PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2001-D48

PROVIDER –
Continue Care Home Health II, Inc.
Cleveland, Mississippi

Provider No. 25-7305

vs.

INTERMEDIARY –
Blue Cross/Blue Shield Association/
Palmetto Government Benefits
Administrators

DATE OF HEARING-
August 22, 2001

Cost Reporting Period Ended -
December 31, 1997

CASE NO. 00-1179

INDEX

ISSUES:

1. Was the Intermediary=s adjustment, at the Home Office level, to the owner=s bonus for untimely liquidation proper?

2. Was the Intermediary=s adjustment, at the Provider level, to employee bonuses for untimely liquidation proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Continue Care Home Health II, Inc. (AProvider@)@ is a proprietary home health agency located in Cleveland, Mississippi. It is part of the Home Health Care Management, Inc. chain organization.

On September 29, 1999, the Intermediary issued a Notice of Program Reimbursement (NPR) which reflected the impact of adjustments applicable to the untimely liquidation of both owner and employee bonuses.[1] On February 17, 2000, the Provider filed a timely request for a hearing with the Provider Reimbursement Review Board (ABoard@), and has met the jurisdictional requirements of 42 C.F.R. ' 405.1835-.1841. The estimated Medicare reimbursement effect is approximately $4,531 for issue No. 1 and $24,562 for issue No. 2. A third issue has been administratively resolved. The Provider is represented by Robert N. Warrington, Esquire, of Campbell, DeLong, Hagwood and Wade, LLP. The Intermediary is represented by Bernard M. Talbert, Esquire, of the Blue Cross and Blue Shield Association.

Issue 1 - Adjustment of Owner=s Bonus for Untimely Liquidation:

Facts

The Home Office accrued bonuses for the employees and owner at year-end. The Intermediary reviewed accrued bonuses to determine if the cost was allowable and liquidated in accordance with Medicare regulations.[2] Bonus checks were dated December 16, 1998 to the employees and March 16, 1998 to the owner. In a sample of payments, the Intermediary noted the $10,000 bonus paid to the owner was not liquidated timely. The check was dated March 16, 1998 but it did not clear the bank until March 23, 1998. The Intermediary considered this unallowable and disallowed the expense at the Home Office level in that the check needed to clear the bank on or before March 16, 1998.

1 Intermediary Exhibit I-4. Also, Provider Exhibits A, B, & C.

2 Intermediary Exhibit I-13.

Issue 2 - Adjustment of Employee Bonuses for Untimely Liquidation:

Facts

Bonus checks to employees were dated December 16, 1998 to liquidate the accrual for the fiscal year ended December 31, 1997. In a sample, the Intermediary noted and disallowed ten payments totaling $24,562 which did not clear the bank timely (by December 31, 1998).

PROVIDER=S CONTENTIONS:

The Provider contends that the two issues can be treated as one in that the general concept is the same. (First issue involves an adjustment to the Provider=s Home Office and the second issue involves a direct adjustment to the Provider).

The Provider asserts that the delivery of the bonus checks to the Provider=s employees (and the Provider=s delivery of bonus checks to its employees) prior to December 31, 1998 satisfied the liquidation requirement of HCFA Pub. 15-1 ' 2305. That section provides as follows:

> AA short term liability must be liquidated within 1 year after the end of the cost reporting period in which the liability is incurred . . . Liquidation must be made by check or other negotiable instrument . . .@

As such, the Provider contends that the Intermediary=s position, which is that the check must have cleared the bank in order to satisfy the requirements of HCFA Pub. 15-1 ' 2305, is without merit. The Provider points out that the Intermediary=s position is clearly contrary to the Uniform Commercial Code, the law that governs checks in the State of Mississippi and most of the other states in the United States. Mississippi follows the general rule that the "time of payment" of a debt is the time when the check is received by the payee-creditor, rather than the time the check is paid by the debtor's bank. See Brady on Bank Checks 7th Edition[3]. Mississippi has adopted the Uniform Commercial Code, the law that governs negotiable instruments (including checks). Pursuant to Mississippi Code Ann. Section 75-3-310, as amended, the relation back to the time of delivery of the check is the law in Mississippi.[4]

---

[3] Provider Exhibit E.

[4] Provider Exhibit F.

Moreover, the Intermediary=s position is completely contrary to the Internal Revenue Code and other regulations which provide that the mere placing of a check in the mail prior to the end of the tax year is sufficient to allow a deduction in the year in which the check is mailed. The Provider also notes that the Intermediary refused to offset the amount of the proposed adjustment by those 1995 bonus checks which cleared the bank in January 1997. Had the Intermediary applied its methodology consistently, that action would have produced a positive adjustment to the Provider=s cost report.

INTERMEDIARY=S CONTENTIONS:

Issue 1. Was the Intermediary=s adjustment at the Home Office level to the owner=s bonus for untimely liquidation proper.

The Intermediary contends that the Provider incorrectly used HCFA Pub. 15-1 '2305 as its basis for asserting that the owner=s bonus was liquidated timely. That section states the following:

> A short-term liability must be liquidated within 1 year after the end of the cost-reporting period in which the liability is incurred, subject to the exceptions specified in 2305.1 and 2305.2. Liquidation must be made by check or other negotiable instrument, cash or legal transfer of assets such as stocks, bonds, real property, etc. Where liquidation is made by check or other negotiable instrument, these forms of payment must be redeemed through an actual transfer of the provider's assets within the time limits specified in this section. Where the liability (1) is not liquidated within the 1-year time limit, or (2) does not qualify under the exceptions specified in ' 2305.1 and 2305.2, the cost incurred for the related goods and services is not allowable in the cost reporting period when the liability is incurred, but is allowable in the cost reporting period when the liquidation of the liability occurs.

Id. (Emphasis added).

The Intermediary contends that the use of Section 2305 treats the adjustment as employee related to support the Provider=s assertion of aIlowability. Had this disallowance pertained to employees, the Provider would have more time to liquidate the liability, which Section 2305 states as within 1 year after the end of the cost-reporting period in which the liability is incurred.

The Intermediary contends it is improper to use Section 2305 in regard to liquidating liabilities incurred by the owner. Regulations and manual instructions specifically address the liquidation of owner's liabilities which indicate that a difference exists between the treatment of owner's and employee's liabilities in regard to liquidation.

The Intermediary argues that HCFA Pub. 15-1 ' 906.4 supports the Intermediary=s contention for disallowance of the owner's bonus for current and subsequent reporting periods as stated below:

> The compensation of stockholder-employees and individuals described in '901 (other than sole proprietors and partners) is included for a cost reporting period if earned within the period, even if not paid until after the close of the period. However, <u>**payment must be made**</u> (whether by check or other negotiable instrument, cash or legal transfer of assets such as stocks, bonds, real property, etc.) <u>**within 75 days after the close of the period**</u>**.** Where payment is made by check or other negotiable instrument (e.g., a promissory note), these forms of payment <u>**must be liquidated through an actual transfer of the provider's assets within 75 days after the close of the period in order to meet the requirements of this section**</u>**. If payment, including the liquidation of negotiable instruments,** is not **made within the cost reporting period, or** within 75 days thereafter, the **unpaid compensation is** <u>**not includable in allowable costs**</u> **either** in the period when **earned or in the period when** actually paid.

<u>Id</u>. (Emphasis added).

The Intermediary points out that the Provider is not entitled to an exception which would allow additional time to liquidate the liability. HCFA Pub. 15-1 ' 2305.1 states the following in regard to exceptions:

> If, within 1 year following the end of a provider=s cost reporting period, the provider furnishes to the intermediary sufficient written justification (based upon documented evidence) for nonpayment of the liability, the intermediary may grant an extension for good cause. This extension must not extend beyond 3 years after the end of the cost-reporting period in which the liability was incurred. Examples of valid justification, i.e., good cause, would include, but are not limited to,

> insufficient cash flow, or accounting error in the receipt and processing of bills for the cost of goods and services.

Id.

Further, HCFA Pub. 15-1 ' 2305.2 is explicit in its language that owner=s compensation, which requires 75-day liquidation after the end of the cost reporting period, cannot be considered an exception to the 1-year limit. See HCFA Pub. 15-1 '2305.2D.

The Intermediary also argues that the following Provider contentions are without merit:

a. The Intermediary's position is contrary to the Uniform Commercial Code (UCC),

b. The Intermediary's position is contrary to the Internal Revenue Promulgations which provides a mere placing of a check in the mail prior to the end of a tax year is sufficient to allow deduction in the year in which the check is mailed,

c. Legal effect of check delivery is a matter determined by state law,

d. Mississippi follows the general rule that the "time of payment of a debt is the time when the check is received by the payee-creditor, See Brady on Bank Checks, 7th Edition, Pages 4- 20.

The Intermediary contends that the references cited above deal with Arecognition of timely payment@ and not liquidation. Further, the Provider participates in the Medicare program and is reimbursed according to Program laws, regulations, instructions and other Program issuances. The Intermediary recognizes the postmark date concerning the timely filing of a Medicare cost report, not the liquidation of liabilities. Liquidation is addressed and discussed in Transmittal No. 391,[5] dated February, 1996, which states, in part:

> For cost reporting periods beginning on or after October 1, 1995, any compensation not paid through an actual transfer of provider assets within 75 days after the close of the year in which the compensation is earned, including the liquidation of negotiable instruments, is unallowable in the period when earned or in the period when actually paid.

---

[5] Intermediary Exhibit I-10.

Id.

Finally, the Intermediary contends that the Provider=s argument that the Intermediary refused to offset the amount of this adjustment by the 1995 bonus checks, which cleared the bank in January, 1997, is without merit. First, the Provider=s NPR for 1995 does not include an adjustment for unliquidated checks. A reopening would be appropriate to allow the cost in 1997 only if it was disallowed in 1995. However, the Intermediary did not perform a field review on the Provider=s cost for 1995. It is evident problems existed based on the Provider=s admission regarding the 1995 accrued liability being untimely liquidated in 1997 instead of by December 31, 1996. A focus review was performed on-site for the Home Office cost statement in 1995 and the scope did not include accrued bonuses or salaries.

Issue 2: Was the Intermediary's adjustment to the Provider's employee bonuses for untimely liquidation proper?

The Intermediary contends that HCFA Pub. 15-1 ' 2305 states as follows:

> A short-term liability must be liquidated within 1 year after the end of the cost-reporting period in which the liability is incurred, subject to the exceptions specified in ' 2305.1 and 2305.2. Liquidation must be made by check or other negotiable instrument, cash or legal transfer of assets such as stocks, bonds, real property, etc. Where liquidation is made by check or other negotiable instrument, these forms of payment must be redeemed through an actual transfer of the provider's assets within the time limits specified in this section. Where the liability (1) is not liquidated within the 1-year time limit, or (2) does not qualify under the exceptions specified in '' 2305.1 and 2305.2, the cost incurred for the related goods and services is not allowable in the cost reporting period when the liability is incurred, but is allowable in the cost reporting period when the liquidation of the liability occurs.

Id. (Emphasis added).

The Intermediary points out that HCFA Pub. 15-1 ' 2305 is not ambiguous as to the criteria necessary to be considered liquidated. The fact the Provider referenced it in their position paper also indicates they are cognizant of the liquidation criteria for checks, which requires an actual transfer of the Provider's assets. The Provider is correct that it is the Intermediary=s position, as well as the Program's position, that the check must clear the bank in order to satisfy the liquidation requirements. HCFA Pub. 15-1 ' 2305 also states an actual transfer of the

Provider=s assets must occur, which amounts to a reduction of funds available in the Provider=s bank account due to the transfer. A check does not represent an actual transfer of the Provider=s assets to cover liabilities. It is only a negotiable instrument satisfied when presented for payment.

The Intermediary further points out that the employee=s bonus accrual itself is not being disallowed by the Intermediary, only the amounts that were untimely liquidated. The Intermediary contends that the cost is allowable in the cost reporting period when liquidation occurs since it was not timely liquidated (emphasis added). Therefore, the cost should be reported in fiscal year ended December 31, 1999.

The Intermediary also contends that the Provider failed to request an extension for liquidation of the liability. The instructions for an exception are stated in HCFA Pub. 15-1 ' 2305.1 as follows:

> Exception to 1-Year time Limit- lf, within 1 year following the end of a provider's cost reporting period, the provider furnishes to the intermediary sufficient written justification (based upon documented evidence) for nonpayment of the liability, the intermediary may grant an extension for good cause. This extension must not extend beyond 3 years after the end of the cost-reporting period in which the liability was incurred. Examples of valid justification, i.e., good cause, would include, but are not limited to, insufficient cash flow, or accounting error in the receipt and processing of bills for the cost of goods and services.

Id. (Emphasis added).

The Intermediary=s files indicate the Provider failed to request an extension for liquidation of the liability. In light of this fact, the Intermediary should not arbitrarily give the Provider an extension.

The Intermediary asserts that since the Provider treated Issue 1 and 2 as a single issue, its responses to these issues are the same as those addressed in Issue 1.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Regulations B 42 C.F.R.:

'' 405.1835-.1841 - Board Jurisdiction

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

' 906.4	-	Unpaid Compensation
' 2305	-	Liquidation of Liabilities
' 2305.1	-	Exception to 1-Year Time Limit
' 2305.2	-	Application and Exception

3. Other:

Brady on Bank Checks, 7th Edition

Medicare Transmittal No. 391, February 1996

Mississippi Uniform Commercial Code ' 75-3-310

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration and analysis of the controlling law, regulations, and program instructions, the facts of the case, documentary evidence presented, and the parties= contentions, finds and concludes as follows:

Issue 1. - Adjustment of Owner=s Bonus for Untimely Liquidation:

The Board notes that a bonus check was issued to the Provider=s owner on March 16, 1998. However, that check did not clear the bank until March 23, 1998. HCFA issued Transmittal No. 391 in February 1996. That document contained new implementing instructions for HCFA Pub. 15-1 ' 906.4 (Unpaid Compensation) and was effective for cost reporting periods beginning on or after October 1, 1995. The instructions state in part:

> Where payment is made by check or other negotiable instrument (e.g., a promissory note), these forms of payment must be liquidated through an actual transfer of the provider=s assets within 75 days after the close of the period in order to meet the requirements of this section. If payment, including the liquidation of negotiable instruments, is not made within the cost reporting period, or within 75 days thereafter, the unpaid

> compensation is not includable in allowable costs either in the period earned or in the period when actually paid.

Id.

Based on a review of the record, the Board finds that the Provider did not meet the requirements of HCFA Pub. 15-1 ' 906.4.

The Board notes that the Provider cited HCFA Pub. 15-1 ' 2305 to support its position that the liability was timely liquidated. However, the Board finds that particular manual section is applicable to the liquidation of employees= liabilities, as distinguished from the liquidation of an owner=s compensation liability. The Board also considered but rejects, the Provider=s argument that delivery of a check constitutes payment. A closer reading of the Uniform Commercial Code[6] revealed that in the case of an uncertified check, suspension of the obligation (as opposed to discharge) continues until dishonor of the check or until it is paid or certified. Similarly, the Board=s review of Brady on Bank Checks [7] revealed that the courts are not always unanimous in holding that the payment of a debt is the time when the check is received by the payee.

Issue 2 - Adjustment of Employee Bonuses for Untimely Liquidation:

The Board finds that the Provider accrued over $400,000 in employee bonuses for the 1997 fiscal year. Of that amount, $24,562 was disallowed by the Intermediary for untimely liquidation. The Board also finds that HCFA Pub. 15-1 ' 2305 requires a short term liability must be liquidated within one year after the end of the cost report period in which the liability is incurred. In the instant case, liquidation of the liability for employee bonuses should have been completed by December 31, 1998. However, the amounts in question were not liquidated until January 1999. The Board notes that the Provider did not seek an exception, as provided by HCFA Pub. 15-1 ' 2305.1, which may have allowed the Provider additional time to liquidate the liability.

The Board also finds that HCFA Pub. 15-1 ' 2305 states in part

> Where the liability (1) is not liquidated within the 1-year time limit, or (2) does not qualify under the exceptions specified in '' 2305.1 and 2305.2, the cost incurred for the related goods and services is not allowable in the cost reporting period when

---

6 Provider Position Paper at Tab F.

7 Provider Position Paper at Tab E.

> the liability is incurred, but is allowable in the cost reporting period when the liquidation of the liability occurs.

Id.

The Board also notes that the Intermediary recognized that the costs in questions are allowable in the cost reporting period when liquidation occurs.[8] Therefore, the cost should be properly reported in the Medicare cost report for the fiscal year ended December 31, 1999.

DECISION AND ORDER:

Issue 1.Adjustment of Owner=s Bonus for Untimely Liquidation:

HCFA Pub. 15-1 ' 906.4 is the proper methodology to apply regarding the liquidation of an owner=s compensation liability. The Intermediary=s adjustment is affirmed.

Issue 2. Adjustment of Employee Bonuses for Untimely Liquidation:

HCFA Pub. 15-1 ' 2305 is the proper guideline to apply regarding the liquidation of employee bonuses. The Intermediary adjustment is affirmed. Assuming the Provider had notice of this adjustment prior to filing its fiscal year 1999 Medicare cost report and presuming it was claimed in that year, the amount should be allowable as a reimbursable cost for 1999.

Board Members Participating:

Irvin W. Kues
Henry C. Wessman, Esquire
Stanley J. Sokolove

FOR THE BOARD

Date of Decision: September 17, 2001

Irvin W. Kues
Chairman

---

8 Intermediary Position Paper at p. 13. & Exhibit I-14.