

**PROVIDER REIMBURSEMENT REVIEW BOARD  
 DECISION  
 ON THE RECORD  
 2003-D21**

**PROVIDER –**  
 AllCare Home Health, Inc.  
 Denver, Colorado

Provider No. 06-7201

**vs.**

**INTERMEDIARY –**  
 Cahaba Government Benefit  
 Administrators



**DATE OF HEARING-**  
 January 29, 2003

Cost Reporting Period Ended  
 May 31, 1998

**CASE NO.** 01-0153

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ISSUE:

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

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

AllCare Home Health, Inc. ("Provider") is a proprietary home health agency located in Denver, Colorado. For its cost reporting period ended May 31, 1998, the Provider claimed owner's compensation in the amount of \$200,930 for its Chief Executive Officer ("CEO") and \$171,048 for its Chief Financial Officer ("CFO"). The CEO and CFO are husband and wife and co-own the facility. The compensation amounts consist of the following:

	<u>CEO</u>	<u>CFO</u>
<u>Salary</u>	\$ 72,000	\$ 48,000
<u>Benefits</u>	38,416	25,611
<u>Deferred Salary (Bonus)</u>	<u>90,514</u>	<u>97,437</u>
Total Compensation	\$200,930	\$171,048

Cahaba Government Benefit Administrators ("Intermediary") audited the Provider's cost report for the subject reporting period and concluded that the bonuses paid to its owners were unallowable. The Intermediary compared the salary and benefits paid to the owners to reasonable cost guidelines contained in the Michigan Study and the Homecare Salary and Benefits Report and determined that those two components of compensation were reasonable. However, the Intermediary also compared the sum of the owners' bonuses to the total amount of their facility's reasonable costs, and to Medicare's reimbursable cost limitation. Based upon this comparison, the Intermediary determined that the bonuses were actually year-end payments reflecting the difference between the Provider's otherwise incurred costs and the cost limit. The Intermediary concluded, therefore, that the bonuses actually represented a return on equity capital, which is an unallowable expense.

On September 26, 2000, the Intermediary issued a Notice of Program Reimbursement perfecting an adjustment disallowing the owners' bonuses in the amount of \$187,951 (\$90,514 + \$97,437). On October 25, 2000, 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 Medicare funds in controversy is approximately \$165,000.<sup>1</sup>

The Provider was represented by Elizabeth Zink Pearson, of Pearson & Bernard PSC. The Intermediary was represented by Bernard M. Talbert, Esq., Associate Counsel, Blue Cross and Blue Shield Association.

<sup>1</sup> Provider's Supplemental Position Paper at 3. Intermediary Position Paper at 9.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary's adjustment is arbitrary and not in accordance with applicable laws and regulations governing owner's compensation.<sup>2</sup> The Provider contends that the subject adjustment is based upon interpretive findings and the Intermediary has presented no evidence to support its position. The Provider argues that the Intermediary: (1) tied the bonuses at issue to Medicare's cost limitations without any proof or argument or legal support for its argument, (2) asserts that the nature of bonuses should emanate from a well defined incentive plan, but presents no reference to a Medicare rule or program instruction, and (3) argues that the bonuses are "analogous to a return on equity," but with no evidence to support such a finding. The Provider asserts there is simply no evidence that the subject bonuses were made based upon anything other than long-standing procedures memorialized by its Board of Directors, and there is no rule that payments analogous to a return on equity are unallowable. Moreover, the Provider notes that the Board must comply with Medicare laws, regulations, and rulings as opposed to interpretive findings, pursuant to 42 C.F.R. § 405.1867.<sup>3</sup>

The Provider contends that the total amount of monies paid to its owners as compensation, including the bonuses, is reasonable. Therefore, it is entitled to be reimbursed for these costs pursuant to 42 U.S.C. §1395x(v)(1)(A), (providers are reimbursed their "reasonable cost"); 42 C.F.R. § 413.102, (reasonable cost includes "a reasonable allowance of compensation for services of owners,") and program instructions at Provider Reimbursement Manual, Part I (HCFA Pub. 15-1) § 902.3, stating in part:

compensation allowance be such an amount as would ordinarily be paid for comparable services by comparable institutions depending upon the facts and circumstances of each case. Reasonable compensation is limited to the fair market value of services rendered by the owner in connection to patient care . . . as determined by supply and demand factors of the open market.

HCFA Pub. 15-1 § 902.3.

The Provider rejects the Intermediary's argument regarding its failure to base the subject bonuses on an existing, established bonus plan. The Provider asserts that it did in fact have a bonus plan.<sup>4</sup> Notwithstanding, the Provider argues there still exists no pre-

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<sup>2</sup> Provider's Supplemental Position Paper at 7.

<sup>3</sup> Provider's Supplemental Position Paper at 8.

<sup>4</sup> Exhibit P-5.

ordained program rule or procedure for the calculation of bonuses for owners or employees.<sup>5</sup> The Intermediary's argument that the bonuses must be disallowed on the basis that there was no "well-stated" bonus plan is contrary to the facts and applicable rules and regulations.

Finally, the Provider acknowledges but rejects the findings in AllCare Home Health Inc. v. Blue Cross and Blue Shield Association/Wellmark Blue Cross and Blue Shield, PRRB Dec. No. 2000-D9, December 9, 1999, Medicare & Medicaid Guide (CCH) ¶ 80,384, decl'd rev., CMS Administrator, February 1, 2000, aff'd., sub nom., AllCare Home Health, Inc. v. Shalala, No. 00-k-307 (D.C. Colo. Aug. 9, 2000), Medicare & Medicaid Guide (CCH) ¶ 300,525, aff'd., No. 00-1405 (10<sup>th</sup> Cir. Dec. 14, 2001) ("AllCare"), that payments characterized as bonus would be unallowable costs based upon the theory that they were analogous to a return on equity.

Again, the Provider asserts there is no law, regulation or program instruction supporting this conclusion. Moreover, the Provider asserts that here, as in AllCare, there was no accrued equity available for distribution in accordance with the actual rules on return of equity contributions. 42 C.F.R. § 413.157(c); HCFA Pub. 15-1 § 902.2. In all, the Provider believes the Intermediary is attempting to establish the Board's factual finding from the prior Allcare case as precedent, which is impermissible and legally invalid.

#### INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that the owners' bonuses represent a return on equity capital, an unallowable expense, based upon the fact that they are approximately 50 percent of the total compensation paid to the owners. During the subject cost reporting period the bonuses amounted to \$187,951, and the owners' total compensation amounted to \$371,978.<sup>6</sup> Moreover, since the variance between the Provider's reimbursable cost and Medicare's cost limit is only .009, the Intermediary concludes that the bonuses were calculated based upon the cost limit computation.

The Intermediary notes that the bonuses paid to the Provider's employees ranged from \$75 to \$500. This is unlike the bonuses paid to the owners (\$187,951), which represent 91 percent of the total amount of bonuses paid (\$205,500).<sup>7</sup> The Intermediary also notes that the Provider supplied no information related to its policy of issuing bonuses.

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<sup>5</sup> Provider's Supplemental Position Paper at 14.

<sup>6</sup> Intermediary Position Paper at 9.

<sup>7</sup> Exhibit I-7 at 3.

The Intermediary contends that its adjustment complies with Medicare regulations at 42 C.F.R. § 413.9 - Cost Related to Patient Care, 42 C.F.R. § 413.102 - Compensation of Owners, and 42 C.F.R. § 413.157- Return on Equity Capital of Proprietary Providers, as well as HCFA Pub. 15-1 § 900 - Compensation of Owners.

The Intermediary cites 42 C.F.R. §§ 413.102(b)(1) and (2), which state:

- (1) Compensation means the total benefit received by the owner for services he furnishes to the institution . . . .
- (2) Reasonableness requires that the compensation allowance--
  - (i) Be such an amount as would ordinarily be paid for comparable services by comparable institutions; and
  - (ii) Depend upon the facts and circumstances of each case.

42 C.F.R. §§ 413.102(b)(1) and (2).

The Intermediary notes that the regulation goes on to state:

[o]rdinarily, compensation paid to proprietors is a distribution of profits. However, where a proprietor renders necessary services for the institution, the institution is in effect employing his services, and a reasonable compensation for these services is an allowable cost.

42 C.F.R. § 413.102(c)(2).

Moreover, 42 C.F.R. § 413.157(b)(5)(ii) states:

[f]or cost reporting periods beginning on or after July 6, 1987, there is no allowance for return on equity capital for nonhospital and non-SNF providers.

42 C.F.R. § 413.157(b)(5)(ii).

And, clarifying instructions at HCFA Pub. 15-1 § 902.2 state:

[p]ayments found to represent a return on equity capital are not compensation and are in no event allowable as an item of reimbursable cost. Nor are such payments considered as

compensation for purposes of determining the reasonable level of reimbursement of the owner.

HCFA Pub. 15-1 § 902.2.

Respectively, the Intermediary asserts that the employees in question are the Provider's owners and are subject to the regulations and manual instructions concerning owner's compensation and return on equity capital, noted above. The Intermediary further asserts that Medicare's cost limits do not create payment entitlement. Payments in the nature of a bonus should emanate from a well-defined incentive plan with clear standards. The Provider did not supply any documentation related to having a plan for issuing bonuses.

Finally, the Intermediary cites the Board's decision in AllCare finding that the bonus payments claimed as owner's compensation for the subject CEO and CFO in a prior cost reporting period were analogous to a return on equity capital and were unallowable. The Intermediary notes the Board's decision in AllCare was affirmed by the Tenth Circuit Court of Appeals.<sup>8</sup>

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the parties' contentions and evidence presented, finds and concludes as follows:

The total compensation amounts claimed by the Provider for its two owners who function as the Provider's CEO and CFO, are as follows:

	<u>CEO</u>	<u>CFO</u>
<u>Salary</u>	\$ 72,000	\$ 48,000
<u>Benefits</u>	38,416	25,611
<u>Deferred Salary (Bonus)</u>	<u>90,514</u>	<u>97,437</u>
Total Compensation	<u>\$200,930</u>	<u>\$171,048</u>

With respect to the claimed bonus payments, the Board finds no evidence in the record to support the existence of a formalized incentive program that would validate the sizeable bonus payments claimed by the owners for services rendered in their respective management positions. Rather, the Board finds the most persuasive evidence in this case, i.e., regarding how the bonus amounts were derived, stems from testimony elicited from the Provider's CEO at the Board hearing held on January 28, 1999, regarding this very same issue in the Provider's 1996 cost reporting period.<sup>9</sup> The Board believes the

<sup>8</sup> Exhibit I-16.

<sup>9</sup> The Provider submitted testimony from the prior hearing as evidence in the instant case. Exhibit P-3 at 227.

following excerpts from that testimony clearly reflect the character of the bonus payments claimed by the Provider:

By Mr. Talbert:

- Q. When you referred to looking at the agency's profit to determine additional compensation over the base salary, what did you mean?
- A. I don't mean profit. I mean, if you have -- if you're still going to be well beneath the caps and you realize that you have some key employees that you didn't give a raise to, how you compensate different people, including ourselves. That's what I'm referring to.
- Q. So you used the cap, the cost caps, the difference between your costs as they're developed on a periodic basic basis, including the base salary, and the cost caps to determine some type of additional amounts to use as raises or bonuses? Is that correct?
- A. Not for the salary purpose. But, essentially, we know -- we don't know from day one where we're going to be. And so we've already allocated, even from my salary, roughly what I should be making. So rather than --
- Q. When you say roughly what you should be making, what number are you referring to? The \$72,000?
- A. Based on the previous year.
- Q. Okay.
- A. So, rather than changing the payroll and getting into a problem later, we make the adjustments either once a year or twice a year.
- Q. Your bonus was paid, if I understand the testimony, or the presentation of your case, the bonus that you and Mrs. Bhasin received came out of a \$153,000 bonus accrual that took place at the end of the fiscal

period. Is that correct?

A. That's correct.

Q. How is that \$153,000 determined in total?

A. Essentially, it was a joint discussion between Mr. Baird, Mrs. Bhasin and myself.

Q. But, is there some written agency policy that describes the bonus program and how it's to be computed?

A. I'm not sure.

AllCare Transcript at 62-64.

The Board finds the above testimony provides substantial evidence that the bonus payments claimed as owner's compensation for the CEO and CFO resulted from the Provider's year-end analysis of its actual reportable costs versus the maximum amount of program reimbursement obtainable without exceeding the Medicare cost limits. Accordingly, the Board concludes that such payments are analogous to the payment of a return on equity capital to the owners of the home health agency and should not be treated as allowable compensation in the determination of the Provider's reasonable cost. Under the provisions of 42 C.F.R. § 413.102(c)(2) and HCFA Pub. 15-1 § 902.2, the bonus payments of \$187,951.00 claimed by the Provider for its CEO and CFO are not compensation amounts for purposes of determining the reasonable level of reimbursement for the services provided by the owner.

The Board acknowledges the Provider's argument that the total amount of compensation claimed by the two subject individuals is "reasonable" based upon established Medicare rules and should therefore be reimbursed by the program. The Board finds, however, that "reasonableness," as that term applies to owner's compensation, is not at issue in this case; rather the issue is precisely the nature of the subject bonus payments and their status as allowable or unallowable program costs.

Similarly, the Board acknowledges the Provider's argument that the Board must recognize only Medicare's reasonable compensation rules that have been formally promulgated. It argues that the Board must reject the Intermediary's position that payments "analogous" to a return on equity are unallowable; because payments "analogous. . ." are not specifically addressed by the Medicare regulation but are an interpretation. The Board, however, disagrees. The Board finds that program instructions at HCFA Pub. 15-1 § 902 are consistent with the regulation and provide latitude regarding return on equity capital determinations. In part, the instructions state "payments found to represent a return on equity capital are not compensation and are in no event

allowable as an item of reimbursable cost.” Id. (Emphasis added). Moreover, the Board finds that the Tenth Circuit Court of Appeals addressed this exact matter in AllCare supra, and confirmed the Board’s conclusions in that case. In part, the court states “ [t]hese admissions support the PRRB’s determination that the bonuses were analogous to a return on equity and therefore not allowable.”

DECISION AND ORDER:

The Intermediary’s adjustment disallowing bonuses paid to the Provider’s CEO and CFO from allowable program costs is proper. The Intermediary’s adjustment is affirmed.

Board Members Participating:

Suzanne Cochran, Esq.  
Henry C. Wessman, Esq.  
Dr. Gary Blodgett  
Martin W. Hoover, Jr., Esq.

Date of Decision – March 21, 2003

FOR THE BOARD:

Suzanne Cochran  
Chairman