Review of Vendor Rebates Paid to Hospitals

St. Luke's Hospital & Health Network
Bethlehem, Pennsylvania

Daniel R. Levinson
Inspector General

MAY 2007
A-05-07-00054
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OAS FINDINGS AND OPINIONS

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.
Report Number: A-05-07-00054

Ms. Lori L. Williamson
Reimbursement Supervisor
St. Luke’s Hospital & Health Network
801 Ostrum Street
Bethlehem, Pennsylvania 18015

Dear Ms. Williamson:

This final report provides the results of our audit of a vendor rebate in the amount of $34,579 that a drug manufacturer paid to St. Luke’s Hospital & Health Network of Bethlehem, Pennsylvania. We identified this rebate through a national statistical sample of rebates.

BACKGROUND

St. Luke’s Hospital & Health Network

St. Luke’s Hospital & Health Network (the provider) is a regional, integrated network of hospitals, physicians, and other related organizations providing care in Lehigh, Northampton, Carbon, Schuylkill, Bucks, Montgomery, Berks, and Monroe counties in Pennsylvania.

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
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 2004 Medicare cost report by the $34,579 vendor rebate it received.

**(Scope)**

As part of a national statistical sample of rebates that a single drug vendor sent directly to providers, we selected a $34,579 rebate that the provider received during calendar year 2003. We limited our review to identifying the rebate amount and determining whether the provider credited the amount 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

The provider did not reduce costs reported on its fiscal year 2004 cost report by the $34,579 rebate, contrary to Federal regulations and CMS guidance. The provider did not report the rebate because of an inadvertent omission. Instead of using the rebate to reduce its health care costs, the provider recorded the rebate in an account that was not included in its 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 2004 Medicare cost report, if not already settled, to properly reflect the $34,579 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 (1) a revised 2004 Medicare cost report was issued and associated funds have been refunded to the Medicare program through an interim payment reduction, (2) a correction to the 2005 Medicare cost report was requested and received containing an adjustment to correctly reduce costs for the vendor rebate, and (3) education was provided to staff on the proper cost report treatment of rebates. 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-05-07-00054.

Sincerely,

Marc Gustafson
Regional Inspector General
for Audit Services

Direct Reply to HHS Action Official:

Ms. Verlon Johnson
Acting Regional Administrator
Center for Medicare & Medicaid Services
Public Ledger Building, Suite 216
150 S. Independence Mall West
Philadelphia, Pennsylvania 19106
APPENDIX
March 23, 2007
Marc Gustafson
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Audit Services
233 North Michigan Avenue
Chicago, Illinois 60601

Dear Mr. Gustafson:

In response to your draft report dated March 13, 2007 and entitled Review of Vendor Rebates Paid to Hospitals for St. Luke's Hospital & Health Network, this letter serves as our formal response to your findings and recommendations enclosed in the aforementioned report.

With regard to the revision and resubmission of the 2004 Medicare cost report, St. Luke's Hospital, through correspondence dated 7/5/06 with our fiscal intermediary, Highmark Medicare Services, requested a re-opening of the FY 2004 Medicare cost report to correctly reduce the hospital costs by the vendor rebate in question. Subsequent to that date, on 12/14/06, a revised FY 2004 NPR Medicare cost report was issued containing a Worksheet A-8 audit adjustment disallowing the full vendor rebate amount per the general ledger of $1,013,845. Also, the associated monies with regard to the revised FY 2004 NPR Medicare cost report have been refunded to the Medicare program through an interim payment reduction.

To ensure the proper handling of future vendor rebates on the Medicare cost reports, we have implemented steps to correct and improve the process in order to be in compliance with 42 CFR 413.98 and Chapter 8 of the Provider Reimbursement Manual. As part of this corrective action, we have provided internal education in this regard, which includes, but is not limited to, educating our staff on proper cost report treatment of rebates and auditing to ensure compliance. We also requested a correction to the FY 2005 Medicare cost report and have subsequently received the NPR FY 2005 Medicare cost report, dated 12/6/06, again containing an audit adjustment to correctly reduce costs for the vendor rebate. Our recent submission of the FY 2006 Medicare cost report was filed with expenses already reduced for the vendor rebate via a Worksheet A-8 adjustment.

We are confident that this issue has been addressed and we will continue to be in compliance in future periods. If however, you need additional information or support for any of the statements above, feel free to contact me at 610-954-3198.

Sincerely,

Lori L. Williamson
Reimbursement Supervisor

Cc: Henriette Frey, AVP, Finance
Francine Botek, AVP, Finance