

# PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2005-D50

**PROVIDER -**  
Hillcrest Baptist Medical Center  
Waco, Texas

Provider No.: 45-0101

**vs.**

**INTERMEDIARY -**  
BlueCross BlueShield Association/  
TrailBlazer Health Enterprises, LLC

**DATE OF HEARING -**  
September 2, 2004

Cost Reporting Period Ended -  
August 31, 1986

**CASE NO.:** 89-1584

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ISSUES:

1. Whether capitalized interest that may have been amortized in future years can be expensed in the current year when future cost reports are no longer subject to reopening.
2. Whether the Intermediary's determination of allowable interest expense which deducted Hillcrest Medical Tower (HMT) interest from allowable versus total expense is proper.

MEDICARE STATUTORY AND REGULATORY BACKGROUND:

This is a dispute over the amount of Medicare reimbursement due a provider of medical services.

The Medicare program was established to provide health insurance to the aged and disabled. 42 U.S.C. §§1395-1395cc. The Centers for Medicare and Medicaid Services (CMS), formerly the Health Care Financing Administration (HCFA), is the operating component of the Department of Health and Human Services (DHHS) charged with administering the Medicare program. CMS' payment and audit functions under the Medicare program are contracted out to insurance companies known as fiscal intermediaries. Fiscal intermediaries determine payment amounts due the providers under Medicare law and under interpretive guidelines published by CMS. See, 42 U.S.C. §1395(h), 42 C.F.R. §§413.20(b) and 413.24(b).

At the close of its fiscal year, a provider must submit a cost report to the fiscal intermediary showing the costs it incurred during the fiscal year and the proportion of those costs to be allocated to Medicare. 42 C.F.R. §413.20. The fiscal intermediary reviews the cost report, determines the total amount of Medicare reimbursement due the provider and issues the provider a Notice of Program Reimbursement (NPR). 42 C.F.R. §405.1803. A provider dissatisfied with the intermediary's final determination of total reimbursement may file an appeal with the Provider Reimbursement Review Board (Board) within 180 days of the issuance of the NPR. 42 U.S.C. §1395oo(a); 42 C.F.R. §405.1835.

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Hillcrest Baptist Medical Center (Provider) is a general short-term hospital located in Waco, Texas. The Provider renovated its hospital and built a medical office building. During the fiscal years in issue, Medicare shared in the Provider's capital costs by reimbursing its share of depreciation, interest and other related capital costs. This case involves how those capital expenses are accounted for in the cost report.

Issue 1: Renovation Interest – Current Expense v. Capitalized

The parties stipulated to the following material facts:

1. The Series 1984 bond proceeds funded the construction project in the amount of \$22,105,000, including the following items:
 

• New Construction	\$11,676,000
• Equipment	3,266,000
• Professional Fees	1,340,000
• Renovation Costs	4,617,000
• Contingency	<u>1,206,000</u>
• Total	\$22,105,000
  
2. The parties agree to the construction – in – progress (CIP) schedule of completion amounts and timing, as set forth in Provider Exhibit P-60 and the calculation of the 43.5% expense ratio before considering renovations.
  
3. The parties acknowledge that the use of estimated percentages of completion for the financial statements and related disclosure (footnote 6) is in accordance with GAAP FASB 34 (see Provider Exhibit P-24) [sic]<sup>1</sup> since the differences would not have a material impact on the audited financial statements. In addition, the parties agree that Medicare has not adopted FASB 34, and Medicare requires that the actual capitalization percentages be used in determining the interest cost to be expensed and capitalized in the cost report.
  
4. The parties agree with the total renovations amount of \$4,729,569 and the methodology used in the determination of the interest expense ratio of renovations which yielded an additional expense ratio of 29.0% as set forth in Section 3.5-2 and Table 3 of the Provider’s Final Position Paper. This results in a final expense ratio of 72.5% (sum 43.5% per item 2 above plus the 29.0% for renovations).
  
5. The parties agree that the amount of interest expense capitalized on renovations that should have been expensed was \$1,266,485 (29.0% x \$4,367,191 total interest cost).

None of the interest related to the renovations addressed in Stipulation #5 above was included in the Provider’s fiscal year ended August 31, 1986 (FY 86) cost report as part of allowable interest expense. Since the \$4.7 million of renovations were completed in FY 86, the Provider is requesting that 29% of the total 1986 interest (\$1,266,485) be allowed as part of the current year’s interest expense.

TrailBlazer Health Enterprises (Intermediary) argues that since all interest expense for FY 86 has been accounted for and either capitalized or expensed, any capitalized interest

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<sup>1</sup> FASB 34 is at Exhibit P-20 to the Provider’s final position paper.

in future years (FY 87-FY 89) could not be reduced in those years because the Intermediary was barred from reopening the Provider's cost report due to regulatory limitations. Further, the Intermediary believes that all capitalized interest has been recouped through the Provider's depreciation allowances after the Provider's facilities were put into service.

#### Issue 2 – Hillcrest Medical Tower (HMT) Interest Offset Calculation

The Parties agree that audit adjustment number 3 properly disallowed \$175,470 in interest expense claimed for Hillcrest Medical Tower (HMT), a non-allowable medical office building. They also agree that audit adjustment number 52 properly offsets additional non-allowable interest expense of \$3,074. Prior to the hearing, however, the Provider challenged the methodology employed by the Intermediary to compute allowable current year and capitalized interest. The Intermediary's computation deducted the audit adjustments (3 and 52) from allowable current year interest expense. The Provider argues that the adjustments should have been deducted from total interest expense first, with the balance of allowable interest expense being allocated between current year interest expense and capitalized interest. The reimbursement impact using the Provider's computation methodology is an increase of approximately \$17,381.

The Provider appealed the Intermediary's determination to the Board and met the jurisdictional requirements of 42 C.F.R. §§405.1835 – 405.1841. The Provider was represented by Lance S. Loria, C.P.A., of Loria Associates, Inc. The Intermediary was represented by James R. Grimes, Esquire, of Blue Cross Blue Shield Association.

#### FINDINGS OF FACT, CONCLUSION OF LAW AND DISCUSSION:

The Board, after considering the Medicare law, program instructions, the evidence and the parties' contentions, finds and concludes as follows:

##### Issue 1 – Current Expense v. Capitalized

Interest expense incurred in 1986 relating to renovation expense incurred that year is not allowable as a current operating expense.

The Board's decision on the treatment of the \$1.2 million of interest related to the \$4.6 million of renovations completed in FY 86 is based on what the Provider actually did in recording interest expense on its books and the Medicare cost report as opposed to what the Provider now wishes to do based on its re-examination of the facts relating to its renovations. The Board observes that the Provider chose to capitalize all of the interest expense relating to the new construction and renovations of its campus. The Intermediary accepted the Provider's treatment of this expense and did not challenge the Provider's original approach of calculating interest related to the renovations. The Board finds that the Provider, therefore, elected an accounting treatment that did not take advantage of Medicare's more favorable reimbursement policy of allowing interest expense for renovations in the year in which the cost is incurred. Instead, the Provider

chose to capitalize the interest expense as part of the cost of renovations, thereby deferring the related reimbursement to future years when depreciation would be allowed over the useful life of the renovations. The Intermediary contends that the Provider is bound to continue using the same methodology and the Board concurs. The Provider is made whole and reimbursed over the life of the facility. The Intermediary has clearly shown that all interest expense incurred was accounted for from 1986 – 1988. That interest was allocated between current and capitalized interest based on undisputed percentages. Further, when the facilities were put into use, the Provider was reimbursed capitalized interest through its depreciation allowance. Therefore, the Provider's concerns over whether capitalized interest was included in the 1987-1990 cost reports and the Intermediary's concern that, if the disputed interest on renovations were allowed, the 1987-1990 cost reports could not be reopened to remove the same interest claimed in later years under 42 C.F.R. §405.1855, is now moot. Finally, the Board concludes that the Provider's original decision to capitalize all renovation interest resulted in the appropriate payment of interest made over the long-term via the Provider's depreciation allowance.

#### Issue 2 – HMT Offset Calculation

The Intermediary concurs with the Provider's proposed offset methodology and the mechanics of the calculation as proposed by the Provider in exhibit P-81. However, the Intermediary does not agree that a 72.5% completion percentage should be applied to determine allowable interest expense. The Intermediary has only agreed to use a 43.5% completion ratio (page 5 of the Intermediary's post-hearing brief). Since the Provider offered no argument as to why the revised ratio was more appropriate, and the burden of proof to support the allowability of costs and related allocations is on the Provider, the Board concludes that the Intermediary's percentage used to calculate current interest to expense is reasonable and acceptable.

#### DECISION AND ORDER:

##### Issue 1 – Current Expense v. Capitalization

The interest expense related to the 1986 renovations remains part of capitalized interest and cannot be considered a current expense in 1986. The Intermediary's acceptance of the Provider's original treatment of this cost is affirmed.

##### Issue 2 – HMT Offset Calculation

The 43.5% used by the Intermediary to allocate the current period portion of interest expense is reasonable and allowable. The Intermediary calculation is affirmed.

BOARD MEMBERS PARTICIPATING:

Suzanne Cochran, Esquire  
Martin W. Hoover, Jr., Esquire  
Gary B. Blodgett, D.D.S.  
Elaine Crews Powell, C.P.A.  
Anjali Mulchandani-West

FOR THE BOARD:

DATE: August 11, 2005

Suzanne Cochran  
Chairperson