PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

ON-THE-RECORD
98-D60

PROVIDER -
Midwest City Regional Hospital
Midwest City, Oklahoma

Provider No. 37-0094

vs.

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

DATE OF HEARING-
April 17, 1998

Cost Reporting Period Ended -
December 31, 1986

CASE NO. 89-1568

INDEX

ISSUE:

Was the Intermediary's offset of investment income earned on the Provider's funded depreciation account against interest expense proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Midwest City Regional Hospital ("Provider") is a 178-bed, municipally-owned, acute care general hospital located in Midwest City, Oklahoma. The Midwest City Memorial Hospital Authority ("Authority") is a public trust created in 1961 for the benefit of Midwest City ("City"); and the trustees thereof are members of the City Council. In 1963, the City leased the Provider's hospital facilities to the Authority. In 1964, the Authority executed an operating contract for the daily operation of the Provider to the Provider's Board. The Board members are selected by the Authority. The Hospital is not a distinct legal entity separate from the Authority.

The Provider is reimbursed under the Medicare prospective payment system (PPS), but capital costs continue to be reimbursed on a cost basis which includes depreciation and necessary interest expense. For the cost year under appeal it is undisputed that 1) the Provider properly maintained funded depreciation accounts (FDAs) for the acquisition of depreciable assets related to patient care and for other capital purposes; 2) the source of these funds was from operating revenues; 3) the FDAs were (a) clearly identified and designated as such in the provider's records, (b) maintained in several different bank accounts (primarily as certificates of deposit [CD]) to minimize risk of loss, and (c) segregated from the Provider's other accounts; 4) the interest income earned on the CDs were deposited directly into the general cash operating fund (rather than the FDAs) with a corresponding credit to "interest income;" and 5) the Provider did not offset the interest income earned on the FDAs. The heart of this appeal is the Intermediary's disagreement with the Provider's methodology of depositing the interest income earned on the CDs directly into the operating fund rather than the FDA as stated in items 4) and 5) above. The disagreement focuces on section 226.2 of the Provider Reimbursement Manual ("HCFA Pub. 15-1") that requires earned income to be deposited in the FDA to become part of the FDA and qualifying for the regulatory sheltering provision, i.e., that the earned income is exempt from the general offset requirements against other interest expense. Blue Cross and Blue Shield of Oklahoma ("Intermediary") issued a notice of program reimbursement (NPR) that included an adjustment offsetting the interest income earned on the CDs against the allowable interest expense claimed in the cost report. The Provider timely appealed the NPR to the Provider Reimbursement Review Board (Board) pursuant to the provisions of 42 C.F.R. §§ 405.1835-.1841 and has met the jurisdictional requirements of those regulations. The amount of Medicare reimbursement in dispute is approximately $122,000.

The Provider is represented in this dispute by Dennis M. Barry, Esquire, and Christopher L. Crosswhite, Esquire, of Vinson & Elkins, L.L.P.. The Intermediary is represented by Bernard M. Talbert, Esquire, of Blue Cross Blue Shield Association.

Relevant Medicare Statutory, Regulatory and Policy Background:

The Medicare reimbursement regulations governing interest expense and the funding of depreciation set forth the requirements that:

1) necessary and proper interest on capital indebtedness is an allowable expense; 2) such interest expense is reduced by investment income except where the income is from funded depreciation or a qualified pension fund, then there is no offset, i.e., a shelter provision; and 3) the shelter exception does not apply if the FDA funds were not used for capital purposes or the FDA account was not properly maintained.

Section 413.153 of the regulations specifically governs the allowability of interest expense. During the 1986 cost reporting period, this regulation stated:

> (a)(1) Principle. Necessary and proper interest on both current and capital indebtedness is an allowable cost. . . .
>
> * * *
>
> (b) Definitions.
>
> * * *
>
> (2) Necessary. Necessary requires that the interest be --
>
> (i) Incurred on a loan made to satisfy a financial need of a provider. Loans that result in excess funds or investments would not be considered necessary;
>
> (ii) Incurred on a loan made for a purpose reasonably related to patient care; and
>
> (iii) Reduced by investment income except if such income is from gifts and grants, whether restricted or unrestricted, and which are held separate and not commingled with other funds. Income from funded depreciation or a provider's qualified pension fund is not used to reduce interest expense. Interest received as a result of judicial review by a Federal court . . . is not used to reduce interest expense.

* * *

(c) * * *

(3) If funded depreciation is used for purposes other than improvement, replacement, or expansion of facilities or equipment re]ated to patient care, allowable interest expense is reduced to adjust for offsets not made in prior years for earnings on funded depreciation. . . .

42 C.F.R. § 413.153 (emphasis added).

42 C.F.R. § 413.153(c)(3) provides for a qualification to the funded depreciation exception when the FDA funds are not used for capital purposes. If so, then allowable interest expense must be reduced not only in the current year but adjustments must be made for offsets not made in prior years for earnings on the FDA.

For the 1986 cost year under appeal, the Medicare regulation pertaining to the funding of depreciation did not impose any specific requirements. The regulation in 1986 stated:

(e) Funding of depreciation. Although funding of depreciation is not required, it is strongly recommended that Providers use this mechanism as a means of conserving funds for replacement of depreciable assets, and coordinate their planning of capital expenditures with areawide planning activities of community and State agencies. As an incentive for funding, investment income on funded depreciation will not be treated as a reduction of allowable interest expense.

42 C.F.R. § 413.134(e).

In 1991 and 1994,[1] 42 C.F.R. § 413.134(e) was significantly expanded to incorporate several previous HCFA policy statements and manual instructions relevant to the funding of depreciation.
Where the Medicare regulations do not set forth specific requirements or fail to sufficiently explain the language or mechanics of certain reimbursement principles, HCFA has issued policy statements or program instructions providing such explanations. The Provider Reimbursement Manual, HCFA Pub. 15-1, (referred to as "program instructions"), provides further interpretation and explanation of the Secretary's reimbursement principles set forth in the regulations and/or HCFA's statements of policy. These program instructions function as interpretive rules, and do not have the force and effect of law like regulations. Thus, the Board may use these interpretive rules as guides, but it is not required to follow them.

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[1] 56 Fed. Reg. 43,456 (1991); and 59 Fed. Reg. 45,401 (1994).

The Provider Reimbursement Manual, HCFA Pub. 15-1 § 226 et seq., provides specific requirements regarding the funding of depreciation and the mechanics of the FDA including the payment of interest on loans made from the FDA, deposits of interest earned, other deposits and withdrawals from the FDA, etc. Important provisions regarding the maintenance and mechanics of the FDA were added to HCFA Pub. 15-1 in January 1983.[2] In 1991,[3] the Medicare regulations were amended at 42 C.F.R. § 413.134(e) to include most of these manual provisions relating to the mechanics of properly maintaining the FDA.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary's adjustment is improper for the following reasons:

1. The FDA was properly established and qualified as such under both the regulations and the basic provisions of HCFA Pub. 15-1 § 226.

2. Section 226.2 is inconsistent with the regulations.

3. Board decisions have not required the depositing of interest income in the FDA.

4. In related funded depreciation situations, the decisions of both the Board and HCFA have considered intent, purpose, and result.

5. The interest income earned on FDA can be traced to capital expenditures.

6. In this case, substance over form should govern.

7. The provisions of HCFA Pub. 15-1 § 226.2 that requires the depositing of the interest income in the FDA was not validly promulgated under the Administrative Procedures Act ("APA").

I

It is undisputed (See, item 3 in "Statement of Case...") that the Provider's FDA was properly established and qualified as such under the regulations at 42 C.F.R. § 413.134(e); and the Provider asserts that the FDA also qualifies under the basic provisions of HCFA Pub. 15-1 § 226.

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[2] Transmittal 279, January 1983, Medicare and Medicaid Guide (CCH) ¶ 5124.

[3] 56 Fed. Reg. 43,456 (1991).

The Medicare regulations governing interest expense and the funding of depreciation set forth the requirements that 1) necessary and proper interest on capital indebtedness is an allowable cost, and 2) such cost is reduced by investment income except where the income is from funded depreciation or a qualified pension fund, then there is no offset. Section 413.153 of the regulations specifically governs the allowability of interest expense. During the 1986 cost reporting period, this regulation stated:

> (a)(1) Principle. Necessary and proper interest on both current and capital indebtedness is an allowable cost. . . .
>
> (b) Definitions.
>
> * * *
>
> (2) Necessary. Necessary requires that the interest be --
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> * * *
>
> (iii) Reduced by investment income except if such income is from gifts and grants, whether restricted or unrestricted, and which are held separate and not commingled with other funds. Income from funded depreciation or a provider's qualified pension fund is not used to reduce interest expense. Interest received as a result of judicial review by a Federal court . . . is not used to reduce interest expense.

42 C.F.R. § 413.153 (emphasis added) (Provider Exhibit 4).

However, the regulations also provide for a qualification to the funded depreciation exception when the FDA funds are not used for capital purposes. The regulation states:

> (3) If funded depreciation is used for purposes other than improvement, replacement, or expansion of facilities or equipment re]ated to patient care, allowable interest expense is reduced to adjust for offsets not made in prior years for earnings on funded depreciation. . . .

42 C.F.R. § 413.153(c)(3) (emphasis added).

The Medicare regulation pertaining to the funding of depreciation does not impose any specific requirements. This regulation states:

> (e) Funding of depreciation. Although funding of depreciation is not required, it is strongly recommended that Providers use this mechanism as a means of

> conserving funds for replacement of depreciable assets, and coordinate their planning of capital expenditures with areawide planning activities of community and State agencies. As an incentive for funding, investment income on funded depreciation will not be treated as a reduction of allowable interest expense.

42 C.F.R. § 413.134(e)

The Provider asserts it has complied with these regulatory requirements.

The Provider also maintains it has complied with the basic requirements of the Provider Reimbursement Manual (HCFA Pub. 15-1) § 226ff that sets forth certain specific characteristics for the FDA such as: 1) the approval to fund depreciation by the appropriate managing body of the provider, 2) the funds must be clearly designated as FDA in the provider's records, 3) the FDA funds must be readily available, and 4) the funds must be used to acquire depreciable assets related to patient care or for other related capital purposes, §§ 226; 226.4 and 226.5.

II

The Provider states this appeal focuses on the Intermediary's interpretation and application of § 226.2 which can not be enforced because 1) it is inconsistent with the regulations, 2) it represents a substantive change in Medicare policy which was not promulgated through the "notice and comment" process as required by the APA. (See, VII below).

The Provider contends that § 226.2, which addresses the treatment of investment income earned on FDA, is inconsistent with the regulations because it places a requirement not stated in the regulations and can not be enforced. Section 226.2 states:

> Interest or Other Income Earned by the Funded Depreciation Account
>
> Where the provider funds depreciation, it is expected that the money in the fund will be invested to earn revenues. Investment income earned by the funded depreciation account . . . is not a reduction of allowable interest expense, provided such investment income is deposited in and becomes part of the funded depreciation account.

HCFA Pub. 15-1 § 226.2 (emphasis added).

The Provider asserts that the emphasized portion was not part of the manual prior to its improper inclusion in January 1983 (by Transmittal No.279). Prior to that time, the Provider claims it was in complete compliance with the HCFA Pub. 15-1 provisions; and the

Intermediary had accepted (and never questioned) the Provider's practice of placing the interest income directly in the general operating fund. The interest income was then used to purchase depreciable assets or for other capital purposes.

III

The Provider avers that prior Board decisions support the Provider's position that the depositing of interest income in the FDA is not required where the FDA was clearly established and identified in the Provider's records. The Provider states Pleasant Valley Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Virginia, PRRB Dec. No. 92-D51, August 21, 1992, Medicare and Medicaid Guide (CCH) ¶ 42,577, involved a similar situation. The Board held direct depositing was not required where there was substantial proof that the investment income withdrawn from the FDA was used for the purchase of capital assets. The Provider states that case is substantially the same as the present case and the holding of Pleasant Valley Hospital should also be applied in this case.

In addition, the Good Samaritan Hospital[4] case involved a similar situation that was decided prior to the change in § 226.2. In that case, the income earned on a bond reserve fund was found to qualify as a FDA which was deposited in the operating funds, and it was exempt from the offset for that portion used to pay principal payments. Further, the HCFA Administrator affirmed the Board's decision stating that "... it is not necessary to segregate the interest income for a fund to qualify as funded depreciation. ... The earnings can be placed in the general fund or be allowed to accumulate in the funded depreciation account." The Provider claims that this case establishes the principle that the character of the FDA earnings do not change simply because investment income is placed in the provider's general fund. In addition, this holding buttresses the Provider's contention that the revision to § 226.2 in January 1983 was a substantive change.

IV and V

The Provider states that in other related funded depreciation situations, the decisions of both the Board and HCFA have considered "intent, purpose, and result." The Provider cites the Mercy Medical Center of Springfield (Springfield, Ohio), PRRB Dec. No. 78-D78, December 6, 1978, Medicare and Medicaid Guide (CCH) ¶ 29,561, aff'd HCFA Admr, February 4, 1979, Medicare and Medicaid Guide (CCH) ¶ 29,620. That case involved several questions concerning FDA including the depositing of the investment income in a general operating fund that was used for the purchase of depreciable assets. The Board found that the intermediary's offset was improper because it was proper to consider the "intent, purpose, and

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[4] The Good Samaritan Hospital v. Blue Cross and Blue Shield Association/Mutual Hospital Insurance, Inc., PRRB Decision No. 79-D80, November 26, 1979, Medicare and Medicaid Guide (CCH) ¶ 30,330.

result" concerning those funds, i.e., the management's authority of restricting certain funds and the ultimate purchase of depreciable assets. Moreover, the Administrator agreed with the Board's concept and stated that the evidence showing that capital acquisitions exceeded the FDA investment income during the year under appeal supported the "purpose and result" aspects. This case also supports the HCFA policy concept, as of this time, which was that interest income earned on FDA did not have to be deposited in FDA to retain its identity and to be sheltered from the interest income offset provisions.

VI

The Provider argues that the interest income earned on FDA can be traced to capital purchases/expenditures. The Provider states that all equipment purchases are made through its general operating account, since it does not have a special capital equipment fund for such purchases. ln FY 1986, the total amount of funds expended on equipment purchases from the Provider's general operating account was $1,465,783 which far exceeded the total earnings on the FDA for the same period. In addition, in each and every month during FY 1986, the monthly equipment expenditures exceeded the monthly earnings on its funded depreciation accounts. (See Provider Exhibit 2.) Since all the purchases were made from the CD earnings, it was unnecessary to make any withdrawals from the FDA nor was any new debt incurred.

VII

The Provider contends that the regulations in effect during the Provider's FY 1986 did not require that earnings on funded depreciation be retained in the FDA. The only provision concerning the deposit of income in a FDA was added to the manual § 226.2 by Transmittal No. 279 in January 1983. (Provider Exhibit 8) At that time, HCFA characterized the provision as a new policy that was effective prospectively only. The Provider contends that this represented a substantive change in policy. However, HCFA chose to make this substantive change through a manual transmittal rather than revise its regulations. The Administrative Procedures Act (APA) requires that substantive changes in existing law or policy or changes that impose obligations or produce other significant effects on private interests must be promulgated with the opportunity for public comment. Every substantive rule must be supported by an adequate "basis and purpose" statement. The Provider contends that the provisions of the new manual provisions in § 226.2 were not validly promulgated through the rulemaking procedure as required by the APA.

Prior to the Transmittal No. 279, HCFA had concluded in Good Samaritan Hospital case that investment income did not have to be retained in the FDA. The adopted provisions stated in Transmittal No. 279, which added the deposit requirement for investment income to the funded depreciation account, imposed a stricter standard than the prior policy and constitutes an impermissible rulemaking since the APA procedures were not followed.

Other provisions of Transmittal No. 279 have been held to constitute substantive rules that were procedurally invalid under the APA. In St. Francis Hospital v. Sullivan, Medicare & Medicaid Guide (CCH) ¶ 39,091 (D. Del. 1991) ("St Francis"), the court invalidated provisions of Manual §§ 226(C) and 226.4(C) concerning the contractual commitment standard that were adopted through Transmittal No. 279. Recognizing the substantial impact of interest expense issues on providers, the magistrate's report adopted by the court reasoned that:

> [w]hatever merits such a formulation has from an administrative standpoint, when the substance of an agency pronouncement is to change the standard by which officials exercise their discretion in reviewing, i.e., a provider's method of financing capital projects (and thus to more narrowly circumscribe the provider's options in structuring such project), it is a rule rather than an interpretation.

St. Francis, CCH ¶ 39,091.

The Provider asserts that the deposit provision added to Manual § 226.2 also represents a change in the standard for application of the shelter for investment income on funded depreciation. Thus, it is likewise an invalidly promulgated rule. As such, it can not be applied to this Provider, i.e., that the investment income earned on its FDA must be offset against interest expense as required by this new provision.

INTERMEDIARY'S CONTENTIONS:

The Intermediary makes the following contentions:

1. The Medicare regulations at 42 C.F.R. §§ 413.134(e) and 413.153(b)(2)(iii) provide that allowable interest expense is to be reduced by interest income unless that income is earned from funded depreciation. To qualify this investment income for the "sheltering provision", the provider must comply with the various requirements relative to the funding of depreciation set forth in the HCFA Pub. 15-1.

2. That the Provider has not complied with certain provisions of HCFA Pub. 15-1 concerning the requirements for the funding of depreciation particularly §§ 226.2 and 226.3.

   Section 226.2 states that in order for investment income from funded depreciation to qualify for the sheltering provisions, then the "... investment income [earned on funded depreciation] is deposited in and becomes part of the fund depreciation account."

   Section 226.3 states in part that "... Deposits to the fund depreciation account

must remain for at least six months or more to be considered valid funding transaction and to permit application of §§226.1 and 226.2...." relative to the sheltering provisions.

3. That the Provider's deposits of the investment income from the CDs directly into its general operating funds completely violates these provisions, thereby causing the investment income not to become part of the FDA; and, thus, ineligible for the sheltering provisions.

4. The Provider's accounting treatment of the investment income also shows a complete bypassing of the FDA because the cash was recorded as operating funds and the income was only recorded as interest income. The accounting records did not show any entries to the FDA.

The Intermediary cites the following regulations and manual provisions in support of its position:

42 C.F.R. § 413.134, Depreciation: Allowance for Depreciation Based on Asset Costs. (Intermediary Exhibit B-2) states in part;

> "(e) Funding of depreciation. Although funding of depreciation is not required, it is strongly recommended that Providers use this mechanism as a means of conserving funds for replacement of depreciable assets. Funded depreciation account funds must be placed in readily marketable investments of the type that assures the availability and conservation of the funds. Additions to the funded depreciation account must remain in the account for at least 6 months to be considered valid funding transactions."
>
> "(1) Incentive. As an incentive for funding, investment income on funded depreciation is not treated as a reduction of allowable interest expense."

The regulation concerning interest expense. (Provider Exhibit B-3) states in part;

> (a) Principle. (1) Necessary and proper interest on both current and capital indebtedness is an allowable cost.
>
> (2) Necessary. Necessary requires that the interest be
>
> (iii) Reduced by investment income except if such income is from gifts and grants, whether restricted or unrestricted, and that are held separate and not commingled with other funds. Income from funded depreciation that meets the requirements of Section 413.134 or a Provider's qualified pension fund is not

> used to reduce interest expense ...

42 C.F.R. § 413.153.

HCFA Publication 15-1, Chapter 2, Interest Expense. (Intermediary Exhibit C) states in part;

> 200. principle - Necessary and proper interest on both current and capital indebtedness is an allowable cost.
>
> 202.1 Interest. ... to be allowable under the Medicare program, interest must be: ... necessary and proper for the operation, maintenance, or acquisition of your facilities.
>
> 202.2 Necessary. - ... Necessary also requires that the interest be reduced by investment income, except investment income earned by ... funded depreciation (see Section 226.2), ...
>
> 226. Funded Depreciation - Funding of depreciation is the practice of placing funds, including nonborrowed bond reserve and sinking funds, in a segregated account(s) for the acquisition of depreciable assets used in rendering patient care or for other capital purposes related to patient care ...
>
> 226.2 Interest or Other Income Earned by the Funded Depreciation Account
>
> Where the provider funds depreciation, it is expected that money in the fund will be invested to earn revenues. Investment income earned by the funded depreciation account attributable to cumulative allowable depreciation expense funded in periods either before or after the Provider's participation in the Medicare program is not a reduction of allowable interest expense provided such investment income is deposited in and becomes part of the funded depreciation account."
>
> 226.3 Deposits in the Funded Depreciation Account - The provider's cumulative deposits in this account cannot exceed its total cumulative allowable depreciation expense. Investment income from such funded depreciation deposits retains it identity and becomes a part of the funded depreciation fund if deposited in the funded depreciation account at the time of receipt by the provider.

The Intermediary contends that the Provider has failed to comply with the Medicare regulations and Provider manual provisions that afford the offset exemption against allowable interest expense for the interest income earned on qualified funded depreciation accounts.

The exemption is only available if certain specific criteria are met. Some of the requirements are as follows:

1. Funds must be placed in readily marketable investments. Additions to the account must remain in the account for at least 6 months to be considered valid funding transactions.

2. Funded depreciation investment income is deposited in and becomes part of the funded depreciation account.

3. Funded depreciation investment income retains its identity and becomes a part of the funded depreciation fund if deposited in the funded depreciation account at the time of receipt.

The Intermediary states the Provider failed to meet these stated requirements. In particular, since the investment income was deposited directly into the operating funds, the income did not become part of the FDA, thereby making these funds ineligible for the sheltering provisions ordinarily afforded. In addition, the accounting treatment was merely to debit operating funds and to credit interest income, which bypasses the FDA.

CITATION OF LAW, REGULATIONS, AND PROGRAM INSTRUCTIONS:

1. Law - United States Code ("U.S.C."):

   5 U.S.C. Administrative Procedures Act

   § 553 et seq. - Rule Making

   42 U.S.C. Public Health and Welfare

   § 1395x(v)(1)(A) - Reasonable Cost

2. Regulations - 42 C.F.R.:

   § 405.1835-41 - Board Jurisdiction

   § 413.5 - Cost Reimbursement - General

   § 413.9 - Cost Related to Patient Care

   § 413.20 - Financial Data and Reports

§ 413.24	-	Adequate Cost Data and Cost Finding
§ 413.134 et seq.	-	Depreciation: Allowance for Depreciation Based on Asset Costs
§ 413.153 et seq. (Previously designated as § 405.419)	-	Interest Expense

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

§ 200 et seq.	-	Interest Expense
§ 226 et seq.	-	Funded Depreciation
§ 226.2	-	Interest or Other Income Earned by the Funded Depreciation Account
§ 226.3	-	Deposits in the Funded Depreciation Account

4. Other:

Transmittal 279, January 1983, Medicare and Medicaid Guide (CCH) ¶ 5124.

56 Fed. Reg. 43,456 (1991)

59 Fed. Reg. 45,401 (1994)

5. Case Law:

The Good Samaritan Hospital v. Blue Cross and Blue Shield Association/Mutual Hospital Insurance, Inc., PRRB Decision No. 79-D80, November 26, 1979, Medicare and Medicaid Guide (CCH) ¶ 30,330.

High Point Regional Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of North Carolina, PRRB Dec. No. 97-D46, April 10, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,172.

Mercy Medical Center of Springfield (Springfield, Ohio), PRRB Dec. No. 78-D78, December 6, 1978, Medicare and Medicaid Guide (CCH) ¶ 29,561, aff'd HCFA Admr, February 4, 1979, Medicare and Medicaid Guide (CCH) ¶ 29,620.

Monongahela Valley Hospital v. Sullivan, 945 F.2d 576, 592 (3rd Cir. 1991).

Pleasant Valley Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Virginia, PRRB Dec. No. 92-D51, August 21, 1992, Medicare and Medicaid Guide (CCH) ¶ 40,771; Rev'd HCFA Admr., October 19, 1992, CCH ¶ 40,903; aff'd, 837 F. Supp. 738 (S.D.W.Va. 1993), CCH ¶ 41,973; aff'd, 32 F.3d 67 (4th Cir. 1994), CCH
¶ 42,577.

St. Francis Hospital v. Sullivan, Medicare & Medicaid Guide (CCH) ¶ 39,091 (D. Del. 1991).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' briefs and contentions, and evidence submitted, finds and concludes that the Intermediary's offset of investment income earned on the FDA against allowable interest expense was proper under the circumstances. The Intermediary's adjustments are affirmed.

The fundamental issue is whether interest income earned on FDA funds must be deposited in the FDA account to qualify as FDA funds and afforded the benefit of the sheltering provision.

The Board finds that the interest income earned on the FDA did not ultimately qualify as FDA funds because the income was never deposited in the FDA and inherently could not be on deposit for 6 months or more. Hence, it was proper to offset such income against allowable interest expense.

The regulations provide that as an incentive for funding depreciation, investment income earned on funded depreciation will not be treated as a reduction of allowable interest expense.[5] This is commonly referred to as the “sheltering provision.” However, to qualify for the benefit of the sheltering provision, the Provider must properly maintain its FDA.

The Board recognizes that the regulations in 1986 did not impose specific requirements regarding the mechanics of the FDA. However, section 226 et seq., HCFA Pub. 15-1, did provide a variety of program instructions relating to the mechanics of properly maintaining the FDA. The Board finds these instructions to be consistent with the language and purpose of the basic relevant statutory and regulatory provisions, and they represent a reasonable interpretation of the purpose and intent of those provisions. The Board disagrees with the Provider's assertion that section 226 is inconsistent with the regulations.

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[5] 42 C.F.R. § 413.153(b)(2)(iii).

The Board finds that the provisions of §§ 226.2 and 226.3 HCFA Pub. 15-1 are relevant to the issue. These sections state in part:

> Investment income earned by the funded depreciation account . . . is not a reduction of allowable interest expense provided such investment income is deposited in and becomes part of the funded depreciation account."

HCFA Pub. 15-1 § 226.2 (emphasis added).

> Investment income from such funded depreciation deposits retains it identity and becomes a part of the funded depreciation fund if deposited in the funded depreciation account at the time of receipt by the provider."
>
> Deposits to the funded depreciation account must remain for 6 months or more to be considered as valid funding transactions and to permit application of §§ 226.1 and 226.2. Deposits of less than 6 months duration are not eligible for the benefits of those sections.

HCFA Pub. 15-1 § 226.3 (emphasis added).

The Board finds that the Provider failed to comply with critical specific requirements of the above stated provisions that affords the benefit of the offset exemption against allowable interest. It is uncontroverted that the Provider deposited the earned income on FDA funds directly into its operating fund. The operating fund is not a FDA. Failing to deposit the earned income in the FDA causes these deposits to be ineligible to qualify as FDA funds pursuant to § 226.2, HCFA Pub. 15-1; and as such, these funds do not qualify for the offset exemption. Further, since the funds were not deposited in the FDA, they inherently were not in the account for at least six months as required by § 226.3, HCFA Pub. 15-1. Thus, they do not qualify as FDA funds for the sheltering benefit.

The Board notes that the Provider's accounting treatment for the investment income was simply to debit operating funds and to credit interest income thereby completely bypassing the FDA.

The Board finds the Provider cannot bypass the clear requirements of §§ 226.2 and 226.3 of HCFA Pub. 15-1 by depositing the earned investment income on FDA funds into the operating fund to allegedly accommodate the purchase of depreciable assets. The Board finds that the Provider's methodology creates a commingling of funds which violates the established regulatory[6] concept that FDA funds must be segregated and not commingled.

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[6] 42 C.F.R. § 413.153(b)(2)(iii).

The Board disagrees with the Provider's reliance on the Pleasant Valley Hospital case. The Board notes its original decision in that case was reversed by the HCFA Administrator which was upheld by the 4th Circuit Court of Appeals. The Board finds the Court's holding in that case to be persuasive. The Board's ruling in this case is consistent with other more recent PRRB decisions, such as High Point Regional Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of North Carolina, PRRB Dec. No. 97-D46, April 10, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,172.

The Board also disagrees with the Provider's assertion that the changes to the FDA provisions in HCFA Pub. 15-1 by Transmittal 279, January 1983 were substantive and issued in violation of the APA. Medicare policy basically required providers to clearly identify and segregate funded depreciation monies.[7] The Board finds the requirement of depositing the investment income into the FDA is reasonable to ensure identification and segregation of funds, and to safeguard that the income is solely used for acquisitions of depreciable assets or other capital purposes. Further, it serves as a protective measure against funded depreciation monies being diverted for general operating expenses; and unlike simple debit/credit accounting, it promotes a clear audit trail for all FDA funds and the ultimate use of such funds.

DECISION AND ORDER:

The Intermediary's offset of investment income earned on the Provider's funded depreciation account against interest expense was proper. The Intermediary's adjustments are affirmed.

Board Members Participating:

Irving W. Kues
James G. Sleep
Henry C. Wessman, Esquire

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[7] Pleasant Valley Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Virginia, PRRB Dec. No. 92-D51, August 21, 1992, Medicare and Medicaid Guide (CCH) ¶ 40,771; Rev'd HCFA Admr., October 19, 1992, CCH ¶ 40,903; aff'd, 837 F. Supp. 738 (S.D.W.Va. 1993), CCH ¶ 41,973; aff'd, 32 F.3d 67 (4th Cir. 1994), CCH ¶ 42,577. Monongahela, 945 F.2d 576, 592 (3rd. Cir. 1991).

Date of Decision: June 03, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman