PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

99-D59

PROVIDER -
Bryn Mawr Terrace
Convalescent Center
Bryn Mawr, Pennsylvania

Provider No. 39-5095

vs.

INTERMEDIARY -
Blue Cross and Blue Shield
Association/Veritus Medicare Services

DATE OF HEARING-
October 14, 1998

Cost Reporting Period Ended -
December 31, 1994

CASE NO. 97-0139

INDEX

ISSUES:

1. Was the Intermediary's reclassification of employment taxes proper?
2. Was the Intermediary's adjustment to owner's compensation proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Bryn Mawr Terrace Convalescent Center ("Provider") is a skilled nursing facility located in Bryn Mawr, Pennsylvania. For the fiscal year in contention, the Provider filed its Medicare cost report claiming costs associated with the above-stated issues. Upon audit of the cost report, Blue Cross and Blue Shield Association/Veritus Medicare Services ("Intermediary") issued a Notice of Program Reimbursement which included various adjustments to these claimed costs. The Provider appealed the Intermediary's determinations to the Provider Reimbursement Review Board ("Board") under the provisions of 42 C.F.R. §§ 405.1835-.1841 and has met the jurisdictional requirements of those regulations. The aggregate amount of Medicare reimbursement in controversy is approximately $31,000.

The Provider was represented by Stevan P. Gottlieb, CPA, of Gottlieb & Associates, P.C. The Intermediary's representative was James R. Grimes, Esquire, of the Blue Cross and Blue Shield Association.

Issue 1 - Employment Taxes:

The Provider included employment related taxes, i.e. FICA taxes, in the administrative and general ("A&G") cost center on its filed cost report. The Intermediary made an adjustment to reclassify these taxes from the A&G cost center to the employee benefits cost center. The reimbursement effect of this adjustment was about $18,000.

PROVIDER'S CONTENTIONS:

The Provider contends that employment related taxes are considered business expenses of the employer and are includable in their entirety as part of administrative costs classified in the A&G cost center. In support of this position, the Provider cites the provisions of § 2122.3 of the Provider Reimbursement Manual ("HCFA Pub. 15-1") which states:

> Employment-Related Taxes--Provider-Based Physicians.---
> Employment-related taxes, i.e., FICA, Workers' Compensation and Unemployment Compensation, which are paid by a provider on behalf of a provider-based physician, are considered business expenses of the employer and not fringe benefits (§ 2108.3C1). Hence, they are includable in their entirety as part of the administrative cost of the

> provider, without allocation to the physician's professional component, and reimbursable to the provider on a reasonable cost basis.

HCFA Pub. 15-1 § 2122.3.

While this manual provision applies to provider-based physicians, the Provider believes the nature of the costs should not change based upon the classification of the employee. The Provider rejects the Intermediary's assertion that employment related taxes are a fringe benefit that should be allocated based on the associated salaries of the employees. Contrary to the Intermediary's inclination, HCFA Pub. 15-1 does not state that payroll taxes are fringe benefits. Moreover, the provisions of HCFA Pub. 15-1 § 2144.1 define fringe benefits as "amounts paid... from which the employee, his/her dependent... or his/her beneficiary derives a personal benefit before or after the employee's retirement or death." Although the calculation of the tax is based on wages paid, an employee derives no direct benefit from employment related taxes. With respect to FICA taxes, these taxes are a funding source for current social programs, and have no relationship to benefits an employee may receive in the future.

The Provider further points out that HCFA Pub. 15-1 § 2144.4 lists examples of fringe benefits, and that employment related taxes are notably not included in that list. Moreover, in his testimony before the Board, a senior auditor from the Intermediary agreed that this section of the manual does not spell out payroll taxes as a fringe benefit.[1] With respect to the Intermediary's reliance on Worksheet A-6 to the cost report and Form HCFA 339, this witness also agreed that the instructions to these documents are not regulatory policy, and that payroll taxes are not considered fringe benefits in the specific instructions used to prepare these forms.[2]

The Provider believes it has a sound basis for classifying employment related taxes as an administrative and general cost. In addition to the arguments presented above, the Provider's representative made a request to the prior intermediary that made the adjustment at issue, and proposed that the employment related taxes be classified to the A&G cost center.[3] The intermediary responded to this request as follows:[4]

> We have reviewed your proposal to treat Employment Related Taxes (ERT) ... as part of the administrative and general costs of the Provider. The Intermediary believes your treatment of ERT is an acceptable means of classifying ERT costs.

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1 Tr. at 95-96.

2 Tr. at 98 and 101.

3 See Provider Exhibit 6.

4 See Provider Exhibit 7.

The Provider believes it should be able to rely on instructions from intermediaries, and that the response it received represents prior written approval for its classification of such costs in the A&G cost center.[5]

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that it properly reclassified the employment related taxes from the A&G cost center to the employee benefit cost center in order to properly match expenses to the benefitting activity using gross salaries as the allocation basis. The regulation at 42 C.F.R. § 413.24 sets forth the requirements for adequate cost data and cost findings, and establishes the methodology for recasting a provider's financial and statistical data to determine the cost of services furnished. One of the cost finding methods covered in the regulation is the step-down methodology which is designed to allocate cost in the most accurate manner based on how the cost was incurred. While the regulation outlines the approved methods of cost finding, specific instructions for completing the cost finding methodology is found in the Provider Reimbursement Manual (HCFA Pub. 15-1 and 15-2).

The Intermediary argues that the instructions to the cost report clearly establish that employment taxes such as FICA and federal and state unemployment taxes are to be considered "wage related costs" and allocated as part of the employee benefit cost center. The instructions in HCFA Pub. 15-2 § 3517 and § 3605 list such taxes as employee benefits which may need to be reclassified from the A&G cost center to the employee benefits cost center, and allocated to other revenue and non-revenue cost centers using gross salaries as the allocation basis. The Intermediary asserts that this methodology is clearly intended in the instructions found at HCFA Pub. 15-1 § 2144.1, which describes fringe benefits as follows:

> amounts paid to, or on behalf of an employee, in addition to direct salary or wages, and from which the employee, his/her dependent (as defined by the IRS), or his/her beneficiary derives a personal benefit before or after the employees death. In order to be allowable, such amounts must be properly classified on the Medicare cost report, i.e. included in the costs of the cost center(s) in which the employee renders services to which the fringe benefits relates and , when applicable, have been reported to the IRS for tax purposes....

HCFA Pub. 15-1 § 2144.1.

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[5] Note: Subsequent to the hearing and the submmission of post-hearing briefs, the Provider submitted Provider Exhibits P-19, P-20 and P-21. The Board ruled that these Exhibits were filed untimely, and may not be considered part of the record in this case.

The Intermediary contends that FICA taxes are paid on behalf of the employees, based on the employees wages, and are paid to secure a right to social security old age or disability benefits. While the Provider argues that FICA taxes are merely a general tax levied by the government, the Intermediary believes this argument ignores the stated purpose of the taxation. In summary, the Intermediary insists that the most accurate allocation basis for expenses derived from the payment of salaries is gross salaries identified to the benefitting cost centers. To allocate wage related costs through the A&G cost center using accumulated costs as the statistic would base the allocation on costs that do not reflect the way in which the tax expenses were incurred.

Issue 2 - Owner's Compensation:

On its filed cost report, the Provider claimed costs of $230,000 as reasonable compensation relating to four top management positions held by family members. This figure reflected the net amount claimed after the Provider made a reduction adjustment of $425,922 from the total actual payment of $655,922. In applying a reasonableness test to determine excessive owner's compensation, the Intermediary made an additional adjustment of $74,629 based on its application of the Michigan Study, which was updated to adjust for the compensation survey performed in 1974. The following is a summary of the salaries and adjustments effected for the four positions held by the related family members:

	Father/ Administrator	Sister-In-Law/ Officer	Son/ Computer Analyst	Daughter/ Assistant Director	Total
Actual Salary	$165,988	$220,740	$141,865	$127,329	$655,922
Provider's Adjustments	(60,988)	(220,740)	(91,865)	(52,329)	(425,922)
Claimed Amount	$105,000	$ -0-	$ 50,000	$ 75,000	$ 230,000
Intermediary's Adjustments	(44,092)	-0-	-0-	(30,537)	(74,629)
Reasonable Compensation Per Intermediary	$ 60,908	$ -0-	$ 50,000	$ 44,463	$ 155,371

The Intermediary's reasonable compensation determination reduced Medicare reimbursement by approximately $13,000.

PROVIDER'S CONTENTIONS:

The Provider contends that the regulatory provisions of 42 C.F.R. § 413.102 provides for a reasonable allowance of compensation for owners, and that the manual instructions at HCFA Pub. 15-1 § 904 require intermediaries to determine reasonableness by comparing such compensation with amounts paid to other individuals in similar circumstances. It is the Provider's position that the Intermediary did not follow these guidelines when it utilized the Michigan Study developed in 1974 because it does not reflect current market conditions.

In making its calculation of reasonable compensation for the owner administrator, the Intermediary used a low range of $24,163 and a high range of $66,890, which were calculated from the outdated 1974 study. To support these amounts, the Intermediary relied on another survey distributed by the Medical Group Management Association ("MGMA") that was prepared for 1994 based on 1993 data.[6] Contrary to the Intermediary's belief that the MGMA Study upholds its determination, the Provider argues that this study demonstrates that the results of the Michigan Study are not accurate. A review of the data from the MGMA Study shows a high range of $110,000 (90th percentile) and a low of $41,891 (10th percentile) for the position of an administrator in the eastern geographical location of the Provider. The Provider further notes that the real average (mean) cost of the MGMA Study is $73,285 with a standard deviation of $31,646. Given the fact that the 75th percentile of the MGMA Study for the eastern section is $86,053, the evidence clearly shows that the $105,000 claimed by the Provider for its Administrator is between the 75th and 90th percentile, and is in fact an amount that would ordinarily be paid for comparable services by comparable institutions.

At the hearing, the Intermediary's witness acknowledged that the high and low ranges of the 1974 Study were not comparable to those reflected in the 1994 MGMA Study.[7] This witness further testified that he had never seen an administrator's salary below $30,000, and also agreed that the low range amount used by the Intermediary was not accurate and, thus, the calculation of allowable compensation may not be accurate.[8] The Intermediary's witness also testified that "mathematically" the $105,000 claimed by the Provider for its Administrator fell into the high and low range of the MGMA Study, and that the $75,000 claimed for the Provider's Assistant Administrator would equate to the 75 percent calculation used by the Intermediary in determining the allowable portion of the Assistant

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[6] Intermediary Exhibit I-11.

[7] Tr. at 34.

[8] Tr. at 40-41.

Administrator's salary.[9]

In further support of its position, the Provider cites the Board's decision in Stat Home Health Care, Inc. v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 96-D7, January 30,1996, HCFA Admin. Decl. Rev., Medicare and Medicaid Guide (CCH) ¶ 44,011. In that decision, the Board found that the intermediary did not use proper survey data and ignored other survey data in the record to limit the owner's compensation. Since the intermediary allowed the maximum of an outdated range, the Board allowed the maximum of an appropriated range from evidence presented by the provider, which exceeded the provider's claimed compensation. Based on the evidence presented, the Provider believes that the amount of owner's compensation claimed is more representative of actual market conditions than that used by the Intermediary.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that the statutory provisions of 42 U.S.C. § 1395x(v)(1)(A) require that providers of services to Medicare beneficiaries be reimbursed based on the reasonable cost of those services. The regulation at 42 C.F.R. § 413.9(c) concerns the application of reasonable cost and provides the following in pertinent part:

> Application. (1) It is the intent of Medicare that payments to providers of services should be fair to the providers, to the contributors to the Medicare trust funds and to other patients.

42 C.F.R. § 413.9(c).

With respect to compensation to owners, the regulation at 42 C.F.R.§ 413.102 (c)(2) states:

> Reasonableness of compensation may be determined by reference to or in comparison with, compensation paid for comparable services and responsibilities in comparable institutions: or it may be determined by other appropriate means.

42 C.F.R. § 413.102(c)(2).

Pursuant to the statutory and regulatory requirements and the manual instructions set forth in HCFA Pub.15-1 § 900ff, the Intermediary applied the reasonableness test to all of the top management positions of the Provider that were held by the owner and related family members. In making this determination, the Intermediary applied the 1974 Michigan Study which takes into consideration geographic information as well as bed size of the facility when determining a range of reasonable

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[9] Tr. at 72.

compensation.[10] Applying update factors for years 1975-1994, the Intermediary determined an estimated range for the Provider's Administrator from a low of $24,163 to a high amount of $66,890. The appropriate salary within the range was determined to be $60,908, based on the education and experience of the incumbent, as well as the size and location of the Provider's facility. The reasonable compensation of the Assistant Administrator was determined by taking 75 percent of the reasonable compensation of the Administrator, resulting in a reasonable compensation amount of $44,463.

As a check of the compensation amounts determined under the Michigan Study, the Intermediary reviewed a survey distributed by the Medical Group Management Association for 1994. Based on this review, the Intermediary found that the MGMA Study placed similar positions, in the same geographic region as the Provider, into comparable salary ranges. It was the Intermediary's conclusion that the Michigan study produced a reasonable compensation level compared to other similar providers in the same geographic area.

In as much as there is no separation between the governing body that sets the salary and the executive who receives it, the Intermediary contends that owner's compensation requires close scrutiny when determining reasonable cost under the Medicare program. It is not sufficient for the Provider to argue that the Intermediary's determination is unreasonable. While it was incumbent on the Provider to support the reasonableness of the claimed compensation, no such showing was made in the instant case. The Intermediary believes the Michigan Study produced a reasonable compensation range and the MGMA Study affirmed its determination. Accordingly, the Intermediary concludes that the only evidence before the Board support its adjustments and should be affirmed.

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
§ 405.1847	-	Disqualification of Board Members
§ 413.9	-	Cost Related to Patient Care
§ 413.9(c)	-	Cost Related to Patient Care - Application

[10] See Intermediary Exhibit I-10.

§ 413.24	-	Adequate Cost Data and Cost Finding
§ 413.102	-	Compensation of Owners
§ 413.102(c)(2)	-	Reasonable Compensation - Application

3. Program Instructions - Provider Reimbursement Manual:

Part I (HCFA Pub. 15-1):

§ 900ff	-	Compensation of Owners
§ 904	-	Criteria for Determining Reasonable Compensation
§ 2122.3	-	Employment - Related Taxes - - Provider - Based Physicians
§ 2144.1	-	Fringe Benefits - Definition
§ 2144.4	-	Fringe Benefits Includable as Provider's Cost

Part 2 (HCFA Pub. 15-2):

§ 3517	-	Worksheet A-6 - - Reclassifications
§ 3605	-	Worksheet S-3 - -Hospital and Hospital Health Care Complex Statistical Data and Hospital Wage Index Information

4. Case Law:

Stat Home Health Care, Inc. v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 96-D7, January 30, 1996, HCFA Admin. Decl. Rev., Medicare and Medicaid Guide (CCH) § 44,011.

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:

Issue 1 - Employment Taxes:

The Board finds the Intermediary's treatment of the FICA employment taxes resulted in the proper allocation of those costs to the benefitting cost centers where the associated salaries were incurred. As an allocation issue, the Board believes the primary consideration is the payment of reasonable costs consistent with the fundamental reimbursement principles set forth in 42 C.F.R. §§ 413.9 and 413.24.

In accordance with the regulatory provisions of 42 C.F.R. § 413.9, reasonable cost includes both direct and indirect costs which are necessary and proper in the provision of patient care services, and must be determined in accordance with regulations establishing the method or methods to be used and the items to be included. The regulations at 42 C.F.R. § 413.24 set forth certain reimbursement principles for determining allowable costs and require that payments to providers be supported by adequate cost data based on an approved method of cost finding. With respect to the recasting of data derived from a provider's accounting records, the use of various cost finding methodologies are explained which include step-down, double apportionment or more sophisticated methods. The objective of the above-cited regulations is the development and application of methodologies which yield the most accurate determination of actual costs incurred in the provision of health care services to individuals covered under the Medicare program.

This issue centers on the appropriate allocation basis for distributing FICA employment taxes under the step-down cost finding method. As a salary generated cost, the Board finds that the use of gross salaries as the allocation basis properly matches these expenses to the activities which benefitted from the services rendered by the employees. Accordingly, it is the Board's conclusion that the Intermediary's reclassification adjustment produces the most accurate and equitable manner of allocation consistent with the governing regulatory provisions.

Issue 2 - Owner's Compensation:

Based on the complete record presented by the parties, the Board finds that the Intermediary's reasonable compensation determinations were not appropriate and cannot be supported under the reasonable compensation provisions of 42 C.F.R. § 413.102 and HCFA Pub. 15-1 §900ff. Accordingly, the compensation amounts claimed by the Provider for the Administrator and Assistant Administrator are considered reasonable amounts that should be allowed in determining reimbursable costs under the Medicare program.

The regulations at 42 C.F.R. § 413.102 explain that the reasonableness of compensation paid to owners of health care organizations may be determined by comparing such amounts to compensation paid for like services performed in comparable institutions or " by other appropriate means." The program instructions at HCFA Pub. 15-1 §900ff provide further guidance by establishing factors which are to be considered in determining the comparability of institutions. Consistent with the broad language of these policy provisions, the Intermediary applied the data and methodology set forth under

the Michigan Study in making its reasonable compensation determinations. In the instant case, the Board finds the salary range data generated from the outdated Michigan Study produced results that are not commensurate with the Provider's contemporary organization, and cannot serve as the basis for the cost disallowances devised by the Intermediary.

The evidence shows that the Intermediary estimated a salary range for the Administrator position from a low of $24,163 to a high range amount of $66,890. This range was calculated based on salary data obtained in 1974 and the application of update factors for years 1975-1994. Using the methodology set forth in the Michigan Study for assigning point values relating to education, experience, volume, job duties and geographic location, the Intermediary calculated placement within the range to be $60,908 for the Provider's Administrator. A reasonable compensation amount of $44,463 was determined for the Assistant Administrator by taking 75 percent of the reasonable compensation of the Administrator. The Intermediary then compared the results obtain from the application of the Michigan Study to salary ranges for similar positions developed for the 1994 MGMA Study.

In addition to using an outdated salary survey, the Board notes that the Intermediary applied a government inflation rate which does not directly relate to the payment of compensation. Given the application of such outmoded data, and the wide disparity between the salary ranges in the Michigan Study and the 1994 MGMA Study, the Board finds there is no assurance that the compensation data developed from the Michigan Study is representative of the compensation levels paid health care organizations in the Providers geographic location. The Board rejects the Intermediary's contention that the salary data obtained from the MGMA Study corroborated the salary ranges and reasonable compensation determinations obtained from the Michigan Study. Whereas the Michigan Study produced a salary range from $24,163 to $66,890, the MGMA Study reflects a low of $41,891 (10th percentile) and a high of $110,000 (90th percentile) for the position of an administrator. Contrary to the Intermediary's opinion, the MGMA Study highlights the disparity between the two studies and significantly weakens the validity and relevancy of the Michigan Study. Moreover, the Intermediary's witness acknowledged that the high and low ranges of the 1974 Michigan Study were not comparable to those reflected in the 1994 MGMA Study.[11]

It is the Board conclusion that the 1994 MGMA Study reflects the most contemporaneous and valid data for determining reasonable compensation in the Provider's geographical location, and that this study represents the best available evidence for evaluating the compensation claimed by the Provider for its Administrator and Assistant Administrator positions. The Board further notes that the Intermediary used the full ranges of both studies in making its reasonable compensation determinations. Accordingly, the Board believes it is appropriate to utilize the same ranges in making the reasonable compensation determinations under the MGMA Study. Since the compensation claimed by the Provider for the Administrator position is below the 90th percentile for the high range, the Board finds the claimed amount of $105,000 to be reasonable in determining the amount of allowable costs

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[11] Tr. at 34.

reimbursable under the Medicare program. Similarly, the Board accepts the Intermediary's rationale for determining the Assistant Administrator's reasonable compensation by taking 75 percent of the reasonable compensation paid to the Administrator. Therefore, the Board finds the claimed compensation amount of $75,000 for the Assistant Administrator is also reasonable for purposes of determining Medicare reimbursement.

DECISION AND ORDER:

Issue 1 - Employment Taxes:

The Intermediary's reclassification of employment taxes was proper and is affirmed.

Issue 2 - Owner's Compensation:

The Intermediary improperly adjusted owner's compensation claimed by the Provider. The Intermediary's adjustments are reversed.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esquire
Martin W. Hoover, Jr., Esquire
Charles R. Barker (Withdrew from any participation in this case in accordance with 42 C.F.R. § 405.1847)

Date of Decision: August 19, 1999

For The Board

Irvin W. Kues
Chairman