

**STATE OF NEW YORK
DEPARTMENT OF HEALTH**

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| In the Matter of the Appeal of | : | |
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| Episcopal Residential | : | Decision Without |
| Health Care Facility, Inc. | : | Hearing Pursuant to |
| Provider # [REDACTED] | : | 18 NYCRR 519.23 |
| | : | |
| from a determination to recover Medicaid Program | : | |
| overpayments | : | #06-1037 |
| | : | |

Before: John Harris Terepka
Administrative Law Judge

Held at: Submitted on papers
New York State Department of Health
259 Monroe Avenue
Rochester, New York 14607
Record closed February 16, 2010

Parties: New York State Office of the Medicaid Inspector General
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JURISDICTION

The New York State Department of Health (the Department) acts as the single state agency to supervise the administration of the Medicaid Program in New York State. Social Services Law 363-a. The New York State Office of the Medicaid Inspector General (OMIG), an independent office within the Department, is responsible for the Department's duties with respect to the prevention, detection and investigation of fraud and abuse in the Medicaid Program and the recovery of improperly expended Medicaid funds. Public Health Law 31.

The OMIG issued a final audit report for Episcopal Residential Health Care Facility, Inc. (the Appellant) in which the OMIG concluded that the Appellant had received Medicaid Program overpayments. The Appellant requested this hearing pursuant to SSL 22 and former Department of Social Services (DSS) regulations at 18 NYCRR 519.4 to review the overpayment determination. The parties agreed to submit the appeal for a decision without hearing pursuant to 18 NYCRR 519.23.

SUMMARY OF FACTS

An opportunity to be heard having been afforded the parties and evidence having been considered, it is hereby found:

1. At all times relevant hereto, Episcopal Residential Health Care Facility was a 172 bed residential health care facility (RHCF), licensed under PHL Article 28 and enrolled as a provider in the Medicaid Program. The facility, located in Buffalo, New York, closed on December 24, 2005. (Stipulated facts 1.)

2. Auditors from the OMIG reviewed the Appellant's reimbursement from the Medicaid Program for the rate period January 1, 2001 through December 24, 2005.

The Appellant's Medicaid rates for property cost reimbursement for this period were established on the basis of a combination of the January 1, 1999 through December 31, 2003 (base period) property expenses and actual rate year expenses. In particular, the Appellant's reported 2003 property expenses were used to calculate its 2005 property rates pursuant to 18 NYCRR 86-2.10(g). (Stipulated facts 1.)

3. On September 4, 2008, the OMIG issued a final audit report that identified several property expense disallowances. The OMIG's letter accompanying the audit report advised the Appellant that it intended to recover Medicaid Program overpayments on the basis of these disallowances. (Stipulated facts 6, 7; Exhibit H.)

4. On October 30, 2008, the Appellant requested an administrative hearing to challenge OMIG's determination. (Stipulated facts 8; Exhibit J.) The parties having settled all other issues raised by the Appellant's hearing request,^{*} property expense disallowance 11, "Extraordinary Gain from Mortgage Transaction" is the only issue remaining for this hearing decision. (Stipulated facts 15.)

5. In 2003, Greystone Servicing Corporation purchased the Appellant's mortgage from the Dormitory Authority of the State of New York. (Stipulated facts 16a.)

6. In connection with Greystone's purchase of the mortgage, excess debt service reserve funds in the amount of \$443,846 were released to the Appellant. (Stipulated facts 16d, 16e.)

7. The Appellant's 2003 cost report (RHCF-4), reported the \$443,846 it had received as an "extraordinary gain from a mortgage transaction." (Stipulated facts 16h.)

^{*} This includes the Appellant's argument at earlier stages of this audit that any overpayment should be reduced to reflect certain rate appeals submitted to the Department pursuant to 10 NYCRR 86-2.13(b). This contention is no longer at issue in this proceeding. (Stipulated facts 17; Appellant reply brief, pages 2-3.)

8. The Appellant used the \$443,846, received in 2003, to make payments in 2003 on its working capital line of credit. (Stipulated facts 16f.)

9. In this audit, the OMIG applied the reported extraordinary gain against the Appellant's reported interest expense for 2003, resulting in a disallowance of \$380,021 for the 2005 rate year. (Stipulated facts 15; Exhibit H, pages 8-9; OMIG brief, page 3.)

ISSUE

Has the Appellant established that the OMIG's audit report disallowance 11, "Extraordinary Gain from Mortgage Transaction" is not correct?

APPLICABLE LAW

A residential health care facility can receive reimbursement from the Medicaid Program for costs that are properly chargeable to necessary patient care. 10 NYCRR 86-2.17. As a general rule, these kinds of costs are allowed if they are actually incurred and the amount is reasonable. Allowable costs usually include employee wages and salaries, administration, maintenance and supplies, and other operating expenses. 10 NYCRR 86-2.10(a)(7). They can also include a component for capital costs such as, in this case, necessary interest on both current and capital indebtedness. 10 NYCRR 86-2.10(a)(9), 86-2.20(a).

The facility's costs are reimbursed by means of a per diem rate set by the Department on the basis of costs reported by the facility. A facility's rate is provisional and subject to audit. If an audit identifies an overpayment the Department can retroactively adjust the rate. SSL 368-c; 10 NYCRR 86-2.7; 18 NYCRR 517.3. The Department may then require the repayment of any amounts not authorized to be paid under the Medicaid Program. 18 NYCRR 518.1.

If the Department determines to recover an overpayment, the facility has the right to an administrative hearing. 18 NYCRR 519.4. The facility has the burden of showing that the determination of the Department was incorrect and that all costs claimed were allowable. 18 NYCRR 519.18(d)(1).

DSS regulations pertinent to this hearing are found at 18 NYCRR Parts 517, 518 and 519, and address the audit, overpayment and hearing aspects of this case. Also pertinent are DOH regulations at 10 NYCRR Part 86-2 (reporting and rate certifications for RHCfs, in particular section 86-2.20 regarding interest expense.) Also applicable, unless otherwise provided in Part 86-2 (see 86-2.17(a)), are the principles of reimbursement developed for determining payments under the Medicare Program. These are primarily found at 42 CFR Chapter IV, and in the Medicare Provider Reimbursement Manual (PRM), also known as HIM-15.

DISCUSSION

The parties agreed that this appeal could be decided without a hearing pursuant to 18 NYCRR 519.23. On January 8, 2010, the parties stipulated to certain facts and to the admission of Exhibits A-L. (Statement of stipulated facts and attachments.) Each side also submitted two briefs.

Necessary interest on both current and capital indebtedness is an allowable cost for RHCfs. 10 NYCRR 86-2.20(a). However, pursuant to 86-2.20(c):

- (1) Interest expense shall be reduced by investment income with the exception of income from funded depreciation, qualified pension funds, trustee malpractice insurance funds, or in instances where income from gifts or grants is restricted by donors. Interest on funds borrowed from a donor-restricted fund or funded depreciation is an allowable expense. *Investment income* shall be defined as the aggregate net amount realized from dividends, interest, rental income, interest earned on temporary investment of withholding taxes,

as well as all gains and losses. If the aggregate net amount realized is a loss, the loss is not allowable.

The OMIG relies on this regulation for offsetting the gain reported by the Appellant. The Appellant argues that the gain it reported is not *investment income* as defined by this regulation, and so is not subject to offset against interest expense under this regulation.

The Appellant suggests that because it reported this gain in accordance with generally accepted accounting principles (GAAP) “therefore no adjustment is proper.” (Appellant brief, page 8.) This argument confuses Medicaid reimbursement principles with GAAP. The issue in this case is not a reporting or accounting issue – the parties agree the gain was properly reported and there is no dispute about the amount – but a reimbursement one. Following GAAP in cost reporting does not obviate the Medicaid reimbursement principle that a provider is entitled to reimbursement only for actual and necessary costs.

The Appellant does not claim that the gain in question fits under one of the enumerated exceptions in section 86-2.20(c) for “income from funded depreciation, qualified pension funds, trustee malpractice insurance funds, or in instances where income from gifts or grants is restricted by donors.” The Appellant argues, rather, that the gain in question simply does not fit the definition of *investment income* at all. (Appellant brief, pages 7, 11, reply brief, pages 2, 3.) The OMIG, on the other hand, relies on the inclusion of the phrase “as well as all gains and losses” in the definition to support its determination to recognize the gain as *investment income* under this regulation. (OMIG brief, page 9.)

The Appellant argues that under the OMIG’s interpretation any revenue whatsoever - even the Appellant’s own Medicaid receipts - would qualify as *investment*

income under this regulation. (Appellant brief, page 8; reply brief, page 3.) The OMIG's application of the regulation in this case does not entail the adoption of such a position. The regulation in question, 10 NYCRR 86-2.20, is not about income, revenue or gain in general. It is entitled and is solely about "interest expense for all residential health care facilities." Given the very specific subject matter of the regulation, the OMIG has reasonably interpreted the phrase "all gains" in this context to include net gains on current and capital indebtedness.

After the \$443,846 was released to the Appellant in 2003, the terms of its mortgage obligation remained the same as they had been. Neither the interest rate nor the principal balance nor the remaining term changed. The Appellant's receipt of \$443,846 in 2003 was a windfall in the form of a refund of previously paid mortgage costs - mortgage costs that the Medicaid Program had paid. As the interest expense was refunded in a later accounting period than the interest expense was incurred, it was appropriate to apply the refund to reduce interest expense in the period in which the refund was received. PRM-I, §804; St. John's Mercy Health Cntr., Medicare and Medicaid Guide (CCH) ¶ 41,653 (PRRB Hearing Dec. No. 93-D76, Aug. 13, 1993).

The Appellant offers "examples of alternative accounting methodology" (Appellant reply brief, page 2) in a bid to drastically reduce the amount of the extraordinary gain to be applied against interest expense by recognizing only a small portion of the gain in 2003. The Appellant proposes two ways of doing this as alternatives to applying the entire amount of the gain to the period in which it was received.

The Appellant first suggests that the gain in this case “is analogous to the gain to a facility resulting from early retirement of a mortgage under the circumstances provided under 10 NYCRR 86-2.10(f),” and should be amortized over the remaining life of the mortgage. (Appellant brief, pages 8-9.) This proposal is rejected because the \$443,846 was not applied to retire, or even pay down the mortgage. As the OMIG points out, the Appellant had immediate and full use of the \$443,846 refund, which it used for other purposes than paying down the mortgage, and there was no change in its mortgage obligation. (OMIG brief, pages 10-11.)

The Appellant’s alternative suggestion is that the gain should be “treated as a reduction of principal resulting from refinancing.” (Appellant brief, page 9.) In September 2003, the Department had invited the Appellant to refinance its mortgage, reducing the principal amount in recognition of any gains realized by doing so. (Exhibit C.) The Appellant proved, however, to be ineligible for such refinancing. (Exhibits D, E.)

The Appellant argues that “[t]he extraordinary gain on the mortgage transaction the Facility recognized is exactly the same as the amount of the excess debt service funds the Department directed the Facility to adjust any approved refinancing amount by.” (Appellant brief, pages 9-10.) The pertinent point, however, is that the Appellant did not refinance. The excess debt service funds did not go to adjust the principal amount of the mortgage. They were instead paid directly to the Appellant, in cash, and put to entirely different purposes than contemplated by the Department’s mortgage refinancing initiative.

In this case, the mortgagee, not the mortgage, changed as a result of a transaction that the Appellant was not involved in. The Appellant then received a refund of expenditures that the Medicaid Program had paid, i.e. costs of carrying the mortgage to date. It received the entire amount in 2003, and was able to use it to pay expenses it would otherwise have had to pay anyway. There is no good reason to amortize this windfall because the Appellant received it in cash that it was immediately able to use in any manner it chose.

The Appellant is entitled to reimbursement for actual and necessary costs. It is not entitled to make a profit on financing costs paid by the Medicaid Program. In this adjustment, the OMIG is simply recognizing the actual net cost of a mortgage and consequently adjusting Medicaid Program reimbursement paid to the Appellant to reflect actual interest expenses. Tioga Nursing Home v. Axelrod, 90 A.D.2d 570, 456 N.Y.S.2d 144 (3rd Dept. 1982), *affirmed* 60 N.Y.2d 717, 469 N.Y.S.2d 73 (1983). This is neither an irrational nor an unreasonable application of 10 NYCRR 86-2.20.

DECISION: The OMIG's audit report disallowance 11, "Extraordinary Gain from Mortgage Transaction" is affirmed.

This decision is made by John Harris Terepka, Bureau of Adjudication, who has been designated to make such decisions.

DATED: Rochester, New York
November 12, 2010

_____/s/_____
John Harris Terepka
Bureau of Adjudication