GAO Highlights

Highlights of GAO-15-13, a report to congressional requesters

October 2014

GROUP PURCHASING ORGANIZATIONS

Funding Structure Has Potential Implications for Medicare Costs

Why GAO Did This Study

GPOs are purchasing intermediaries that negotiate contracts for medical products and services. GPOs contract with vendors and receive a fee from them when providers purchase from the vendor. These fees are a source of operating revenue for GPOs, and they are allowed to collect them if they meet the requirements of a safe harbor to the "anti-kickback" provision of the Social Security Act—known as the Anti-Kickback statute—which would otherwise prohibit such fees.

You raised questions about GPOs' contracting practices and about the impact of the GPO funding structure. This report examines (1) GPO contracting practices and the reported effects of these practices; (2) how GPOs are funded and the reported effects of this funding structure. To do this work, GAO sent a questionnaire to representatives of the 5 largest national GPOs about their contracting practices and sources of revenue; reviewed the literature on the effects of the GPO funding structure; reviewed laws, regulations, and guidance on the GPO safe harbor; interviewed representatives from HHS, FTC, the Department of Justice (DOJ), vendors, hospitals, trade associations, and economic and health care experts.

What GAO Recommends

GAO recommends that the Secretary of HHS determine whether hospitals are appropriately reporting administrative fee revenues on their Medicare cost reports and take steps to address any under-reporting that may be found. HHS agreed with the recommendation. GAO also incorporated technical comments from HHS, FTC, DOJ, and GPOs.

View GAO-15-13. For more information, contact Linda Kohn at (202) 512-7114 or kohnl@gao.gov.

What GAO Found

According to representatives from the 5 large group purchasing organizations (GPO) in GAO's review, GPO contracting generally involves three phases: (1) issue requests for proposals or invitations for vendors to competitively bid for a contract, (2) review proposals, and (3) negotiate and award contracts. GPOs reported negotiating and awarding different types of contracts to vendors in different situations. All 5 GPOs reported that the majority of the contracts they negotiate are either dual-source or multi-source, meaning that the majority of the products sold through their contracts have more than one vendor available on the GPOs' contracts. In addition, all GPOs reported that they did not bundle unrelated products and awarded mostly contracts with 3-year terms in 2012. The views of experts and others GAO interviewed on the effects of GPO contracting practices varied on issues such as whether the practices affect product innovation. In addition, while officials from the Federal Trade Commission (FTC) stated that they continue to receive and review complaints each year about GPO contracting practices, in the last 10 years, the FTC has not initiated any enforcement actions directed at GPO conduct.

The 5 GPOs in GAO's review reported being predominately funded by administrative fees collected from vendors, which were almost always based on a percentage of the purchase price of products obtained through GPO contracts. The 5 GPOs reported that these fees totaled about $2.3 billion in 2012, and nearly 70 percent of these fees were passed on to GPO customers or owners. The literature and the views of experts varied widely on the effects of this funding structure. Some suggested it creates misaligned incentives for GPOs to negotiate higher prices for medical products in order to increase the amount of vendor fees that they receive. Others suggested that competition between GPOs incentivizes them to negotiate the lowest possible prices, and mitigates these concerns. There is little empirical evidence available to either support or refute these concerns. However, to the extent that the vendor fee-based funding structure affects prices for medical products and services, Medicare payment rates may be affected over time through the annual update to hospital payment rates, which relies, in part, on information that hospitals report to the Centers for Medicare & Medicaid Services (CMS)—an agency in the Department of Health and Human Services (HHS). Moreover, Medicare payments also could be affected if hospitals do not account for revenue they receive from GPOs, which they are required to report as a reduction in costs on their cost reports. However, the extent to which hospitals are reporting this revenue is not known because this has not been reviewed by HHS since 2005, and CMS officials stated that the agency has not specifically identified this as information that should be routinely audited. Repealing the safe harbor—which allows administrative fees—could eliminate the potential effects of the GPO funding structure on Medicare payment rates, but experts and others stated that this could be disruptive to the health care supply chain at least in the near term. Over the longer term, GPOs and hospital systems are likely to adapt to the new market environment. While a repeal of the safe harbor provision would require a clearer understanding of the impact of the GPO funding structure, hospitals' potential underreporting of administrative fee revenue presents an immediate risk that can be addressed within the current GPO funding structure.