

PROVIDER REIMBURSEMENT REVIEW BOARD HEARING DECISION

99-D45

PROVIDER -
Rehabilitation Associates, Inc.

DATE OF HEARING-
January 29, 1999

Provider No. 23-6616

Cost Reporting Period Ended -
December 31, 1995

vs.

INTERMEDIARY -
United Government Services

CASE NO. 98-0105

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ISSUE:

Was the Intermediary's adjustment to owner's compensation proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Rehabilitation Associates, Inc. ("Provider") is a Medicare certified, proprietary, outpatient physical therapy facility located in Battle Creek, Michigan.¹ For its cost reporting period ended December 31, 1995, the Provider claimed \$210,288 in owner's compensation expense. This amount consists of approximately \$42,058 in salary and fringe benefits for administrative services performed by the owner, and approximately \$168,230 in salary and fringe benefits for patient care services rendered by the owner as a physical therapist.²

Health Care Services Corporation ("Intermediary")³ audited the Provider's cost report for the subject reporting period. As part of this review the Intermediary applied compensation guidelines to the salary expense claimed by the Provider for its owner/administrator. As a result of this application the Intermediary reduced the amount of owner's compensation claimed for administrative services to \$20,673, and the amount claimed for professional services to \$41,900, reflecting a total adjustment of \$147,715 to claimed program expenses.⁴

On July 15, 1997, the Intermediary issued a Notice of Program Reimbursement reflecting its adjustment to the Provider's owner's compensation. On October 13, 1997, the Provider appealed the Intermediary's adjustment to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 405.1835-.1841, and met the jurisdictional requirements of those regulations. The amount of program funds in controversy is approximately \$25,380.⁵

The Provider was represented by Gordon Allen, P.T., President, Rehabilitation Association, Inc. The Intermediary was represented by James Grimes, Esq., Associate Counsel, Blue Cross and Blue Shield Association.

¹ Intermediary's Position Paper at 1.

² Intermediary's Position Paper at 3. Exhibit I-3.

³ United Government Services became the Intermediary on October 1, 1998, and is the representative in this appeal. See Intermediary's Position Paper at 1.

⁴ Intermediary's Position Paper at 2. Exhibit I-3.

⁵ Provider's Position Paper at Remedies. Transcript ("Tr.") at 18.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary's adjustment is improper because it was determined using a methodology that is inaccurate and invalid.⁶ The Intermediary's adjustment is based upon reasonable compensation guidelines that were developed by Blue Cross and Blue Shield of Michigan in 1983 ("the Michigan Study"), which the Intermediary updated to the subject reporting period using an inflation index. However, program instructions require intermediaries to evaluate the reasonableness of owner's compensation using guidelines issued by the Health Care Financing Administration ("HCFA"), not another intermediary.⁷ Moreover, the program's rules require HCFA's guidelines to be based upon data obtained from providers every 3 years, not from a survey taken 16 years ago.⁸

Program instructions contained in the Provider Reimbursement Manual, Part I ("HCFA Pub. 15-1") § 904, establish the criteria intermediaries are to use to evaluate the reasonableness of owner's compensation. In general, these instructions require intermediaries to furnish compensation data to their HCFA Regional Office ("RO") where it is consolidated with data obtained from other intermediaries to produce ranges of reasonable compensation. Program instructions contained in the Intermediary Manual, Part 2 ("HCFA Pub. 13-2") § 2120.1 elaborate upon the reimbursement manual's instructions by explaining that intermediaries are to provide the requisite data to their ROs every 3 years, and reiterates the RO's responsibility to consolidate the data and issue ranges of reasonable compensation for the intermediaries to use.⁹

The Provider rejects the Intermediary argument that the Michigan Study is an appropriate basis for the subject adjustment since it compares the Provider's compensation with the compensation claimed by similar institutions in the same area. The Provider notes that the manual instructions specifically explain that salary ranges used to evaluate owner's compensation are to be based upon salary data applicable to non-owners.¹⁰ Therefore, the

⁶ Provider's Position Paper at 1. Tr. at 6.

⁷ The Provider notes that Blue Cross and Blue Shield of Michigan had been a Medicare intermediary. See Provider Position Paper at Issue 1 at Violations.

⁸ Provider's Position Paper at Issue 1. Tr. at 11.

⁹ Id. Tr. at 7-11.

¹⁰ See HCFA Pub. 13-2 § 2120.1.

survey data used by the Intermediary is inappropriate since it would contain salary data applicable to proprietary owners only.¹¹

The Provider also believes that actual salary ranges in both proprietary and non-proprietary facilities greatly exceed the ranges that have been computed by the Intermediary. An analysis of the percentage increases used to update the Michigan Study to subsequent cost reporting periods shows a drastic drop in the rate of increase beginning in 1983. The Provider asserts that this occurred at a time when there was a substantial shortage of physical therapists in the United States and special visa waivers were granted to foreign therapists. Meanwhile, a comparison of the percentage increases used by the Intermediary to a 12 percent annual increase, which would be the average of the increases between 1977 and 1983, or even a 6 percent annual increase, which is one-half the average, is far greater than the percentages used by the Intermediary.¹²

Additionally, the Provider asserts that the compensation paid to its owner meets the test of reasonableness as intended in the program's regulations. The Provider explains that it receives \$67.48 per visit for its physical therapy services, while the average compensation paid to Michigan hospital physical therapy departments is \$569.89 per visit. The Provider notes the Intermediary's testimony that the owner's compensation at issue would be considered reasonable if the differences in program payments made to hospitals and to the Provider, as discussed above, were actual circumstances. In response, the Provider refers to a letter dated June 16, 1995, from Blue Cross and Blue Shield of Michigan, which discloses the average fee of \$569.89 paid to outpatient hospital physical therapy departments.¹³

The Provider contends that the Intermediary also failed to comply with program instructions regarding placement of an owner within established salary ranges. Moreover, the methodology used by the Intermediary for this purpose conflates the rules for determining salary ranges with the placement criteria.¹⁴

In general, HCFA Pub. 15-1 § 904 explains that HCFA is responsible for establishing salary ranges for "comparable institutions," and that the Intermediary is responsible for determining where a particular owner falls within the appropriate range, i.e., the range established for institutions comparable to the owner's. According to HCFA Pub. 15-1 § 904.1, the factors to be considered in determining comparability of institutions include the size of an institution, its classification, the number and types of personnel employed, and geographical location.

¹¹ Tr. at 11.

¹² Provider's Position Paper at Issue 1. Tr. at 13. Exhibits P-3 and P-4.

¹³ Provider's Post Hearing Summary. Tr. at 43.

¹⁴ Provider's Position Paper at Issue 2. Tr. at 13.

According to HCFA Pub. 15-1 § 904.2, the factors used to place an individual within the range for his or her comparable institution includes an individual's qualifications including education and experience, the number and types of professionals supervised, the duties and responsibilities of the owner and the actual services rendered, and whether or not the owner performs services for any other institutions or is engaged in any other occupation.

With respect to the instant case, the Intermediary used a point assignment work sheet similar to that outlined in HCFA Pub.13-2 § 2120.1 J to place the owner within the selected salary range. However, unlike the work sheet shown in the manual, "volume," or visits per year, accounts for 40 percent of the possible points on the Intermediary's work sheet.¹⁵ The use of a volume criterion in this process is improper as it is a measurement of a provider's size. HCFA Pub. 15-1 § 904.1 A. The correct procedure as outlined in HCFA Pub. 15-1 § 904 is to survey non-owners who work in institutions of a given size and then establish salary ranges for institutions of that size. Owners who operate institutions of the given size are then given a specific placement within that salary range. The Intermediary's methodology, however, utilizes a single salary range for institutions of all sizes, thus violating a primary objective of HCFA's instructions, which is to compensate owners at the same level as non-owners in comparable institutions.

The Provider also contends that the methodology used by the Intermediary to evaluate its owner's compensation would not recognize the fact that the owner worked in excess of 2080 hours a year. The Provider asserts that this prohibition is not only unfair but also violates program regulations at 42 C.F.R. § 413.102, as well as the Intermediary's own guidelines.¹⁶

The Provider maintains that it was informed by the Intermediary that the owner could claim compensation for no more than 2080 hours of work in a single year. Since the owner worked substantially more than 2080 hours, with the extra hours going to physical therapy, this limitation significantly impacted the amount of compensation that could be claimed.

The Provider also explains, however, that the services furnished by the owner were necessary and if he had not performed them additional therapists would have had to be employed. According to 42 C.F.R. § 413.102 (a): "[a] reasonable allowance of compensation for services of owners is an allowable cost provided that their services are actually performed in a necessary function.

Regulations at 42 C.F.R. § 413.102 (b)(3) define "necessary" as follows:

Necessary requires that a function be--

- (i) Such that had the owner not furnished the services, the institution would

¹⁵ See Exhibit P-2.

¹⁶ Provider's Position Paper at "Limitation on Hours Worked." Tr. at 15.

have had to employ another person to perform the services; and

(ii) Pertinent to the operation and sound conduct of the institution.

42 C.F.R. § 413.102 (b)(3).

Thus, the Provider asserts that the Intermediary's failure to compensate the owner for the additional hours worked constitutes a violation of program regulations.

The Provider adds that the Intermediary's own guidelines show that the restriction placed on the number of hours worked is arbitrary and unfounded. The Provider explains that the Intermediary's internal guidelines cite an example of their methodology in which an owner worked more than 2080 hours per year. In this example, the owner is compensated for the additional hours and no restrictions on hours worked seem to be in effect.¹⁷

The Provider rejects the Intermediary's reliance upon Medical Rehabilitation Services, P.C. (West Bloomfield, Mich.) v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Michigan, PRRB Dec. No. 84-D6, Nov. 9, 1983, Medicare & Medicaid Guide (CCH) ¶ 33,658 ("Medical Rehabilitation") since it is irrelevant and immaterial.¹⁸ The issue in Medical Rehabilitation was whether or not home health agencies and visiting nurse associations could be considered comparable institutions to outpatient physical therapy providers. The issue in the instant case is whether or not salary surveys were conducted, and whether or not the Intermediary used appropriate methodology for placing an owner within a salary range of comparable institutions.

The Provider also rejects the Intermediary's argument that it furnished no evidence to show that the subject adjustment was improper.¹⁹ In part, the Intermediary states:

[t]he Provider disagrees with the Intermediary's final adjustment and finds many flaws with the Intermediary's computations but did not provide adequate support that they had special characteristics or qualifications that would cause it to be unfair to be compared with other facilities in a similar region that provides [sic] the same type of service.

¹⁷ Exhibit P-2 at 46.

¹⁸ Provider's Position Paper at Response to Intermediary's Position Paper at Argument 1.

¹⁹ Provider's Position Paper at Response to Intermediary's Position Paper at Argument 2.

Intermediary's Position Paper at 6 (emphasis added).

In response, the Provider argues that it is not claiming "special characteristics or qualifications." Rather, the Provider merely wants to be assessed according to the program's regulations and manual instructions. The Intermediary has not followed these requirements in its evaluation of the compensation at issue.

Moreover, the Provider does not contend that it is "unfair" for it to be compared with other facilities in the region that provide similar services. In fact, the Provider maintains that it wants to be compared to other such facilities, but claims that the Intermediary and HCFA have failed to comply with the appropriate regulations which were developed to ensure accurate and fair assessment of an owner's compensation.

Also, the Provider rejects the Intermediary's claim that the Provider bears the burden for determining reasonable compensation in the absence of the Intermediary's and HCFA's compliance with program rules. The Provider argues that it does not have the resources nor the responsibility to gather the data needed to meet the requirements of the aforementioned regulations and manual instructions.²⁰

Finally, the Provider rejects any assertions made by the Intermediary that its owner's compensation is actually a distribution of profits. While the Provider agrees that its owner's salary is tied to the financial health of the company, the Provider also notes that all employees receive a year end bonus tied to the company's financial health.²¹

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that its adjustment to the Provider's compensation expense is proper. Program instructions at HCFA Pub. 15-1 § 905.1 require intermediaries to evaluate the reasonableness of owner's compensation and provide procedures for making that determination. In accordance with these instructions, the Michigan Study was used to evaluate the reasonableness of the Provider's costs and produced the subject adjustment.²²

The Intermediary contends that the Michigan Study is a reasonable approach to calculating owner's compensation. It was developed specifically to evaluate the reasonableness of costs incurred by outpatient physical therapy providers, and it is based upon data obtained from audits of providers located in Michigan. Moreover, the study provides salary ranges for different administrative positions (Administrator, Comptroller, etc.) as well as a schedule of

²⁰ Provider's Post Hearing Summary.

²¹ Provider's Post Hearing Summary--Addendum.

²² Intermediary's Position Paper at 5. Intermediary's Post Hearing Brief at 2.

allowances for direct therapy services. These guidelines are updated annually using an inflation factor provided by HCFA.²³

The Intermediary agrees that the Michigan Study does not reflect the exact methodology described in HCFA Pub. 15-1 § 900 for determining reasonable compensation. However, the Intermediary argues that the study does meet the requirements contained in the manual, in that it seeks to compare the owner's compensation at issue to the compensation paid similarly qualified non-owners working in similar institutions. This is accomplished by determining the appropriate salary for the subject owner, within the salary ranges provided in the study, using a point system that reflects the owner's educational background and experience, as well as the size and location of the Provider.²⁴ This information was obtained from the Provider using a questionnaire that was completed by its owner.²⁵

In support of the Intermediary's use of the Michigan Study, the Intermediary cites the Board's decision in Medical Rehabilitation. The Intermediary asserts that in that case the Board allowed the results of a survey of home health agencies and visiting nurses associations to evaluate administrative services. Moreover, the survey applied in that case involved the use of "cost of living index updates" to derive a current level of reimbursement.²⁶

The Intermediary contends that the owner's compensation at issue is not based upon the going rate for similar services provided in the area. As the Provider stated at the hearing before the Board, the owner's salary is determined by "what's left over at the end of the year."²⁷ The Intermediary asserts that to pay the owner "what's left over" is not compensation based upon necessary services but is a distribution of profits that is not allowed pursuant to 42 C.F.R. § 413.102.

The Intermediary contends that the Provider furnished no evidence to support its claim that the amount of owner's compensation at issue in this case is reasonable. Therefore, the only evidence before the Board supports the Intermediary's adjustment. The Intermediary explains that owner's compensation requires close scrutiny because there is no separation between the governing body that sets the compensation and the individual who receives it. Therefore, it is not sufficient for the Provider to argue that the subject adjustment is not reasonable. Rather, it

²³ Intermediary's Post Hearing Brief at 2.

²⁴ Id. Tr. at 22.

²⁵ Intermediary's Position Paper at 3. Exhibits I-2 and I-3.

²⁶ Intermediary's Position Paper at 5.

²⁷ Intermediary's Post Hearing Brief at 2. Tr. at 63.

is incumbent upon the Provider to support its claim.²⁸

Finally, the Intermediary acknowledges the Provider's argument that its owner works more than 2080 hours a year, and that factor was not considered in the Intermediary determination. In response, the Intermediary agrees to review its determination if substantial documentation is provided to support the number of hours claimed in excess of 2,080.²⁹

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Law - 42 U.S.C.:

§ 1395x(v)(1)(A) - Reasonable Cost

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

§§405.1835-.1841 - Board Jurisdiction

§413.9 - Cost Related to Patient Care

§413.102 et seq. - Compensation of Owners

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

§900 - Compensation of Owners

§904 - Criteria for Determining Reasonable Compensation-General

§904.1 - Factors to be Considered in Determining Comparability of Institutions

§904.2 - Factors to be Applied in Evaluating Compensation Within Range for Comparable Institutions

§905.1 - Procedures for Determining Reasonable Compensation-General

²⁸ Intermediary's Post Hearing Brief at 3.

²⁹ Intermediary's Position Paper at 5.

4. Program Instructions-Medicare Part A Intermediary Manual, Part 2 (HCFA Pub.13-2):

- | | | |
|-----------|---|---|
| §2120 | - | Compensation of Owners |
| §2120.1 | - | Procedures for Establishing Ranges |
| §2120.1 J | - | Utilization of Ranges by Intermediaries |

5. Case Law:

Medical Rehabilitation Services, P.C. (West Bloomfield, Mich.) v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Michigan, PRRB Dec. No. 84-D6, Nov. 9, 1983, Medicare & Medicaid Guide (CCH) ¶ 33,658.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, evidence presented, testimony elicited at the hearing, and post hearing briefs, finds and concludes as follows:

There are two distinct parts to the subject adjustment. One part is a reduction to the portion of owner's compensation attributed to administrative services, and the second part is a reduction to the portion of compensation attributed to professional services, i.e., physical therapy services rendered to patients.

There is a general lack of qualitative evidence supporting either party's contentions. The Intermediary's primary argument is that it is responsible for evaluating the reasonableness of owner's compensation and that the Michigan Study is an acceptable approach to accomplish that task. In response, the Provider challenges the accuracy and validity of the Michigan Study. In general, the Provider points out that program instructions, HCFA Pub. 15-1 § 904 and HCFA Pub. 13-2 § 2120 et. seq., require intermediaries to evaluate owner's compensation using guidelines issued by HCFA, not guidelines issued by another intermediary as is the case with the Michigan Study. Moreover, such guidelines are to be based upon survey data collected every 3 years as opposed to the data used to develop the Michigan Study which is approximately 16 years old. And, the point system used by the Intermediary to place the owner within the compensation range contained in the Michigan Study relies heavily upon a provider's size, which is incorrect. Pursuant to HCFA Pub. 15-1 § 900, "size" is a factor used to determine comparable institutions, not a factor used to place an individual within a specific range such as education and experience.

With respect to the adjustment made to the administrative services portion of the owner's compensation, the Board finds that the only quantitative evidence presented in this case is, in

fact, the Intermediary's application of the Michigan Study. Although the Board believes the Provider's general objections to the Michigan Study have merit, the Provider did not furnish any evidence to show that the amount of compensation claimed for the administrative duties performed by its owner are reasonable. The Board notes that regulations at 42 C.F.R. §413.102(c)(2) explain that the reasonableness of compensation claimed for program reimbursement may be determined by comparing it to the compensation paid for similar services in comparable institutions, or "it may be determined by other means." Id. Respectively, the Board finds that the Michigan Study, while not consistent with the program's instructions regarding comparable services and institutions, is a viable "other means" for evaluating owner's compensation absent other data. The Board concludes, therefore, that the Intermediary's adjustment to the administrative services portion of the owner's compensation at issue in this case is proper.

With respect to the professional services portion of the Intermediary's adjustment, the Board finds evidence in the record supporting the Provider's contention that the compensation paid to its owner is reasonable. The average compensation paid to the Provider for its professional services is \$68.48 per visit. This rate compares favorably with the fee paid by Blue Cross and Blue Shield of Michigan for outpatient physical therapy services provided during the same period, which is \$71.00 per visit. The Board notes that the Blue Cross rate is patterned after the way Medicare reimburses physical therapists.

Also, the average fee paid by Blue Cross and Blue Shield of Michigan for physical therapy services provided in hospital outpatient departments during the same period was \$569.89 per visit. While the Board does not purport that fees paid to hospitals have any direct correlation to the costs of a freestanding outpatient physical therapy facility or the compensation of its owner, the Board does believe the hospital fee is relevant to its analysis. In particular, the hospital fee shows that a reimbursement level far greater than that of the Provider's for like services can be considered reasonable.

Exhibit I-3 indicates that the owner worked a total of 2600 hours during the subject reporting period, and that 80 percent of this time, or 2080 hours, was spent performing professional services. The exhibit also shows that the owner was paid \$168,230 for these services, which equates to \$80.87 per hour in salary and fringe benefits. The Board believes this rate is more likely to reflect actual compensation levels for physical therapists than the \$25.18 per hour rate allowed by the Intermediary, which also includes fringe benefits.

In all, the Board finds this data compelling. It is contemporaneous to the subject reporting period and demonstrates that the compensation paid to the Provider's owner is in line with other payment and salary data within the physical therapy profession. As discussed above, the Board believes the Michigan Study can be a viable means to evaluate owner's compensation. However, the Board does not believe the Michigan Study is the best data presented in this case with respect to the professional services portion of the Intermediary's adjustment. In contrast to the data discussed herein, the Michigan Study is based upon survey

data collected approximately 16 years ago, which was updated to the subject reporting period through the application of inflation factors.

DECISION AND ORDER:

The Intermediary's adjustment is affirmed in part, and reversed in part. The Intermediary's adjustment to the administrative services portion of the owner's compensation at issue is proper and is affirmed. The Intermediary's adjustment to the professional services portion of the owner's compensation is improper and is reversed.

Board Members Participating:

Irvin W. Kues

James G. Sleep

Henry C. Wessman, Esq.

Martin W. Hoover, Jr., Esq.

Charles R. Barker

FOR THE BOARD:

Irvin W. Kues
Chairman