**Private Equity in the U.S. Health Care System**
**Testimony of Ernest C. Tosh**

The focus of today's hearing is to discuss private equity (PE) and its impact on the U.S. health care system. This discussion is the precursor to determining if there are problems created by PE investment in the health care industry and if there are problems, what actions, if any, are needed to correct the problems identified.

The first question that needs to be asked and answered is "why is private equity investing, at an increasing level, in the health care industry? The answer to that is that the private equity firms see the health care industry as an investment that will maximize their rates of return at a risk level, they are willing to accept. It's basic economics. If the level of risk of two or more investments is the same, you will invest in the one that gives you the greatest return on your investment. Put more bluntly, private equity is investing in the health care industry because there are profits to be made.

The focus of my work is within the skilled nursing industry (nursing homes). I will not rehash the February 2021 paper by Gupta, Howell and Yannelis that discusses the impact of private equity ownership within the nursing home industry. It suffices to say they found a correlation between private equity ownership and increased nursing home reimbursements but at the same time found an increase in negative resident outcomes. Thereby identifying the main question before the public, the nursing home industry and the legislature; are the negative outcomes in for-profit nursing homes due to a lack of reimbursement by the state and federal government or is it due to a lack of proper resource allocation?

**The remainder of this written testimony is dependent upon the "annual cost reports", CMS Form 2540-10, that are required to be field by every nursing home that receives Medicare/Medicaid reimbursements. It should be noted that under every administration, until the Trump administration, this information was freely available to the public and could be obtained with a simple Freedom of Information Act (FOIA) request. However, late in the Trump administration CMS instituted a policy in which they refuse to release annual cost reports to the public, claiming the data contained therein is "trade secret", even though this information had been released to the public for 25 years. It should also be noted that CMS has also taken action to redact the "Home Office Cost Reports", CMS Form 287, to such a degree that they are unusable for any meaningful analysis. Therefore, the analysis used for this testimony can no longer be accomplished using FOIA requested data, thus, the nursing home industry is completely veiled from public view.**

**Financial Information for Individual Nursing Homes**

Since 1996 CMS has required all nursing homes to file annual cost reports. The cost reports are known as CMS Form 2540-96 and 2540-10. The "-96" form was in effect from 1996 until it was modified in 2010 and the new form, "-10" was adopted for use in 2011 and has been the form nursing homes have filed for the past decade. The annual cost report collects financial data from the individual facility and with the "-10" version also collects staffing information.

On the surface the financial information appears to be useful, until one realizes the financial picture of a single facility can be highly manipulated if it is within a chain of nursing homes that also contains multiple related corporations.

*Income Statement*

The income statement is also known as a "profit or loss statement". It contains the facilities revenues and expenses during a particular period. The "bottom line" is "net income". Net Income = Total Revenue – Total Expenses.

The following is an income statement from a skilled nursing facility (nursing home) in Georgia. From the CMS annual cost report, it appears as though this facility lost money all three years. Losing a total of $688,000 between July 2016 and June 2018.

| Income Statement | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Total Patient Revenues | 8,935,526 | 8,900,835 | 9,606,721 |
| Less: contractual allowances for discounts on patients accounts | 2,026,100 | 2,028,967 | 1,961,616 |
| Net Patient Revenues | 6,909,426 | 6,871,868 | 7,645,105 |
| Less: Total operating expenses | 6,974,591 | 7,294,462 | 7,901,782 |
| Net Income from services to patients | (65,165) | (422,594) | (256,677) |
| Other Income: | | | |
| Contributions, donations, bequests | 0 | 0 | 0 |
| Income from investments | 5 | (5) | 4 |
| Revenues from communications (telephone & internet) | 0 | 0 | 0 |
| Revenue from television and radio service | 0 | 0 | 0 |
| Purchase Discounts | 0 | 0 | 0 |
| Rebates and refunds of expenses | 0 | 0 | 0 |
| Parking lot receipts | 0 | 0 | 0 |
| Revenue from laundry and linen service | 0 | 0 | 0 |
| Revenue from meals sold to employees and guests | 3,884 | 2,206 | 1,765 |
| Revenue from rental of living quarters | 0 | 0 | 0 |
| Revenue from sale of medical and surgical supplies | 0 | 0 | 0 |
| Revenue from sale of drugs to other then patients | 0 | 0 | 0 |
| Revenue from sale of medical records | 0 | 0 | 0 |
| Tuition | 0 | 0 | 0 |
| Revenue from gifts, flowers, coffee shops | 0 | 0 | 0 |
| Rental of vending machines | 627 | 710 | 182 |
| Rental of skilled nursing space | 0 | 0 | 0 |
| Governmental appropriations | 0 | 0 | 0 |
| Other Income - Other | 819 | 598 | 379 |
| Total Other Income | 11,000 | 10,995 | 33,963 |
| | | | |
| Total | (54,165) | (419,085) | (254,347) |
| Other Expenses | 0 | 0 | 0 |
| | 0 | 0 | 0 |
| | 0 | 0 | 0 |
| Total other expenses | 0 | 0 | 0 |
| **Net Income** | **(54,165)** | **(411,599)** | **(222,714)** |

*Balance Sheets*

The balance sheet is a financial document that is a statement of the assets, liabilities and capital of a business at a particular point in time. It's a snapshot of these balances as of a particular day.

The following are the balance sheets for the same facility in Georgia. This facility has no land, no building, less than $40,000 in cash, with its only real asset being it's accounts receivable (i.e. payments due to it from Medicare/Medicaid/Insurance companies). Its liabilities are basically the current amounts owed to its employees for the last pay period. There are no short-term loans, no mortgages, no long-term loans, no loans from owners and apparently no line of credit.

It is somewhat perplexing that a facility that is grossing almost $7,000,000 per year has virtually no assets and no liabilities.

| Current Assets | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Cash on Hand | 33,533 | 35,842 | 38,932 |
| Temporary Investments | 0 | 0 | 0 |
| Notes receivable | 0 | 0 | 0 |
| Accounts Receivable | 973,028 | 1,043,710 | 929,766 |
| Other Receivables | 2,275,756 | 1,909,549 | 1,053,444 |
| Less: Allowances for uncollectable notes and accounts receivable | (466,610) | (561,077) | (196,469) |
| Inventory | 0 | 0 | 0 |
| Prepaid Expenses | 14,505 | 20,844 | 16,010 |
| Other Current Assets | 0 | 0 | 0 |
| Due from other funds | 0 | 0 | 0 |
| | | | |
| **Total Current Assets** | **2,830,212** | **2,448,868** | **1,841,683** |

| Fixed Assets | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Land | 0 | 0 | 0 |
| Land Improvements | 0 | 0 | 0 |
| Less: Accumulated Depreciation | 0 | 0 | 0 |
| Buildings | 0 | 0 | 0 |
| Less: Accumulated Depreciation | 0 | 0 | 0 |
| Leasehold Improvements | 283,000 | 317,500 | 795,003 |
| Less: Accumulated Depreciation | (137,212) | (153,318) | (187,230) |
| Fixed Equipment | 256,093 | 256,093 | 303,474 |
| Less: Accumulated Depreciation | (201,862) | (218,759) | (235,025) |
| Automobiles and Trucks | 58,698 | 58,698 | 58,698 |
| Less: Accumulated Depreciation | (58,698) | (58,698) | (58,698) |
| Major Movable Equipment | 387,375 | 387,375 | 578,122 |
| Less: Accumulated Depreciation | (373,679) | (378,820) | (418,920) |
| Minor Equipment Depreciable | 0 | 0 | 0 |
| Minor equipment nondepreciable | 0 | 0 | 0 |
| Other Fixed Assets | 81,881 | 129,384 | (11,268) |
| | | | |
| **Total Fixed Assets** | **295,596** | **339,455** | **824,156** |

| Other Assets | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Investments | 0 | 0 | 0 |
| Deposits on leases | 0 | 0 | 0 |
| Due from owners/officers | 0 | 0 | 0 |
| Other assets | 0 | 0 | 6,825 |
| | | | |
| **Total Other Assets** | **0** | **0** | **6,825** |
| | | | |
| **Total Assets** | **3,125,808** | **2,788,323** | **2,672,664** |

| Current Liabilities | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Accounts Payable | 155,814 | 157,855 | 456,692 |
| Salaries, Wages & Fees Payable | 283,554 | 274,765 | 296,226 |
| Payroll Taxes Payable | 3,325 | 2,614 | 2,307 |
| Notes and Loans Payable | 0 | 0 | 0 |
| Deferred Income | 0 | 0 | 0 |
| Accelerated Payments | 0 | 0 | 0 |
| Due to Other Funds | 0 | 0 | 0 |
| Other Current Liabilities | 199,219 | 283,964 | 72,283 |
| | | | |
| **Total Current Liabilities** | **641,912** | **719,198** | **827,508** |

| Long Term Liabilities | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| Mortgage Payable | 0 | 0 | 0 |
| Notes Payable | 0 | 0 | 0 |
| Unsecured Loans | 0 | 0 | 0 |
| Loans from Owners | 0 | 0 | 0 |
| Other Long Term Liability | 0 | 0 | 0 |
| Other (specify) | 0 | 0 | 0 |
| | | | |
| **Total Long Term Liab.** | **0** | **0** | **0** |

| | | | |
|---|---|---|---|
| **Total Liabilities** | **641,912** | **719,198** | **827,508** |

| Capital Accounts | | | |
|---|---|---|---|
| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
| General Fund Balance | 2,483,896 | 2,069,125 | 1,845,156 |
| Specific Purpose Fund | 0 | 0 | 0 |
| Donor Created Endowment - Restricted | 0 | 0 | 0 |
| Donor Created Endowment - Unrestricted | 0 | 0 | 0 |
| Governing Body Created Endowment | 0 | 0 | 0 |
| Plant Fund Balance - invested in plant | 0 | 0 | 0 |
| Plant Fund Balance - reserve | 0 | 0 | 0 |
| | | | |
| **Total Fund Balances** | **2,483,896** | **2,069,125** | **1,845,156** |

| | 7-1-2016 to 6-30-2017 | 7-1-2017 to 6-30-2018 | 7-1-2018 to 6-30-2019 |
|---|---|---|---|
| **Total Liabilities And Fund Balances** | **3,125,808** | **2,788,323** | **2,672,664** |

*Related Parties*

The unusual nature of this facility's finances comes down to the basic question of where are its assets and liabilities and why does it continue to operate as an ongoing business if it is losing money every year?

The answer is that it is part of a nursing home chain with several related parties. A related party is a company that has shared ownership with the nursing home, or one company controls the other company. An example of this would be a situation where an individual (Mr. Smith) owns a nursing home and owns the pharmacy that sells the prescription drugs to the nursing home. The nursing home and the pharmacy are "related parties" due to them having shared ownership; Mr. Smith owns both.

Related parties can be used to manipulate the income statement. This is accomplished by overpaying the related parties for the services they provide thereby siphoning profits from the nursing home. By overpaying the related parties, the chain can make it appear as though the facility is losing money, while hiding the profits in completely opaque related parties.

The related party data collected from the Georgia facility is shown below. Unfortunately, the CMS 2540-10 only collects a maximum of twenty-five related party transactions. This facility has so many related parties that it was unable to list them all on the form. This is only evident if one adds up each of the columns and realizes the totals are significantly more than the sum for the columns, meaning there are more transactions included in the "totals" then are included on the page. The total for the third column "Over / Under Pmt" displays an overpayment to related parties by $398,000. This means that the total expenses used to calculate the facility's income on the income statement was overstated by $398,000, thereby driving down the facility's profit that year by $398,000. And that's if the costs reported in the first column "Allowable Cost" is accurate. There is no way for CMS or the public to audit these numbers currently.

There is no financial reporting currently required for related parties and there is no requirement that the parent company file audited consolidated financial statements, so there is no way for the public to determine if this chain is profitable or not. What we are left with are individual facility financial reports that can be easily manipulated by chains who are intent on obscuring their activities.

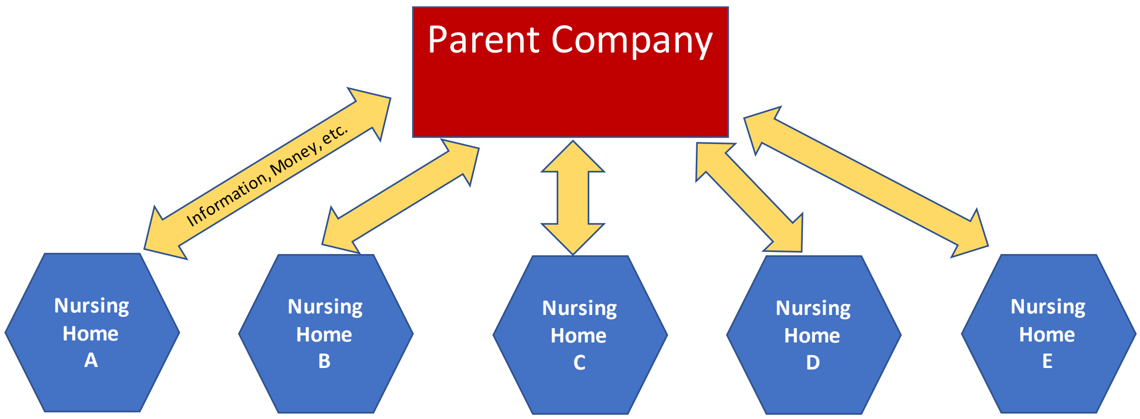
| Payments to Related Parties | | | |
|---|---|---|---|
| | 7-1-2017 to 6-30-2018 | | |
| | Allowable Cost | Payment | Over / Under Pmt |
| FACILITY LEASE | 268,597 | 502,020 | 233,423 |
| HOME OFFICE - CAPITAL RELATED | 32,356 | 0 | (32,356) |
| HOME OFFICE - ADMIN DIRECT | 68,146 | 0 | (68,146) |
| HOME OFFICE - POOLED COST | 219,100 | 416,413 | 197,313 |
| PH COLLECTIONS | 566 | 35 | (531) |
| PH CONSULTING - NURSING | 91,548 | 140,255 | 48,707 |
| PH CONSULTING - NURSING ADMIN | 0 | 5,777 | 5,777 |
| PH CONSULTING - DIETARY | 18,985 | 24,299 | 5,314 |
| PH CONSULTING - ADMINISTRATION | 4,890 | 0 | (4,890) |
| PH PHARMACY - PHARM CONSULTANT | 26,898 | 21,600 | (5,298) |
| PH PHARMACY - MED RECORDS CONSULT | 5,845 | 4,116 | (1,729) |
| PH MEDICAL - CAPITAL RELATED | 0 | 0 | 0 |
| PH MEDICAL - ADMINISTRATION | 7,201 | 7,848 | 647 |
| PH MEDICAL - MAINTENANCE | 38,407 | 41,856 | 3,449 |
| PH MEDICAL - LAUNDRY | 20,585 | 22,433 | 1,848 |
| PH MEDICAL - HOUSEKEEPING | 27,438 | 29,902 | 2,464 |
| PH MEDICAL - DIETARY | 58,491 | 63,743 | 5,252 |
| PH MEDICAL - NURSING ADMIN | 0 | 0 | 0 |
| PH MEDICAL - MEDICAL RECORDS | 2,120 | 2,311 | 191 |
| PH MEDICAL- SOCIAL SERVICE | 0 | 0 | 0 |
| PH MEDICAL - ACTIVITIES | 775 | 845 | 70 |
| PH MEDICAL - NURSING | 133,855 | 145,875 | 12,020 |
| PH MEDICAL - RADIOLOGY | 0 | 0 | 0 |
| PH MEDICAL- OXYGEN THERAPY | 0 | 0 | 0 |
| PH MEDICAL - PHYSICAL THERAPY | 7,326 | 7,984 | 658 |
| **Total** | **1,514,230** | **1,912,275** | **398,045** |

Related parties can also be used to manipulate balance sheets by holding assets and liabilities in related parties, away from the nursing home. An example of this is the use of a real estate holding company that holds the building and land as well as the mortgage on the property. The real estate and mortgages are therefore assets and liabilities of the related party, not the nursing home, once again being obscured from public view.

**Structure of a Nursing Home Chain**

When most individuals imagine the structure of a nursing home chain, they probably think of a very shallow, very unsophisticated structure such as this two-layer structure.

**Anticipated Chain Structure**



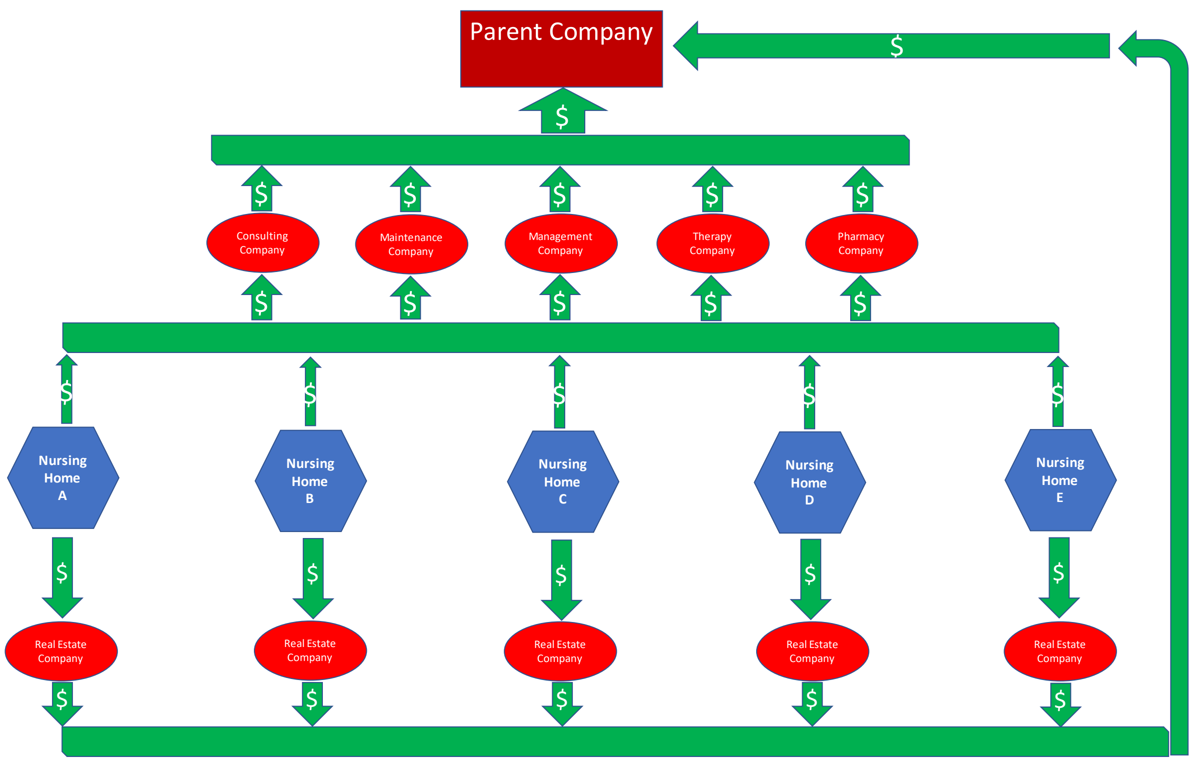

Unfortunately, this is not the structure of most for-profit facilities as this structure does not account for the use of related parties. A for-profit nursing home may contract with more than a dozen related parties and has a structure that looks more like a spider.

**Nursing Home with Related Parties**

The diagram above is a pictorial representation of the financial information collected by CMS Form 2540-10 (annual cost report). It reports the income and balance sheet information **after** the nursing home has interacted with its related parties. We will have a balance sheet that contains no assets, other than accounts receivable, and an income statement that may have been manipulated to show lower profits, possibly even financial losses, due to overpayment of related parties. The public can not determine the profitability of the related parties or the parent corporation under the current reporting rules.

The use of related parties makes the structure of the chain much more complicated as there can be dozens of facilities, each with a separate related party real estate holding company. There are many nursing home chains that have more than a hundred related companies within the umbrella of the corporate parent. In the simple example below, using only five nursing homes, there are fifteen companies within the corporate structure.

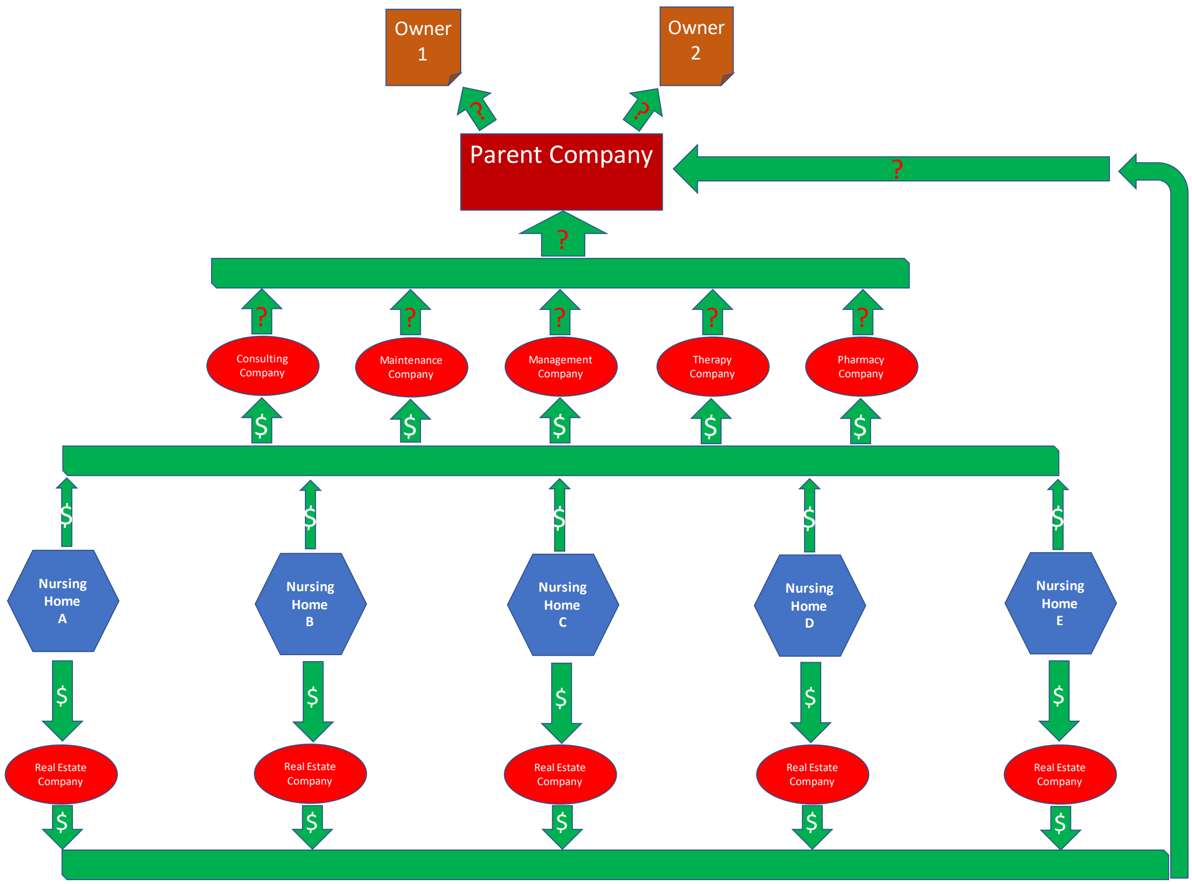
**Corporate Structure with Related Parties**




The use of related parties allows the chains to file cost reports for a single facility that may show that it is losing money but this may be due to fact that the profits are being siphoned out of the facility with the use of related party transactions. Likewise, the same facility can be made to appear as if it has no assets by holding all the major assets in related parties and leasing them back to the nursing home. Examples of this would be the real estate holding company and an equipment company that owns all the beds, furniture, lifts, etc. and leases them to the nursing home.

Currently there is no transparency when it comes to determining profitability within the nursing home industry. There is no way for the public, or the legislature, to determine which nursing homes are making a profit. There is no way to determine how much, if any, profit is being made by the parent company or how much the ownership of the chain is profiting.

**No Transparency as to Profitability**




**Private Equity – What's the problem?**

Private equity firms have entered the nursing home industry to make a profit. They have not entered the industry to conduct charity work. We know from recent academic studies that private equity owned chains have a higher incident of negative outcomes for the residents. The two questions that immediately come to mind are "why is this the case?" and "how do we fix it?".

Academic article after academic article, for the past twenty years, have reiterated the fact that staffing levels in nursing homes drive the outcomes. Staff higher and negative outcomes should decrease; staff lower and negative outcomes will probably increase. From the staffing information that is publicly available it is apparent that for-profit nursing homes are staffed lower than non-profit nursing homes and therefore have a higher incident of negative outcomes. It would appear, from the available information, that the answer to how to fix negative outcomes in for-profit nursing homes is to increase staffing.

However, if you ask the for-profit chains to increase staffing, they will invariably claim they are unable to increase staffing because reimbursement rates are so low they are barely able to keep their doors open. Unfortunately, we have no way of testing the veracity of this statement. Currently nursing home chains can hold up their individual facility cost reports (CMS 2540-10) and claim that all their nursing homes are losing money and the only way they can survive is if they get more taxpayer money. What they are conveniently failing to provide to the public, and the legislature, are audited consolidated financial statements for the entire chain. The question is not "are the individual facilities profitable?", the question is "is the chain as a whole profitable?". If the chain is profitable, they can increase staffing without further increases in reimbursements.

**Conclusion**

America's nursing home industry is dominated by for-profit chains, including chains owned by private equity firms. Understaffing is a chronic problem in for-profit nursing homes and leads to an increase in negative outcomes for the residents. The solution to this problem is to increase staffing.

The only real question is whether there is adequate reimbursement at this time to require more staffing or will that requirement require a higher reimbursement from Medicare and Medicaid to be realized. That question can not be answered using currently available public information.

To determine if current reimbursement levels are adequate for a higher staffing requirement the chains need to be required to file audited consolidated financial statements so that the legislature, and the public, can see exactly how profitable (or unprofitable) the chains are at this time. Only then can the legislature make an informed decision as to raising reimbursement levels.