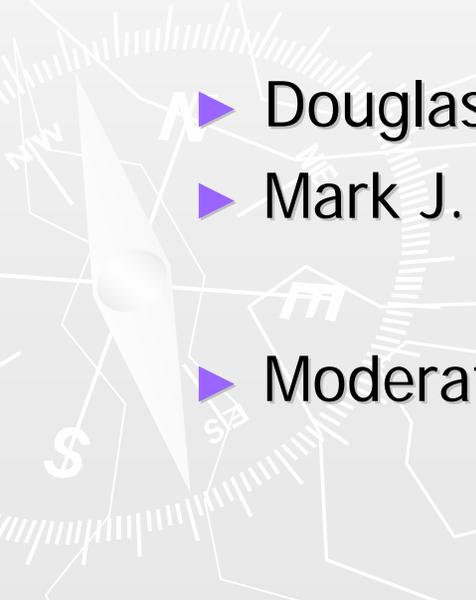


**Reimbursement Primer for Compliance, Ethics and Legal Officers:  
“Everything You Have Always Wanted to Know About  
Reimbursement but Were Afraid to Ask.”**

**Cost Reporting Principles  
April 4, 2007**



▶ Douglas J. McGregor

▶ Mark J. Rich

▶ Moderated by Lawrence W. Vernaglia, JD, MPH

# Introductions

## ▶ Douglas J. McGregor

- is the Director of HealthCare and Human Service Provider Services at Feeley & Driscoll, P.C. Mr. McGregor has more than thirty years' experience in the health care industry. His career has been devoted exclusively to providing accounting, auditing, reimbursement consulting, financial feasibility, valuation counseling, and strategic planning services to the full continuum of health care and human service providers.

## ▶ Mark J. Rich

- is currently the System Vice President for Business Development at Caritas Christi Health Care System – New England's second largest healthcare system with 6 acute care hospitals, over 1700 affiliated physicians and multiple post-acute care services. His responsibilities include the creation of new business opportunities, the expansion of existing services and overall strategic planning for the System. Prior to joining Caritas, Mr. Rich was the Director of the Healthcare Consulting division at Feeley & Driscoll, P.C. for 16 years, specializing in the areas of planning, reimbursement and compliance.

# Reasonable Cost

- ▶ **Reasonable Costs** are determined in accordance with regulations establishing the method or methods to be used, and the items to be included. Reasonable cost takes into account both direct and indirect costs of providers of services, including normal standby costs.
  - Reasonable costs do not exceed what a prudent and cost conscious buyer pays for a given item or service.
- ▶ **Costs Related to Patient Care** include all necessary and proper costs which are appropriate and helpful in developing and maintaining the operation of patient care facilities and activities.
  - Necessary and proper costs related to patient care are usually costs which are common and accepted occurrences in the field of the provider's activity. Including:
    - Personnel Costs;
    - Administrative Costs;
    - Employee Pension Plans;
    - Standby Cost;
    - Direct Care – Professional and Other
  - **Allowability** of costs is subject to the regulations prescribing the treatment of specific items under the Medicare Program.

# Non Patient Care Costs

- ▶ **Costs not related to patient care** are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities and activities.
  - Costs which are not necessary include costs which usually are not common or accepted occurrences in the field of the provider's activity. Including:
    - ▶ Cost of meals for other than Patient & Provider Personnel
    - ▶ Cost of drugs sold to other than patients;
    - ▶ Cost of operation of a gift shop;
    - ▶ Cost of alcoholic beverages furnished to employees or to others regardless of how or where furnished;
    - ▶ Costs of gifts or donations;
    - ▶ Cost of entertainment, including tickets to sporting and other entertaining events;
    - ▶ Cost of personal use of motor vehicles;
    - ▶ Cost of fines or penalties resulting from violations of Federal, State, or local laws;
    - ▶ Cost of meals served to executives that exceed the cost of meals served to ordinary employees

# Unallowable Non Patient Care Expenses

- **Unallowable Costs Include:**
  - **Ambulance Service** is covered under Part B of the Medicare Program. A provider may furnish ambulance services directly or it may furnish the service under arrangements with a supplier of ambulance services.
    - ▶ If a provider furnishes ambulance services with its own equipment and staff, the cost it incurs (depreciable cost of equipment, supplies, employee compensation, overhead, etc.) is its cost of the service payment purposes. If it furnishes the service under arrangements, the charge to the provider by the ambulance company becomes the provider's direct cost of furnishing the service.
      - Medicare Part B carriers have established reasonable charge screens for a wide range of ambulance services. Medicare expects that the costs incurred by a provider for ambulance services furnished under arrangement with a supplier of ambulance services will not exceed the amount a carrier would pay the ambulance supplier for the same service. Therefore, if a provider furnishes ambulance service under arrangements, to the extent the provider's total costs of the services, direct costs and any indirect costs, exceeds what a carrier would pay a supplier of ambulance services for the same services in the same locality, the costs are unreasonable and cannot be paid by the provider's intermediary.

# Unallowable Non Patient Care Expenses

- **Private Duty Personnel**
- **Luxury Items or Services**
- **Dental Services** to or for an individual patient are not allowable provider costs and are non-reimbursable to the provider. The costs, however, of consultative services furnished by an advisory dentist to a provider are allowable costs, subject to the usual rules concerning reasonable costs incurred by providers. Consultative services may include, for example, participating in the staff development program for nursing and other personnel and recommending policies relating to oral hygiene or dietary matters.
- **Vocational and Scholastic Training Expenses** are the costs attributable to vocational, scholastic, or similarly oriented training activities conducted by providers on behalf of patients are not allowable costs. For example, costs incurred by a psychiatric facility in operating an elementary or secondary school for patients are unallowable costs.
- **Noncompetition Agreement Costs** paid to the seller of an ongoing facility by the purchaser to acquire an agreement not to compete are considered capital expenditures. Where the agreement covers a stated number of years and the provider amortizes the amount paid over the agreed number of years, the amortized costs for such agreements are not allowable costs under the program.

# Unallowable Non Patient Care Expenses

- **Costs of Reserving Beds or Services** pursuant to a reserved bed agreement with another health care facility under which the provider receives guaranteed or priority placement for its discharged patients.
  - ▶ The revenue received by a provider for reserving its beds or services is not considered related to patient care. Therefore, the payments received are not required to be offset against the provider's operating costs.
- **Advertising Costs** incurred in connection with the provider's public relations activities are allowable if the advertising is primarily concerned with the presentation of a good public image and directly or indirectly related to patient care.
- **Philanthropy Department Expenses**

# Cost of Telephone, Television, and Radio

- Cost of Telephone, Television, and Radio, where items are located in patient accommodations, and which are furnished solely for the personal comfort of the patients (full costs include costs both directly associated with personal comfort items or services plus an appropriate share of indirect costs) are not includable in allowable costs of providers.
  - ▶ The costs of television and radio services are includable in allowable costs where furnished to the general patient population in areas of providers other than patient accommodation, e.g., day rooms, recreation rooms, waiting rooms, etc.
  - ▶ The cost of a nurse-patient communication system that has no capability for other than communications between patient and nurse (or other facility employees) are includable in allowable costs.
  - ▶ The cost of television and radio located in lounges and other areas designated for the use of provider employees is includable in allowable costs.
  - ▶ Where providers use the combined systems, the basic cost of the components designed and used for patient care communication is an allowable cost. Any incremental costs attributable to the additional components or capability for providing the patient's entertainment or convenience are not allowable and must be excluded.

# Parking Lot Costs

- **Parking Lot** costs are allowable costs provided the parking facilities are for the use of patients, visitors, employees, and other provider purposes.
  - ▶ Revenue from parking must be used to reduce related allowable parking costs. Any excess revenue is applied against other parking costs, but not against other allowable costs.

# Related Party Expenses

- **Related Party** costs include all reasonable costs, direct and indirect, incurred in the furnishing of services, facilities, and supplies to the provider. The principles of reimbursement of provider costs will generally be followed in determining the reasonableness and allowability of the related organization's costs. In situations where the provider is a proprietary organization, an allowance of a reasonable return on equity capital invested and used in furnishing services, facilities and supplies to the related provider is includable as an element of the reasonable cost of the related organization.
  - **The Provider must make available adequate documentation to support the costs incurred by the related organization, including, when required, access to the related organization's books and records, attributable to supplies and services furnished to the provider. Such documentation must include an identification of the organization's total costs, the basis of allocation of direct and indirect costs to the provider, and other entities served.**

# Related Party Expenses

- An exception to the related organization principle applies if the provider demonstrates by convincing evidence to the satisfaction of the intermediary that the following criteria have been met:
  - ▶ The supplying organization is a bona fide separate organization.
  - ▶ A substantial part of the supplying organization's business activity of the type carried on with the provider is transacted with other organizations not related to the provider and the supplier by common ownership or control and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization.
  - ▶ The services, facilities, or supplies are those which commonly are obtained by institutions such as the provider from other organizations and are not a basic element of patient care ordinarily furnished directly to patients by such institutions.
  - ▶ The charge to the provider is in line with the charge for such services, facilities, or supplies in the open market and no more than the charge made under comparable circumstances to others by the organization for such services, facilities, or supplies.
  - ▶ Where all of the conditions of the exception are met, the charges by the supplier to the provider for such services, facilities, or supplies are allowable costs.

# Home Office Expenses

- **Home Office Expenses** directly related to those services performed for individual providers which related to patient care, plus an appropriate share of indirect costs are allowable to the extent they are reasonable.
  - ▶ The organization costs of a home office are considered allowable under the Medicare program and must be amortized in accordance with the provisions in HCFA Pub. 15-1. Reorganization costs and stock-holder servicing costs are not allowable organization costs.
  - ▶ Startup Costs of a home office are considered allowable costs under the Medicare program and must be amortized in accordance with the provisions of HCFA Pub. 15-1.
  - ▶ Costs related to the acquisition of the capital stock of a provider, whether or not such facilities are participating or subsequently will participate in the Medicare program, are not allowable. Costs connected with the transfer of assets to a chain are not allowable as organization costs but, instead, must be capitalized as part of the cost of the asset.
  - ▶ Interest on Loans Between Home Office and Components of Chain are generally not an allowable cost and the interest income earned from such a loan is not used to reduce allowable interest expense.

# Interest Expenses

- **Necessary and proper interest on both current and capital indebtedness is an allowable cost.**
- To be allowable under the Medicare program, interest must be:
  - ▶ Supported by evidence of an agreement that funds were borrowed and that payment of interest and repayment of the funds are required;
  - ▶ Identified in your accounting records;
  - ▶ Related to the reporting period in which the costs are incurred; and
  - ▶ Necessary and proper for the operation, maintenance, or acquisition of your facilities.
- Interest expenses are not allowable if incurred as a result of:
  - ▶ A judicial review by a Federal court resulting in a reversal of an adverse decision to the provider by the PRRB or the HCFA Administrator;
  - ▶ An interest assessment on a determined Medicare overpayment
- Only interest expense which is necessary is an allowable cost. To be considered necessary, the interest must be:
  - ▶ Incurred on a loan that is made to satisfy a financial need,
  - ▶ For a purpose related to patient care, and
  - ▶ Incurred on a loan that is reduced by investment income.

# Interest Expenses

- The provider's allowable interest expense is reduced (offset) by the provider's investment income in order to determine the amount of interest expense that is necessary and therefore allowable. The investment income is only offset against allowable interest expense.
  
- Excluded from the definition of investment income is the investment income from:
  - ▶ Grants, gifts, and endowments, whether restricted or unrestricted
  - ▶ Funded depreciation,
  - ▶ Qualified pension funds,
  - ▶ Deferred compensation funds,
  - ▶ Self-funded health insurance,
  - ▶ Self-funded worker's compensation, and
  - ▶ Self-funded unemployment insurance.
  
- Proper means that the interest be incurred at a rate not in excess of what a prudent borrower would have had to pay in an arm's-length transaction in the money market when the loan was made.

# Interest Expenses

- If unrestricted funds are used to make "loans" to the general fund of the provider for use in current operations, or for other purposes, interest paid by the general fund to the unrestricted fund is not allowable as a cost. Unrestricted funds are available for the use of the provider, and the provider should use them rather than "borrow" them.
- If a provider's donor-restricted funds make loans to the general fund of the provider, the interest paid by the general fund to the restricted fund is included in allowable cost at a rate not to exceed the interest rate the fund is currently earning.

# Compensation

- Determination as to the reasonableness of a person's compensation is made by comparing it with the compensation paid to other individuals in similar circumstances.
- Physician Compensation is either reimbursed through prospective payment or on a reasonable cost basis. When reimbursement is made on a reasonable cost basis, the allowable cost shall not exceed the lower of the actual cost or the reasonable compensation equivalents (RCEs).
  - ▶ The methodology for determining RCEs by considering average physician income by specialty and type of location. The RCE limit represents reasonable compensation for a full-time physician. Full time is 2,080 hours per year, including a reasonable amount of time devoted to vacation, sick leave and continuing education.

# Compensation

- The cost of physicians' direct medical and surgical services rendered in a teaching hospital to Medicare patients is determined on the basis of an average cost per diem for physicians' direct medical and surgical services to all patients. For the following:
  - Physicians on the hospital staff
  - Physicians on the medical school faculty
- ▶ The average cost per diem for physicians' direct medical and surgical services, including supervision of interns and residents in the care of individual patients, rendered in teaching hospital to patients means the amount computed by dividing total reasonable costs of such services by the sum of inpatient days and outpatient visit days.

# Approved Education

- Approved education activities formally organized and planned programs of study operated or supported by an institution is an allowable cost if:
  - Designed to enhance the quality of health care in the institution or to improve the administration of the institution,
  - Where required, licensed by State law,
- Or
- Where licensing is not required, approved by the recognized professional organization for the particular activity.

# Approved Education

- The direct and general service cost of approved educational activities (including stipends) of trainees, compensation of teachers, and other costs) should be reduced by any reimbursement from:
  - Grants;
  - Tuition;
  - Donations received for educational purposes
- ▶ Grants and donations are designated to support internship and residency programs in family medicine, general internal medicine, or general pediatrics are not deducted in calculating net costs.

# Studies Related to Administration and Operation

- Studies, analyses, surveys, and related activities aimed at improving and making provider administration and operation more efficient are not considered research costs, but are included in allowable administrative costs.
- ▶ Access Clause, which gives the government access to contractor's records to verify the nature & extent of services rendered.
  - Cost is not allowable if the clause is omitted.
  - Applies if cost is \$10,000 or more in 12 months
  - Clause must provide for access:
    - ▶ Up to 4 years after service
    - ▶ To contractors' related parties' records

# Grants, Gifts, and Income from Endowments

- Unrestricted grants, gifts, and income from endowments should not be deducted from operating costs in computing reimbursable cost.
- Restricted grants, gifts, and income from endowments designated for cost reporting periods beginning October 1, 1983, should not be deducted from the particular operating costs or group of costs.
- Unrestricted contributions are not deducted from costs in computing allowable costs. These funds are considered the property of the provider to be used as it deems appropriate. These funds generally give the provider a means of recovering costs which are not otherwise recoverable, such as costs related to bad debts of patients not covered under Medicare.
- Restricted contributions which are designated by the donor for paying certain provider operating costs, or groups of costs, or costs of specific groups of patients, are deducted from the designated costs or group of costs only for cost reporting periods beginning before October 1, 1983. Where the cost or group(s) of costs designated covers services rendered to all patients, including Medicare beneficiaries, operating costs applicable to all patients are reduced by the amount of the restricted grants, gifts, or income from endowments thus resulting in a reduction of allowable costs.

# Rebates, Refunds, and Discounts

- Discounts, allowances, and rebates must be used to reduce the total cost of the goods or services for all patients without regard to whether or not the discount, allowance, refund, or rebate is designated for supplies or services used by all patients or by a specific group or category of patients.

# Emergency Stand by Cost

- ▶ Provider Reimbursement Manual states that the Hospital must maintain the following documentation:
  - Signed copy of contract.
  - Written copy of allocation agreement including supporting documentation (i.e. time studies).
  - Permanent record of payments made to the physician.
  - Permanent record of all patients treated by physician including copies of all patient bills.

# Emergency Stand by Cost

- Schedule of physician charges.
- Evidence that the provider explored alternative methods for obtaining emergency room coverage.
- Documentation may include board minutes, letters from providers stating they will not provide coverage for just the professional fees, etc.

# Reporting of Cost

- ▶ **GOAL:** Reclassification and Adjustment of trial balance of expenses for proper “grouping” of total provider expenses on the proper CMS lines and remove **non-allowable** expenses to arrive at net allowable expenses for allocation.
  
- ▶ **General Service Cost Centers**
  - ▶ Perform services for another cost center (overhead departments)
    - Capital – Depreciation
    - Administration and General
  
- ▶ **Routine Service Cost Centers**
  - ▶ Perform “routine” type services, such as the Medical /Surgical, ICU, and Psychiatry Units.
  
- ▶ **Ancillary Service Cost Centers**
  - ▶ Perform special patient services, such as Radiology and Anesthesiology.
  
- ▶ **Outpatient Service Cost Centers**
  - ▶ Perform outpatient services such as Emergency Room and Clinics, which includes Neurology, Diabetes, and the Provider Based Clinics.
  
- ▶ **Non-Patient Service Cost Centers**
  - ▶ Perform non-reimbursable activities, such as Specialty Services, Physician Consultants, the Wellness Center, and the Philanthropy Department.

# Reporting of Cost

- **Disaggregation of Overhead:** Reporting of administrative services by department for more accurate allocation. Examples include: Patient Accounting, Purchasing, Communication, and Materials Management.
- Income and Cost Offsets
  - Investment Income (Should not exceed interest expense);
  - Cafeteria Income;
  - Purchase Discounts Income;
  - Marketing Costs;
  - Physician Recruitment Costs (Non employee of Hospital);
  - Non-Physician Practitioners (Including Benefits)

# Allocation of Cost

- ▶ **Step-Down Method:** All costs of non-revenue producing centers are allocated to all centers which they serve, regardless of whether these centers produce revenue. The cost of the non-revenue producing center serving the greatest number of other centers is allocated first. Following the allocation of the cost of the non-revenue producing center, that center will be considered "closed" and no further costs are allocated to that center. This applies even though it may have received some services from a center whose cost is allocated later. Generally, when two centers render service to an equal number of centers while receiving benefits from an equal number, that center which has the greatest amount of expense should be allocated first.

Assigning Overhead Cost to Production Areas

# Allocation of Cost

	<b>Recommended</b>	<b>Simplified Method</b>
<b>Overhead Expense</b>	<b>Statistic</b>	<b>Statistic</b>
Building and Fixtures	Square Footage	Square Footage
Movable Equipment	Dollar Value	Square Footage
Employee Benefits	Salaries	Salaries
Administration and General	Accumulated Costs	Accumulated Costs
Maintenance and Repairs	Square Footage	Square Footage
Operation of Plant	Square Footage	Square Footage
Laundry and Linen	Pounds	Patient Days
Housekeeping	Square Footage	Square Footage
Dietary	Meals	Patient Days
Cafeteria	Full Time Equivalents	Salaries
Maintenance and Personnel	Housing Log	Eliminated
Nursing Administration	Time Spent	Nursing Salaries
Central Services	Costed Requisitions	Costed Requisitions
Pharmacy	Costed Requisitions	Costed Requisitions
Medical Records	Time Spent	Gross Patient Revenue
Social Service	Time Spent	Patient Days
Nursing School	Assigned Time	Assigned Time
Interns and Residents	Assigned Time	Assigned Time
Paramedical Education	Assigned Time	Assigned Time
Nonphysician Anesthetists	100% to Anesthesiology	100% to Anesthesiology

# Allocation of Cost

▶ **Double-Apportionment Method:** Recognizes that services rendered by certain non-revenue producing departments or centers are utilized by certain other non-revenue producing centers, as well as by the revenue-producing centers. The first allocation of the costs of the non-revenue producing centers is made to all cost centers serviced by these centers. These centers are not "closed" after the first allocation. They remain "open" accumulating their portion of the costs of all other non-revenue producing centers from which service is received. The first allocation is followed by a second allocation of costs involving the allocation of all costs remaining in the non-revenue producing centers. The second allocation equates to the step-down method of cost allocation.

- ▶ Double - Appointment Accumulative
- ▶ Double - Appointment Nonaccumulative

# Allocation of Cost

- ▶ **Double-Apportionment Accumulative:** This method of double-apportionment cost finding allocates the direct and indirect costs of the non revenue producing centers during the first allocation. The cost of the non-revenue producing center is allocated to all cost centers which receive service from that center (including itself if it provides service to itself) during the first allocation. The second allocation allocates the costs received during the first allocation in the same manner as the step-down cost finding method. The statistics used in the second allocation are the same as the statistics used in the first allocation except for (a) accumulated cost which is used as the recommended basis for allocating the cost of the administrative and general cost center, and (b) elimination of the statistics of the "closed" cost center, from an equal number, that center which has the greatest amount of expense should be allocated first.
- ▶ **Double-Apportionment Nonaccumulative:** This method of double-apportionment cost finding allocates only the direct cost of the non-revenue producing centers during the first allocation. The direct costs are allocated to all centers receiving service (including itself if it provides service to itself) during the first allocation. The second allocation allocates the indirect costs received during the first allocation in the same manner as step-down cost finding. The statistics used in the second allocation are the same as the statistics used in the first allocation except for (a) accumulated cost which is used as the recommended basis for allocating the administrative and general cost center, and (b) the elimination of the statistics for "closed" cost centers

# Allocation of Cost

- ▶ **Multiple-Apportionment:** This method of cost finding allocates the cost of the non-revenue-producing centers in the same manner as the double-apportionment, except that the number of allocations is determined by the user. For example: A user elects five allocations under multiple-apportionment method of cost finding. Allocations one through four are identical to the first allocation described in the double-apportionment methodologies. The fifth allocation is identical to the second allocation described in the double-apportionment methodologies.
- ▶ As an alternative approach to the cost finding methods identified above, the provider may request a simplified cost allocation methodology. This methodology reduces the number of statistical bases a provider maintains. The following statistical bases must be used for purposes of allocating overhead cost centers. There can be no deviation of the prescribed statistics and it must be utilized for all the following cost centers. Once the simplified method is elected, the provider must continue to use this method for no less than 3 years, unless a change of ownership occurs.

Bottom-line – You have *some* flexibility to arrive at the most accurate cost finding method. But you must negotiate the choice with your FI. They must be convinced that your method is (more) reasonable, the supporting stats can be reasonably maintained, that your method is mathematically correct and that their staff can understand / audit the method.

# Allocation of Cost

In this order

## ▶ Home Office costs:

- Direct cost
  - ▶ Entity specific
    - Legal fees
    - Consulting fees
    - Salaries of key employees
    - Depreciation
- Allocation (i.e. step-down)
  - ▶ Retainer fees for legal counsel
  - ▶ Planning / consulting cost covering multiple entities
  - ▶ Utility cost
- Cumulative cost
  - ▶ Based on TOTAL operating expense base of each entity, including non-Medicare entities (relative to each other).

Cost from the Home Office Cost Report *replaces* management fees charged throughout the year whether the cost assigned is higher or lower than the interim expense

# Question and Answer Session

- 
- ▶ Douglas J. McGregor
  - ▶ Mark J. Rich
  - ▶ Moderated by Lawrence W. Vernaglia, JD