PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D73

DATE OF HEARING-
June 2, 2000

PROVIDER -
Citizens Medical Center
Victoria, Texas

Provider No. 45-0023

vs.

Cost Reporting Periods Ended -
June 30, 1990,
June 30, 1991

CASE NOs.
94-1477
94-1520

INTERMEDIARY -
Blue Cross and Blue Shield Association/
TrailBlazer Health Enterprises, LLC

INDEX

Page No.

ISSUE:

Were the Intermediary=s initial, amended and reopening adjustments to interest expense and bond related cost proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Citizens Medical Center (AProvider@) is a government controlled, general short-term hospital located in Victoria, Texas. It filed the Medicare cost report for the fiscal years ended June 30, 1990 and 1991 including the various costs under appeal. Blue Cross and Blue Shield of Texas[1] (AIntermediary@) issued two Notices of Program Reimbursement (ANPR@), one on September 1, 1992 and the other on September 20, 1993 for fiscal year 1990. The fiscal year 1991 NPR was issued on August 16, 1993 which included the appealed audit adjustments to the Provider=s cost report. The Provider timely appealed similar audit adjustments for both fiscal years to the Provider Reimbursement Review Board (ABoard@) on January 19, 1994. The Provider=s filing meets the jurisdictional requirements of 42 C.F.R. '' 405.1835-.1841. The Provider is represented by Ernst & Young, LLP. The Intermediary is represented by Blue Cross and Blue Shield Association. The amount in dispute for fiscal years 1990 and 1991 is $100,000 and $110,000, respectively.

Pertinent Provider facts related to the Series 1982 and 1986 Revenue Bonds are outlined below:[2]

C The Series 1982 Hospital Revenue Bonds issued in the face amount of $9,890,000 and dated December 1, 1982 were deemed necessary and allowable debt.

C The Series 1986 Hospital Refunding and Improvement Revenue Bonds issued in the face amount of $17,000,000 and dated November 1, 1986 were used to: advance refund the Series 1982 bonds, construct the Aproject,@ establish required bond reserve funds, and pay debt issuance costs (Exhibit P-13).

C The Series 1982 Hospital Revenue Bonds contained restrictive covenants which caused the Provider to advance refund the 1982 bonds to increase the amount of outstanding debt (Exhibit P-13).

---

1 Blue Cross and Blue Shield of Texas withdrew from the Medicare Program in Fiscal Year 1999 and TrailBlazer Health Enterprises, LLC has assumed their fiscal intermediary duties.

2 See Provider=s Position Paper Fiscal Years 1990 and 1991, page 3.

C During fiscal 1986, at the time of borrowing, the Provider=s working capital requirements for 75 days of operations was $4,949,311.

C At the time of the series 1986 borrowing, the Provider=s available working capital was $4,200,000.

C The ADays Net Revenue in Patient Receivables@ during fiscal 1986 was 70.5 days.

C At the time of the series 1986 borrowing, the provider had an available funded depreciation balance of $3,448,439.[3]

C Total capital expenditures from 1987 through 1991 were $23,739,368.

C The new construction Aproject@ was budgeted at $4,073,000 (Exhibit P-7).

C The actual cost for the Aproject@ was $7,358,315 (Exhibit P-9).

Explanation of Audit Adjustments[4]	1991	
Unnecessary Borrowing	$ 188,623	- Adj # 3
Offset of Interest Income	$ 11,524	- Adj # 34 & 39
Amortized Bond Issue Cost	$ 3,654	- Adj # 36
Adjust Interest Expense	$ 7,016[5]	- Adj # 37
Properly State Loss on the Refunded 1982 Bonds	$ 148,670	- Adj # 38
Total Adjustment	$ 359,487[6]	

[3] The Intermediary contends that the Provider had an available funded depreciation balance of $4,419,209 as of October 1986. See Intermediary Position Paper Fiscal Year 1990, page 4.

[4] For FYE 1990 breakdown of audit adjustments cannot be determined due to amended and reopened cost reports, however the same or similar categories were adjusted as in fiscal year 1991. The total adjustment was $329,763.

[5] Amount not included in dispute per Provider Position Paper, page 3.

[6] An Administrative Resolution (AAR@) of this issue was proposed by the Intermediary

PROVIDER=S CONTENTIONS:

The Provider contends that it is entitled to interest expense because there was no excess working capital. Neither the regulation at 42 C.F.R. ' 413.153 nor manual instruction at HCFA Pub. 15-1 ' 202.2 define excess working capital, however HCFA Pub. 15-1 ' 1202.3 defines net working capital:

> Working capital is the difference between current assets and current liabilities. For provider reimbursement purposes, net working capital is working capital reduced by any amount determined to be excessive for the necessary and proper operation of patient care activities.

The Provider argues that in the absence of program guidance, the facts and the Provider=s unique circumstances must be evaluated.

The Provider=s working capital requirements as of June 30, 1986 to meet 75 days of normal operating needs is $4,946,311.[7] The Provider=s working capital on June 30, 1986 was $3,201,419.[8] Based on the audited financial statement data, the Provider had approximately $3.2 million in available working capital as compared to the $5 million needed for 75 days of operations. Based on this analysis, the Provider has met the criteria set forth in 42 C.F.R. ' 413.153(b)(2)(i). The criteria set forth in 42 C.F.R. ' 413.153(b)(2)(ii) has been met since the debt proceeds were used for advance refunding allowable debt capital additions, and related bond issuance costs which were reasonably related to patient care.

The criteria set forth in 42 C.F.R. ' 413.153(b)(2)(iii) has been met since there is no dispute regarding the requirement to offset investment income; however, the Provider does dispute the method of allocation and offset computed by the Intermediary.

---

whereby the amount of unnecessary borrowing would be reduced based on the AFunds Needed and Funds Available@ for the defined Aproject and other related modifications.@ The AR is not reflected in the fiscal year 1990 and 1991 adjustments shown in the above table. The estimated reduction in the adjustments for fiscal year 1990 is $71,000 and $32,000 in 1991. See Intermediary Exhibits I-4 and I-5 for fiscal year 1990 and Exhibits I-3 and I-5 for fiscal year 1991.

[7] Provider=s Position Paper, page 4.

[8] Provider=s Position Paper, page 5.

The Provider contends that it met the criteria set forth in 42 C.F.R. '' 413.153(b)(3)(i) and 413.153(b)(3)(ii) since the Provider took advantage of its tax exempt status and obtained market competitive based rates and the 1986 Revenue Bonds were held by lenders who were not related.

The Provider contends that there was no excess in the funded depreciation account. The Provider had $3,448,439[9] in available Funded Depreciation and additional financing was $4,073,000. These two amounts are well below the actual capital expenditures of $23,739,368.[10]

The Provider contends that the Series 1982 Bonds were determined to be necessary borrowing and the related bond costs and interest expenses have consistently, been allowed. Therefore, the 1986 refinancing of the allowable 1982 debt is also allowable.

The Provider argues that the treatment of interest, loan principal, funded depreciation and other funds, should achieve the same results as if the available funds had been used instead of the loan. The Provider borrowed $4,073,000 for capitalized expenditures. Funded depreciation was not used and working capital was used to purchase capital assets. The resulting interest expense is the same in both cases.

The Provider argues that if the bond (interest) is deemed allowable, then the full interest income should be offset against the full interest expense on the bonds.

The Provider disputed the offset of $39,605 for investment income earned from professional liability accounts. The Provider argues that interest income on self funded insurance meets requirements of HCFA Pub. 15-1 ' 2162.7(B)(6) and is not required to be offset.

The Provider disputes the interest income offset on the Bond Interest and Sinking Fund and argues that the portion related to principle repayments qualify as funded depreciation in accordance with HCFA Pub. 15-1 ' 226.2

The Provider contends that the loss on refinancing was not calculated properly. However the Provider did not submit documentation to support this contention.

INTERMEDIARY=S CONTENTIONS:

The Intermediary contends that except for references to the funded depreciation and the amount of the interest income offset, the Provider had not identified specific areas or amounts included in the Intermediary=s workpapers to which they take exception. Since the aforementioned areas represent the

9 Provider=s Position Paper, page 7.

10 Provider=s Position Paper, page 8.

bulk of the adjustment under dispute, no other areas will be argued.

The Intermediary argues that in their fiscal year 1991 position paper borrowing for a purpose for which funded depreciation account funds should be used makes the borrowing unnecessary to the extent that funded depreciation account funds are available at the time of the borrowing. HCFA Pub. 15-1 ' 226.C provides as follows:

> Funded depreciation (total market value of fund) must be available (unless contractually committed as noted below) on as needed basis for the acquisition of the providers=s depreciable assets used to render patient care, or for other capital purposes related to patient care. Loans made from funded depreciation do not alter the requirement that funded depreciation must be available.
>
> Funds are considered available unless committed, by virtue of contractual arrangements, to the acquisition of depreciable assets used to render patient care, or to other capital purposes. Borrowing for a purpose intended by funded depreciation is unnecessary to the extent funded depreciation is available. Thus, interest expense for borrowing up to the amount of available funded depreciation is not an allowable cost.

Id. (Emphasis added).

At the time of the Series 1986 borrowing the Provider had an available Funded Depreciation balance of $4,419,209 (See Exhibit P-10). The Provider has computed available funded depreciation in Table 4 of its Position Paper at $3,448,439. The Intermediary rejects the Provider=s computation for two reasons. First of all, it appears that the Provider=s starting amount for Funded Depreciation at October 1986 in the amount of $4,249,332 (per Table 4 of the Provider=s Position Paper) is in fact the balance in funded depreciation at the end of November 1986. (See Exhibit P-10 of Provider=s Position Paper). The October balance is $4,419,209. Secondly, in Table 4 of its Position Paper, the Provider is subtracting $800,000 from the balance for April 1986 deposits due to the fact that this deposit had not been in the funded depreciation account for at least 6 months. The Intermediary rejects the Provider=s contention that deposits that have not remained in the funded depreciation account for at least 6 months should not be considered in making the determination of Aavailability.@ The Provider makes this point because of HCFA Pub. 15-1 ' 226.3 which states that deposits to Funded Depreciation must remain for 6 months to be considered a valid funding transaction. However, the Board found in Mercy Medical Center v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Oregon, PRRB Dec. No. 92-D73, September 30, 1992, Medicare & Medicaid Guide (CCH) & 40,831, decl. rev., HCFA Administrator, November 5, 1992, that this provision only refers to the application of HCFA Pub. 15-1 '' 226.1 and 226.2 which pertain to the determination of the interest income and interest expense offset rule. The Board found that whatever amount is on deposit in the Funded Depreciation Account(s) at the time of the borrowing is the threshold Aavailable@ in determining unnecessary borrowing.

The Provider contends in its Position Paper that the actual construction cost for the Aproject@ was $7,358,315 or $3,285,315 in excess of the planned cost of $4,073,000. Prior to filing its draft Position Paper, the Intermediary requested from the Provider the documentation which supports these Aactual costs@ (Exhibit I-2). The Intermediary also requested the planning documents which support the estimated cost of the Aproject,@ including a detailed list of the Acertain items of capital equipment@ referenced in the bond statement. Based on the information received from the Provider and on additional analysis performed by the Intermediary, an AR of this issue was proposed by the Intermediary (Exhibit I-3) whereby the amount of unnecessary borrowing would be reduced based on the AFunds Needed@ and AFunds Available@ for the defined project in a manner consistent with that proposed for the 1990 appeal (Exhibit I-4). From the information received from the Provider, a direct correlation could be made between the AActual Project Costs@ as identified in the Provider=s Position Paper and the cost of many of the items outlined in the bond statement. There were, however, some exceptions, the most notable being the MRI. Although listed on the Provider=s list of AActual Project Costs,@ the MRI was not defined as part of the project in the bond statement and was therefore not included in the Intermediary=s determination of AFunds Needed@ used in its calculation of additional allowable Capital Related Interest Expense (Exhibit I-4). The Intermediary rejected the Provider=s Supplemental Exhibits which argued that the MRI was part of the proposed construction project included in the Series 1986 Bonds.

The Intermediary proposed in the AR to further reduce the unnecessary borrowing by the Provider=s spend-down of funded depreciation based on the LIFO method as required by 42 C.F.R. ' 413.134(e)(3)(c). The result of the Intermediary=s analysis reflected an increase in Capital Related Interest Expense as noted on page 4 of this Decision. To date, the Provider has neither accepted nor rejected the Intermediary=s proposed AR of this issue.

As part of the AR proposed by the Intermediary and referenced above, the amount of interest income offset has been recalculated (<u>See</u> Exhibit I-5) and is reflected in the net amount by which the Intermediary proposes to increase Capital Related Interest Expense.

The Intermediary notes that the Provider argues that the Loss on Refinancing offset may not be calculated based on Program Instructions, however sufficient documentation has not been provided to evaluate this comment.

Based on an additional analysis performed, the Intermediary=s AR of this issue properly states interest expense and income related to the 1986 bonds. Again, the Intermediary notes that the Provider has not documented the objections and arguments in relation to the Intermediary=s audit workpapers, nor have they commented on the proposed AR. We request the Board to affirm the Intermediary's determination.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Regulations 42 C.F.R.:

§§ 405.1835-.1841	-	Board Jurisdiction
§ 413.134(e)(3)(c)	-	Funding of Depreciation - Exception
§ 413.153 et. seq.	-	Interest Expense

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

§ 202.2	-	Interest - Necessary
§ 226.C	-	Funded Depreciation - Restrictions
§ 226.1	-	Interest Paid on Loans From Funded Depreciation
§ 226.2	-	Interest and Other Income Earned By Funded Depreciation Account
§ 226.3	-	Deposits in Funded Depreciation Account
§ 1202.3	-	Net Working Capital
§ 2162.7(B)(6)	-	Condition Applicable to Self-Insurance

3. Cases:

Mercy Medical Center v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Oregon, PRRB Dec. No. 92-D73, September 30, 1992, Medicare & Medicaid Guide (CCH) ¶ 40,831, decl. rev., HCFA Administrator, November 5, 1992.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board after considering the law, regulations, program instructions, facts, parties= contentions and evidence conclude that the Intermediary=s adjustments disallowing interest expense and bond related cost for 1990 and 1991 were proper.

The Board finds that the series 1986 Hospital Refunding and Improvement Revenue Bonds were issued to advance refund the series 1982 bonds, construct the Aproject,@ establish required bond reserve funds and pay debt issuance cost. The Board finds that the refinancing of the allowable 1982 debt is an allowable expense. However, the Board also finds that a portion of the 1986 refunding and improvements bonds resulted in unnecessary borrowing. The dominant issue in this appeal is whether or not funded depreciation was available at the time the Provider borrowed money to fund the acquisition and installation of certain capital assets. The Board finds that the Provider had funded depreciation in the amount of $4,419,209 as of the issuance date of the 1986 revenue bonds. The actual cost of the Aproject@ according to the Provider was $7,358,315. The Board notes that HCFA Pub. 15-1 ' 226.C provides as follows:

> Funded depreciation (total market value of fund) must be available (unless contractually committed as noted below) on as needed basis for the acquisition of the provider=s depreciable assets used to render patient care, or for other capital purposes related to patient care. Loans made from funded depreciation do not alter the requirement that funded depreciation must be available.
>
> Funds are considered available unless committed, by virtue of contractual arrangements, to the acquisition of depreciable assets used to render patient care, or to other capital purposes. Borrowing for a purpose intended by funded depreciation is unnecessary to the extent funded depreciation is available. Thus, interest expense for borrowing up to the amount of available funded depreciation is not an allowable cost.

The Board notes that the Intermediary performed an analysis of interest expense and bond related cost which included a proposed AR. The Board finds the Intermediary=s analysis to be reasonable. The Provider has not responded to the proposed resolution in their position paper arguments.

The Board notes that the Provider makes several contentions regarding the Intermediary=s audit adjustments; however, they do not provide sufficient documentation and argument in order to evaluate their position or they cite a program instruction which does not appear to apply to the situation (HCFA Pub. 15-1 ' 2162.7(B)(6)).

DECISION AND ORDER:

The Intermediary=s adjustments disallowing interest expense and bond related costs for 1990 and 1991 are proper. The Intermediary=s adjustments as proposed in the Administrative Resolution are affirmed.

Board Members Participating:

Irvin W. Kues
Henry C. Wessman, Esquire
Martin W. Hoover, Jr., Esquire
Charles R. Barker
Stanley J. Sokolove

Date of Decision: August 08, 2000

FOR THE BOARD:

Irvin W. Kues
Chairman