PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2006-D32

PROVIDER -
Osteopathic Founders Foundation
Tulsa, Oklahoma

Provider No.: 37-0078

vs.

INTERMEDIARY -
Blue Cross Blue Shield Association/Blue Cross Blue Shield of Oklahoma

DATEs OF HEARING -
May 19 and 20, 2004

Cost Reporting Period Ended -
January 10, 1996

CASE NO.: 01-2850

INDEX

	Page No.
Issues	**2**
Medicare Statutory and Regulatory Background	**2**
Statement of the Case and Procedural History	**2**
Stipulations	**3**
Parties' Contentions	**4**
Findings of Fact, Conclusions of Law and Discussion	**6**
Decision and Order	**9**

ISSUES:

1. Whether the closing costs of $943,089, incurred for the sale of the hospital are allowable as a deduction from the sales price to determine gain or loss on the sale.

2. Whether a portion of the sales proceeds received by the Provider from the sale of its hospital should be allocated to medical records and assembled work force assets to determine the amount of gain or loss on the sale.

MEDICARE STATUTORY AND REGULATORY BACKGROUND:

This is a dispute over the amount of Medicare reimbursement due to a health care provider.

The Medicare program provides health insurance to the aged and disabled. 42 U.S.C. §§1395-1395cc. The Centers for Medicare & 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 the program's administration. 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 providers under Medicare law and interpretative guidelines published by CMS. See, 42 U.S.C. §1395h, 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 portion 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 NPR. 42 U.S.C. §1395oo(a); 42 C.F.R. §405.1835.

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Under the Medicare statute, a provider is entitled to claim as a reimbursable cost the depreciation (i.e., the loss of value over time) of property, plant and equipment used to provide health care to Medicare patients. An asset's depreciable value is initially set at its "historical cost," generally equal to the purchase price. 42 C.F.R. §413.134(a)(2)(b)(1). To determine annual depreciation, the historical cost is prorated over the asset's estimated useful life in accordance with an acceptable depreciation method. 42 C.F.R. §413.134(a)(3).

The calculated annual depreciation is only an estimate of the asset's declining value. If an asset is ultimately sold by the provider for less than the depreciated basis calculated under Medicare (equivalent to the "net book value" and equal to the historical cost minus the accumulated depreciation, see 42 C.F.R. §413.134(b)(9)), then a "loss" has occurred, since the sales price was less than the estimated remaining value. In that event, the Secretary of DHHS (Secretary) assumes that the asset had depreciated more than was originally estimated and, accordingly, provides additional reimbursement to the provider. Conversely, if the asset is sold for more than its depreciated basis, then a "gain" has occurred, and the Secretary takes back or "recaptures" previously paid reimbursement. 42 C.F.R. §405.415(f)(1).

Where a provider sells several assets for a lump sum, the regulation at 42 C.F.R. §413.134(f)(2)(iv) requires the determination of the gain or loss (depreciation adjustment) for each depreciable asset by allocating the lump sum among all of the assets sold in accordance with the fair market value of each asset as it was used by the provider at the time of sale. An appropriate part of the purchase price is allocated to "all of the assets sold" regardless of whether they are depreciable (and thus Medicare-reimbursable) or non-depreciable, such as land. The allocation of the lump sum to non-depreciable assets results in a smaller amount being allocated to the Medicare - reimbursable assets and, thus, a higher calculated loss attributable to the depreciable assets.

Osteopathic Founders Foundation (the "Provider") formerly did business as Tulsa Regional Medical Center, a short-term, acute care hospital located in Tulsa, Oklahoma. On January 11, 1996, the Provider sold all of its hospital assets to Columbia/HCA for $43,000,000. Since the net book value of the hospital's assets was greater than the purchase price, the Provider claimed a loss for purposes of Medicare reimbursement. Blue Cross Blue Shield of Oklahoma (the "Intermediary") reviewed the Provider's cost report and adjusted the Provider's loss calculation. The Intermediary disallowed $943,089 in closing costs which the Provider had deducted from the sale proceeds as costs incurred in selling the hospital. In addition, the Intermediary disallowed an allocation of the sales proceed for the appraised value of the Provider's medical records (MR) and assembled work force (AWF). The appraised value of the Provider's MR was $6,500,000, and the Provider allocated $2,164,704 to this item. The appraised value of the Provider's AWF was $8,900,000, and the Provider allocated $2,963,979 to it.[1]

The Provider appealed the Intermediary's adjustments to the Board pursuant to 42 C.F.R. §§405.1835-405.1841 and met the jurisdictional requirements of those regulations. The amount of Medicare funds in controversy is approximately $1,228,516 ($165,768 for the disallowance of sales costs and $1,062,748 applicable to the allocation of the sales price to MR and AWF).[2]

STIPULATIONS:

The parties' stipulated to the following:

---

[1] See Parties' Stipulation Of Facts.
[2] Provider's Position Paper at 3.

- the sale of the hospital assets to Columbia/HCA was a bona fide arms-length transaction.[3]

- the appraisal of the hospital assets meets applicable Medicare requirements.[4]

- the Intermediary acted in response to a memorandum from CMS in determining whether to allocate a portion of the sales price to MR and AWF.[5]

- no payment has been made by Medicare for closing costs the Provider incurred to sell the hospital assets, and no Medicare payment was made for costs associated with the acquisition of these items when the Provider first acquired these assets, and these assets were never sold under the Medicare program before their January 11, 1996 sale to Columbia/HCA.[6]

The Provider was represented by David P. Page, Esq., of Miller & Keffer, LLP. The Intermediary was represented by Bernard M. Talbert, Esq., Associate Counsel, Blue Cross Blue Shield Association.

PARTIES' CONTENTIONS:

Issue No. 1- Closing Costs

The Intermediary relies upon 42 U.S.C. §1395x(v)(1)(O)(ii), which states: "[s]uch regulations shall not recognize, as reasonable in the provision of health care services, costs (including legal fees, accounting and administrative costs, travel costs, and the costs of feasibility studies) attributable to the negotiation or settlement of the sale or purchase of any capital asset (by acquisition or merger) for which any payment has previously been made under this subchapter." CMS reviewed this issue and was unable to determine whether Medicare had previously shared in the payment of these types of costs, but was "hard pressed" to imagine the Provider acquired the assets without incurring such costs.[7] The Intermediary cites Dakota Midland Hospital v. Blue Cross and Blue Shield of Iowa, PRRB Dec. No. 97-D72, June 25, 1997, Medicare & Medicaid Guide (CCH) ¶ 45,464, dec'l. rev., CMS Admin., August 13, 1997 (Dakota Midland), where the Board found that the Provider was not entitled to deduct the selling expenses from the purchase price in order to determine the amount of purchase price to be used in calculating the gain or loss on the sale of the facility.[8]

---

3 Stipulation of Facts at 7
4 Stipulation of Facts at 12.
5 Stipulation of Facts at 16.
6 Stipulation of Facts at 17.
7 Intermediary's Position Paper at 5-6. Exhibit I-4.
8 Intermediary's Position Paper at 7. Exhibit I-6.

However, the Intermediary stipulated the Provider had not incurred any costs associated with the acquisition of these assets. The parties agreed that the sale of the hospital to Columbia/HCA was the first purchase or sale of the hospital since its inception in 1944.[9] In addition, the Provider contends there are no statutory or regulatory provisions prohibiting closing costs from being deducted from gross sales proceeds unless it can be shown that payments had previously been made for such costs. Therefore, it is appropriate to deduct these costs from the gross sales price in accordance with Accounting Principles Board Opinion No. 30.[10]

Issue No. 2- MR and AWF

The Intermediary contends that MR and AWF are part of a going concern and may have value if the purchase price was greater than the value of the tangible assets. However, with respect to the instant case, the purchase price was less than the appraised value of the tangible assets as well as their net book value. Accordingly, no intangible assets can exist and MR and AWF should not be recognized as assets that receive an allocation of the sales proceeds. The Intermediary cites Dakota Midland where the Board states:

> [the Board] is not persuaded by the Provider's arguments that there were intangible assets, even in light of the Provider's independent appraisal, which attached a value to intangible assets. These intangible assets are not the basis of any offset, and the Board does not recognize any of the intangible assets. The transferring of patient records and maintaining the work force were part of the seller's obligations or conditions necessary for the sale to close. They are not quantifiable assets.

Dakota Midland

The Intermediary also cites Paragraph 39 of Statement No. 141 issued by the Financial Accounting Standards Board (FASB), which states in part: ". . . an assembled workforce shall not be recognized as an intangible asset apart from goodwill."[11]

Finally, the Intermediary acknowledges that where more than one asset is sold for a lump sum sales price, the gain or loss is determined by allocating the sales price based upon the fair market value of the assets agreed to by the buyer and seller. 42 C.F.R. §413.134(f)(2)(iv). However, the Intermediary asserts that it is not bound by the parties' allocation agreement. Initially, buyers and sellers had their respective motives for allocating sales price within the scheme of Medicare reimbursement. This balance helped to assure an appropriate allocation of sales price. However, the implementation of Medicare's prospective payment system for capital-related costs diminished those

---

[9] Provider's Post-Hearing Brief at 15.

[10] Provider's Position Paper at 8. APB Opinion No. 30 – Reporting the results of operations – Reporting the effects of disposal of a segment of a business and extraordinary, unusual and infrequently occurring events and transactions.

[11] Intermediary's Supplemental Position Paper at 10. Exhibit I-11 at 12 of 20.

motives, and intermediaries have the authority to accept/reject parts of the parties' agreement to assure proper program payments.

The Provider contends that 42 C.F.R. §413.134(f)(2)(iv) requires lump sum sales proceeds to be allocated to all assets sold based upon the agreement reached between the buyer and seller. Since the buyer and seller in this case had agreed on the allocation, and since the allocation was performed in accordance with an accepted independent appraisal, the allocation to MR and AWF is binding on all parties, including the Intermediary.[12] The Provider cites Creighton Omaha Regional Health Care Corporation v. Sullivan, U.S District Court, District of Nebraska, No. CV. 89-0-522, December 14, 1990, finding that the Intermediary must follow the buyer and sellers agreed-to allocation among sold assets, including MR,[13] and Sullivan Community Hospital v. Blue Cross and Blue Shield of Missouri, PRRB Dec. No. 94-D31, April 26, 1994, Medicare & Medicaid Guide (CCH) ¶ 42,256, vac'd. and rem'd., HCFA Administrator, June 27, 1994, Medicare & Medicaid Guide (CCH) ¶ 42,256, requiring a portion of purchase price to be allocated to intangible assets, including MR.[14]

The Provider disagrees with the Intermediary's interpretation of FASB 141 and contends that the evidence shows that its MR and AWF are separate assets that could be and were assigned a value for the purpose of allocating the purchase price.[15] Both the Provider (seller) and Columbia/HCA (buyer) agree that MR and AWF are separately identifiable assets and that a portion of the purchase price should be allocated to them. An independent appraisal was performed, in accordance with Medicare rules and regulations, that supports an allocation to MR and AWF; and testimony elicited at the hearing made references to certain texts and court cases in support of the proposition that MR and AWF were appropriately identified as distinct assets in the allocation agreement and assigned a value by the independent appraisal.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

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

Issue No. 1- Closing Costs

The parties, by stipulation, agree that the Provider incurred $943,089 in costs as part of the sale of its hospital assets to Columbia/HCA. These costs consist of legal fees, a fairness opinion, title insurance, sales taxes, and an appraisal.[16] Also, it is undisputed that these costs are generally reimbursable pursuant to Medicare rules and regulations. However, the issue before the Board is whether these costs are reimbursable pursuant to

---

[12] Provider's Post-Hearing Filing at 19.
[13] Provider's Post -Hearing Filing at 22. Exhibit P-K.
[14] See also La Grange Colonial Manor v. Blue Cross and Blue Shield Association/ Health Care Services Corporation, 1987-2 Med Guide-TB ¶ 36,210 (January 15, 1987), and Vallejo General Hospital v. Bowen, 1988-2 Med Guide TB ¶ 37,179 (May 24, 1988). Exhibits P-M and P-O, respectively.
[15] Provider's Post-Hearing Filing at 29.
[16] Stipulation of Facts at 15.

42 U.S.C §1395x(v)(1)(o)(ii), enacted by the Deficit Reduction Act of 1984 (DEFRA). In pertinent part, DEFRA prohibits the payment of acquisition costs incurred by a buyer or seller on all change of ownership transactions for hospitals and SNFs occurring on or after July 18, 1984, where any payment had previously been made under the Medicare program for those expenses.

The parties, by stipulation, agree that the subject costs had not been previously incurred or reimbursed by the program.[17] The Provider contends that these costs should be applied as a reduction to the gross sales proceeds it received from Columbia/HCA in order to determine its loss for Medicare reimbursement. The Intermediary contends, however, that the costs are non-allowable based upon guidance from CMS. In a letter dated November 1999,[18] CMS expressed its opinion that the Provider more than likely incurred these types of costs when it originally acquired the assets, and that reflecting them as a reduction to the sales proceeds would effectively cause the program to pay for them a second time in violation of DEFRA.

The evidence does not, however, support the Intermediary's disallowance. As noted above, CMS' position is admittedly speculative. In its November 1999 letter, CMS states: "<u>[w]hile we are unable to determine whether or not Medicare has shared previously in payment of these types of costs</u>, we are hard pressed to imagine that the former owner acquired the assets without incurring such costs" (emphasis added).[19] However, other more substantive evidence supporting the Provider's argument is compelling. The parties' Stipulation of Facts at paragraph 17 states:

> [n]o payment has been made by Medicare for closing costs (set forth in paragraph 15 above). No Medicare payment was made for costs associated with the acquisition of these items when OFF [Osteopathic Founders Foundation] first acquired these assets. These assets were never sold under the Medicare program before their January 11, 1996 sale to Columbia/HCA.

The Board also finds that it is appropriate to offset the closing costs against the gross sales proceeds used to determine the Provider's loss on sale as opposed to reflecting these expenses in some other manner within its Medicare cost report. CMS did not dispute the treatment of closing costs as a reduction to sales proceeds but was only concerned about duplicate payments being made in violation of DEFRA. Moreover, testimony elicited at the hearing indicates that Medicare policy routinely allowed closing costs to be offset against sales proceeds to determine gains and losses on change of ownership transactions.[20]

---

[17] Stipulation of Facts at 16.
[18] Exhibit I-4.
[19] <u>Id</u>.
[20] Transcript (Tr.) at 576.

Issue No. 2- MR and AWF

The Provider sold its facility to Columbia/HCA, operating as Notami Hospitals of Oklahoma, Inc., for the lump sum sales price of $43 million. These proceeds are substantially less than the net book value of the facility's depreciable assets of approximately $49 million.[21] Accordingly, it is undisputed that the Provider incurred a loss on sale for purposes of Medicare reimbursement.

The facility's sale was based upon an Asset Purchase Agreement (Agreement) entered into on January 11, 1996.[22] Section 10.2 of the Agreement provides for the allocation of purchase price based upon the appraised fair market value of the facility's tangible assets as well as its intangible assets, which specifically include MR and AWF. The appraisal, performed by an independent firm, established the fair market value of the facility's assets at roughly $76 million, which included $6.5 million attributable to MR and $8.9 million attributable to AWF.[23] Since the Provider and Columbia/HCA agreed on the allocation, and since an appraisal was performed to establish the allocation base, the Provider contends that an allocation of the sales proceed to MR and AWF to determine its loss is proper. In part, the Provider relies upon 42 C.F.R. § 413.134(f)(2)(iv), which states:

> [i]f a provider sells more than one asset for a lump sum sales price, the gain or loss on the sale of each depreciable asset must be determined by allocating the lump sum sales price among all the assets sold, in accordance with the fair market value of each asset as it was used by the provider at the time of sale. If the buyer and seller cannot agree . . . the intermediary for the selling provider will require an appraisal by an independent appraisal expert to establish the fair market value of each asset and will make an allocation of the sales price in accordance with the appraisal.

The Board finds, however, that the sales price should not be allocated to MR and AWF to determine the Provider's loss. MR and AWF are intangible assets that have going concern value and only exist in sales transactions where the sales proceeds exceed the value of the land and other tangible assets involved in the purchase. As noted above, the sales proceeds did not exceed the value of the tangible assets in the instant case; therefore, MR and AWF are not found to exist. In part, the Board relies upon the definition of "intangible value" published in A Dictionary for Accountants,[24] as follows:

> [t]he value of an enterprise in its entirety, as a *going concern,* in excess of the value of its *net tangible assets*.

---

[21] The purchase price of $43 million includes the acquisition of approximately $16 million in current assets. Therefore, the Provider's loss on depreciable assets is measured against a purchase price of approximately $26 million. Intermediary Exhibit I3.

[22] Exhibit P-E.

[23] Exhibit P-G.

[24] Exhibit I-8.

> Intangible value, arising from a monopoly, secret processes, patents, trademarks, customer goodwill, managerial skill, growth of population, or numerous other possible causes, is often reckoned as the present worth of total earning power in excess of normal return on the value of net tangible assets.

The Board also finds that Paragraph 39 of FASB 141 supports its position.[25] Relevant to this case, Paragraph 39 explains that intangible assets that do not arise from contractual or other legal rights will be recognized as assets apart from goodwill only if they are capable of being separated from the acquired entity and sold. The Board does not find that MR and AWF, even if found to exist, could be separated and sold apart from the Provider's operation.[26] Moreover, Paragraph 39 goes on to state that "an assembled workforce shall not be recognized as an intangible asset apart from goodwill." The Board further finds that MR shares the same fundamental characteristics as AWF.[27]
In summary, the Board finds that the Provider's loss on sale is to be determined in accordance with 42 C.F.R. §413.134(f)(2)(iv), and that the lump sum sales price received by the Provider is to be allocated among all assets sold in accordance with their fair market value. However, no amount of the sales price is to be allocated to MR and AWF.

DECISION AND ORDER:

Issue No. 1- Closing Costs

The Intermediary's adjustment disallowing the Provider's closing costs as a reduction to the gross sales price used to calculate the Provider's loss on sale of depreciable assets was improper. The Intermediary's adjustment is reversed.

Issue No. 2- MR and AWF

The Intermediary's adjustment disallowing an allocation of the gross sales price to MR and AWF in the calculation of the Provider's loss on sale of depreciable assets was proper. The Intermediary's adjustment is affirmed.

Board Members Participating:

Suzanne Cochran, Esq.
Dr. Gary B. Blodgett, D.D.S.
Elaine Crews Powell, C.P.A
Anjali Mulchandani-West
Yvette C. Hayes

---

[25] Exhibit I-11 at 12 of 20.
[26] See Tr. at 732-737 for testimony corroborating the un-severable nature of MR and AWF from the Provider's ongoing operation.
[27] Although FASB 141 was issued after the subject cost reporting period, the Board believes it reflects the accounting policy applicable to the arguments in this case.

<u>FOR THE BOARD</u>:

<u>DATE</u>: Jun 22, 2006

Suzanne Cochran, Esq.
Chairperson