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*REPORT OF THE  
COMPTROLLER GENERAL  
OF THE UNITED STATES*

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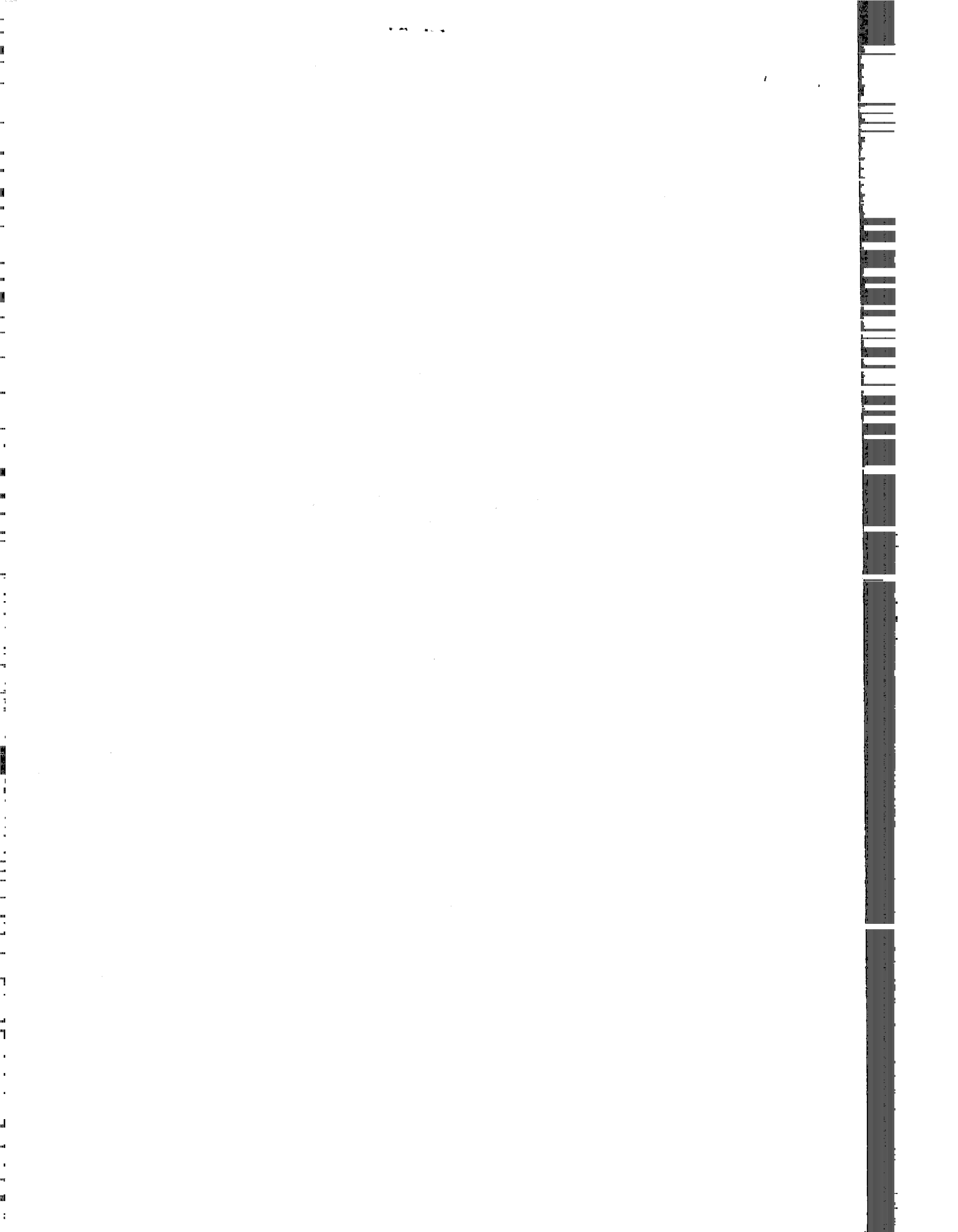
Grants For Development Of  
Health Maintenance Organizations  
In Region IV

Department of Health, Education,  
and Welfare

This report furnishes information on the (1) organizational status of federally assisted health maintenance organizations, (2) HEW audits of health maintenance organizations, and (3) HEW's monitoring and evaluation of the region's health maintenance organizations.

~~708992~~

094717





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

B-164031(5)

The Honorable Ernest F. Hollings  
United States Senate

Dear Senator Hollings:

This is our report that you requested in September 1974 on the development of health maintenance organizations throughout the Department of Health, Education, and Welfare's region IV.

Since our report on the Health Maintenance Organization of South Carolina, region IV's organization and management activities have changed extensively, but we cannot conclude that the region's management of the health maintenance organization program improved.

To better assess the effectiveness of the Department's management of the program, we have undertaken a comprehensive review in each of the Department's 10 regional offices. We will furnish you a copy of our report on this review.

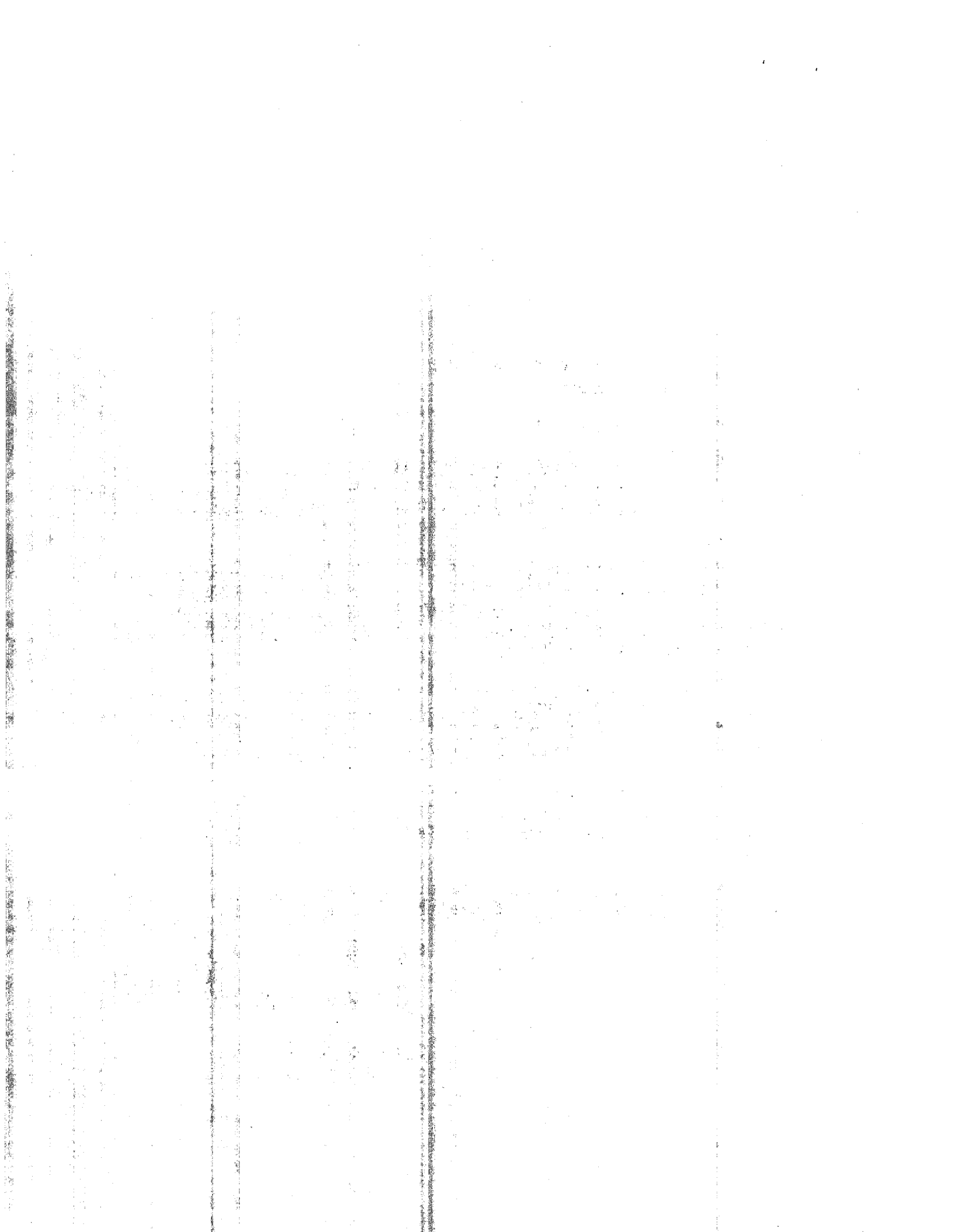
As you requested, we have not obtained written comments from the Department or any of the grantees. We did, however, discuss our findings with Department officials and considered their remarks.

As your office agreed, we are providing copies of this report to the Secretary of Health, Education, and Welfare.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Thomas B. Staats".

Comptroller General  
of the United States





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

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Sincerely yours

A handwritten signature in cursive script, appearing to read "Luther B. Stutz".

Comptroller General  
of the United States



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ABBREVIATIONS

FHPC Florida Health Care Plan, Inc.  
GAO General Accounting Office  
HEW Department of Health, Education, and Welfare  
HMO Health Maintenance Organization  
HMOSC Health Maintenance Organization of South Carolina,  
Inc.  
HSA Health Services Administration



D I G E S T

Senator Ernest F. Hollings requested information concerning grants awarded by the Department of Health, Education, and Welfare for developing health maintenance organizations in region IV of the Department. (See p. 1.) He requested information concerning

- the organizational status of the grantees, the amount of funds each received, and the Department's plans for future funding;
- the results of any internal audits of health maintenance organization grantees; and
- the Department's efforts to monitor and evaluate health maintenance organization grantees in the region. (See app. I.)

STATUS OF GRANTEES

Before the Health Maintenance Organization Act of 1973, the Department provided 10 organizations in region IV with grant support totaling \$2,427,025. The timespans of the grants varied, within a period between July 1971 and March 1975. As of April 1, 1975, all these grants had expired, been terminated, or were being terminated. (See app. II.)

All 10 grantees had problems, including hostility of the local medical community, unavailability of risk capital and/or insurance, restrictive State laws, and internal management weaknesses.

Two of the ten grantees funded before the act had programs which had received financial assistance under the act. (See p. 3.)

MWD-76-41

A third had developed an operational prepaid health care plan, which, however, cannot presently comply with the organizational requirements of the Act. (See p. 3.)

During fiscal year 1975, the first full year of grant and loan activity under the Health Maintenance Organization Act, region IV received 39 grant fund applications and 1 loan application. As of June 30, 1975, the Department had awarded or approved the loan for \$1,446,000 and 16 grants in Region IV, totaling \$1,035,120. (See app. II.)

#### HEW AUDITS

On April 23, 1975, the Department's audit agency issued a report on region IV administration of the health maintenance organization program. The findings of their review can be summarized as follows:

- Regional office responsibilities for the health maintenance organization program had not been clearly delineated. (See p. 8.)
- Procedures that provide for considering grantee problems during funding had not always been followed. (See p. 9.)
- The regional office had no adequate monitoring standards and did not use available reports. (See p. 9.)
- Grant closeout procedures designed to protect the Government's interests had not been followed. (See p. 10.)

The audit agency is currently surveying the internal management systems of health maintenance organization projects shortly before or after grant awards. (See p. 11.)

#### DEPARTMENT MONITORING AND EVALUATION OF HEALTH MAINTENANCE ORGANIZATIONS IN REGION IV

An assessment of Department efforts to monitor and evaluate the health maintenance organization grants made before enactment is difficult at this time.

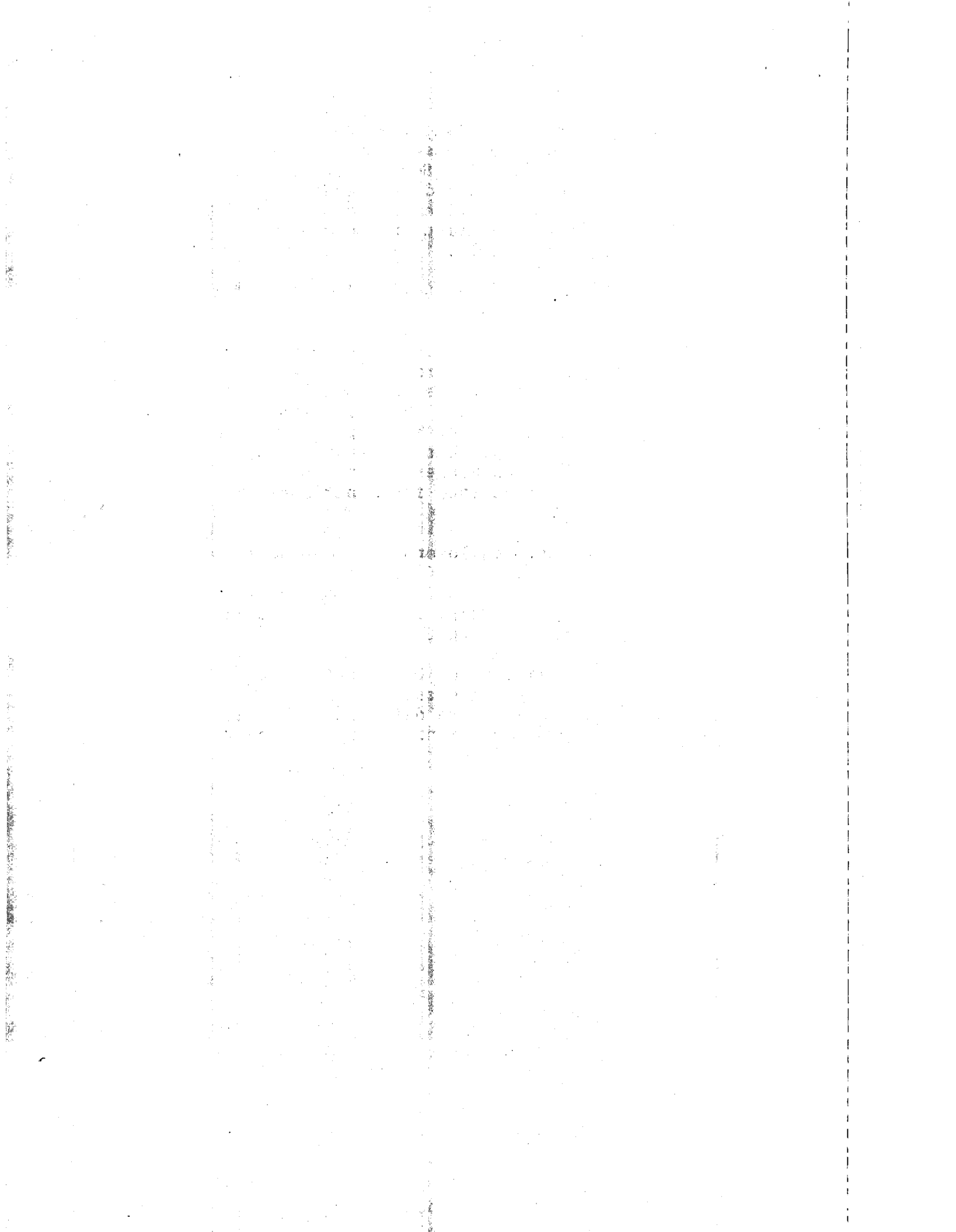
The Department had long been aware of the problems which caused the failure of several grantees. Some of the fundamental problems could not readily be solved by either the grantees or the Department, and continuing the grants could achieve little.

However, the Regional Health Administrator said:

"\* \* \* In dealing with weaknesses after the awards were made, it was our feeling that the best way to deal with these was to assist the grantees in solving their problems. If we had simply cut off their water because of weaknesses, there would have been no chance for a national program."

This management philosophy of keeping a sinking ship afloat, if carried to the extreme, could cause inefficient use of Federal funds. (See app. IV for a discussion of the Florida Health Care Plan.)

The Health Maintenance Organization Act has made better organization possible, but it is too early to determine its full effect on program administration. (See p. 13.)



## CHAPTER 1

### INTRODUCTION

Before the Health Maintenance Organization (HMO) Act of 1973 (42 U.S.C. 300e) was enacted on December 29, 1973, the Department of Health, Education, and Welfare, (HEW) had made grants beginning July 1971 to 10 organizations (see app. II) in HEW region IV (Alabama, Florida, Georgia, Kentucky, Mississippi, North and South Carolina, and Tennessee) for planning or feasibility studies for particular HMOs. These grants totaling \$2,427,025 were awarded under sections 304, 314(e), and 910(c) of the Public Health Service Act, as amended (42 U.S.C. 242b, 246(e) and 299j(c).(1970)).

The Public Health Service Act authorized grants and/or contracts as follows:

- Section 304: for research, experiments, or demonstration projects to develop new or improved methods of organizing, delivering, or financing health services.
- Section 314(e): to any public or nonprofit private agency, institution or organization to cover part of the cost of (1) providing services to meet health needs of limited geographic scope or of specialized regional or national significance or (2) developing and supporting, for an initial period, new programs of health services.
- Section 910(c): for support of research, studies, investigation, training, and demonstrations designed to maximize the utilization of manpower in delivering health services.

The Health Maintenance Organization Act of 1973 authorizes a 5-year trial Federal program to develop alternatives to the traditional forms of health care delivery and financing by encouraging the establishment and expansion of HMOs.

During fiscal year 1975, the first full year of grant and loan activity under the HMO Act of 1973, HEW region IV received 1 loan and 39 grant applications. As of June 30, 1975, HEW had approved in region IV 16 grants totaling \$1,035,120 and a loan for \$1,446,000. (See apps. III and IV.)

In a September 2, 1975, telephone conversation with an agency official of the Office of Health Maintenance Organizations, we were informed that HEW is planning two funding cycles (see p. 6) for fiscal year 1976 with applications due in the regional offices on September 29, 1975, and January 5,

1976. Approximately \$15 million in grant funds are available for fiscal year 1976. At the time of our review, HEW had no regional estimates of the number of grants to be awarded.

#### SCOPE

Our review was conducted at the Health Services Administration in Rockville, Md., and at the HEW regional office, Atlanta, Ga. We reviewed applicable legislation, regulations, and related instructions; grant files; and HEW audit reports and related working papers and talked with officials of both the headquarters and regional offices.

## CHAPTER 2

### GRANT ACTIVITIES

HEW began encouraging the development of HMOs as an alternative to the traditional fee-for-service delivery system in early 1971. Since that time, HEW has provided grant assistance to establish and expand HMOs through grant funds both before and under the HMO Act.

#### BEFORE THE HMO ACT

HEW provided 10 organizations in region IV with pre-HMO-Act grant support totaling \$2,427,025. The timespans of the grants varied within a total period between July 1971 and March 1975. As of April 1, 1975, all these grants had expired, been terminated, or were being terminated. As of June 30, 1975, only 2 (Florida Health Care Plan, Inc., and University of Kentucky Research Foundation) of the 10 organizations had applied for and received financial assistance under the HMO Act of 1973. The Florida Health Care Plan, Inc., in Daytona Beach, is now a federally qualified HMO. (See p. 22.) The other grantee, the University of Kentucky Research Foundation, used pre-HMO-Act funds to finance an HMO feasibility study which resulted in the formation of an organization called Health Care of Louisville, Inc., which received a planning grant under the HMO Act.

A third pre-HMO-Act grant for HMO development to the Tennessee Group Health Foundation, Inc./Mid-Cumberland Comprehensive Health Planning Council resulted in the Total Health Care Corporation (a private, nonprofit, prepaid plan) in Nashville, Tenn. The regional office HMO program consultant told us that as of May 30, 1975, the program had about 8,000 enrollees but did not satisfy the HMO Act. He did not expect it to seek further Federal funds unless the act is changed. Total Health Care Corporation cannot qualify under the existing act because subscribers do not constitute one-third of the Board of Directors.

All 10 grantees had problems, including hostility of the local medical community, unavailability of risk capital and/or insurance, restrictive State laws, and internal management weaknesses. Examples follow.

Health Facilities Research, Inc., Punta Gorda, Fla., received grants totaling \$171,678 intended for the period July 1, 1971, through June 30, 1973. The period was extended through December 31, 1973, and then through June 30, 1974, with no increase in the grant, which expired June 30, 1974.

The former HEW project officer told us that because the State of Florida decided not to certify Health Facilities Research, Inc., as an HMO without deposit of a cash reserve of \$100,000, little progress has been made since June 30, 1973.

On May 30, 1974, the Regional Health Administrator wrote to the grantee that a May 1974 program audit of the project conducted for HEW by a contractor indicated that the grantee had failed to (1) identify a source of funds to cover an operational deficit and (2) negotiate contracts with physicians and a hospital. These actions were needed to make the project operational by June 30, 1974, and financial assistance would not be extended beyond that date.

The HEW audit agency performed a cursory examination of Health Facilities Research, Inc., in June 1974 and noted that the project had not become operational, not only because of its inability to meet State requirements concerning capital funds, but also because of resistance from various medical groups.

The University of North Carolina at Chapel Hill received one grant of \$150,125 for January 1, 1972, through 30, 1973. The project associate director wrote to HEW in June 1973 that the project's steering committee had decided to postpone HMO development in Chapel Hill for at least a year, "\* \* \* due primarily to the general state of flux present in the health care delivery system of the community."

A contractor that reviewed and evaluated HMO grantees for HEW in May 1974 concluded that the University of North Carolina had not taken the basic steps of a feasibility study. He attributed the lack of progress to an excessively academic, theoretical orientation, an inability to involve either providers or consumers, and an unfulfilled expectation that the University's medical center would forego its traditional orientation and manifest a concern for community service.

The Health Maintenance Organization of South Carolina, Inc., (HMOSC) Charleston, S. C., received grants totaling \$477,216 for November 1, 1971, through December 31, 1974, to study and develop an HMO. In May 1974, we issued a report to Senators Ernest F. Hollings and Strom Thurmond 1/ on the operations of the grantee and the weaknesses in HEW management.

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1/ Review of Grants to Health Maintenance Organization of South Carolina, Inc. (B-164031(2)), May 17, 1974.



On June 6, 1975, the final HEW audit agency report on this grantee was issued, with these findings.

"HMOSC was awarded a grant totaling \$477,216 for the period November 1, 1971 through December 31, 1974. At the time HEW discontinued payments under this grant, the grantee had received Federal funds of \$437,216 and they have requested that an additional \$29,000 be released to pay operating costs through September 30, 1974 including 1973 accounts payable of \$28,049. Our audit disclosed that the grantee's accounting records and internal controls were inadequate. We are (1) not raising any questions on \$309,798 of expenditures, (2) asking HEW officials to review \$39,952 of 1974 salaries charged to the grant because there was little or no support, and (3) recommending that \$87,466 be returned to HEW and that the \$29,000 of additional funds requested by HMOSC not be given to them."

As a result of our review, HEW decided to terminate the grant to HMOSC. This decision has been appealed by the grantee. As of August 5, 1975, the HEW Appeals Board had not set a ruling date. The board's executive secretary cited (1) the high level of press interest which caused officials to handle the case cautiously and (2) a recent reorganization of the board as a permanent office as reasons for the delay in resolving the case.

Mercy Hospital-Street Memorial Clinic, Vicksburg, Miss., received grants totaling \$187,974 for January 1, 1972, through June 30, 1974. The period was subsequently extended to July 31, 1974, to permit the orderly phaseout of personnel and the filing of final reports.

The grantee's board of directors decided not to seek further HEW assistance, citing a number of factors, especially problems in marketing the HMO's services.

In a survey of the Mercy Hospital-Street Memorial Clinic, the HEW audit agency found the grantee's accounting system inadequate to account properly for grant funds because documentation was insufficient and bank accounts were not reconciled regularly. Further, some expenditures were counter to HEW's policy.

#### SINCE THE ACT

As of June 30, 1975, HEW region IV was administering 16 grants under the HMO Act of 1973. These include 13 feasibility, 2 planning, and 1 initial development grant. Only Florida Health Care Plan and Health Care of Louisville,

Inc., (formed as a result of a pre-HMO-Act grant to the University of Kentucky Research Foundation) received assistance before the act.

In awarding these new grants, the regional office followed review guidelines designed to pinpoint weaknesses and improve HEW's monitoring and assistance.

During the five funding cycles of fiscal year 1975, 1/ several of the current grantees' applications were rejected until the review guidelines were satisfied. Thirty-nine grant applications were received during the year; 16, or about 41 percent, were approved.

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1/ During fiscal year 1975, HEW implemented five overlapping 13-week funding cycles for the HMO program. Applications for each cycle were due in the regional offices on June 30, Sept. 2, and Nov. 4, 1974, and Feb. 3 and May 5, 1975.

### CHAPTER 3

#### REGION IV HMO MANAGEMENT

##### CHANGES IN REGION IV ORGANIZATION

Until March 1975, HEW regional staff responsible for operation of the HMO program were located in three separate branches of the Division of Health Services. These branches were referred to as the program consultation branch and operations branches I and II.

The program consultation branch had an HMO program consultant responsible for assistance and monitoring. This consultant was responsible to the chief of the program consultation branch but worked with the staffs of operations branches I and II.

Operations branch I reviewed grant applications and monitored activities for 12 different grant programs, including HMO, in Alabama, Florida, and North and South Carolina. Operations branch II did the same work for 11 different grant programs in the remaining 4 States--Georgia, Kentucky, Mississippi, and Tennessee.

On March 3, 1975, HMO program responsibilities in region IV were reassigned from the Division of Health Services to the Division of Financing and Health Economics. This transfer was prompted by the regional health administrator to emphasize certain organizational and financial aspects of HMOs. The administrator justified this change by saying that most people in the Public Health Service found HMO programs complex and unlike past programs.

To justify the change in responsibilities, the regional health administrator wrote to the Acting Assistant Secretary for Health on January 28, 1975, saying:

- The review of HMO applications requires considerable management and financial expertise, including ability to evaluate data such as projections of income and expenses, cash flows, financial condition at various stages of employment, and methods of obtaining capital.
- In-depth analysis of program and fiscal results for comparison with prior projections is necessary for effective program administration.
- The Division of Financing and Health Economics has staff with such skills and a very capable full-time director.

The administrator believes the present HMO staff can get the job done and region IV's HMO personnel compare favorably with other regions and HEW headquarters. He said also that people with the necessary experience are hard to find and generally unavailable at the salary HEW can pay. In April 1975, the HMO program consultant expressed his concern to the Director about not having someone directly on staff who could go into an HMO plan and fully analyze its financial system and potential.

In May 1975, the regional health administrator said he needed six more people in the Office of Management Support, the office responsible for monitoring and evaluating all Public Health Service programs in the region, including the HMO program. At that time, the region had only 2 qualified management analysts to monitor financial management for about 1,200 grants valued at about \$304 million.

#### HEW AUDIT AGENCY REVIEW OF REGIONAL ADMINISTRATION

On April 23, 1975, the HEW audit agency reported on its review of regional office administration of the HMO program. The report covered July 1, 1971, through November 15, 1974. The review's findings can be summarized as follows:

- Regional office responsibilities for the program had not been clearly delineated.
- Procedures that provide for considering grantee problems during funding had not always been followed.
- The regional office had no adequate monitoring standards and did not use available monitoring reports.
- Grant closeout procedures, designed to protect the Government's interests, had not been followed.

#### Regional program responsibilities not clearly delineated

The audit agency reported that since the HMO program began in 1971, the regional office has been responsible for reviewing grant applications, monitoring grantee progress, and providing technical assistance, but because there was no complete statement of authority, the regional office could not identify its responsibilities toward the HMO program.

The regional health administrator agreed essentially with the audit agency and pointed out that a number of

legislative proposals pending in the Congress and the uncertainty of program funding additionally created administrative difficulties.

#### Preaward review procedures not followed

The audit agency reported that a major part of the preaward procedure was reviewing grant applications by

- other regional health-oriented agencies,
- interested State agencies, and
- the central office of the Health Services Administration.

The audit agency found, however, that

- the regional office (1) did not always make the prescribed reviews and (2) insufficiently considered the comments of the reviewers and
- grant applicant weaknesses were not detected and/or continued after award.

The regional health administrator acknowledged the above problems, but stated that the central office also visited grantees and monitored their reports and therefore should have known their problems. He noted further that finding grantee weaknesses would not necessarily prevent funding but would identify areas needing technical assistance.

#### Inadequate monitoring of HMO projects

The audit agency reported that the regional office had not systematically monitored HMO projects to follow up on known grantee problems. In some instances, problems inhibiting progress and inadequate financial management were evident from application reviews, site visits, and progress reports. The audit agency found no evidence of followup on these problems. With no followup, the deficiencies continued and eventually led to grant terminations.

The regional health administrator maintained that the audit agency did not review all the records nor consider the overall design of the HMO program and the "system" within which regional and central office program personnel were working. He said that regional office personnel were constantly monitoring grantees' progress and did identify many problems. They gave technical assistance to the grantees, either directly or through contractors, to resolve them. He said that the problems by their nature--dealing with physician participation, marketing arrangements, quality of care, medical records, and management information systems--could not be resolved within 1 or 2 years.

Grant closeout procedures  
not followed

HEW's Grant Administration Manual provides that within 180 days of the end of a grant, all administrative actions must be completed, including determinations that the grantee has submitted all required reports and properly disposed of any balance or any property acquired with grant funds.

The audit agency reported that these requirements had not been met with respect to three HMO grantees--Health Care of Louisville, Inc.; University of North Carolina; and the State of Franklin Health Council. Specifically, the audit agency noted that:

- All three grantees did not turn in final project reports.
- One did not turn in a final expenditure report.
- Another had an undisposed balance of \$326.
- HEW had not acted on one grantee's request for disposition of property acquired with grant funds.

The regional health administrator agreed that prescribed procedures had not been followed in closing out the cited grants, attributing this situation to an excessive workload in the grants and contract management branch of the Office of Management Support.

The audit agency's report contained the following recommendations which it said central office officials agreed with:

- Insure that current preaward review procedures are followed and that all items considered and decisions reached during the review process are documented.
- Establish adequate monitoring standards and use available monitoring reports.
- Visit sites to monitor grantees and evaluate grant operations. The information obtained should be made available to all Public Health Service components that could benefit from it.
- Assure that prescribed grant closeout procedures are followed.

## MONITORING AND EVALUATION OF GRANTEE ACTIVITIES

We reviewed the regional office onsite monitoring of HMO grantees, procedures for assuring compliance with grant conditions, and HEW audit agency activities.

### Visits to HMOs

We wanted to determine whether and by whom preaward visits had been made to grantees and whether conclusions in the site-visit reports were incorporated in grant conditions.

We selected for review five of seven projects with grants approved during the first funding cycle of fiscal year 1975. Visits had been made to three projects, involving one initial development grant and two planning grants. The two remaining projects were not visited, because they were feasibility projects, which do not require preaward site visits.

We could not assess the adequacy or value of preaward visits from the trip reports. The three trip reports were brief, one consisting mostly of information previously presented in the grant application. Two were issued 5 and 9 weeks after the site visits.

The Director of the Division of Financing and Health Economics recognized the need to improve the content and reporting of all site visits.

### Procedures for assuring compliance with grant conditions

The Office of Management Support, in addition to monitoring and evaluating the HMO program, is responsible for assuring that grant conditions, especially in financial management, are monitored and complied with. However, this office was not staffed adequately for monitoring and had no established monitoring system. (See pp. 8 and 10.)

### HEW audit agency surveys

The HEW audit agency has made near-award surveys <sup>1/</sup> of some grantees to assess their internal management systems. Although at the time of our review none of the near-award surveys had been made in time to affect grant conditions or approval, we found that some of the survey findings warranted followup visits by regional officials.

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<sup>1/</sup>Near-award surveys are made before or shortly after the grant award to assess the likelihood of satisfactory performance.

The regional health administrator told us that the frequency of HEW audit agency near-award surveys depends on the availability of staff. He and the Director of the Division of Financing and Health Economics agreed to institute the followup visits we suggested.



## CHAPTER 4

### OBSERVATIONS

At this time, it is difficult to objectively assess HEW's efforts to monitor and evaluate the HMO grants made before the HMO Act of 1973. HEW has long been aware of the problems cited as causing several grantees to fail. Some of the fundamental problems which prevented grantees from operating--restrictive State laws, unavailability of risk capital and insurance, hostility of the medical community--could not readily be solved either by the grantees or HEW, and continuing the grants could achieve little.

The regional health administrator disagreed, in his response to the HEW audit agency's draft report on its survey of regional office program administration.

"The basic concept in having a national effort to develop a national rather than a local system is based on the premise that the potential exists (though it may not be recognized) in many places, and that even though weakness, even major weaknesses, exist, these can be overcome in time with a sufficient amount of financial support, guidance, and technical assistance. A part of this is based on the interest and commitment of the sponsor. In dealing with weaknesses after the awards were made, it was our feeling that the best way to deal with these was to assist the grantees in solving their problems. If we had simply cut off their water because of weaknesses, there would have been no chance for a national program."

As discussed in the previous chapter, HEW has taken steps to strengthen HMO program management. However, we believe that the above-stated management philosophy of keeping a sinking ship afloat, if carried to the extreme, could cause inefficient use of Federal funds. See appendix IV for a discussion of HEW actions in funding the Florida Health Care Plan which, in our opinion, are illustrative of this management philosophy.

The HMO Act of 1973 has made possible a more organized commitment to an HMO program, but in region IV some management actions are too recent to determine their full effects on program administration or have not been taken, such as adequate staffing of the Office of Management Support.

To better assess the effectiveness of HEW's HMO-program management, we have undertaken a comprehensive review in each of the 10 HEW regional offices.

ERNEST F. HOLLINGS  
SOUTH CAROLINA

## OFFICES:

SENATE OFFICE BUILDING  
202-225-6121

FEDERAL BUILDING, COLUMBIA, S.C.  
803-765-5731

FEDERAL BUILDING, SPARTANBURG, S.C.  
803-585-8271

141 EAST BAY, CHARLESTON, S.C.  
803-723-5211

## United States Senate

WASHINGTON, D.C. 20510

September 9, 1974

B-164031(5)

The Honorable Elmer B. Staats  
Comptroller General of the  
United States  
General Accounting Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Staats:

By letter dated July 25, 1974, I requested that your office furnish information as to the current status of the Department of Health, Education, and Welfare's (HEW) actions concerning the grant made to the Health Maintenance Organization of South Carolina, Inc., and whether grant funds continue to be spent by the grantee. You furnished an interim reply to this request on August 8, 1974.

I have since become concerned about the use of HEW grant funds to develop Health Maintenance Organizations (HMOs) throughout Region IV, in which South Carolina is located.

I would like to request that you inquire into the current status of these HMOs and furnish me information on

- organizational status and amount of HEW funds received,
- results of any HEW audits, and
- future plans for HEW funding.

I would also like to have a listing of HMO grants awarded in HEW Region IV and information on HEW efforts to monitor and evaluate grants awarded in this region. My concern is that such efforts are adequate to insure the proper expenditure of Federal funds. Since the HMOs in Punta Gorda, and Daytona Beach, Florida, have been specifically cited, you may want to begin your inquiry with these two grants.

COMMITTEES:  
APPROPRIATIONS  
SUBCOMMITTEES:  
LEGISLATIVE CHAIRMAN  
LABOR, HEALTH, EDUCATION, AND WELFARE  
MILITARY CONSTRUCTION  
STATE, JUSTICE, COMMERCE, AND  
THE JUDICIARY  
AGRICULTURE

COMMERCE  
SUBCOMMITTEES:  
OCEANS AND ATMOSPHERE: CHAIRMAN  
AVIATION  
MERCHANT MARINE  
SURFACE TRANSPORTATION,  
COMMUNICATIONS

POST OFFICE AND CIVIL SERVICE  
SUBCOMMITTEES:  
POSTAL OPERATIONS: CHAIRMAN  
COMPENSATION AND UNEMPLOYMENT  
BENEFITS

BEST DOCUMENT AVAILABLE

I would appreciate your prompt attention to  
this matter.

Sincerely,



Ernest F. Hollings

EFH:jb

RECEIVED

HEALTH MAINTENANCE ORGANIZATION GRANTS  
AWARDED IN REGION IV BEFORE THE  
HEALTH MAINTENANCE ORGANIZATION ACT OF 1973

<u>Grantee</u>	<u>Date of initial award</u>	<u>Period</u>		<u>Total awarded</u>
		<u>From</u>	<u>To</u>	
Florida Health Care Plan, Inc. Daytona Beach, Fla.	6/30/71	7/1/71	6/30/74	\$ 443,450
Health Facilities Research, Inc. Punta Gorda, Fla.	6/30/71	7/1/71	6/30/74	171,678
Metropolitan Atlanta Foundation for Medical Care, Inc., Ga.	1/18/72	1/1/72	12/31/74	242,122
University of Kentucky Research Foundation, Lexington, Ky.	6/29/71	7/1/71	12/31/72	59,700
Mercy Hospital-Street Memorial Clinic, Vicksburg, Miss.	1/18/72	1/1/72	7/31/74	187,974
The State of Franklin Health Council, Inc., Cullowhee, N.C.	6/30/71	7/1/71	12/31/72	40,000
University of North Carolina at Chapel Hill, N.C.	1/18/72	1/1/72	<u>a/6/30/73</u>	150,125
Health Maintenance Organization of South Carolina, Inc., Charleston, S.C.	1/18/72	11/1/71	12/31/74	477,216
South Carolina Department of Health and Environmental Control, Columbia, S.C.	1/10/72	1/1/72	4/1/75	252,179
Tennessee Group Health Founda- tion, Inc., Nashville, Tenn. (note b)	6/30/71	7/1/71	12/31/74	<u>402,581</u>
Total				<u>\$2,427,025</u>

a/Grantee discontinued operations on 12/15/72.

b/Unobligated funds transferred to Mid-Cumberland County Comprehensive Health Planning Council, effective July 1, 1974.

GRANTS AWARDED IN REGION IV UNDER THE  
HEALTH MAINTENANCE ORGANIZATION ACT OF 1973

<u>Grantee</u>	<u>Date</u>	<u>Period</u>		<u>Amount</u>
		<u>From</u>	<u>To</u>	
Grants for feasibility studies:				
Baptist Medical Centers, Birmingham, Ala.	10/30/74	11/1/75	6/30/75	\$ 45,000
Big Bend Health Plan, Inc., Tallahassee, Fla.	3/14/75	5/1/75	4/30/76	50,000
Clearwater Health Care Plan, Inc., Fla.	10/29/74	12/1/74	7/31/75	48,890
Community Health of South Dade, Inc., Miami, Fla.	3/14/75	2/1/75	9/30/75	39,277
Foundation for Medical Care in Duval County, Inc., Jacksonville, Fla.	10/30/74	11/1/74	7/31/75	49,300
Seminole Employment Economic Development Corporation, Sanford, Fla.	12/27/74	11/1/74	10/31/75	50,000
Job Start Corporation, London, Ky.	12/27/74	12/1/74	11/30/75	50,000
Memphis and Shelby County Hospital Authority, Tenn.	3/14/75	1/1/75	12/31/75	47,500
Metropolitan Inter-Faith Association, Memphis, Tenn.	11/ 7/74	10/1/74	9/30/75	49,992
Mississippi Action for Commu- nity Education, Inc., Green- ville, Miss.	6/19/75	5/1/75	4/30/76	50,000
Atlanta Health Care Founda- tion, Inc., Ga.	6/30/75	7/1/75	6/30/76	50,000
Durham County Hospital Cor- poration, N.C.	6/30/75	7/1/75	6/30/76	49,698
University Medical Center, Lebanon, Tenn.	6/30/75	7/1/75	3/31/76	<u>43,897</u>
Total				<u>\$623,554</u>
Grants for planning and initial development:				
Florida Health Care Plan, Inc., Daytona Beach, Fla.	11/11/74	7/1/74	6/30/75	166,000
Health Care of Louisville, Inc., Ky.	11/ 7/74	10/1/74	9/30/75	120,566
The Gulf Coast Family Health Foundation, Inc., Pasca- goula, Miss.	11/ 7/74	10/1/74	9/30/75	<u>125,000</u>
Total				<u>\$411,566</u>
				<u>\$1,035,120</u>

FLORIDA HEALTH CARE PLAN, INC.DAYTONA BEACH

The Florida Health Care Plan, Inc. (FHCP), is a community-sponsored, nonprofit organization in Daytona Beach, Volusia County. As of May 30, 1975, the Government has granted, loaned, and committed a total of \$2,055,450.

FHCP began delivering prepaid health care services on August 1, 1974. By June 30, 1975, the program had 2,218 enrollees covered by 849 prepaid health care contracts.

PREACT GRANTS

FHCP received three Federal grants for the period July 1, 1971, through June 30, 1974, under sections 304, 314(e), and 910(c) of the Public Health Service Act, as shown in the following table.

<u>Grant type</u>	<u>Period</u>	<u>Amount</u>
Development (314(e))	7/1/71 - 6/30/72	\$ 75,000
Continuation (910(c))	7/1/72 - 6/30/73	208,000
Continuation (304)	7/1/73 - 6/30/74	<u>160,450</u>
Total		<u>443,450</u>

Expenditure reports submitted by the grantee show that all these funds were spent for grant purposes and that several of the officers and directors of FHCP contributed about \$7,500 for related expenditures.

On July 11, 1974, the HEW audit agency completed a survey of FHCP's grant management practices. The audit agency noted that the grantee failed to maintain records supporting the amount of salaries and wages charged to grant funds as required by controlling HEW instructions. The audit agency reported that salaries and wages were charged to grant funds in the amounts budgeted in the grant applications--which may or may not have been consistent with the actual effort devoted to grant activities.

Other audit agency findings included failure to maintain adequate records to support claimed in-kind contributions and failure to establish and implement adequate written policies and procedures for paying employee travel expenses.

The audit agency recommended that before making any future grant awards to FHCP, HEW require the grantee to

- support professional salaries with a payroll distribution system,
- adequately account for in-kind contributions, and
- implement adequate written policies and procedures for paying travel expenses.

#### HMO ACT GRANT

In the first cycle of grants made under the HMO Act, the FHCP application for an initial development grant was disapproved twice before being approved. On November 11, 1974, FHCP received an initial development grant of \$166,000 under section 1304(b) of the HMO Act of 1973--bringing its total grants to \$609,450.

In July 1974, FCHP applied for an initial development grant of \$149,500 under the HMO Act of 1973. The application projected expenditures at \$168,000, with the applicant and others supplying \$18,500, and HEW supplying the remainder.

To justify the funds requested, the applicant stated:

"Initially, these funds are needed to provide gearing up expenses. Monies will be necessary in this area on a continuing basis during the first year of the Plan's operation. None of these funds will be used for direct operational costs but will be utilized in support branches of the administration to provide satisfactory information systems, computerization, enlargement of the administrative staff, supplemental funds to enlarge the marketing sectors, funds for additional rental space and general gearing up expenses to enable this plan to provide ancillary services for increasing enrollment and enlarged marketing patterns."

HEW disapproved this application primarily on the grounds that the applicants had not demonstrated a knowledge of the requirements of the HMO Act of 1973 and the implementing regulations and guidelines.

FHCP officials complained that deficiencies in the application resulted because they were misinformed by HEW regional representatives. Subsequently, two HEW representatives visited the applicant to explain the reasons for rejecting the application and what changes would be required before the application could be considered for funding.



FHCP then submitted a second application. The budget in this application had some changes in positions and salaries, but the totals remained the same. The narrative was expanded to describe generally consultant services to be acquired, a community health education program, and a number of purposes for which travel expenses would be paid. However, the application still did not show knowledge of the activities necessary to enable the project to become a qualified HMO, nor did it detail the activities to be accomplished with grant funds.

The HEW regional office initially disapproved this second application, citing

- insufficient justification for the community health education program and consultant services,
- lack of clarification as to how the applicant would prevent using initial development grant funds to pay operation expenses,
- insufficient information concerning sources and amounts of in-kind contributions,
- failure to relate the financial plan to the marketing plan, and
- failure to submit evidence that one-third of applicant's board of directors was taken from its subscribers.

The regional office HMO program consultant prepared a list of HEW's "areas of concern," which was given to FHCP officials and served as the basis for a meeting of the regional office application-review panel with the applicant on October 11, 1974.

After the meeting, the regional office application-review panel voted unanimously for approval of the application with a number of special conditions. The application was approved on November 11, 1974, by the HEW central office. On the same day, the regional office awarded a grant of \$166,000. Although the grant application was for \$149,500, HEW disallowed \$1,500 in entertainment expenses but added \$18,000 to employ a financial director.

None of the recommendations of the HEW audit agency (see p. 10.) were implemented before the award. The special conditions did not specifically refer to the HEW audit agency's findings or recommendations but did include the following:

- All monies expended under the grant award must be in compliance with the HMO Act and program guidelines.
- Within 60 days grantee is to submit to regional office for approval a revised milestone chart reflecting continuity with Federal funds.
- The grant money is to be used only for developmental purposes and not operational purposes. An accounting system must be maintained to distinguish between the two activities.

### Qualification and Loan Commitment

On January 14, 1975, FCHP submitted to HEW an application for qualification as an HMO under section 1310 of the act, and an application for a loan in the amount of \$743,000 to cover its estimated initial operating deficit.

The HMO Act and related regulations require that for direct loan assistance, HMOs must first qualify under section 1310, by complying with the organizational requirements and providing the services listed in section 1301 of the act. One requirement is that the loan applicant have a financially viable organization.

The Health Services Administration (HSA) determines applicants' eligibility for qualification and for a direct loan under Public Law 93-222 through independent reviews by a qualification unit and by loan specialists.

On March 13, 1975, HSA's qualification unit informed FHCP that its application could not be approved because the grantee was neither organized nor operating in accordance with the act. FHCP asked HEW to reconsider its initial decision, and during the week of April 7, 1975, representatives of region IV and HSA's qualification unit and loan specialists visited FHCP. This review disclosed weaknesses in the applicant's financial management system. The lack of a current balance sheet, among other factors, made it impossible to accurately evaluate the plan's current financial picture.

HSA loan specialists also found that the financial projections of FHCP had omitted several important expenses and overestimated fee-for-service revenues. They said the financial projections would have to be revised.

Based on these findings, the loan specialists recommended that no decision on FHCP's loan application be made until:

--FHCP submitted for review the required financial statements, including a reasonable explanation of how existing liabilities will be paid.

--FHCP assured that it would improve financial management including hiring a competent, full-time financial manager as quickly as possible.

--Financial projections were revised.

--A written report was prepared by HEW regional office staff of (1) the findings of their April 1975 study of FHCP's accounting for its initial development grant and (2) disposition of the recommendations in the HEW audit agency report of July 11, 1974.

On May 8, 1975, the loan specialists reported, based on additional information obtained from the applicant, that the deficiencies noted during their visit had been corrected, and recommended that a loan of \$1,160,000 be committed to FHCP pending its qualification as an HMO. HEW waived its requirement that one-third of the loan be obtained from a private lending source, because FHCP could obtain no private financing.

In a May 15, 1975, memorandum to the Acting Administrator of HSA, the special assistant for HMO certification, who serves as head of the qualification unit, recommended that FHCP be approved as a qualified HMO. The special assistant cautioned:

"We would be remiss to fail to express our obvious concern with the ability of FHCP to become self sustaining. However, since the personnel responsible for determining the ability of the applicant to repay the loan have concluded that the applicant will be able to repay the loan, and since the regulations do not allow the qualification process to be discretionary, we recommend your approval of the attached letter to Florida Health Care Plan, Inc., finding them in compliance. Because of our concerns we will, as part of our continuing compliance activities, monitor their marketing activities and the financial aspects of their operation very closely."

The qualification unit doubted the fiscal viability of FHCP. It said that FHCP did not appear to have an accounting system sufficient to monitor cash flow projections or to track income

and expenses. The accounting system lacked detail and did not prepare monthly income and expense statements or cost accruals.

The qualification unit's examination of liabilities revealed that FHCP was running at a deficit of \$50,000 per month--a total deficit of \$458,904 as of May 1, 1975. Of this amount, \$395,795 was owed to two corporate officers. Payment was deferred until after May 1, 1979, but the qualification unit was concerned that in case of death or bankruptcy of the creditors or the assignment of loans, other parties would have rights to the debt obligations and this might cause the collapse of the health plan. Fiscal viability was also endangered by an inadequate marketing plan. For example, FHCP had not thoroughly surveyed potential employment groups and lacked a planned marketing strategy.

On May 20, 1975, HEW informed FHCP that it qualified under the HMO Act and related regulations, pending written assurances that it will continue to abide by the requirements of the act. 1/

On May 28, 1975, HEW informed the applicant that its direct loan was approved for \$1,446,000--the projected operating deficit during the first 36 months of operation. Because of a requirement in the act limiting to \$1,000,000, the amount of a loan that can be disbursed in any fiscal year, the agreement provides for two separate disbursements of \$1,000,000 and \$446,000. In addition, HEW informed the applicant that the Department was waiving its limitation of the loan to two-thirds of projected deficit. Originally, the amount of the commitment recommended by HSA's loan specialists for approval was for \$1,160,000. However, this amount was increased by \$286,000, because the loan commitment was computed without capitalization of startup costs which had been incurred prior to the applicant's eligibility for the direct loan.

On May 29, 1975, the HMO central office recommended that the loan for \$1,446,000 be closed, since the five conditions which were required to be met before closing have been satisfactorily resolved as follows:

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1/A second HMO in region IV, the Piedmont Health Care Plan, Greenville, South Carolina, has been receiving grants from the Appalachian Regional Commission since 1971 and was federally qualified as an HMO on June 24, 1975.

- "1. The Assistant Regional Health Administrator has advised FHCP that all special conditions related to the grant award of November 11, 1974, except those of a continuing routine nature, have been removed.
2. The Assistant Regional Health Administrator has advised the Director, Division of Organization Development [previously referred to as the loan specialists for HMOs] that the recommendations contained in the HEW Audit Agency report dated July 11, 1974, have been implemented.
3. The Florida Health Care Plan, Inc. has developed formal procedures for (a) allocating costs to pre-paid services vs. fee-for-service, and (b) a formal system of cash-needs planning. These procedures have been approved by the Director, Division of Organization Development.
4. The letter of qualification signed by the Acting Administrator, HSA, required the signing by FHCP of certain assurances. The assurances have been signed and notarized by FHCP.
5. The qualification letter also required assurance that notes payable to creditors will not be called in the event of death, disability, or bankruptcy of the creditors. Such assurance has been provided."

On May 30, 1975, the loan closing was approved. A series of notes were issued for a total \$1,000,000 which, together with a second series of notes to be issued at a later date, constitutes the loan of \$1,446,000.

