

Office of Inspector General

REVIEW OF MULTI-STATE NURSING HOME CONTRACTS

The daily rate for one single-state nursing home contract needed to be re-negotiated, and a multi-state contract needed to be amended regarding medication costs.

Report No. 8R4-A07-027

Date: October 20, 1997

Office of Inspector General
Washington DC 20420

**Department of
Veterans Affairs**

Memorandum

Date: OCT 20 1997

From: Assistant Inspector General for Auditing (52)

Subj: Review of Multi-State Nursing Home Contracts - Report No. 8R4-A07-027

To: Under Secretary for Health (105E)

1. This memorandum is the final response to your March 28 request for assistance regarding multi-state nursing home contracts. In our August 7 interim response (Enclosure I), we provided you with information on the resolution of complaints about drug pricing by Beverly Enterprises. In this memorandum, we will answer your questions with regard to Harmony Provider Network, Inc. (Harmony) and their operations in California. In addition, we will also make you aware of a related Congressional inquiry involving Beverly Enterprises.

2. In accordance with your request, we assessed the cost-benefit of VHA's multi-state nursing home contracts in California, with particular emphasis on the contract with Harmony. The request for the audit was prompted by complaints from Harmony officials that VA medical facilities had not utilized the Harmony contract to the extent anticipated. Our review found that VA facilities did not use the Harmony contract because there was (i) no reduction in costs, (ii) no significant increase in access to community nursing home (CNH) beds, and (iii) no increase in services.

3. Instead of reducing VA's costs for CNH care, the Harmony contract allowed CNHs already doing business with VA to join Harmony and then increase their rates without providing any additional services for patients. VA facilities already had local contracts with 15 of the 38 Harmony homes. These contracts were "bundled" or "all-inclusive"--that is, the contract daily care rate covered ancillary services provided the patient. The Harmony contract did not provide any services not already covered by the all-inclusive local contracts.

4. During our review, the contracting officer and VHA Geriatrics and Extended Care officials took action to address the issue of Harmony's higher rates. The most significant additional costs resulting from the Harmony contract involved eight CNHs that VAMC Palo Alto had long used for psycho-geriatric care. The VAMC had local contracts with the eight CNHs at an average daily rate of \$118. The eight CNHs joined Harmony, and the rate increased to \$150, which was the Harmony contract rate. In July the contracting officer negotiated a contract modification that lowered the \$150 rate back to \$118, effective June 1, 1997. However, VA agreed to pay the \$150 rate for the 6-month period December 1996 through May 1997. This resulted in additional CNH costs

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Under Secretary for Health (105E)

of about \$518,000 that VA would not have incurred if the Harmony contract had not been awarded.

5. Another condition noted with the Harmony contract was that the standard skilled care rate of \$125 was higher than most locally negotiated rates for the same level of care. To address this issue, the contracting officer negotiated a lower rate of \$105 for Harmony's Southern California and Fresno area homes. The Northern California rate remained at \$125. We concluded that the \$105 rate was in line with other CNHs in Southern California. However, in our opinion the Northern California rate of \$125 is questionable when compared with rates charged under locally negotiated contracts. We suggest that VHA attempt to negotiate a rate that is more competitive so that VA facilities will be more likely to use Harmony homes and benefit from the increased access to CNH beds offered by the Harmony contract.

6. With the negotiation of the new rates, the problems with the Harmony contract have largely been resolved. The contract will not reduce VA's CNH costs in California, but neither will it significantly increase these costs, and it will marginally benefit VA facilities by providing access to a few more CNHs. This is also true for the other multi-state contracts. The main benefit of these contracts is that they give VA facilities more CNHs that can be utilized if needed. However, VA facilities have continued to rely primarily on local contracts because they are satisfied with local CNHs, and the multi-state contracts offer no significant advantages in terms of cost, services provided, or convenience for the patient. (A more detailed report of our review is contained in Enclosure II.)

7. In addition to the two issues that you asked us to look at regarding multi-state nursing home contracts, we received another inquiry, almost simultaneously, from Senator Arlen Specter, Chairman of the Senate Veterans Affairs Committee. The Senator was concerned that funds intended for the care of our nation's veterans were being paid to Beverly Enterprises, a company which the General Accounting Office (GAO) has cited for labor law violations. The Senator questioned whether VA contracting officers should bar companies from being awarded contracts when they are guilty of such violations.

8. We provided the Senator essentially the same answer that the Department has used to respond to similar inquiries over approximately the past year (Enclosure III). Namely, Comptroller General decisions from 1937 and again in 1962 prohibit the withholding of contracts from labor law violators, citing that the law provides other penalties for dealing with such violators.

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9. We appreciate the opportunity to be of assistance to you. If you have any questions concerning Harmony, please contact David Sumrall at (206) 220-6654. For questions concerning Beverly Enterprises, please contact William DeProspero at (708) 216-2667.

For the Assistant Inspector General for Auditing

Original signed by

MICHAEL SLACHTA, JR.

Deputy Assistant Inspector General for Auditing

Enclosures

**Department of
Veterans Affairs****Memorandum**

Date: AUG 7 1997

From: Deputy Inspector General (50A)

Subj: Review of Multi-State Nursing Home Contracts - Report No. 8R4-A07-027

To: Under Secretary for Health (10)

1. This memorandum is in partial response to your request for audit assistance regarding irregular billing practices in VISN 9 by a multi-state nursing home contractor. Specifically, VA Medical Center (VAMC) Huntington, WV was experiencing irregular medication charges by one of the multi-state nursing home contractors. Our audit has found that a proposed contract modification should resolve the issue concerning the irregular medication charges. The following paragraphs detail our findings.

2. Beverly Enterprises was awarded one of the seven VHA multi-state nursing home contracts on September 1, 1996. The Vanceburg Health Care Center is part of the Beverly Corporation, and it is one of the nursing facilities that VAMC Huntington utilizes under the multi-state contract. It is also the facility that was charging VA for patient medications at two times the cost of those medications. VAMC Huntington determined that doubling the actual prescription costs was apparently the standard operating policy of Beverly Enterprises.

3. VAMC Huntington staff contacted the VACO contracting officer concerning this matter and were told that the cost of medications, under multi-state nursing home contracts, were to be reimbursed to the extent that such costs exceeded 7.5 percent of the per diem rate. Additionally, they were told that the allowance for additional charges was to be for the actual cost of the medications, not a marked-up price.

4. In order to clarify the exact terms of the contract regarding medication costs, members of my audit staff met with the contracting officer for the Beverly Enterprises contract and with the Chief Consultant of the Geriatrics and Extended Care Strategic Healthcare Group (114) and a member of her staff. We also obtained and reviewed a copy of the Beverly Enterprises multi-state nursing home contract.

5. We noted that the contract was actually "silent" on how to calculate charges to VA for excess medication costs. Program and contracting officials determined that a contract modification would be necessary to clarify exactly how much multi-state nursing home contractors could charge VA for such medications. We have obtained a copy of the draft contract modification which states:

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Drug costs which comprise more than 7.5 percent of the per diem rate are generally not considered routine ancillary services. High drug costs will be determined by the Average Wholesale Price (AWP) of the drugs plus a transaction fee of 3% per month. The calculation will only apply to those days of the month when the high drug costs are incurred.

6. Although we are awaiting word that this contract modification has been finalized, we believe that it should clarify this issue for all parties concerned, and it should also allow VISN 9 medical centers to feel more confident in utilizing the services of multi-state nursing home contractors.

7. We have not yet finished our review of the other multi-state nursing home contract issues (the California contract) on which you asked our assistance. I will notify you of the results of the other parts of our review upon their completion. If you or your staff have any questions or need further information on the issue discussed in this memorandum, please contact Mr. Michael Sullivan, Assistant Inspector General for Auditing, at (202) 565-4625.

Original signed by

WILLIAM T. MERRIMAN

Review of Harmony Network Nursing Home Care Contract

Background

Purpose of Review. The Under Secretary for Health asked the Office of Inspector General (OIG) to assess the cost-benefit of the Veterans Health Administration's (VHA's) new multi-state nursing home contracts (MSNHCs) in California, with particular emphasis on the contract with the Harmony Provider Network, Inc. (Harmony). The Under Secretary's concern was prompted by complaints from Harmony officials that VA medical centers (VAMCs) had not utilized the Harmony contract to the extent anticipated.

VA Policy on MSNHCs. On September 1, 1996, VHA awarded 6 multi-state contracts and 1 single-state contract to providers operating 1,053 community nursing homes (CNHs) in 43 states. The purposes of these contracts were to: (1) reduce administrative costs by decreasing the number of contracts VAMCs had to process; (2) reduce direct costs by obtaining lower daily care rates than VAMCs could negotiate through local CNH contracts; and (3) improve VA's access to CNH beds by adding homes where immediate placement of patients was guaranteed. As an incentive to participate in the MSNHC program, the contracts guaranteed the seven providers specified payments regardless of the number of VA patients placed in contract CNHs. (For example, Harmony was guaranteed \$400,000 a year.)

The MSNHCs were intended as an additional resource or capability that VAMCs could use to provide CNH care to veterans. VHA encouraged, but did not require, VAMCs to use MSNHC homes whenever clinically and financially feasible. However, VAMCs could continue using locally contracted homes if these homes better met patient needs and/or were less costly.

The Harmony Provider Network. The one single-state contract was awarded to Harmony, the lower of two bidders. VHA awarded this contract because of a perception that California VA facilities, especially those in Northern California, had experienced difficulties in placing patients and needed access to more CNH beds.

Harmony was formed in 1995 by a group of independently owned CNHs that wanted to better position themselves to compete for contracts with large health care organizations such as VA. As of June 30, 1997, Harmony consisted of 38 CNHs.

Other CNH Providers. Before the MSNHCs were awarded, the seven VAMCs and two VA clinic systems in California obtained CNH care through locally negotiated contracts with nursing home operators. As of June 30, the 9 VA facilities had contracts with at least 133 CNHs. Of the 6 multi-state providers, 4 had a total of 108 homes in California. Therefore, the total number of homes available to VA was 279 (38 Harmony; 133 local contracts, 108 other MSNHC).

CNH Program Data. As of June 30, 1997, California VA facilities had 739 patients in CNHs—554 (75.0 percent) in 133 CNHs under local contracts; 104 (14.1 percent) in 15 Harmony homes; and 81 (10.9 percent) in 33 other MSNHC homes.

Results of Review

The Harmony Contract Has Not Added Significant Value to VA's CNH Program

We concluded that VA facilities had valid reasons for not using Harmony. The Harmony contract did not reduce costs, did not significantly increase access to CNH beds, and did not provide additional services that were not already covered by local contracts.

Low Usage of Harmony Contract. VAMC and VA clinic system staff gave four reasons for not using Harmony homes:

1. Two VAMCs and two clinic systems reported that Harmony's price for the most frequently utilized level of care, standard skilled care, was too high compared to local contracts.
2. Two VAMCs stated that there was low demand for placement in Harmony homes because they were not conveniently located for patients or did not provide needed patient services.
3. Four VAMCs reported that Harmony had no homes in their geographic service areas.
4. Two VAMCs had concerns about the quality of care at certain Harmony homes.

Higher Cost of Harmony Contract. The Harmony contract did not result in reduced costs for CNH care. Instead, the contract allowed CNHs already doing business with VA to join Harmony and then increase their rates without providing any additional services or improved care for VA patients. VAMCs already had local contracts with 15 of the 38

Harmony homes. These 15 CNHs were among the most heavily utilized, especially by VAMCs Palo Alto, San Francisco, and Fresno and the Northern California System of Clinics.

The Harmony contract did not provide any services not already covered by the local contracts. These contracts were “bundled” or “all-inclusive”--that is, the contract daily care rate covered ancillary services provided the patient (with the exception of certain specialized services, such as dental care). The Harmony contract did not provide any services not already provided by the all-inclusive local contracts.

The most significant additional costs resulting from the Harmony contract involved eight CNHs that VAMC Palo Alto had long used for psycho-geriatric nursing home care. The VAMC had local contracts with the eight CNHs at an average per diem rate of \$118. The 8 CNHs accounted for 87 of the 88 patients in Harmony homes located in Northern California. The CNHs joined the Harmony network, and the per diem rate increased to \$150, which was the Harmony contract rate for psychiatric nursing home care. If this rate had been allowed to stand, VA would have incurred additional costs of about \$1.02 million a year ($\$150 \text{ Harmony rate} - \$118 \text{ local contract rate} = \$32 \times 87 \text{ patients} \times 365 \text{ days/year} = \1.02 million).

During our review, VHA officials and the contracting officer addressed this issue by negotiating a contract modification that lowered the \$150 rate back to \$118, effective June 1, 1997. However, VA agreed to pay the \$150 rate for the 6-month period December 1996 through May 1997. This resulted in additional CNH costs of about \$518,000 that VA would not have incurred if the Harmony contract had not been awarded.

Another problem with the Harmony contract was that the standard skilled care rate of \$125 was higher than many locally negotiated rates, especially in Southern California. For example, VAMC Long Beach had a local contract with a CNH for a rate of \$100. When the CNH joined the Harmony Network the rate increased to \$125, without any increase in services. To address this problem, the contracting officer negotiated a lower rate of \$105 for Harmony’s Southern California and Fresno area homes, effective June 1, 1997. The Northern California rate remained at \$125.

We concluded that the new \$105 rate for Southern California was probably reasonable. The \$105 rate falls at about the midpoint between the lowest and the highest average per diem rates for VAMC local contracts (low average rate = \$96.73 at VAMC West Los Angeles; high average rate = \$114.54 at VAMC San Diego). In addition, only 69 (40.6

percent) of the 170 standard skilled care patients in Southern California CNHs received care for less than \$105 per day.

The \$125 rate for Northern California is more questionable. This rate exceeds the average local contract rates for all the Northern California VA facilities (low average rate = \$102.74 at VAMC Palo Alto; high average rate = \$108.45 at the Northern California System of Clinics). The midpoint for the average rates would be about \$106, or \$19 less than the Harmony rate. In addition, 123 (93.2 percent) of the 132 standard skilled care patients in Northern California CNHs received care for less than \$125 per day.

Although the \$125 rate is questionable, it is not a major problem at this time because VA does not have any patients receiving standard skilled care in the Northern California Harmony homes. So long as Harmony homes are not competitive, it is unlikely that VAMCs will use them. As a result, VA loses one of the expected benefits of the Harmony contract, access to more CNHs. To address this issue, VHA should attempt to negotiate a new rate that is closer to the \$106 midpoint.

Access to CNH Beds Not Significantly Improved. According to VHA Geriatrics and Extended Care officials, the Harmony contract was awarded because of a belief that Northern California VA facilities had problems placing patients and needed access to more CNH beds. However, responsible staff at all the Northern California VA facilities told us that they had never experienced major difficulties in placing patients. They occasionally were unable to immediately place patients requiring psycho-geriatric care. The Harmony contract did not help with this problem because it did not add any psycho-geriatric beds that had not already been available under existing local contracts.

The Harmony contract did not significantly increase the number of CNHs available to VA facilities. Before the contract was awarded, these facilities had access to at least 148 CNHs through local contracts. The Harmony contract added only 23 CNHs (as of June 30, 1997). According to facility staff, many of these 23 CNHs were not conveniently located for most VA patients or did not provide needed services and therefore were likely to be only occasionally used.

VAMC Use of Other MSNHC Providers. Although our review focused on the Harmony contract, we also found that VA facilities had not made extensive use of the four other MSNHC providers with homes in California. Based on our discussions with VA facility staff, we believe that the main reasons for this are the same as the reasons for the low utilization of Harmony--that is, the MSNHC homes do not offer a cost advantage, are not conveniently located for most veterans, and/or do not provide needed services.

During our review, we noted that one MSNHC provider, Vencor Corporation, had a standard skilled care rate of \$126, which was higher than the Harmony rate and the rates of the other three MSNHC providers. In our opinion, VHA should evaluate the potential for negotiating a lower rate as they did with the Harmony contract.

Conclusion

The Harmony contract did not add significant value to VA's CNH program in California. The VA facilities in California had not experienced significant problems in placing patients in CNHs, and they already had locally negotiated contracts with many of the CNHs that joined the Harmony Provider Network. The initial effect of the Harmony contract was to increase costs for these VAMCs, without adding any new services. VHA and the contracting officer have addressed this issue by negotiating new Harmony rates that are more in line with the locally negotiated rates. However, for the eight VAMC Palo Alto CNHs previously covered by local contracts the award of the Harmony contract cost VA \$518,000 in CNH costs that otherwise would not have been incurred.

With the negotiation of the new rates, the problems with the Harmony contract have largely been resolved. The contract will not reduce VA's CNH costs, but neither will it significantly increase these costs, and it will marginally benefit VA facilities by providing access to a few more CNHs. This is also true of the other MSNHCs. The main benefit of these contracts is that they provide more CNHs that VA facilities can use. However, VAMCs have continued to rely primarily on local contracts. VA staff are generally satisfied with local CNHs, and the MSNHC homes generally offer no significant advantage in terms of cost, services provided, or convenience for the patient. Since the main benefit of the MSNHC contracts is increased access to CNH beds, VHA should attempt to realize more of this benefit by negotiating lower rates for the Harmony homes in Northern California and for the Vencor homes.



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

AUG 18 1997

The Honorable Arlen Specter
Chairman, Committee on Veterans Affairs
United States Senate
Washington, DC 20510-6375

Dear Mr. Chairman:

This is in response to your letter dated May 15, 1997 in which you expressed concerns about a Department of Veterans Affairs (VA) nursing home contract with Beverly Enterprises. You requested that the Office of Inspector General determine whether the Department of Veterans Affairs' procurement system has placed, or is likely to place, veteran-patients at risk by not taking into account violations of law by prospective VA contractors.

As I stated in my June 11, 1997, letter to you, my office is reviewing the nursing home contract with Beverly Enterprises at the request of the Under Secretary for Health. To efficiently use our limited resources, we incorporated a review of VA practices with contractors who have violated the National Labor Relations Act into this audit. The following information is provided in response to your request.

The Veterans Health Administration (VHA) has sought to reduce the cost of the Community Nursing Home (CNH) Program and to improve the quality of veteran care by introducing the Multi-State Nursing Home Contract initiative. VHA has awarded seven of these contracts to large nursing home care providers, one of which is Beverly Enterprises. Currently, VA has contracts with approximately 300 of Beverly Enterprises' 700 nursing facilities.

We have found that pursuant to Federal law, VA does not directly consider violations of the National Labor Relations Act in awarding a contract. As you pointed out, the General Accounting Office (GAO) has previously addressed the fact that Beverly Enterprises has violated U.S. labor laws, particularly the National Labor Relations Act. However, the Comptroller General has stated that "The Congress has provided the means of enforcing compliance with the requirements of [the National Labor Relations Act], but the

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The Honorable Arlen Specter

withholding of Government contracts from a violator of such requirements is not one of the means so provided.” 17 Comp. Gen. 37 (1937).

In addition, a 1962 Comptroller General decision further states that “Compliance with the requirements of the National Labor Relations Act, may not be required as a condition of a contract, nor may noncompliance therewith be considered as a ground for rejection of a bid.” 42 Comp. Gen. 1 (1962). Based on these citations, VA does not have the authority to refuse to do business with contractors such as Beverly Enterprises, based solely upon labor law violations.

We have confirmed that the Department has a mechanism in place to monitor the quality of care issues that you have raised concerning current contractors. If National Labor Relations Act violations affect the contractor’s ability to perform under the contract, the contract can be canceled. Each VA facility utilizing contract nursing home services has an evaluation team which is required to review the performance of each contractor. In addition, VA staff make visits to patients placed in contract nursing homes to monitor the quality of care provided in the contract facilities. If quality of care problems are discovered by these evaluation teams and site visits, VA staff have the authority to refuse to do further business with a particular vendor, or to cancel a multi-state contract.

Furthermore, multi-state nursing home contracts, including the contract with Beverly Enterprises, include the following provisions:

- VA will provide follow-up supervision visits to veterans placed in contract nursing homes in order to monitor care, assure the continuity of care, and assist in the veteran’s transition back to the community. These visits do not relieve the nursing home of the responsibility for the daily care and medical treatment of the veteran.
- VA will terminate the contract when there is a series of conditions at more than one nursing home which adversely affect the quality of patient care. Such conditions are evidenced by one or all of the following: de-certification for Medicare/Medicaid Programs; loss of State license; State survey findings of nursing homes not in substantial compliance with standards; and a pattern of patient re-hospitalizations, indicating potential issues of quality of care as documented in VA’s quality assessment and improvement program.

Finally, based upon our research into the issues that you raised, it is our opinion that further legislation would be necessary to allow Federal agencies to not consider doing

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business with potential vendors based solely on National Labor Relations Act violations that they may have committed, even if those violations do not affect the contractor's ability to perform. However, such legislation may have a much broader impact than anticipated since the determinations regarding who can be considered for a Government contract are based on a determination that the contractor is a responsible contractor.

Thank you for bringing this issue for our review.

Sincerely,

Original signed by

WILLIAM T. MERRIMAN
Deputy Inspector General