



089413 OPPF
UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548



CIVIL DIVISION

December 22, 1971

Dear Mr. Ball:

We have made a review of the reasonableness of selected Medicare cost reimbursements to extended care facilities (ECFs) in the State of New York. During the review we examined into the extent that ECFs rent their facilities from organizations in which their owners or administrators have a financial or other interest. We also examined into the adequacy of the intermediary's application of the Medicare reimbursement principle pertaining to related organizations. We noted that:

- some degree of relationship existed between the ECFs and the lessors of four of eight facilities included in our test, and
- the Social Security Administration's guidelines for determining whether a relationship exists between a provider and a seller or renter of goods or services did not appear to be sufficiently definitive to assure uniform treatment of situations involving apparent affiliated relationships.

MEDICARE REIMBURSEMENT PRINCIPLE
PERTAINING TO RELATED ORGANIZATIONS

HEW Medicare reimbursement regulations (20 CFR 405.427(a)) provide that:

"...Costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includible in the allowable costs of the provider at the cost to the related organization..."

The regulations go on to define "related to the provider" as meaning:

"...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.

* * * * *

"...Control exists where an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution." (underscoring supplied)

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Beyond the case examples contained in Chapter 10 of the Provider Reimbursement Manual, we were unable to locate any HEW or SSA instructions which defined "significantly" as used in the above quoted regulations. As discussed later in this report, one intermediary did not consider the guidelines interpreting the HEW regulations on related organizations to be sufficiently definitive. Reports issued by the Bureau of Health Insurance Program Validation Staff indicate that other intermediaries were having difficulty in applying these regulations to other ECFs.

RELATED ORGANIZATIONS IDENTIFIED
IN NEW YORK SAMPLE

Our examination into the lessor/lessee relationships of eight providers which claimed rent as an allowable Medicare cost showed that four of the providers were to some degree related to the lessor. The relationship of one of the providers--College Nursing Home (Provider No. 33-5154)--was being investigated by the Bureau of Health Insurance Program Validation Staff.

The following summarizes our findings at the other three providers.

Belair Nursing Home (Provider No. 33-5140) and
Montclair Nursing Home (Provider No. 33-5141)

Momed Associates owned the facilities housing two ECFs--Belair Nursing Home and Montclair Nursing Home. Belair paid an annual rent of \$85,000 plus property taxes. Montclair's annual rent was \$120,000 plus property taxes.

The fiscal intermediary (Travelers) allowed, as a reasonable cost, the rents paid by the ECFs for reporting periods ending on December 31, 1967, even though the paid executive administrator of the two ECFs was a partner in Momed Associates, the owner of the facilities. The other two partners were his brothers. No settlement for reporting periods after 1967 had been made at these ECFs.

At one time, Belair Nursing Home, Montclair Nursing Home, and Momed Associates were three separate partnerships owned by the same principals consisting of three brothers and a group of doctors. Momed Associates' sole business was that of leasing the premises housing the two nursing homes. On August 1, 1966, the brothers sold their interest in the ECFs to the doctors and the doctors sold their interest in Momed Associates to the brothers. The doctors retained one of the brothers as the executive administrator for both homes.

In our opinion, such a situation seems to constitute a relationship as envisioned by the Medicare reimbursement principles pertaining to related organizations requiring that reimbursement be limited to the cost of the lessor. The intermediary initially had the same opinion.

However, after some correspondence with the executive administrator of the ECFs, the intermediary changed its position on the basis that a significant relationship between the lessor and lessee could not be presumed to exist in view of the executive administrator's assurances to the intermediary that he had no control over the procurement practices or policies of the lessee ECFs. Also, Travelers informed us that at the time this decision was made, SSA's guidelines were not definitive as to what constituted a related organization. We noted that the only change in the guidelines since that time was to add some illustrative examples.

It should also be noted here that the ECFs also purchased house-keeping and dietary services from business enterprises owned by the three brothers.

Woodbury Nursing Home (Provider No. 33-5231)

The Woodbury Nursing Home was a participating Medicare ECF and was owned equally by three partners. One partner (partner A) was also a general partner of The Peartree Company which owns the building occupied by the ECF. The rent paid to Peartree amounted to \$120,000 a year plus property taxes.

Prior to Woodbury's commencing operations in the newly constructed facility, partner A executed a document dated July 31, 1967, divesting himself--retroactive to May 1, 1967--as a general partner in The Peartree Company. May 1, 1967, was the date used as the beginning of the first Medicare cost reporting period which ended on December 31, 1967. The ECF did not begin to take patients until July 25, 1967. A description of partner A's duties relating to administration of Woodbury stated that he was responsible for negotiating and signing contracts for services, equipment, and supplies.

Because of (1) partner A's former ownership interest in the lessor organization, (2) the proximity of the dates of his divestiture of that interest and the beginning of ECF operations, and (3) his responsibility of negotiating contracts for the ECF, it appears likely that partner A was in a position to "significantly" influence the amount of rentals under the lease.

The intermediary (Travelers) did not question the inclusion of rent as an allowable expense when it made settlement with the ECF for the 8-month reporting period ending December 31, 1967. No cost settlement had been made for later periods.

To assist us in examining further into the applications by intermediaries of the reimbursement principle concerning related organizations, we would like to establish more definitively what SSA considers to be a "significant" relationship between a provider and a seller or renter of goods or services.

In this regard we noted that the State of New York, under the Medicaid program, considers that a related organization exists if the provider has any interest whatsoever--by common ownership or control--in organizations providing services, facilities or supplies to a medical facility. The State regulations provide that costs applicable to such services, facilities, and supplies are includible in the Medicaid reimbursable rate computation at the cost to the related organization. In applying this regulation to rents paid to related organizations, New York considers an interest of 10 percent or more to constitute a non-arm's length transaction.

We therefore recommend that SSA evaluate the facts in the cases discussed above and advise us as to whether the relationships between the lessors and lessees were significant enough for the intermediary to have disallowed the claimed rental expenses as reimbursable Medicare items and to have limited reimbursement to the costs of the related lessor organizations.

We recommend also that SSA more clearly define the ingredients of a "significant" relationship between a provider and a seller or renter of goods or services as set forth in the regulations and related instructions.

We would appreciate being advised of any action taken by SSA or the intermediary regarding the matters discussed in this report. If we can be of assistance, please let us know.

Sincerely yours,


Philip Charam
Associate Director

Mr. Robert M. Ball
Commissioner of Social Security
Department of Health, Education,
and Welfare