

Issue:

During rate setting audits, DHCS's Audits & Investigations (A&I) staff remove from the allowable costs those expenses deemed unreasonable. The basis for their determinations of reasonableness appears arbitrary.

Though applying reasonableness standards when determining allowability of costs is well within the State's rightful scope, the inconsistent determination that certain legitimate costs of operation are unreasonable and thus not allowed in the rate setting cost basis is not appropriate and does not follow Medicare cost principles.

Definitions:

*Allowable cost* – A cost (either direct or indirect) related to patient care (including personnel, administrative costs, etc.) that is necessary and proper in providing services, reasonable and supported by adequate cost data and documentation.

*Reasonable cost* – A cost that is not excessive, follows the “prudent buyer” principle and is necessary and proper for the efficient delivery of services to patients.

Regulations:

- Medicare Reasonable Cost Principles in 42 CFR, Part 413
- CFR › Title 42 › Chapter IV › Subchapter B › Part 405 › Subpart X › Section 405.2467: Requirements of the FQHC PPS
- CFR › Title 42 › Chapter IV › Subchapter B › Part 405 › Subpart X › Section 405.2468: Allowable costs
- CFR › Title 42 › Chapter IV › Subchapter B › Part 405 › Subpart X › § 405.502: Criteria for determining reasonable charges
- Social Security Act, Part E – Miscellaneous Provisions, Definitions of Services, Institutions, Etc., Section 1861 (v)(1)(A): Reasonable Cost

Per the *Instructions for Completing Home Office Cost Report* (DHCS 3089i), “Home Office Costs: To the extent the home office furnishes services to a facility related to health care, the reasonable costs of such services are included in the facility's cost report. Where the home office provides services not related to patient care, these costs may not be recognized as allowable costs of the FQHC/RHC clinic. For example, certain advertising costs, some franchise taxes, costs of noncompetitive agreements, certain life insurance premiums, certain membership costs, or those costs related to nonmedical enterprises are not considered allowable home office costs.”

In the Provider Reimbursement Manual, Part 1, Chapter 21, under costs related to patient care, there is the definition of “reasonable costs” in section 2102.1 where Medicare recognizes cost can be different from institution to institution, but it also states “except where a particular institution’s costs are found to be substantially out of line with other institutions in the same area which are similar in size, scope of services, utilization and other relevant factors.” This section goes on to say, “Implicit in the intention that actual costs be paid to the extent they are

reasonable is the expectation that the provider seeks to minimize its costs and that its actual costs do not exceed what a prudent and cost-conscious buyer pays for a given item or service. If costs are determined to exceed the level that such buyers incur, the absence of clear evidence that the higher costs were unavoidable, the excess costs are not reimbursable under the program.”