

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA DEPARTMENT OF HUMAN SERVICES

In the Matter of the Rate Appeal of
Sleepy Eye Care Center, Crystal Care
Center, Maplewood Care Center,
Edina Care Center, and Volunteers of
America, Inc.,

Appellants,

vs.

Minnesota Department of Human
Services,

Respondent.

**RECOMMENDATION TO PARTIALLY
GRANT APPELLANTS' MOTION FOR
SUMMARY DISPOSITION AND ORDER
DENYING DEPARTMENT'S MOTION
FOR SUMMARY DISPOSITION**

The above-captioned matter is pending before Administrative Law Judge Phyllis A. Reha pursuant to a Notice of and Order for Hearing and Prehearing Conference issued by the Deputy Commissioner of the Minnesota Department of Human Services on April 25, 1995. Both parties have moved for summary disposition on the issues in this matter. A hearing was held on the cross-motions on May 8, 1996, at 2:00 p.m. in Courtroom 15 at the Office of Administrative Hearings, Suite 1700, 100 Washington Square, Minneapolis, Minnesota.

Jacqueline M. Moen, Assistant Attorney General, 445 Minnesota Street, Suite 900, St. Paul, Minnesota 55101-2127, appeared on behalf of the Department of Human Services ("the Department"). Samuel D. Orbovich and Thomas L. Skorczeski, Orbovich & Gartner, Chartered, 445 Minnesota Street, Suite 710, St. Paul, Minnesota 55101, appeared on behalf of Appellants, Sleepy Eye Care Center, Crystal Care Center, Maplewood Care Center, Edina Care Center, and Volunteers of America, Inc. ("Providers" or "Appellants"). The record on these cross-motions closed on May 17, 1996, when the last post hearing brief was received.

Based upon all of the files, records, and proceedings herein, and for the reasons set forth in the Memorandum attached hereto,

IT IS HEREBY RECOMMENDED that the Commissioner issue an Order as follows:

(1) That the Appellants' Motion for Summary Disposition is GRANTED on the issue of central office costs.

IT IS FURTHER ORDERED as follows:

(1) That the Department's Motion for Summary Disposition is DENIED in its entirety.

(2) That the Appellants' Motion for Summary Disposition is DENIED on the issue of allocated interest costs.

(3) Since genuine issues remain for hearing, a prehearing telephone conference will be held on June 26, 1996, at 2:00 p.m. to discuss any outstanding prehearing issues and schedule a hearing date. The Administrative Law Judge will initiate the call.

Dated this _____ day of June, 1996.

PHYLLIS A. REHA
Administrative Law Judge

MEMORANDUM

The Department and Appellants have each filed motions for summary disposition on all of the issues in this case. Summary disposition is the administrative equivalent to summary judgment. Minn. Rules pt. 1400.5500(K). Summary judgment is appropriate where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Sauter v. Sauter, 70 N.W.2d 351, 353 (Minn. 1955); Louwagie v. Witco Chemical Corp., 378 N.W.2d 63, 66 (Minn. App. 1985); Minn. R. Civ. P. 56.03. The Office of Administrative Hearings has generally followed the summary judgment standards developed in judicial courts in considering motions for summary disposition regarding contested cases. See Minn. Rules pt. 1400.6600.

It is well established that, in order to successfully resist a motion for summary judgment for the purpose of holding a hearing, the non-moving party must show that specific facts are in dispute which have a bearing on the outcome of the case. Hunt v. IBM Mid America Employees Federal Credit Union, 384 N.W.2d 853, 855 (Minn. 1986). The existence of a genuine issue of material fact must be established by the non-moving party by substantial evidence; general averments are not enough to meet the non-moving party's burden under Minn. R. Civ. P. 56.05. Id.; Murphy v. Country House, Inc., 307 Minn. 344, 351-52, 240 N.W. 2d 507, 512 (1976); Carlisle v. City of Minneapolis, 437 N.W.2d 712, 715 (Minn. App. 1988). Summary judgment may be entered against the party who has the burden of proof at the hearing if that party fails to make a sufficient showing of the

existence of an essential element of its case after adequate time to complete discovery. *Id.* To meet this burden, the party must offer “significant probative evidence” tending to support its claims. A mere showing that there is some “metaphysical doubt” as to material facts does not meet this burden. *Id.*

Both parties have vigorously denied that any facts are in dispute. One part of this matter has been placed before the Judge on the extremely narrow issue of whether the provider presented, at the desk audit stage, reasonable documentation of claimed central office costs to render those costs allowable. Based upon the memoranda, affidavits, and depositions filed by the parties, there appear to be no relevant facts in dispute regarding this issue. Therefore, the issue of the allowability of central office costs at desk audit is appropriate to determine by summary disposition.

Appellants operate intermediate care facilities (ICFs) in Minnesota and other states. The Minnesota ICFs are reimbursed by the Department for allowable costs incurred in providing care to residents under the federal Medicaid Act, 42 U.S.C. §1396, and the state’s Medical Assistance Program, Minn. Stat. Ch. 256B. The reimbursement rates have been set under Minn. Rules 9549.0010-.0080 (Rule 50). Rule 50 rates are set on an annual basis and are based upon costs incurred in the prior year. A tentative rate is set by the Department each year based upon a desk audit conducted in the Department’s offices of the annual cost reports filed by the ICFs. Desk auditors typically expect some disputed costs to be clarified by further information. The Department also periodically conducts on-site field audits of each facility’s books and records. Changes are proposed to the facility’s rate based upon the findings of the field audit. Auditors, during field audits, rely on actual invoices and other documentation when they determine whether costs claimed for reimbursement are allowable.

In years prior to the rate years at issue, Appellants’ Minnesota ICFs were managed by a regional office in Minnesota operated by Volunteers of America Health Services, Inc. (VOAHS). VOAHS is a subsidiary of Volunteers of America, Inc. (VOA). The Minnesota ICFs are owned by either of two entities that are controlled by VOA. The costs of the regional office were allocated to the Minnesota ICFs as central office costs and those costs were reimbursed by the Department, to the extent the costs were found to be allowable. In 1991, VOAHS reduced its regional office staff in Minnesota from thirty to eleven. The ICFs obtained central office services to replace the lost staff from the VOA office in New Orleans. Gould Affidavit, at 4. Other ICFs outside of Minnesota and other organizations not engaged in providing nursing care also receive central office support from the VOA office in New Orleans.

Appellants did not claim reimbursement for central office costs from VOA in New Orleans in 1990. In its cost reports for fiscal year 1991, Appellants claimed central office costs from the VOA central office in New Orleans allocated for the Minnesota ICFs. The allocation process used by Appellants was to charge a management fee based on revenues. Gould Affidavit, at 4. The cost reports submitted for each Minnesota ICF for fiscal year 1991 listed the management fee as a service, not a central office cost.

Joe Stevens, Auditor for DHS, performed a desk audit of the 1991 Minnesota ICFs cost reports submitted on behalf of Appellants. On February 26, 1992, Stevens sent VOA a letter requesting additional information. The only information requested regarding central office costs were as follows:

1. For Educational Seminars, Travel please provide an analysis of amount paid, to whom, and a description of each item over \$500.
2. Please describe the category for National Supervision. How many persons have salaries in this category? What is the salary per person?

Orbovich Affidavit, Exhibit G, at 2-3.

In response to the request, VOA submitted a schedule of costs to answer the first question, and identified the National Supervision fee category as payment for the managerial and supervisory functions performed by VOA and allocated by the revenues of each facility. Orbovich Affidavit, Exhibit H, at 2.

DHS set the July 1, 1992 reimbursement rate for the Appellants. Pursuant to Minnesota Rule 9549.0036, Subp P, DHS disallowed corporate office costs identified for the Minnesota Regional Controller, and for National Administration. Appellants appealed the disallowances by letter dated June 19, 1992. Moen Affidavit, Exhibit DHS-B. The appeal letter explained that the costs claimed were National Administration Costs allowable under Minn. Rule 9549.0035, subp. 7. *Id.* Accompanying the appeal letter was a spreadsheet prepared by Appellants, providing a breakdown of the costs claimed, into categories such as salaries, travel, and depreciation & amortization. These figures, by category, are allocated to all VOA nursing homes, reduced by non-Minnesota resident days, and then allocated to VOA's Minnesota ICFs by number of resident days. *Id.* Exhibit DHS-B.3. No costs are allocated to the ICFs for endowment awards or founders fund awards. *Id.*

Bob Cooke, Auditor for DHS, conducted the desk audit of Appellants' cost reports for 1992. On February 22, 1993, Cooke requested that Cindy Bunting, Regional Controller for VOA, provide to DHS, Appellants' cost reports for the year ending September 30, 1992. The request demanded the information be submitted within twenty days (unless extended for "extreme good cause") or the costs would either be disallowed or the cost report would be rejected, resulting in a calculation of a facility rate based upon eighty percent of the previous year's costs. Moen Affidavit, Exhibit DHS-E.1. The information requested constituted a full page of questions including financial statements, breakdowns of costs, analyses of accounts, and direct identification of costs for four categories. *Id.*

On March 9, 1993, Bunting responded to the request with the requested information in the form of a letter and spreadsheet. Moen Affidavit, Exhibit DHS-F. The letter answers a number of the questions asked by Cooke. The spreadsheet identified "Functional Expenses" for VOA under the headings "Program Services" and "Support

Functions”; and were further divided into categories for “Regional Support,” “Resource Development,” “Direct Development,” “Communications,” “Housing Development,” “Other Support,” “Total Programs,” “Management and General,” “Fund Raising,” and “Total Support.” *Id.* Each category identified expenses for salaries, employee benefits, professional fees, enrichment awards, founders fund awards, development awards, occupancy expense, insurance, equipment rental and maintenance, printing and publications, vehicle expense, other, and depreciation and amortization. *Id.*

Cooke asked Bunting for further information directly identifying costs directly related to nursing homes. On March 31, 1993, Bunting responded by submitting an updated version of the spreadsheet, removing a number of items from the total claimed. Moen Affidavit, Exhibit DHS-G.2. Cooke disallowed all central office costs not falling under the category of “Management and General.” There is nothing in the record to indicate that Cooke was aware of what actual costs were reflected under any of the categories claimed by the provider to be central office costs from VOA applicable to the Minnesota ICFs. The disallowances were appealed by letter dated July 16, 1993. Moen Affidavit, Exhibit DHS-I.

In August, 1993, DHS Field Audit Director, Phyllis Krautbauer, contacted VOA’s Director of Finance, Tom Turnbull, and requested a further explanation of how Program Services and Support Functions cost areas in the VOA are identified for purposes of claiming central office costs. Engel Affidavit, Exhibit 1. Turnbull, by this time Associate Vice President for Finance, responded by sending Krautbauer a description of the functions performed by VOA’s central office, and spreadsheets detailing the costs incurred for each type of expense. Engel Affidavit, Exhibit 2. John Burns, Field Audit Supervisor for DHS, responded to the additional information from Turnbull by asking for answers to “additional questions (attached) that we believe will give us sufficient knowledge of your operation to aid us in performing any on site work deemed necessary in an efficient and effective manner.” Engel Affidavit, Exhibit 3. The attached questions requested detailed information on central office staff position descriptions; documentation used to support the allocation of costs; “a detailed analysis of . . .VOA national office departmental accounts;” depreciation and amortization schedules of the national office; and floor plans for the office space used by the national office with information as to who used what space, when, and for what entity. *Id.*

Turnbull responded to Burns’ request that the information could not feasibly be copied and mailed to DHS due to the volume of the records requested and the lack of staff available. Engel Affidavit, Exhibit 4. Turnbull offered to make the requested records available in the VOA central office. *Id.* DHS did not send auditors to New Orleans to examine the records it requested.

After the appeals to DHS, no National Office Costs were allowed for the Appellants for the 1992 reimbursement rate. For the 1993 reimbursement rate, DHS allowed \$191,369 of the \$653,900 in costs allocated by Appellants for National Office Costs. Orbovich Affidavit, Exhibit I. The total number is further allocated among the Minnesota ICFs operating under the VOA national administration. On May 20, 1994, VOAHs requested a contested case hearing on all of the issues , *inter alia*, the National

Office Cost disallowances and the disallowance of the allowable debt cost claimed by the Sleepy Eye Care Center (discussed below). On April 25, 1995, a Notice of and Order for Hearing and Prehearing Conference was issued by the Department.

The Department has asserted that under the holding in In the Matter of the Contested Case of Greenbrier Home, Inc. and Donald K. Van Slyke, OAH Docket No. 50-1800-0077-2 (Commissioner's Order issued September 17, 1987), Appellants are precluded from introducing any information to decide this matter that was not made available to the desk auditor. Appellants argue that the Greenbrier holding is inapplicable because the rate in that case was being set under Rule 52 (that portion of Minn. Rule Chap. 9549 that governs reimbursement to ICFs for mentally retarded persons) not Rule 50; because Minn. Stat. § 256B.50, subd. 1h (1994) supersedes the holding; and that the holding, by its own language, applies only to field audits not desk audits. Appellants also assert that restricting the evidence that can be submitted in appealing a desk audit is a denial of due process.

There is no significant distinction to be made between the audit processes of Rule 52 and Rule 50. Both rules provide for desk audits and field audits. The methodology is the same. Minn. Stat. § 256B.50, subd. 1h, has no language purporting to limit or expand evidentiary boundaries in contested cases after either a desk audit or field audit. The Department identified the holding in Greenbrier as:

[W]here the Department has disallowed a cost on the basis that the cost was not supported by the provider's records at the time of field audit, and the facility has been clearly informed which records were not available and has been given a reasonable opportunity to provide them, the facility may not later refute the disallowance at hearing by producing records which were not made available to the Department at field audit.

DHS May 10, 1996 Letter Brief, at 1-2 (citing In re Greenbrier, Commissioner's Order Memorandum, at 7).

Greenbrier sets out several standards that must be met before a cost is precluded. The basis of the disallowance must be inadequate records. The provider must be "clearly informed" what records are needed. The provider must be given a "reasonable opportunity" to present the information. Also, the information must not have been made available during a "field audit". The Department asserts that this last standard should also apply to "desk audits". Therefore, the relationship of desk audits and field audits must be examined.

The Department correctly described the process as set out in its own rules as follows:

All cost reports are subject to a desk audit, which is the Department's "review and analysis of required reports, supporting documentation and work sheets submitted by the nursing facility" for the purposes of establishing a payment rate. Minn.R. 9549.0020, subp. 19 (1993). The

cost reports may also be subject to a field audit, which is the “on-site examination, verification, and review of the financial records, statistical records, and related supporting documentation of the nursing facility and any related organization.” Minn.R. 9549.0020, subp. 22 (1993).

DHS Memorandum in Opposition, at 3.

Minn. R. 9549.0041, subp. 13, governs audits. Desk audits are mentioned throughout the subpart as adjuncts to desk audits. Item B, specifically discussing only field audits, states:

Field audits may cover the four most recent annual cost reports for which desk audits have been completed and payment rates have been established. The field audit must be an independent review of the nursing facility’s cost report. All transactions, invoices, or other documentation that support or relate to the costs claimed on the annual cost reports are subject to review by the field auditor. If the provider fails to provide the field auditor access to supporting documentation related to the information reported on the cost report within the time period specified by the commissioner, the commissioner may calculate the total payment rate by disallowing the cost of the items for which access to the supporting documentation is not provided or apply the penalty in subpart 12, item A, whichever would result in the least amount of change in the total payment rate.

There is no specific penalty provision in subpart 13 governing desk audit noncompliance. The Commissioner is authorized to reject any cost report that is “incomplete or inaccurate.” Minn. Stat. § 256B.48, subd. 3. Under that statute, the Commissioner can impose an eighty percent limitation on the provider’s payment rate until the accurate information is filed. At such time, the provider’s rate would be retroactively adjusted to provide the payment to which the provider is entitled. *Id.*

Based upon the rule definitions of “desk audit” and “field audit”, the Department’s 1993 request for additional information, which requested a great volume of documentation and detail, was more akin to a field audit than a desk audit. The Department has never provided Appellants with a notice of field audit. There is no evidence in the record to support the Department’s request for such an unusually high level of detail of supporting documentation at the desk audit stage. DHS explains the information request as follows:

The Department’s field audit staff, in connection with a field audit of the VOAHS central office, also tried to obtain more detailed information, which it hoped to be able to review at the Eden Prairie site. Accordingly, in February 1994, the Department officials sent VOA a set of questions that in the view of the Department’s field audit supervisor, would provide the Department with “sufficient knowledge of [VOA’s] operation to aid [the

Department] in performing any on site work deemed necessary in an efficient and effective manner.”

DHS Memorandum in Opposition, at 12-13.

The foregoing description of the Department's actions indicates that the Department was indeed conducting a “field audit” of Appellants' claimed central office costs in 1993. The audit was on-site. The work to be done was the examination, verification, and review of the financial records, statistical records, and related supporting documentation. And the entities involved were the nursing facility and a related organization (here, a central office). All of the standards for a field audit were met using the definition of “field audit” in Minn.R. 9549.0020, subp. 22 (1993), *except*, the DHS auditors did not follow through by attending the audit and actually examining the central office documentation.

When the costs were disallowed on appeal to DHS in 1994, the Department stated its reasons in the appeal determination as:

The services grouped in national office cost centers for direct development, communications, other support, resource development, and fundraising do not appear to be related to resident care. The services the national office provided to the facility have also not been identified.

Engel Affidavit, Exhibit 7, at 8.

In answer to Appellants' Interrogatories, DHS stated the reason for the 1991 cost report (the 1992 reimbursement rate) was noncompliance with the allocation methodology in Minn. Stat. § 256B.432, subd. 3, 4 and 5. Orbovich Affidavit, Exhibit I. For the 1992 cost report, the Department indicated that the disallowance was done because the central office costs were not shown to be related to resident care and that the amounts claimed included costs not allowable as fundraising (Minn. R. 9549.0036 R and Minn. R. 9549.0035, subp. 8). Orbovich Affidavit, Exhibit I. At the hearing on the cross-motions for summary disposition, DHS has relied upon Minn. R. 9549.0036 Y (which renders costs not adequately documented to be nonallowable), as its reason for not recognizing the allocated central office costs claimed by Appellants.

Applying the Greenbrier standards to the facts presented on these cross-motions, the basis for the Department's disallowance in 1991 was not inadequate records, but the application of an incorrect standard to the Appellants' cost reports. The Appellants were not “clearly informed” what records were needed in 1992, since the request for records was irrelevant to the allowability of the costs. In 1993, the “global” request for records regarding the functioning of the VOA central office did relate to records relevant to the allowability of the costs claimed. Under Greenbrier, however, the provider must have a reasonable opportunity to provide the requested documentation. By demanding that all such records be mailed to DHS, Appellants were denied a “reasonable opportunity” to present the information. Indeed, the Appellants offered DHS a reasonable opportunity to view all the records the auditors requested.

Whether or not the Greenbrier holding applies to desk audits in Rule 50 cases, the Department has not met the standards for limiting the introduction of further evidence in this matter.

The Commissioner's holding in Greenbrier states that the information must not have been provided at a "field audit". Examining the differences in scope and depth between desk audits and field audits, the Judge concludes that sound procedural and due process reasons exist for not expanding the exclusionary principle in Greenbrier to desk audit appeals. Desk audits are not structured to allow the detail and accuracy of field audits. Desk auditors exercise substantial discretion to allow or disallow costs claimed. There is no clear standard of compliance for adequately documenting claimed costs. The effect of a disallowance at desk audit, combined with the exclusion of evidence that could prove reimbursable costs were properly claimed, could result in the effective denial of a provider's due process right to appeal. The desk auditor could request irrelevant information, as happened in this matter. The Department has the right to initiate a field audit of a provider's records to determine allowability. Any funds which may have been overpaid to the provider after a desk audit, could then be recaptured. For the provider, however, the appeal from the desk audit is the only certain remedy for correcting an improperly set rate. If no field audit is initiated by the Department, the desk audit rate is not subject to further appeal. By folding the field audit methods and standards into a desk audit, there is a significant possibility that the provider will be denied the opportunity to obtain reimbursement for properly incurred costs not deemed "adequately supported" by the desk auditor. Greenbrier does not stand for this result. The holding in that case applies only to field audits.

DHS argues that the claimed costs for 1991 must be disallowed because the Appellants have not met the requirements for claiming costs from related organizations under Minn. R. 9549.0035, subd. 7. According to the Department, the actual cost paid by the related organization for "services, assets, or supplies furnished to the facility" must be reported. DHS Memorandum in Opposition, at 19. This rule provision is known as the "related organizations rule." Since that was not done, the Department maintains that the costs must be disallowed. Appellants maintain that while the initial cost reporting for reimbursement was in the form of reporting a management fee, this is a normal practice among providers in Minnesota, and does not change the nature of the cost claimed from central office costs. According to the providers, the auditor used the wrong rule part to disallow costs that should properly have been allowed as central office costs.

Minn. Stat. § 256B.432 sets out the standards for allowing central office costs. Subdivision 2 of that statute requires that the standards in subdivisions 3 through 6 be used for determining the central office cost allocation in rate setting for rate years beginning on July 1, 1990 or later. Subdivisions 3 and 4 require that costs which can be directly identified with specific facilities or activities must be allocated to those entities. Subdivision 5 sets out the formula for allocating the remaining costs between allowable and nonallowable activities based on a ratio of expenses. The numerator of the ratio is determined by the precise relationship between the entities.

Appellants have introduced the affidavit of an officer responsible for Appellants' cost reports and supporting information for the years at issue in this matter. Turnbull Affidavit. This affidavit identifies the information in the possession of the Department that is adequate to support allowing the claimed central office costs. *Id.* at 1-9. The information was arranged on the Department's suggested worksheet for claiming central office costs to demonstrate the allowability of those costs. Turnbull Affidavit, Exhibit 1. Appellants have also introduced an affidavit of an experienced preparer of cost reports who examined the processes used by the Appellants and the Department in treating these costs, and opined that the central office costs are allowable costs. Eelsey Affidavit, at 4-11. DHS has introduced no evidence challenging those conclusions. Rather, DHS has asserted that the affidavit of the preparer should be excluded. DHS Memorandum in Opposition, at 22. The opinion of the preparer is relevant and competent to the issue of Department practices regarding allowability of central office costs and the manner in which such costs are normally claimed. The information introduced by Appellants demonstrates that the costs claimed are allowable central office costs for Rule 50 rate setting purposes.

There are differences between the central office costs claimed in the Minnesota ICFs cost reports and the costs claimed allowable in Turnbull's submissions from VOA. The Department asserts that the differences in central office costs demonstrate that the desk audit disallowances for central office costs are appropriate. The Department has not identified any matter, other than this one, where the entire central office cost claimed by a facility has been disallowed after a desk audit. Theresa Engel, Nursing Home Rate Setting Supervisor for DHS, indicated that internal cost allocation processes by a facility do not determine the allowability of costs for that facility. Engel Deposition, at 108. Engel could not say that disallowing all central office costs would be an appropriate response to a lack of documentation that all the claimed costs were allowable. *Id.* at 58.

Engel indicated that desk audits are usually performed with a facility's cost report, supporting schedules, and other information specifically requested by the auditor. Engel Deposition, at 20. The facility is not required to provide "all of the supporting documentation." *Id.* The desk auditor reviews "the cost report and information submitted to determine if costs are allowable." *Id.* Where the desk auditor has questions about a cost item, the auditor can request additional information to determine allowability. *Id.* A desk auditor can also complete a document used internally by DHS, known as a Field Audit Classification Sheet. *Id.* at 38. This form contains an area for comment and a rating scale for prioritizing field audits. Engel Deposition, Exhibit 1. The form was in use at the time of the audits at issue in this matter.

Joe Stevens, the DHS desk auditor who completed the 1991 desk audits, completed a Field Audit Classification Sheet in 1992 for a different facility and noted "review central office for direct identification of costs on work paper F-7." Engel Deposition, Exhibit 1. Engel acknowledged that there would be no reason to note this item for field audit unless it had been allowed as a cost at the desk audit. *Id.* at 41. A desk audit by a different auditor was reviewed by Engel and she prepared notes of that

review. Engel Deposition, Exhibit 2. The desk auditor's field audit comments contains the notation:

While reviewing supply schedules which were requested on last year's desk audit it appears items which should be capitalized or repairs, etc. which actually belong in the plant and maintenance category are being improperly reported. As noted above nearly all of the supply accounts showed some significant increases and consequently requesting schedules for all of these lines seemed impractical for desk audit. Special notice should be taken of purchases recorded to the supply accounts.

Engel Deposition, Exhibit 2, Field Audit Notes ¶ 4.

A different desk auditor examined the cost report for an unrelated facility and noted in her report:

At this point, I will accept the central office costs as reported. Without detailed trial balances and knowing where and what direct expenses have been reported, it is difficult to review on desk audit. The central office will be marked for field audit.

Engel Deposition, Exhibit 3.

In response to a request for additional information made by a desk auditor, an unrelated facility submitted a ledger sheet documenting officer's meals. Engel Deposition, Exhibit 5. A handwritten note on the ledger (apparently by the desk auditor) states "F/A some of these are clearly unallowable but the amount is immaterial. Many more are questionable." *Id.* Engel opined that "F/A" stood for field audit. Engel Deposition, at 63.

The evidence in the record clearly demonstrates there is no long-standing agency practice of denying central office costs at the desk audit stage where some of the costs claimed are questionable. There is a practice, memorialized in a form, whereby the desk auditor establishes the urgency of initiating a field audit, where any questionable costs can be examined further. All the evidence in the record indicates the Department has a practice of allowing costs that are not adequately supported and identifying questionable cost areas for field audits.

DHS has framed the issue as "whether a facility can refuse to provide information necessary to prove their costs, and instead, demand that the Department accept and reimburse their own estimates, charges, and preferences." Of course, no facility can refuse to provide information to the Department and obtain reimbursement. Similarly, no facility can set its own standards for reimbursement. Neither practice has occurred in this matter. Appellants have opened their books to the Department and only balked at the cost and effort of duplicating large amounts of records to prove their costs, item by item, for a "desk audit." While the Appellants originally submitted their central office cost using an incorrect calculation, subsequent information used a facially correct

calculation. Once a facially correct calculation was used, the reason for the disallowance at the desk audit stage is subject to question.

The foregoing analysis demonstrates that summary disposition in favor of the Department must be denied. The issue remains, however, whether Appellants have demonstrated that they are entitled to disposition in their favor as a matter of law, or whether genuine issues of material fact remain for hearing. As discussed above, the moving party must first demonstrate a prima facie case. To successfully defend against a motion for summary disposition, the nonmoving party (here the Department) must show that genuine issues remain for hearing. The nonmoving party cannot rely upon speculation or unsupported assertions to meet this burden.

Appellants served a Notice of Deposition requiring DHS to make available one or more persons knowledgeable about the audit process for Rule 50 cost reporting. DHS chose not to make available for that deposition any of the auditors with direct involvement in Appellants' cost reports. In responding to Appellants' Motion for Summary Disposition, DHS has not introduced any affidavits of persons with first-hand knowledge of the audit performed on Appellants' cost reports. Without any direct evidence of why a particular audit decision was made, the Department must rely upon facts that can be determined from the record or long-standing agency practices supported by the affidavits or depositions in the record to demonstrate that either: a) the disallowance must be upheld as a matter of law, or b) that genuine issues of material fact remain for hearing in this matter.

DHS has chosen not to provide any evidence directly addressing the substantive reason for the disallowance. Rather, the Department has asserted that the Administrative Law Judge can arrive at a determination of the reasonability of the cost disallowance based on the evidence in the record, and without the benefit of expert testimony as to what standard should be applied.

There is evidence in the record that the Department allowed at a desk audit of a different provider, a central office cost of six million dollars identified as "Restruct. Special #3599", and further explained by that provider, as "miscellaneous costs which are considered to be non-recurring." Engel Deposition, Exhibit 2, at ¶ 10. There is no evidence in the record of this matter that the Department required that provider to produce invoices or other documentation prior to approving the claimed cost at desk audit. That item was marked for field audit. Without any explanation from the Department as to why the six million dollar cost is allowable on desk audit with no meaningful description of the underlying expense, the Judge cannot conclude that the Department has met its burden to show that disallowing Appellant's central office costs is reasonable for failure to document the claimed cost at the desk audit stage.

Appellants have demonstrated that DHS has a practice of questioning costs during desk audits and, if adequate documentation is lacking, prioritizing those costs for field audit. Appellants have shown that the Department allows costs on desk audit if the costs are facially appropriate. The Department has not identified any facts in the record which demonstrate that there are genuine issues remaining for hearing. There is no

expert testimony to support a conclusion that all the claimed central office costs are not allowable. There has been no showing that such claimed costs are routinely disallowed rather than prioritized for field audit. There are no specific facts identified which support disallowing the claimed central office costs following a "desk audit." Were such facts introduced, the Appellants' motion for summary disposition would have been denied, and this matter would go to hearing.

After a "field audit", it is certainly possible that some of the central office costs claimed by Appellants could be disallowed. Here, however, no field audit has been performed. The Department has asserted that its auditors have the discretion to disallow costs not adequately supported by documentation. While the Department is correct that its auditors do have discretion, that discretion cannot be exercised without limits. Disallowing costs not obviously outside the reimbursement scheme must be done upon evidence and for reasons that can be reviewed in a contested case proceeding. Absent such evidence and reasons, the disallowance is arbitrary and capricious. Since Appellants have demonstrated a prima facie case that the claimed central office costs are allowable, and the Department has not met its burden to demonstrate that genuine issues of material fact remain for hearing, summary disposition in favor of the Appellants on central office costs is appropriate.

Allocation of Debt and Interest Cost

The other cost item at issue in these cross motions for summary disposition is the allowability of the debt and interest adjustments arising from the construction of a connection between the Sleepy Eye nursing facility and an adjacent senior apartment building. The connection included space and fixtures for services provided by Sleepy Eye, as well as other uses not related to the operation of the nursing facility. Bunting Affidavit, at 2. The total cost of the project was \$2,393,853. *Id.* at 3. An architect estimated that 9% of the total space was dedicated to nursing home purposes. *Id.* at 3. However, the construction costs for the nursing home portion of the project is 72% higher per square foot. *Id.* at 3-4. When Sleepy Eye reported its nursing home's debt, and associated interest costs for 1989 and 1990 for Rule 50 reimbursement, Sleepy Eye claimed \$287,262, or 12% of the total project cost was related to the nursing home. *Id.*

The Department disallowed these costs in their entirety on the basis that the provider had not adequately documented the costs since it did not identify:

the parts of the connecting link used for purposes relating to the care of nursing home residents or how much of the time these areas are used for those purposes. The provider has also not directly identified the loan proceeds with the connecting link or provided an explanation of how it determined that \$300,000 was the portion of the bond issue allocable to connecting link.

Engel Affidavit, Exhibit 7.

As discussed in the analysis on central office costs, the “lack of documentation” standard is used in field audit appeals to preclude the introduction of evidence after the Department has made its determination. This matter is on appeal from a desk audit. The Department has acknowledged that providers are entitled to costs directly identified to resident care and where such costs cannot be identified, an allocation is made between allowable and nonallowable costs based on the relative area of the nursing home space to the total area of the construction project. DHS Memorandum, at 46.

Sleepy Eye has submitted estimates of the percentage of square footage of the new construction used for nursing home purposes and the cost per square foot of the nursing home construction. This, together with the total cost estimates of the project, is all that is required under the Department’s long-standing practice to determine the allowable portion of the interest cost of the project.

The Department argues that some of the project costs were paid for with proceeds outside the loan, that the nonallowable portion of the project expense cannot be determined from the information provided, that the 12% figure was not explained, that the 9% figure may not have included garage space in the calculation. DHS Memorandum, 47-51. Since the facility provided the information to allocate the allowable and nonallowable interest expense by the long-standing method used by the Department, the objections by the Department go to the propriety of the facility’s calculation. These objections are genuine issues of material fact, not a demonstration that the provider has not established a *prima facie* case. Under the established standards for summary disposition, the matter must be heard to resolve the issues raised by the parties and determine the appropriate amount of allowable interest expense.

There are no genuine issues of material fact that remain for hearing regarding central office costs. Summary disposition is appropriate on that issue in favor of the Appellants. Appellants have presented a *prima facie* case on the allowability of the interest cost claimed for Sleepy Eye. The Department has identified a number of genuine issues of material fact that remain for hearing on that issue. Neither party is entitled to summary disposition on the interest cost claim. The remaining issues must be resolved at a contested case hearing. A conference call is thereby scheduled to set the hearing date and to resolve any remaining prehearing issues.

P.A.R.

