC's INTERCOMPANY AGREEMENTS

This chart depicts the contractual agreements between (1) OHC and its affiliated firms and (2) affiliated firms. The chart shows that OHC contracts with affiliated firms for most of the services needed to fulfill its PHP contract. Omni-Rx Systems is tied into each of OHC's contracts either directly or indirectly. For example, Omni-Rx Systems leases a building from Av-El Medical Building. OHC contracts for medical services with the Av-El Medical Group which in turn subleases the building from Omni-Rx Systems. Omni-Rx Systems also receives additional funds from the Av-El Medical Group for management services. Omni-Rx Systems has the same contractual agreements relating to the other medical group, the Imperial West Medical Group.

Omni-Rx Systems receives funds directly from OHC through a management services agreement and through contracts between its ancillary divisions and OHC.



AGREEMENTS

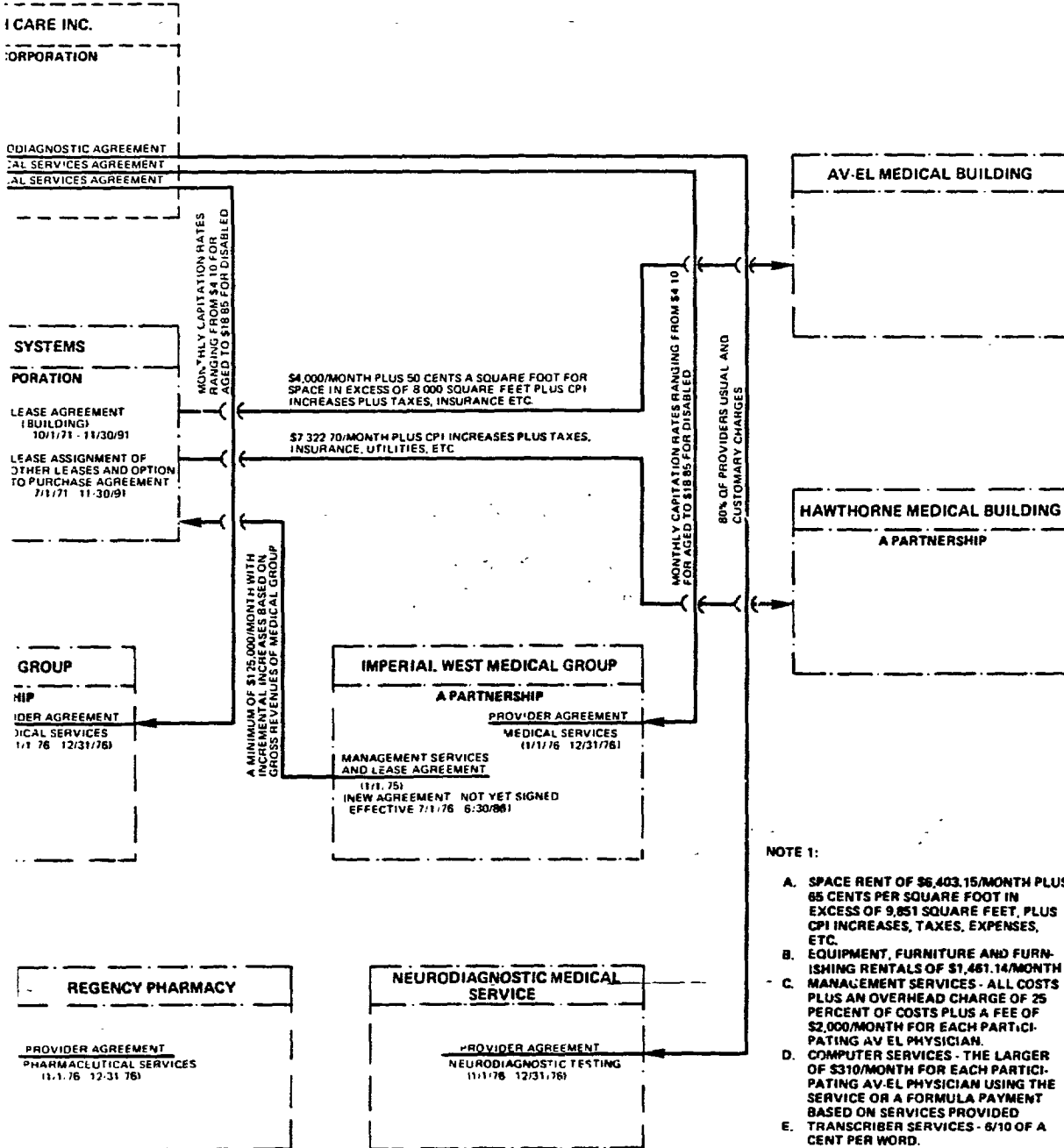
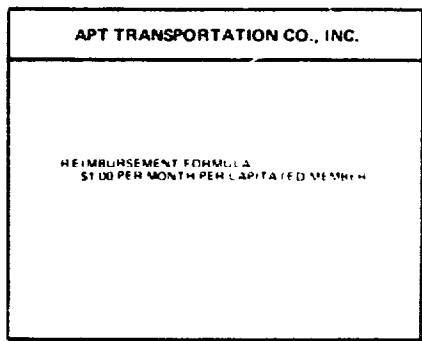
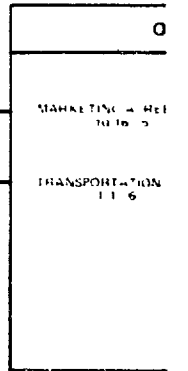
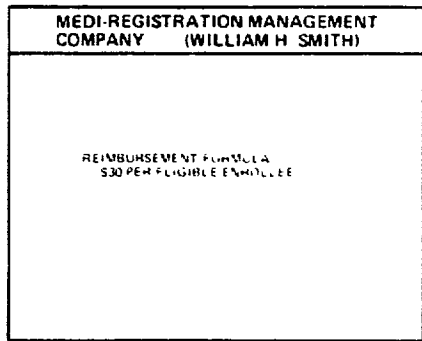


CHART XII--OHC's AGREEMENTS WITH UNAFFILIATED
PROVIDERS--BASIS FOR REIMBURSEMENT

Chart XII shows that the only services OHC contracts for with unaffiliated firms are marketing, transportation, and inpatient hospital and nursing home services. The reimbursement bases for these contracts are indicated on the chart.

**AGREEMENTS
BASIS**



RE, INC.

CHART XII

**RELATED PROVIDERS
REIMBURSEMENT**

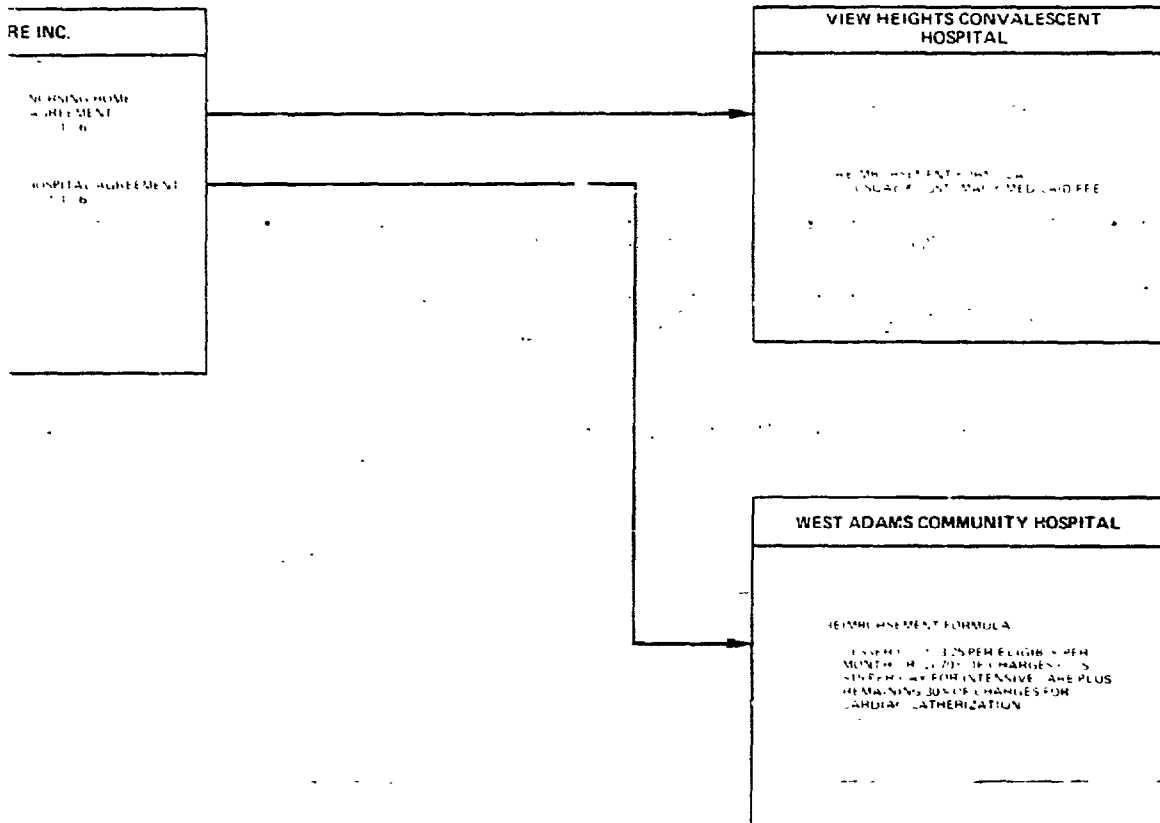


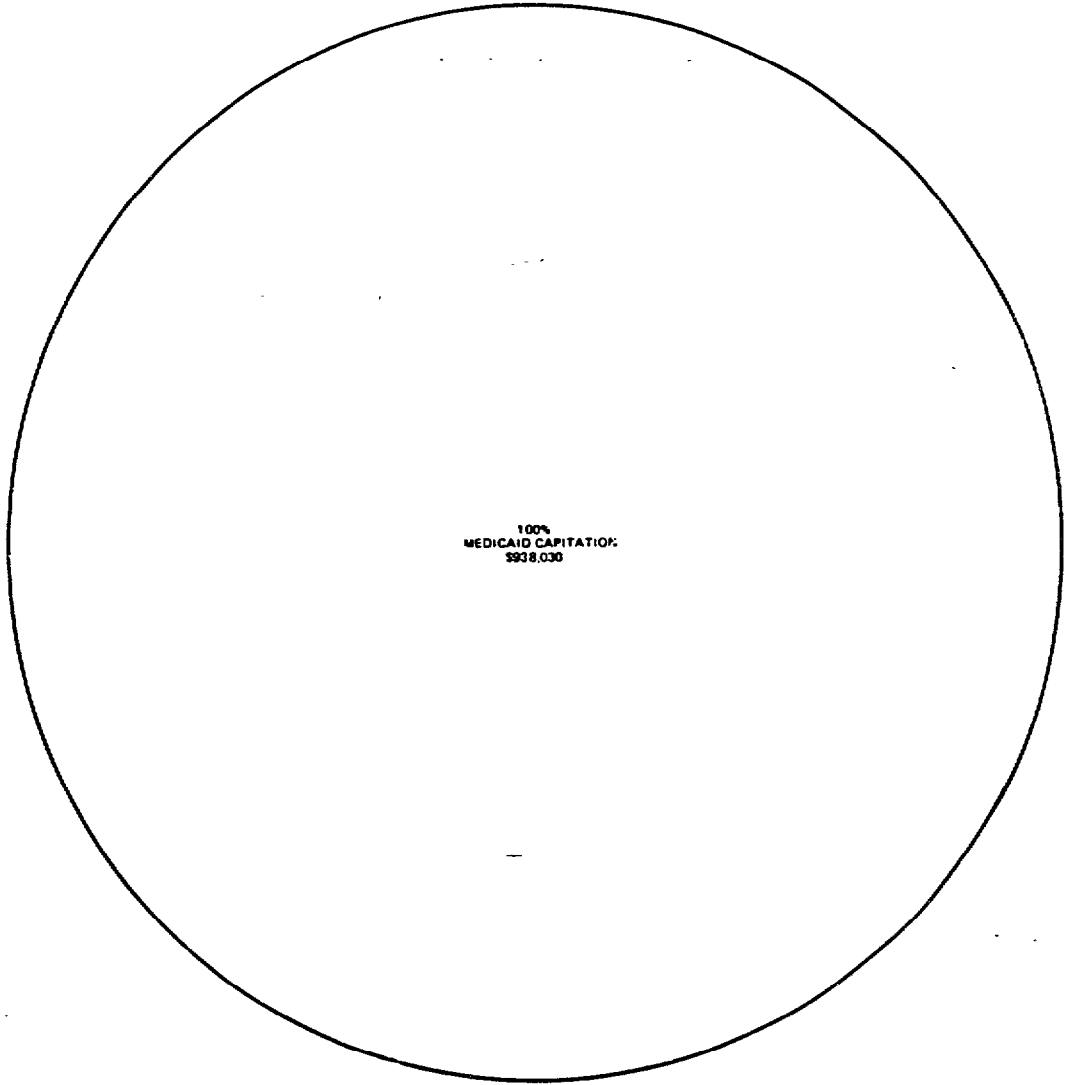
CHART XIII--OHC'S REVENUES AND EXPENSES FOR THE PERIOD*
JUNE 1 THROUGH AUGUST 31, 1975 (UNAUDITED)

Chart XIII shows the revenue and expenses of OHC. All revenues came from its Medicaid PHP contract. About 52 percent of OHC's expenses represented payments to affiliated firms.

We were not able to obtain data to permit us to make comparable revenue and expense charts for the affiliated firms.

F
FOR TH

REVENUES \$938,030
6/1/75 - 8/31/75



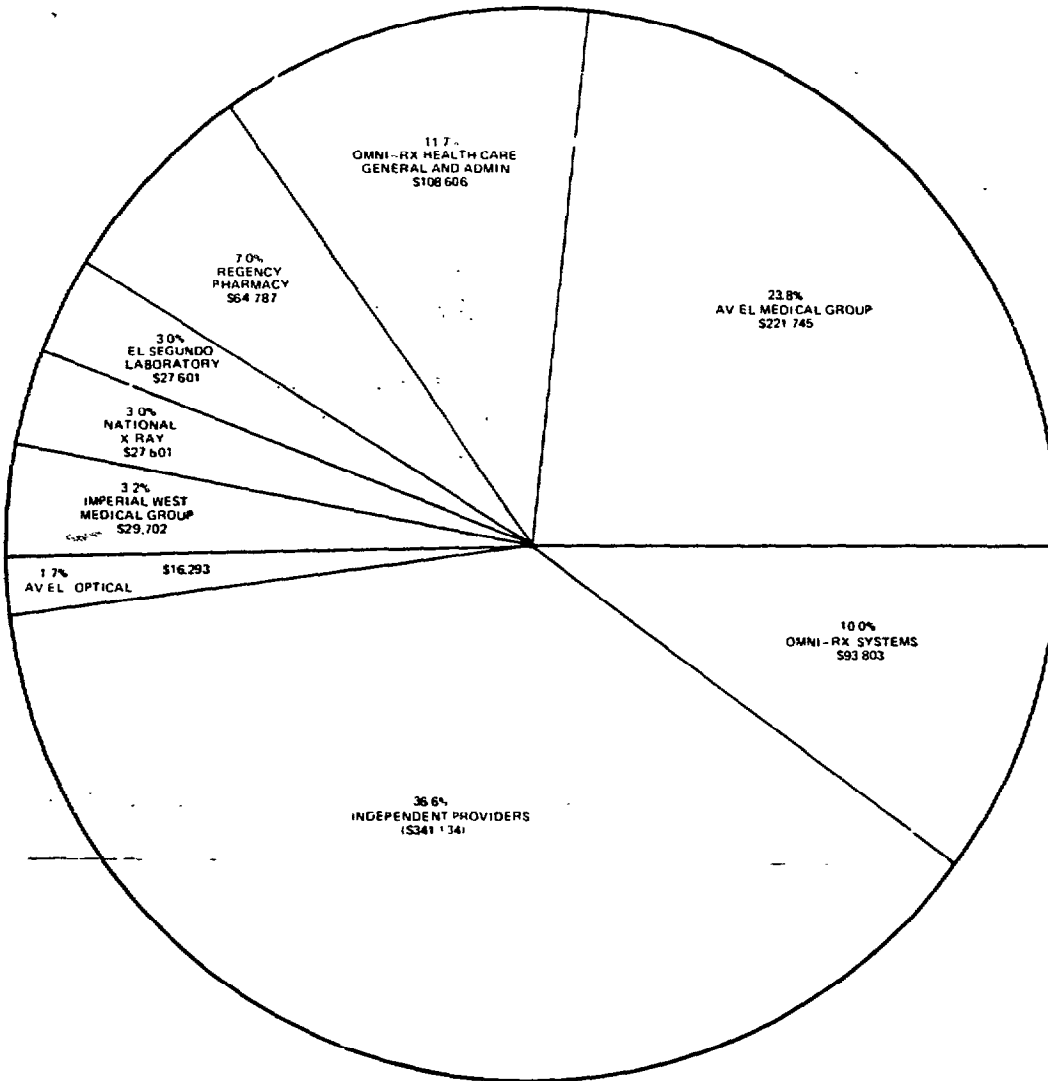
100%
MEDICAID CAPITATION:
\$938,030

E INC.
ORATION

CHART XIII

ENSES
HRU 8/31/75
1)

EXPENSES \$931,272
6/1/75 - 8/31/75



REMUNERATION OF OFFICIALS OF OMNI-RX SYSTEMS

The following table lists the annual salaries as of July 1976 of the officers of Omni-Rx Systems.

<u>Names and titles</u>	<u>Salary</u>
Edward R. Dickstein, M.D., President	<u>a/\$50,000</u>
Merv Newell, Executive Vice Pres./Treasurer	47,500
Harry Standers, Senior Vice Pres./Secretary	<u>a/b/47,500</u>
Myron Koch, M.D.	<u>a/25,000</u>
Alvin Markowitz, M.D.	<u>a/25,000</u>
William Burke, Vice President, Special Projects	30,000
Shirley Phillips, Vice President and Controller	22,000

a/Excluding partnership salaries and/or income distribution and income from leases on facilities and equipment leased to Omni-Rx Care and Omni-Rx Systems.

b/66.67 percent of salary is allocated to OHC.

CHAPTER 5

FAMILY HEALTH PROGRAM, INC.

Family Health Program, Inc. (FHP) is a non-profit, tax exempt PHP which received about 39 percent of its fiscal year 1975 revenues from its Medicaid PHP contract. FHP had about 15,700 Medicaid enrollees (out of a total of about 42,700 enrollees) in June 1976. FHP was incorporated in July 1965.

FHP is unusual in respect to the five PHPs studied because it is the only one which actually provided medical services itself. However, FHP is affiliated with 11 for profit organizations through common management and common ownership. The 11 for profit organizations are principally engaged in providing the physical plant, equipment, buildings and land necessary to deliver the health care services required by its PHP contract, and a pleasure boat and a mountain cabin. According to FHP, in its early stages of development it was faced with the problems of obtaining financial resources because of a reluctance by lending institutions to lend funds to organizations who have no principals willing to cosign the loans. FHP said it obtained capital indirectly through entities established by its principals and/or providers, either private corporations or limited partnerships.

with respect to the ownership interest of the FHP principals and other individuals in the affiliated firms, FHP's position is that:

"In total, there are 26 investors involved in all these limited partnerships and corporations. Legally, a limited partnership must consist of individuals who are associated with each other in some organization or endeavor, or are known to each other; otherwise it becomes a public offering. Therefore, it was necessary that the limited partnerships consist of individuals who are either FHP staff members or were associated with FHP as medical consultants, management consultants, or members of the Board.

"It must be noted that this is not an easy task-- to convince employees or associates to come up with hard cash out of their savings on what was in 1965 and 1966 a very speculative concept. One of the elements of a limited partnership that helps make this possible is that the tax advantage depreciation of the property inures to the investors,

thus giving them some tax shelter.

"The limited partners range from consultants, individuals that have worked as enrollment [representatives], a few Board members, staff physicians, and managers. This method also has the advantage of involving key individuals in the ultimate success of the organization.

"It was the philosophy of the Chief Executive that if he were to ask someone to invest their funds in this project, he would invest a substantial amount himself and take the total liability as the General Partner. Thus, in this method the limited partners have limited liability for adverse financial conditions."

CHART XIV--FHP's INTERRELATIONSHIP WITH
AFFILIATES AND SUBSIDIARIES--
BOARD OF DIRECTORS, OFFICERS, AND OWNERSHIPS

Chart XIV lists the Board of Directors and officers of FHP. As shown by the chart, all of these individuals, except for the consumer representatives and one of the provider representatives on the board, are partial owners of one or more of the affiliated firms. Health Maintenance Life Insurance Company is a wholly owned, for profit subsidiary of FHP.

**CORPORATE INTERRELATION
BOARD OF DIRECTORS, E**

BOARD OF DIRECTORS - F.H.P.		
FOR PROFIT AFFILIATED ORGANIZATIONS ASSOCIATED WITH		
WILLIAM BARAL PUBLIC REPRESENTATIVE	(B C E L M)	ELTON WISDOM DIRECTOR CCI
GUNTHER KLAUS Ph.D. DIRECTOR PUBLIC REPRESENTATIVE	(B C E G H I J K L)	FRANK VOLPE M.D. DIRECTOR
FRANK EATON M.D. DIRECTOR PROVIDER REPRESENTATIVE	(NONE)	IRENE SWEENEY DIRECTOR
ROBERT GUMBINER M.D. DIRECTOR PROVIDER REPRESENTATIVE	(B C D E F G H I J K L M)	WILLIAM STABLER DIRECTOR
BEN HOLZMAN DIRECTOR CONSUMER REPRESENTATIVE	(B J L)	
CORPORATE OFFICERS - F.H.P.		
ROBERT GUMBINER M.D. PRESIDENT	(SEE ABOVE)	FRANK EATON M.D. SECRETARY
CARMEN NESS D.P.S. VICE PRESIDENT	(NONE)	SEYMOUR STEIN CONTROLLER
BEN HOLZMAN TREASURER	(SEE ABOVE)	

PROFIT MAKING

C PLAZA PHARMACY CORPORATION	
ROBERT GUMBINER M.D.	49.0%
GUNTHER KLAUS	35.0
ROBERT BOLLING	8.0
WILLIAM BARAL	2.0
DELBERT STOKESBARY M.D.	2.5
HERBERT TRACY M.D.	1.5
DR. SALVADORE	1.0
IRVING SIEGEL M.D.	1.0

D PLAZA LAND CORPORATION	
PRIVATE PARTNERSHIP	
ROBERT GUMBINER	100%
JOSEPHINE GUMBINER	

P
CHP
ROB
PLA
GUM

WIL
DOL
FRS

H SANTA ANA DEVELOPMENT ASSOCIATES (BUILDING LEASE)	
LIMITED PARTNERSHIP	
ROBERT GUMBINER M.D.	30%
GUNTHER KLAUS	20
DONALD WYRENS M.D.	10
ROBERT BOLLING	10
ROBIN OXMAN M.D.	10
IRVING SIEGEL M.D.	9
FRANK VOLPE M.D.	5
DOLORES KELLET	4
HENRY SCHULTZ	2

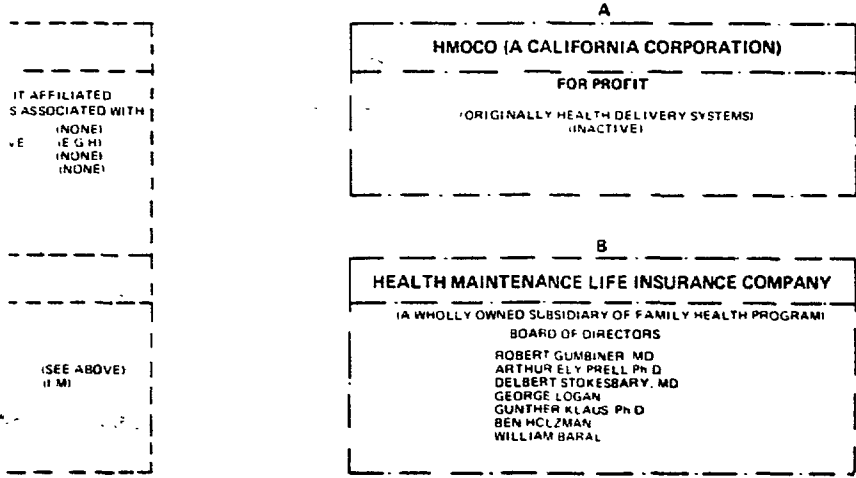
I FOUNTAIN VALLEY LAND DEVELOPMENT CO.	
LIMITED PARTNERSHIP	
ROBERT GUMBINER M.D.	64%
GUNTHER KLAUS	29
DOLORES KELLET	4
SEYMOUR STEIN	2
CHARLES EUBANKS M.D.	1

J DEVELOPMENT ASSOCIATES	
PARTNERSHIP	
ROBERT GUMBINER M.D.	30.0%
GUNTHER KLAUS	17.0
PERCO J	12.5
BEN HOLZMAN	6.875
ROBERT GUMBINER TRUST	4.25
ROBIN OXMAN M.D.	6.25
DELBERT STOKESBARY M.D.	6.25
HERBERT TRACY M.D.	6.125
IRVING SIEGEL M.D.	5.0
FHP RETIREMENT TRUST	3.75

--- INDICATES NOT FOR PROFIT ENTITIES
 --- INDICATES FOR PROFIT ENTITIES

J/ PHYSICIAN EQUIPMENT RENTAL COMPANY

**ILIATES AND SUBSIDIARIES
CERS, AND OWNERSHIP**



ARTNERSHIPS

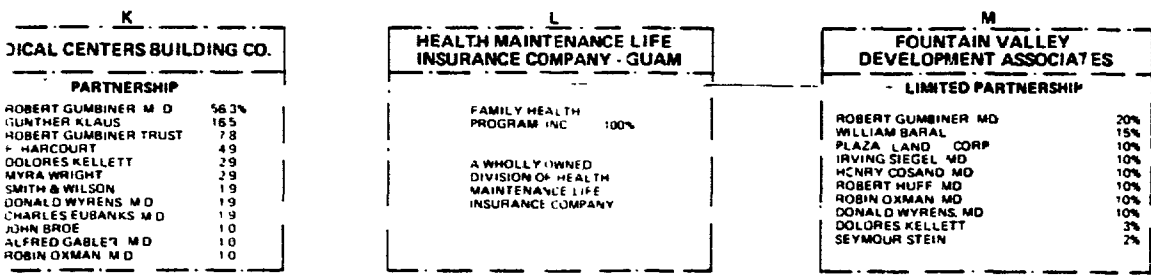
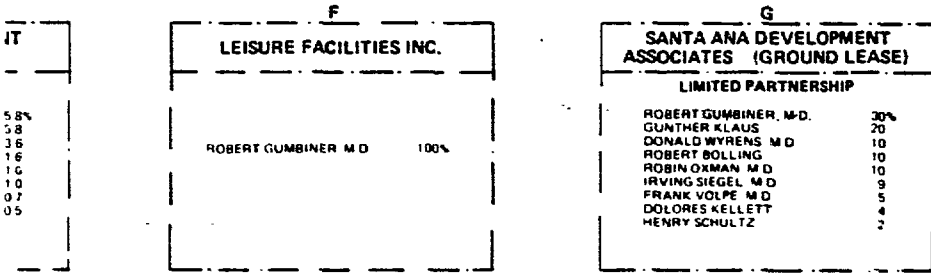
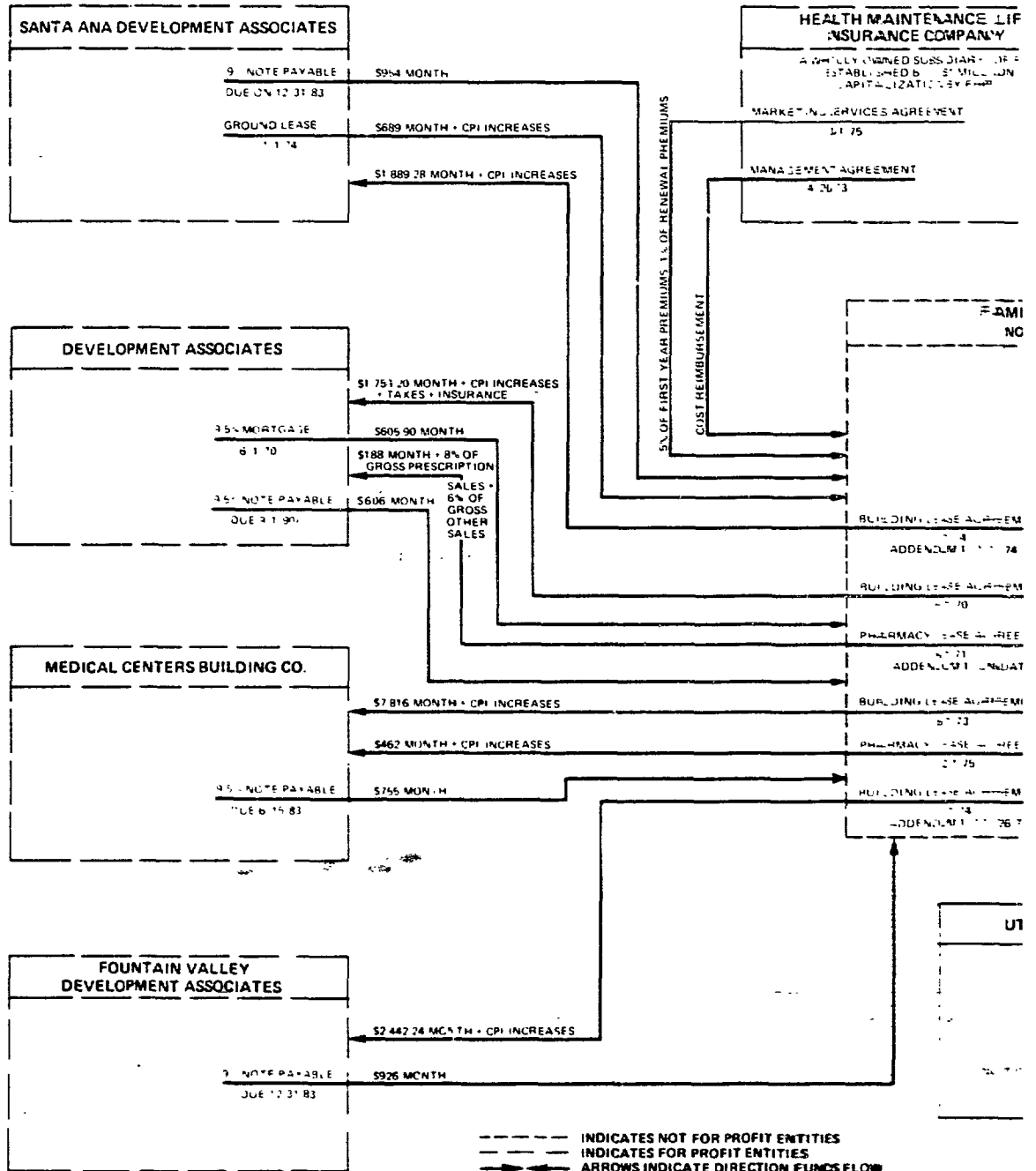


CHART XV--FHP'S INTERCOMPANY AGREEMENTS

This chart shows the agreements between FHP and its affiliated firms. Most of these agreements relate to the medical and office buildings FHP leases. Typically, money flows in both directions relating to these leases. Payments flow to FHP from the real estate owners as payment on notes payable or mortgages used to construct the building and/or purchase equipment. Payments also flow from FHP to the real estate owners as payments for leasing the building. In some cases, there are separate lease agreements for the pharmacy portion of the building. In one case, there is also a land lease agreement.

FHP also leases a boat and a mountain cabin from an affiliated firm and provides marketing and management services to its wholly owned for profit insurance subsidiary.



EMENTS

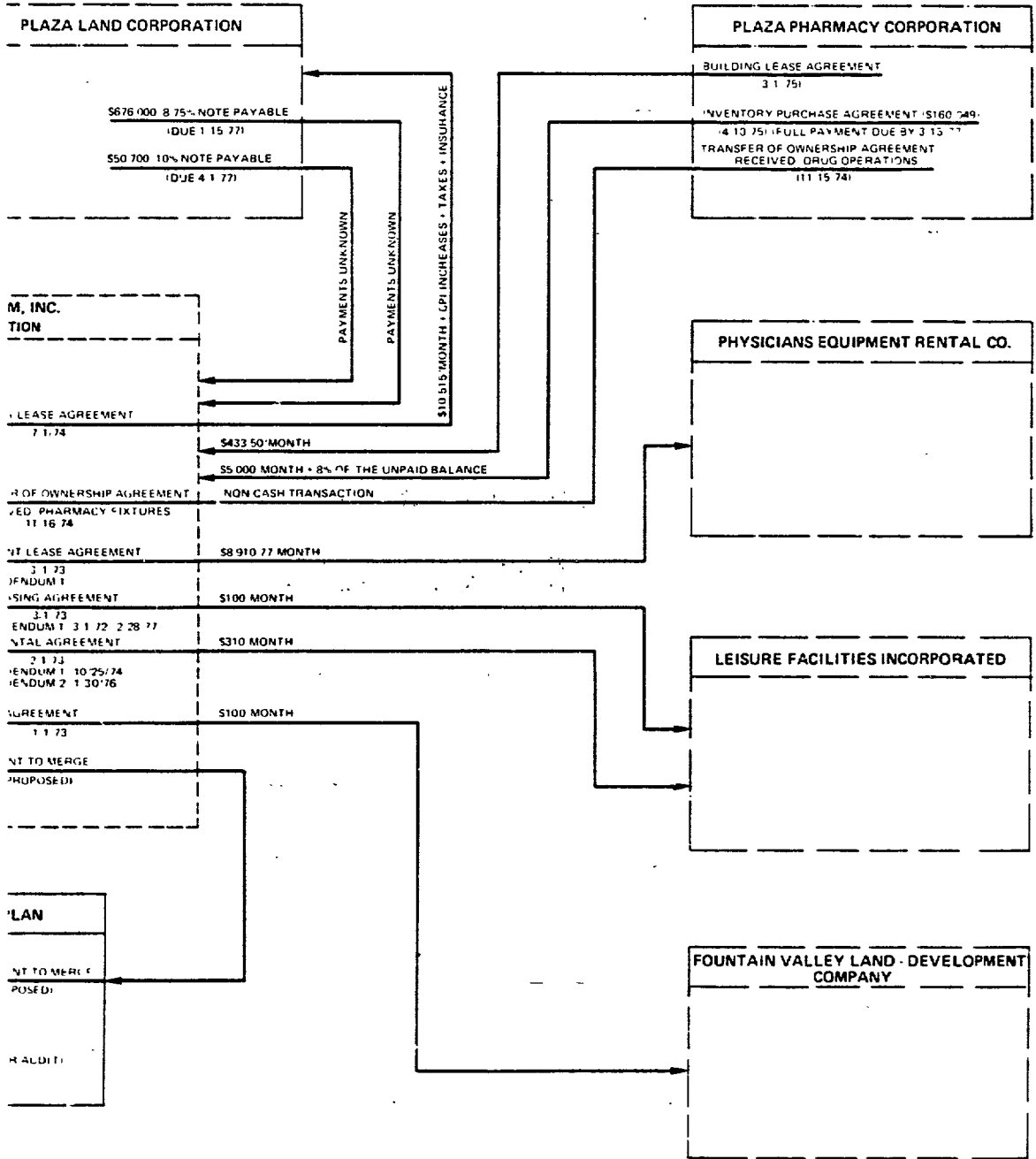
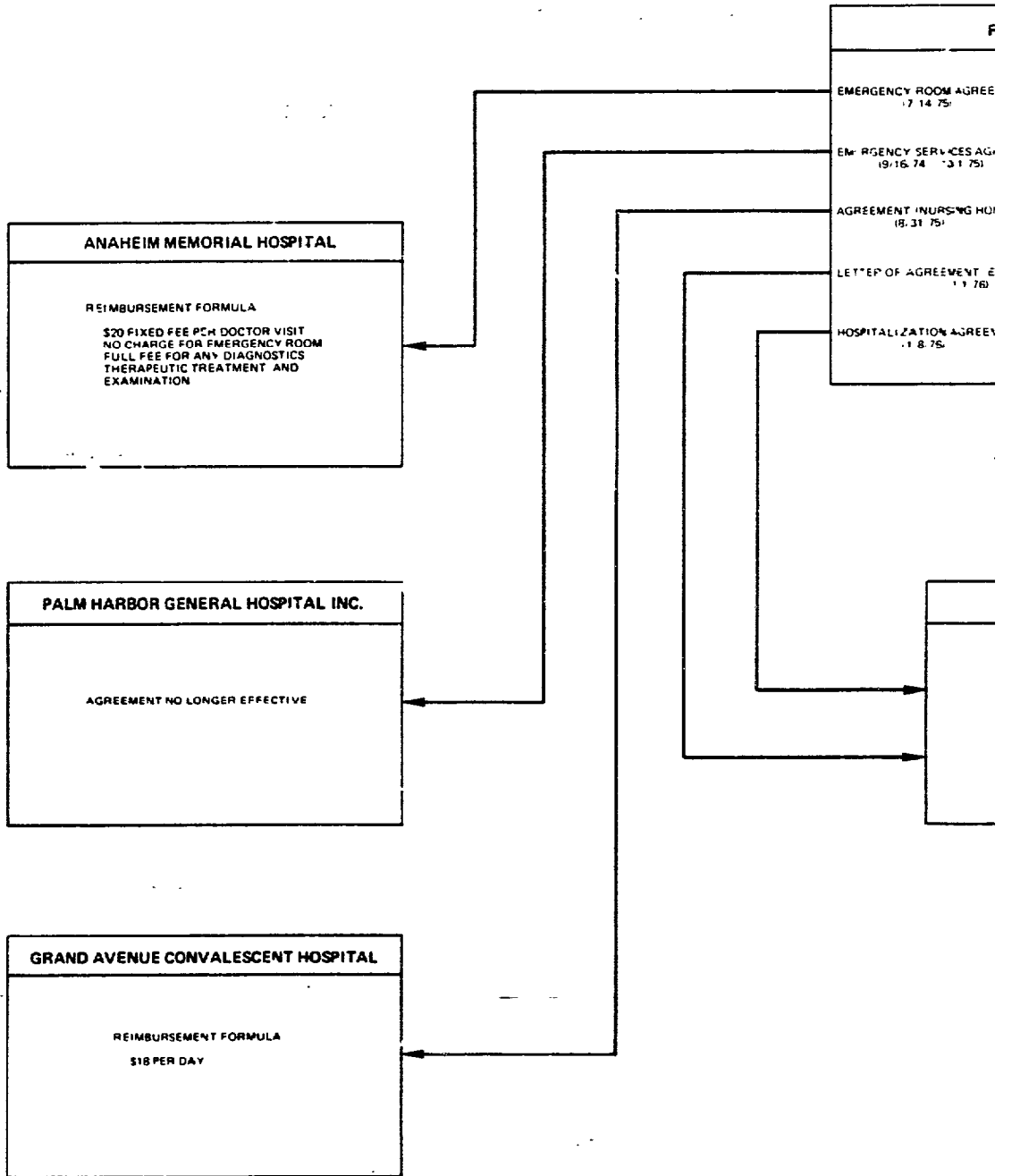


CHART XVI--FHP's AGREEMENTS WITH UNAFFILIATED PROVIDERS

Chart XVI shows FHP's agreements with unaffiliated providers. Generally these agreements call for reimbursement on a fixed-fee or fixed-fee-plus-cost-sharing basis.

AGREEMENT



ATED PROVIDERS

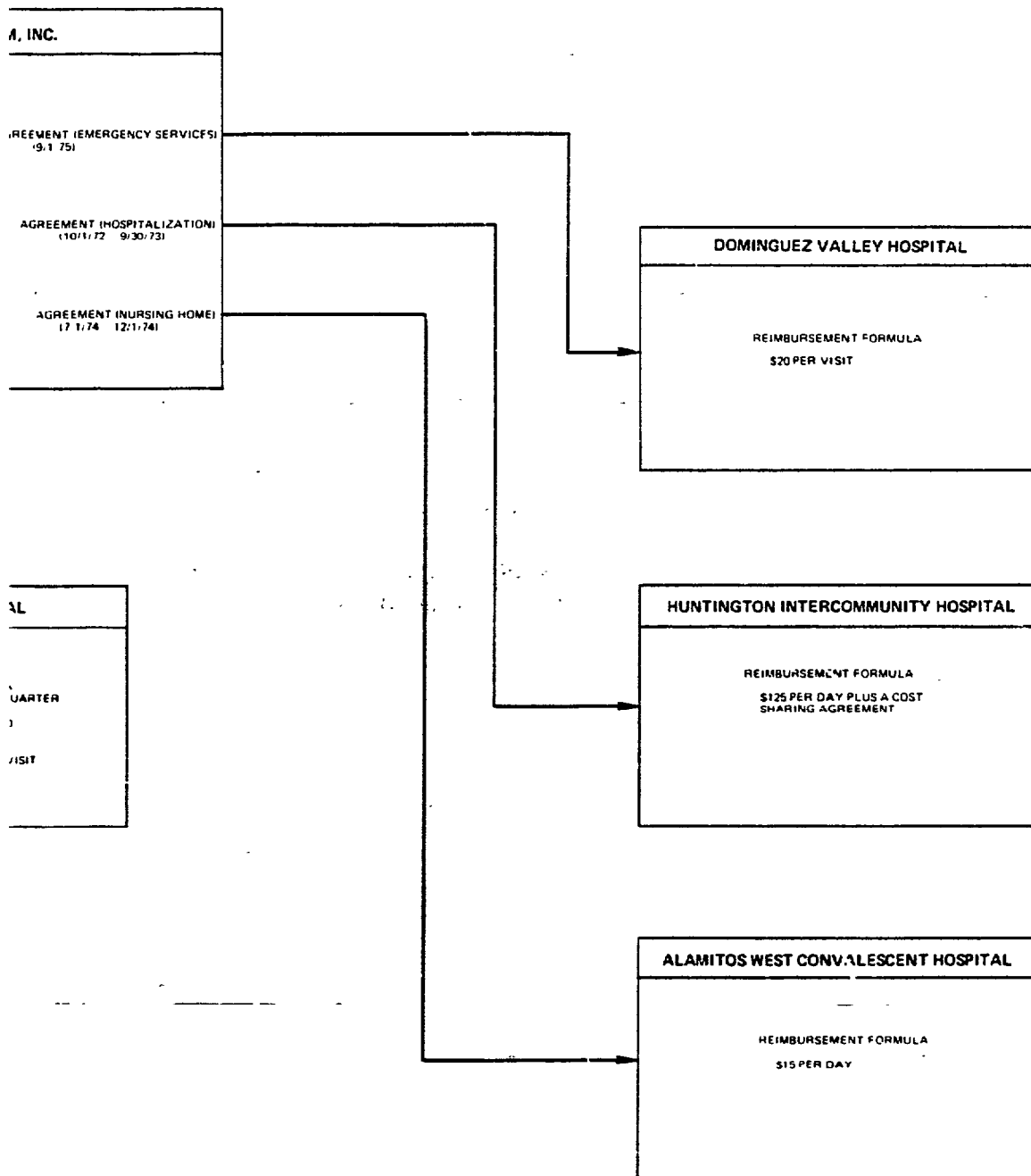


CHART XVII--FHP's AND AFFILIATES'
REVENUE AND EXPENSES

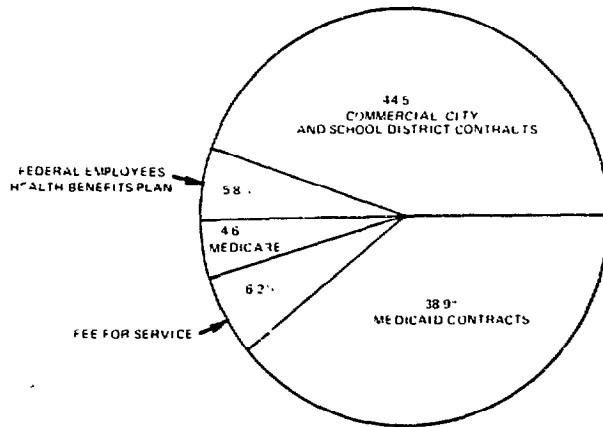
This chart depicts the revenue and expenses of FHP and its affiliates. In most cases, the affiliates revenues come solely from FHP. The affiliates had before-tax earnings ranging from a profit of 58.9 percent of revenues to a 47.4 percent loss.

FHP itself had a net excess of revenues over expenses of \$688,757 or about 4.4 percent of total revenues. This would be analogous to a before-tax profit for a for profit firm.

The financial data presented was provided to us by FHP and/or its affiliates. We did not attempt to verify the data and it had not been audited by independent accounting firms except for the data relating to Health Maintenance Life Insurance.

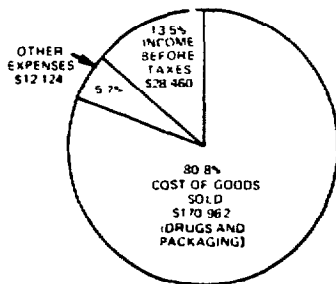
REVE
(UNAUDITE
MAINTENA

FAMILY HEALTH PROGRAM
SOURCES OF REVENUE
FISCAL YEAR ENDED JULY 31, 1975

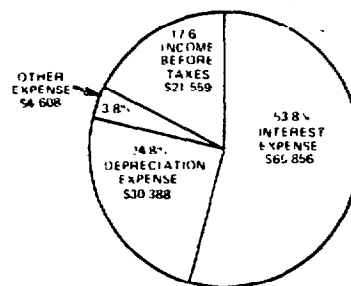


FHP F
OPERATING
OTHER REV
TOTAL
EXPENSES
DECREASE (I
TOTAL
EXCESS OF I
OVER I

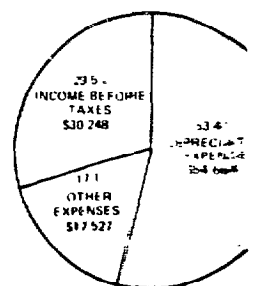
PLAZA PHARMACY
YEAR ENDED FEBRUARY 28, 1975
TOTAL REVENUE \$211,546



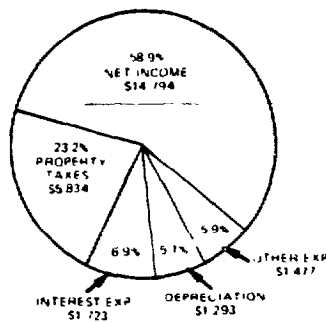
PLAZA LAND CORPORATION
YEAR ENDED MAY 31 1975
TOTAL REVENUE \$122,411



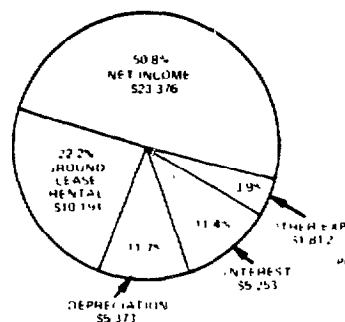
PHYSICIAN'S EQUIPME
RENTAL COMPANY
YEAR ENDED JUNE 30, 1975
TOTAL REVENUE \$102,414



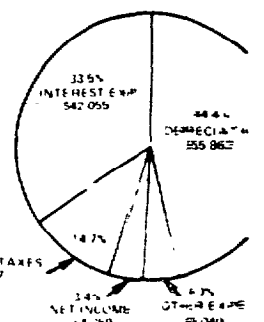
FOUNTAIN VALLEY LAND DEVELOPMENT CO.
YEAR ENDED 12/31/75
TOTAL INCOME \$25,121



DEVELOPMENT ASSOCIATES
YEAR ENDED 12/31/75
TOTAL INCOME: \$46,000



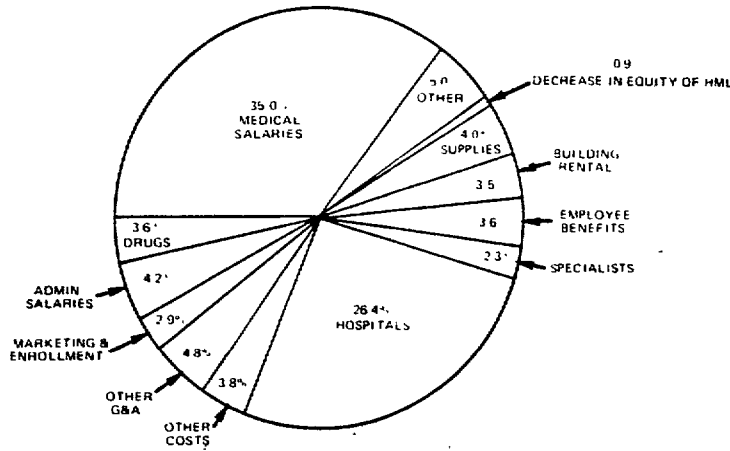
MEDICAL CENTERS BLDG.
YEAR ENDED 12/31/75
TOTAL INCOME \$125,685



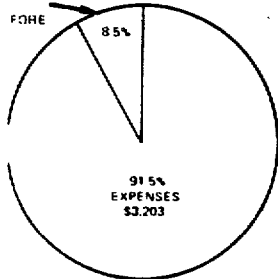
**NSES
HEALTH
INSURANCE CO.)**

**FAMILY HEALTH PROGRAM
BREAKDOWN OF COSTS
FISCAL YEAR ENDED JULY 31, 1975**

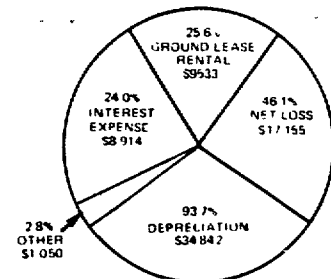
USES
\$15,544,423
236,765
\$15,781,188
14,951,503
140,928
\$15,092,431
688,757



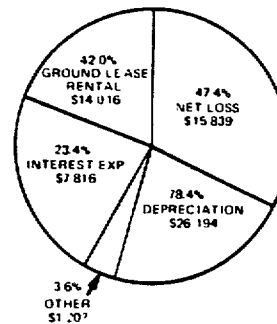
**LEISURE FACILITIES, INC.
YEAR ENDED FEBRUARY 28, 1975
TOTAL REVENUE \$3,500**



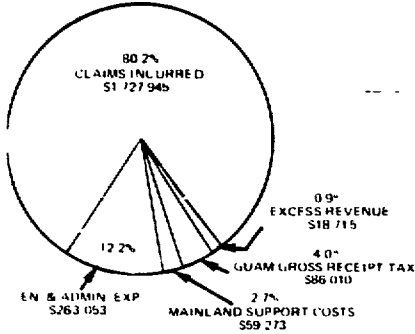
**SANTA ANA DEVELOPMENT ASSOCIATES
YEAR ENDED 12/31/75
TOTAL REVENUE \$37,174**



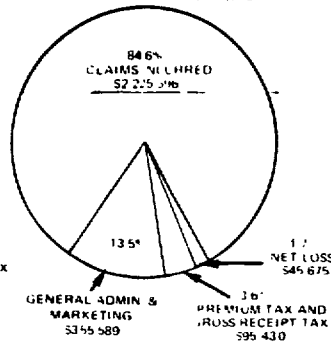
**FOUNTAIN VALLEY DEVELOPMENT ASSOC.
YEAR ENDED 12/31/75
TOTAL REVENUE \$33,394**



**HEALTH MAINTENANCE LIFE
GUAM DIVISION
YEAR ENDED 12/31/75
TOTAL REVENUE \$2,154,996**



**HEALTH MAINTENANCE LIFE INSURANCE (HML)
CONSOLIDATED STATEMENT (INCLUDES GUAM)
YEAR ENDED 12/31/75
TOTAL REVENUE \$2,630,940**



REMUNERATION OF FHP's OFFICERS

The following table lists the annual salaries as of June 1976 of FHP's officers.

<u>Names and titles</u>	<u>Salary</u>
Robert Gumbinder, M.D. President	a/\$65,000
Carmen Ness, H.S.D., Vice President	40,000
Ben Holzman, Treasurer	a/0
Frank Eaton, M.D., Secretary	44,500
Seymour Stein, Controller	a/29,000

a/Excluding profit distribution from affiliates, income from leases for facilities and equipment, and partnership salaries, if any.

CHAPTER

AMERICAN HEALTH CARE PLAN, INC.

American Health Care Plan, Inc. (AHCP) is a nonprofit, tax exempt PHP. AHCP's only source of medical revenue is the capitation paid by the State for Medicaid eligibles which amounted to \$2,800,738 in 1975. The plan had about 8,000 Medicaid enrollees as of March 1975.

AHCP is affiliated with 3 medical groups with which it contracts for medical services. It also contracts with unaffiliated firms for ancillary, inpatient, and specialist services.

CHART XVIII--AHCP's CORPORATE INTERRELATIONSHIP WITH
AFFILIATES--BOARD OF DIRECTORS, PRINCIPAL OFFICERS,
AND OWNERSHIPS

This chart shows that AHCP is affiliated through common boards of directors and/or officers with three medical groups. A fourth affiliated group was disbanded in March 1976 and its principals joined the other medical groups. We were not able to obtain the ownership percentages of one of the affiliated groups.

AME

**CORPORATE IN
BOARD OF DIRECTOR**

AME
A
DIRECTORS
NORMAN SHAPIRO MD CHAIRMAN ARTHUR M COLEMAN MD VICE JOSEPH PIERCE SECRETARY DONALD LASTHETO MD TREAS ETHEL DOTSON ALIPRAN A WI RENE LARIVAS MEMBER OF THE ROBERT J HARVEY MD MEMBER
PRINCIPAL OFFICERS
ARTHUR M COLEMAN MD PRES WILLIAM L YOUNGBLOOD SENIOR HARRY H YEE CONTROLLER

A

ASSOCIATES CLINICAL GROUP
A NON PROFIT CORPORATION
DIRECTOR
ARTHUR M COLEMAN MD JOHN JONER PH D LAWRENCE NEBLETT MD HARRISON PARKER D O S WILLIAM SALE MD
MEMBER
ROBERT J HARVEY MD

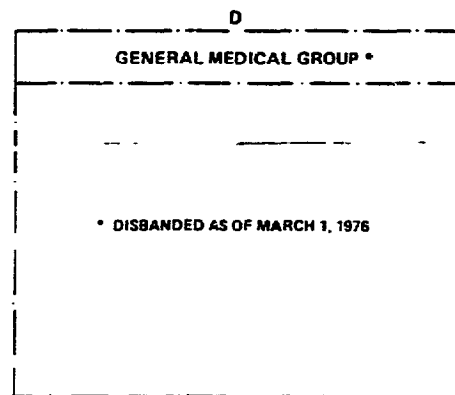
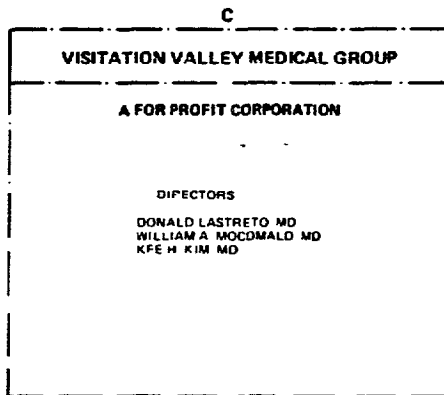
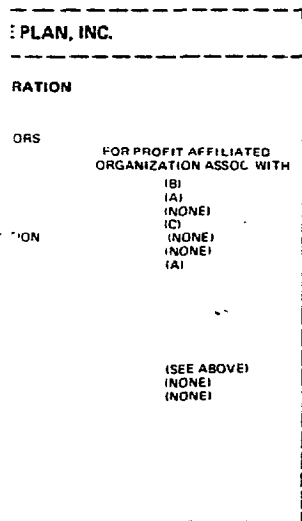
B

GOLDEN GATE MEDICAL ASSOCIATES OF UNITY HOSPITAL, INC.	
A FOR PROFIT CORPORATION	
OWNERS	STOCK OWNERSHIP
JOHN BERTRAND MD*	50
BENJAMIN CANDOLORIO MD	50
EDWARD HAMBRECK MD*	50
RAUL SILVA MD	50
E M CHRISTOBAL MD	50
NORMAN SHAPIRO MD*	50
HELEN M HERRA MD	50
MARVIN LIPTON	50
HERBERT KONKOFF	50
EDGAR FREUDER MD*	50
TOTAL	500 **
* ALSO DIRECTORS	
** TOTAL SHARES OUTSTANDING	

PLAN, INC.

CHART XVIII

**HIP WITH AFFILIATES
OFFICERS AND OWNERSHIP**



**DT FOR PROFIT ENTITIES
NR PROFIT ENTITIES**

CHART XIX--AHCP'S AGREEMENTS WITH PROVIDERS

This chart shows AHCP's agreements with both affiliated and unaffiliated providers. About 40 percent of the Medicaid funds received by AHCP are paid to affiliated firms. Two of the principals of AHCP also have consulting contracts with it.

Unaffiliated providers are generally paid on a fee-for-service basis.

AMER

AGREEE

GOLDEN GATE MEDICAL ASSOCIATES

AGREEMENT FOR MEDICAL SERVICES
4/30/74
AMENDMENT 1 9/15/75

VISITATION VALLEY MEDICAL GROUP

AGREEMENT FOR MEDICAL SERVICES
2/1/74
AMENDMENT 1 1/30/75
AMENDMENT 2 10/1/75
AMENDMENT 3 11/29/75

NOTE 1

NOTE

UNAFFILIATED PROVIDERS

PROVIDER AGREEMENTS - RADIOLOGY

PROVIDER AGREEMENT WITH JACK J. LEE 2/1/76
PROVIDER AGREEMENT WITH DIAGNOSTIC RADIOLOGISTS OF SAN FRANCISCO 1/22/74
PROVIDER AGREEMENT WITH ASSOCIATES & HAY 11/7/73

PROVIDER AGREEMENTS - LABORATORY

PACIFIC MEDICAL LABORATORY 3/14/74
ROBERT A. STEVEN, MD 3/20/74
OCEAN VIEW MEDICAL LAB INC 2/14/73
CENTRAL DIAGNOSTIC LABORATORY 11/23/73
RISKIND LABORATORY, INC 11/28/73

PROVIDER AGREEMENTS - PHARMACY

PROFESSIONAL PHARMACY JOHN WESLEY JONES 2/12/73
INTERNATIONAL DRUG 1/30/74
ALLA WEL COMMUNITY PHARMACY 11/26/73
FRANKLIN HOSPITAL PHARMACY PHILIP LEE 1/14/74
DISERNIA'S PHARMACY 11/20/73

AMER

MEDICAL SERVICES
MEDICAL SERVICES
RADIOLOGIST SERV AGREEMENTS
LABORATORY AGR
PHARMACY AGREEMENTS

HOS

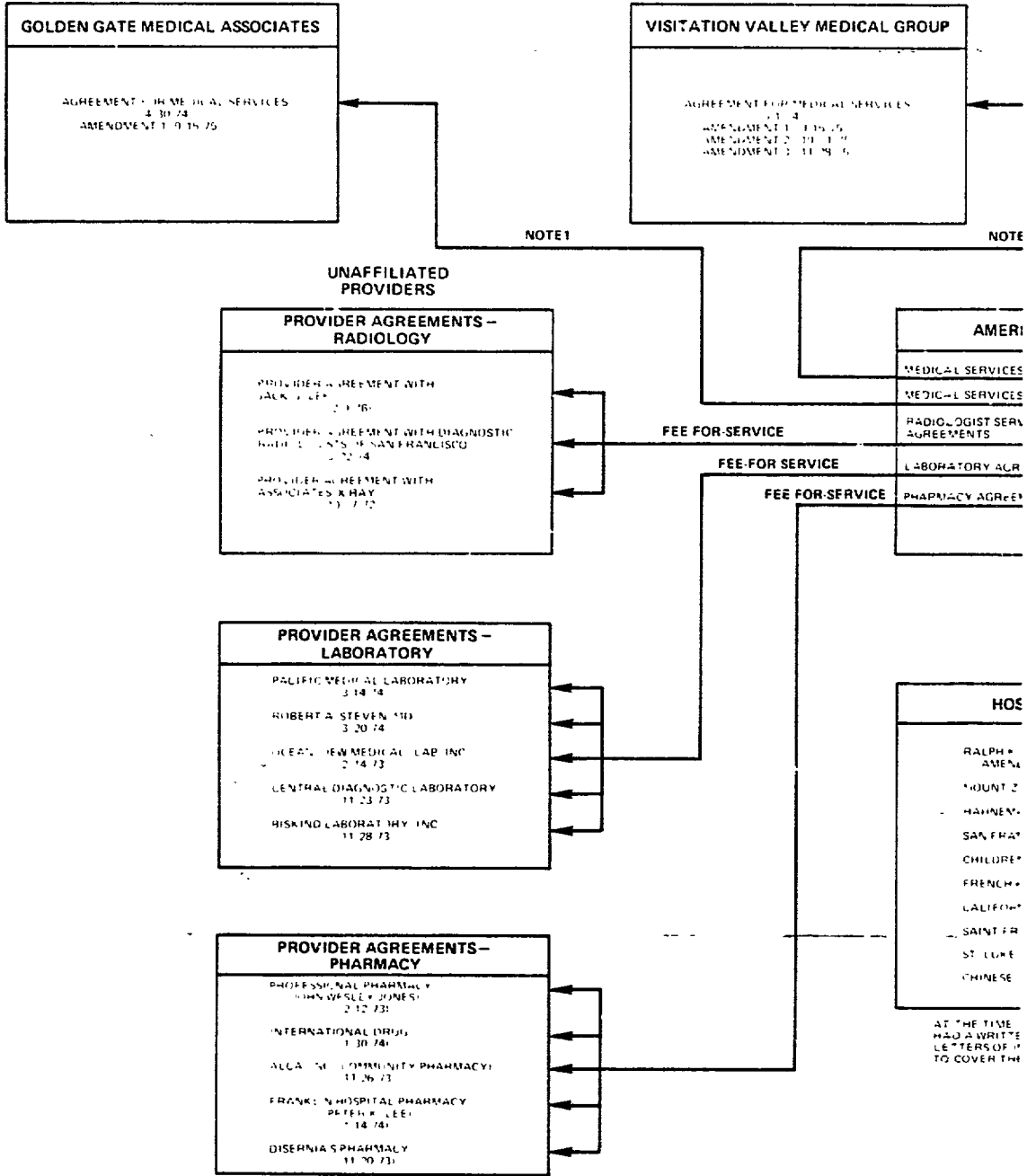
RALPH AMEN
MOUNT Z
HAYNES
SAN FRANCISCO CHILDREN
FRENCH
CALIFORNIA
SAINT FRANCISCO
ST. LUKE
CHINESE

AT THE TIME HAD A WRITE LETTERS OF IT TO COVER THE

FEE FOR SERVICE

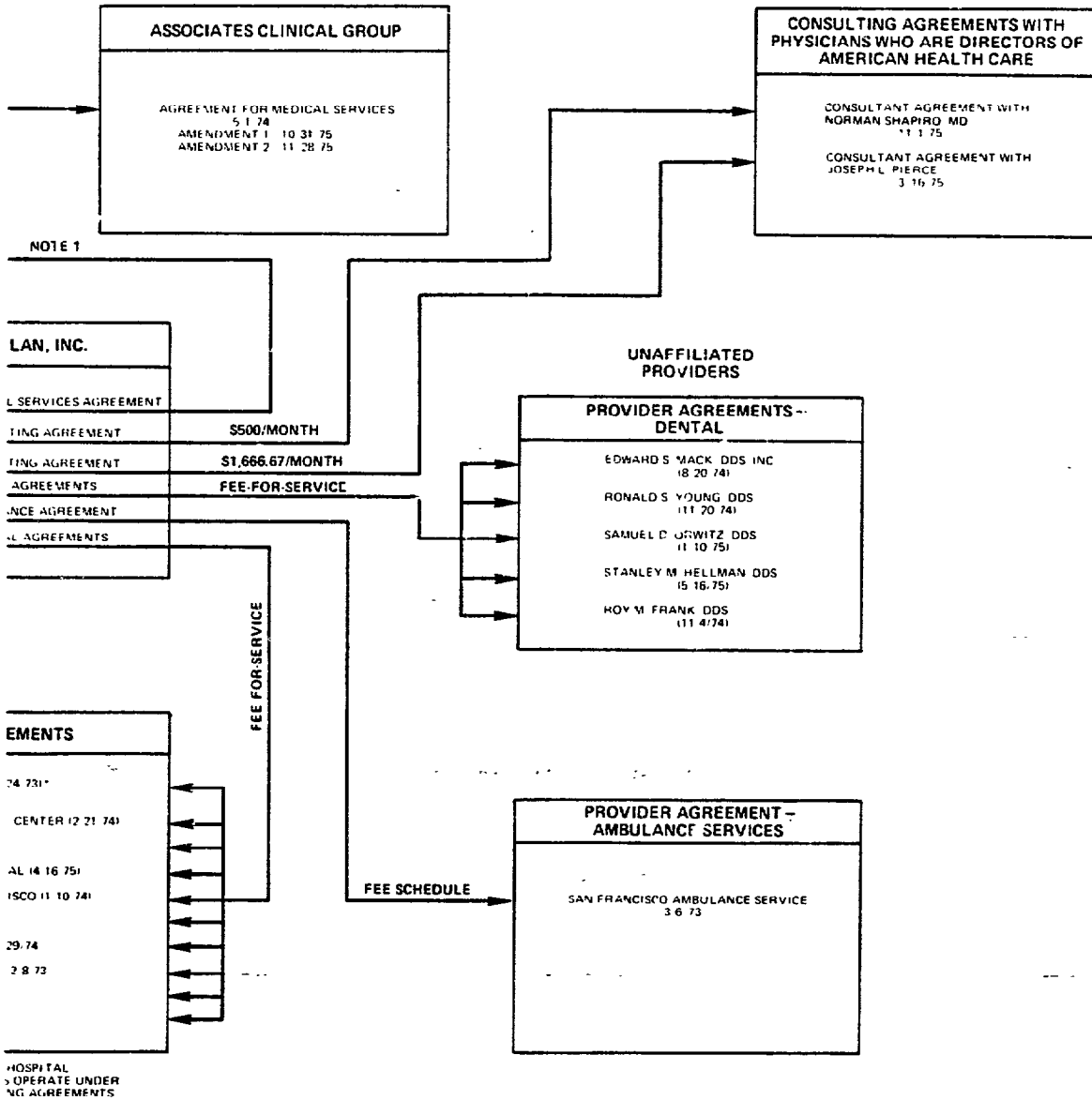
FEE FOR SERVICE

FEE FOR SERVICE



PROVIDERS

RES



NOTE 1: EACH OF THESE GROUPS IS PAID, FOR INDIVIDUALS ASSIGNED TO THE GROUP, A PERCENTAGE OF THE PER CAPITA PREMIUM REMAINING AFTER SUBTRACTION OF MARKETING ENROLLER'S COMMISSION. GOLDEN GATE MEDICAL ASSOCIATES RECEIVE 42% AND THE OTHER TWO GROUPS RECEIVE 41%.

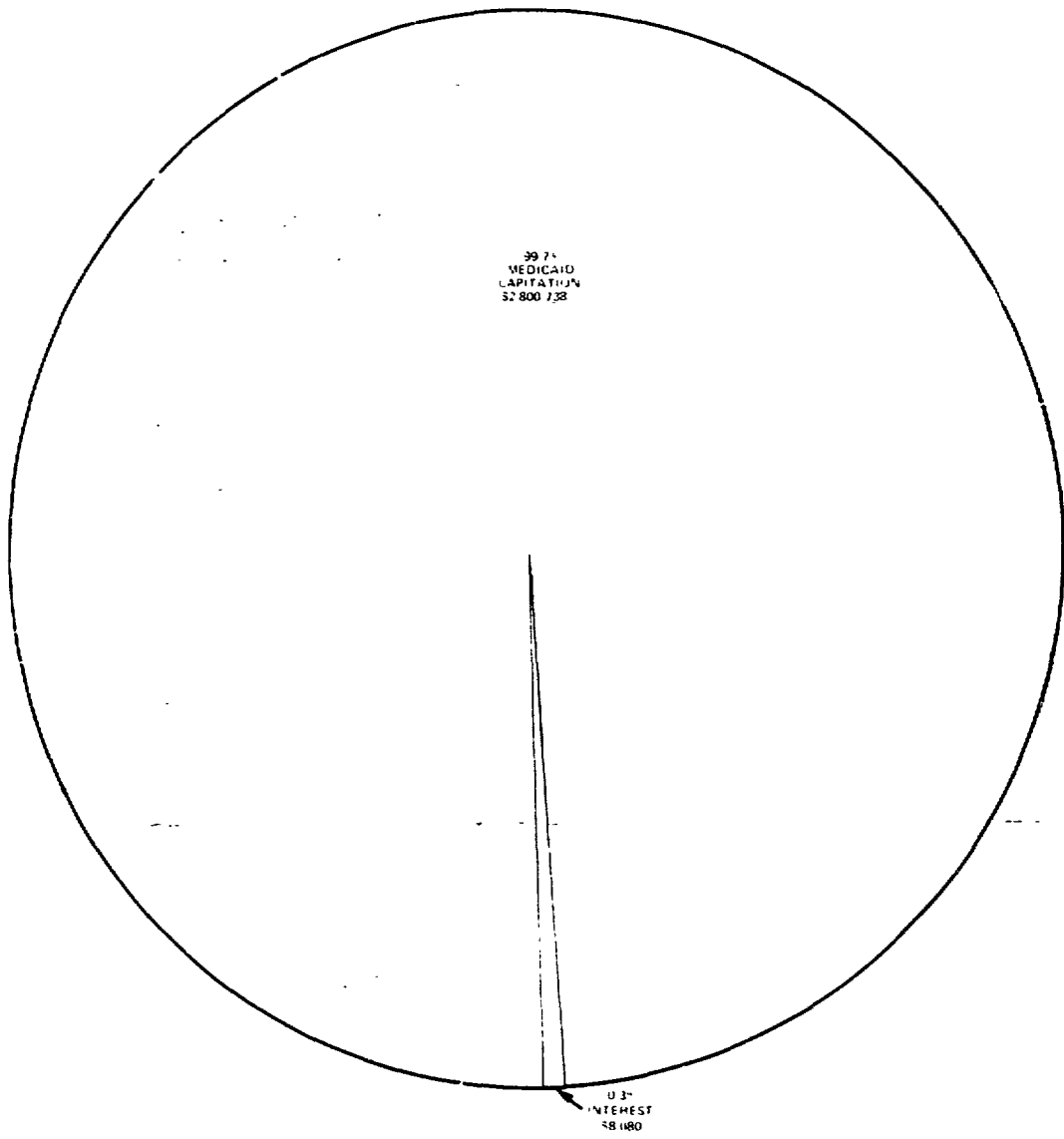
CHART XX--AHCP'S REVENUES AND EXPENSES (AUDITED)

Chart XX shows AHCP's revenues and expenses for the year ending December 31, 1975. Forty-one percent of AHCP's revenues were paid to affiliated firms. The data was audited by an independent accounting firm.

We did not obtain data on the revenues and expenses of AHCP's affiliated firms.

A
R
FOR TI

REVENUE
FOR THE FY ENDING DECEMBER 31, 1975
TOTAL: \$2,808,818



ARE PLAN, INC.
CORPORATION

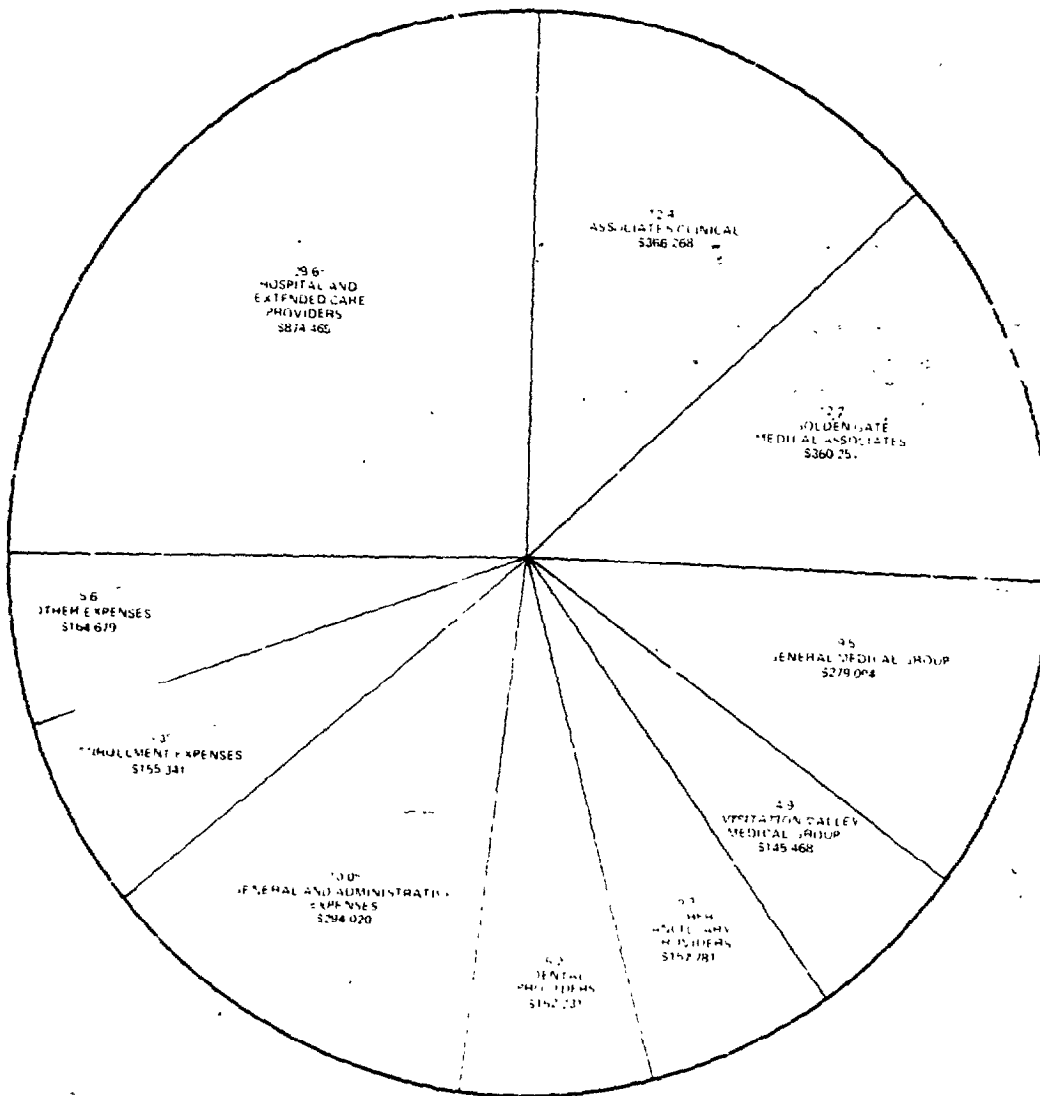
CHART XX

EXPENSES

FOR THE YEAR ENDING
DECEMBER 31, 1975

D1

EXPENSES
FOR THE YEAR ENDING DECEMBER 31, 1975
TOTAL: \$2,949,598



REMUNERATION OF AHCP's DIRECTORS AND PRINCIPAL OFFICERS

The following table lists the remuneration, including annual salaries, as of July 1976 of AHCP's directors and principal officers.

<u>Names and titles</u>	<u>Remuneration</u>
Norman Shapiro, M.D.--Chairman	\$ a/0
Arthur H. Coleman, M.D.--Vice Chairman, President	b/1,028
Donald Castreto, M.D.--Director, Treasurer	e/0
Robert J. Harvey, M.D.--Director	d/0
Joseph L. Pierce--Director, Secretary	e/0
Ethel Dotson--Director (Consumer Representative)	0
Irene Vargas--Director (Consumer Representative)	0
William L. Youngblood--Senior Vice President	e/29,948
Harry H. Yee--Controller	25,000

a/Does not include salaries and/or income distributions from affiliates; does not include \$6,000 annual consulting fee from AHCP.

b/Includes \$715 per month for residence provided and \$204 per month for automobile provided; does not include salaries and/or income distributions from affiliates.

c/Does not include \$204 per month for automobile provided; does not include salaries and/or income distributions from affiliates.

d/Does not include salaries and/or income distributions from affiliates

e/Does not include \$20,000 annual consulting fee from AHCP.

CHAPTER 7

APPROVAL OF PHP CONTRACTS AND

SUBCONTRACTS BY THE STATE AND HEW

The State requires:

1. All PHP subcontracts shall be entered into pursuant to regulations established by the State agency.
2. All PHP subcontracts shall be in writing and shall be transmitted by the PHP to the State agency for approval.
3. The PHP subcontracts must demonstrate to the satisfaction of the State agency the legal sufficiency of the subcontractor's commitment and ability to perform.
4. The PHP subcontracts shall state the amount of compensation or other consideration which the subcontractor or provider will receive under the terms of the subcontract with the PHP.

HEW regulations provide that PHP contracts with expected values over \$100,000 must be approved by HEW before they are initiated.

STATE ADHERENCE TO APPROVAL REQUIREMENT

The State agency has not established criteria or regulations outlining the elements required to be included in a PHP's subcontracts. A "for discussion only" draft of such elements was issued in April 1976. As of September 1, 1976, the draft had not been finalized.

A State official in charge of PHP operations stated that no guidelines or criteria have been established for review and approval of subcontracts by State contracting officers. Consequently, the State approval process basically consists of a cursory review of the subcontract submitted for approval.

This official further stated that the State generally does not give written approval to a PHP for subcontracts; rather, the common practice is to give tacit approval by not objecting to the subcontract. For the PH's studied, the State had not approved their subcontracts, but had given preliminary approval for subcontracts in the case of Omni-Rx

Health Care. Also, the State is only aware of those subcontracts which are submitted by the PHP and not those that a PHP has failed to submit. Another State official stated that many PHPs entered into subcontracts prior to the approval requirement.

In summary, the State has not provided the PHPs with regulations regarding subcontract format, nor has it prepared criteria for subcontract approval for use by its contract managers. The State has not formally approved PHP subcontracts as required by State law.

HEW APPROVAL OF PHP CONTRACTS AND SUBCONTRACTS

HEW requires prior approval of expenditures under all PHP contracts with values of over \$100,000. The contracts with the five PHPs studied had been approved by the HEW Regional Office. The HEW Associate Regional Commissioner responsible for the Medicaid program told us that HEW has not required prior approval of PHP subcontracts, but that a move is underway to clarify HEW's responsibilities with respect to subcontract approval. More specifically, the Associate Commissioner stated that although there have been several policy interpretations since the August 9, 1975, amendment to the regulations which required prior approval of expenditures under State contracts with values over \$100,000, these policy interpretations need further clarification. The Associate Commissioner indicated that his region is seeking guidance from the HEW central office.

We also learned that HEW plans to:

1. Require that the State approve all PHP subcontracts prior to their taking effect, and all PHP subcontracts be subjected to the same type of a review as is given the prime contract.
2. Strongly urge that the State require every PHP contractor to deliver the basic "core" services within its own organization to avoid creating problems with PHP contractors that act only as "front" organizations and subcontract for all services.