Report in Brief
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U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL

Medicare Paid New Hospitals Three Times More for Their Capital Costs Than They Would Have Been Paid Under the Inpatient Prospective Payment System

Why OIG Did This Audit

Medicare regulations require that established hospitals be paid for capital costs through the Inpatient Prospective Payment System (IPPS). These regulations also allow new hospitals to be exempt from the IPPS payment methodology for capital costs and, instead, to be paid for these costs on a cost reimbursement basis for their first 2 years of operation. The stated rationale for this IPPS exemption is that new hospitals may not have adequate Medicare utilization in those initial 2 years and may have incurred significant startup costs.

Our objective was to determine the potential cost savings to Medicare if the IPPS exemption were removed such that capital payments to new hospitals would be paid under the IPPS.

How OIG Did This Audit

Our audit covered Medicare program payments totaling $423.2 million for capital costs that were paid to 112 new hospitals under the current (reasonable cost) methodology for Federal fiscal years 2012 through 2018. We calculated what the IPPS payments to new hospitals would have been by using the Provider Statistical and Reimbursement Reports, cost report data from the Centers for Medicare & Medicaid Services' (CMS's) Healthcare Cost Report Information System, and inpatient claim data. We also compared actual capital costs and utilization reported by 35 of the 112 new hospitals.

What OIG Found

We identified significant potential cost savings to Medicare if the IPPS exemption were removed and capital payments to new hospitals were made through the IPPS. For the 112 new hospitals that we reviewed, Medicare paid a total of $283 million more for capital costs than it would have paid if these hospitals had been paid through the IPPS. The IPPS exemption resulted in new hospitals being paid three times more—or an average of almost $1.3 million more per cost report—under the reasonable cost methodology than if they had been paid for their capital costs under the IPPS.

With respect to the reasons for the IPPS exemption, we compared the first 2 years of operation with the subsequent 2 years of operation of the 35 new hospitals for which such data were available and determined that in the first 2 years of operation, average Medicare-related capital costs were only 3 percent higher and average Medicare utilization was 15 percent lower.

Most of these new hospitals (approximately 59 percent) were also part of chain organizations that might have been able to provide reserve capital to their new hospitals if needed.

What OIG Recommends and CMS Comments

We recommend that CMS review the findings in this report and, if it determines that a separate payment methodology for capital costs at new hospitals is no longer warranted, change its regulations to require new hospitals to have their Medicare capital costs paid through the IPPS with an option for payment adjustments or supplemental payments if necessary.

CMS concurred with our recommendation and stated that it would further review our findings and determine whether any modifications to the capital payment methodology for new hospitals should be proposed in future Federal rulemaking.