

**PROVIDER REIMBURSEMENT REVIEW BOARD  
HEARING DECISION**

ON-THE-RECORD  
98-D30

**PROVIDER** -Southern Inyo Hospital  
Lone Pine, California

**DATE OF HEARING-**  
December 18, 1997

Provider No.           05-0388

Cost Reporting Period Ended -  
June 30, 1987

**vs.**

**INTERMEDIARY** -  
Blue Cross and Blue Shield Association/  
Blue Cross of California

**CASE NO.**   90-2029

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ISSUE:

Was the Intermediary's adjustment disallowing the costs associated with the repossessed equipment proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Southern Inyo Hospital ("Provider") is a general, short-term hospital located in Lone Pine, California. The Provider filed its Medicare cost report for the fiscal year ended June 30, 1987, ("FY 87") claiming a loss on disposal of repossessed equipment. Blue Cross of California ("Intermediary") issued a Notice of Program Reimbursement which disallowed that loss. The Provider appealed this adjustment to the Provider Reimbursement Review Board ("Board"). The Provider's filing has met the requirements of 42 C.F.R. §§ 405.1835-.1841. The Provider is represented by Withbert W. Payne of Starcare International, Inc. The Intermediary is represented by Bernard Talbert, Esquire, of Blue Cross and Blue Shield Association.

The Provider claimed a loss on disposal of asset as a component of the capital-related costs - movable equipment cost center in its as-filed cost report. The Provider calculated the related amount as follows:

Cost of Equipment	\$120,000
Less: Depreciation to June 1986	<u>30,000</u>
Book Value	\$ 90,000
Less: Loan Balance as June 1986	<u>70,574</u>
Loss on Sale	\$ 19,426
Add: Write Back of Accrual to July 1986	<u>14,867</u>
Loss on Disposal	<u>\$ 34,293</u>

On April 30, 1984, the Provider signed a Master Loan and Security Agreement with the Manufacturers Hanover Leasing Corporation ("MHLC") for the purchase of a Worthington Analyzer and related equipment.<sup>1</sup> The purchased assets were used as collateral for the loan. The Provider defaulted in making payments to MHLC in fiscal year ended June 30, 1986. The Analyzer was subsequently repossessed on July 8, 1986. MHLC also held the Provider liable for the unpaid loan balance which, as indicated by the Provider to the Intermediary, would be determined through litigation. On August 13, 1986, the equipment was sold for \$17,500.

The Intermediary noted that since the Provider has severe cash flow problems, the Provider was not prudent in its decision to purchase the asset on account and in managing the

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<sup>1</sup> See Intermediary Exhibit No. 5.

purchased asset. Thus, the Intermediary disallowed the Provider's claimed loss. This resulted in a reduction in Medicare reimbursement of approximately \$15,000.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary was incorrect in eliminating the loss on disposal of assets of \$34,293 claimed in the "filed" cost report. The Provider also disputes the Intermediary's reasoning to eliminate the loss on disposal of assets. Some of the reasons cited by the Intermediary in the position paper and the audit workpaper,<sup>2</sup> to justify the elimination were:

- (i) Provider could have purchased less expensive equipment for its purposes, as it subsequently did following repossession of the analyzer;
- (ii) Provider had cash flow problems and should not have undertaken financial burden;
- (iii) Provider did not realize that debtor was liable for payment, even after equipment was resold by Leasing Company;
- (iv) Repossession of equipment does not fall under the provisions HCFA Pub. 15-1 §§ 130, 132 & 133; and
- (v) The amount claimed by the Provider was not a loss on depreciable asset, pursuant to 42 C.F.R. § 413.134(f); or an allowable capital-related cost, pursuant to 42 C.F.R. § 413.130.

The Provider's position is that the reasons given by the Intermediary to justify the elimination of the loss on disposal of assets of \$34,293 are not supported by the Medicare regulation. The Provider cites the Medicare regulation at 42 C.F.R. § 413.134(f) on the Gains and Losses on Disposal of Assets in support of its position that the Medicare program treats the loss on disposal of assets as "allowable" capital-related costs. That regulation specifically states that:

Depreciable assets may be disposed through sale, scrapping, trade-in, exchange, demolition, abandonment, condemnation, fire, theft, or other casualty. . . the Amount of a loss to be included shall be limited to the undepreciated basis of the asset permitted under the program.

42 C.F.R. § 413.134(f) (emphasis added).

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<sup>2</sup> See Provider Exhibit 6.

The Medicare regulation at 42 C.F.R. § 413.134(f)(6) on “Involuntary Conversion” also states that:

“Losses resulting from the involuntary conversion of depreciable assets, such as condemnation, fire, theft, or other casualty, are generally included in the determination of allowable costs. . . . However, losses resulting from a provider's imprudent management of its depreciable assets, such as the failure to obtain proper insurance coverage, are not include in the determination of allowable cost.”

42 C.F.R. § 413.134(f)(6) (emphasis added).

The Provider contends that the above reasons cited by the Intermediary cannot be classified as imprudent management of its depreciable assets by the Provider. The Medicare regulation, which has also been cited by the Intermediary, deals only with the “management of the depreciable asset” and not with reasons given by the Intermediary in eliminating the loss on disposal of assets of \$34,293.

#### INTERMEDIARY’S CONTENTIONS:

The Intermediary contends as follows:

1. The amount claimed by the Provider was not:
  - A loss on depreciable asset, pursuant to 42 C.F.R. § 413.134(f) and HCFA Pub. 15-1, §§ 132 or 133;
  - An allowable capital-related cost, pursuant to 42 C.F.R. § 413.130, HCFA Pub. 15-1, Section 2806.1, and HCFA Pub. 13-4, Section 4198.
2. The Provider did not demonstrate with compelling or convincing evidence that the claimed amount should be allowed because:
  - it exercised a prudent management decision to minimize its costs as a prudent and cost-conscious buyer, pursuant to 42 C.F.R. § 413.9 and HCFA-Pub. 15-1, §§ 2100 and 2102.1;
  - it followed the provision of HCFA-Pub. 15-1 § 133, which states that losses resulting from a provider’s imprudent management of depreciable assets, such as failure to obtain proper insurance coverage, are not includable in allowable costs; and

- it followed sound and prudent management practice by protecting itself against likely losses in accordance with HCFA-Pub. 15-1, § 2160.
3. The Provider should have claimed reimbursement for such loss through its insurance company, not the Medicare Program. Under the circumstances, the Intermediary cannot allow such loss in accordance with HCFA-Pub. 15-1, § 2160, which states:

Where a provider chooses not to file a claim for losses covered by insurance, the costs incurred by the provider as a result of such losses may not be included in allowable costs.

HCFA Pub. 15-1 § 2160.

4. There was insufficient information and supporting documentation regarding the Provider's insurance coverage or result of the aforementioned court litigation. Therefore, the Intermediary did not have a sufficient basis on which to allow the related costs pursuant to HCFA-Pub. 15-1, § 2160.2.
5. Due to insufficient information and supporting documentation, and since the Provider did not adequately support its contentions, the Intermediary's determination is in accordance with 42 C.F.R. §§ 413.20 and 413.24, and HCFA-Pub. 15-1, §§ 2300, 2304 and 2404.2.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Law - Title XVIII of the Social Security Act:
- |                 |   |                 |
|-----------------|---|-----------------|
| § 1861(v)(1)(A) | - | Reasonable Cost |
|-----------------|---|-----------------|
2. Regulation - 42 C.F.R.:
- |                  |   |                                       |
|------------------|---|---------------------------------------|
| § 405.1835-.1841 | - | Board Jurisdiction Regulations        |
| § 413.9          | - | Cost Related to Patient Care          |
| § 413.20         | - | Financial Data and Reports            |
| § 413.24         | - | Adequate Cost Data and Cost Finding   |
| § 413.130        | - | Introduction to Capital Related Costs |

- § 413.134 - Depreciation: Allowance for Depreciation Based on Asset Costs
  - § 413.134(f) - Gains and Losses on Disposal of Assets
  - § 413.134(f)(6) - Involuntary Conversion
3. Program Instructions - Provider Reimbursement Manual, Part I (HCFA Pub. 15-1):
- § 130 - Disposal of Assets
  - § 132 - Gains and Losses on Disposal of Depreciable Assets (Excluding Involuntary Conversions)
  - § 133 - Treatment of Casualty Losses
  - § 2100 - Principle
  - § 2102.1 - Reasonable Costs
  - § 2160 - Losses Arising from Other than Sale of Assets
  - § 2160.2 - Liability Losses
  - § 2300 - Principle
  - § 2304 - Adequacy of Cost Information
  - § 2404.2 - Examination of Pertinent Data and Information
  - § 2806.1 - Costs Included in Capital-Related Costs
4. Medicare Intermediary Manual - HCFA Pub. 13-4:
- § 4198 - Exhibits for PPS Audits

**FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:**

The Board, after considering the law, regulation, facts and parties' contentions finds and concludes that both parties improperly applied the regulations and program instructions in their arguments. Thus, neither party's conclusion results in the correct application of Medicare's requirements. The Provider improperly mixed asset and loan values in calculating its loss on disposal. Offsetting loan values against the net book value to arrive at a loss on disposal does not meet the regulatory calculation for determining the loss.

The Board finds that the regulation at 42 C.F.R. § 413.134(f)(6) and HCFA Pub. 15-1 §§ 130 and 132 provide the correct calculation. First, the Board considers the repossession of the Worthington Analyzer an involuntary conversion. The above regulation provides examples of involuntary conversions such as condemnation, fire, theft or other casualty. The regulation, however, has constructed these as examples. Thus, it essentially permits other types of "involuntary conversions." The Board considers repossessions appropriate involuntary conversions. The asset in this case was taken from the Provider on an involuntary basis.

The Board notes the following facts in this case:

- (1) the asset was eventually sold for \$17,500. That represents an appropriate salvage value.
- (2) The Provider eventually replaced the repossessed analyzer with another type of analyzer.

Given these additional facts, the Board concludes that a loss of \$72,500 resulted from the repossession. That loss represents the difference between the net book value of the asset (\$90,000) and the salvage value (\$17,500) of the asset. Since the loss exceeds \$5000, 42 C.F.R. § 413.134(f)(6)(iii) requires it to be capitalized and amortized over the useful life of the replacement asset.

**DECISION AND ORDER:**

The Provider incurred a loss on the repossession of the Worthington Analyzer. Reimbursement of the loss should be in accord with the requirements of 42 C.F.R. § 413.134(f)(6)(iii). The Intermediary's adjustment is modified.

Board Members Participating:

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

Date of Decision: February 26, 1998

FOR THE BOARD:

Irvin W. Kues  
Chairman