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WASHINGTON D C 20548

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MAY 1 1974

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C The Honorable Ernest F Hollings  
United States Senate

R Dear Senator Hollings

1 This is in response to your recent request that we provide you with information concerning (1) the extent of the audits by the Department of Health, Education, and Welfare (HEW) of the grants and contracts awarded by HEW aimed at assisting the development of health maintenance organizations (HMOs), (2) the nature and scope of our review started in March 1973 of such grant and contract projects, and (3) examples of our findings pertaining to grantee financial management including questionable grantee expenditures and deficiencies in accounting controls and financial reporting

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This request supplements your earlier request dated December 14, 1973, for an audit and report on the HEW grants awarded to the Health Maintenance Organization of South Carolina, Inc. and the Charleston Area Comprehensive Health Planning Agency.

GENERAL BACKGROUND

In his February 1971 and March 1972 health messages to the Congress, the President endorsed the concept of HMOs and proposed setting up a network of HMOs throughout the country as an alternative to the traditional fee-for-service health care delivery system. To implement his proposal, HEW, in fiscal year 1971 began awarding grants and contracts to organizations to provide financial assistance in the planning and development of HMOs. This grant and contract program for the development of HMOs was carried out under various sections of the Public Health Service Act and section 1110 of the Social Security Act.

The HEW grant and contract program has been principally administered by the Health Maintenance Organization Service of the Health Services and Mental Health Administration. After an HEW reorganization in July 1973, the Service was placed in the Bureau of Community Health Services of the Health Services Administration located at Rockville, Maryland.

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In December 1973, the Congress passed the Health Maintenance Organization Act of 1973 (Public Law 93-222) which amended the Public Health Service Act to specifically provide for an HMO development program to be carried out by grants, contracts, loans, and loan guarantees. The Act authorized \$325 million for such purposes for fiscal years 1974 through 1977.

SCOPE OF HEW GRANT AND  
CONTRACT PROGRAM

Under its pre-Public Law 93-222 program, HEW awarded about \$22.3 million to 110 projects during fiscal years 1971, 1972, 1973, and 1974, for the following purposes.

- 84 organizations were awarded grants totaling about \$16.9 million to plan and develop HMOs.
- 4 organizations were awarded generator contracts totaling about \$1.3 million to assist organizations in the same geographic area interested in developing an HMO.
- 6 organizations were awarded experimental system contracts totaling about \$1.2 million to examine and formulate innovative approaches to health care delivery, including the HMO concept.
- 8 organizations were awarded grants and contracts totaling about \$2.2 million to provide technical resources and perform research related to the HMO concept.
- 8 organizations were awarded grants totaling about \$.7 million to evaluate aspects of health care delivery systems related to the HMO concept.

Some of the above organizations also received funds under other HEW health programs as well as under the Office of Economic Opportunity (OEO) Comprehensive Health Services Program.

In addition, HEW awarded contracts totaling about \$8.7 million to 43 organizations during fiscal years 1971, 1972, 1973, and 1974 to provide technical assistance, to evaluate program efforts, to study HMO resources nationally, and to identify key factors in HMO development.

FUNDING OF THE 110  
PROJECTS BY  
FISCAL YEAR

As shown by the following table, about 60 percent of the 110 projects were initially funded in fiscal year 1971 with the remaining organizations being initially funded in fiscal year 1972. Much of the funding activity during fiscal year 1972 and all of the activity during fiscal years 1973 and 1974 consisted of awarding continuation grants and contracts to those projects previously financed by HEW

<u>Fiscal year</u>	<u>Number of new projects</u>	<u>Continuation grant or contract</u>	<u>Total amount funded (in millions)</u>
1971	67	-	\$ 6.7
1972	43	36	9.0
1973	-	41	5.0
1974	<u>-</u>	<u>14</u>	<u>1.6</u>
<b>Totals</b>	<u><u>110</u></u>	<u><u>91</u></u>	<u><u>\$22.3</u></u>

The grants or contracts were awarded to various types of organizations. For the 110 projects, the grant or contract awards involved 35 community organizations such as cooperatives formed by consumers or health planning agencies, 22 physician group practice plans, 19 individual practice associations such as medical societies and foundations, 12 colleges or medical schools, 11 hospitals, 5 State or local Governments, 4 consulting firms, and 2 professional organizations.

Many of these organizations had not been previous recipients of HEW grants under other health programs and some apparently were formed for the purpose of receiving an HMO grant. Therefore, HEW had only limited experience or knowledge in dealing with these organizations.

HEW AUDIT EFFORT

As far as we can determine, the HEW Audit Agency has not made any audits of the grant and contract awards pertaining to the 110 projects

This lack of audit activity pertained not only to those grant or contract projects which were not refunded by HEW, but also to those organizations that had received one or more continuation grants or contracts without benefit of an audit of how they had spent the money under their previous grants or contracts. In fairness, however, we must point out that in April 1973, an HEW Audit Agency official informally contacted our Office regarding the Agency's proposed fiscal year 1974 audit plans. The official indicated that the Audit Agency was considering making audits of a total of nine HMO grantees in three regions. However, after we explained to him the scope of our review which had started the previous month, the Audit Agency apparently decided not to make audits of HMO grantees during fiscal year 1974.

SCOPE OF GAO REVIEW

Because of the then pending legislation to authorize a specific program to provide financial support in the form of grants, contracts, and loans to organizations for the planning, development, and operating of HMOs, we initiated our review of the existing HEW grant and contract program in March 1973.

Our review was made at HEW headquarters in Rockville, Maryland, and at HEW regional offices in San Francisco, California, Denver, Colorado, Chicago, Illinois, Boston, Massachusetts, New York, New York, and Philadelphia, Pennsylvania. We visited 33 HEW grant and contract projects in 13 States. The HEW grants and contracts for the 33 projects amounted to about \$7.3 million. Four projects reviewed had also received funds from OEO.

Although our review was principally directed toward the effectiveness of the HMO development program, we made surveys of the grantees' and contractors' accounting and internal controls including any reports of the grantees' independent auditors and made limited tests of disbursements. On the basis of problems encountered in these surveys and limited tests, we believed it desirable to make more detailed financial audits at four HEW and two HEW-OEO funded projects.

Examples of our findings pertaining to the financial audits at four of the six projects are described below.

Grantee A

The grantee is a community organization located in New Hampshire. The grantee was awarded an HMO development grant totaling about \$168,000 for the 12-month period ending June 30, 1972, and an HMO continuation grant totaling about \$161,000 for the 12-month period ending June 30, 1973, for a total of about \$329,000. During the period September 1970 through June 1973, the grantee was also financed by about \$313,000 in Federal funds from other programs including about \$288,000 from HEW, and by about \$26,000 in non-Federal funds.

From September 1970 to May 1971, the grantee's financial records consisted of only two checkbooks and a cash disbursements register. Although a general ledger was established in May 1971, expenses still were not matched with fund sources. The grantee's accounting and internal control systems were inadequate to protect the interests of the Federal Government and to ensure that grant funds were spent for intended purposes. As a result

- The same expenses were charged to the HMO grant and to another Federal contract because the grantee's accounting system did not provide for matching expenses with funding sources. Consequently, the Federal Government was overcharged about \$10,000. The HMO grant was also overcharged \$233 for payroll taxes and health insurance.
- Unallowable expenses of about \$5,500 were improperly paid from Federal funds because the grantee's non-Federal funds to which such unallowable expenses were to be charged had been previously spent.
- The former Executive Director received about \$10,700 in excess of amounts earned because of inadequate internal controls over disbursements, failure to comply with the Standardized Government Travel Regulations in the absence of an established (written) travel policy, and the failure to properly account for petty cash. Although the Executive Director resigned in June 1973, he still had not repaid about \$3,500 as of January 17, 1974.

--Most expenses for travel and entertainment were not adequately documented and some were unreasonably high in comparison with expenses authorized for Federal employees traveling under the Standardized Government Travel Regulations. For example, the former Executive Director made six trips and stayed overnight in hotels and/or motels with nightly rates of \$32 00, \$35 00, \$56 00, \$62 00, \$70 00, and \$76 00 respectively. Further, his travel expense voucher for a trip to Atlantic City, New Jersey on November 12-15, 1972, included meal charges of \$55 25 on November 14 and \$47 90 on November 15. There was no indication of who the meals were for or whether they involved grantee business.

On March 7, 1974, we reported the results of our financial review of this grantee to an HEW headquarters official

Grantee B

The grantee was a group practice organization located in Illinois. The grantee was awarded an HMO development grant totaling about \$99,000 for the 12-month period ending December 31, 1972, an HMO continuation grant of about \$125,000 for the 12-month period ending December 31, 1973, and a second HMO continuation grant totaling about \$75,000 for the 6-month period ending June 30, 1974, for a total of about \$299,000.

In 1972, the grantee used a rudimentary cash basis, single-entry accounting system, consisting of a cash disbursements journal, check stubs, bank statements and reconciliations, and cancelled checks. During the second year of the grant, the grantee converted to a double-entry accrual accounting system using cash journals, general journals, and ledger accounts. Major weaknesses, however, still existed in internal controls and the documentation to support transactions.

--The grantee's HMO activities to be financed by the grant were intermingled with the group's on-going fee-for-service medical practice.

--The grantee did not have a system documenting how amounts charged to the HEW grant for personnel services were determined. Charges to the grant for professional staff services were not certified as being applicable to the grant. Charges to the grant for non-professional staff services were not supported by time and attendance and payroll distribution records.

- Charges to the grant for payments of \$42,000 to consultants in 1972 were not supported by written agreements or detailed billing statements. These payments included about \$22,000 incorrectly classified and reported as personnel services for three individuals, two of whom were on the grantee's board of directors. Prior approval by HEW was not obtained for payments to the latter individuals as required by HEW regulations.
- The grantee had no written procedures to assure that expenditures were properly authorized and chargeable to the grant and were properly processed, recorded, and reported. As a result, entries were based on oral instructions. For example, travel was not authorized in advance in writing and the costs were charged to the grant on the basis of oral instructions.

### Grantee C

The grantee is a community organization located in Pennsylvania. In June 1971, the grantee was awarded an HMO development grant totaling about \$62,500 for the 12-month period ending June 30, 1972, to develop the actuarial skills necessary for the development of a broad prepayment scheme and to institute a marketing strategy. This grantee also received an HEW grant of \$630,000 for fiscal year 1973 to develop a family health center and several OEO grants totaling about \$2.8 million.

When we began our review of this grantee, we found its financial records to be in a state of disarray with records being maintained in a disorganized manner, and a general lack of documentation for expenditures.

In a report of grant expenditures accompanying the final project report for the HMO development grant sent to HEW on October 6, 1972, the grantee reported that the total grant of \$62,500 had been expended by the end of the grant period, June 30, 1972. However, our review of the grantee's records indicated that only about \$56,700 of the grant funds had actually been spent at that date.

By letter dated December 20, 1973, to the HEW Philadelphia Regional Office, we suggested that the unexpended funds of about \$5,800 be recovered. HEW has concurred with our suggestion.

Grantee D

The grantee is an individual group practice organization located in California. The grantee was awarded an HMO development grant totaling about \$102,800 for the 12-month period ending June 30, 1972, and an HMO continuation grant totaling about \$169,500 for the 12-month period ending June 30, 1973, to develop an HMO HEW later extended the continuation grant to June 30, 1974, without additional funding.

Our financial audit of these two grants disclosed several weaknesses in the grantee's accounting system as follows:

- Inadequate documentation of payments to the sponsoring foundations for equipment rental, administrative assistance, and consulting services.
- Inadequate procedures to control the expenditures of travel funds
- Lack of written personnel and travel policy guidelines.
- Failure to maintain adequate records of hours worked by employees.

Although our review did not disclose misuse of Federal funds by the grantee, because of the lack of documentation, we were unable to verify the accuracy or the allowability of the grantee's claimed expenditures.

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In our March 7, 1974, report to HEW involving grantee A, we suggested that before grants are awarded, there should be some assurance that prospective grantees have adequate accounting systems with appropriate internal controls to protect the interests of the Federal Government. In addition, we suggested that grants should be audited periodically to ensure that (1) grantees' accounting and internal control systems are operating effectively, (2) adequate records are being maintained, and (3) grant funds are being adequately controlled, and expended only for grant purposes in accordance with Federal grant policies



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We trust that this report meets the needs of your request. As agreed with your office, we are providing copies of this report to the Secretary of HEW.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James P. Beets". The signature is written in dark ink and is positioned above the typed name.

Comptroller General  
of the United States