DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Washington, D.C. 20201

JAN 19 2005

TO: Mark B. McClellan, M.D., Ph.D.
Administrator
Centers for Medicare & Medicaid Services

FROM: Daniel R. Levinson
Acting Inspector General

SUBJECT: Review of Revenue From Vendors at Three Group Purchasing Organizations and Their Members (A-05-03-00074)

The attached final report provides the results of our audit of revenue at three group purchasing organizations (GPO) and their members. GPOs are buying consortiums designed to leverage the purchasing power of members, primarily hospitals and other health care providers, and to allow them to obtain discounts on medical supplies. In exchange for administrative services and the ability to sell through a GPO to its members, vendors pay administrative fees to GPOs. While conducting prior work at GPOs and their members, we noted that GPOs' revenues from vendor fees substantially exceeded operating costs.

Our objectives were to determine (1) how much revenue three large GPOs received from vendors and what the disposition of that revenue was, (2) how members treated distributions of net administrative fee revenue received from GPOs on their Medicare cost reports, and (3) whether members properly recorded rebates received from vendors on their Medicare cost reports.

The three GPOs that we reviewed—which were among the largest in the United States—collected administrative fee revenue of $1.8 billion during our audit period.[1] Of this amount, $1.3 billion represented net revenue in excess of operating costs. The GPOs retained $415 million of the $1.3 billion in net revenue to provide reserves and venture capital for new business lines. They distributed the remaining $898 million to members.

Based primarily on the significance of the dollars received, we reviewed how 21 members accounted for the net revenue distributed by the 3 GPOs. The 21 members received a total of $255 million, or 28 percent, of the $898 million distributed. These members did not fully account for the net revenue distributions on their Medicare cost reports. While members of one GPO offset 92 percent of the distributions, members of another offset only 54 percent. In total, the 21 members offset on their Medicare cost reports $200 million of the $255 million distributed by the GPOs. We believe that specific guidance from the Centers for Medicare & Medicaid Services (CMS) regarding the treatment of GPO net revenue distributions on Medicare cost reports would help promote full reporting in this area.

[1]For two of the three GPOs, we reviewed the 5-year period covering fiscal years 1998 through 2002. At the third GPO, we reviewed a period of slightly less than 4 years because the GPO did not exist in its present form for the entire 5-year period.

The 21 GPO members also received rebates totaling $285 million directly from vendors or passed from vendors through the GPOs. Although we found some minor errors, GPO members generally offset rebates on their Medicare cost reports as required. However, 7 of the 21 members did not offset rebates totaling about $3 million.

We recommend that CMS:

- provide specific guidance on the proper Medicare cost report treatment of net revenue distributions received from GPOs and

- prepare a "frequently asked questions" or other bulletin to remind institutional providers that all rebates from vendors must be shown as credits on their Medicare cost reports.

In response to our draft report, CMS acknowledged that policy guidance did not specify that GPO net revenue distributions must be used to reduce costs on cost reports. However, CMS stated that the policy as written was clear in its intent that net revenue distributions must be offset against costs on cost reports provided that the distributions do not exceed the costs of the related cost centers. CMS did not agree that additional guidance was needed. CMS concurred with our recommendation to remind institutional providers that they must show all rebates from vendors as credits on their cost reports.

As we reported, providers offset 78 percent, but did not offset 22 percent, of net revenue distributions on their Medicare cost reports. We therefore continue to believe that CMS should issue specific guidance on the proper cost report treatment of net revenue distributions received from GPOs.

Please send us your final management decision, including any action plan, as appropriate, within 60 days. If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at george.reeb@oig.hhs.gov. Please refer to report number A-05-03-00074 in all correspondence.

Attachment

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF REVENUE FROM VENDORS AT THREE GROUP PURCHASING ORGANIZATIONS AND THEIR MEMBERS

JANUARY 2005
A-05-03-00074

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Group purchasing organizations (GPO) are buying consortiums designed to leverage the purchasing power of members, primarily hospitals and other health care providers, and to allow them to obtain discounts on medical supplies. In exchange for administrative services and the ability to sell through a GPO to its members, vendors pay administrative fees to GPOs. While conducting prior work at GPOs and their members, we noted that GPOs' revenues from vendor fees substantially exceeded operating costs.

There has also been considerable public interest in recent years regarding the operations of GPOs and their receipt of vendor fees. The Senate Judiciary Committee, Subcommittee on Antitrust, Competition Policy and Consumer Rights, has investigated the GPO industry and conducted hearings. The congressional concern about vendor fees appears to be longstanding: a 1986 House conference report expressed concern about the level of vendor fees and directed the Secretary of Health and Human Services to monitor vendor payment arrangements for possible abuses (House Conference Report 99-1012 (1986)). The U.S. Federal Trade Commission recently conducted hearings about the business practices of GPOs and issued a report describing such practices. The press has also shown considerable interest in the GPO industry. For example, the New York Times published a series of investigative reports in 2002.

Although the Department of Health and Human Services does not directly "regulate" GPOs, Medicare regulations provide guidance on the reporting of rebates that hospitals receive from vendors. Specifically, 42 CFR § 413.98 and Chapter 8 of the "Provider Reimbursement Manual" generally require health care providers to offset purchase discounts, allowances, and refunds of expenses against expenses on their Medicare cost reports.

Medicare-certified institutional providers, such as hospitals, are required to submit an annual cost report to a fiscal intermediary. The information in cost reports is one of the primary sources that the Medicare Payment Advisory Commission (MedPAC) uses in reviewing the reasonableness of Medicare payment levels. MedPAC provides advice to Congress on payment levels and other issues affecting Medicare.

OBJECTIVES

Our objectives were to determine (1) how much revenue three large GPOs received from vendors and what the disposition of that revenue was, (2) how members treated distributions of net administrative fee revenue received from GPOs on their Medicare cost reports, and (3) whether members properly recorded rebates received from vendors on their Medicare cost reports.

SUMMARY OF FINDINGS

GPO Fee Revenue

The three GPOs that we reviewed—which were among the largest in the United States—collected administrative fee revenue of $1.8 billion during our audit period.[1] Of this amount, $1.3 billion represented net revenue in excess of operating costs. The GPOs retained $415 million of the $1.3 billion in net revenue to provide reserves and venture capital for new business lines. They distributed the remaining $898 million to members.

Treatment of Distributed Net Revenue

Based primarily on the significance of the dollars received, we reviewed how 21 members accounted for the net revenue distributed by the 3 GPOs. The 21 members received a total of $255 million, or 28 percent, of the $898 million distributed.

We found that members did not fully account for net revenue distributions on their Medicare cost reports. While members of one GPO offset 92 percent of the distributions, members of another offset only 54 percent. In total, the 21 members offset on their Medicare cost reports $200 million of the $255 million distributed by the GPOs. In other words, 22 percent of net revenue distributions were not offset. Less than full reporting can affect certain types of Medicare payments. We believe that specific guidance from the Centers for Medicare & Medicaid Services (CMS) regarding the treatment of GPO net revenue distributions on Medicare cost reports would help promote full reporting in this area.

Treatment of Rebates From Vendors

The 21 GPO members received rebates totaling $285 million directly from vendors or passed from vendors through the GPOs. Although we found some minor errors, GPO members generally offset rebates on their Medicare cost reports as required. However, 7 of the 21 members did not offset rebates totaling about $3 million.

RECOMMENDATIONS

We recommend that CMS:

- provide specific guidance on the proper Medicare cost report treatment of net revenue distributions received from GPOs and

- prepare a “frequently asked questions” or other bulletin to remind institutional providers that all rebates from vendors must be shown as credits on their Medicare cost reports.

[1]For two of the three GPOs, we reviewed the 5-year period covering fiscal years 1998 through 2002. At the third GPO, we reviewed a period of slightly less than 4 years because the GPO did not exist in its present form for the entire 5-year period.

CMS COMMENTS

In response to our draft report, CMS acknowledged that policy guidance did not specify that GPO net revenue distributions must be used to reduce costs on cost reports. However, CMS stated that the policy as written was clear in its intent that net revenue distributions must be offset against costs on cost reports provided that the distributions do not exceed the costs of the related cost centers. CMS did not agree that additional guidance was needed. CMS concurred with our recommendation to remind institutional providers that they must show all rebates from vendors as credits on their cost reports.

OFFICE OF INSPECTOR GENERAL RESPONSE

As we reported, providers offset 78 percent, but did not offset 22 percent, of net revenue distributions on their Medicare cost reports. We therefore continue to believe that CMS should issue specific guidance on the proper cost report treatment of net revenue distributions received from GPOs.

TABLE OF CONTENTS

INTRODUCTION

BACKGROUND

Group Purchasing Organizations

GPOs are buying consortiums designed to leverage the purchasing power of members, primarily hospitals and other health care providers, and to allow them to obtain discounts on medical supplies. In 2002, the Government Accountability Office (GAO) reported that "Hospitals buy everything from sophisticated medical devices—for example, cardiac defibrillators—to commodities such as saline solution through GPO-negotiated contracts. By pooling the purchases of their member hospitals, . . . [GPOs] are intended to negotiate lower prices from vendors (manufacturers and distributors) . . . ."[2] GAO also reported that "hundreds of GPOs operate today, but only about 30 negotiate sizeable contracts on behalf of their members."

In exchange for administrative services and the ability to sell through a GPO to its members, vendors pay administrative fees to GPOs. While conducting prior work at GPOs and their members, we noted that GPOs' revenues from vendor fees substantially exceeded operating costs.

Recent Scrutiny of Vendor Payments

There has been considerable public interest in recent years regarding the operations of GPOs and their receipt of vendor fees. The Senate Judiciary Committee, Subcommittee on Antitrust, Competition Policy and Consumer Rights, has investigated the GPO industry and conducted hearings. The congressional concern about vendor fees appears to be longstanding: a 1986 House conference report expressed concern about the level of vendor fees and directed the Secretary of Health and Human Services to monitor vendor payment arrangements for possible abuses (House Conference Report 99-1012 (1986)). The U.S. Federal Trade Commission recently conducted hearings about the business practices of GPOs and issued a report describing such practices. The press has also shown considerable interest in the GPO industry. For example, the New York Times published a series of investigative reports in 2002.

Although the Department of Health and Human Services does not directly "regulate" GPOs, Medicare regulations provide guidance on the reporting of rebates that hospitals receive from vendors. Specifically, 42 CFR § 413.98 and Chapter 8 of the "Provider Reimbursement Manual" generally require providers to offset purchase discounts, allowances, and refunds of expenses against expenses on their Medicare cost reports.

[2]"Group Purchasing Organizations: Pilot Study Suggests Large Buying Groups Do Not Always Offer Hospitals Lower Prices," GAO-02-690T, April 30, 2002.

GAO Pilot Study

As referenced above, GAO performed a pilot study to determine, among other things, the extent to which selected hospitals saved money by using a GPO contract to buy pacemakers and safety needles. In summary, GAO found that, for the hospitals studied, a hospital's use of a GPO did not guarantee that the hospital would save money. GAO reported that GPO prices were not always lower and were often higher than prices paid by hospitals that negotiated directly with vendors. GAO also reported that:

> Whether hospitals using GPO contracts got better prices than hospitals that did their own contracting varied widely by product model. For some pacemaker models, the hospitals using GPO contracts got considerably better prices—up to 26 percent lower than hospitals not using a GPO contract. But for other models, hospitals using a GPO got prices that were much worse—up to 39 percent higher than hospitals not using a GPO.

Medicare Cost Reports

Medicare-certified institutional providers, such as hospitals, are required to submit an annual cost report to a fiscal intermediary. The cost report contains provider information such as facility characteristics, utilization data, costs and charges by cost center (in total and for Medicare),[3] Medicare settlement data, and financial statement data. Medicare contractors use these data to compute some elements of Medicare reimbursement, such as inpatient outlier payments.

MedPAC, an independent Federal body established by the Balanced Budget Act of 1997, provides advice to Congress on payment levels for Medicare providers and other issues affecting Medicare. The information in Medicare cost reports is one of the primary sources that MedPAC uses in reviewing the reasonableness of Medicare payment levels.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine (1) how much revenue three large GPOs received from vendors and what the disposition of that revenue was, (2) how members treated distributions of net administrative fee revenue received from GPOs on their Medicare cost reports, and (3) whether members properly recorded rebates received from vendors on their Medicare cost reports.

Scope

We selected three of the largest GPOs in the United States for our review. For two of the three GPOs, we reviewed financial information for the 5-year period covering fiscal years 1998 through 2002. At the third GPO, we reviewed a period of slightly less than 4 years,

[3]A cost center is generally an organizational unit having a common functional purpose for which direct and indirect costs are accumulated, allocated, and apportioned.

covering fiscal years 1999 through 2002, because the GPO did not exist in its present form for the entire 5-year period. Based on our review of financial information, we selected several members of each GPO for site reviews. The 21 members selected received about 28 percent of total net administrative fee distributions from the GPOs. We conducted fieldwork from October 2002 through June 2003 at the 3 GPOs and the 21 members.

Our review was limited to the extraction of financial data from books and records, much of it verifiable to audited financial statements, and to interviews with officials and staff from each GPO and GPO member. A detailed review of internal controls was not necessary to meet our audit objectives.

Methodology

To accomplish our objectives, we:

- reviewed relevant laws, regulations, legislative history, and CMS guidance;
- examined organization and financial information related to the 3 GPOs and the 21 GPO members;
- determined the types of fees collected by GPOs and their members;
- identified the agreements between GPOs and their members and vendors;
- quantified revenue distributed by GPOs to their owners and members; and
- determined whether the 21 members reported net administrative fee revenue distributions and rebates related to cost centers on their Medicare cost reports.

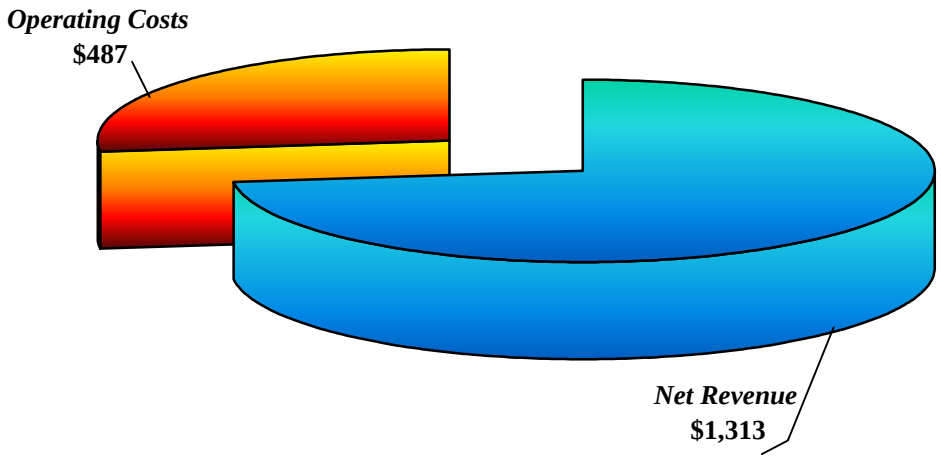
We conducted our audit in accordance with generally accepted government auditing standards.

RESULTS OF REVIEW

GPO FEE REVENUE

Administrative fees paid by vendors to GPOs comprised the vast majority of revenue received by the three GPOs we reviewed. All three GPOs generated revenue from vendors' administrative fees in excess of related operating costs. The GPOs collected administrative fee revenue of $1.8 billion for the period reviewed. Of this amount, $1.3 billion, or 72 cents of every dollar collected, represented net revenue in excess of operating costs. The remaining $487 million, or 27 cents of every dollar collected, was used to cover the GPOs' operating costs. (See Figure 1.)

Figure 1: Total GPO Revenue of $1.8 Billion
(in Millions)

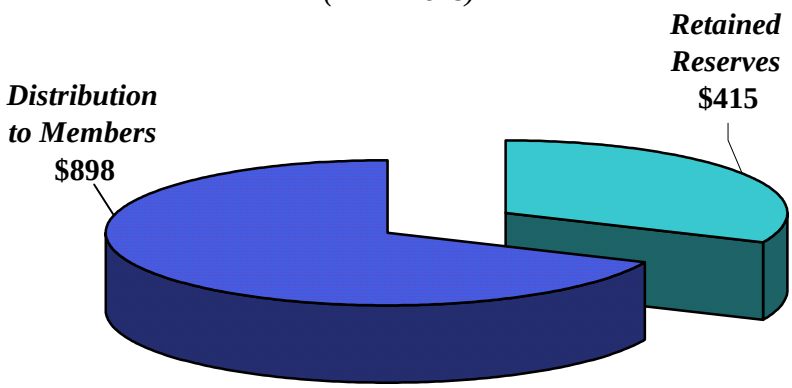


Generally, the administrative fees collected were 3 percent or less of the cost of the goods or services. However, we noted that all three GPOs had at least one contract that paid fees in excess of 3 percent, and some paid as much as 10 percent.

TREATMENT OF DISTRIBUTED NET REVENUE

Of the $1.3 billion in net revenue in excess of operating costs, $898 million was distributed to members. The GPOs retained the remaining $415 million to provide reserves and venture capital for new business lines. (See Figure 2.)

Figure 2: Disposition of $1.3 Billion in Net Revenue
(in Millions)



Based primarily on the significance of the dollars received, we reviewed how 21 members accounted for the net revenue distributed by the 3 GPOs. The 21 members received a total of $255 million, or 28 percent, of the $898 million distributed. The results of our review are summarized in the following table.

Treatment of Net Administrative Fee Revenue Distributions Received by 21 Members ($ in Millions)

	Number of Members Reviewed	Total GPO Revenue	Net Revenue Amount Distributed	Amount Reviewed	Amount Offset on Cost Reports	Amount Not Offset	Percent Offset
Total	**21**	**$1,821**	**$898**	**$255**	**$200**	**$55**	**78%**

As the table shows, the members did not fully account for net revenue distributions on their Medicare cost reports. Collectively, the 21 members credited (reduced gross costs) on their cost reports 78 percent of the net revenue received. They did not offset 22 percent of net revenue distributions. Those revenue distributions did not exceed the costs of the related cost centers. We also noted variability among the members of each of the three GPOs. While members of one GPO offset 92 percent of the net revenue distributions, members of another offset only 54 percent.

We could not find any CMS guidance specifically addressing the reporting of net revenue distributions to GPO members from our review of the CMS "Provider Reimbursement Manual" or our contacts with various CMS and departmental staff. Given the increasing participation of GPOs in the health care marketplace, we believe that specific CMS guidance regarding the treatment of GPO net revenue distributions on Medicare cost reports would help promote full reporting in this area.

TREATMENT OF REBATES FROM VENDORS

Although we found some minor errors, GPO members consistently offset vendor rebates on their Medicare cost reports as required. Regulations (42 CFR § 413.98) and Chapter 8 of the "Provider Reimbursement Manual" require GPO members to offset purchase discounts, allowances, and refunds of expenses against expenses on their Medicare cost reports.

A rebate is a form of a discount that is given not at the time of sale but at a later time, such as on a quarterly or yearly basis. Rebates are usually dependent on achieving a specified purchasing volume.

At the 21 members reviewed, we examined a total of $285 million in rebates to determine how the members treated rebates received directly from vendors or passed through their GPOs. Of the 21 members, 7 did not offset all rebates on their Medicare cost reports as required. Rebates not offset amounted to more than $3 million at the seven members.

EFFECT OF INCONSISTENT OR INCORRECT REPORTING OF NET REVENUE DISTRIBUTIONS AND REBATES

Cost reports play an important role in determining Medicare payments to hospitals that do not participate in the prospective payment system (PPS), as well as those that do. The less than full reporting of net revenue distributions and rebates on Medicare cost reports has a very direct impact on non-PPS hospitals, such as critical access, psychiatric, and cancer hospitals. Medicare reimburses these hospitals based on their actual costs of providing services. Therefore, failure to reduce costs by GPO net revenue distributions or rebates will result in larger Medicare payments.

Although Medicare pays PPS hospitals at a fixed rate per patient for a particular service, the data in cost reports directly affect some payments to PPS hospitals. For example, the data in cost reports are used to calculate payments for "outlier" cases in which patients are unusually expensive to treat. The amount of an outlier payment is, in part, based on the relationship between the "retail" amount that a hospital charges for a service and the cost of providing that service. Using data submitted by each hospital on its yearly cost report, CMS's contractors calculate a hospital-specific ratio of costs to charges and generally use that ratio to determine if the hospital is eligible for outlier payments. The ratio will be too high if costs shown on a hospital's cost report are overstated. Multiplying a ratio that is too high by an individual patient's charges can then result in erroneous Medicare outlier payments to the hospital.

Because the costs shown on cost reports affect reimbursement to non-PPS as well as PPS hospitals, we believe that full reporting of GPO net revenue distributions and rebates by members is necessary for equitable Medicare reimbursement.

In addition, MedPAC and CMS continually evaluate Medicare operations to determine what changes, if any, are needed in Medicare reimbursement policies. For hospital reimbursement, much of the information used in their evaluations centers on cost report data. CMS could use the information in this report and, where necessary, perform additional analysis to assess whether GPO revenue distribution patterns should be considered in evaluating Medicare reimbursement policies.

RECOMMENDATIONS

We recommend that CMS:

- provide specific guidance on the proper Medicare cost report treatment of net revenue distributions received from GPOs and

- prepare a "frequently asked questions" or other bulletin to remind institutional providers that all rebates from vendors must be shown as credits on their Medicare cost reports.

CMS COMMENTS

In response to our draft report, CMS acknowledged that policy guidance did not specify that GPO net revenue distributions must be used to reduce costs on cost reports. However, CMS stated that the policy as written was clear in its intent that net revenue distributions must be offset against costs on cost reports provided that the distributions do not exceed the costs of the related cost centers. CMS did not agree that additional guidance was needed.

CMS officials concurred with our recommendation to remind institutional providers that they must show all rebates from vendors as credits on their cost reports.

The full text of CMS's comments is included as an appendix to this report.

OFFICE OF INSPECTOR GENERAL RESPONSE

As we reported, providers offset 78 percent, but did not offset 22 percent, of net revenue distributions on their Medicare cost reports. Those revenue distributions did not exceed the costs of the related cost centers. We therefore continue to believe that CMS should issue specific guidance on the proper Medicare cost report treatment of net revenue distributions received from GPOs.

APPENDIX

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: NOV 19 2004

TO: Daniel R. Levinson
Acting Inspector General
Office of Inspector General

FROM: Mark B. McClellan, M.D., Ph.D.
Administrator
Centers for Medicare & Medicaid Services

SUBJECT: Office of Inspector General (OIG) Draft Report: "Review of Revenue from Vendors at Three Group Purchasing Organizations and Their Members" (A-05-03-00074)

Thank you for the opportunity to review and comment on the OIG report that was prepared as a result of an audit of revenue at three group purchasing organizations (GPOs) and their members. The report raises the issue of whether entities that are members of GPOs properly account on their cost reports for distributions of excess revenues from the GPOs.

Although the great majority of Medicare providers are paid on some form of prospective payment system, rather than on a reasonable cost basis, the cost reports submitted by hospitals, skilled nursing facilities, and certain other entities still play an important role in Medicare payment and reimbursement decisions. Both Medicare and the Medicare Payment Advisory Commission (MedPAC) use the data from cost reports for a variety of purposes, including validating the appropriateness of payment decisions.

For reimbursement and cost reporting purposes, if a hospital or other provider receives discounts, allowances, refunds or rebates for its purchases, the provider's reasonable cost incurred is its net cost of the discounts, allowances, refunds, or rebates. Providers can receive discounts, allowances, and rebates by purchasing through GPOs. As the OIG indicated, GPOs are buying consortiums designed to leverage the purchasing power of the GPOs' members in order that the members might obtain discounts. Also, as the OIG discussed, in exchange for administrative services and the ability to sell through a GPO to its members, vendors pay administrative fees to GPOs. The OIG selected three GPOs to review the administrative fees they received from their vendors. Those GPOs received fees that generated revenue in excess of the GPOs' operating costs (net revenue). The GPOs retained a portion, distributing the remainder to their members.

As applicable to Medicare, the OIG's objectives were to determine how the member providers treated the GPOs' net revenue distributions on their Medicare cost reports and whether they also properly treated purchase rebates received from vendors on their cost reports. The OIG found that there was variability among the providers audited in offsetting the net revenue distributions against costs on their cost reports. Collectively, they offset 78 percent of the net revenue distributions. However, for rebates received from vendors, they offset nearly all, though not 100 percent, of those amounts.

The OIG could not find the Centers for Medicare & Medicare Services'(CMS) guidance specifically addressing a provider's reporting of net revenue distributions from GPOs. Therefore, OIG recommended that CMS provide specific guidance on the proper cost report treatment of such distributions, that it prepare a "frequently asked questions" or other bulletin to providers reminding them that all rebates from vendors must be shown as credits on the cost report, and that it notify MedPAC of the results of the OIG's review for MedPAC's consideration in evaluating Medicare reimbursement on the cost report.

Under reimbursement principles, Medicare shares only in a provider's net incurred cost because, in the end, that is the only cost the provider incurred. The CMS appreciates that the OIG reviewed this issue to apprise CMS of providers' treatment on the cost report of not only vendor rebates but also of net revenue distributions that GPOs might additionally distribute to their members. To the extent providers do not offset those amounts, in addition to the vendor rebates, the providers are claiming on the cost report gross costs incurred rather than net costs after receiving amounts back from the vendors or GPOs which reduce the costs actually incurred. The CMS agrees that if costs are not properly reported as net on the cost report, Medicare reimbursement as computed on the cost report is overstated.

OIG Recommendation

Provide specific guidance on the proper Medicare cost report treatment of net revenue distributions received from GPOs.

CMS Response

Medicare policy in 42 CFR 413.98 and in Provider Reimbursement Manual, Part I, Chapter 8, has long been that purchase discounts, allowances, refunds, and rebates are reductions on the cost report to the cost center containing the costs to which the discounts, allowances, refunds, and rebates apply. Although the net revenue distributions addressed in the report are not specifically articulated in the policy they are, nevertheless, encompassed in the policy and, therefore, must be used to reduce costs on the cost report under that policy. According to the draft report, the member providers generally made the required offsets, collectively, for 78 percent of the distributions. The report does not address why providers did not offset all the distributions. Where offsets were not made because providers believed that the Medicare policy does not require offset of the distributions, that is an incorrect application of the policy. However, there could be other reasons why offsets were not made. Medicare policy requires offsets to be made only against the total costs of the cost center(s) in which the costs at issue were included on the cost report. If rebates or other amounts received exceed the costs of the

cost center(s), there is no offset of the excess. It is possible that this may have been the case in some situations and therefore the reason for not offsetting all the distributions received.

In summary, CMS believes that the policy as written is clear in its intent that any receipt of funds by a provider related to its purchase of items or services, whether typical vendor rebates or, in this case GPO net revenue distributions, are to be offset against the applicable costs, not to exceed the total costs of the cost center, so that the provider properly reports its net costs incurred related to the purchases. Therefore, at this point, CMS does not believe that additional guidance is needed on this issue.

OIG Recommendation
Prepare a "frequently asked questions" or other bulletin to remind institutional providers that all rebates from vendors must be shown as credits on their Medicare cost reports.

CMS Response
It is clear to CMS that most member providers were aware that vendor rebates are required to be offset on the Medicare cost report. Some 99 percent of the rebates were offset by the providers audited. However, CMS agrees with the OIG that it may be prudent to reiterate to providers Medicare's policy requiring providers to report on their cost reports only the cost of purchases net of discounts, rebates, and other refunds which reduce their purchase costs. We will notify providers using an appropriate vehicle for communication such as "frequently asked questions" or other bulletin.

* OIG Recommendation
Notify MedPAC of the results of the OIG's review of this issue for MedPAC's consideration in evaluating Medicare reimbursement.

* CMS Response
CMS is unclear why OIG is requesting that CMS be the referral source to MedPAC.

We conclude by offering our appreciation for the efforts that OIG has made on this issue. Our Agency agrees that a provider is to report only the costs of its purchases net of amounts received which are related to those purchases, including discounts, allowances, rebates, and, as to the subject of the draft report, GPO net revenue distributions (not to exceed the costs of the applicable cost centers).

*OIG NOTE: These paragraphs are not applicable because the recommendation referred to by CMS is not included in the final report.