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Some Selected Skilled Nursing Facilities Did Not Comply With Medicare Requirements for Reporting Related-Party Costs

HHS Office of Inspector General

REPORT HIGHLIGHTS

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Some Selected Skilled Nursing Facilities Did Not Comply With Medicare Requirements for Reporting Related-Party Costs

Why OIG Did This Audit

- Most of the approximately 15,000 nursing homes in this country are certified by Medicare to serve as skilled nursing facilities (SNFs). As of FY 2023, about 1.2 million people resided in nursing homes.
- SNFs file cost reports with Medicare. Accurate cost reports are important because cost reports provide the Medicare program with transparency about the costs SNFs incur in providing care for residents and with critical information that CMS uses to update SNF payment rates.
- SNFs and other Medicare providers regularly obtain services, facilities, or supplies (e.g., therapy services for SNF residents) from parties related to the provider (related parties).
- SNFs and other providers must report related parties and related-party costs on their cost reports. Compliance with Medicare cost reporting requirements ensures that SNFs are not reporting related-party costs in excess of what is allowable.
- For Medicare cost reporting periods ending during FYs 2015 through 2020, SNFs reported receiving a total of $160.4 billion in Medicare payments and paying a total of $65.4 billion to related parties.
- This audit examined whether selected SNFs reported related parties as required and whether their related-party costs complied with Medicare requirements.

What OIG Found

- Of the 14 SNFs in our nonstatistical sample, 3 SNFs did not properly disclose 1 or more related parties on their Medicare cost reports. In addition, 7 of the 14 SNFs did not properly adjust some of their related-party costs to Medicare-allowable costs as required, which resulted in more than $1.7 million in overstated costs.
- Medicare administrative contractors (MACs) did not review, as part of their oversight activities, the disclosure or reporting of related parties and their costs, and CMS did not provide sufficient guidance to SNFs that explained how to determine Medicare-allowable related-party costs.

What OIG Recommends

We recommend that CMS:

1. require the MACs to include, as part of the normal desk review or audit process, a review of reporting and disclosure of related-party costs;
2. develop and implement guidance for SNFs on the appropriate methods for providers to determine their allowable related-party costs; and
3. provide guidance to reeducate MACs on the need to review, grant, and document requests from SNFs for exceptions to cost reporting requirements in compliance with 42 CFR § 413.17(d).

CMS did not concur with our first recommendation. CMS concurred with our second and third recommendations and stated that it would explore the most feasible way to address each of them.

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INTRODUCTION

WHY WE DID THIS AUDIT

As of Federal fiscal year (FY) 2023, there were approximately 1.2 million people residing in approximately 15,000 nursing homes in the United States.[1] Most nursing homes in this country are certified by Medicare to serve as skilled nursing facilities (SNFs), which provide a clinically managed recovery period after a person's hospitalization. For Medicare cost reporting periods ending during FYs 2015 through 2020 (audit period), SNFs reported receiving a total of $160.4 billion in Medicare payments.[2] These SNFs also reported paying a total of $65.4 billion during our audit period to related parties (that is, organizations or entities that are associated with or affiliated with the provider and that also furnish services, facilities, or supplies to that provider; discussed further below).

Understanding SNFs' costs is crucial to understanding the incentives that contribute to nursing home performance and how nursing homes deliver care to residents. Under the prospective payment system, Medicare pays SNFs a per diem payment of a predetermined, fixed rate for providing care to individuals receiving Medicare benefits, based on the classification of that service. For SNFs, the prospective payment for an enrollee's care is based on a number of clinical, functional, and resource-based factors, but that payment is not directly tied to the costs incurred by the SNF. Although a SNF's reported costs do not affect the current payments it receives, SNFs' cost reports provide critical information that CMS uses when updating SNF payment rates.

This report conveys our findings from the first of two audits that examine SNF related-party costs. Ensuring that related parties and their costs are properly reported and understanding how SNFs allocate costs is important so that the Centers for Medicare & Medicaid Services (CMS), policymakers, and other stakeholders can better understand how ownership and financing structures affect SNF spending, quality of care, and other aspects of nursing home performance. This report focuses on the reporting of related parties and related-party costs by SNFs in the Medicare program.[3]

OBJECTIVES

Our objectives were to determine whether selected SNFs reported related parties as required and whether their related-party costs complied with Medicare requirements.

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[1] These data were current as of July 2023 and may be found at Total Number of Residents in Certified Nursing Facilities | KFF and Total Number of Certified Nursing Facilities | KFF (both accessed on July 18, 2024).

[2] SNFs submit annual cost reports generally covering a 12-month period of operations based upon the SNF's accounting year, which do not necessary align with Federal FYs, which run from October 1 to September 30.

[3] Our second report focuses on the amount of funds (including Medicare funds) that selected SNFs paid to related parties and, for each selected SNF, any relationships between those payments and certain quality-of-care metrics.

BACKGROUND

Medicare Coverage of Skilled Nursing Facilities

Medicare provides health insurance for people aged 65 and over, people with disabilities, and people with permanent kidney disease. Medicare Part A provides inpatient hospital insurance benefits and coverage for extended care services for enrollees after discharge—including allowable services provided at SNFs—and Medicare Part B provides supplementary medical insurance for medical and other health services, including coverage of therapy services. Covered enrollees are those who require skilled nursing or rehabilitation services and receive the services from a Medicare-certified SNF after a qualifying hospital stay of at least 3 days. The maximum benefit under Medicare Part A is 100 days per "spell of illness." CMS administers the Medicare program, and contracts with Medicare administrative contractors (MACs) to, among other things, process and pay fee-for-service (*i.e.*, Parts A and B or Traditional Medicare) claims submitted by health care providers.

A SNF is a nursing facility that has the staff and equipment to provide skilled nursing care and, in most cases, skilled rehabilitative services and other related health services to people with and without Medicare. Under the prospective payment system (discussed below), Medicare covers SNF care that includes: nursing care provided by or under the supervision of a registered professional nurse; bed and board in connection with the furnishing of that nursing care; physical therapy, occupational therapy, and speech-language pathology services; medical social services; drugs, biologicals, supplies, appliances, and equipment; and other services that are generally provided by (or under arrangements made by) SNFs (42 CFR § 409.20(a)). Medicare does not cover custodial care, which includes activities of daily living (like bathing, dressing, using the bathroom, and eating) or personal needs when they can be done safely and reasonably without professional skills or training.

Medicare Cost Reports

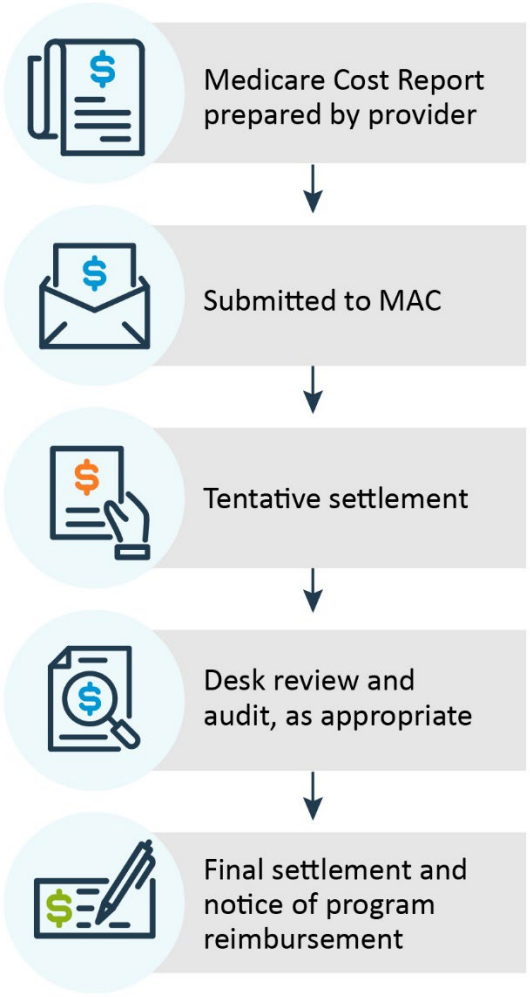
SNFs submit cost reports (Form CMS-2540-10) to their MACs annually. Each cost report is based on that SNF's financial and statistical records and, among other purposes, serves as the mechanism for the SNF to report costs, including related-party costs, for providing care for patients who are covered by Medicare. CMS uses the data from SNF cost reports when updating prospective payment rates. SNFs attest to the accuracy of the data when submitting their cost reports. Effective for FY 2022 and subsequent FYs, CMS has used FY 2018 cost reports as the basis for its prospective payment rate updates. Historically CMS has updated that basis about every 4 years.

After acceptance of each cost report, the MAC performs a tentative settlement, then performs a desk review of the cost report (discussed further below) and conducts an audit, as appropriate, before bringing that cost report to final settlement. The MAC then issues a Notice of Program Reimbursement to the provider. As the final settlement document, this notice shows whether payment is owed to the provider or to the Medicare program. Generally, cost

reports may be reopened and revised within 3 years after their final settlement date. However, a cost report may be reopened and revised at any time if it is established that the final settlement of that cost report was procured by fraud or similar fault (42 CFR § 405.1885(b)).

Figure 1 below depicts the Medicare cost report submission, review, and settlement process.

Figure 1: Medicare Cost Report Process



Medicare Administrative Contractor Cost Report Reviews

CMS relies on MACs to serve as the primary operational contact between the Medicare fee-for-service program and the health care providers enrolled in the program. MACs perform many administrative activities, including desk reviews and audits of cost reports.

MACs are required to conduct desk reviews of cost reports for all providers that file a Medicare cost report, with the exception of cost reports for hospices and for low- or no-Medicare-utilization providers. A desk review analyzes the provider's cost report to evaluate its adequacy

and completeness and to assess the accuracy and reasonableness of the data contained in the cost report. It is a process of reviewing information pertaining to the cost report without performing detailed verification and is designed to identify issues that may warrant additional review and, where appropriate, to resolve some of those issues. A MAC's desk review thus aims to determine whether the cost report can be settled without an audit or whether an in-house or field audit is necessary (*Medicare Financial Management Manual*, CMS Pub. No. 100-06, chapter 8, § 20.1).

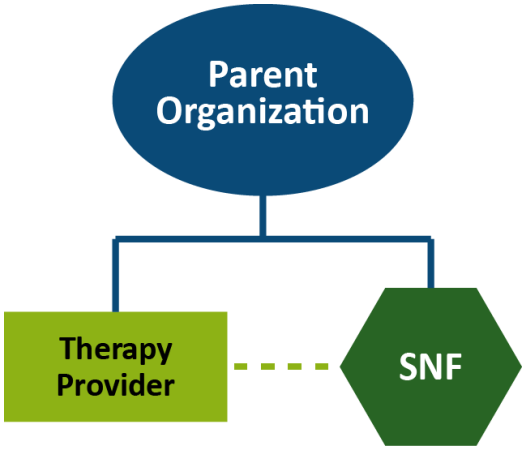
At its discretion, a MAC may audit a Medicare cost report after the desk review. An audit is more thorough than a desk review and examines in detail financial transactions, accounts, reports, and associated information as they relate to the cost report in order to test the provider's compliance with applicable Medicare laws, regulations, CMS Manual instructions, and directives. The *Medicare Financial Management Manual*, chapter 8, section 40, states that a MAC's audit work plan and selection process, while influenced by budgetary restrictions imposed by CMS and by CMS guidance about the types of providers or potential issues to be audited, is generally based on the MAC's professional judgment in determining which provider(s) represent the greatest risk of incorrect payment.

Related Parties

SNFs and other Medicare providers regularly obtain services, facilities, or supplies from parties related to the provider. Providers conduct business with related parties to assure a steady flow of supplies or services, to reduce competition, to gain a tax advantage, to extend influence, and for other reasons (42 CFR § 413.17(c)). Federal regulations state that "[r]elated to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies" (42 CFR § 413.17(b)). Federal requirements state that to be allowable, the related-party costs of services, facilities, or supplies must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere (42 CFR § 413.17).

In a simple example of the structure of related parties, a SNF may be owned by a parent organization that also owns a therapy provider that renders services to that SNF. The therapy provider is related to the SNF because both the therapy provider and the SNF are owned by the parent organization, as depicted in Figure 2 on the following page. Related-party structures can also be complex, as depicted in Appendix B.

Figure 2: Generic Example of Related Parties That Share Common Ownership



All related parties with which a provider conducted business transactions must be identified on the Medicare cost report (*Provider Reimbursement Manual–Part 2*, CMS Pub. No. 15-2, chapter 41, §§ 4104.1 (Worksheet S-2, Part II, Line 3) and 4117 (Worksheet A-8-1, Part II)). Providers must report information on each such related party, such as their name, the type of business, and how they are related.

Costs applicable to services, facilities, and supplies furnished to a provider by related parties can be included as Medicare-allowable costs for that provider, but an allowable cost must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere (42 CFR § 413.17). As part of its annual Medicare cost report, each SNF files Worksheet A-8-1, which identifies the costs of services, facilities, and supplies furnished by parties related to the SNF. The Worksheet identifies the expenses that the SNF incurred from each related party and provides for the computation of any needed adjustments to arrive at the allowable cost of those expenses for purposes of Medicare payment.

HOW WE CONDUCTED THIS AUDIT

We identified 12,571 SNFs that reported a total of $65.4 billion in related-party expenses, which those SNFs adjusted to $60,100,552,442 in reported allowable related-party costs on their Medicare cost reports with cost reporting periods ending during FYs 2015 through 2020 (audit period).

We used CMS's Healthcare Cost Report Information System (HCRIS) data to identify all Medicare SNFs' cost reports that: (1) covered provider cost reporting periods ending during our audit period and (2) reported related-party costs.

We selected a nonstatistical sample of 14 SNFs, which included 1 probe provider for our initial review and an additional 13 SNFs that we reviewed later. The 14 SNFs were selected to represent a variety of geographic locations, sizes, ownership characteristics (i.e., recent

ownership changes, type of ownership, chain organizations, affiliations with private equity companies), and CMS quality ratings.[4, 5]

We selected 1 cost report from each of the 14 SNFs, based on factors and considerations that included:

- the recency of changes in ownership,
- significant variances in reported related-party costs compared to other cost reporting periods for the same SNF, and
- related-party costs that constituted a higher percentage of total expenses for the SNF for that cost reporting period as compared to other cost reporting periods within our audit period for the same SNF.

For the 14 cost reports that we selected, we reviewed the associated SNFs' documentation and used outside sources (e.g., county property tax records and State business registration filings) to verify the accuracy of the information about the related parties and of the amounts of related-party costs that the SNFs reported on their cost reports. We determined whether all related parties were properly disclosed on these 14 cost reports and whether the associated SNFs adjusted related-party costs to allowable cost, as required.[6] If the related-party costs were incorrectly adjusted or not adjusted at all, we determined the allowable costs based on the financial records of the SNFs and their related parties. We identified the related parties' costs that were directly tied to the services, facilities, or supplies that they provided (for example, to calculate capital costs, we examined the depreciation, property taxes, and interest expenses incurred by real estate management companies, if possible; or by allocating and removing the related parties' profit from their transactions with the SNFs. We did not compare the related-party costs to the price of comparable services, facilities, or supplies that could be purchased elsewhere.

[4] A chain organization consists of a group of two or more health care facilities that are owned, leased, or otherwise controlled by one organization.

[5] CMS created the Five-Star Quality Rating System to help consumers, their families, and caregivers compare nursing homes more easily and to help identify areas about which those stakeholders may want to ask questions. The system gives each nursing home a rating of between 1 and 5 stars. Nursing homes with 5 stars are considered to have much above average quality and nursing homes with 1 star are considered to have much below average quality. There is one overall rating for each nursing home, and separate ratings for that nursing home's health inspections, staffing, and quality measures.

[6] In an effort to identify related parties that were not disclosed by a SNF, we obtained financial documents from the SNF and used that information to determine whether a provider or vendor was considered a related party. Although we were able to identify some undisclosed related parties, we do not know whether all related parties were identified, as we were limited to the information that we obtained from the SNFs.

We also contacted the individual MACs responsible for reviewing the selected cost reports to determine whether the desk reviews or audits that the MACs performed included reviews of any related-party costs that those SNFs reported.

We conducted site visits at four of the selected SNFs, during which we met with the SNFs' administrators to discuss the facilities' use of related parties.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains details of our audit scope and methodology.

FINDINGS

Some of the selected SNFs did not comply with Medicare requirements for reporting related parties. Of the 14 SNFs in our nonstatistical sample, 3 SNFs did not properly disclose 1 or more related parties on their Medicare cost reports. In addition, some of the selected SNFs did not comply with Medicare requirements when adjusting some of their related-party costs to Medicare-allowable costs. Specifically, of the 14 SNFs in our nonstatistical sample, 7 SNFs did not properly adjust some of their related-party costs to Medicare-allowable costs as required, which resulted in $1,703,734 in overstated costs. These overstated costs could affect future SNF prospective payments if they are used by CMS when updating prospective payment rates.

These errors were not identified or corrected by the MACs because they did not review, as part of their oversight activities, the disclosure of related parties or the reporting of related-party costs when the MACs performed desk reviews or audits of the selected SNFs' cost reports during our audit period. Furthermore, CMS did not provide sufficient guidance to SNFs that explained how to determine Medicare-allowable related-party costs.

MEDICARE REGULATIONS AND GUIDANCE

Federal regulations state: "Except as provided in paragraph (d) of this section, costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includable in the allowable cost of the provider at the cost to the related organization. However, such cost must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere" (42 CFR § 413.17(a)).

Federal regulations define the term "related to the provider" to mean that the provider is, to a significant extent, associated or affiliated with or has control of or is controlled by the

organization furnishing the services, facilities, or supplies (42 CFR § 413.17(b)). This report refers to associations or affiliations of this nature as "related-party" relationships.

"Common ownership" exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider. "Control" exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of another organization or institution (42 CFR § 413.17(b)).

Federal regulations (42 CFR § 413.17(d)) make an exception to the requirement of section 413.17(b) if the provider demonstrates by convincing evidence, to the satisfaction of the MAC, that the related party supplying the services, facilities, or supplies has all of the following attributes:

(1) the supplying organization is a *bona fide* separate organization;

(2) a substantial part of the supplying organization's business activity, of the type carried on with the provider, is also transacted with non-related organizations, and there is an open, competitive market for the type of services, facilities, or supplies furnished by the supplying organization;

(3) the services, facilities, or supplies are those that commonly are obtained by institutions such as the provider from other organizations and are not a basic element of patient care ordinarily furnished directly to patients at such institutions; and

(4) the charge to the provider is in line with the charge for such services, facilities, or supplies in the open market and is no more than the charge made under comparable circumstances to others by the supplying organization for such services, facilities, or supplies.

As part of its annual Medicare cost report, each SNF files Worksheet A-8-1, which identifies the costs of services, facilities, and supplies furnished by parties related to the SNF. The Worksheet identifies the expenses that the SNF incurred from each related party and provides for the computation of any needed adjustments to arrive at the allowable cost of those expenses for purposes of Medicare payment. Certain other information concerning the related parties with which the provider has transacted business must also be shown on this Worksheet, such as the related parties' names and the type of business in which the related party engages (e.g., medical drugs, medical supplies, laundry, and linen service) (*Provider Reimbursement Manual–Part 2*, CMS Pub. No. 15-2, chapter 41, § 4117).

The provider must, at its MAC's request, make available to the MAC adequate documentation to support the costs incurred by the related party, to include, when required, granting access to the related party's books and records that are attributable to supplies and services furnished to the provider. Such documentation must include an identification of the related party's total costs, the basis of allocation of costs to the provider, and an identification of other entities

served by the related party (*Provider Reimbursement Manual–Part 1*, CMS Pub. No. 15-1, chapter 10, § 1005).

SOME SELECTED SKILLED NURSING FACILITIES DID NOT COMPLY WITH MEDICARE REQUIREMENTS FOR REPORTING RELATED PARTIES

Skilled Nursing Facilities Did Not Properly Disclose Associated Related Parties

Some of the selected SNFs did not report all related parties as required. Specifically, three of the SNFs in our nonstatistical sample did not comply with Medicare requirements because they did not properly disclose a total of five related parties on their Medicare cost reports. The nondisclosure of some of these related parties resulted in overstated costs on the parts of the associated SNFs (Facility 1 and Facility 4), which we discuss in detail in our second finding below.

The first of these three SNFs, Facility 1, did not properly disclose its relationship with both a therapy provider and a medical equipment supplier, each of which was related to the SNF by shared common ownership. Although Facility 1 did not disclose the relationship with the therapy provider by name on Worksheet A-8-1, it did perform an adjustment to "related-party therapy" elsewhere on that SNF's cost report. We determined that the medical equipment supplier had begun operations in the same year as the year covered by our selected cost report. We also determined that Facility 1 had not made its cost report preparer aware of Facility 1's payments to that supplier; the preparer therefore did not disclose the related party or adjust the associated costs.

Facility 4 did not properly disclose its relationships with both a real estate management company and a pharmacy, each of which was related to that SNF by shared common ownership. Officials from Facility 4 stated that they did not report the real estate management company as a related party because they believed that although there was common ownership, the minority partner in the SNF had an ownership stake of approximately 5 percent in the real estate management company and was not in a position to exercise control. We note, however, that the relevant criteria (42 CFR §§ 413.17(a) and (b)) specify that a related-party relationship exists as a function of either ownership *or* control. Facility 4 officials acknowledged that the SNF should have disclosed its relationship with the pharmacy, and agreed to disclose the relationship with the real estate management company based on our review.

Facility 10 did not properly disclose its relationship with a home health agency that was related to that SNF by shared common ownership. Officials from Facility 10 stated that they did not disclose the SNF's relationship with the home health agency because they believed that Facility 10 qualified for an exception with respect to the reporting of costs for this related party under

42 CFR § 413.17(d). However, Facility 10 never requested an exception under 42 CFR § 413.17(d) from its MAC.[7]

For the remaining 11 SNFs (of the 14 we selected), we did not identify any undisclosed related parties.

Medicare Administrative Contractors Did Not Review Disclosure or Reporting of Related Parties as Part of Their Oversight Activities

The errors we identified were not identified or resolved because the MACs for these three selected SNFs did not review, as part of their oversight activities, whether all related parties were disclosed when the MACs performed desk reviews. In addition, the MACs did not perform any audits of the cost reports for these three SNFs.

We noted, moreover, that none of the MACs responsible for reviewing the selected SNFs' cost reports performed any review of the related-party costs. When we queried the relevant MACs on this aspect of their operations, one MAC responded that "a review of related party cost is not typically an audit area for a SNF" and another MAC responded that "for SNFs, no review of related party costs would be performed as part of the normal desk review or audit process due to how SNFs are paid." CMS has not encouraged the MACs to enhance their oversight of related-party costs.

SOME SELECTED SKILLED NURSING FACILITIES DID NOT COMPLY WITH MEDICARE REQUIREMENTS WHEN ADJUSTING SOME OF THEIR RELATED-PARTY COSTS TO MEDICARE-ALLOWABLE COSTS

Some of the related-party costs that some of the selected SNFs reported did not comply with Medicare requirements. Specifically, seven of the SNFs in our nonstatistical sample did not comply with Medicare requirements to adjust the costs from some of their related parties to Medicare-allowable costs. Of these SNFs, two did not adjust any of the costs from their undisclosed related parties (as discussed in our first finding), four did not adjust any of the costs for some of the related parties that were disclosed, and three incorrectly adjusted related-party costs for some of the related parties that were disclosed.[8]

[7] We determined that Facility 10 correctly adjusted its related-party costs to include only Medicare-allowable costs for this home health agency on its cost report. We therefore do not discuss any related-party costs associated with Facility 10 in our second finding.

[8] Although this finding addresses seven selected SNFs that did not comply with Medicare requirements, in this particular instance we specify nine selected SNFs that were not compliant, because two of the conditions we describe here involved the same SNFs. Specifically, Facility 4 did not adjust related-party costs at all for two related parties that this SNF did not disclose and for one related party that it did disclose. In addition, Facility 5 did not adjust related-party costs at all for one related party and incorrectly adjusted related-party costs for another related party.

The other 7 SNFs (of the 14 we selected) properly adjusted related-party costs to Medicare-allowable costs for all related parties as required.

Skilled Nursing Facilities That Did Not Adjust Related-Party Costs for Undisclosed Related Parties

As a result of not disclosing some of their related parties, two of the three SNFs identified in our first finding also did not adjust their related-party costs for some of those related parties to Medicare-allowable costs as required. Facility 1 did not adjust the related-party costs associated with the undisclosed medical equipment supplier and Facility 4 did not adjust the related-party costs associated with the undisclosed real estate management company and pharmacy.[9] Table 1 summarizes the overstated costs for these two SNFs and their related parties.

Table 1: Related-Party Costs That Were Not Adjusted for Undisclosed Related Parties

Facility	Type of Related Party	Reported Allowable Costs From Related Party	OIG-Calculated Allowable Costs From Related Party	Difference (Overstated Costs)
1	Medical Equipment Supplier	$1,177	$1,059	$118
4	Real Estate Management Company	1,622,542	773,207	849,335
4	Pharmacy	70,223	62,507	7,716
Total		**$1,693,942**	**$836,773**	**$857,169**

Based on our review of these related parties' financial records, we calculated that these two SNFs overstated their costs by including a total of $857,169 in profits paid to these related parties on their Medicare cost reports.

Skilled Nursing Facilities That Did Not Adjust Related-Party Costs for Disclosed Related Parties

Four SNFs (Facilities 4, 5, 6, and 9) did not adjust related-party costs for disclosed related parties when reporting Medicare-allowable costs and, therefore, incorrectly included profits associated with some of the related parties. Facility 4 incorrectly included profits from a related management company, Facility 5 and Facility 6 incorrectly included profits from related

[9] As was the case for Facility 10 in our first finding (footnote 7), although Facility 1 did not disclose its related-party therapy provider, that SNF correctly adjusted its related-party costs to include only Medicare-allowable costs for this therapy provider on its cost report. Accordingly, Facility 1 did not overstate any related-party costs associated with the therapy provider.

therapy providers, and Facility 9 incorrectly included profits from a related hospitality services provider.[10] Table 2 below summarizes the overstated costs for these related parties.

Table 2: Related-Party Costs That Were Not Adjusted for Disclosed Related Parties

Facility	Type of Related Party	Reported Allowable Costs From Related Party	OIG-Calculated Allowable Costs From Related Party	Difference (Overstated Costs)
4	Management	$853,066	$357,954	$495,112
5	Therapy	829,422	597,172	232,250
6	Therapy	822,308	818,001	4,307
9	Hospitality	459,513	427,347	32,166
Total		**$2,964,309**	**$2,200,474**	**$763,835**

Based on our review of these related parties' financial records, we calculated that these four SNFs overstated their costs by including a total of $763,835 in profits paid to these related parties on their Medicare cost reports.

Officials from Facility 4 stated that they inadvertently did not remove the management company's non-allowable amounts when developing the SNF's cost report. Facility 5 did not adjust related-party costs for its therapy provider at all because, according to Facility 5 officials, at some point in the 1990s the SNF received an exception from its MAC (known at that time as a fiscal intermediary) under 42 CFR § 413.17(d). However, we determined that neither the SNF, its MAC, nor CMS had documentation of any such exception being granted to Facility 5 at that time or at any time since then. Officials from Facility 6 stated that the therapy provider charged that SNF an amount to cover only the expenses that the therapy provider incurred; however, we determined that the amount that the therapy provider charged to Facility 6 incorrectly included a profit margin that was not adjusted.

Officials from Facility 9 stated that they did not believe that the hospitality services provider was a related party because the owners of Facility 9 had an ownership interest in a subsidiary company but not in the parent company that provided the hospitality services. We noted, however, that Facility 9's cost report identified that provider as a related party. Moreover, Facility 9 officials said that the identification of the hospitality services provider as a related party on this SNF's cost report was an attempt to be fully transparent. Two other selected SNFs owned by the same group also reported the hospitality services provider's parent company as a related party, and those two SNFs attempted to adjust their related-party costs to Medicare-allowable costs. Based on our review of the relationships at these three facilities, we determined that a related-party relationship existed. We therefore accepted Facility 9's disclosure of the relationship, and we calculated the correct Medicare-allowable costs for the related-party expenses that should have been reported on Facility 9's cost report.

[10] Hospitality services generally include laundry and linen, housekeeping, and dietary services.

Skilled Nursing Facilities That Incorrectly Adjusted Related-Party Costs for Disclosed Related Parties

Three SNFs (Facilities 2, 3, and 5 (footnote 8)) incorrectly included some profits associated with related-party costs (which exceeded the amounts of costs that were allowable by Medicare) because they incorrectly adjusted those costs when reporting their Medicare-allowable costs. Of these three SNFs, Facility 2 and Facility 3 did not correctly adjust profits they received from related therapy providers and hospitality services providers (footnote 10). Facility 5 did not correctly adjust profits from a related nursing provider. Table 3 summarizes the overstated costs for these related parties.

Table 3: Related-Party Costs That Were Incorrectly Adjusted for Disclosed Related Parties

Facility	Type of Related Party	Reported Allowable Costs From Related Party	OIG-Calculated Allowable Costs From Related Party	Difference (Overstated Costs)
2	Therapy	$592,685	$592,417	$268
2	Hospitality	739,695	739,515	180
3	Therapy	572,639	572,381	258
3	Hospitality	613,539	613,387	152
5	Nursing	3,933,458	3,851,586	81,872
Total		**$6,452,016**	**$6,369,286**	**$82,730**

Based on our review of these related parties' financial records, we calculated that these three SNFs overstated their costs by including a total of $82,730 in profits paid to these related parties on their Medicare cost reports.

CMS Did Not Provide Sufficient Guidance to Skilled Nursing Facilities Regarding the Determination of Medicare-Allowable Related-Party Costs

The errors we identified in these seven selected SNFs occurred because CMS did not provide sufficient guidance to SNFs that explained how to determine Medicare-allowable related-party costs, including how to determine the price of comparable services, facilities, or supplies that could be purchased elsewhere and how to implement and process exceptions.

Federal requirements state that allowable cost must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere (42 CFR § 413.17(a)). When we asked CMS if it had issued any implementing guidance to help SNFs and other providers identify the market price for any services, facilities, or supplies, CMS responded that "[w]e refer providers to CMS Publication 15-1, Chapter 21, section 2103, Prudent Buyer section." That section of the *Provider Reimbursement Manual* conveys guidance to MACs on how to detect and investigate situations in which costs appear excessive, but it does not provide any

instructions for SNFs or other providers regarding how to determine market prices or how to identify comparable purchasers. The absence of such instructions was reflected in the fact that the selected SNFs that adjusted related-party costs attempted only to adjust those costs to the related parties' actual costs, not to the lower of costs or market as required. None of these seven selected SNFs performed an analysis, as part of a process of determining the Medicare-allowable costs, to identify whether the price of comparable services, facilities, or supplies could be purchased elsewhere for a lower price. Our findings show that providing guidance to providers would help ensure that SNFs (and other providers) correctly determine and report related-party costs in compliance with Medicare requirements.

When we asked CMS whether it had issued any guidance on implementation or processing of allowed exceptions under 42 CFR § 413.17(d), CMS responded that "MACs no longer are reviewing this exception request as the prior granting of the exception no longer has an impact upon SNF payment once they [i.e., MACs and providers] transitioned fully to the PPS [prospective payment system] payment methodology over twenty years ago. Any previously granted exceptions are not currently reviewed on any frequency by the MAC for the same rationale—lack of payment impact." We note that although the application of an exception may, as CMS said, no longer impact the payment to the individual provider, it does affect the accuracy of the identification of related parties as well as the related-party costs that SNFs and other providers report—a fact that could impact future payment rates. Therefore, it remains appropriate that exceptions be requested, reviewed, and granted and that associated documentation be maintained.

Summary of Overstated Costs From Undisclosed and Disclosed Related Parties

The seven SNFs that did not comply with Medicare requirements to adjust the costs from some of their related parties to Medicare-allowable costs overstated their costs from related parties by a total of $1,703,734, consisting of:

- a total of $857,169 in overstated costs from undisclosed related parties for which profits were not removed at all,

- a total of $763,835 in overstated costs from disclosed related parties for which profits were not removed at all, and

- a total of $82,730 in overstated costs for which profits were not correctly adjusted.

These overstated costs could affect future SNF prospective payments if they are used by CMS when updating prospective payment rates. However, based on CMS's historic timelines for updating these rates (as explained in "Medicare Cost Reports" earlier in this report), these prior years' cost reports will most likely not be used as a basis for future prospective payment rate updates. For that reason, we are not recommending that CMS reopen any of the cost reports we selected for review in this audit.

RECOMMENDATIONS

We recommend that the Centers for Medicare & Medicaid Services:

- require the MACs to include, as part of the normal desk review or audit process, a review of reporting and disclosure of related-party costs;

- develop and implement guidance for SNFs on the appropriate methods for providers to determine their allowable related-party costs; and

- provide guidance to reeducate MACs on the need to review, grant, and document requests from SNFs for exceptions to cost reporting requirements in compliance with 42 CFR § 413.17(d).

CMS COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

CMS COMMENTS

In written comments on our draft report, CMS did not concur with our first recommendation. CMS concurred with our second and third recommendations and stated that it would explore the most feasible way to address each of them.

CMS's comments included a discussion that related to our first recommendation. Specifically, CMS stated that we did not compare the related-party costs to the price of comparable services, facilities, or supplies that could be purchased elsewhere. CMS described this comparison as "necessary in determining how much more should have been disclosed. A vendor not affiliated with the SNF would likely have profits baked into its prices because [the vendor is] not simply providing services for cost." CMS added that non-allowable related party costs do not have a direct impact on Medicare payments to SNFs.

CMS also said that the cost report is not the only basis for calculating payment rates under the SNF PPS. In this context, CMS referred to the MACs' desk reviews and audits of cost reports. CMS also referred to our audit methodology by which, for our selected cost reports, we reviewed the associated SNFs' documentation and used outside sources (e.g., county property tax records and State business registration filings) to verify the accuracy of the information about the related parties and of the amounts of related-party costs that the SNFs reported on their cost reports. CMS stated that directing the MACs to expand their SNF desk reviews by using outside sources in the ways that we did to verify the accuracy of cost report information "would require significant resources and funding without a commensurate impact on Medicare payment." CMS added that in light of these considerations, "in a time of limited resources" it did not concur with our first recommendation.

For our second and third recommendations, CMS stated that it would explore "the most feasible way" to provide guidance to SNFs on how to ensure that their related-party costs are

reduced to costs incurred and guidance to MACs as in relation to the provisions of 42 CFR § 413.17(d).

CMS's comments appear in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing CMS's written comments, we maintain that all of our recommendations remain valid. We commend CMS for concurring with our second and third recommendations and for stating that it would explore the most feasible ways to address them. We also acknowledge the validity of both CMS's concerns about resource limitations and its reference to the importance of focusing on issues that "have a direct impact on Medicare payments to SNFs."

Nevertheless, we continue to believe that an expansion of the MACs' desk review and audit processes to include reviews of the reporting and disclosure of related-party costs, as stated in our first recommendation, could result in greater efficiency and cost savings to the Medicare program. We maintain that requiring MACs to review related-party costs, despite the limited potential impact on current Medicare payments, would still help ensure that CMS has an accurate financial basis when updating prospective payment rates in the future.

In this respect, we also acknowledge that—as we state in "How We Conducted This Audit" and in Appendix A—we did not compare the related-party costs to the price of comparable services, facilities, or supplies that could be purchased elsewhere. We limited our audit in this way because CMS has not issued any guidance to the MACs on how to perform such comparisons.

We look forward to continuing to work with CMS as we continue to perform audit work that examines SNF related-party costs and their effect on the Medicare program and is enrollees.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We identified 12,571 SNFs that reported a total of $65.4 billion in related-party expenses, which those SNFs adjusted to $60,100,552,442 in reported allowable related-party costs on their Medicare cost reports with cost reporting periods ending during FYs 2015 through 2020 (audit period).

For the 14 cost reports that we selected for a nonstatistical sample, we reviewed the associated SNFs' documentation and used outside sources (e.g., county property tax records and State business regulation filings) to verify the accuracy of the information about the related parties and of the amounts of related-party costs that the SNFs reported on their cost reports.

We did not perform an overall assessment of the internal control structures of CMS. Rather, we limited our review to those controls that were significant to our objective. Specifically, we contacted the individual MACs responsible for reviewing the selected cost reports to determine whether the desk reviews or audits that the MACs performed included a review of any related-party costs that those SNFs reported. We also asked CMS if it had provided any guidance to MACs or providers on how to determine the price of comparable services, facilities, or supplies that could be purchased elsewhere.

We did not compare the related-party costs to the price of comparable services, facilities, or supplies that could be purchased elsewhere because, as explained earlier in this report, CMS has not issued sufficient guidance on what would constitute an appropriate basis for making such comparisons.

We performed audit work from September 2022 to August 2024.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and guidance;

- obtained HCRIS data for all SNFs that reported related-party costs on cost reports that covered provider cost reporting periods ending during FYs 2015 through 2020;

- assessed the reliability of the HCRIS data by comparing them to data from cost reports actually submitted by the SNFs;

- selected a nonstatistical sample of 14 SNFs, which included 1 probe provider for our initial review and an additional 13 SNFs that we reviewed later, and which represented a variety of geographic locations, sizes, ownership characteristics (i.e., recent ownership

changes, type of ownership, chain organizations (footnote 4), affiliations with private equity companies), and CMS quality ratings (footnote 5))—information that we obtained by:

  - using CMS's recently published Ownership database to identify any SNFs that listed known private equity groups as, or among, their owners;

  - querying the list of SNFs in CMS's Ownership database to identify any changes of SNF ownership on record and to determine when those changes occurred; and

  - using information from CMS's Care Compare website to research quality of care metrics, health inspection reports, and CMS quality ratings (footnote 5) for Medicare SNFs in our frame;

- selected 1 cost report from each of the 14 selected SNFs based on factors and considerations that included: recency of changes in ownership, significant variances in reported related-party costs compared to other cost reporting periods for the same SNF, and related-party costs that constituted a higher percentage of total expenses for the SNF for that cost reporting period as compared to other cost reporting periods within our audit period for the same SNF;

- reviewed documentation from the selected SNFs as well as outside sources (e.g., county property tax records and State business registration filings) to verify the accuracy of the information about the related parties and of the amounts of related-party costs reported on each selected cost report;

- reviewed financial records from the selected SNFs and their related parties as well as outside sources to determine the allowable related-party costs for each selected cost report by:

  - identifying the related parties' costs that were directly tied to the services, facilities, or supplies provided, if possible—for example, the depreciation, property tax, and interest expenses incurred by real estate management companies; or

  - allocating and removing the related parties' profit from their transactions with the SNFs, using the related parties' profit percentages on the services, facilities, or supplies provided;

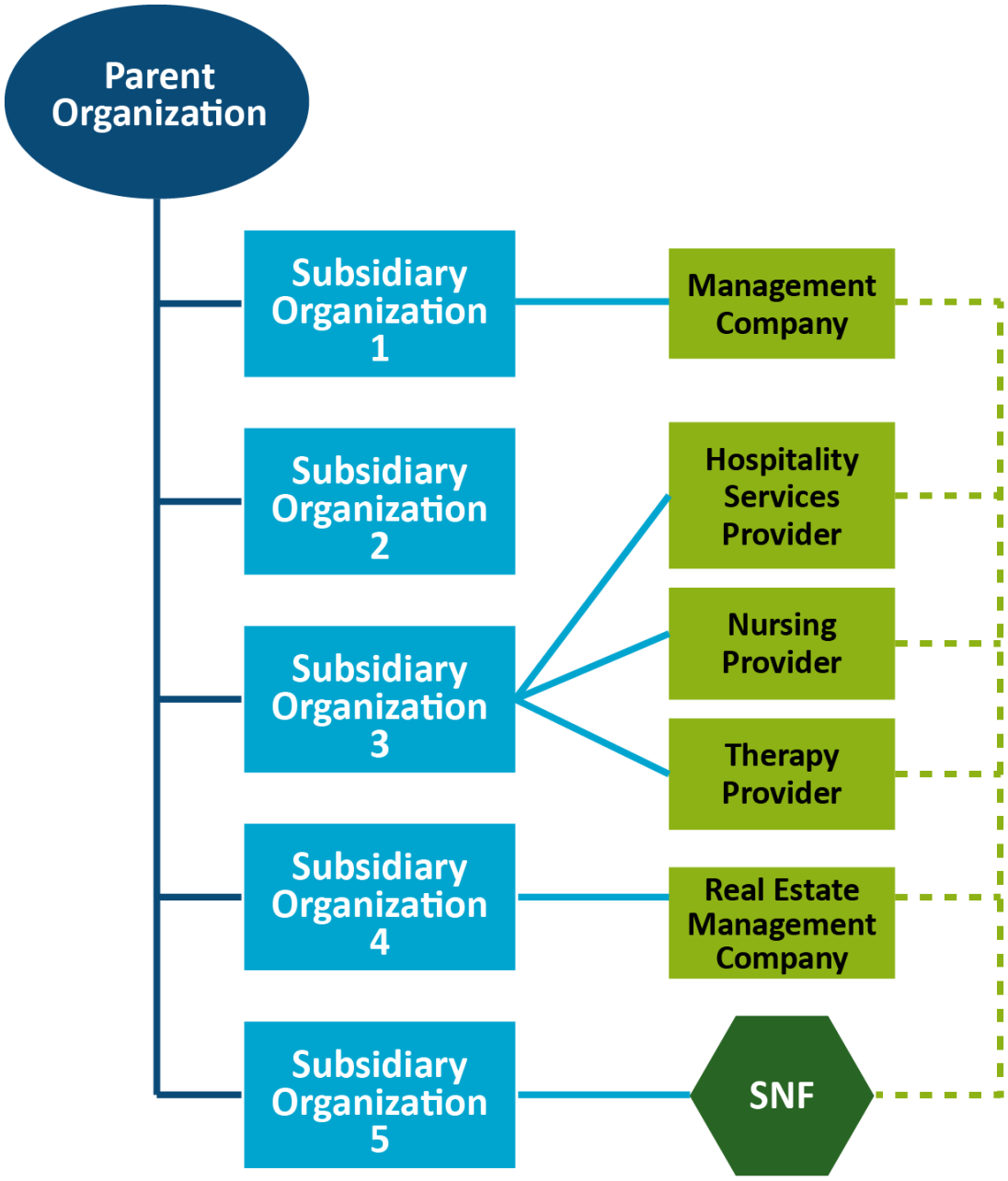
- contacted the individual MACs responsible for reviewing the selected cost reports to determine whether the desk reviews or audits that the MACs performed included reviews of any related-party costs that those SNFs reported;

- conducted site visits at 4 of the selected SNFs, during which we met with the SNFs' administrators to discuss the facilities' use of related parties; and

- discussed the results of our audit with CMS officials.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain enough, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX B: EXAMPLE OF COMPLEX STRUCTURE OF RELATED PARTIES THAT SHARE COMMON OWNERSHIP



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: September 27, 2024

TO: Amy J. Frontz
Deputy Inspector General for Audit Services

FROM: Chiquita Brooks-LaSure
Administrator

SUBJECT: Office of Inspector General (OIG) Draft Report: Some Selected Skilled Nursing Facilities Did Not Comply with Medicare Requirements for Reporting Related-Party Costs, A-07-21-0283

The Centers for Medicare & Medicaid Services (CMS) appreciates the opportunity to review and comment on the Office of Inspector General's (OIG) draft report.

CMS takes its role in improving the safety and quality of care in our nation's nursing homes seriously, and as such, CMS is leading efforts to increase accountability for nursing homes. CMS is also committed to protecting the fiscal integrity of the Medicare Trust funds and using its resources in a cost-effective manner to ensure that CMS complies with the statutory and regulatory framework of payments to providers.

The Biden-Harris Administration has taken action to hold nursing homes accountable for their services and empower nursing home residents to make informed decisions. In April 2022, CMS released data publicly available for the first time ever on mergers, acquisitions, consolidations, and changes of ownership from 2016 – 2022 for nursing homes enrolled in Medicare.[1] Building upon this transparency and accountability effort, in September 2022, CMS made additional data publicly available that includes information about the ownership of all Medicare-certified nursing homes.[2] This data provides state licensing officials, state and federal law enforcement, researchers, and the public an enhanced ability to identify common owners of nursing homes across nursing home locations. The data CMS made available online can be linked to other data sources to identify the performance of facilities under common ownership, such as owners affiliated with multiple nursing homes with a record of poor performance. The data includes detailed information on the ownership of approximately 15,000 nursing homes certified as a Medicare Skilled Nursing Facility (SNF) – regardless of any change in ownership, including providing more information about organizational owners of nursing homes. For example, the expanded data elements include information about each organizational owner, such as whether

[1] CMS Press Release: HHS Releases New Data and Report on Hospital and Nursing Home Ownership, April 20, 2022

[2] CMS Press Release: Biden-Harris Administration Makes More Medicare Nursing Home Ownership Data Publicly Available, Improving Identifications of Multiple Facilities Under Common Ownership, September 26, 2022

it's a holding company or a consulting firm. CMS also provided key identifiers that reflect groups of nursing homes with common managerial control. The data is updated monthly to help all stakeholders analyze how ownership of particular nursing homes or groups of nursing homes impacts the quality-of-care nursing home residents receive.

It is critical to note that ownership information is self-reported, and a primary challenge in assessing the completeness of ownership information is the lack of a centralized data source for verifying ownership information. However, CMS does verify the information provided on the Medicare Enrollment Application. CMS utilizes the Provider Ownership Verification (POV) contractor to review self-reported ownership information and verifies against available data sources such as filings with the applicable Secretary of State. To date, the POV contractor has reviewed ownership information reported for 14,440 SNFs. CMS also screens all owners and managing employees listed against OIG's exclusion list and for any felony convictions.

Separate from CMS's efforts to verify ownership, each Medicare-certified institutional provider, including SNFs, are required to submit an annual cost report to a Medicare Administrative Contractor (MAC), which contains provider information such as facility characteristics, utilization data, cost, and charges by cost center (in total and for Medicare), Medicare settlement data, and financial statement data. SNFs must provide adequate cost data based on financial and statistical records, which must be verifiable by qualified auditors.[3]

Costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are included in the allowable cost of the provider at the cost to the related organization. It is important to note, however, that such costs do not have a direct impact on Medicare SNF payment as SNFs are paid based on the SNF Prospective Payment System (PPS).

Under the SNF PPS, as established by section 4432(a) of the Balanced Budget Act (BBA) of 1997, SNFs receive a per diem prospective payment for all costs (routine, ancillary, and capital) related to the services furnished to beneficiaries under Part A of the Medicare program. For SNFs, the prospective payment for an enrollee's care is based on several clinical, functional, and resource-based factors, but that payment is not directly tied to the costs incurred by the SNF. Federal rates under the SNF PPS are set using allowable costs from Fiscal Year 1995 cost reports. The rates also include an estimate of the cost of services which, prior to July 1, 1998, had been paid under Part B but furnished to SNF residents during a Part A covered stay. These payment rates are increased each federal fiscal year. Although SNF's reported costs do not affect the current payments it receives, CMS considers the information provided when updating payment rates.

Once the MACs receive the cost report and any supporting documentation, they conduct a desk review, which analyzes the provider's cost report to determine the data's adequacy, completeness, accuracy, and reasonableness.[4] For a SNF desk review, MACs utilize a SNF acceptability checklist. For example, to determine if a SNF cost report is acceptable, the MACs review whether the SNF included supporting documentation corresponding to the amount of bad

[3] 42 CFR § 413.24(a)

[4] CMS Medicare Financial Management Manual, Chapter 8 – Contractor Procedures for Provider Audits, 20.1

debt claimed in the provider's cost report and whether a Home Office Cost Statement was submitted to the chain provider's servicing contractor.[5] A desk review is an analysis of the cost report and the provider's background. Its completion creates and documents an immediate awareness of changes, open issues, and problem areas. MACs may conduct an audit on a SNF cost report if they believe it is warranted based on their professional judgement and document the reasoning for the audit.[6]

In the report, OIG did not compare the related-party costs to the price of comparable services, facilities, or supplies that could be purchased elsewhere. CMS notes that this is necessary in determining how much more should have been disclosed. A vendor not affiliated with the SNF would likely have profits baked into its prices because they are not simply providing services for cost. As noted previously, the inclusion of additional costs, including non-allowable related party costs, does not have a direct impact on Medicare payment to SNFs. Considering the limited resources with which CMS currently must operate, CMS's focus is on actions that have the most significant impact.

CMS thanks OIG for their efforts on this issue and looks forward to working with OIG on this and other issues in the future.

OIG's recommendations and CMS' responses are below.

OIG Recommendation

Require the MACs to include, as part of the normal desk review or audit process, a review of reporting and disclosure of related-party costs

CMS Response

CMS understands OIG's concern about SNFs overstating their costs by including the full amount paid to related parties on their Medicare cost reports without adjusting the amount to the cost of comparable services as required by the regulation (42 CFR 413.17(a)). However, the inclusion of additional costs, including non-allowable related party costs, does not have a direct impact on Medicare payment to SNFs. As explained above, CMS considers the information provided when updating payment rates, but the cost report is not the only basis for calculating payments under the SNF Prospective Payment System.

As explained above, the MACs conduct audits if, in their judgment, the audit is warranted. Requiring the MACs to expand the SNF desk review to audit the SNFs' cost report documentation by using outside sources (e.g., county property tax records and State business registration filings) to verify the accuracy of the information about the related parties and of the amounts of related-party costs that the SNFs reported on their cost report would require significant resources and funding without a commensurate impact on Medicare payment.

Considering this information, in a time of limited resources, CMS does not concur with this recommendation.

[5] CMS Change Request 11644: Revision to the Cost Report Acceptability Checklist, August 2020
[6] CMS Medicare Financial Management Manual, Chapter 8 – Contractor Procedures for Provider Audits, 20.2

OIG Recommendation

Develop and implement guidance for SNFs on the appropriate methods for providers to determine their allowable related-party costs

CMS Response

CMS concurs with this recommendation. CMS will explore the most feasible way to provide SNFs with guidance on how SNFs can ensure their related-party costs are reduced to actual costs incurred.

OIG Recommendation

Provide guidance to reeducate MACs on the need to review, grant, and document requests from SNFs for exceptions to cost reporting requirements in compliance with 42 CFR § 413.17(d)

CMS Response

CMS concurs with this recommendation. CMS will explore the most feasible way to provide guidance to MACs as it relates to 42 CFR § 413.17(d).

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Washington, DC 20201

Email: Public.Affairs@oig.hhs.gov