PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2020-D25

PROVIDER –
Cherokee Regional Medical Center

Provider No.: 16-1362

vs.

MEDICARE CONTRACTOR -
WPS Government Health Administrators (J-5)

HEARING DATE –
October 30, 2018

Fiscal Year Ending –
December 31, 2014

CASE NO.: 16-2381

INDEX

ISSUE

The Parties were unable to come to an agreement on an issue statement for the hearing.[1] The issue as stated by the Provider is:

> Whether the Medicare Contractor improperly disallowed certain related party costs claimed by Cherokee Regional Medical Center ("Cherokee" or "Provider") based on its determination that Cherokee Regional Medical Center had not incurred the claimed costs.[2]

The issue as stated by the Medicare Contractor is:

> Whether the Medicare Contractor properly disallowed administrative and general ("A&G") costs allocated to Cherokee by St. Luke's Regional Medical Center ("St. Luke's").[3]

DECISION

After considering Medicare law and regulations, arguments presented, and the evidence admitted, the Provider Reimbursement Review Board ("Board") finds that the Medicare Contractor properly adjusted Cherokee's cost report for fiscal year ("FY") 2014 to disallow certain A&G costs allocated to Cherokee by St. Luke's.

INTRODUCTION

Cherokee is a critical access hospital ("CAH") located in Cherokee, Iowa.[4] St. Luke's is an acute care hospital located in Sioux City, Iowa.[5] The Medicare contractor[6] assigned to Cherokee is Wisconsin Physician Services ("Medicare Contractor").

When auditing Cherokee's FY 2014 cost report, the Medicare Contractor made an adjustment to Cherokee's Worksheet A-8-1, which limited Cherokee's related party costs to the amount reported on Cherokee's trial balance.[7] Cherokee timely appealed the Medicare Contractor's final determination to the Board and met the jurisdictional requirements for a hearing. The Board conducted a live hearing on October 30, 2018. Cherokee was represented by Robert Mazer, Esq.

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[1] Transcript, ("Tr.") at 5.
[2] *Id.*; Provider's Final Position Paper at 2.
[3] Tr. at 5-6.
[4] Provider's Final Position Paper at 1.
[5] *Id.*
[6] CMS' payment and audit functions under the Medicare program were historically contracted to organizations known as fiscal intermediaries ("FIs") and these functions are now contracted with organizations know as Medicare administrative contractors ("MACs"). The term "Medicare contractor" refers to both FIs and MACs as appropriate.
[7] The Medicare Contractor first adjusted the amount reported in column 5 - $373,600 - to the amount of actual costs incurred for management fee and contract CEO in Cherokee's trial balance - $404,772. The Medicare Contractor then adjusted Cherokee's claimed related party cost in column 4 - $3,865,923 - to column 5. *See* Medicare Contractor's Final Position Paper at 14; Exhibit I-3.

and Leslie Demaree Goldsmith, Esq. of Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C. The Medicare Contractor was represented by Edward Lau, Esq. of Federal Specialized Services.

STATEMENT OF FACTS

Medicare pays CAHs 101 percent of the reasonable costs of providing services to Medicare patients.[8] As a CAH, Cherokee was paid on this reasonable cost basis for FY 2014. As a full service hospital, St. Luke's is not paid by Medicare on a reasonable cost basis but rather is paid under the inpatient prospective payment system ("IPPS"). Under IPPS, Medicare pays hospitals a predetermined, standardized amount per discharge, subject to certain payment adjustments.[9]

Medicare's regulation at 42 C.F.R. § 413.24 instructs providers on the requirements for adequate cost data and cost findings, setting forth the underlying principle in section (a):

> (a) *Principle*. Providers receiving payment on the basis of reimbursable cost must provide adequate cost data. This must be based on their financial and statistical records which must be capable of verification by qualified auditors. The cost data must be based on an approved method of cost finding and on the accrual basis of accounting . . . .

Section (d) of this regulation instructs providers on cost finding methods and states the following regarding the costs of services a provider furnishes to a free standing entity:

> (7) *Costs of services furnished to free-standing entities*. – The costs that a provider incurs to furnish services to free-standing entities with which it is associated are not allowable costs of that provider. Any costs of services furnished to a free-standing entity must be identified and eliminated from the allowable costs of the servicing provider, to prevent Medicare payment to that provider for those costs. This may be done by including the free-standing entity on the cost report as a non-reimbursable cost center for the purpose of allocating overhead costs to that entity. If this method would not result in an accurate allocation of costs to the entity, the provider must develop detailed work papers showing how the cost of services furnished by the provider to the entity were determined. These costs are removed from the applicable cost centers of the servicing provider.

Medicare's regulation at 42 C.F.R. § 413.17(a) states, in relevant part:

> [C]osts 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

[8] 42 C.F.R. § 413.70.
[9] 42 U.S.C. § 1395ww(d); 42 C.F.R. Part 412.

> 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.

During FY 2014, Cherokee was a party to a Hospital Management Agreement ("Management Agreement") with St. Luke's Health System d/b/a Unity Point Health – St. Luke's ("St. Luke's Health").[10] Under the terms of the agreement, St. Luke's Health provided Cherokee with an array of management services, through a sister corporation, St. Luke's Regional Medical Center, an acute care hospital located in Sioux City, Iowa.

The articles of incorporation of St. Luke's Health System specify that Iowa Health System ("IHS") is the sole corporate member. IHS is a non-profit entity that operates a health system principally in Iowa, but also in other states, and it later became known as Unity Point Health. Likewise, the articles of incorporation of St. Luke's Regional Medical Center specify that IHS is the sole corporate member. Thus, St. Luke's Health System and St. Luke's Regional Medical Center have the same parent, IHS or Unity Point, and are sister corporations.[11]

The services specified in the Management Agreement included operations consultation services, an annual operational review, clinical daily operations expertise, assistance with regulatory compliance including CAH requirements, assistance with reimbursement issues, physician recruitment services, medical staff credentialing services, clinical education opportunities, monitoring administrative performance, and administering an employee satisfaction survey.[12] Cherokee would be able to participate in various discount arrangements to which St. Luke's was a party. St. Luke's CEO or his designee would be required to attend meetings of Cherokee's governing board and to provide information and advice to its members. Representatives of Cherokee were also permitted to participate in various network and continuing education programs provided by Unity Point Health or St. Luke's. All of these services were included in an annual management fee.[13]

Additionally, St. Luke's was required to provide Cherokee with a chief executive officer ("CEO"), referred to in the Management Agreement as an Administrator. As compensation for St. Luke's services furnished under the Management Agreement, Cherokee was required to reimburse St. Luke's for the compensation that it paid to the individual serving as Cherokee's CEO plus a $60,000 annual management fee, subject to annual renegotiation. Under the terms of the Management Agreement, additional payments would be required for temporary staff fees, education course material, on-site educational programs, specific reimbursement services and

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[10] Exhibit P-3. The relationship between St. Luke's and Cherokee Medical Center was consistent with the mission of Unity Point Health ("UPH"), the organization of which St. Luke's was a part. UPH was a regional health care delivery system furnishing care throughout the State of Iowa. As part of its mission to improve health care available to the people and communities that it served, UPH "senior affiliates" such as St. Luke's participated in collaborative relationships to assist smaller community hospitals located in rural areas throughout the State of Iowa. Provider's Final Position Paper at 1-2.

[11] Tr. at 12-15; Exhibits P-43, P-44.

[12] *See* Exhibit P-3 at 9-10.

[13] *See* Provider's Final Position Paper at 5-7; Exhibit P-3.

certain special administrative projects, which might be requested by Cherokee. Total payments made by Cherokee to St. Luke's during FY 2014 were $404,772.[14]

When St. Luke's prepared its FY 2014 cost report it did not prepare a home office cost statement to determine the amount of cost that should be allocated to Cherokee.[15] Rather the compensation for Cherokee's CEO was directly assigned to Cherokee and eliminated from the relevant St. Luke's cost report.[16] Additionally, St. Luke's allocated a portion of its A&G costs to Cherokee using a statistic that included the accumulated cost of both St. Luke's and Cherokee. This was done by including Cherokee's total cost in a non-reimbursable cost center on St. Luke's cost report.[17] Once St. Luke's allocated its A&G costs to Cherokee it advised Cherokee of the amount, and Cherokee recorded this amount on its FY 2014 cost report, using a Worksheet A-8-1 adjustment.[18]

When issuing Cherokee's Notice of Program Reimbursement, the Medicare Contractor disallowed Cherokee's claimed related party costs in excess of the amount paid to St. Luke's (Adjustment No. 38). Specifically, the Medicare Contractor disallowed $3,865,923, the amount determined based on St. Luke's Medicare cost report, and recognized $404,772, the amount Cherokee paid to St. Luke's for FY 2014. The Medicare reimbursement impact of the reduction in allowable costs was $969,737.[19]

DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

Cherokee asserts that the Medicare Contractor's adjustment to remove the $3,865,923 in costs allocated from St. Luke's, and replace it with the $404,772 paid by Cherokee to St. Luke's, was because Cherokee was related to St. Luke's by control and not by ownership.[20] Cherokee points to a home office article developed by the Medicare Contractor as proof that the disallowance was because Cherokee was related by control.[21] Cherokee maintains that this is incorrect as CMS regulations are clear that costs for services provided by a related organization are included in allowable costs at the cost to the related organization regardless of whether the parties are related by ownership or related by control.[22] Cherokee contends that the fact that the payments made to St. Luke's of $404,772 were far less than the $3,865,923 allocated to Cherokee by St. Luke's is irrelevant because the regulations allow Cherokee to claim the actual cost to the related party as long as they do not include any profit.[23]

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[14] *Id.* at 6-7 (citing Exhibit P-5 at 11, 15, 16, 28); Exhibit P-3.
[15] Tr. at 111 – 112.
[16] *See* Provider's Final Position Paper at 7-8.
[17] *See id. See also* Tr. at 18-20.
[18] *See* Provider's Final Position Paper at 8.
[19] *Id.* at 9.
[20] Tr. at 9 -10; Provider's Final Position Paper at 15; Medicare Contractor's Final Position Paper at 18.
[21] Provider's Final Position Paper at 15 (citing Exhibits P-27, P-28).
[22] *Id.* at 13 (citing 42 C.F.R. § 413.17). *See also* Tr. at 9-11.
[23] Tr. at 147.

Cherokee points out the reason for the Medicare Contractor's disallowance is because the cost were not incurred by the hospital.[24] Cherokee asserts that the costs were not disallowed because they were unreasonable, they had been determined incorrectly, or the parties were unrelated.[25] Rather, Cherokee asserts that, the Medicare Contractor's supplemental position paper is interjecting new arguments into an appeal of the disallowance of its related party costs and asks the Board to reject the arguments in the Medicare Contractor's supplement position paper. Cherokee would like the Board to review the disallowance only on the basis upon which the Medicare Contractor relied when it made the audit adjustment.[26]

Finally, Cherokee asserts that it was permissible for it to claim related party costs that were determined by use of a non-reimbursable cost center on St. Luke's cost report because there is nothing that prohibits use of a non-reimbursable cost center to determine Cherokee's related party costs. In support of its position, Cherokee points to previous Board and Administrator decisions that have permitted the cost of services furnished by a Medicare provider to a related entity to be determined using a non-reimbursable cost center.[27]

The Medicare Contractor counters that Cherokee failed to use an acceptable/accurate method for identifying the portion of St. Luke's costs that might be applicable to services rendered to Cherokee.[28] Additionally, the Medicare Contractor asserts that Cherokee failed to demonstrate, with auditable documentation, that the claimed costs were reasonable with respect to the services received under the Management Agreement.[29]

The Medicare Contractor points out that the allocation methodology used by St Luke's to determine Cherokee's costs results in an overstatement of those costs. The Medicare Contractor explains that by including Cherokee's total operating costs in a non-reimbursable cost center on St. Luke's cost report, St Luke's allocated more of its A&G costs to Cherokee than to any of St. Luke's cost centers. The Medicare Contractor claims this allocation methodology results in a fragrant miscalculation of Cherokee's costs because Cherokee is only a 25-bed CAH and yet it received a larger allocation of St. Luke's A&G costs than St. Luke's 172-bed inpatient cost centers.[30]

The Board reviewed the issue statements, the final and supplemental position papers, and exhibits that were submitted by the parties. The Board disagrees with Cherokee that the Medicare Contractor's supplemental position paper added new issues and that the Board should review the disallowance only on the basis contained in the Medicare Contractor's audit adjustment. It is clear from the Medicare Contactor's audit adjustment that the costs under appeal were disallowed because they were not costs incurred by Cherokee. It is also clear from the Medicare Contractor's final position paper that it believes St Luke's flawed methodology resulted in St Luke's allocating an excessive amount of its incurred costs to Cherokee which resulted in Cherokee incurring costs in excess of services provided to it by St. Luke's. These

[24] Exhibit I-3 at 5.
[25] Provider's Response to Medicare Contractor's Final Position Paper at 2.
[26] *Id*. at 2-3.
[27] *Id*. at 7-9.
[28] Medicare Contractor's Final Position Paper at 17.
[29] Id. at 17-18.
[30] *Id*. at 19-20.

arguments were presented in the Medicare Contractor's final position papers (and not, as alleged, for the first time in the supplemental position paper). The Board finds that the supplemental position paper merely expanded upon the arguments in the final position paper and did not introduce new arguments. Finally, while Cherokee would like the Board to limit its review to whether the costs were incurred by the related organization, the Board disagrees. The regulation at 42 C.F.R. § 413.17(a) requires the incurred cost of the related organization to be reasonable for the services provided. Therefore, the Board considered the evidence and testimony to determine if the costs allocated from St Luke's to Cherokee were costs incurred by St. Luke's for services provided to Cherokee, *and* if those costs were reasonable.[31]

The Board agrees with Cherokee that, based on 42 C.F.R. § 413.17(a), the costs attributable to services furnished to Cherokee by organizations related to Cherokee (whether by common ownership **or control)** are includable in the allowable cost of Cherokee in the same amount as the costs incurred by the related organization. However, these costs must also be reasonable as the regulation states that the "such cost must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere." Cherokee submitted no evidence or testimony to demonstrate that the cost of the services provided based on the Management Agreement met the § 413.17(a) requirement and could not be purchased elsewhere for less than the $3,865,923 allocated from St. Luke's. Rather, Cherokee simple states that the $3,865,923 in related party costs from St Luke's were allocated by St. Luke's to Cherokee based on "accumulated costs in accordance with Medicare cost reporting principles."[32]

The Board disagrees with Cherokee that St. Luke's used an allocation method in accordance with Medicare cost reporting principles. While the regulation at 42 C.F.R. § 413.24(d)(7) allows for the use of non-reimbursable cost centers when allocating costs, and the cost report instructions suggest using accumulated costs to allocate A&G,[33] the Board finds nothing in these instructions directing St. Luke's to add the accumulated costs of Cherokee to its statistic.[34] As the Medicare Contractor points out, the accumulated cost statistic used by St. Luke's implies that St. Luke's provided the *same* A&G services, and incurred the related costs for Cherokee, in the *same* ratio as it did for itself. However, this is clearly not the case, as the Management Agreement between Cherokee and St. Luke's is for a *limited* number of services and, therefore, a significant portion

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[31] The Provider points out that in *Greene County Medical Center v. WPS*, PRRB Case Nos. 14-1248, 14-1445 (June 16, 2015) the Medicare Contractor disallowed the Home office costs because it believed the Home Office and the Provider were not related. Provider's Response to Medicare Contractor's Final Position Paper at 2. In that hearing, the Board limited testimony to the question of whether the parties were related and did not allow testimony about the amount of cost claimed. The Board points out that the *Greene County* case is different than this case because the dispute in *Green County* centered around whether the parties were related while the dispute here centers around the issue of whether the costs incurred by St. Luke's were for services provided to Cherokee and were reasonable.

[32] Provider's Final Position Paper at 7.

[33] Hospital Cost Report CMS Form 2552-10 Worksheet B-1 Column 5 instructions indicate accumulated cost as the statistic for A&G. (*Available at*: https://www.cms.gov/Regulations-and-Guidance/Guidance/Transmittals/downloads/R1P240.pdf.)

[34] CMS Pub 15-2 § 4013 also instructs providers to establish non-reimbursable cost centers for non-patient related costs incurred by the provider. The instructions use an example of physicians' private offices and do not include the total operating costs of the physician offices as it does not include salaries, etc.

of Cherokee's costs are incurred without reliance on St. Luke's and should not be included in St. Luke's statistic.[35]

Further, the Board finds nothing in this regulation or the cost report instructions that require or even suggest that a provider include the total cost of another provider on its cost report when allocating costs based on accumulated costs. In this regard, Provider Reimbursement Manual ("PRM") 15-2 § 4013 states:

> In accordance with 42 CFR 413.20, the methods of determining costs payable under title XVIII involve using ***data available from the institution's basic accounts,*** as usually maintained, to arrive at equitable and proper payment for services. Worksheet A provides for recording the trial balance of ***expense accounts from your accounting books and records***.[36]

In addition, PRM 15-1, § 2302.8 defines a cost center and, in pertinent part, states:

> An organizational unit, generally a department or its subunit, having a common functional purpose for which direct and indirect costs are accumulated, allocated and apportioned. In addition, those natural expense classifications (e.g., depreciation) and nonallowable cost centers (e.g., research) specifically required by the instructions to be shown on the cost report fall under this definition.

When St. Luke's created a non-reimbursable cost center for Cherokee and added all the operational costs of Cherokee (thus treating it as an organizational unit of St. Luke's), it did not comply with these manual instructions. Cherokee is a separate entity and is clearly not an organizational unit or department of St. Luke's. Furthermore, the data included in the non-reimbursable cost center on St. Luke's cost report was clearly neither "data available from the institutions' basic accounts" nor expense accounts from its accounting records. Therefore, St. Luke's clearly did not comply with Medicare cost reporting instructions when it determined the amount of costs associated with its Management Agreement with Cherokee. Rather, as explained by the Medicare Contractor, this methodology resulted in an inappropriate shifting of St. Luke's cost to Cherokee.[37]

CMS' cost report instructions recommend allocating related party costs using a home office cost statement ("HOCS"). This allocation methodology ensures direct, functional and pooled methodologies to facilitate proper cost allocation.[38] Cherokee stated it did not use a HOCS for FY 2014 as it did not have a home office number.[39] While the Board recognizes that the regulations and manuals do not require the filling of a HOCS, as explained above, the Board

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[35] Medicare Contractor's Final Position Paper at 26-28.
[36] (Emphasis added.)
[37] *Id.* at 20.
[38] PRM 15-1 § 2150.3.
[39] Tr. at 111.

finds that the St. Luke's method of allocating the cost of the Management Agreement to Cherokee was not in accordance with Medicare cost reporting principles.

Since St. Luke's did not allocate it costs to Cherokee based on Medicare cost reporting principals, the Board reviewed the amount of St Luke's cost claimed by Cherokee on its FY 2014 cost report to determine if this amount was reasonable based on the parties' Management Agreement. Under the Management Agreement, St. Luke's was to provide Cherokee a range of services including operations consultation services, an annual operational review, clinical daily operations expertise, assistance with regulatory compliance including CAH requirements, assistance with reimbursement issues, physician recruitment services, medical staff credentialing services, clinical education opportunities, monitoring administrative performance, and administering an employee satisfaction survey.[40] Additionally, St. Luke's was required to provide Cherokee with a CEO. Cherokee was to reimburse St. Luke's for the compensation that it paid for Cherokee's CEO plus a $60,000 annual management fee, subject to annual renegotiation. Additional payments were required for temporary staff fees, educational course material, on-site educational programs, and certain special administrative projects, which might be requested by Cherokee. The total payments made by Cherokee to St. Luke/s during FY 2014 were $404,772.[41]

The record contains no documentation of the actual services provided to Cherokee by St. Luke's including the amount of time St. Luke's spent providing services under the Management Agreement or how the costs Cherokee claimed on its cost report are reasonably related to the costs that St. Luke's incurred for providing these management services.[42] Rather, the testimony at the hearing showed that many of the costs Cherokee claimed came from areas at St. Luke's that were *not* in the Management Agreement. Cherokee's witness identified approximately twenty five A&G departments that were allocated in part to Cherokee.[43] The Board's review of these areas finds that a significant number of the departments and services included in St. Luke's A&G allocation to Cherokee (*e.g.*, spiritual care, patient access, volunteer services, information technology, telecommunications, Iowa Provider tax, cost report preparation) were *not* part of the Management Agreement. When the Provider's witness was asked if he thought St. Luke's allocation methodology resulted in an accurate allocation of cost he replied "we were following the process, the forms themselves. I think it would be the MAC's determination of whether it was accurate or not is the way I see it." [44]

As explained earlier, the Board disagrees with the witness that St. Luke's followed the cost report forms when it allocated costs to Cherokee. Rather, the Board agrees with the Medicare Contractor that a significant portion of the A&G cost allocated to Cherokee came from departments not covered by the Management Agreement.[45] This included a large amount of A&G attributable to IHS/Unity Point. It is not clear what, if any, services IHS/Unity actually

[40] *See* Provider's Final Position Paper at 5-7; Exhibit P-3.
[41] *See id.*
[42] Tr. at 160 – 161.
[43] *Id.* at 182.
[44] *Id.* at 192
[45] Medicare Contractor's Supplemental to its Final Position Paper at 7.

provided to Cherokee. Even the witness testimony only identified the various services available to Cherokee "should they be needed,"[46] but did not provide clarity on the quantity of services that were actually provided for the $3,865,923 in A& G allocated to Cherokee. The record is simply devoid of documentation to support any of the actual services provided for an allocation of cost in this amount.

The regulation at 42 C.F.R. § 413.17(a) states that, when organizations are related through common ownership or control, the applicable services provided "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."[47] In addition, 42 C.F.R. § 413.24 states that, "Providers receiving payments on the basis of reimbursable cost *must provide adequate cost data*. This must be based on their financial and statistical records which must be *capable of verification by qualified auditors*."[48] Based on the record, the Board finds that neither Cherokee nor St. Luke's maintained the documentation necessary to determine the amount of costs St. Luke's incurred for providing services to Cherokee.

As there is no documentation of the actual services provided to Cherokee under the Management Agreement, and St. Luke's did not follow the Medicare cost reporting instructions when allocating its cost to Cherokee, the Board concludes that the Medicare Contractor was correct to reduce Cherokee's cost to the amount paid under the Management Agreement as that is the only documentation available related to the services provided under that agreement. Therefore, the Board upholds the Medicare Contractor's adjustment that allows the $404,772 paid by Cherokee to St. Luke's, but disallows the $3,865,923 that St. Luke's allocated to Cherokee based on St. Luke's unsupported allocation methodology.

DECISION AND ORDER

After considering Medicare law and regulations, arguments presented, and the evidence admitted, the Board finds that the Medicare Contractor properly adjusted Cherokee's cost report for FY 2014 to disallow certain A&G costs allocated from St. Luke's to Cherokee.

Board Members Participating:

Clayton J. Nix, Esq.
Gregory H. Ziegler, CPA
Robert A. Evarts, Esq.

For the Board:

9/29/2020

X Clayton J. Nix

Clayton J. Nix, Esq.
Chair
Signed by: Clayton J. Nix -A

[46] Tr. at 165.
[47] (Emphasis added.)
[48] (Emphasis added.)