

**PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION**

ON-THE-RECORD
98-D21

PROVIDER -Emanuel Medical Center
Turlock, California

DATE OF HEARING-
December 16, 1997

Provider No. 05-0179

Cost Reporting Period Ended -
January 31, 1987

vs.

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

CASE NO. 89-2023

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ISSUE:

Was the Intermediary's adjustment to the amortization of the loss on the sale of Turlock Community Hospital proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Emanuel Medical Center ("Provider" or "EMC") is an urban, short term general acute district hospital located in Turlock, California. The Provider purchased Turlock Community Hospital ("Turlock" or "TCH") from National Medical Enterprises, Inc., on June 1, 1977. The Turlock facility was a 39-bed acute hospital also located in Turlock, California.

The Provider ceased operations at the Turlock facility on January 31, 1981. The 39-beds at the Turlock facility were transferred to a new wing at the Provider. The Provider sold Turlock on March 3, 1981; the loss incurred on the sale was approximately \$450,000.¹ During the Medi-Cal audit of Turlock's 1981 cost report, the California Department of Health Services capitalized the computed loss on the sale of Turlock to the new wing at the Provider.² The remaining useful life of the new wing at the Provider, at the end of the fiscal year 1981, was 20 years. Therefore, the amortized loss on sale of the Turlock facility for a fiscal year is approximately \$22,500 (\$450,000/20 years).

Blue Cross of California ("Intermediary") disallowed \$22,500 of the amortized loss on sale of the Turlock facility claimed in the as-filed January 31, 1987 Medicare cost report because the Provider did not apply the prudent buyer concept at the time of the sale.³ The Provider timely appealed the Intermediary's adjustment to the Provider Reimbursement Review Board ("Board") and has met the jurisdictional requirements of 42 C.F.R. §§ 405.1835-.1841.⁴ The amount of Medicare reimbursement in dispute is approximately \$10,000.⁵ The Provider was represented by Withbert W. Payne of Starcare International, Inc. The Intermediary was represented by Bernard Talbert, Esquire of Blue Cross and Blue Shield Association.

¹ The loss was computed based on Medi-Cal utilization and was not challenged by the Intermediary in the record. Provider Supplemental Position Paper Exhibit P-2, Intermediary Position Paper Exhibit I-9.

² Provider Supplemental Position Paper at 2.

³ The record indicates this adjustment was consistent with prior years' adjustments by the Intermediary on the same issue. Intermediary Exhibit I-9, Pg. 10 of 10.

⁴ All other issues on the Provider's original appeal have either been withdrawn, administratively resolved or transferred to existing group appeals.

⁵ Intermediary Position Paper at 5, Provider Position Paper at 27.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary was incorrect in disallowing the amortized loss on sale of the Turlock facility claimed in the filed cost report for the fiscal year 1987. The Provider explains that in 1981, the Department of Health Services (Medi-Cal Audit) capitalized the loss on the sale of specific assets with regards to the sale of the Turlock facility.⁶ The Provider subsequently appealed the Medi-Cal capitalization adjustment. The Provider further explains that the Administrative Law Judge held that "although there was a bona fide sale of land, there was not a bona fide sale of the building. The building was abandoned by the Provider. It was also found that this abandonment was approved by the Office of Statewide Health Planning and Development and, therefore, the loss suffered by the Provider is governed by 42 C.F.R. § 405.415 (f)(5)(iv)(A)⁷ and Provider Reimbursement Manual, Part I (HCFA Pub. 15-1) § 132A.3a(3)(a)."⁸

In finalizing the cost report for Turlock for the fiscal year ended January 31, 1981, Medi-Cal Audit excluded the loss on the sale of the said facility indicating that the loss on the sale of the facility should be capitalized as part of the costs of the new wing of the Provider. The audit adjustment⁹ specifically stated:

[t]o capitalize, to the new wing at EMC, the computed loss on sale of TCH. The new wing is considered a replacement as a deferred charge and amortized over the estimated useful life of the replacement asset (HIM-15 Section 132.A.39(3)(b)).

The Provider contends that the Intermediary's basis for disallowing the loss on the sale of the Turlock facility, pursuant to 42 C.F.R. § 413.134 and the Provider Reimbursement Manual HCFA Pub. 15-1 §§ 132.4 and 2103, is without merit.¹⁰ Regulation 42 C.F.R. § 413.134(f)(8) and HCFA Pub. 15-1 § 132.4 state that:

[i]f a provider sells a replacement or restored asset while participating in the Medicare program or within 1 year immediately following the date on which it terminates its participation in the Medicare program, the unrecovered loss

⁶ Provider Supplemental Position Paper at 1.

⁷ The regulation at issue here was renumbered: 42 C.F.R. § 405.415 (f)(5)(iv)(A) was renumbered as 42 C.F.R. § 413.134 (f)(5)(iv)(A).

⁸ Provider Supplemental Position Paper at 2.

⁹ Id. at Exhibit P-1.

¹⁰ Id. at 3.

entered on the books of the Provider as a deferred charge in accordance with paragraphs (f)(5) and (6) of this section will not be included in determining the gain or loss realized from the sale of the replacement or restored asset.

42 C.F.R. § 413.134(f)(8) emphasis added.

The Provider contends the above citation has no bearing to this case since the building that was sold is not a replacement or restored asset.

The Provider rejects the Intermediary's contention that it did not apply the prudent buyer concept in this case. The Provider points out that Intermediary concluded that it was not applying the prudent buyer concept based on the following comments:

Facts Relating to Turlock Community Hospital:

1. EMC purchased TCH on June 1, 1977.
2. TCH showed a profit from operation for the last two years.
3. The property sales agreement stated that the property is restricted from activities which are in direct or indirect competition with Emanuel Medical Center.
4. EMC let the building go at 0.

Intermediary Exhibit I-9, Provider Supplemental Position Paper Exhibit P-3.

The Provider points out that the property sales agreement¹¹ for Turlock stated that “[t]he \$175,153 is for the land; we place no value on the hospital facility because the purchaser will have to pay for the cost of demolition. . . .” The Provider asserts this is a normal business transaction. The Provider was aware that only the land had real value for the new owner. It would be imprudent for the Provider to set a price for a building that would be demolished.

The Provider contends that it has not violated the prudent buyer concept because of the following economic and business reasons:

1. It would be economical and cost effective for the Provider to operate the additional 39 beds in one location which is Emanuel Medical Center.

¹¹ Provider Supplemental Position Paper Exhibit P-4.

2. The additional agreement that the property (Turlock) is restricted from activities which are in direct or indirect competition with the Provider is a prudent business decision that has financial future benefits.

Provider Supplemental Position Paper at 5.

The Provider contends the amortized cost on the loss incurred on the sale of Turlock is supported by regulation 42 C.F.R. § 413.134. The Provider notes that 42 C.F.R. § 413.134(f) on Gains and Losses on Disposal of Assets -1 General states that:

[d]epreciable assets may be disposed of through sale, scrapping, trade-in exchange, demolition, abandonment, condemnation, fire, theft, or other casualty. If disposal of a depreciable asset results in a gain or loss, an adjustment is necessary in the provider's allowable cost. The amount of a gain included in the determination of allowable cost shall be limited to the amount of depreciation previously included in Medicare allowable costs. The amount of a loss to be included shall be limited to the undepreciated basis of the asset permitted under the program. The treatment of the gain or loss depends upon the manner of disposition of the asset, as specified in paragraphs (f)(2) through (f)(6) of this section.

Id.

The Provider further explains that 42 C.F.R § 413.134(f)(2) on “Bona Fide Sale or Scrapping” states that:

gains and losses realized from the bona fide sale or scrapping of depreciable assets are included in the determination of allowable cost only if the sale or scrapping occurs while the provider is participating in Medicare. The extent to which such gains and losses are included is calculated by prorating the basis for depreciation of the asset in accordance with the proportion of the assets' useful life for which the provider participated in Medicare.

Id.

The Provider contends the Intermediary's treatment of not recognizing the loss in any form is unreasonable and not in accordance with the above Medicare regulations. It is the Provider's position that the loss on the sale of Turlock could be treated in any of the following options:¹²

1. Recognition of the loss on sale of Turlock (\$450,000) in the year it was incurred (1981), or,

¹² Provider Supplemental Position Paper at 7.

2. Amortization of the loss on sale for twenty (20) years, the estimated remaining life of the new wing at the Provider; or,
3. The net loss realized must be capitalized as a deferred charge and amortized over the remaining life of the demolished or abandoned asset, or at a rate of \$5,000 per year (HIM 15-1 § 132.3a (3)(a)). However, since Turlock ceased participation in the Medicare/Medi-Cal programs, under GAAP, deferred charges could be expensed in the year a provider terminates participation in the Medicare/Medi-Cal program.

In summary, the Provider requests the Board to instruct the Intermediary to reopen the cost report to (i) properly treat the amortized loss on sale of the Turlock; or (ii) to reopen the 1981 cost report to recognize the loss on sale of Turlock in the amount of \$450,000.

INTERMEDIARY'S CONTENTIONS:

The Intermediary explains it disallowed \$22,500 of the amortized loss on the sale of Turlock, claimed in the Provider's as-filed cost report, because the Provider did not apply the prudent buyer concept.¹³ The prudent buyer concept, as indicated by HCFA Pub. 15-1, § 2103, states that, "[t]he prudent and cost-conscious buyer not only refuses to pay more than the going price for an item or service, he also seeks to economize by minimizing cost."

The Intermediary rejects the Provider's contention that it was incorrect in disallowing the amortized loss on the sale of Turlock, pursuant to 42 C.F.R. § 413.134(f) which states:

[d]epreciable assets may be disposed of through sale, scrapping, trade-in exchange, demolition, abandonment, condemnation, fire, theft, or other casualty. If disposal of a depreciable asset results in a gain or loss, an adjustment is necessary in the provider's allowable cost. The amount of a gain included in the determination of allowable cost shall be limited to the amount of depreciation previously included in Medicare allowable costs. The amount of a loss to be included shall be limited to the undepreciated basis of the asset permitted under the program. The treatment of the gain or loss depends upon the manner of disposition of the asset, as specified in paragraphs (f)2 through (f)6 of this section.

Id.

The Provider asserts, however, that the loss should be included in reimbursable costs, pursuant to 42 C.F.R. § 413.134(f)(2), which states in part:

¹³ Intermediary Position Paper at 21.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND DISCUSSION:

The Board, after consideration of the controlling law, regulations, facts of the case, parties' contentions, and evidence presented makes the following findings of fact and conclusions of law.

The Board finds there was a bona fide sale of Turlock Community Hospital by the Provider that resulted in a loss on the disposal of depreciable assets which the Provider properly claimed in accordance with governing regulations at 42 C.F.R. § 405.415(f). The Board finds that while the loss was recorded in the financial records of Turlock, Emanuel Medical Center was the surviving Provider after the sale and it assumed the loss. The Board also finds there is evidence in the record that an abandonment of the building occurred in accordance with 42 C.F.R.

§ 405.415(f)(5).¹⁵ The Board further finds that the parties are in agreement as to the loss on the sale of approximately \$450,000.

The Provider claimed that the abandonment was approved by the Office of Statewide Health Planning and Development and the Intermediary does not dispute this claim. Therefore, the Board finds an abandonment occurred on the sale of Turlock and, accordingly, the loss is governed by either 42 C.F.R. § 405.415 (f)(5)(iii) or (iv). The application of paragraph (iii) or (iv) is dependent on whether the abandoned assets are at least 80 percent depreciated. The record is unclear as to whether the abandoned assets are at least 80 percent depreciated. Therefore, the Intermediary is directed to examine the depreciation records of the Provider to determine whether paragraph (iii) or (iv) applies.

The Board disagrees with the Intermediary's contention that since the Provider did not exercise the prudent buyer concept, all losses should be disallowed. There is no documentation in the record to support the Intermediary's contention. On the contrary, the Board notes that the Provider has provided documentation¹⁶ to substantiate its position that it acted as a prudent buyer during the Turlock transaction.

The Board also disagrees with the Intermediary's argument that losses should be disallowed in accordance with 42 C.F.R. § 413.134(f)(8) and HCFA Pub. 15-1, § 132.4, Sale of replacement or restored assets. As noted above, the Board has concluded that an abandonment and not a sale of a replacement asset has occurred.

¹⁵ Provider Supplemental Position Paper at 2.

¹⁶ Id. at 5.

DECISION AND ORDER:

The Intermediary's adjustment improperly disallowed the loss claimed by the Provider on the sale of Turlock Community Hospital and is reversed. The Intermediary is directed, as discussed above, to examine the depreciation records of the Provider and determine whether paragraph (iii) or (iv) of 42 C.F.R § 405.415(f)(5) applies and calculate the appropriate disposition of the loss to be allowed.

Board Members Participating:

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

FOR THE BOARD:

Irvin W. Kues
Chairman