

# MAINE STATE LEGISLATURE

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AUGUSTA, MAINE 04333

May 7, 1980

Honorable Richard H. Pierce  
Assistant Majority Leader  
The Senate of Maine  
State House, Station 3  
Augusta, Maine 04333

Dear Senator Pierce:

This letter is in response to your inquiry of April 11, 1980, relative to the opinion on the Maine Long-Term Care Principles of Reimbursement which was issued by the Department of Human Services on January 12, 1979, and designated as Opinion No. 17.

On January 1, 1978, the Department's new set of reimbursement regulations, "Principles of Reimbursement for Long-Term Care Facilities" went into effect. To facilitate the transition from the "old" principles to the "new" principles and in anticipation of the implementation of Subchapter III of the Maine Administrative Procedure Act (5 M.R.S.A. § 9001), the Department instituted a system whereby providers could seek guidance from the Department as to how the Department would interpret provisions of the new Principles. As 5 M.R.S.A. § 9001 makes clear, such advisory rulings are not rules within the meaning of the APA. See 5 M.R.S.A. § 8002(9). Indeed, these opinions are not binding on the Department except that a person's justifiable reliance on the ruling is to be considered in mitigation in any action brought by the Department to enforce a penalty.

It is our view that Opinion No. 17 is an advisory ruling under 5 M.R.S.A. § 9001. As such, it is merely the Department's statement of the interpretation it gives to the language of Principle 3032.1. While an agency's interpretation of its own rules is to be accorded great deference, a provider is entitled to challenge the Department's interpretation of Principle 3032.1 if applied to his detriment.<sup>1/</sup> We would

<sup>1/</sup> Pursuant to Principle 6050, a provider may appeal audit adjustments.

note, however, that the Department's interpretation comports with guidelines set out in the Medicare Provider Reimbursement Manual. (Attachment A) This Manual is specifically incorporated by the 1978 Principles, at page 6, as a guide for interpretation of the Department's Principles. (Attachment B).

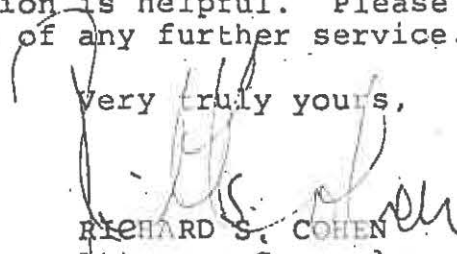
We are not aware of any inconsistent interpretations given to Principle 3032.1 prior to the issuance of Opinion No. 17. Therefore, it is our opinion that the Department may apply its interpretation to any set of facts governed by Principle 3032.1.

It is also our understanding that the Department has applied Principle 3032.1 to interest expense for years after January 1, 1978 on notes entered into prior to January 1, 1978. However, this application does not impair any rights. Principle 3(a) of the 1972 Principles of Reimbursement (Attachment C), the principle in effect prior to January 1, 1978, did not allow any reimbursement for interest on current indebtedness incurred by proprietary providers except where incurred as a result of the Department's failure to make timely payments. Where allowed, interest on current indebtedness was defined by Principle 3(b) in the same language as is now contained in Principle 3032.1. Again, we are not cognizant of any interpretations given to Principle 3(b) which are inconsistent with the interpretation of the language addressed in Opinion No. 17.

In conclusion, it is the opinion of this Office that Opinion No. 17 is an advisory ruling under 5 M.R.S.A. § 9001. In the absence of any detrimental reliance on any prior inconsistent rulings, it is our view that the Department may apply its interpretation of "relatively short term," as expressed in Opinion No. 17, to any set of facts governed by either Principle 3032.1 of the 1978 Principles of Reimbursement or Principle 3 of the 1972 Principles of Reimbursement. Any person who is aggrieved by the Department's interpretation may challenge it through the appropriate channels.

I hope this information is helpful. Please feel free to contact me if I can be of any further service.

Very truly yours,

  
RICHARD S. COHEN  
Attorney General

## INTEREST EXPENSE

**200. Principle**

Necessary and proper interest on both current and capital indebtedness is an allowable cost. (Cross refer to 98 2422ff.)

**202. Definitions****202.1 Interest**

Interest is the *cost incurred for the use of borrowed funds*, generally paid at fixed intervals by the user. Interest on current indebtedness is the cost incurred for funds borrowed for a relatively short term, usually for one year or less. Current borrowing is usually for purposes such as working capital for normal operating expenses. Interest on capital indebtedness is the cost incurred for funds borrowed for capital purposes, such as the acquisition of facilities, equipment, and capital improvements. Generally, loans for capital purposes are long-term loans.

Interest is usually expressed as a percentage of the principal. Sometimes, it is identified as a separate item of cost in a loan agreement. Interest may be included in "finance charges" imposed by some lending institutions or it may be a prepaid cost or "discount" in transactions with those lenders who collect the full interest charges when funds are borrowed. Reasonable finance charges and service charges together with interest on indebtedness are includable in allowable cost.

To be allowable under the Medicare program, interest must be: (1) supported by evidence of an agreement that funds were borrowed and that payment of interest and repayment of the funds are required; (2) identifiable in the provider's accounting records; (3) related to the reporting period in which the costs are incurred; and (4) necessary and proper for the operation, maintenance, or acquisition of the provider's facilities.

To support the existence of a loan, the provider should have available a signed copy of the loan contract which should contain the pertinent terms of the loan such as amount, rate of interest, method of payment, due date, etc. Where the lender does not customarily furnish a copy of the loan contract, correspondence from the lender stating the pertinent terms of the loan such as amount, rate of interest, method of payment, due date, etc., will be acceptable.

Where funds are borrowed from the provider's funded depreciation account or other restricted funds, authorization from appropriate officials of the provider should be on file. Appropriate officials of the provider would include the persons to whom responsibility for the management of the restricted amounts or funds has been granted, such as the board of trustees, financial committees, or other individuals or groups, as appropriate in the particular case.

Various methods of identifying and accounting for interest costs are used. These include periodic cash payments of interest with or without repayment of all or part of the loan; prepayment of interest when the liability is incurred with charges to interest expense recorded in relation to the accounting period; and accrual of interest with no cash payment with a corresponding record of the unpaid liability reflected in the accounting records. The method actually used depends on the type of loan and the terms of the loan agreement.

Where interest expense has been determined to be allowable and the interest expense records are maintained physically away from the provider premises such as in a county treasurer's office, such records will be deemed to be those of the provider. This would be applicable where bond issues have been specifically designated for the construction or acquisition of the provider's facilities and the financial records relative to the bond issue are maintained by some governmental body other than the provider.

**202.2 Necessary**

Necessary means that the interest be incurred on a loan made to satisfy a financial need of the provider and for a purpose reasonably related to patient care. For example, where funds are borrowed for purposes of investing in other than the provider's operations, interest expense is not allowable; such a loan is not considered "necessary." Likewise, when borrowed funds create excess working capital, interest expense on such borrowed funds is not an allowable cost.

Necessary also requires that the interest be reduced by investment income. There is an exception to this general rule where the investment income is from grants and gifts, whether restricted or unrestricted, and which are not commingled with other

## ATTACHMENT B

All long-term care facilities are required to submit annual cost reports as prescribed herein to the State of Maine Department of Human Services, Division of Health Care Audit, State House, Augusta, Maine 04333. Such cost reports shall be based on the fiscal year of the facility.

However, to accommodate the revisions in the principles of cost reporting and reimbursement which are effective on January 1, 1978, the following implementing procedures apply:

- a. Phase-out of the former system. All long-term care facilities will submit a final cost report for the period ending December 31, 1977 in accordance with the former principles of reimbursement, cost report instructions and forms. This final report should be filed no later than March 31, 1978. This final report shall be prepared in accordance with the same method of accounting (cash, accrual, etc.) as used for the previous reports.
- b. Phase-in of the new system. All long-term care facilities will submit an initial cost report for the period from January 1, 1978 through the end of their fiscal year in accordance with the revised principles of reimbursement, cost report instructions and forms prescribed herein. Annual reports will be filed thereafter on the basis of the provider's fiscal year.

### ALLOWABILITY OF COSTS

A determination of whether or not a cost is allowable and interpretations of definitions, not specifically detailed in these principles, will be based on Medicare Provider Reimbursement Manual (HIM-15) guidelines and Internal Revenue Service guidelines in effect at the time of such determination.

### EFFECTIVE DATE

The effective date of these principles is January 1, 1978.

### PUBLIC HEARINGS

The State of Maine will provide for public hearings as necessary in our State Plan, according to State procedures.

### ICF-MR FACILITIES

Intermediate Care Facilities for the Mentally Retarded Patients are to be paid under the regulations as spelled out in these principles.



## 1972 PRINCIPLES OF REIMBURSEMENT

(3) The provider has the option to renew the lease at a significantly reduced rental, or the provider has the right to purchase the facilities or equipment at a price which appears to be significantly less than what the fair market value of the facilities or equipment would be at the time or times acquisition by the provider is permitted.

(h) Lease Rentals as Allowable Costs. For rental charges paid under a sale-and-leaseback arrangement to be includable in allowable costs, the transaction must have been at arm's length and a reasonable one for economic and technical purposes and not one designed to increase or accelerate allowable costs under the program. Thus, unless conditions (1) - (3) in above (f) are all met, the rentals included in reimbursable costs will be limited to the amount the provider would have been allowed had he kept legal title to the property (mortgage interest, taxes, depreciation, insurance and maintenance costs).

(i) Lease Purchase Agreements. Where the lease of a facility or piece of equipment is the same as a purchase of it, the rental charge is treated as a reimbursable cost only to the extent that the provider would have had allowable costs if it had bought the asset (straight-line depreciation, insurance and interest). The unallowable portion of the rental charges is treated as a deferred charge and capitalized as part of the depreciable cost when the asset is purchased. As to whether a lease is a purchase, see conditions (1) - (3) above (f).

### 3. INTEREST EXPENSE

(a) Principle. Necessary and proper interest on both current and capital indebtedness is an allowable cost to qualified charitable providers. Necessary and proper interest on capital indebtedness is an allowable cost to proprietary providers. Necessary and proper interest on current indebtedness incurred as a result of failure by the State of Maine Department of Health and Welfare to make timely payments under the program is an allowable cost to proprietary providers.

(b) Definitions.

(1) Interest. Interest is the cost incurred for the use of borrowed funds. Interest on current indebtedness is the cost incurred for funds borrowed for a relatively short term. This is usually for such purposes as working

capital for normal operating expenses. Interest on capital indebtedness is the cost incurred, for funds borrowed for capital purposes, such as acquisition of facilities and equipment and capital improvements. Generally loans for capital purposes are long-term loans.

(2) Necessary. Necessary requires that the interest:

- (i) Be incurred on a loan made to satisfy a financial need of the provider. Loans which result in excess funds or investments would not be considered necessary.
- (ii) Be incurred for a purpose reasonably related to recipient patient care.

(3) Proper. Proper requires that interest:

- (i) Be incurred at a rate not in excess of what a prudent borrower would have had to pay in the money market existing at the time the loan was made, except that such interest shall under no circumstances be allowable in excess of 9 percent.
- (ii) Be paid to a lender not related through control to the borrowing organization. However, interest is allowable if paid on loans from the provider's donor-restricted funds in the provider's qualified pension fund.

(4) Timely Payments. To be timely, payments by the State of Maine Department of Health and Welfare on behalf of duly entitled recipients should be made by the end of the month following the month in which services are provided to such recipients and billed or forty-five days from the date of billing whichever is later.

(c) Borrower-Lender Relationship. To be allowable, interest expense must be incurred on indebtedness to lenders or lending organizations not related through control or personal relationship to the borrower.