PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D38

PROVIDER -
Professional Rehabilitation Outpatient Services
Spring, Texas

Provider No. 45-6689

vs.

INTERMEDIARY -
Mutual of Omaha Insurance Company

DATE OF HEARING-
September 7, 1999

Cost Reporting Period Ended -
December 31, 1995

CASE NO. 98-0273

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ISSUE:

Was the Intermediary's adjustment to the accrued salaries proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Professional Rehabilitation Outpatient Services ("Provider") is an outpatient rehabilitation facility located in Spring, Texas. The Provider filed its calendar year 1995 cost report on or about April 30, 1996. As detailed in its cost report, the Provider's board of directors and shareholders met on January 5, 1996 and voted to convert their accrued salaries to notes payable, shareholders, and to reclassify the same as long-term debt. This action was taken only after consultation with the Intermediary, and within seventy five days of the close of the cost reporting period.

The Provider's board agreed that the notes would bear interest at the rate of six percent (6%) per annum, and that the notes would be payable by December 31, 1998.[1] These notes were fully paid and retired on December 7, 1998, as evidenced by the Provider's canceled checks.[2]

On or about May 29, 1997 Mutual of Omaha ("Intermediary") sent the Provider a Notice of Program Reimbursement ("NPR").[3] The NPR indicated that the Provider was overpaid in the total amount of $214,444, of which $152,400 represented the deferred salaries. The Intermediary eliminated the $152,400 from reimbursable costs since the notes were not considered to have been liquidated within a reasonable time frame. The Provider disagreed with the adjustment and on November 11, 1997, filed an appeal with the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§1835-.1841 and has met the Jurisdictional requirements of those regulations. The Medicare reimbursement amount in contention is approximately $152,400.

The Provider was represented by Dale Trimble, Esq. of The Trimble Firm P.L.L.C. The Intermediary was represented by John McGuire, Esq. of Mutual of Omaha Insurance Company.

PROVIDER'S CONTENTIONS:

The Provider contends that it received from the Intermediary a copy of the Intermediary's A&R Memorandum # 0078.01 which purported to represent the Intermediary's position regarding utilization of deferred salaries.[4] Paragraph 1 of the Memorandum which cites HCFA Pub. 15-1 §906.4, gives permission to defer salaries, provided that those salaries are "actually paid" within 75 days of the closing

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[1]Exhibit P-B

[2]Exhibit P-C

[3]Exhibit P-D

[4]Exhibit P-F

of the cost report. The memorandum also states that "actual payment may be made in the form of cash, negotiable instrument, or in kind." It also defines a negotiable instrument as one that is "in writing and signed, must contain an unconditional promise or order to pay a certain sum of money on demand or at a fixed and determinable future time, and must be payable to order or to bearer." Paragraph 3 of the memorandum defines a promissory note as: "capable of meeting the definition of negotiable instrument."

The Provider also points out that the Intermediary discussed the relevant provisions of the Uniform Commercial Code Section 3-104 (UCC) and other sections of HCFA Pub. 15-1 and stated "as long as a negotiable instrument is written within 75 days after the end of the cost reporting period, it constitutes acceptable payment for Medicare purposes." There was no mention that the note has to be retired or paid off within 75 days.

The Provider contends that the promissory notes meet the definition of a negotiable instrument. In addition, the notes were executed within 75 days from the end of the cost reporting period. The Provider points out that the notes meet the requirements because they were drafted and prepared in response and reliance upon the information received from the Memorandum prepared by the Intermediary.

The Provider points out that the Intermediary's Memorandum does not mandate that all promissory notes be liquidated within 75 days. Instead, it says that, to meet the requirements, the note must be payable: "at a fixed and determinable future time." The Provider contends that its notes were payable on December 31, 1998. The Provider argues that an interpretation that all such notes be liquidated within the 75 day period is ludicrous. It does a business entity very little good to attempt to defer salaries, as it is allowed to do, and then be required to pay those salaries a maximum of 75 days later.

The Provider contends that there is nothing in the HCFA Pub. 15 -1 §906.4 that speaks of the time limit of a negotiable instrument. Likewise, there is nothing in HCFA Pub. 15-1 §2305 that mandates a definite term for negotiable instruments. HCFA Pub. 15-1 does provide that liquidation must occur within 75 days. However, there is confusion between the meaning of the term liquidate and the term actual cash payment within the relevant time period. The term liquidate can have various meanings when applied to a financial situation, and is ambiguous at best as applied to the facts of this or a similar case. According to Black's Law Dictionary, fifth edition, 1979, the term liquidate means:

> To pay and settle; To adjust; To ascertain the amount, or the several amounts, of the liabilities of insolvent and apportion the assets toward discharge of the indebtedness; To ascertain the balance due and to whom payable; To assemble and mobilize the assets, settle with the creditors and the debtors and apportion the remaining assets, if any, among the stockholders or owners; To clear up; To determine by agreement to litigation precise amount of indebtedness; To distinguish an indebtedness; To gather in the assets, convert them into cash and distribute them according to the legal rights of the parties interested; To

> lessen; To make amount of indebtedness clear and certain; To reduce to precision in amount and to satisfy, "wind up" affairs of a business.

Id.

The Provider argues the interpretation from the above cited definition does not mean, as has apparently been interpreted in the NPR, that the actual cash payments must change hands within the 75 day time period. Instead, under these definitions, the notes are to be considered liquidated at the time that they are made, since they make the amount of the indebtedness clear and certain and ascertain the amount due and to whom payable.

The Provider points out that throughout the hearing the Intermediary admitted that the subject notes complied with the Uniform Commercial Code Section 3-104 (UCC) requirements and the only problem was their length of payment time. The Provider argues that its Intermediary never suggested that it obtain a loan from a bank or other lending institution to retire the deferred compensation.

The Provider contends that there was no additional cost to the Medicare program as a result of the Provider issuing the notes. The 1995 deferred compensation expense for the Provider was eliminated on its profit-loss summary and replaced by a debit entitled "Notes Payable- Shareholders" in the long term liability section of the 1996 balance sheet. This would have been the case whether the Provider borrowed the money to pay deferred compensation from a bank or provided said financing itself.

The Provider argues that there is no difference between it issuing a promissory note or a financial institution issuing a note so long as the Provider maintained a consistent method of tracking the indebtedness and honoring it as a promissory note, even though the Intermediary disallowed the deferred compensation and required the Provider to reimburse Medicare for this expense. The notes issued by the Provider were paid out as though a bank had issued them.

The Provider argues that HCFA Pub. 15-1 §2305 indicates that a short-term liability must be liquidated within one year after the end of the cost reporting period in which the liability is incurred, subject to exceptions specified in §§2305.1 and 2305.2. This provision also indicates liquidation must be made by check or negotiable instrument, cash or legal transfer of assets, such as stocks, bonds or real property. Payment must be redeemed through an actual transfer of a provider's assets within the time period specified in this section. Section 2305.1 allows an extension not to exceed three (3) years following the end of the cost reporting period in which to liquidate the liability. This three year period would accommodate the period for which the Provider's notes were written. The Intermediary's argument that the notes should not have been written for a period beyond 75 days is totally contradictory to the provisions expressed in the manual section.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that the Audit and Reimbursement Memorandum # 0078.01 [5] states that:

> it has always been the intent of HCFA that notes, checks and other negotiable instruments as payment for corporate owners compensation be liquidated promptly. In the absence of a specific time limit in (HIM15-1) section 906.4 for liquidating negotiable instruments, HCFA has advised intermediaries to permit providers an additional reasonable period for liquidation beyond the 75 day period. We have determined that 60-90 days beyond the 75 day period is reasonable and if not liquidated within that additional period of time, we are to disallow the compensation either in the period earned or in the period actually paid.

Id.

Therefore, the Intermediary guideline never supported the Provider's determination that a three year promissory note meets the reasonableness test for liquidation of a liability beyond the 75 day period after the close of the fiscal year.

The Intermediary argues that its guideline never supported the Provider's determination that a three year promissory note meets the reasonableness test for liquidation of a liability beyond the 75 day period after the close of the fiscal year. The Intermediary points out that its Audit and Reimbursement Memorandum # 0078.01[6] clarifies HCFA policy in program instruction §§906.4 and 2305 pertaining to a reasonable time frame for liquidating a negotiable instrument. It states:

> it has always been the intent of HCFA that notes, checks and other negotiable instruments as payment for corporate owners' compensation be liquidated promptly. In the absence of a specific time limit in HIM 15-1, section 906.4 for liquidating negotiable instruments, HCFA has advised intermediaries to permit providers an additional reasonable period for liquidation beyond the 75 day period. We have determined that 60-90 days beyond the 75 day period is reasonable and if not liquidated within that additional period of time, we are to disallow the compensation either in the period earned or in the period actually paid.

The Intermediary points out that the instruction HCFA Pub. 15-1 §906.4 states:

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[5] Exhibit I-1

[6] Tr at 14

> for cost reporting periods beginning on or after October 1, 1995, any compensation not paid through an actual transfer of provider assets within 75 days after the close of the year in which the compensation is earned, including the liquidation of negotiable instruments, is unallowable in the period when earned or in the period when actually paid.

Id.

The Intermediary points out that while the Provider's cost report period is prior to the revision, it believes that the instruction in § 906.4 permitting the Provider an additional, reasonable period for liquidation has been exceeded.

The Intermediary contends that the negotiable instrument detailing the deferral of owner's compensation for the period ending 12-31-95 for a three year period 12/31/98 is not considered a reasonable period for liquidation under HCFA's general guideline.

The Intermediary contends that Medicare regulation at 42 C.F.R. §413.24, concerning the adequacy of documentation to support Medicare costs, is one of the cornerstones of Medicare law and regulations which govern Medicare program reimbursement. At the hearing when asked why a Provider with such a large percentage of Medicare volume would not request in writing the decisions or recommendations on such a critical issue impacting reimbursement, the Provider's witness said:

> when we tried to contact people at high levels of reimbursement,... we were advised that Mutual provided a Provider with a help line. We were assigned to a team. We were told to call the help line, that's what they're for(sic). We could call a help line, we would ask a question and they would call us back with an answer. At this time, we were not very skilled in doing business.[7]

The Intermediary argues that the Provider's consultant never requested or received anything in writing to support its contention that the Intermediary was in agreement with the Provider about the length of the note. The Provider's witness stated at the hearing that the consultant was involved with the Intermediary concerning the negotiable instruments but apparently the consultant never requested nor received anything in writing which would support the Provider's contention that the intermediary was in full agreement with the three year term of the negotiable instruments.[8]

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[7]Tr at 33

[8]Tr at 35

The Intermediary contends that the length of time assigned to the liquidation of the notes has created a situation where HCFA is providing what in essence is an interest free three year loan to the Provider. At the hearing a Board member stated:

> I guess another way of looking at this, and maybe this is the way the Intermediary is looking at it, is that if you issue a negotiable instrument with a due date, or a notes payable as you've described it, three years in the future, that this could be considered an interest-free loan by the government for three years......
>
> and
>
> I'm just saying, in the scenario we have here, we have you really asking the government to say: we'll allow you an expense and it's like a loan, whether it's interest-free or not, for three years to clear the loan.[9]

CITATIONS OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Regulations-42 C.F.R.:

    §§1835-.1841 - Board Jurisdiction

    §413.24 - Adequate Cost Data and Cost Finding

2. Provider Reimbursement Manual, Part 1 ("HCFA Pub. 15-1"):

    §906.4 - Unpaid Compensation

    §2305 et.seq. - Liquidation of Liabilities

3. Other:

    Intermediary A&R Memorandum No. 0078.01

    Blacks Law Dictionary, fifth edition, 1979

    Uniform Commercial Code Section 3-104

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[9]Tr at 51,52

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The majority of the Board, after consideration of the facts, parties' contentions and evidence presented, finds and concludes that the Intermediary improperly disallowed the accrued salary compensation that was paid by a promissory note.

The majority of the Board finds that the owners did negotiate a proper promissory note. The note was executed within 75 days of the close of the Provider's cost reporting year and was in the amount of the owner's compensation that was accrued at the end of the Provider's cost reporting year. The note was for a period of three years and was paid at the end of the three year period.

The majority of the Board notes that there is a lack of specific guidance in the Medicare regulations and the Medicare Manual as to the time frame in which to liquidate a note. The only instruction is that the debt must be liquidated within 75 days of the end of a provider's cost reporting year. In this case the debt was liquidated within the 75 day period by the use of a promissory note. The promissory note was a valid method of paying the debt. The Intermediary acknowledged that the note could be paid within a reasonable time. However, since their is no guidance as to the length of a reasonable time, the majority of the Board concludes the three year note is a reasonable time. The majority of the Board concludes that for a business to operate efficiently the issuance of a three year note is reasonable and prudent.

The majority of the Board concludes that there was a liquidation of the debt by the issuance of the promissory note, and that the length of time of the note was reasonable. If the provider would have taken the note to a bank, within three months of issue, the note would have been discounted and the Provider would have received its money, less the discount fee and the entire amount would have been an allowable cost for Medicare purposes. Therefore, the majority of the Board concludes that the Provider acted in a reasonable manner and that the length of time to pay the note was reasonable.

DECISION:

The Intermediary's disallowance of the owner's compensation was improper. The Intermediary's adjustment is reversed.

Board Members Participating:

Irvin W. Kues
Henry C. Wessman, Esq.
Martin W. Hoover, Jr. Esq.
Charles R. Barker (dissenting opinion)

Date of Decisio n: March 27, 2000

FOR THE BOARD:

Irvin W. Kues
Chairman

Dissenting Opinion of Charles R. Barker

I respectfully dissent:

The Provider claims the issuances of four Promissory Notes (dated 12/31/95) totaling $152,400, and their subsequent conversion to "Notes Payable - Shareholder" in the 1996 balances sheet has satisfied the requirements of HCFA Pub. 15-1, § 906.4.

The Intermediary argues even though the notes are negotiable instruments, the deferral of actual payment does not meet the test of reasonableness for liquidation under HCFA's general guidelines. I concur with the Intermediary and feel that there was not a liquidation of the debt in this case.

I view this case as one to be decided based on an evolutionary review of HCFA's regulations and instructions and the connection thereof.

1. The 75-day payment requirement was removed from 42 C.F.R. §405.426(d)(2) effective September 1, 1983, with the preamble comment at 48 F.R. 39798 that program instructions in Section 2305 of HCFA Pub. 15-1 provide rules applicable to liquidation of short-term liabilities that are sufficient to safeguard against abuse in this area. However, the 75-day rule was retained in Section 906.4 of HCFA Pub. 15-1 (See PRRB Decision 90-D41), Dimmit County Home Health Care, Inc.)

2. Section 906.4 during the period in question mirrors the language in the deleted regulation noted above, however the Federal Register Preamble provides the connection to Section 2305 which establishes the reasonableness test for liquidating liabilities as well as how they should be liquidated (i.e. actual transfer of the Provider's assets within the time limits specified).

3. Although there are no regulations directly on this point presently, Section 906.4 in Transmittal No. 391 dated 2/96, has clarified HCFA's intent (since 1971) of prompt liquidation of negotiable instruments and that the liquidation should be with an actual transfer of provider assets within 75 days of the cost report period closing. (This is actually more stringent than section 2305 requirements).

The remaining question is how do we relate this to the Providers' situation.

1. The Provider should have been aware through Transmittal No. 391 dated 2/96, that HCFA was requiring an actual liquidation of negotiable instruments on a timely basis (75 days). This policy was effective for compensation earned in cost reporting periods ending on or after 3/24/71.

2. The Provider could have corrected its situation prior to filing the FY 1995 cost report or at least argued that they were entitled to the year period of liquidation since the clarification was isssued after their FYE. The Provider did neither of these.

3. The Provider also did not seek an exception, as provided by Section 2305.1 of HCFA Pub. 15-1 which may have allowed the provider until three years after the end of the 1995 cost reporting period to liquidate the liability.

As a result of their actions the Provider attempted to be reimbursed in FY 1995 for expenses that were not liquidated within a reasonable period. At the time the appeal was filed and through the case development process the notes were not paid. The notes were actually paid in December 1998. An alternative argument could be made by the Provider to allow the expenses in the year paid, however the actual payment was well past any point of requesting an exception under Section 2305.1.

For the reasons cited above 1) regulatory and instructional connection 2) HCFA's long standing intent on prompt liquidation (actual payment) of negotiable instruments and 3) the Provider ability to correct the situation, I will sustain the adjustments made by the Intermediary to the Provider.

Charles R. Barker Date