DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAY - 1 2006

**TO:** Wynethea Walker
Director, Audit Liaison Staff
Centers for Medicare & Medicaid Services

**FROM:** Joseph E. Vengrin
Deputy Inspector General for Audit Services

**SUBJECT:** Review of the North Shore University Hospital's Controls to Ensure Accuracy of Wage Data Used for Calculating Inpatient Prospective Payment System Wage Indexes (A-02-05-01008)

Attached is an advance copy of our final report on North Shore University Hospital's (the hospital's) controls to ensure the accuracy of wage data used for calculating inpatient prospective payment system wage indexes. We will issue this report to the hospital within 5 business days.

This review is one in a series of reviews of the accuracy of hospitals' fiscal year (FY) 2003 wage data, which the Centers for Medicare & Medicaid Services (CMS) will use in developing FY 2007 wage indexes.

Under the prospective payment system for acute care hospitals, Medicare Part A pays hospitals at predetermined, diagnosis-related rates for patient discharges. The payment system base rate includes a labor-related share. CMS adjusts the labor-related share by the wage index applicable to the area in which a hospital is located.

The objective of our review was to determine whether the hospital complied with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report.

The hospital did not fully comply with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report. Specifically, the hospital overstated its wage data by $3,119,582 and 1,567 hours. Our correction of the hospital's errors reduced the average hourly wage rate by about 1 percent. The errors in reported wage data occurred because the hospital did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare requirements.

If the hospital does not revise the wage data in its FY 2003 Medicare cost report, the applicable FY 2007 New York State Nassau-Suffolk wage index will be inflated, which will result in overpayments to this hospital and to the other hospitals that use this wage index.

We recommend that the hospital:

- submit a revised FY 2003 Medicare cost report to the fiscal intermediary to correct the wage data overstatements totaling $3,119,582 and 1,567 hours and

- implement review and reconciliation procedures to ensure that the wage data reported on future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

In its comments on our draft audit report, the hospital concurred with three of our findings, but disagreed with our finding on unfunded pension and postretirement benefit costs. After reviewing applicable Federal regulations and guidelines, and the hospital's comments on our draft report, we continue to believe that our findings and recommendations are valid.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or James P. Edert, Regional Inspector General for Audit Services, Region II at (212) 264-4620. Please refer to report number A-02-05-01008.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES OFFICE OF INSPECTOR GENERAL

OFFICE OF AUDIT SERVICES
Region II
Jacob K. Javits Federal Building
New York, New York 10278
(212) 264-4620

MAY - 4 2006

Report Number A-02-05-01008

Mr. Robert S. Shapiro
Senior Vice President & Chief Financial Officer
North Shore-Long Island Jewish Health System
145 Community Drive
Great Neck, New York 11021

Dear Mr. Shapiro:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of the North Shore University Hospital's Controls to Ensure Accuracy of Wage Data Used for Calculating Inpatient Prospective Payment System Wage Indexes." A copy of this report will be forwarded to the action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 522, as amended by Public Law 104-231), OIG reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-02-05-01008 in all correspondence.

Sincerely yours,

James P. Edert

James P. Edert
Regional Inspector General
for Audit Services

Enclosures

**Direct Reply to HHS Action Official:**

Mr. James T. Kerr
Regional Administrator
Centers for Medicare & Medicaid Services
Department of Health and Human Services
26 Federal Plaza, 38th Floor
New York, New York 10278

Department of Health and Human Services

**OFFICE OF INSPECTOR GENERAL**

# REVIEW OF THE NORTH SHORE UNIVERSITY HOSPITAL'S CONTROLS TO ENSURE ACCURACY OF WAGE DATA USED FOR CALCULATING INPATIENT PROSPECTIVE PAYMENT SYSTEM WAGE INDEXES


Daniel R. Levinson
Inspector General

May 2006
A-02-05-01008

# *Office of Inspector General*

http://oig.hhs.gov

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## EXECUTIVE SUMMARY

### BACKGROUND

Under the inpatient prospective payment system for acute care hospitals, Medicare Part A pays hospitals at predetermined, diagnosis-related rates for patient discharges. The Centers for Medicare & Medicaid Services (CMS) adjusts hospital payments by the wage index applicable to the area in which each hospital is located.

CMS calculates a wage index for each core-based statistical area (CBSA) and one statewide rural wage index per State for areas that lie outside CBSAs. CMS will base the fiscal year (FY) 2007 wage indexes on wage data collected from hospitals' FY 2003 Medicare cost reports. Hospitals must accurately report wage data for CMS to determine the equitable distribution of payments and ensure the appropriate level of funding to cover hospitals' costs of furnishing services.

North Shore University Hospital (the hospital) reported wage data of $418.66 million and 10.36 million hours on its FY 2003 Medicare cost report, which resulted in an average hourly wage rate of $40.39. The $40.39 average hourly wage rate is the quotient of $418.66 million (numerator) divided by 10.36 million hours (denominator).[1] Arriving at the final numerator and denominator in this rate computation involves a series of calculations. Therefore, inaccuracies in either the dollar amounts or hours reported may have varying effects on the final rate computation.

As of FY 2005, the New York State Nassau-Suffolk CBSA wage index applied to the hospital and 24 other hospitals.

### OBJECTIVE

The objective of our review was to determine whether the hospital complied with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report.[2]

### SUMMARY OF FINDINGS

The hospital did not fully comply with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report. Specifically, the hospital reported the following inaccurate data, which affected the numerator and the denominator of the wage rate calculation:

- unfunded pension and postretirement benefit costs, which overstated wage data by $3,678,314;

- understated excluded area costs, which overstated wage data by $152,196;

[1]Difference due to rounding, see Appendix A.
[2]The hospital's cost reporting year began January 1, 2003, and ended December 31, 2003.

- understated physician Part A costs, which understated wage data by $710,928; and

- overstated contract labor hours, which overstated wage data by 1,567 hours.

These errors occurred because the hospital did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance. As a result, the hospital overstated its wage data by $3,119,582 (numerator) and 1,567 hours (denominator) for the FY 2003 Medicare cost report period. Our correction of the hospital's errors reduced the average hourly wage rate about 1 percent, from $40.39 to $40.10. If the hospital does not revise the wage data in its cost report, the applicable FY 2007 CBSA wage index will be inflated, which will result in overpayments to this hospital and the other hospitals that use this wage index.[3]

## RECOMMENDATIONS

We recommend that the hospital:

- submit a revised FY 2003 Medicare cost report to the fiscal intermediary to correct the wage data overstatements totaling $3,119,582 and 1,567 hours and

- implement review and reconciliation procedures to ensure that the wage data reported on future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

## HOSPITAL'S COMMENTS

In its comments on our draft report, the hospital concurred with three of our findings, but disagreed with our finding on unfunded pension and postretirement benefit costs. The hospital contended that it developed and reported its wage related data in accordance with generally accepted accounting principles (GAAP), as it was explicitly directed to do so by the 2003 cost report instructions.

The full text of the hospital's comments is included as Appendix B.

## OFFICE OF INSPECTOR GENERAL'S RESPONSE

While we agree that the hospital computed these costs in accordance with GAAP, the costs were not reported in accordance with Medicare requirements. We continue to believe that our findings and recommendations are valid.

[3] The extent of overpayments cannot be determined until CMS finalizes its FY 2007 wage indexes.

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# INTRODUCTION

## BACKGROUND

### Medicare Inpatient Prospective Payment System

Under the inpatient prospective payment system for acute care hospitals, Medicare Part A pays hospital inpatient costs at predetermined, diagnosis-related rates for patient discharges. Medicare Part B, on the other hand, pays for medical costs such as physicians' services rendered to patients, clinical laboratory services, and outpatient hospital services.

In fiscal year (FY) 2005, according to the Centers for Medicare & Medicaid Services (CMS), Medicare Part A expects to pay 3,900 acute care hospitals about $105 billion, an increase of about $5 billion over FY 2004.

### Wage Index

The geographic designation of hospitals influences their Medicare payments. Under the hospital inpatient prospective payment system, CMS adjusts payments through a wage index to reflect labor cost variations among localities. CMS uses the Office of Management and Budget (OMB) metropolitan area designations to identify labor markets and to calculate and assign wage indexes to hospitals. In 2003, OMB revised its metropolitan statistical area definitions and announced new core-based statistical areas (CBSAs). CMS calculates a wage index for each CBSA and one statewide rural wage index per State for areas that lie outside CBSAs. The wage index for each CBSA and statewide rural area is based on the average hourly wage rate of the hospitals in those areas divided by the national average hourly wage rate. All hospitals within a CBSA or within a statewide rural area receive the same labor payment adjustment.

To calculate wage indexes, CMS uses hospital wage data (which include wages, salaries, and related hours) collected 4 years earlier to allow time for the cost report settlement process and CMS's data review. Accordingly, wage data collected from hospitals' Medicare cost reports in FY 2003 will be used to calculate wage index values in FY 2007. A hospital's wage rate is the quotient of dividing total dollars (numerator) by total hours (denominator). Arriving at the final numerator and denominator in this rate computation involves a series of calculations. Therefore, inaccuracies in either the dollar amounts or hours reported may have varying effects on the final rate computation.

Hospitals must accurately report wage data for CMS to determine the equitable distribution of payments and ensure the appropriate level of funding to cover hospitals' costs of furnishing services. Section 1886(d)(3)(E) of the Social Security Act requires that CMS update the wage indexes annually in a manner that ensures that aggregate payments to hospitals are not affected by changes in the indexes.

## North Shore University Hospital

North Shore University Hospital (the hospital), located in Manhasset, New York, is a 731-bed hospital within the North Shore-Long Island Jewish Health System, and is an academic campus for the New York University School of Medicine.

As of FY 2005, the Nassau-Suffolk CBSA wage index applied to the hospital and 24 other hospitals.

## OBJECTIVE, SCOPE, AND METHODOLOGY

### Objective

The objective of our review was to determine whether the hospital complied with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report.[1]

### Scope

Our review covered the $418.66 million and 10.36 million hours that the hospital reported to CMS on Schedule S-3, part II, of its FY 2003 Medicare cost report, which resulted in an average hourly wage rate of $40.39.[2] We limited our review of the hospital's internal controls to the procedures the hospital used to accumulate and report wage data for its FY 2003 Medicare cost report.

We performed our fieldwork at the hospital's administrative offices in Westbury, New York, from February through July 2005.

### Methodology

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidance;
- obtained an understanding of the hospital's procedures for reporting wage data;
- verified that wage data on the hospital's trial balance reconciled to its audited financial statements;
- reconciled the total reported wages on the hospital's FY 2003 Medicare cost report to its trial balance;
- reconciled the wage data from selected cost centers to detailed supporting records such as payroll registers or accounts payable invoices;

[1]The hospital's cost reporting year began January 1, 2003, and ended December 31, 2003.
[2]Difference due to rounding, see Appendix A.

- selected for testing wage data in the FY 2003 Medicare cost report from cost centers that accounted for at least 2 percent of the total hospital wages;

- tested a sample of transactions from these cost centers and reconciled wage data to payroll records;

- interviewed hospital staff regarding the nature of services that employees and contracted labor provided to the hospital;

- traced a sample of contract labor costs and hours to supporting invoices and time cards;

- reviewed fiscal intermediary audit reimbursement adjustments to the wage data reported by the hospital in its FY 2003 Medicare cost report; and

- determined the effect of the reporting errors by recalculating the hospital's average hourly wage rate using the CMS methodology for calculating the wage index, which includes an hourly overhead factor, in accordance with instructions published in the Federal Register. (See Appendix A.)

We conducted our review in accordance with generally accepted government auditing standards.

## FINDINGS AND RECOMMENDATIONS

The hospital did not fully comply with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report. Specifically, the hospital reported the following inaccurate data, which affected the numerator and the denominator of the wage rate calculation:

- unfunded pension and postretirement benefit costs, which overstated wage data by $3,678,314;

- understated excluded area costs, which overstated wage data by $152,196;

- understated physician Part A costs, which understated wage data by $710,928; and

- overstated contract labor hours, which overstated wage data by 1,567 hours.

These errors occurred because the hospital did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare regulations and guidance. As a result, the hospital overstated its wage data by $3,119,582 (numerator) and 1,567 hours (denominator) for the FY 2003 Medicare cost report period. Our correction of the hospital's errors reduced the average hourly wage rate about 1 percent, from $40.39 to $40.10. If the hospital does not revise the wage data in its FY 2003 Medicare cost report, the FY 2007 New York State Nassau-Suffolk wage index

will be inflated, which will result in overpayments to the hospital and the other hospitals that use this wage index.[3]

## ERRORS IN REPORTED WAGE DATA

The errors in reported wage data are discussed in detail below, and the cumulative effect of the findings is presented in Appendix A.

### Unfunded Pension and Postretirement Benefit Costs

The Provider Reimbursement Manual (the Manual), part II, section 3605.2, states, "For purposes of determining the wage-related costs for the wage index, a hospital must use generally accepted accounting principles (GAAP) . . . Although hospitals should use GAAP in developing wage-related costs, the amount reported for wage index purposes must also meet the reasonable cost provisions of Medicare."

The principles of reasonable cost reimbursement are found in 42 CFR Part 413. 42 CFR § 413.100(c)(2)(vii)(A) states, "Reasonable provider payments made under unfunded deferred compensation plans are included in allowable costs only during the cost reporting period in which actual payment is made to the participating employee." In addition, 42 CFR § 413.100(c)(2)(vii)(B) states, "Accrued liability related to contributions to a funded deferred compensation plan must be liquidated within 1 year after the end of the cost reporting period in which the liability is incurred." Further, 42 CFR § 413.100(c)(2)(vii)(C) states, "Postretirement benefit plans . . . are deferred compensation arrangements and thus are subject to the provisions of this section regarding deferred compensation and to applicable program instructions . . . ."

The hospital used GAAP to include postretirement benefit and pension costs on Schedule S-3, part II, of the FY 2003 Medicare cost report but did not liquidate the entire amounts associated with these costs within 1 year of the FY 2003 cost reporting period. The unfunded postretirement benefit and pension costs total $3,072,048 and $755,776, respectively. As a result, after the data are adjusted for overhead costs, the hospital overstated its wage data by a total of $3,678,314 ($2,952,058 for postretirement benefits and $726,256 for pension costs).

### Understated Excluded Area Costs

The Manual, part II, section 3605.2, requires that hospitals ensure that the wage data reported on their Medicare cost reports is accurate and excludes data for wages incurred in furnishing skilled nursing facility services.

The hospital incorrectly included $182,157 of bonuses as Part A overhead wages rather than as costs incurred for its skilled nursing facility. As a result, after the data are adjusted for overhead costs, the hospital overstated its wage data by $152,196.

[3]The extent of overpayments cannot be determined until CMS finalizes its FY 2007 wage indexes.

### Understated Physician Part A Costs

The Manual, part I section 2182.3, states that "physician compensation costs are monetary payments, fringe benefits, deferred compensation and any other items of value (excluding office space, billing and collection services) a provider or other organization furnishes a physician in return for the physician's services to the provider." The Manual, part II, section 3605.2, also states that hospitals should ensure that the wage data are accurate.

Although the hospital recorded a total of $1,128,673 of Part A physician malpractice insurance as wage data, the hospital actually incurred $1,868,498 for malpractice insurance for its Part A physicians. As a result, the hospital's wage data were understated by $710,928 after being adjusted for overhead costs.

### Overstated Contract Labor Hours

The Manual, part II, section 3605.2, states that hospitals should ensure that their wage data are accurate.

The hospital included 9,394 hours for contract labor services based on an estimated rate (the prior year's average hourly contract labor rate) rather than on actual hours. Hospital documentation supported only 7,827 hours in contract labor services on the FY 2003 Medicare cost report. As a result, the hospital overstated its wage data by 1,567 hours.

## CAUSES OF WAGE DATA REPORTING ERRORS

The errors in reported wage data occurred because the hospital did not sufficiently review and reconcile wage data to ensure that all amounts reported were accurate, supportable, and in compliance with Medicare requirements.

## EFFECT OF OVERSTATED WAGE DATA

As a result of the reporting errors, the hospital overstated its wage data by $3,119,582 (numerator) and 1,567 hours (denominator) for the FY 2003 Medicare cost report period. Our correction of the hospital's errors reduced the average hourly wage rate about 1 percent, from $40.39 to $40.10. If the hospital does not revise the wage data in its cost report, the applicable FY 2007 CBSA wage index will be inflated, which will result in overpayments to this hospital and the other hospitals that use this wage index.

## RECOMMENDATIONS

We recommend that the hospital:

- submit a revised FY 2003 Medicare cost report to the fiscal intermediary to correct the wage data overstatements totaling $3,119,582 and 1,567 hours and

- implement review and reconciliation procedures to ensure that the wage data reported on future Medicare cost reports are accurate, supportable, and in compliance with Medicare requirements.

## HOSPITAL'S COMMENTS

In its comments on our draft report, the hospital concurred with three of our findings, but disagreed with our finding on unfunded pension and postretirement benefit costs. The hospital contended that it developed and reported its wage related data in accordance with GAAP, as it was explicitly directed to do so by the 2003 cost report instructions.

The full text of the hospital's comments is included as Appendix B.

## OFFICE OF INSPECTOR GENERAL'S RESPONSE

While we agree that the hospital computed these costs in accordance with GAAP, the costs were not reported in accordance with Medicare requirements. Section 3605.2 of the Manual states that hospitals should use GAAP to develop wage related costs and that the amount reported for wage index purposes must also meet Medicare reasonable cost principles.

Medicare reasonable cost principles found at 42 CFR § 413.100 require hospitals to fund the pension and other postretirement benefit costs shown on their Medicare cost reports within 1 year of the end of the cost reporting period. Medicare does not pay for deferred compensation plans accrued during a cost reporting period unless the costs are liquidated, or funded, within the required period. Because pension and postretirement benefit plans are deferred compensation arrangements, they are, for reasonable cost purposes, subject to these provisions.

# APPENDIXES

## CUMULATIVE EFFECT OF FINDINGS

| Components<br>North Shore Univ. Hosp. | | Reported FY 2003 Wage Data | Unfunded Pension Cost | Unfunded PRB Cost | Understated Excluded Area Cost | Understated Physician Part A Cost | Overstated Contract Labor Hours | Adjusted FY 2003 Wage Data |
|---|---|---|---|---|---|---|---|---|
| *WorkSheet S - 3, Part II* | | | | | | | | |
| **Total Salaries** | | | | | | | | |
| line1/col. 3 | TOTAL SALARIES | $490,173,175.00 | | | | | | $490,173,175.00 |
| | Excluded Salaries | | | | | | | |
| Line 4.01/col. 3 | TEACHING PHYSICIAN SALARIES | 23,920,464.00 | | | | | | 23,920,464.00 |
| line5/col. 3 | PHYSICIAN - PT B | 45,943,380.00 | | | | | | 45,943,380.00 |
| line6/col. 3 | INTERNS AND RESIDENTS | 20,165,822.00 | | | | | | 20,165,822.00 |
| line 8/col. 3 | SNF SALARIES | 10,986,176.00 | | | $182,157.00 | | | 11,168,333.00 |
| line8.01/col. 3 | EXCLUDED AREA SALARIES | 36,770,153.00 | | | | | | 36,770,153.00 |
| subtotal (subtract) | | $137,785,995.00 | | | $182,157.00 | | | $137,968,152.00 |
| | Additional Salaries | | | | | | | |
| line9/col. 3 | CONTRACT LABOR | $422,716.00 | | | | | | $422,716.00 |
| line 10/col. 3 | CONTRACT LABOR-Physician Part A | $0.00 | | | | | | $0.00 |
| line13/col. 3 | WAGE-RELATED COST (CORE) | $93,197,606.00 | ($723,698.68) | ($2,941,662.03) | | | | $89,532,245.29 |
| line 14/col. 3 | Wage related costs-other | $0.00 | | | | | | $0.00 |
| line 18/col. 3 | Physician Part A | $3,747,457.00 | ($32,077.27) | ($130,386.42) | | $739,825.00 | | $4,324,818.31 |
| sub-tot-b (ADD) | | $97,367,779.00 | ($755,775.95) | ($3,072,048.45) | $0.00 | $739,825.00 | $0.00 | $94,279,779.60 |
| | adjusted salaries | $449,754,959.00 | ($755,775.95) | ($3,072,048.45) | ($182,157.00) | $739,825.00 | $0.00 | $446,484,802.60 |
| **Total Paid Hours** | | | | | | | | |
| line1/col. 4 | TOTAL HOURS | 13,661,913.00 | | | | | | 13,661,913.00 |
| | Excluded Hours | | | | | | | |
| line 4.01/col. 4 | TEACHING PHYSICIAN HOURS | 172,102.00 | | | | | | 172,102.00 |
| line5/col. 4 | PHYS PT B HOURS | 353,231.00 | | | | | | 353,231.00 |
| line6/col. 4 | INTERN AND RESIDENTS HOURS | 742,755.00 | | | | | | 742,755.00 |
| line 8/col. 4 | SNF HOURS | 436,721.00 | | | | | | 436,721.00 |
| line8.01/col. 4 | EXCLUDED AREAS HOURS | 1,180,920.00 | | | | | | 1,180,920.00 |
| sub-tot-c (LESS) | | 2,885,729.00 | | | | | | $2,885,729.00 |
| | Additional Hours | | | | | | | |
| line9/col. 4 | CONTRACT LABOR HOURS | 9,394.00 | | | | | (1,567.00) | 7,827.00 |
| line 10/col. 4 | CONTRACT LABOR-Physician Part A Hours | 0.00 | | | | | | 0.00 |
| sub-tot-d (ADD) | | 9,394.00 | | | | | (1,567.00) | 7,827.00 |
| | adjusted hours | 10,785,578.00 | 0.00 | 0.00 | 0.00 | 0.00 | (1,567.00) | 10,784,011.00 |

| Components<br>North Shore Univ. Hosp. | | Reported FY 2003 Wage Data | Unfunded Pension Cost | Unfunded PRB Cost | Understated Excluded Area Cost | Understated Physician Part A Cost | Overstated Contract Labor Hours | Adjusted FY 2003 Wage Data |
|---|---|---|---|---|---|---|---|---|
| ***WorkSheet S - 3, Part III*** | | | | | | | | |
| **OVERHEAD(OH) ALLOCATION** | | | | | | | | |
| line13/col. 3 | TOTAL OVERHEAD WAGES | $166,028,451.00 | | | ($182,157.00) | | | $165,846,294.00 |
| line13/col. 4 | TOTAL OVERHEAD HOURS | 2,558,985.00 | | | | | | 2,558,985.00 |
| | TOTAL HOURS | 13,661,913.00 | | | | | | 13,661,913.00 |
| | LESS: | | | | | | | |
| | TEACHING PHYSICIAN HOURS | 172,102.00 | | | | | | 172,102.00 |
| | PHYS PT B HOURS | 353,231.00 | | | | | | 353,231.00 |
| | INTERN AND RESIDENTS HOURS | 742,755.00 | | | | | | 742,755.00 |
| | TOTAL OVERHEAD HOURS | 2,558,985.00 | | | | | | 2,558,985.00 |
| | SUBTOTAL -> | 3,827,073.00 | | | | | | 3,827,073.00 |
| | REVISED HOURS(revised hrs) | 9,834,840.00 | | | | | | 9,834,840.00 |
| | OVERHEAD REDUCTION FOR EXCLUDED AREAS- HOURS | | | | | | | |
| | SNF HOURS | 436,721.00 | | | | | | 436,721.00 |
| | EXCLUDED AREA HOURS (e.g; home health) | 1,180,920.00 | | | | | | 1,180,920.00 |
| | SUBTOTAL --> | 1,617,641.00 | | | | | | 1,617,641.00 |
| | EXCLUDED OVERHEAD RATE [(snf+excluded area hrs)/revised hours] | 0.164480663 | | | | | | 0.1645 |
| | EXCLUDED OVERHEAD WAGES ($OH X Excluded OH rate) | 27,308,469.63 | | | ($29,961.30) | | | 27,278,508.33 |
| | EXCLUDED OVERHEAD HOURS (OH Hrs X Excluded OH rate) | 420,903.55 | | | | | | 420,903.55 |
| | OVERHEAD RATE (oh hrs/(revised hrs + oh hrs - snf hrs - excluded area hrs) **Revised per August 12, 2005 Federal Register** | 0.23746671 | | | | | | 0.2375 |
| | WAGE-RELATED COST (CORE) | 93,197,606.00 | ($723,698.68) | ($2,941,662.03) | | | | 89,532,245.29 |
| | WAGE-RELATED COST(OTHER) | 0.00 | | | | | | 0.00 |
| | PHYSICIAN PART A | 3,747,457.00 | ($32,077.27) | ($130,386.42) | | $739,825.00 | | 4,324,818.31 |
| | SUBTOTAL | 96,945,063.00 | (755,775.95) | ($3,072,048.45) | | 739,825.00 | | 93,857,063.60 |
| | overhead work wage-related cost | 23,021,225.51 | ($179,471.63) | ($729,509.25) | | $175,683.81 | | 22,287,928.45 |
| | excluded work wage -related cost | 3,786,546.43 | ($29,519.61) | ($119,990.16) | | $28,896.59 | | 3,665,933.24 |
| | Adjusted Salaries | 449,754,959.00 | ($755,775.95) | ($3,072,048.45) | ($182,157.00) | $739,825.00 | | 446,484,802.60 |
| | Less: excluded overhead salaries | 27,308,469.63 | | | ($29,961.30) | | | 27,278,508.33 |
| | excluded work related cost | 3,786,546.43 | ($29,519.61) | ($119,990.16) | | $28,896.59 | | 3,665,933.24 |
| REVISED WAGES | | 418,659,942.94 | ($726,256.34) | ($2,952,058.29) | ($152,195.70) | $710,928.41 | | 415,540,361.03 |
| | MULTIPLY BY : INFLATION FACTOR ( Per Federal Register) | 1.00000 | | | | | | 1.00000 |
| **INFLATED WAGES (Adjusted Wages used in report) -** | | 418,659,942.94 | ($726,256.34) | ($2,952,058.29) | ($152,195.70) | $710,928.41 | | $415,540,361.03 |
| **REVISED HOURS (Adjusted Hours used in report) -** | | 10,364,674.45 | 0.00 | 0.00 | 0.00 | 0.00 | (1,567.00) | 10,363,107.45 |
| | [adjusted hours - excluded oh hrs] | | | | | | | |
| **Average hourly wage** | | $40.39 | ($0.07) | ($0.29) | ($0.02) | $0.07 | $0.01 | $40.10 |

| Total Wage Data Revisions: | | | | | | Totals |
|---|---|---|---|---|---|---|
| Inflated Wages | ($726,256.34) | ($2,952,058.29) | ($152,195.70) | $710,928.41 | $0.00 | ($3,119,581.91) |
| Revised Hours | 0.00 | 0.00 | 0.00 | 0.00 | (1,567.00) | (1,567.00) |

North Shore LIJ
*North Shore-Long Island Jewish Health System*

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March 29, 2006
**VIA OVERNIGHT MAIL**

ROBERT S. SHAPIRO

Senior Vice President
Chief Financial Officer

Mr. James P. Edert
Regional Inspector General
For Audit Services, Region II
26 Federal Plaza
New York, New York 10278

Re: Draft OIG Audit Report # A-02-05-01008

Dear Mr. Edert:

On behalf of North Shore University Hospital ("NSUH"), I am writing in response to the above-numbered Office of Inspector General ("OIG") draft audit report entitled "Review of North Shore University Hospital's Controls to Ensure Accuracy of Wage Data Used for Calculating Inpatient Prospective Payment System Wage Indexes." I appreciate your courtesy in sharing the draft report with us on an advance, confidential basis and welcome the opportunity to comment on its findings of fact and interpretations of law before the report is published in final.

At the outset, I note that NSUH accepts three of the four findings reflected in the OIG's draft audit report. Thus, NSUH acknowledges that it inadvertently placed excluded area costs on an incorrect line; that it understated the malpractice insurance expense associated with Part A physician services; and that it overstated contract labor hours by carrying forward the average hourly rate from the prior-year cost report. As you know, the amounts associated with these errors were minor in view of the more than $418 million in wage-related costs appropriately reported by NSUH for 2003. In fact, the latter two errors reduced, rather than inflated, the computation of NSUH's average hourly rate in 2003. However, NSUH recognizes that these minor discrepancies require its full attention and is pledged to improve its internal reconciliation and verification procedures to ensure that future wage index data are fully supported by corresponding appropriate documentation.

NSUH disagrees, however, with the OIG's proposed conclusion that it overstated its hospital wage data on Worksheet S-3, Part II, with regard to pension and post-retirement benefit costs. NSUH contends that, for purposes of this Worksheet, it developed and reported its wage-related data in accordance with Generally Accepted Accounting Principles ("GAAP"), as it was explicitly directed to do by the 2003 cost report instructions that, as of May 2004, bound the hospital and, indeed, had been in effect for almost a decade. Thus, NSUH respectfully requests that the OIG withdraw this particular finding relating to NSUH's alleged overstatement of unfunded pension and post-retirement benefit costs in the aggregate amount of $3,678,314 on the

wage index worksheet. As set forth below, since October 1, 1994, NSUH had been instructed to report these costs for wage index purposes in accordance with GAAP, as distinguished from the concededly different, and unique, Medicare principles governing the recognition of fringe benefit costs. *See, e.g.*, 59 Fed. Reg. 45330, 45357 (September 1, 1994) (the "FY 1995 Inpatient PPS Rule"). In fact, not until the FY 2006 inpatient prospective payment system final rule, published by CMS on August 12, 2005 (the "FY 2006 Inpatient PPS Rule"), did CMS abrogate this long-standing policy, reverse course and instruct hospitals to depart from GAAP accrual principles when they differ from the generally applicable Medicare rules requiring the timely liquidation of accrued liabilities. *See, e.g.*, 42 C.F.R. § 413.100(c).

In the FY 1995 Inpatient PPS Rule, CMS sharply distinguished between the reporting of wage-related costs on Worksheet S-3, Part II, for the purpose of enabling CMS to calculate the geographic wage index adjustments, on the one hand, and the determination of hospital-specific reimbursable costs, on the other. "[B]eginning on or after October 1, 1994," CMS wrote, ***"hospitals are required to follow Generally Accepted Accounting Principles (GAAP) in developing the wage-related costs contained in the Worksheet S-3, Part II,*** for purposes of the hospital wage index. Medicare principles, however, will continue to apply in determining the allowability of fringe benefit costs." 59 Fed. Reg. at 45357 (emphasis added). CMS's rationale for this distinction was that "the application of GAAP for purposes of compiling data on wage-related costs used to construct the wage index will more accurately reflect relative labor costs" and thereby avoid "the large swings in these costs from year to year" that could arise from the happenstance of "large over or under-funded pension estimates" at specific institutions. *Id.* As recently as August 2005, when it issued the FY 2006 Inpatient PPS Rule, CMS acknowledged that the 1994 rulemaking required hospitals to use GAAP "for developing pension, deferred compensation, and other wage-related costs for wage index purposes." 70 Fed. Reg. 47278, 47369 (August 12, 2005).

In August 2005, prompted by the OIG's concern that applying GAAP to accrued, but unfunded, post-retirement liabilities was causing a patchwork of inconsistent reporting practices by hospitals, CMS reversed direction and articulated a new set of rules for wage data reporting. While styling this change as a "policy clarification," CMS's commentary left little doubt that it was charting a new course. *See, e.g.*, 70 Fed. Reg. at 47369 (***"With the FY 2007 wage index,*** hospitals and fiscal intermediaries must ensure that pension, post-retirement health benefits, and other deferred compensation plan costs for the wage index are developed according to the above terms") (emphasis added). Moreover, specifically with respect to the recognition of accrued pension liabilities, the commentary to the FY 2006 Inpatient PPS Rule noted a "major difference between GAAP and Medicare principles": the former requires these liabilities to be reported when accrued,[1] whereas the latter allows them to be recognized for payment purposes only if they are timely liquidated. *Id.* (citing 42 C.F.R. § 413.100). Thus, on the very reporting question that underlies the OIG's principal audit finding in the draft report – namely, the reporting of

[1] *See* FASB Statements/FAS 87: Employer's Accounting for Pensions (December 1985) (requiring employers to accrue unfunded net periodic pension costs, determined in accordance with an actuarial report, as a liability for financial statement reporting purposes).

NSUH's unfunded pension and post-retirement benefit costs – CMS has itself recognized that the GAAP and Medicare directives materially differ.

Viewed in this context, the OIG's proposed conclusion that the "hospital did not fully comply with Medicare requirements for reporting wage data in its FY 2003 Medicare cost report" is without foundation because it rests on an after-the-fact, and thus unwarranted, application of the FY 2006 Inpatient PPS Rule. In keeping with the FY 1995 Inpatient PPS Rule, NSUH applied GAAP in reporting its wage-related data on Worksheet S-3, including liabilities associated with both its funded pension plan and its unfunded plan for the provision of health and life benefits to non-Medicare retirees. Then, to the extent required by the Medicare rules governing the allowance of employee fringe benefits for reimbursement purposes, NSUH excluded from the cost report itself amounts that were not allowable in 2003, either because such amounts were not actually paid out to retirees in that year (as required for unfunded post-retirement benefits) or because the accrued liabilities were not liquidated within one year (as required for funded pension plans).[2]

That NSUH "did not liquidate the entire amount associated with these costs within 1 year of the FY 2003 cost reporting period," as the OIG draft states, is true, but irrelevant to NSUH's reporting obligations as they then applied to 2003 wage-related cost data. At the time that the 2003 Worksheet S-3 was due to be submitted, the CMS guidance on point expressly required NSUH to apply GAAP accrual principles in reporting these post-retirement costs without regard to when – or, in fact, whether – the liabilities were funded or paid out to eligible retirees. Likewise, CMS's update in 2003 to its cost report instructions for the preparation of Worksheet S-3 cannot fairly be construed as notice that GAAP principles governing the reporting of accrued post-retirement liabilities should be superseded when inconsistent with Medicare timely liquidation standards.[3] Since it was only eight months ago that CMS abandoned its mandate that accrued post-retirement costs be reported exclusively on a GAAP basis, NSUH's treatment of these costs on the 2003 Worksheet S-3 was no more and no less than what Medicare then required. Not only would the OIG's proposed finding penalize NSUH for adhering to the rules that were in place in FY 2003 – long before CMS changed its position in 2005 – but it would also single out NSUH for retroactive application of the 2005 policy. As a consequence, NSUH

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[2] *See* 42 C.F.R. §§ 413.100(c)(vii)(A) (unfunded post-retirement costs) & (c)(vii)(B) (contributions to funded plans). Indeed, it should be noted that NSUH conservatively disallowed an excess of $406,389 over the amount required by these Medicare funding principles on the applicable schedule of the 2003 cost report itself (*i.e.*, Worksheet A-8 of Form CMS 2552-96). Thus, there should be no suggestion – and, quite appropriately, the OIG draft report makes none – that NSUH claimed excess post-retirement costs for reimbursement purposes in the year under audit.

[3] *See* Provider Reimbursement Manual ("PRM"), Part II, § 3605.2, *cited in* 70 Fed. Reg. at 47369. When read in the overall context of the PRM, CMS clearly intended this update to clarify that hospitals must follow Medicare reasonable cost principles in determining the ***amount*** of the liability to be accrued, not the ***timing*** of the accrual. *See, e.g., id.* ('[a]lthough hospitals should use GAAP in developing wage related costs, the amount reported for wage index purposes must meet the reasonable costs provisions of Medicare").

would be unfairly disadvantaged compared with every other acute-care hospital whose GAAP-based calculations on the 2003 Worksheet S-3 have been neither reversed on audit nor recalculated by the Medicare fiscal intermediary.

In this regard, I note that the OIG recently responded to a similar argument raised by Windham Hospital, in Willimantic, Connecticut, by removing a proposed finding that the "hospital's wage data was overstated due to the inclusion of unfunded PRB [post-retirement benefit] costs."[4] Like NSUH, Windham Hospital had relied on the preamble to the FY 1995 Inpatient PPS Rule in good faith and applied GAAP in calculating the wage-related data to be reported on its Worksheet S-3 submitted for FY 2000. As with Windham Hospital, so here the OIG should not criticize NSUH for adhering in its 2003 cost report to the CMS policy guidance that was then in effect, notwithstanding CMS's decision to reconsider and modify that guidance in a subsequent rulemaking. Indeed, NSUH should be entitled to the same treatment today as the OIG extended to Windham Hospital in April 2005, given that both OIG audits of hospital wage-related data were for cost report years preceding CMS's recent "clarification" of its policy.

Lastly, NSUH believes that the OIG's recommendation that NSUH submit a revised 2003 cost report to the fiscal intermediary, Empire Medicare Part A, is unnecessary, since Empire has already taken into account every adjustment recommended by the OIG in aggregating NSUH's wage data with those of other hospitals in the New York State Nassau Suffolk CBSA. Therefore, the objective of submitting a new Worksheet S-3, prepared in accordance with the 2005 CMS policy, has already, in effect, been accomplished as evidenced by the "public use file" containing the intermediary's compilation of NSUH's wage index data for FY 2007 rates.

Thank you for your consideration of our response. If you have further questions or comment, do not hesitate to call me at (516) 465-8257.

Very truly yours,

Robert S. Shapiro
Senior Vice President & Chief Financial Officer

cc: William J. Fuchs
Vice President for Budget & Reimbursement

[4] OIG Final Audit Report, "Review of Windham Hospital's Controls to Ensure Accuracy of Wage Data Used for Calculating Inpatient Prospective Payment System Wage Indexes," A-01-04-0511 (April 2005), p. 5.