PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2021-D04

PROVIDER –
Henry County Health Center

Provider No.: 16-1356

vs.

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

HEARING DATE –
January 16, 2020

Cost Reporting Periods Ended –
June 30, 2013, June 30, 2014, June 30, 2015

CASE NOS. –
16-0927, 16-1860, 16-2470

INDEX

ISSUE STATEMENT

Whether the Medicare Contractor improperly disallowed certain related party costs claimed by Henry County Health Center ("Henry Center" or "Provider") based on its determination that Henry Center had not incurred the claimed costs.[1]

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 Henry Center's cost reports for the fiscal years ending June 30, 2013, June 30, 2014, and June 30, 2015 ("FYs 2013 through 2015") to disallow certain administrative and general costs allocated from Great River Medical Center ("Great River").

INTRODUCTION

Henry Center is a critical access hospital ("CAH") located in Mount Pleasant, Iowa.[2] Henry Center's assigned Medicare contractor is WPS Government Health Administrators ("Medicare Contractor").[3] The Medicare Contractor made adjustments to Henry Center's cost reports for FYs 2013 through 2015, eliminating a portion of Administrative and General ("A&G") costs allocated from Great River. In addition, the Medicare Contractor adjusted Laundry costs for FYs 2013 and 2015 and adjusted Occupational Health and Physical Therapy costs for FY 2013.[4] However, the parties administratively resolved the adjustments related to Laundry and Occupational and Physical Therapy.[5] Accordingly, the only issue remaining in this appeal is the elimination of a portion of the A&G costs allocated from Great River for FYs 2013 through 2015.

Henry Center timely appealed the disallowance of these costs to the Board, and met the jurisdictional requirements for a hearing. The Board conducted a live hearing on January 16, 2020. Henry Center was represented by Robert Mazer, Esq. of Baker, Donelson, Bearman, Caldwell, & Berkowitz, PC. The Medicare Contractor was represented by Joseph Bauers, Esq. of Federal Specialized Services.

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[1] Transcript ("Tr") at 6. The issues of "[w]hether [the Medicare Contractor] violated Medicare regulations related to reopening prior cost report settlements when it issued a notice of correction of program reimbursement that disallowed management laundry and speech pathology cost and whether [the Medicare Contractor] improperly determined Henry Center's occupational therapy cost" were read into the record. *Id.* However, before the hearing, the Provider Representative and the Medicare Contractor stated that the issues are in the process of being administratively resolved and would not be part of the hearing. These issues have since been administratively resolved. *See* the Partial Administrative Resolution for Case No. 16-0927 (Aug. 8, 2020).

[2] Stipulation of Parties at ¶ 1 ("Stipulations").

[3] The term "Medicare Contractor" refers to fiscal intermediary or Medicare administrative contractor as relevant.

[4] Stipulations at ¶¶ 13, 17, 20.

[5] *See* Administration Resolution for Case Nos. 16-1356, 16-2470.

STATEMENT OF FACTS

The Medicare program pays CAHs 101 percent of the reasonable costs of providing services to Medicare patients.[6] Accordingly, the Medicare Program paid Henry Center as a CAH based on this reasonable cost basis for FYs 2013 through 2015.

In contrast, the Medicare program pays Great River as a full service hospital based on the inpatient prospective payment system ("IPPS") rather than on a reasonable cost basis. Under the IPPS, Medicare pays hospitals a predetermined, standardized amount per discharge, subject to certain payment adjustments.[7]

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 in cost finding methods and directs, as follows, the calculation of 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 nonreimbursable 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

[6] 42 C.F.R. § 413.70.
[7] 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 FYs 2103 through 2015, Henry Center was party to a Hospital Management Agreement ("Management Agreement") with Great River Health Systems, Inc. ("Great River Health"). Great River Health included Great River Medical Center, retail pharmacies, suppliers of durable medical equipment and supplies, and physician clinics. Great River Health was the sole member of Great River, a 378-bed general hospital located in West Burlington, Iowa, approximately 26 miles from Henry Center.[8]

The Management Agreement required Great River Health to recruit and employ a Hospital Administrator for Henry Center, a Director of Human Resources Professional (effective May 31, 2014), and to provide general management services to Henry Center, which included providing access to and assistance for certain specified services.[9] The Management Agreement required Henry Center to: (1) reimburse Great River for the compensation of the Administrator and Human Resources Professional; and (2) pay a monthly management fee of $2,500, which increased by 5 percent annually, subject to renegotiation by the parties at the end of year.[10]

Under the Management Agreement, Henry Center could call on advice from an individual at Great River designated as liaison to Henry Center's governing board and from Great River's administrative and management staff as needed. These individuals would provide Henry Center with information and problem-solving assistance related to a broad range of issues, including advice from Great River's in-house counsel, its Performance Improvement and Human Resources staff, its coding consultants, and its Advisory Board. Henry Center was also entitled to advice from Great River's management regarding: (1) clinical and physician education; (2) physician recruitment, employment and contracting; (3) patient satisfaction; and (4) staff leadership education.[11]

For the three fiscal years at issue, Great River included Henry Center on its Medicare cost report as a non-reimbursable cost center.[12] A portion of Great River's A&G costs were assigned to this non-reimbursable cost center.[13] At the end of each fiscal year, Great River advised Henry Center of the amount of such costs as reflected on its Medicare cost report. For each fiscal year, Great River's allocation of its A&G cost (as reflected on its Medicare cost report) was in excess of the amount that Henry Center paid Great River Health under the Management Agreement.[14]

Costs of management services, as determined by Great River, were then included on Henry Center's Medicare cost report, using Worksheet A-8-1.[15] For FYs 2013 through 2015, Henry Center claimed related party costs on its Medicare cost report reflecting amounts assigned to the

[8] Stipulations at ¶ 1.
[9] *Id.* at ¶ 2.
[10] *Id.* at ¶ 3.
[11] Provider's Final Position Paper at 6.
[12] Stipulations at ¶ 6.
[13] *Id.* at ¶ 7.
[14] *Id.* at ¶ 8.
[15] *Id.* at ¶ 9.

non-reimbursable cost center on the corresponding Medicare cost report for Great River.[16] For FY 2013, Henry Center claimed $1,495,128 as the cost of management services provided by Great River. The Medicare Contractor recognized $280,058 of the claimed management services costs, which equaled the amount paid by Henry Center for those services, and disallowed the remaining amount.[17] Similarly, for FYs 2014 and 2015, Henry Center claimed $1,511,864 and $1,595,236, respectively, for the cost of the Great River management costs. The Medicare Contractor recognized only the amount paid by Henry Center for those services, which totaled $318,376 and $416,997 for FYs 2014 and 2015, respectively, and disallowed the remaining amount.[18]

DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

The issue to be decided for each of the three fiscal years at issue is whether the allocation of A&G costs from Great River's cost report to Henry Center reflects an accurate value of the services provided to Henry Center. For each of the fiscal years at issue, Great River set up a non-reimbursable cost center for Henry Center on its cost report, and included Henry Center's total operating costs in that cost center.[19] Great River maintains that this was necessary so that Henry Center would receive the proper amount of A&G costs that is allocated based on total accumulated costs in Great River's cost report.[20]

Henry Center maintains that they are related to Great River through control and, as a result, they are allowed to allocate the related party costs from Great River's cost report to Henry Center. As a result, Henry Center argues that the Medicare Contractor should have recognized these costs, and was incorrect in only allowing the amount paid to Great River based on the Management Agreement. In support of its position, Henry Center cites to the Medicare regulation governing related party costs which specifies that a provider is required to recognize the costs of the related organization irrespective of whether this amount is less than or greater than any amounts paid by the provider to the related organization.[21] To this end, Henry Center maintains that the amounts paid by the provider to the related organization, if any, are irrelevant.[22]

In addition, Henry Center asserts that the "[its] related party costs were disallowed solely because they exceeded amounts paid by Henry Center and that "[t]he audit adjustments made by [the Medicare Contractor] reference no additional grounds" for the adjustment.[23] Accordingly, Henry Center requests that the Board address only the issues that were made by the Medicare Contractor in its own audit determination.[24] In support of its position, the Provider points to the Board's 2018 decision in *Greene County Medical Center v. Wisconsin Physicians Service*

[16] *Id.* at ¶¶ 10, 16, 19.
[17] *Id.* at ¶ 13.
[18] *Id.* at ¶¶ 17, 20.
[19] Tr. at 207, 264-265.
[20] *Id.* at 208.
[21] Provider's Final Position Paper at 26-31.
[22] *Id.* at 27.
[23] Provider's Response to the Medicare Contractor's Final Position Paper at 2 (citations omitted).
[24] *Id.* at 2-3.

("*Greene County*").[25] In that case, the Medicare contractor had disallowed the home office costs because it determined that the home office and the provider were not related. Henry Center alleges that the following occurred during the *Greene County* hearing:

> . . . [the Medicare contractor's] attorney attempted to question the provider's witness regarding the cost amounts claimed. The Board refused to let him so proceed because his questions did not relate to the basis on which the costs were disallowed.[26]

Accordingly, the Provider asserts that, similar to *Green County*, the Board should focus on whether Henry Center and Great River are related entities and not on the methodology of the allocation of costs from Great River to Henry Center.[27]

Henry Center also claims that had Medicare Contractor raised the issue of whether they searched the marketplace to obtain competitive bids at audit, they would have learned that Henry Center could not find another entity that both could and would provide the services that Henry Center required.[28] Henry Center also makes the following arguments regarding the application of the relevant provisions in the Provider Reimbursement Manual, CMS Pub. No. 15-1 ("PRM"):

> [The Medicare Contractor's] statement that PRM § 2135, addressing reasonableness of amounts *paid* for management and administrative services, is the "the [*sic*]most applicable CMS Manual to the arrangement in the instant case" is ludicrous, particularly because there is no dispute that Great River and Henry Center were related parties and another manual provision (PRM 1000) specifically requires a Medicare provider to include the *cost* of a related organization that provides services, facilities or supplies to a Medicare provider in the provider's allowable costs.[29]

Henry Center states "[to] our knowledge, neither the Board nor CMS Administrator has ever applied PRM § 2135 to a contract management arrangement between related parties, where the amounts paid under the arrangement are disregarded and costs of the supplying organization are recognized."[30]

Henry Center argues further that it is permissible to include a non-reimbursable cost center on Great River's cost report so that the related party costs are properly allocated to Henry Center. They assert that, prior to the fiscal years at issue, the "[Medicare Contractor] advised Henry Center's reimbursement consultant that it was permissible to use a non-reimbursable cost center to determine Great River's cost of services provided to Henry Center because it would yield the

[25] PRRB Dec. No. 2018-D1 (Oct. 26, 2017), *available at* https://www.cms.gov/Regulations-and-Guidance/Review-Boards/PRRBReview/Downloads/2018D01.pdf.
[26] Provider's Response to Medicare Contractor's Final Position Paper at 3 (citing to *Greene County* and the Transcript for *Greene County* (Day 1 of 2) at 152-53 (copy at Exhibit P-44)).
[27] *Id.* at 2-3.
[28] *Id.* at 5-6.
[29] *Id.* at 6 (emphasis in original).
[30] *Id.*

same results as the other available alternative – use of a home office cost statement (“HOCS”).”[31]

In connection with the Management Agreement, Henry Center notes that the costs of the management services that Great River provided to Henry Center for FYs 2013 through 2015 were allocated to a non-allowable cost center for Henry Center. Henry Center asserts that the record does not support the Medicare Contractor’s claim that it “advised Henry Center’s representative ‘that allocation could be appropriate, but [Great River Medical Center] would need to prepare documentation to support allocations to the provider, including maintaining a list of services available and accessible by the provider, as well as the services provided.’”[32] Rather, Henry Center alleges that “[w]hile Henry Center’s consultant recommended such an approach, [the Medicare Contractor] never suggested that it would require the documentation that it now asserts is necessary for recognition of related party costs.”[33] In further support of its position, Henry Center asserts that the following guidance for related party costs from PRM § 1005 does not support the Medicare Contractor’s alleged documentation requirement:

> The related organization's costs include all reasonable costs, direct and indirect, incurred in the furnishing of services, facilities, and supplies to the provider.
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> * * *
>
> The provider must make available to the intermediary when requested adequate documentation to support the costs incurred by the related organization, including when required, access to the related organization's books and records, attributable to supplies and services furnished to the provider. Such documentation must include an identification of the organization's total costs, the basis of allocation of direct and indirect costs to the provider, and other entities served.

Henry Center claims that the documentation required under PRM has either been provided to the Medicare Contractor or would have been provided had the Medicare Contractor requested it during the cost report audit process.[34]

Finally, PRM § 2150 is entitled “Home Office Costs—Chain Operations” and Henry Center claims that PRM § 2150 specifically permits related party costs incurred by a home office to be allocated on the same basis that Great River used for FYs 2013 through 2015. In support of this assertion, Henry Center cites to PRM § 2150.3(D) which addresses pooled costs in a home office. Henry Center asserts that this manual provision directs that pooled costs be allocated based on inpatient days or total costs. Henry Center states that the “[d]ocumentation maintained by Great River and Henry Center was comparable to a [Home Office Cost Statement] which [the

[31] *Id.* at 7.
[32] *Id.* at 8 (quoting Medicare Contractor’s Consolidated Final Position Paper at 6).
[33] *Id.* (citing Exhibit P-7).
[34] *Id.* at 8-9.

Medicare Contractor] recognized would result in a substantially identical computation of costs. The documentation requirements that [the Medicare Contractor] would now impose are simply another attempt to disallow the costs at issue after its recognition that the stated basis for its determinations was contrary to Medicare regulations."[35]

The Medicare Contractor contends that (1) they have made "no determination as to whether the parties were related";[36] and (2) "whether Henry Center and Great River are related . . . is not dispositive of the issue that's before the Board[.]"[37] The Medicare Contractor argues that, even if Henry Center is entitled to this allocation due to a related party relationship with Great River, Henry Center has not met its burden to establish that the amounts of the costs allocated to, and claimed by Henry Center were actually being incurred by Great River in rendering the services to Henry Center. The Medicare Contractor maintains that this is the ultimate underlying issue that the Board must decide.[38]

The Medicare Contractor disagrees with Henry Center's assertion that the only issue before the Board is whether Henry Center and Great River are related. For example, at the hearing, the Medicare Contractor asserted that it would be inappropriate to limit the Boards decision on "six or eight words on the adjustment report[.]"[39] The Medicare Contractor insists that the record shows that there was a great deal of discussion about the methodology used to allocate costs.[40] The Medicare Contractor states that what the provider is asking is that "if the [Medicare Contractor] somehow makes a limiting statement in an adjustment report, even though the adjustment is otherwise proper, that will . . . defeat and negate the entire adjustment."[41] This argument, taken out to its logical conclusion, would suggest that if a provider made a mistake anywhere in the cost report, then the whole cost report should be voided "which does not make sense."[42]

In addition, the Medicare Contractor states that there is no evidence that Henry Center searched the marketplace for alternatives to Great River and obtained competitive bids. The Medicare Contactor suggests that one reason for this is that the allocated costs are unrelated to any actual service performed by Great River. The Medicare Contractor points to 42 C.F.R. § 413.17 that addresses cost to related organizations and states:

> [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 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.

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[35] *Id.* at 9.
[36] Tr. at 12
[37] *Id.* at 26-27.
[38] *Id.* at 27.
[39] *Id.* at 12.
[40] *Id.*
[41] *Id.* at 13.
[42] *Id.*

The Medicare Contractor references the § 413.17 limit placed on costs to related organizations and concludes that "[t]here is no evidence the provider considered [this] limit imposed upon costs claimed from a related party."[43]

The Medicare Contractor further states that, if the Board were to adopt the methodology that Henry Center used to allocate related party costs from Great River to Henry Center, then the Medicare program would be reimbursing Henry Center a great deal more money than what Henry Center actually paid to Great River for the management services at issue. The Medicare Contractor points out that Henry Center, as the proponent of the appeal, bears the burden of proving by a preponderance of the evidence that they are entitled to receive the costs allocated from Great River. "The PRM at §2300 states that providers receiving payment on the basis of reimbursable cost . . . must provide adequate cost data."[44] The Medicare Contractor states that there is no cost data to support the services or cost of such services at issue in this case.[45]

The Medicare Contractor argues that the issue of whether the parties are related is not the issue to be decided.[46] Henry Center differs in its position, claiming that the only issue in this appeal is if Great River and Henry Center are related parties.[47] The Board agrees with the Medicare Contractor and rejects the Provider's claim. The regulations require recognition of related party costs irrespective of whether the amount is lessor or greater than any amounts paid to the related organization.[48] These principles apply whether the entity furnishing services to the provider is related by ownership or by control. However, whether the parties are related is irrelevant if the allocation methodology used by the provider does not result in a proper allocation of costs from the entity providing services (which, in this case, is from Great River to Henry Center).

As explained above, Henry Center points to the Board's decision in *Greene County* as a basis for its argument that whether Henry Center and Great River are related parties is the only issue in this appeal. However, the Board finds that *Greene County* involved a distinct issue, which was "[w]hether the [Medicare contractor] improperly disallowed certain home office costs claimed by Greene County Medical Center . . . on the grounds that it was not related to the entity that had furnished the services."[49] Because the issue in that case was limited to the relationship of the parties, the Board did not entertain questions related to the methodology of the cost allocation. The Board finds that the issue in *Greene County* is distinguishable from the issue to be decided in this appeal, namely whether the Medicare Contractor improperly disallowed certain related party costs claimed by Henry Center based on its determination that Henry Center had not incurred the claimed costs. Accordingly, based on the issue statement, the Board will address the

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[43] Medicare Contractor's Consolidated Final Position Paper at 8-9.
[44] *Id.* at 9.
[45] *Id.* at 19 (stating "The insertion of the Provider's accumulated costs onto the [Great River Medical Center] cost report as a non-reimbursable cost center to allocate overhead does nothing to identify the services received and certainly does not support the volume, frequency, and costs of the A&G services provided by [Great River Medical Center] to the Provider.").
[46] Medicare Contractor's Supplement to its Final Position Paper at 5 (stating "the Board need not address the question of whether there is a Medicare related party relationship.").
[47] *See* Provider's Response to Medicare Contractor's Final Position Paper at 2-3.
[48] Provider's Final Position Paper at 27 (citing 42 C.F.R. § 413.17(a)).
[49] *Greene County*, PRRB Dec. No. 2018-D1 at 2.
[49] Provider's Final Position Paper at 27.

methodology used to allocate the related party costs, and whether Henry Center incurred the costs that were allocated to them through the Great River cost report.[50]

The Board finds that the issue to be decided is whether the allocation of A&G costs through Great River's cost report to Henry Center results in an allocation of costs that was reasonable and related to the services provided to Henry Center. Only if the allocation results in an accurate allocation of costs, related to the services provided, does the related party issue become significant.

At the hearing, the Board questioned the CEO of Henry Center and found that Henry Center had in house staff to perform the following functions for FYs 2013 through 2015: accounting, cost report preparation,[51] public relations,[52] spiritual care,[53] and volunteer services.[54] Henry Center also provided a worksheet listing certain services included in A&G on Great River's cost report and allocated to Henry Center for FYs 2013 through 2015.[55] Significantly, this worksheet included the allocation of Great River A&G costs for the following services to Henry Center even though these functions were being performed in-house at Henry Center: accounting, spiritual care, volunteer services and public relations. The Board raised this inconsistency at the hearing with Henry Center's consultant who was involved in the preparation of the Henry Center cost reports at issue and who was called as a witness for Henry Center.[56] Specifically, the Board questioned Henry Center's consultant on the appropriateness of allocating these costs to Henry Center and he agreed that these costs allocated to Henry Center on Great River's cost report were unrelated to services performed for Henry Center and should not have been allocated to them.[57]

In addition, Great River, on its cost report, allocated A&G costs to Henry Center based on an accumulated cost statistic. Henry Center's consultant stated that, "any time you use an accumulated cost statistic, you lose sight of those specific costs, specific services provided to one person or another."[58] The same witness also stated that, "[w]hen you boil it down, any department may or may not use any or all of those services."[59] The Board agrees with these statements and finds that using accumulated costs ***alone*** to allocate A&G is an inherently

[50] The Board further notes that 42 U.S.C. § 1395oo(d) states, in pertinent part, that "[t]he Board shall have the power to affirm, modify, or reverse a final determination of the fiscal intermediary with respect to a cost report and to make any other revisions on matters covered by such cost report (including revisions adverse to the provider of services) even though such matters were not considered by the intermediary in making such final determination."
[51] Tr. at 99. Henry Center also retained a consultant to assist in the cost report preparation (i.e., the consultant who testified at the hearing).
[52] *Id.* at 104.
[53] *Id.* at 103.
[54] *Id.* at 102-03.
[55] Exhibit P-48.
[56] Tr. at 131, 133-34.
[57] *Id.* at 219-220. In response to the question "And I think, and I just want to confirm, that we're in agreement that cost on this schedule, at least the majority, aren't really related to Henry [Center]?", Henry Center's consultant replied "When I filed [*sic* filled] out the schedule – I don't prepare Great River's cost report, but when I got the detail and summarized it on here, yes, I was uncomfortable with some of the items that ultimately get allocated to [Henry Center]." *Id.* at 219. In response to the follow up question "But, basically, we're in agreement that these are unrelated costs and really should not have been allocated down to Henry [Center], right?," Henry Center's consultant replied "Yes." *Id.* at 220.
[58] *Id.* at 211.
[59] *Id.*

inaccurate methodology to allocate related party costs.

Henry Center equated the accumulated cost allocation on Great River's cost report to the pooled cost allocation in a home office cost statement. Although accumulated cost is an allocation statistic used on a home office cost report, the Board notes that it is the ***last*** statistic used in the multi-step process of allocating costs between related entities. As such, The Board notes that a *complete* home office cost statement, when following the multi-step process by which a home office allocates costs to its components, is better able to provide an accurate calculation and allocation of cost of services provided to related entities. The following is a good summary of the general multi-step process by which a home office allocates costs to components of a chain:

> To obtain reimbursement for home office support functions related to the care of Medicare patients, the provider's home office files a cost statement, which identifies the allowable home office costs and how they are allocated among each of its subsidiary companies (also called "components"). *See* PRM [15-1] § 2150.3. First, the home office totals all of its own costs, including those that it incurred on behalf of its subsidiary companies, and deletes from that total all unallowable costs. *See id.* at § 2150.3(A). Second, the home office uses "direct allocation" to allocate as many of its costs as possible. Direct allocation accounts for home office costs that are for the benefit of, or directly attributable to, its Medicare subsidiary or its other subsidiaries. *See id.* at § 2150.3(B). Third, the home office must allocate as many of the remaining costs as possible on a "functional basis." *See id.* at § 2150.3(C).
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> After the home office allocates as many home office costs as possible to its subsidiaries by direct and functional allocation, a "pool" of allowable costs for general management or administrative services remains ("pooled costs"). *See id.* at § 2150.3(D).[60]

Accordingly, before using the pooled cost allocation, the provider must first allocate direct costs and then functional costs. For the allocation of functional costs, the provider is required to build a statistic that most appropriately and accurately allocates the home office costs to the subsidiaries receiving services. The requirement is that the home office must allocate as many of the remaining costs as possible on a functional basis. The only costs left should be those related to all the subsidiaries on the home office cost statement and allocated to the subsidiaries based on accumulated costs. The end of the allocation process should be that each subsidiary receives an allocation of home office costs accurately reflecting the volume and frequency of the services provided to each subsidiary. As a result, the Board finds that: (1) for FYs 2013 through 2015, Henry Center failed to comply with the multi-step process in the PRM by which a home office allocates costs to its components, and (2) in particular, the practice of allocating home office costs ***only*** by an accumulated cost statistic on the Great River cost report fails to accurately

[60] *See Mercy Home Health v. Leavitt*, 436 F.3d 370, 373 (3rd Cir. 2006).

reflect the costs applicable to the services, facilities and supplies furnished to Henry Center for the fiscal years at issue.

The Board also notes that Henry Center did have other options available to accurately calculate the costs related to the management services provided to Henry Center. For example, 42 C.F.R. § 413.24(d)(7) states:

> 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 nonreimbursable 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.[61]

Accordingly, when the cost report will not result in an accurate allocation of costs, a provider is required to develop work papers detailing an alternate methodology that would more accurately allocate costs to an entity. Henry Center's consultant testified during the hearing that he was uncomfortable with some of the A&G costs allocated from Great River to Henry Center.[62] The Board notes that the consultant recommended, "[p]reparing documentation to support allocations to [Henry Center] including obtaining a list of services available and accessible by [Henry Center], as well as services provided under the provisions of the management agreement."[63] The Board agrees that this is exactly what the provider should have done but did not do. Had Henry Center followed this advice, it could have developed a more accurate methodology to allocate costs to Henry Center that were reflective of the frequency of services, facilities and supplies provided to Henry Center.

The Board finds that Henry Center failed to identify the volume, frequency, and costs of the A&G services provided by Great River to Henry Center for FYs 2013 through 2015 and, therefore, has not met the requirements of 42 C.F.R. § 413.17(a). Accordingly, the Board affirms the Medicare Contractor's adjustment disallowing the $4.6 million claimed by Henry Center for Great River's A&G costs for FYs 2013 through 2015. The Board notes that the Medicare Contractor did not disallow all related party costs but rather allowed the amounts Henry Center paid to Great River for the CEO salary, Director of Human Resources salary and the management fees for FYs 2013 through 2015 pursuant to the Management Agreement.

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[61] (Emphasis added).
[62] Tr. at 219.
[63] *Id.* at 225 (quoting Exhibit P-7 at 2).

DECISION AND ORDER

After considering Medicare law and regulations, arguments presented, and the evidence admitted, the Board finds that the Medicare Contractor properly adjusted Henry Center's cost reports for FYs 2013, 2014, and 2015 to disallow certain administrative and general costs allocated from Great River.

BOARD MEMBERS PARTICIPATING:

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

FOR THE BOARD:

11/27/2020

X Clayton J. Nix

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