

CENTERS FOR MEDICARE & MEDICAID SERVICES
Decision of the Administrator

In the case of:

**P-B Health Home Care
Agency, Inc.,**

Provider

vs.

**Blue Cross/Blue Shield Association
Cahaba Government Benefit
Administrators**

Intermediary

Claim for:

**Provider Reimbursement for
Cost Reporting Period Ending:**

06/30/1997

Review of:

PRRB Decision 2007-D15

Dated: January 25, 2007

This case is before the Administrator, Centers for Medicare & Medicaid Services (CMS), for review of the decision of the Provider Reimbursement Review Board (Board). The review is during the 60-day period in §1878(f)(1) of the Social Security Act (Act). Comments were received from CMS' Centers for Medicare Management (CMM) and the Intermediary requesting reversal. The parties were notified of the Administrator's intent to review the Board's decision. Comments were also received from Provider requesting affirmation. Accordingly, this decision is now before the Administrator for final agency review.

ISSUE AND BOARD'S DECISION

The issue is whether the Intermediary adjustment to disallow the cost of accrued compensatory time was proper.

The Majority of the Board, reversing the Intermediary's adjustment, held that the Intermediary improperly disallowed the cost of accrued compensatory time. The Majority found that, although the compensatory hours were not used over several years, these hours still represented a future liability. The Majority noted the Intermediary's argument that the language of the Provider's Employee Handbook prohibits compensatory hours to be exchanged for financial compensation. The Majority found that the language cited does not mean that the Provider will not pay employees for accumulated time off when they retire, leave the company, or die while employed. Thus, the Majority concluded that the accrued compensatory time in FY 1997 represented a future liability.

Moreover, the Majority noted that there are no Medicare regulatory, nor program instructions, that require liquidation of the compensatory time within any prescribed period of time. The Majority also noted that, likewise, the Provider's internal policies did not require liquidation within any specified time period. Thus, the Majority concluded that there were no prohibitions against the Provider permitting its employees an unlimited period of time to utilize accrued compensatory time.

Finally, the Majority found the Intermediary's argument that the compensatory time is not a common and accepted occurrence and that the accrued costs are not allowable because the benefit is not provided to all employees without merit. The Board Majority found that the Intermediary provided no documentation or testimonial evidence to support these contentions. Thus, the Majority concluded that the cost of accrued compensatory time at issue was allowable and proper.

One Board member dissented, finding that the Intermediary's adjustment to disallow the costs of the accrued compensatory time at issue was proper. The Dissenter found that, based on a reading of the Provider's Employee Handbook, exempt employees are not allowed to receive financial compensation in lieu of compensatory time. Thus, the Dissenter concluded that, if no financial compensation is allowed in lieu of accrued compensatory time, the Provider cannot accrue any financial obligation (cost) for the accrued time.

SUMMARY OF COMMENTS

The Intermediary commented, requesting reversal of the Majority's decision. The Intermediary, referring to its arguments in its supplemental position paper and presented at the hearing, argued that the evidence demonstrated that the cost of accrued compensatory time was illusory and there was no such reimbursable cost. The Intermediary asserted that the dissenting opinion represented an accurate assessment of the record and supported reversal. Further, the Intermediary argued that, as the language of Provider's Employee Handbook demonstrates, no financial compensation is provided in lieu of paid days off. Thus, the Intermediary concluded that if financial compensation is not provided, there was no accruable liability.

CMS' Center for Medicare Management (CMM) commented, requesting reversal. CMM argued that the costs associated with the compensatory time worked by the owners of the Provider are not reasonable and are contrary to the Provider's policy. CMM pointed out that the Provider's Employee Handbook states that compensatory time is treated as paid time off. The handbook further provides that no financial compensation is provided in lieu of paid days off. In addition, CMM noted that at the hearing, the Provider argued that its written policy was not

intended to prohibit paying for the compensatory time of employees who leave, retire, or die. However, CMM argued that if the intent of the Provider's policy was to make provisions for exempt employees who leave the company, the Provider's Employee Handbook would have included appropriate guidelines. Finally, CMM noted, that for the periods prior to the cost year at issue, when the Provider accounted for the costs at issue on a cash basis, the Provider did not have an obligation to spend money for the compensatory time. Thus, there were no costs incurred. For the cost year at issue, the Provider converted to an accrual basis of accounting; however, the nature of the compensatory time did not change. Thus, the Provider continued not to incur costs.

The Provider commented, requesting affirmation of the Majority's decision. The Provider argued that testimony provided at the hearing and the plain reading of the Provider's Employee Handbook supports the Majority's decision that the claimed cost associated with the compensatory time is an allowable accrued cost. The Provider pointed out that, under its policy, compensatory time can never be lost. In fact, if the time is not used in the year earned, the Provider's policy required that the time be carried over to the next year and can be used in subsequent years. The Provider further stated that financial compensation is not provided instead of taking the days off and that if an employee were to die, the accrued compensatory time would be paid to the surviving spouse or the estate. The Provider pointed out that employees neither lose compensatory time, nor the ability to get paid for the days when eventually taken off. Thus, the Provider concluded that its obligation to pay for compensatory time carried over to the following year and was no less a liability than its obligation to pay for compensatory time used in the year earned.

DISCUSSION

The entire record furnished by the Board has been examined, including all correspondence, position papers, exhibits, and subsequent submissions. All comments are included in the record and have been considered.

Section 1861(v)(1)(A) of the Social Security Act requires that providers of services to Medicare beneficiaries are to be reimbursed the reasonable cost of those services. Reasonable cost is defined as the "the cost actually incurred, excluding therefrom part of the incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included ...". (Emphasis added) Id. This section does not specifically address the determination of reasonable cost, but authorizes the Secretary to promulgate regulations and principles to be applied in determining reasonable costs. One of the underlying principles set forth in the Act is that Medicare shall not pay for costs incurred by non-Medicare beneficiaries, and vice-versa, i.e., Medicare prohibits cross-subsidization of costs. These principles are reflected and further explained in the regulations. The regulations at 42 CFR §413.9(c) provides that the determination

of reasonable cost must be based on costs related to the care of Medicare beneficiaries and includes “all necessary and proper expenses incurred in furnishing services.”

Further, Section 1815(a) of the Social Security Act provides that no payments shall be made to any provider unless it has furnished such information as the Secretary may request in order to determine the amounts due such provider under this part for the period with respect to which the amounts are being paid or any prior period. Consistent with the statute, 42 CFR 413.20 and 413.24 set forth the general documentation and accounting requirements. The regulations at 42 CFR 413.20 and 413.24 require that providers maintain adequate financial records and statistical data for the accurate determination of costs reimbursable under Medicare. The process of determining such reimbursable costs involves the review of data available from the provider’s usually-maintained accounts to arrive at the proper payment amounts for services to beneficiaries.

Relevant to this case, 42 CFR 413.24(b)(2) defines accrual basis of accounting, as follows:

As used in this part, the term *accrual basis of accounting* means that revenue is reported in the period in which it is earned, regardless of when it is collected; and an expense is reported in the period in which it is incurred, regardless of when it is paid. (See section 413.100 regarding limitations on allowable accrued costs in situations in which the related liabilities are not liquidated timely.) (Emphasis added.)

Further, the regulations at 42 CFR 413.100 provide for special treatment of certain accrued costs, as follows:

(a) *Principle.* As described in § 413.24(b)(2), under the accrual basis of accounting, revenue is reported in the period in which it is earned and expenses are reported in the period in which they are incurred. In the case of accrued costs described in this section, for Medicare payment purposes the costs are allowable in the year in which the costs are accrued and claimed for Medicare payment only under the conditions set forth in paragraph (c) of this section.

(b) *Definitions.* (1) *All-inclusive paid days off benefit.* An all-inclusive paid days off benefit replaces other vacation and sick pay plans. It is a formal plan under which, based on actual hours worked, all employees accrue vested leave or payment in lieu of vested leave for any combination of types of leave, such as illness, medical appointments, holidays, and vacations.

* * * *

(c) *Recognition of accrued costs.* -- (1) *General.* Although Medicare recognizes, in the year of accrual, the accrual of costs for which a provider has not actually expended funds during the current cost reporting period, for purposes of payment, Medicare does not recognize the accrual of costs unless the related liabilities are liquidated timely.

(2) *Requirements for liquidation of liabilities.* For accrued costs to be recognized for Medicare payment in the year of the accrual, the requirements set forth below must be met with respect to the liquidation of related liabilities. If liquidation does not meet these requirements, the cost is disallowed, generally in the year of accrual, except as specified in paragraph (c)(2)(ii) of this section.

(i) *A short-term liability.* (A) Except as provided in paragraph (c)(2)(i)(B) of this section, a short-term liability must be liquidated ... within 1 year after the end of the cost reporting period in which the liability is incurred.

(B) If, within the 1-year time limit, the provider furnishes sufficient written justification (based upon documented evidence) to the intermediary for nonpayment of the liability, the Intermediary may grant an extension for good cause. The extension may not exceed 3 years beyond the cost reporting year in which the liability was incurred.

(ii) *Vacation pay and all-inclusive paid days off.* (A) If the provider's vacation policy, or its policy for all-inclusive paid days off, is consistent for all employees, liquidation of the liability must be made within the period provided for by that policy.

(B) If the provider's vacation policy, or its policy for all-inclusive paid days off, is not consistent for all employees, liquidation of the liability must be made within 2 years after the close of the cost reporting period in which the liability is accrued.

(C) If payment is not made within the required time period or if benefits are forfeited by the employee, an adjustment to disallow the accrued cost is made in the current period (that is, the latest year in which payment should have been made or the year in which the benefits are forfeited) rather than in the period in which the cost was accrued and claimed for Medicare payment....

(iii) *Sick pay.* (A) If a sick leave is vested and funded in a deferred compensation plan, liabilities related to the contributions to the fund must be liquidated, generally, within 1 year after the end of the cost reporting period in which the liability is incurred. If, within the 1-year time limit, the provider furnishes to the intermediary sufficient written justification ... for nonpayment of the liability, the intermediary may grant an extension for good cause. The extension may not to exceed 3 years beyond the end of the cost reporting year in which the liability was incurred.

(B) If the sick leave plan grants employees the nonforfeitable right right to demand cash payment for unused sick leave at the end of each year, sick pay is includable in allowable costs, without funding, in the cost reporting period in which it is earned.

Consistent with the foregoing regulations, section 2146 of the Provider Reimbursement Manual (PRM) provides for reimbursement, under certain conditions, for the costs of vacation benefits for employees of a provider, and section 2144.9 of the PRM explains reimbursement for all inclusive paid days.

In this case, the record reflects that the Provider granted all full-time employees “paid days off (PDO)” based on a length of service standard.¹ In addition, to PDOs, the Provider granted compensatory time off only for exempt employees. Pursuant to the Provider’s Employee Handbook, compensatory time off was to be treated as a PDO.² The Provider’s policy permitted PDO’s to be carried over to subsequent years. However, the policy stated that financial compensation is not provided in lieu of PDOs.³ For the fiscal years end 1995 and 1996, the Provider accounted for these costs on a cash basis, i.e., the Provider did not claim them unless they were used. For the fiscal year end 1997, the cost year at issue, the Provider converted from a cash basis of accounting to an accrual basis of accounting for compensatory time off. The Provider claimed the amounts related

¹ See Provider’s Exhibit P-6, Employee’s Handbook, pages 11 and 12.

² Exempt employees were in executive, administrative, or professional positions and not subject to the Fair Labor Standards Act (FLSA). See also Provider’s Exhibit P-6, Employee’s Handbook, page 3. Although the Board found this practice of awarding compensatory time to owners/managers is an accepted and common occurrence, the record does not demonstrate such a practice common among this class of employees/owners.

³ *Id.*, at p. 11.

to the compensatory time off “banks” or accruals which had been, *inter alia*, carried over and never used. The Intermediary disallowed the cost of the accrued compensatory time because it was determined to be non-allowable for Medicare payment.⁴

Applying the above facts to the law, regulations and policy instructions, the Administrator finds that the Provider’s claimed cost of compensatory time off is not an accruable cost for Medicare payment purposes as the Provider cannot demonstrate that it has incurred an expense associated with the compensatory time for this cost year. The Administrator finds that the Provider did not have a formal plan or contract which demonstrated that the compensatory time off represents a future liability, i.e., unused compensatory time would convert to a cash payment at some certain future time. Although the Provider argued that compensatory time was never lost and that it would be obligated to pay in cash accumulated compensatory time to a surviving spouse or estate if the employee were to die, the Provider submitted no supporting documentation or policy statement to support this claim. In fact, a plain reading of the Provider’s Employee Handbook shows that financial compensation is not provided in lieu of paid days off (including accumulated compensatory time).

The Provider also argued that the accumulated compensatory time represents a future obligation because an employee may carry over such time and could not receive payment in lieu of taking such time off. However, the Administrator finds that this fact alone does not demonstrate that the Provider incurred the expense permitting the cost of accumulated compensatory time to be accrued for this cost year. On contrary, the Administrator finds, in this instance, that the Provider cannot demonstrate that it will be liable for these costs unless the employee actually used the compensatory time off days. Therefore, the Provider may not accrue this unused compensatory time as an incurred cost for this cost year.

An overarching Medicare reimbursement principle requires that Medicare have assurances that obligations are liquidated. Generally, under accrual accounting, expenses must be incurred by a provider of health care services before Medicare will pay its share of those expenses. As the Secretary has noted: “Time limits for liquidating accrued liabilities are essential to ensure that Medicare recognizes only costs associated with a liability that is liquidated timely through an actual expenditure of funds.”⁵ This policy is to prevent the outlay of Federal trust funds

⁴ See Intermediary’s Revised Position Paper, Exhibit I-3. The Intermediary noted that the claimed costs at issue relate only to accumulated compensatory time off for the owner/CEO and her husband/CFO. The Intermediary adjusted to remove the cost of the compensatory time off benefit because it determined that there was no actual liability.

⁵ 60 Fed. Reg. 33136, 33128 (1995).

before they are needed to pay the cost of a provider's actual expenditures.⁶ The regulations reflect Medicare's longstanding policy regarding the circumstances under which it recognizes, for the purposes of program payment, a provider's claim for costs for which it has not actually expended funds during the current cost reporting period.

Notably, in a final rule, the Secretary addressed Medicare's accrual basis of accounting policy.⁷ The Secretary explained that the purpose of this final rule was to clarify the concept of "accrual basis of accounting" to indicate that expenses must be incurred by a provider of health care services before Medicare will pay its share of those expenses. In the preamble, the Secretary stated that:

[U]nder the current definition of the accrual basis of accounting, some providers have claimed costs without evidence of having incurred actual expenditures or the assurance that liabilities associated with accrued costs will ever be fully liquidated through an actual expenditure of funds. For example, under the terms of some provider employment contracts, nonprobationary employees are entitled to accumulate a certain number of sick leave days annually and carry forward a maximum accumulated amount of unused sick leave time. These sick leave days are typically vested (although not funded) but nevertheless are subject to forfeiture. That is, unused accumulated sick leave days are subject to redemption for cash if the employee retires, resigns, or is discharged in good standing, but may be forfeited if the employee is discharged for cause. In the latter case, under the current rule, some providers have sought Medicare payment for sick leave days for which the provider never became liable.

Under this longstanding policy, accrued costs are included in Medicare allowable costs in the year of accrual, provided the related liabilities are liquidated timely, in accordance with the liquidation requirements for the particular type of accrued cost. If the liabilities are not liquidated timely, an adjustment is required to disallow the costs. Generally, the adjustment is made in the year of accrual except for vacation and all-inclusive paid days off, in which case the adjustment generally is made in the year in which the payment for the accrued vacation or all-inclusive paid days off should have been made. (Emphasis added.)

As noted above, CMS recognized the potential abuse in Medicare sharing in costs which were not properly liquidated or costs for which the provider never became

⁶ 60 Fed. Reg. 33129

⁷ 60 Fed. Reg. 33126.

liable. Although the regulations do not specifically address, “compensatory time” the Administrator finds that, as noted above, a prerequisite to permitting a cost to be accrued is a demonstration that such costs will be incurred and subsequently timely liquidated. Thus, despite the Board’s finding that there is no regulatory time limit that the compensatory time be liquidated, the Provider still has the burden to demonstrate that its cost were incurred and will be liquidated.⁸

Further, the Administrator notes the Provider’s argument that it is in compliance with 42 CFR 413.100(c)(2)(ii). However, this provision presumes that the Provider has a policy that requires liquidation of the liability, either within two years or within the time frame set forth in its policy. The Provider fails to meet this initial requirement under 42 CFR 413.100 to show a policy for liquidation of the liability during any period.

In sum, the Administrator finds no evidence that the Provider has ever incurred “actual expenditures” for the unused compensatory time. In addition, the Administrator finds no supporting documentation or policy that gives “assurance that the liabilities associated with the accrued costs will be fully liquidated through an actual expenditure of funds.”⁹ Accordingly, the Administrator concludes that the costs at issue do not represent incurred costs for Medicare payment purposes and were properly disallowed.

⁸ In the least, the general rule is that a short-term liability must be liquidated within one year after the end of the cost reporting period in which the liability is incurred, unless an exemption is timely requested and granted. As a practical matter, Medicare is always going to require a Provider to demonstrate that it has liquidated a liability within the three-year reopening timeframe unless specifically provided by regulation for an adjustment in the current year. Therefore, the Board’s finding that there is no regulatory time limit to liquidate the liability is contrary to general Medicare reasonable cost principles including those requiring that a provider demonstrate that a cost has been incurred. If a cost never has to be liquidated, a provider can never demonstrate that a cost has been incurred.

⁹ 60 Fed. Reg. 33126.

DECISION

The decision of the Board is reversed, consistent with the foregoing opinion.

THIS CONSTITUTES THE FINAL ADMINISTRATIVE DECISION OF
THE SECRETARY OF HEALTH AND HUMAN SERVICES.

Date: 3/22/07

/s/
Herb B. Kuhn
Acting Deputy Administrator
Centers for Medicare & Medicaid Services

DECISION

The decision of the Board is reversed, consistent with the foregoing opinion.

THIS CONSTITUTES THE FINAL ADMINISTRATIVE DECISION OF
THE SECRETARY OF HEALTH AND HUMAN SERVICES.

Date: _____

Leslie V. Norwalk, Esq.
Acting Administrator
Centers for Medicare & Medicaid Services