Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF VENDOR REBATES PAID TO HOSPITALS

SOUTHSIDE HOSPITAL BAY SHORE, NEW YORK

Daniel R. Levinson
Inspector General

MAY 2007
A-05-07-00052

Office of Inspector General

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The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

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REGION V
OFFICE OF
INSPECTOR GENERAL

May 14, 2007

Report Number: A-05-07-00052

Mr. William J. Fuchs
Vice President of Budget and Reimbursement
North Shore-Long Island Jewish Health System
972 Brush Hollow Road, 5th Floor
Westbury, New York 11590

Dear Mr. Fuchs:

This final report provides the results of our audit of vendor rebates totaling $15,074 that a drug manufacturer paid to Southside Hospital of Bay Shore, New York. We identified these rebates through a national statistical sample of rebates.

BACKGROUND

Southside Hospital

Southside Hospital (the provider) is one of eight community hospitals in the North Shore-Long Island Jewish Health System. The 371-bed facility offers medical, surgical, obstetric, gynecological and pediatric specialties along with extensive physical medicine and rehabilitation programs.

Vendor Rebates

A vendor rebate is a retroactive discount, allowance, or refund given to a health care provider after the full list price has been paid for a product or a service. Rebates are usually paid quarterly or annually and are usually dependent on achieving a specific purchasing volume. A rebate is paid directly to a provider (e.g., a hospital) or to a nonprovider (e.g., a group purchasing organization or distributor).

Federal regulations (42 CFR § 413.98) state that rebates are reductions in the cost of goods or services purchased and are not income. The Centers for Medicare & Medicaid Services (CMS) "Provider Reimbursement Manual" (part 1, chapter 8) requires hospitals and other health care providers to report all discounts on their Medicare cost reports.

Medicare Cost Reports

Some types of Medicare-certified providers, such as hospitals, skilled nursing facilities, and home health agencies, must submit an annual Medicare cost report to a fiscal intermediary. The cost report contains provider information, including facility characteristics, utilization data, costs and charges by cost center (in total and for Medicare), Medicare settlement data, and financial statement data. A cost center is generally an organizational unit having a common functional purpose for which direct and indirect costs are accumulated, allocated, and apportioned. Providers must reduce previously reported Medicare costs when they receive rebates.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the provider reduced costs reported on its fiscal year 2003 Medicare cost report by the $15,074 it received for 2 vendor rebates.

Scope

As part of a national statistical sample of rebates that a single drug vendor sent directly to providers, we selected $15,074 in rebates (composed of 2 checks) that the provider received during calendar year 2003. We limited our review to identifying the rebate amounts and determining whether the provider credited the amounts in its accounting records and on its Medicare cost report. We did not perform a detailed review of the provider's internal controls.

We performed our fieldwork from October through November 2005 at the drug vendor's offices in Deerfield, Illinois. We requested and received information from the provider through phone contacts, mail, and electronic mail.

Methodology

To accomplish our objective, we:

- reviewed Federal regulations and CMS guidance related to rebates,
- obtained a statistical sample of rebates paid by the vendor to identify providers that received the rebates,
- requested documentation from the provider regarding the reporting of the rebate,
- determined whether the provider credited the sampled rebate amount on its Medicare cost report, and
- quantified the dollar amount of any rebates not reported and used to reduce previously reported costs.

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

FINDING AND RECOMMENDATIONS

Of the $15,074 in rebates reviewed, the provider reduced costs by $9,690 on its fiscal year 2003 Medicare cost report but did not report $5,384, contrary to Federal regulations and CMS guidance. The provider could not locate the work papers related to the $5,384 rebate check and stated that it presumed the rebate was not credited on its Medicare cost report. Providers must offset costs by rebates to ensure that they report the actual cost of services provided.

We recommend that the provider:

- revise and resubmit its 2003 Medicare cost report, if not already settled, to properly reflect the $5,384 rebate as a credit reducing its health care costs; and

- consider performing a self-assessment of its internal controls to ensure that future vendor rebates are properly credited on its Medicare cost reports.

PROVIDER COMMENTS

In its comments on the draft report, the provider agreed with our recommendations. The provider stated that it (1) intends to notify its fiscal intermediary to make a corresponding adjustment to the provider's reported costs and (2) remains committed to continuous review and revision of its cost report policies and procedures to ensure that all cost report entries are accurate, timely, consistent with applicable Medicare cost report guidance, and supported by appropriate documentation. The provider's written comments are included as the Appendix.

* * * * *

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. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please contact Jaime Saucedo at (312) 353-8693. Please refer to report number A-05-07-00052.

Sincerely,

Marc Gustafson
Regional Inspector General
for Audit Services

Direct Reply to HHS Action Official:

Mr. James Kerr
Regional Administrator
Centers for Medicare & Medicaid Services
26 Federal Plaza, Room 3811
New York, New York 10278

APPENDIX

North Shore LIJ
North Shore-Long Island Jewish Health System

Finance Department
972 Brush Hollow Road
Westbury, New York 11590
Tel (516)876-6000
Fax (516)876-5572

April 5, 2007

VIA OVERNIGHT MAIL

Mr. Marc Gustafson
Regional Inspector General for Audit Services, Region V
Office of Audit Services
Department of Health and Human Services
233 North Michigan Avenue
Chicago, Illinois 60601

RE: Draft OIG Report # A-05-07-00052

Dear Mr. Gustafson:

On behalf of Southside Hospital ("Southside"), located in Bay Shore, New York, I am writing in response to the above-numbered Office of Inspector General ("OIG") draft audit report entitled "Review of Vendor Rebates Paid to Hospitals." Thank you for allowing us the opportunity to comment on the draft report before it is published in final.

OIG's review of vendor rebates at a drug vendor's offices in Deerfield, Illinois, disclosed two rebate checks received by Southside during calendar year 2003. As acknowledged in the OIG's draft report, Southside appropriately reduced allowable costs by the amount of the first $9,690 rebate check on its 2003 Medicare cost report. Unfortunately, Southside could not trace the second $5,384 rebate check in its financial records to confirm with certainty that an appropriate credit of that rebate on its Medicare cost report had been taken.

Southside acknowledges and takes responsibility for its failure to trace the $5,384 rebate check in its financial records. However, Southside believes that its inability to locate workpapers evidencing the appropriate cost report treatment of the second rebate was not only an isolated failure but one largely traceable to an unusual period of transition for Southside's finance and cost report systems and staff. Previously a sponsored community hospital with its own independent finance and accounting staff, Southside submitted its 2003 Medicare cost report to the fiscal intermediary in May, 2004. In November, 2004, before the OIG audit commenced, North Shore-Long Island Jewish Health System (the "NSLIJ System"), a not-for-profit supporting organization to Southside and to other community hospitals in the NSLIJ System, began to centralize Southside's back-office finance operations at the System's finance office in Westbury, Long Island. Southside suspects that its failure to trace the original workpapers applicable to the $5,384 vendor rebate resulted from the subsequent consolidation of its finance operations with those of the NSLIJ System.

Southside believes that the NSLIJ System's existing policies and procedures adequately ensure that Southside's future vendor rebates will be properly credited on its Medicare cost reports. The current "Financial Statement Close Procedure Policy," last updated on June 30, 2006, instructs the responsible staff accountant to offset medical and surgical supply expenses by any purchase discounts and vendor rebates, both of which are to be recorded on a cash basis upon receipt. The financial reporting department reviews the financial statements on a monthly basis to reconcile and verify these expenses, as well as any offsetting rebates and discounts, after which a second, higher-level review and approval process is performed by facility-level executive and senior NSLIJ System management.

Southside takes note of the OIG's recommendation that Southside resubmit its 2003 Medicare cost report, "if not already settled," to the fiscal intermediary to reflect the value of the rebate. Since Southside's cost report has already been final settled, Southside intends to notify the fiscal intermediary by separate letter of the OIG's findings, with a request that the intermediary make a corresponding adjustment to Southside's reported costs in its consideration of an appeal that Southside is simultaneously filing. Both Southside's appeal of its final settlement and its separate notification to the intermediary will be submitted shortly.

With respect to the OIG's second recommended action, the NSLIJ System believes that its internal controls are sufficient to capture and to make appropriate accounting and cost report adjustments when vendors pay rebates with respect to the purchase of drugs and other medical and surgical supply items. Especially now that the centralization of the System's finance operations is complete, and with the NSLIJ System's reconciliation and verification procedures firmly in place, we are confident that the risk of a material overstatement of supply costs will be minimized. As always, the NSLIJ System remains committed to continuous review and revision of its cost report policies and procedures to ensure that all cost report entries are accurate, timely, consistent with applicable Medicare cost report guidance, and supported by appropriate documentation.

Thank you for your consideration of our response. If you have any further questions or comments, please do not hesitate to call me at 516-876-6065.

Respectfully yours,

William J. Fuchs
Vice President, Budget & Reimbursement