PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

98-D53

PROVIDER -
Barton Creek Health Care, Inc.
Austin, Texas

Provider No. 45-7663

vs.

INTERMEDIARY -
Blue Cross and Blue Shield Association/
Blue Cross and Blue Shield of South Carolina

DATE OF HEARING-
September 12, 1996

Cost Reporting Period Ended -
December 31, 1993

CASE NO. 96-0229

INDEX

ISSUE:

1. Was the Intermediary's adjustment disallowing a portion of interest cost incurred proper?

2. Was the Intermediary's proposed adjustment disallowing all interest cost related to accounts receivable financing proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Barton Creek Health Care, Inc. ("Provider") is a proprietary home health agency located in Austin, Texas. The Medicare program certified the Provider's participation on September 1, 1988.

Blue Cross and Blue Shield of New Mexico (referred herein as the former Intermediary) served as the Provider's fiscal intermediary until November 1995. Thereafter, Blue Cross and Blue Shield of South Carolina (referred herein as the Intermediary) took over as the Provider's fiscal intermediary.

The former Intermediary completed the final settlement of the Provider's 12/31/91 and 12/31/93 cost reports. It completed the audit but not the final settlement of the 12/31/92 cost report.
For the 12/31/93 year at issue the former intermediary disallowed $71,982 of the claimed interest expense related to a factoring transaction, stating that the interest rate paid was excessive.[1]
This was communicated to the Provider by the former Intermediary in a Notice of Program Reimbursement ("NPR") dated November 6, 1995. On November 27, 1995, the Provider appealed the Intermediary's adjustment to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 405.1835-.1841, and has met the jurisdictional requirements of those regulations. The amount of Medicare reimbursement in controversy is $68,239.[2]

After completing the 12/31/92, audit the former Intermediary planned to fully disallow all similar interest expense for the 12/31/92 year, and then reopen the 12/31/93 year to effect a full disallowance of the interest expense. However, this was not done before the 1995 intermediary change. The new Intermediary concurred with the former Intermediary's determination in the 12/31/92 cost report. Therefore, through the position paper applicable to

---

[1] Exhibit I-3.

[2] Intermediary's Position Paper at 2.

this Board hearing, the Intermediary expresses its intent to revise the adjustment in dispute by fully disallowing all interest costs of $165,931.[3]

The provider was represented by John W. Jansak, Esq. of Harriman, Jansak, Levy and Wylie. The Intermediary was represented by Bernard M. Talbert, Esq. of the Blue Cross and Blue Shield Association.

PROVIDER'S CONTENTIONS:

Issue 1: Was the Intermediary's adjustment disallowing a portion of interest cost incurred proper?

In fiscal year 1993, the Provider had need of working capital approximating $400,000 a month and secured financing from a factoring organization at a discount rate of 2.3%. The former Intermediary disallowed $71,982 as being excessive.

The Provider contends that the working capital needed in 1993 was, on the average, approximately $400,000 in 1993.[4] No evidence or testimony was submitted by the Intermediary that Barton Creek did not require working capital in that amount.

The Provider contends that the methodology used by the Intermediary to establish Periodic Interim Payments (PIP), a payment mechanism to improve cash flow, resulted in a shortfall of over one million a year.[5] This was attributable to basing the calculations on past year's costs. The Provider contends that PIP should recognize both current costs and the working capital needs, as well as the current volume of business.[6] Further, the use of past, historical data in calculating PIP rates will cause a rapidly growing provider to suffer a cash shortfall almost immediately.[7]

---

3 Id at 3.

4 Transcript at 47.

5 Id at 45 and 18-25.

6 Id at 22.

7 Id at 146.

The Provider contends that it was unable to obtain financing from any of the four different banks it approached in 1993-1994.[8] The Provider's expert witness in financing testified that the discount rate of 2.3% appeared to be the best available at the time.[9]

The Provider further contends that the Intermediary's use of an individual credit card rate was not appropriate. The Intermediary should have made an analysis of interest rates being paid on a provider-by-provider basis, and follow the steps that are set forth in the Medicare rules for determining an out-of-line analysis.[10]

Issue 2: Was the Intermediary's proposed adjustment disallowing all interest cost related to account receivable financing proper?

The original adjustment of the former Intermediary only related to the rate of interest on the factoring arrangement. The new Intermediary, in its position paper for the Board hearing, raised the issue that the arrangement between the Provider and the factor was not a loan but a sale of receivables. As a result the Intermediary proposed to disallow all the interest claimed on the as filed cost report.

The Provider Reimbursement Manual, (PRM) HCFA Pub. 15-1 at § 219 states that if the accounts receivable financing was a loan "[t]he interest incurred on the loan is an allowable expense if it is necessary and proper as defined in (PRM)." Id. However, the referenced program instruction does not contain a distinction between a sale of accounts receivable and a loan with accounts receivable as collateral. The foreword to the PRM states in part that: "[f]or any cost situation that is not covered by the manual's guidelines and policies, generally accepted accounting principles should be applied." The Provider's witnesses and the Intermediary's witnesses testified that the decision of whether the loan was financing would be based on the Statement of Financial Accounting Standards (FAS)-77, Reporting by Transferors for Transfers of Receivables With Recourse, (December 1983).[11] Both parties indicated that these guidelines would be binding on whether the financing transaction was a sale or a loan.

The Provider contends that applying the above cited principle, the transfer of receivables would be considered a loan unless three conditions were met.[12] Condition one is that the

---

8 Provider Exhibits 2, 3, 4, and 5.

9 Transcript at 125.

10 Id at 28.

11 Provider Exhibit 13, at 48.

12 Id at 48.05

seller unequivocally surrenders to the buyer the control of the future economic benefit of the receivables. Condition two is that the seller's remaining obligations to the buyer must be subject to a reasonable estimation on the date of the sale of the receivables. Condition three is that the seller cannot be required to repurchase the receivables except for some minimal amount.

The Provider contends that it did not meet the three conditions cited above that would classify the transaction as a sale. Each condition is discussed as follows:

Condition 1. The Provider submitted testimony and evidence to show that the contract with the lender contained various provisions allowing the seller the option to repurchase the receivables from the buyer, as well as requiring the seller to buy back the receivables under certain conditions.[13]

Condition 2. The Provider maintained there was no way of reasonably estimating the liabilities at the point of sale because the liabilities are subject to retroactive Medicare adjustments.[14]

Condition 3. The seller was required to repurchase nearly all of the receivables upon certain conditions. Moreover, the seller was required to sign a personal and corporate guarantee which showed future economic interest remained with the seller.[15]

The Provider contends that it is clear that all three conditions of FAS-77, that would define the accounts receivable financing as a sale, were not met. Consequently, the transaction must be considered a loan, with the related interest deemed allowable.

<u>INTERMEDIARY'S CONTENTIONS</u>:

The Intermediary contends that, notwithstanding the former Intermediary's original adjustment to partially disallow interest expense, it now intends to fully disallow the claimed interest expense in accordance with HCFA Pub. 15-1, § 219, and generally accepted accounting principles. Section 219 represents a clarification of 42 C.F.R. § 424.70 and states as follows: "[i]n accounts receivable financing, the intermediary must first determine if the arrangement represents a sale of receivables or if it is a loan. If it is a loan, the interest incurred is an allowable expense if it is proper as defined in §§§ 202.1., 202.2, and 202.3." <u>Id</u>.

---

13 Tr. at 129, 131.

14 <u>Id</u> at 151.

15 Tr. at 164.

The Intermediary agrees that a sale of accounts receivable with recourse may have certain characteristics as a loan with accounts receivable as collateral. In that the referenced Program instruction does not contain a distinction between a sale of accounts receivable and a loan with the accounts as collateral, the Intermediary agreed to apply generally accepted accounting principles. In particular, the Intermediary utilized the Statement of Financial Accounting Standards (FAS)-77, Reporting by Transferors for Transfers of Receivables With Recourse, (December 193). FAS-77 requires that a transfer of receivables that is subject to recourse be reported as a sale, if all of the following conditions are met:[16]

Condition 1. The seller unequivocally surrenders to the buyer control of the economic benefits of the receivables.

Condition 2. The seller's remaining obligations to the buyer under the recourse provisions of the transfer agreement must be subject to reasonable estimation on the date of the sale of the receivables.

Condition 3. The seller cannot be required to repurchase the receivables from the buyer except in accordance with the recourse provisions of the transfer agreement.

The Intermediary contends that the aforementioned factoring agreements represent a sale of accounts receivable rather than a loan. Both agreements referred to a sale or factoring of accounts receivable. The agreements set forth that the seller sells, assigns, transfers, conveys, and delivers all rights and interests that relate to the accounts receivable. The agreements dictate how the seller should handle the accounts receivable for the benefit of the Mesa Factors, Inc. and City Financial Services, Inc.[17]

The Intermediary contends that the parties to the agreement can reasonably estimate the amount of any bad debts/related collection costs related to the receivables, as well as the validity of the receivables subject to retroactive Medicare adjustment.[18]

The Intermediary contends that the control of the future economic benefit of the accounts receivable (that is, the rights to exchange or sell the receivables) primarily rests with the Mesa Factors, Inc. and City Financial Services, Inc.

In view of the above, the Intermediary believes it does not have a basis to allow the related costs as interest expense, pursuant to 42 C.F.R. § 413.153(b)(2) and PRM-1, Sections 202ff.

---

16 Exhibit I-6.

17 Exhibits I-1, I-2.

18 Tr. at 155-157.

The referenced Program regulation and instructions define the allowable interest expense as interest incurred, specifically, on a loan.

Alternatively, the Intermediary argues that even if the Board considers the agreements to be loans, the Intermediary does not have a sufficient basis to allow the related costs, pursuant to 42 C.F.R. § 413.153. and HCFA Pub. 15-1, §§ 202ff. Regardless of the previous Intermediary's determination, the Intermediary now determines and contends as follows:

1. The Provider did not furnish an explanation as to why Barton Creek Investments, Inc. (rather than Barton Creek Health Care, Inc.) signed the agreements. Unless proven otherwise, the Intermediary contends that Barton Creek Investments, Inc. used the generated funds to finance the private duty nursing operation rather than the home health agency's operation.

2. The Provider did not furnish any evidence that it acted as a prudent or cost conscious buyer, pursuant to HCFA Pub. 15-1, § 2103. Nothing indicated that the Provider attempted to avoid incurring high interest rates on a long term basis. Nor does it appear that the Provider negotiated lower rates and better terms under the agreements.

3. The Provider did not demonstrate that the total costs associated with the agreements of $165,931 are necessary, proper, and related to patient care, as per 42 C.F.R. § 413.9 and HCFA Pub. 15-1, §§ 2100 and 2102ff. In particular, the Provider did not show that it transferred or sold the agency's accounts receivable to satisfy financial needs that reasonably relate to patient care. It did not support the fact that it needed operating cash or money for capital expenditures whenever it transferred or sold the accounts receivable.

   In addition, the Provider did not demonstrate that if the claimed interest represents the agency's portion of actual costs, how it calculated the amount under the terms of the agreements; or, if it properly accounted for this amount per the requirements of HCFA Pub. 15-1, §§ 2302.1 and 2305.

<u>CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS</u>:

1. <u>Law - 42 U.S.C.</u>:

   § 1395x(v)(1)(A) - Reasonable Cost

2. <u>Regulations 42 C.F.R.</u>:

   § 405.1835-.1841 - Board Jurisdiction

   § 413.9 - Cost Related to Patient Care

§ 413.153(b)(2)	-	Interest Expense-Necessary
§ 424.70	-	Limitations on Assignment and Reaasignment of Claims

3. Program Instructions-Provider Reimbursement Manual, Part 1 (HCFA Pub. 15-1):

§ 202.1	-	Definitions: Interest
§ 202.2	-	Definitions: Necessary
§ 202.3	-	Definitions: Proper
§ 219	-	Accounts Receivable Financing
§ 2100	-	Costs Related to Patient Care Principle
§ 2102	-	Costs Related to Patient Care Definitions
§ 2103	-	Prudent Buyer
§ 2302.1	-	Accrual Basis of Accounting
§ 2305	-	Liquidation of Liabilities

4. Other:

Statement of Financial Accounting Standards (FAS)-77, Reporting by Transferors for Transfers of Receivables With Recourse, (December 1983).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board majority after considering the facts, parties' contentions, testimony elicited at the hearing, and post hearing brief, finds and concludes as follows:

The Board majority finds there are two issues requiring resolution. The key issue is whether the accounts receivable financing obtained by the Provider is a loan or a sale of accounts receivable. The second issue involves the appropriateness of the interest rate relative to the financing agreement.

The Board majority addressed the first issue by noting that the parties agreed to use Generally

Accepted Accounting Principles (GAAP) to determine if the financing arrangement was a loan. The Board majority notes that the GAAP position is stated in FAS-77, Reporting by Transferors for Transfers of Receivables with Recourse. It indicates that a transfer of receivables that is subject to recourse should be reported as a sale if the seller unequivocally surrenders to the buyer the control of the economic benefits of the receivable. If the seller has an option to repurchase the receivable from the buyer, control of the future economic benefits of the receivables has not been unequivocally surrendered.

The Board majority notes that the GAAP guidance also states that legal title or ownership of the receivables does not always include control of the future economic benefits of the receivables. This is the case when a seller retains the right to repurchase the receivables.

The Board majority finds that two different financing agreements were placed into evidence, one of which was unsigned. The Board majority's interpretation of the signed agreement is that the Provider (seller) could repurchase the accounts receivable. In addition, the company president also executed a personal guaranty agreement to pay the factoring company in full in the event the provider defaulted. This was confirmed by testimony during the hearing given by the Provider's chief executive officer. The Board majority further notes there was no cross examination of that testimony during the hearing.

The Board majority also finds that the Provider treated the transaction as a financing arrangement on the Provider income tax returns, as opposed to a capital transaction. Evidence in the record submitted by the Provider's certified public accountant indicates that the Provider bears the full economic risk of the subsequent collection of the receivables.

Based on the evidence presented, the Board majority concludes that the financing transaction was a loan agreement under GAAP principles.

In turning to the second issue, the Board majority finds that the Provider exercised due diligence in seeking working capital funding. The Board majority notes that the Provider sought financing from four different banks in 1993 and 1994, but was turned down on every occasion. Testimony during the hearing indicated that a factoring arrangement would be the only means of financing available to the Provider. Furthermore, the testimony indicates that the borrowing rate of interest was reasonable.

The Board majority finds that the Intermediary's approach of setting an interest rate limit pegged to current credit card interest rates is not supported in the regulations or the manual. In addition, the Provider's expert witness testified that the Intermediary did not perform an analysis of what interest rates other providers were paying in similar circumstances.

The Board majority finds that the Intermediary's alternative arguments are without merit. The evidence shows that the Provider clearly established that it incurred a working capital shortfall, as confirmed by the prior Intermediary, and the testimony of the expert witness. It approached four different banks before utilizing the factoring approach. However, its impaired financial position did not place the Provider in any position to negotiate lower interest rates or better terms, as suggested by the Intermediary. Finally, although Barton Creek Investments, Inc. may have signed one of the factoring agreements, the evidence indicated that the factoring proceeds were deposited in the Barton Creek Health Care, Inc. checking account.

DECISION AND ORDER:

The former Intermediary's adjustment disallowing a portion of the claimed interest expense is improper. The former Intermediary's adjustment is reversed. The current Intermediary's proposal to revise the prior Intermediary's adjustment and now disallow all interest expense related to the factoring arrangement is denied.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esquire (Dissenting)

Date of Decision: May 21, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman

Dissenting Opinion of Henry C. Wessman

I dissent. In my opinion, the "sale of accounts receivable, with recourse" is either a hybrid loan, or a lobrid sale, but it cannot be both. My colleagues are persuaded in this case that it is a loan, I view it as a "sale with recourse". The transaction has elements of both a conditional sale, or a secured loan, depending, it appears, on whether you are attempting to secure cash flow, or obtain federal assistance with the associated usury charge.

My dissent is based on four (4) factors.

Factor 1: Terminology - On its face, the title, and the plain meaning of the underlying document at issue here, entered into by Barton Creek Health Care and City Financial Services is a "Purchase and Sale Agreement". Provider Final Position Paper, Exhibit 11. While there is "recourse", it is approached from the "sales" position.

Factor 2: Assurances - In my opinion, the "assurances" given by the Seller go beyond those of offering collateral for a secured loan, and more closely resemble a conveyance. See Provider Final Position Paper, Exhibit 11: Clauses 1, 4, 5, 15.

Factor 3: Control - Under the "Purchase and Sales Agreement", the "shots" are clearly being called by the Buyer, City Financial Services. See Provider Final Position Paper, Exhibit 11: Clause 3: Invoices: Collection: Power of Attorney. "CFS is hereby authorized, irrevocably as long as this Agreement is in effect, to open, cash, endorse and otherwise collect all checks and other forms of payment tendered in payment of each Receivable, in the name of and as attorney-in-fact for Seller, and to direct Seller's customers to make payment to a different name and/or location. This power of attorney is coupled with an interest." Clause 4. Transfer of Related Interests. " In addition to the Receivables, Seller hereby sells, assigns, transfers, conveys, and delivers to CFS all other rights and interests . . . . in connection with the Receivables, . . ." Clause 6. No Obligation to Purchase Further Receivables. " . . . Seller specifically acknowledges and agrees that CFS has the right to approve or reject future accounts receivable . . . IN ITS SOLE DISCRETION, ..." Clause 13. Verification of Receivables and Accounts; Collection by CFS. " CFS is authorized, but not obligated, to collect, sue for and give releases for all monies due on all Receivables." See also: Clause 12. Offset; Security, Interest. Buyer can move against Reserve Account " at any time without notice," and Seller grants "first priority lien" and "security interest" to Buyer in a variety of assets. I interpret this Clause to provide a secondary "security interest" on top of the primary "sale" of other specified assets. Clause 15. Certain Covenants of Seller. Buyer controls Seller's location of executive office, name, consolidation, or dissolution ability.

Factor 4: Interpretation of Factoring Agreement - Predicated on the above, it is my opinion that the "factoring arrangement" entered into between Barton Creek and City Financial Services clearly meets the definition of a "sale" in the GAAP test of whether a "transfer of receivables, with recourse" is a sale or a liability. As such, in my opinion, the transaction is to be reported as a "sale', and thus not eligible for Medicare payment of the usury costs. Provider Final Position Paper, Exhibit 13: Statement of Financial Accounting Standards (FAS) - 77, Reporting By Transferors for Transfers of Receivables With Recourse (December, 1983) p. 48.05 - 48.06. There is a three-pronged test to determine whether or not the "transfer of receivables subject to recourse" is a sale or liability; if all prongs are met, it is a sale. There is no question in my mind that the Barton Creek/City Financial Services agreement meets prong 2 (obligation under recourse subject to reasonable estimation) and prong 3 (seller can not be required to repurchase receivables except in accordance with transfer agreement) of the test. Prong 1 (seller unequivocally surrenders control of future economic interests to buyer) is a bit more problematic. I endorse the "sale" end of the "transfer" spectrum, however, because, while Barton Creek does have the option to repurchase the specific receivables, Buyer (City Financial Services) maintains its ultimate "in control" position if there is default. Provider Final Position Paper, Exhibit 11, Clause 2. I would thus declare the Barton Creek/City Financial Services transaction a "sale", and deny Medicare funding for the usury costs of the purported "loan".

____

Henry C. Wessman, Esq.
Board Member