APR 21 2005

TO: Herb Kuhn
Director, Center for Medicare Management
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of Windham Hospital's Controls to Ensure Accuracy of Wage Data Used for Calculating Inpatient Prospective Payment System Wage Indexes (A-01-04-00511)

Attached is an advanced copy of our final report on Windham Hospital's (the hospital) controls to ensure the accuracy of wage data used for calculating inpatient prospective payment system (IPPS) wage indexes. We will issue this report to the hospital within 5 business days. This review is the second in a series of reviews of the accuracy of the wage data reported by IPPS hospitals.

Under the acute care hospital IPPS, Medicare payments for hospitals are made at predetermined rates for each hospital discharge. The payment system base rate is comprised of a standardized amount that includes a labor-related share. The Centers for Medicare & Medicaid Services (CMS) adjusts the labor-related share by the wage index applicable to the area in which the hospital is located. Section 1886(d)(8)(C)(iii) of the Social Security Act specifies that the wage index applicable to any hospital that is located in urban areas of a State may not be less than the area wage index applicable to hospitals located in rural areas in that State. The wage index values in fiscal year (FY) 2004 were based on the wage data collected by CMS from the FY 2000 Medicare cost reports submitted by hospitals.

The objective of our review was to determine whether the hospital reported FY 2000 Medicare cost report wage data in compliance with Medicare laws, regulations, and guidance.

We found that the hospital did not fully comply with Medicare laws, regulations, and guidance for the reporting of wage data in its FY 2000 Medicare cost report. Specifically, the hospital overstated wage data reported in its FY 2000 Medicare cost report by $404,402 for the FY 2000 Medicare cost report period.

Overstated wage data occurred because the hospital had not (1) performed sufficient review and reconciliation procedures to ensure all reported wage data was accurate, supportable, and in compliance with Medicare regulations; and (2) established a financial management system to track all wage data.

As a result, the hospital overstated its wage data by $404,402 for the Medicare FY 2000 cost report period. Furthermore, due to the impact of overstated wages, the FY 2004 (1) Connecticut statewide rural wage index is overstated by about 1 percent, and (2) average payment to the 2 hospitals in the Connecticut statewide rural area and 17 additional hospitals in 2 Connecticut urban metropolitan statistical areas is overstated by about $24 per hospital discharge.

We recommend that the hospital strengthen financial reporting controls by:

- implementing procedures to ensure that the wage data reported on the hospital's Medicare cost report is accurate, supported, and allowable in compliance with Medicare regulations and

- improving its financial management system to ensure accountability for all wage data.

In its response to our draft report, the hospital concurred with our findings and recommendations except our finding that wage data was overstated due to the inclusion of unfunded postretirement benefit (PRB) costs. We removed this finding from our final report and we addressed the issue of unfunded PRB costs in the Other Matters section of the report. The hospital's inclusion of these costs resulted in a higher wage index, and consequently higher Medicare reimbursement for the hospital and 18 additional hospitals that utilized this wage index. We are disclosing this issue to CMS for its consideration regarding the appropriate reporting of PRB costs for wage index purposes.

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 Michael J. Armstrong, Regional Inspector General for Audit Services, Region I, at (617) 565-2689.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES OFFICE OF INSPECTOR GENERAL

Office of Audit Services
Region I
John F. Kennedy Federal Building
Boston, MA 02203
(617) 565-2684

APR 27 2005

Report Number: A-01-04-00511

Mr. James N. Papadakos
Vice President, Finance and Chief Financial Officer
Windham Hospital
112 Mansfield Avenue
Willimantic, Connecticut 06226

Dear Mr. Papadakos:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Windham 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 below for review and any action deemed necessary.

The HHS action official named below 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.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. § 552, 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-01-04-00511 in all correspondence.

Sincerely yours,

Michael J Armstrong

Michael Armstrong
Regional Inspector General
for Audit Services

Enclosures - as stated

Direct Reply to HHS Action Official:

Charlotte S. Yeh, M.D.
Regional Administrator
Centers for Medicare & Medicaid Services
Department of Health and Human Services
John F. Kennedy Federal Building, Room 2325
Boston, Massachusetts 02203-0003

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF WINDHAM HOSPITAL'S CONTROLS TO ENSURE ACCURACY OF WAGE DATA USED FOR CALCULATING INPATIENT PROSPECTIVE PAYMENT SYSTEM WAGE INDEXES

APRIL 2005
A-01-04-00511

Office of Inspector General

http://oig.hhs.gov

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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR part 5.)

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.

EXECUTIVE SUMMARY

BACKGROUND

Under the acute care hospital inpatient prospective payment system (IPPS), Medicare payments for hospitals are made at predetermined rates for each hospital discharge. The payment system base rate is comprised of a standardized amount that includes a labor-related share. The Centers for Medicare & Medicaid Services (CMS) adjusts the labor-related share by the wage index applicable to the area where the hospital is located.

CMS uses the Office of Management and Budget metropolitan area designations to identify labor markets, and calculate and assign wage indexes for hospitals. CMS calculates a distinct wage index for each metropolitan statistical area (MSA) and one statewide wage index per State for areas that lie outside of MSAs. CMS bases the wage index values on wage data collected from Medicare cost reports submitted by hospitals. All hospitals within a distinct MSA wage index or within a rural statewide area receive the same labor payment adjustment. Windham Hospital (the hospital), along with one other hospital, is classified into the Connecticut rural area.

OBJECTIVE

The objective of our review was to determine whether the hospital reported fiscal year (FY) 2000 Medicare cost report wage data in compliance with Medicare laws, regulations, and guidance.

SUMMARY OF FINDINGS

We found that the hospital did not fully comply with Medicare regulations and guidance for the reporting of wage data in its FY 2000 Medicare cost report. Specifically, the hospital overstated wage data reported in its FY 2000 Medicare cost report by including (1) wage related benefits cost that was not offset by $255,817 in applicable credits, and (2) $148,585[1] in wages for personal time without supporting documentation for the related hours.

Overstated wage data occurred because the hospital had not (1) performed sufficient review and reconciliation procedures to ensure all reported wage data was accurate, supportable, and in compliance with Medicare regulations; and (2) established a financial management system to track all wage data.

As a result, the hospital overstated its wage data by $404,402 for the FY 2000 Medicare cost report period. Furthermore, due to the impact of overstated wages, the FY 2004 (1) Connecticut statewide rural wage index is overstated by about 1 percent, and (2) average payment to the

[1]The increase of $1,127 from the amount identified in the draft report is due to an adjustment to the overhead calculation. (See Appendix A)

2 hospitals in the Connecticut statewide rural area and 17 additional hospitals in 2 Connecticut urban MSAs is overstated by about $24 per hospital discharge.[2]

RECOMMENDATIONS

We recommend that the hospital strengthen financial reporting controls by:

- implementing procedures to ensure that the wage data reported on the hospital's Medicare cost report is accurate, supported, and allowable in compliance with Medicare regulations and

- improving its financial management system to ensure accountability for all wage data.

HOSPITAL COMMENTS

In written comments on our draft report, the hospital concurred with our findings and recommendations that it did not include the hours associated with wages for personal time and did not reduce reported wage-related costs to reflect applicable credits. The hospital did not agree with our finding, as stated in our draft report, that wage data was overstated due to the inclusion of unfunded postretirement benefit (PRB) costs. The hospital relied on the preamble to the FY 1995 final rule for IPPS, found in Volume 59 of the Federal Register, dated September 1, 1994.

OFFICE OF INSPECTOR GENERAL RESPONSE

We removed the finding that the hospital's wage data was overstated due to the inclusion of unfunded PRB costs from our final report. As stated in the Other Matters section of the report, we will present this issue to CMS for its consideration regarding the appropriate treatment of these costs.

[2] Section 1886(d)(8)(C)(iii) of the Social Security Act (the Act) specifies that the wage index applicable to any hospital that is located in urban areas of a State may not be less than the area wage index applicable to hospitals located in rural areas in that State. The calculated FY 2004 wage index for two Connecticut urban MSAs was below the Connecticut statewide rural wage index. Accordingly, hospitals in these two Connecticut urban MSAs utilize the higher Connecticut statewide rural wage index.

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INTRODUCTION

BACKGROUND

Medicare Inpatient Prospective Payment System

Under the acute care hospital IPPS, Medicare payments for hospital inpatient operating and capital-related costs are made at predetermined specific rates for each hospital discharge. Discharges are classified according to a list of diagnosis-related groups. The hospital base payment rate is comprised of a standardized amount that includes a labor-related share. CMS adjusts the labor-related share by the wage index applicable to the area where the hospital is located.

According to CMS, in FY 2004, Medicare paid about $98 billion to 4,087 acute care hospitals, an increase of $4.1 billion over FY 2003.

Wage Index

Geographic designation influences Medicare payment. Under the hospital IPPS, CMS adjusts payments geographically through a wage index, to reflect labor cost variations among localities. CMS uses the Office of Management and Budget metropolitan area designations to identify labor markets, and calculate and assign wage indexes for hospitals. CMS calculates a distinct wage index for each MSA, and one statewide wage index per State for the areas that lie outside of MSAs. All hospitals within a distinct MSA wage index or within a rural statewide area receive the same labor payment adjustment. Section 1886(d)(8)(C)(iii) of the Act specifies that the wage index applicable to any hospital that is located in urban areas of a State may not be less than the area wage index applicable to hospitals located in rural areas in that State.

The wage index values in FY 2004 are based on the wage data collected from the Medicare cost reports submitted by hospitals in the cost reporting periods beginning in FY 2000. Section 1886(d)(3)(e) of the Act requires that CMS update the wage index annually in a manner that ensures that aggregate payments to hospitals are not affected by changes to hospitals' wage indexes.

Windham Hospital

The hospital is a 130-bed hospital located in Willimantic, CT. The hospital, along with one other hospital, is classified into the Connecticut statewide rural area for the prospective payment system wage index. The Connecticut statewide rural wage index directly influences Medicare payments to 17 additional acute care hospitals in 2 Connecticut urban MSAs.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of our review was to determine whether the hospital reported FY 2000 Medicare cost report wage data in compliance with Medicare laws, regulations, and guidance.

Scope

Our review covered the wage data reported to CMS by the hospital on Schedule S-3, Part II of its FY 2000 Medicare cost report. Our review of internal controls at the hospital was limited to the control procedures used by the hospital to accumulate and report wage data to its FY 2000 Medicare cost report.

Methodology

To accomplish our objective, we:

- reviewed applicable Medicare laws, regulations, and guidance,
- obtained an understanding of the hospital's control 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 2000 Medicare cost report to its trial balance,
- reconciled the wage data from selected cost centers to detail support such as payroll registers or accounts payable invoices,
- tested a sample of personnel from payroll registers and verified hours to timesheets,
- held discussions with the hospital staff regarding the sample of personnel to obtain support for wages and to determine the services provided to the hospital, and
- reviewed fiscal intermediary audit reimbursement adjustments made to the hospital wage data as reported on its FY 2000 Medicare cost report.

We performed our fieldwork at the hospital in Willimantic, CT from January 2004 through March 2004. The hospital's written comments to our draft report are appended in their entirety to this report (see Appendix B) and are summarized and addressed on pages 4 and 5.

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

FINDINGS AND RECOMMENDATIONS

We found that the hospital did not fully comply with Medicare regulations and guidance for the reporting of wage data in its FY 2000 Medicare cost report. Specifically, the hospital overstated wage data reported in its FY 2000 Medicare cost report by including:

- wage-related benefits cost that was not offset by $255,817 in applicable credits and
- $148,585[1] in wages for personal time without supporting documentation for the related hours.

Overstated wage data occurred because the hospital had not (1) performed sufficient review and reconciliation procedures to ensure all reported wage data was accurate, supportable, and in compliance with Medicare regulations; and (2) established a financial management system to track all wage data.

As a result, the hospital overstated its wage data by $404,402 for the FY 2000 Medicare cost report period. Furthermore, due to the impact of overstated wages, the FY 2004 (1) Connecticut statewide rural wage index is overstated by about 1 percent, and (2) average payment to the 2 hospitals in the Connecticut statewide rural area and 17 additional hospitals in 2 Connecticut urban MSAs is overstated by about $24 per hospital discharge. The findings related to overstated wage data are discussed in more detail in the following pages and the cumulative effect of the findings is presented in Appendix A.

WAGE-RELATED BENEFITS COST OVERSTATED

The 42 CFR § 413.24 states that provider cost data must be based on an approved method of cost finding and on the accrual basis of accounting. With regard to recording all applicable credits as offsets to expenditures, the Provider Reimbursement Manual, part II, section 3605.2 states that for wage index purposes, hospitals must report their expenses at cost.

The hospital's wage-related benefits cost was overstated by $255,817 because it did not reflect applicable credits for postretirement and dental insurance benefits.

OVERSTATED WAGES FOR PERSONAL TIME

The 42 CFR § 413.20 requires that providers maintain sufficient financial records and statistical data for proper determination of costs payable under the program. Within this context, the Medicare Provider Reimbursement Manual, part II, section 3605.2 requires hospitals to record the number of paid hours corresponding to the amounts reported as regular time, overtime, paid holiday, vacation and sick leave, paid time-off, and hours associated with severance pay.

The hospital reported $148,585 in wages for personal time but did not report the related hours thereby inflating the average hourly wage.

[1]The increase of $1,127 from the amount identified in the draft report is due to an adjustment to the overhead calculation. (See Appendix A)

CAUSES FOR OVERSTATED WAGE DATA

The hospital overstated its reported wage data because:

- the hospital did not perform sufficient review and reconciliation procedures to ensure that all amounts reported for wage data were accurate, supportable, and in compliance with Medicare regulations and

- the hospital's financial management system was not designed to track all wage data.

EFFECT OF OVERSTATED WAGE DATA

As a result of the conditions identified above, the hospital overstated its wage data by $404,402 for the FY 2000 Medicare cost report period. Furthermore, due to the impact of overstated wages, the FY 2004 (1) Connecticut statewide rural wage index is overstated by about 1 percent, and (2) average payment to the 2 hospitals in the Connecticut statewide rural area and 17 additional hospitals in 2 Connecticut urban MSAs is overstated by about $24 per hospital discharge. [1]

RECOMMENDATIONS

We recommend that the hospital strengthen financial reporting controls by:

- implementing procedures to ensure that the wage data reported on the hospital's Medicare cost report is accurate, supported, and allowable in compliance with Medicare regulations and

- improving its financial management system to ensure accountability for all wage data.

HOSPITAL COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

Hospital Comments

In written comments on our draft report, the hospital concurred with our findings that it did not include the hours associated with wages for personal time and reported wage-related benefits cost that was not offset by applicable credits. The hospital stated it has already established corrective actions to ensure that the wage data reported in future cost report submissions are accurate and supported. The hospital also agreed with our recommendation to improve its financial management system to ensure accountability for all wage data charged to the Medicare program.

The hospital did not agree with our finding as stated in our draft report that wage data was overstated by $1,618,797 in unfunded PRB costs. The hospital relied on the preamble to the FY 1995 final rule for IPPS, found in Volume 59 of the Federal Register, and dated September 1, 1994.

Office of Inspector General Response

We removed the finding that the hospital's wage data was overstated due to the inclusion of unfunded PRB costs from our final report. As stated in the Other Matters section of the report, we will present this issue to CMS for its consideration regarding the appropriate treatment of these costs.

OTHER MATTERS

The hospital included unfunded PRB costs in the wage data reported on its FY 2000 Medicare cost report. The hospital relied on the preamble to the FY 1995 final rule for IPPS that states that hospitals are required to use generally accepted accounting principles (GAAP) for the development of wage-related costs. The GAAP does not impose time limits for liquidating accrued liabilities. Conversely, the Medicare reasonable cost provisions in 42 CFR § 413.100(c)(i) provide that liabilities related to deferred compensation plans ". . . must be liquidated within one year of the end of the cost reporting period in which the liability is incurred." The hospital's inclusion of these costs resulted in a higher wage index, and consequently higher Medicare reimbursement, for this hospital and the additional 18 hospitals that utilize this wage index. We are disclosing this issue to CMS for its consideration regarding the appropriate reporting of PRB costs for wage index purposes.

APPENDIXES

CUMULATIVE EFFECT OF FINDINGS

Windham Hospital (WH)		WH Reported FY 2000 Wage Data	*Employee Wages* Personal Time Off	*Fringe Benefits* Wage Related Benefits Cost	WH Adjusted FY 2000 Wage Data
Work Sheet S - 3, Part II					
Total Salaries					**Total Salaries**
line1/col. 3	**TOTAL SALARIES**	$23,408,723.00	($141,572.00)		$23,267,151.00
	Excluded Salaries				
line5/col. 3	**PHYSICIAN - PT B**	$1,188,485.00			$1,188,485.00
line8.01/col. 3	**EXCLUDED AREA SALARIES**	$210,545.00			$210,545.00
sub-tot-a (LESS)		**$1,399,030.00**			**$1,399,030.00**
	Additional Salaries				
line9/col. 3	**CONTRACT LABOR**	$572,368.00			$572,368.00
line9.02/col. 3	**LAB SERVICE UNDER CONTRACT**	$27,165.00			$27,165.00
line10/col. 3	**CONTRACT LABOR: PHYS PT A**	$475,131.00			$475,131.00
line13/col. 3	**WAGE-RELATED COST (CORE)**	$7,920,368.00		($242,942.00)	$7,677,426.00
line18/col. 3	**PHSY PART A**	$98,631.00		($3,025.32)	$95,605.68
sub-tot-b (ADD)		**$9,093,663.00**		**($245,967.32)**	**$8,847,695.68**
	adjusted salaries	***$31,103,356.00***	***($141,572.00)***	***($245,967.32)***	***$30,715,816.68***
Total Paid Hours					**Total Paid Hours**
line1/col. 4	**TOTAL HOURS**	1,085,635.00			1,085,635.00
	Excluded Hours				
line5/col. 4	**PHYS PT B HOURS**	13,168.00			13,168.00
line8.01/col. 4	**EXCLUDED AREAS HOURS**	13,853.00			13,853.00
sub-tot-c (LESS)		**27,021.00**			**27,021.00**
	Additional Hours				
line9/col. 4	**CONTRACT LABOR HOURS**	12,330.04			12,330.04
line9.02/col. 4	**LAB SERVICE UNDER CONTRACT HRS**	725.25			725.25
line10/col. 4	**CONTRACT PHYS LABOR PT A HRS**	5,845.00			5,845.00
sub-tot-d (ADD)		**18,900.29**			**18,900.29**
	adjusted hours	***1,077,514.29***			***1,077,514.29***

CUMULATIVE EFFECT OF FINDINGS

Windham Hospital (WH)		WH Reported FY 2000 Wage Data	Personal Time Off	Wage Related Benefits Cost	WH Adjusted FY 2000 Wage Data
Work Sheet S - 3, Part III					
Overhead Allocation					**Overhead Allocation**
line13/col. 3	**TOTAL OVERHEAD WAGES**	$8,081,498.00			$8,081,498.00
line13/col. 4	**TOTAL OVERHEAD HOURS**	441,729.00			441,729.00
	TOTAL SALARIES HOURS	1,085,635.00			1,085,635.00
	LESS:				
	PHYS PT B HOURS	13,168.00			13,168.00
	TOTAL OVERHEAD HOURS	441,729.00			441,729.00
	SUBTOTAL ->	454,897.00			454,897.00
	Revised Hours	630,738.00			630,738.00
	OVERHEAD REDUCTION FOR EXCLUDED AREAS HOURS				
	SNF HOURS				
	EXCLUDED AREA HOURS (e.g; home health)	**13,853.00**			**13,853.00**
	SUBTOTAL -->	**13,853.00**			**13,853.00**
EXCLUDED OVERHEAD RATE					
[(snf+excluded area hrs)/revised hours]		**0.0220**			**0.0220**
EXCLUDED OVERHEAD WAGES (OH X Excuded OH ratio)		**$177,495.24**			**$177,495.24**
EXCLUDED OVERHEAD HOURS (OH Hrs X Excluded OH ratio)		**9,701.76**			**9,701.76**
OVERHEAD RATE					
- (oh hrs/(revised hrs + oh hrs)		**0.4119**			**0.4119**
	WAGE-RELATED COST (CORE)	**$7,920,368.00**		**($242,942.00)**	**$7,677,426.00**
	PHSY PART A	**$98,631.00**		**($3,025.32)**	**$95,605.68**
	SUBTOTAL	**$8,018,999.00**		**($245,967.32)**	**$7,773,031.68**
overhead work wage-related cost (e.g; $8,018,999*.41)		**$3,302,874.97**		**($101,309.00)**	**$3,201,565.65**
excluded work wage-related cost (e.g; $3,302,874.97 * .021963)		**$72,541.57**		**($2,225.07)**	**$70,316.50**
	Adjusted Salaries	$31,103,356.00	($141,572.00)	($245,967.32)	$30,715,816.68
	Less: excluded overhead salaries	($177,495.24)			($177,495.24)
	excluded work related cost	($72,541.57)		$2,225.07	($70,316.50)
REVISED WAGES		$30,853,319.19	($141,572.00)	($243,742.25)	$30,468,004.94
MULTIPLY BY : INFLATION FACTOR					
(Per August 1, 2003 Federal Register)		**1.04954**			1.04954
INFLATED WAGES (Adjusted Wages used in report) -		**$32,381,792.62**	**($148,585.48)**	**($255,817.24)**	**$31,977,389.91**
REVISED HOURS (Adjusted Hours used in report) -		**1,067,812.53**			**1,067,812.53**
[Adjusted hours - excluded oh hrs]					

CUMULATIVE EFFECT OF FINDINGS

Windham Hospital (WH)	WH Reported FY 2000 Wage Data	Personal Time Off	Wage Related Benefits Cost	WH Adjusted FY 2000 Wage Data
IPPS IMPACT:				
Average hourly wage (MSA Avg/Natl. Avg. of $24.7072	$30.3254	$30.1862	$30.0858	$29.9466
Federal Register - average hourly wage as published	$30.3254	$30.3254	$30.3254	$30.3254
IMPACT OF CHANGE (used in report) =>		(0.1392)	(0.2396)	(0.3788)
Wage Index - Published		1.2183	1.2183	1.2183
Wage Index - Change		1.2154	1.2134	1.2105
IMPACT OF CHANGE (used in report) =>		(0.0028)	(0.0049)	(0.0078)
Avg. IPPS Payment (Based on a DRG relative weight of 1.0)		$8.76	$15.20	$23.96

TOTAL EFFECT OF WAGE ADJUSTMENTS ON THE MSA AVERAGE HOURLY RATE AND WAGE INDEX

Provider	Cost Report Period	COST REPORT ENDING DATES	REPORTED AND/OR REVISED WAGES (WAGES)	HOURS	AVERAGE HOURLY RATE (WAGES)/(HOURS)
Windam Hospital	19991001	20000930	$31,977,389.91	1,067,812.53	29.9466
Hospital #2	19991001	20000930	$30,908,754.88	1,034,833.00	29.8684
			$62,886,144.79	**$2,102,645.53**	**29.9081**
		NATIONAL WAGE RATE - Oct. 6, 2003 FEDERAL REGISTER			**24.7072**
			Revised Wage Index		**1.2105**

WINDHAM HOSPITAL
Excellence In Community Healthcare

October 28, 2004

Mr. Michael J. Armstrong
Regional Inspector General
For Audit Services, Region 1
Room 2425
John F. Kennedy Federal Building
Boston, MA 02203

Dear Mr. Armstrong:

We have been involved in discussions with you and other OIG staff members regarding the application of GAAP in determining the appropriate amount of pension cost to utilize for the hospital's wage index filing (S-3, Part II).

We agree with the conclusion of the OIG that the hospital did not include the hours associated with the $147,458 in wages for personal time and have already put in place a system for tracking those hours and including them in future cost report submissions. We also acknowledge the need to make improvements in our financial management system to track credits and reduce periodic costs associated with the post retirement benefits charged to the Medicare program.

The function of the wage index is to measure relative hospital labor costs across geographic areas for the purpose of reimbursing hospitals based upon their area's level of wage costs. This is a budget neutral process, and HCFA/CMS was concerned that the use of Medicare cost principles was creating inconsistent reporting and thereby advantaging or disadvantaging different areas of the country based upon varying FI interpretations and definitions of Fringe Benefits. In order to correct these problems and to create a single standard, HCFA/CMS adopted a different definition by creating Wage-Related Costs with its own manner of calculation. That new manner of calculation is Generally Accepted Accounting Principles (GAAP). For Wage-Related Costs, which pertain only to the wage index, this new standard applies.

The Federal Register dated September 1, 1994 addresses Fringe Benefits and the confusion that ~~providers~~ and FI's were experiencing when identifying Fringe Benefit costs. At that time, HCFA/CMS made a differentiation between Fringe Benefits and Wage-Related Costs for wage index purposes. On page 45356 of the aforementioned FR it states: "We believe that this change in terminology will eliminate the confusion regarding those wage-related costs that we will allow to be incorporated in the wage index versus the definition of fringe benefits required by Medicare principles for cost reimbursement purposes." Therefore, when the FR states on page 45357 that "Medicare principles, however-will continue to apply in determining the allowability of fringe benefit costs" - it is referring to Fringe Benefits and not to Wage-Related Costs, which

Windham Community Memorial Hospital, Inc.
And Hatch Hospital Corporation
112 Mansfield Avenue
Willimantic, CT 06226

(860) 456-9116
www.windhamhospital.org

now have separate definitions. In essence then, any definition that refers to Fringe Benefits refers to line 3 of the 2552 and not to the Wage-Related Costs for the S-3 filing.

That same FR discusses using GAAP for the preparation of the wage index data. It states, "We believe 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, because certain wage-related costs (such as pension costs) as recorded under GAAP tend to be more static from year to year. Application of Medicare principles, on the other hand, could create large swings in these costs from year to year, particularly in years when there are large over- or under-funded pension estimates; such application might lead to a wage index that does not accurately reflect relative labor costs. Again, we emphasize that GAAP applies only for purposes of developing wage-related costs on Worksheet S-3 Part II. Our policy requiring the use of applicable Medicare principles for determining fringe benefits for all other purposes remains unchanged."

The CMS staff is contending that if the actuarially-determined pension amount is not paid within one year, then the amount cannot be utilized for wage index purposes (but that is the under-funded amount referred to in the FR). Clarifications to the rule that were stated by CMS staff involved extraordinary circumstances involving "catch up" accruals for retired employees health benefits. We do not dispute those determinations regarding extraordinary items

It is our understanding that the only difference between GAAP and Medicare cost principles is the over- or under-funded amounts as referred to in the aforementioned FR.

It seems clear that HCFA/CMS intended that GAAP be used rather than Medicare cost principles since Medicare cost would not reflect relative labor costs, and the FR states that "the function of the wage index is to measure relative hospital labor costs across areas."

We thank you for your attention to this important matter and look forward to hearing from you with your interpretation.

Sincerely yours,

James N. Papadakos
Vice President, Finance
and CFO