PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D24

PROVIDER - Home Health Corporation of America - Home Office Group Appeals-HHC-90 & HHC-91	**DATE OF HEARING-** March 4, 1999
Provider Nos. See Appendix I & II	Cost Reporting Periods Ended - See Appendix I & II
vs.	
INTERMEDIARY - See Appendix I & II	**CASE NOs.** 94-0302G and 94-0304G

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ISSUE:

Were the Intermediary's adjustments to the Providers' home office cost statements proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

The Providers in the two group appeals at issue are home health agencies ("HHAs") that are separate operating components of Home Health Corporation of America, Inc. ("HHCA"). In addition to managing the HHAs, HHCA is the corporate home office for other health care related components, which include two private duty nursing companies, an outpatient physical therapy company, a nutritional therapy company, and a durable medical equipment supplier. For the fiscal years ended June 30, 1990 and 1991, the Providers' Medicare cost reports included home office costs which were allocated to the HHAs using the functional basis and pooled costs methodologies addressed under the provisions of §2150 ff of the Provider Reimbursement Manual ("HCFA Pub.15-1"). No home office costs were directly assigned to the chain components, and approximately $55,000 of home office costs were allocated under the functional allocation method. The remaining majority of home office costs (the pooled costs), in excess of $2 million, were allocated by first subtracting the cost of goods sold from the total costs of the nutritional therapy and durable medical equipment companies, then distributing the pooled costs among all subsidiaries in proportion to the remaining costs at each of these subsidiaries.

Upon review of the home office cost statements and the Providers' cost reports, the Intermediary (Independence Blue Cross at the time) reworked the allocation statistic to include the cost of goods sold into the total costs reported on Schedule G of the home office cost statements. By increasing the total cost allocation statistic for the nutritional therapy and durable medical equipment companies, the percentage of pooled home office costs allocated to the Providers was reduced, which resulted in a reduction of Medicare reimbursement to the Providers of approximately $82,000 and $85,000 for fiscal years 1990 and 1991, respectively.

The Providers appealed the Intermediary's determination to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§405.1835-.1841, and have met the jurisdictional requirements of these regulations. The Providers were represented by Michael F. Berkey, Esquire, and the Intermediary's representative was Bernard M. Talbert, Esquire, Associate Counsel for the Blue Cross and Blue Shield Association.

PROVIDERS' CONTENTIONS:

The Providers contend that their methodology of allocating home office costs is more accurate and, thereby, more equitable. The cost of goods sold is unique to the nutritional therapy and durable medical equipment companies because it is an inventory type cost which is not incurred by the other components in the chain organization. Further, the costs associated with purchasing, storing and distributing the inventory are also directly charged to these companies as operating expenses. Since the home office does not support the inventory function of these product oriented companies, the inclusion

of these substantial costs in the total cost statistic makes for an inequitable allocation of home office costs, which is contrary to Medicare law and regulations.

The Providers assert that, if cost of goods sold is not excluded from the total costs of the nutritional therapy and durable medical equipment companies, these home office units would be receiving a double allocation of pooled home office costs. The first allocation is from the direct charging of inventory related costs to operating expenses, and the second allocation is from the home office which does not support this function. While the issue of cost of goods sold is not specifically addressed under Medicare reimbursement policy, the reasonable cost principles set forth in the law and regulations do address the fundamental requirement for accuracy and prevention of cost shifting in determining Medicare reimbursement. The statutory provisions of 42 U.S.C § 1395 x(v)(1)(A) address the principles of reasonable cost as follows:

> ...Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this title) in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this title will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs,...

42 U.S.C. §1395x(v)(1)(A) (emphasis added).

The regulations at 42 C.F.R. § 413.5 further explain the requirement for equitable reimbursement by stating:

> All necessary and proper expenses of an institution in the production of services, including normal standby costs, are recognized. Furthermore, the share of the total institutional cost that is borne by the program is related to the care furnished beneficiaries so that no part of their costs would need to be borne by other patients.
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> (3) That there be division of allowable costs between the beneficiaries of this program and the other patients of the provider that takes account of the actual use of services by the beneficiaries of this program and that is fair to each provider individually.

> (4) That there be sufficient flexibility in the methods of reimbursement to be used, particularly at the beginning of the program, to take account of the great differences in the present state of development of record keeping.

42 C.F.R. §413.5 (a) and (b) (emphasis added).

Both the statutory and regulatory provisions require the Medicare program to pay its fair share of allowable costs, and that all payments to providers must be based on the reasonable cost of services related to the care of Medicare beneficiaries. The intent of the statute and regulations is reiterated in the manual at HCFA Pub. 15-1 § 2102.1, which discusses reasonable costs and expands upon the Medicare program's intent to be fair to providers in the payment of allowable costs. It is the Providers' position that the Intermediary's adjustments are flawed because they do not take into account what is fair and equitable.

The manual provision at HCFA Pub. 15-1 § 2150.3 deals specifically with the allocation of home office costs to the components of a chain organization, and states that all activities and functions in the home office must bear their allocable share of home office overhead and general and administrative costs. For the reporting periods in contention, pooled home office costs must be allocated to chain components on the basis of total costs if the chain is composed of either unlike health care facilities or a combination of health care facilities. However, the Providers note that the manual provision also states the following:

> If evidence indicates that the use of a more sophisticated allocation basis would provide a more precise allocation of pooled home office costs to chain components, such a basis can be used in lieu of allocating on the basis of either inpatient days or total costs.

HCFA Pub. 15-1 §2150.3D.

The Providers contend that their methodology of allocating pooled home office costs is a more sophisticated allocation methodology by virtue of the fact that it allows a more accurate and equitable allocation of pooled home office costs to all of the individual entities of the chain organization. While the nutritional therapy and durable medical equipment companies are basically suppliers of tangible health care products to customers, the other health care components of the chain organization are providers of intangible health care services to patients. It was this difference that the corporate parent believed warranted the different treatment of some of the overhead costs incurred at the home office level. Accordingly, HHCA subtracted out the costs of the "product" companies, then computed a cost allocation statistic based on the remaining costs at the component facilities.

The Providers point out that the Medicare methods (direct, functional, and pooled), normally allocate home office costs accurately over the particular lines of business. However, the system breaks down where the components of the chain are not homogeneous, and there is an attribute in a particular entity

that is both cost sensitive and not shared by all the components. The Providers insist that the circumstance in the instant case compels an adjustment to the standard methodology in order to obtain an appropriate allocation that is more precise than those specifically mentioned in the manual provisions. The Providers point out that the Board has recognized these unusual situations in the past, and cites three Board decisions which focused on the questions of accuracy.[1] In each of these decisions, the Board found that the prior approval requirement should not prohibit the election of a more accurate allocation of costs. Pursuant to the provisions of 42 C.F.R. §413.20 (a) ("equitable and proper payment") and 42 C.F.R. §413.24(d)(2)(ii) ("more sophisticated method designed to allocate costs more accurately"), the Providers note that the Board has looked for accuracy, not prior permission. Moreover, the Providers point out that the prior permission requirement for allocating costs from a home office is purely a manual requirement that does not have the backing of regulations. The regulatory requirement for permission applies to Worksheets B and B-1 of the cost report , where statistical allocations are made to recorded costs. No regulatory requirement exists for costs coming from a home office onto Worksheet A, earlier in the cost reporting process. Since the Board is not bound by the manual, it need not be concerned by the requirement for prior permission under HCFA Pub. 15-1 §2150.3.C or D. The Providers believe that the Board should focus on the accuracy requirements in the law and regulations by which it is bound.

The Providers contend they have introduced strong evidence that home office services do not relate to the cost of goods sold at the subsidiaries. While the Providers believe their allocation method is accurate, logical and rationally related to the home office effort expended on the subsidiaries, they also recognize that refinements might be possible. In this regard, the Providers suggest that the Board might also consider the removal of medical supply costs from the other health care components of the chain organization in computing the pooled allocation statistics. As a last alternative, the Providers believe that at least the Intermediary's adjustments relative to the durable medical equipment company be reversed.

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[1] Providers' Exhibits P-J, P-K and P-L.

St. Mary's Hospital and Medical Center v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 90-D34, June 18, 1990, Medicare & Medicaid Guide (CCH) ¶38,627.

Florida Life Care, Inc. Group-"Gross-Up" v. Aetna Life Insurance Co., PRRB Dec. No. 90-D25, May 9, 1990, Medicare & Medicaid Guide (CCH) ¶38,522.

Sunbelt Health Care Centers Group Appeal v. Aetna Life Insurance Co., PRRB Dec. No. 97-D13, December 3, 1996, Medicare & Medicaid Guide (CCH) ¶44,923.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that it appropriately included the cost of goods sold in the pooled allocation statistic in accordance with the reasonable cost provisions of 42 U.S.C. §1395x(v)(1)(A) and 42 C.F.R. §413.9(a). Of particular relevance to this case, the Intermediary cites the cost shifting prohibition at 42 C.F.R. §413.9(b)(1), and the documentation provisions of 42 C.F.R. §413.20 and §413.24 which require providers to maintain financial and statistical records that are sufficient for an accurate determination of program costs. The issue in this case is specifically addressed in HCFA Pub. 15-1 §2150 which establishes the methods for allocating home office costs to components in chain organizations. Where home office costs cannot be directly assigned or functionally allocated, the remainder of the costs must be allocated on a pooled method set forth as follows:

> Pooled home office costs must be allocated to chain components on the basis of total costs if the chain is composed of either unlike health care facilities (e.g., a combination of short-term hospitals, long-term hospitals, and home health agencies) or a combination of health care facilities and nonhealth care facilities (i.e., facilities engaged in activities other than the provision of health care). Under this basis, all chain components will share in the pooled home office costs in the same proportion that the total costs of each component (excluding home office costs) bear to the total costs of all components in the chain. Total costs are costs before Medicare adjustments are made.
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> If evidence indicates that the use of a more sophisticated allocation basis would provide a more precise allocation of pooled home office costs to the chain components, such basis can be used in lieu of allocating on the basis of either inpatient days or total costs. However, intermediary approval must be obtained before any substitute basis can be used. The home office must make a written request with its justification to the intermediary responsible for auditing the home office cost for approval of the change no later than 120 days after the beginning of the home office accounting period to which the change is to apply.

HCFA Pub. 15-1 §2150.3.D.2.b.

It is the Intermediary's contention that the Providers have not satisfied the "request for approval" requirement, nor have they demonstrated that their methodology is a more sophisticated method that results in a more accurate allocation of pooled home office costs. The Providers merely want to customize the statistic already being used by eliminating cost of goods sold from the total costs of two non-provider components. The Intermediary contends that the term "cost of goods sold" is

interchangeable with the "cost of services provided" at the service companies, and that all such costs would also need to be removed from the statistic in order to make an equitable distribution. The Providers are seeking to pick and choose which components of the statistic it alters for which entity, which is neither equitable nor a more sophisticated methodology.

The Intermediary argues that no evidence has been presented to support the Providers' assertion that the costs which comprise cost of goods sold for the nutritional therapy and durable medical equipment companies do not benefit from the functions of the home office operation. The Providers have not offered a distinction between "cost of goods sold" and "cost of services provided." Accordingly, there is no basis for excluding one type of cost from the total costs statistic, while including the other type in its entirety. Under the methodology prescribed under HCFA Pub. 15-1 §2150, the Providers had the opportunity to specifically assign home office costs to the chain components using the direct or functional allocation methods. Having failed to allocate all of the home office costs under these two methods, the residual costs must be allocated using the recommended statistical basis of total costs at the component units. Even if the Providers were not required to make a timely request under the applicable manual provision, the Providers have not proven that their method of allocating home office costs is more sophisticated and more equitable. The Intermediary insists that it followed the conventions and presumptions specified in the manual for the allocation of home office costs. Accordingly, the Board should affirm the Intermediary's inclusion of cost of goods sold in the total costs statistic for allocating pooled home office costs.

CITATION OF LAW, REGULATIONS & 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

§413.5 et seq. - Cost Reimbursement General

§413.9 et seq. - Cost Related to Patient Care

§413.20 et seq. - Financial Data and Reports

§413.24 et seq. - Adequate Cost Data and Cost Finding

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

§2102.1 - Reasonable Costs

§2150 et seq. - Home Office Costs - Chain Operations

4. Case Law:

St. Mary's Hospital and Medical Center v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 90-D34, June 18, 1990, Medicare and Medicaid Guide (CCH) ¶38,627.

Florida Life Care, Inc. Group - "Gross-Up" v. Aetna Life Insurance Co., PRRB Dec. No. 90-D-25, May 9,1990, Medicare and Medicaid Guide (CCH) ¶38,522.

Sunbelt Health Care Centers Group Appeal v. Aetna Life Insurance Co., PRRB Dec. No. 97-D13, December 3, 1996, Medicare and Medicaid Guide (CCH) ¶44,923.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

After consideration of the facts, parties' contentions, evidence presented, testimony elicited at the hearing, and post-hearing submissions, the Board finds and concludes that the Intermediary properly applied the provisions of HCFA Pub.15-1 §2150, which establish the allocation methodology for the distribution of home office costs to components in a chain organization.

The provisions of HCFA Pub. 15-1 §2150.3 establish a specific methodology for distributing home office costs in a manner that reflects the degree and type of effort expended on behalf of the operating components. The initial step in the allocation process is the direct assignment of costs to the chain components that specifically benefitted from the incurrence of the costs. The next stage of the allocation process permits the distribution of allowable home office costs on a functional basis where the direct assignment of costs is not feasible. Where home office costs cannot be directly assigned or allocated on a functional basis, there will be a residual amount, or "pool" of costs incurred for general management or administrative services which must be allocated as one cost center. Based on the facts and circumstances in this case, all components of the chain organization will share in the pooled home office costs in the same proportion that the total costs of each component bear to the total costs of all components in the chain.

In the instant case, the Board finds it noteworthy that no amount of home office costs was directly assigned to the chain components, and that only a minimal amount was allocated using the functional basis method. Accordingly, the pooled home office costs do not reflect the customary residual amount, but instead, represent the vast majority of home office costs. Given the substantial amount of pooled home office costs, it is essential that the allocation statistic employed for the distribution of such costs to the operating components reflects an appropriate allocation basis. While the Board does not oppose

the use of an alternative allocation basis, the acceptance of an alternative is contingent upon the requirement that it is a more appropriate and more accurate allocation of costs, and that it is supported by adequate and auditable documentation.

The Board finds that the record in this case is incomplete as to the operational involvement of the home office in support of the purchasing, distribution and inventory function associated with the cost of goods sold. Neither the evidence in the record nor the testimony of the Providers' witnesses established that the home office provided no support for the inventory function performed for the product oriented components of the chain organization. Moreover, the record also shows that there was inconsistent treatment among the chain components in that the cost of goods sold was not excluded from some of the health care components that were involved in product oriented costs. It is the Board's conclusion that the Providers have not proven that their allocation statistic is more accurate than the allocation basis prescribed by HCFA Pub. 15-1 § 2150.3. In the absence of supporting documentation as required under the provisions of 42 C.F.R. §§413.20 and 413.24, the Board finds no justification for changing the Intermediary's application of the prescribed allocation statistic set forth in the controlling manual provisions.

DECISION AND ORDER:

The Intermediary's adjustments to the Provider's home office cost statements were proper. The Intermediary's adjustments are affirmed.

Board Members Participating:

Irvin W. Kues
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: March 3, 2000

For The Board:

Irvin W. Kues
Chairman