

INTRODUCTION--Providers must follow the Medicare principles of reasonable cost reimbursement, including the provisions of this chapter and other chapters in this manual, when completing the Medicare cost report. Home offices must also follow these principles when completing a home office cost statement.

800. PRINCIPLE

Purchase discounts, allowances, and refunds are reductions of the cost of whatever was purchased. Similarly, refunds of previous expense payments are reductions of the related expense.

802. DEFINITIONS

802.1 Purchase Discounts.--Purchase discounts, within the meaning of this principle, include cash, trade and quantity discounts (see definitions of these terms below). The Medicare program expects providers to take advantage of available discounts. If a provider's costs are inflated from failure to take advantage of available discounts when it is able to do so, the contractor may disallow the excess costs.

802.11 Cash Discounts.--Cash discounts are reductions granted for the settlement of debts within a stipulated period before they become due. Thus, the terms "2/10, net 30" on a vendor invoice mean that a 2 percent discount from the purchase price will be allowed if payment is made within 10 days from the date of the invoice.

EXAMPLE: An invoice for supplies indicates a price of \$500 with terms of 2/10, net 30. The provider paying the invoice within 10 days would remit \$490 in satisfaction of the invoice and this would be the actual cost to the provider.

802.12 Trade Discounts.--Trade discounts are reductions from list prices granted to a class of customers before consideration of credit terms.

EXAMPLE: The invoice for a quantity of supplies purchased indicates a total list price of \$2,400 with trade discounts of 30 percent and 10 percent, and cash discount terms of 2/10, net 30. The cost to the provider would be \$1,481.76 (\$2,400 less \$720 less \$168 and less a cash discount of \$30.24).

802.13 Quantity Discounts.--Quantity discounts are reductions from list prices granted because of the size of individual or aggregate purchase transactions.

EXAMPLE: Paper products are purchased from a supplier during the year and the supplier agrees to grant a 5 percent discount when the provider's quantity purchases of this type of product total at least \$1,500. In addition, the supplier allows cash discount terms of 2/10, net 30. For example, having purchased paper products totaling \$1,700, the provider would be entitled to a quantity discount of \$85 and a cash discount of \$32.30; the provider's net cost would be \$1,582.70.

802.21 Allowances.--Allowances are deductions granted or accepted by the creditor for damage, delay, shortage, imperfection, or other cause, excluding discounts and refunds.

EXAMPLE: A provider purchases dishes costing \$1,200 which are received in a damaged condition. In consideration of the provider's acceptance of the damaged shipment, the supplier grants a \$200 allowance to the provider. The supplier also allows cash discount terms of 2/10, net 30. The cost to the provider would be \$980 (\$1,200 less \$200 allowance and \$20 cash discount).

802.31 Refunds.--Refunds are amounts paid back by the vendor generally in recognition of damaged shipments, overpayments, or returned purchases. Refunds of container deposits are not refunds under this definition.

802.41 Rebates.--Rebates represent refunds of a part of the cost of goods or services. A rebate is commonly based on the total amount purchased from a supplier and differs from a quantity discount in that it is based on the value of the purchases whereas quantity discounts are generally based on the quantity purchased.

804. ACCOUNTING TREATMENT

Discounts, allowances, refunds, and rebates are not to be considered a form of income but rather a reduction of the specific costs to which they apply in the accounting period in which the purchase occurs. The true cost of goods and services is the net amount actually paid for the goods or services.

Where the purchase occurs in one accounting period and the related allowance or refund is not received until the subsequent period, where possible an accrual in the initial period should be made of the amount if it is significant and cost correspondingly reduced. However, if this cannot be readily accomplished, the amounts reduce comparable expenses in the period in which they are received.

Rebates in the form of cash payments on the total value of purchases in one accounting period are not generally received until the subsequent accounting period. Where the amount of the rebate can be determined, the provider accrues it in the initial period and correspondingly reduces costs for that period. A reasonable effort will be made to accrue accurate amounts for allowances and rebates which will be received after the books have been closed. The difference between the accrual and the actual amount received will then be entered in the period in which it is actually received. Where a number of cost centers have received numerous charges from purchases, a rebate in recognition of the total of such purchases will be credited to these cost centers based on an equitable method of allocation.

Where a discount, allowance, refund, or rebate is received on supplies or services, the cost of which is apportioned under the Medicare program, it must be used to reduce the total cost of the goods or services for all patients without regard to whether or not the discount, allowance, refund, or rebate is designated for supplies or services used by all patients or by a specific group or category of patients (e.g., Medicare or non-Medicare patients only).

805. GROUP PURCHASING ORGANIZATIONS

Some providers obtain discounts or rebates on their purchases by joining group purchasing organizations (GPOs). These are treated in the same manner as discounts or rebates received when a provider does not use a GPO. In addition to facilitating discounts/rebates, GPOs may distribute a portion of their revenue -- sometimes referred to as net revenue distributions -- to providers or other organizations using the GPO. These distributions are treated like discounts or rebates on the purchases, further reducing a provider's cost of purchases facilitated through the GPO.

A provider is to act as a prudent and cost-conscious buyer in making its purchases, seeking to economize by minimizing costs (see §2103). The prudent provider chooses to either use a GPO or buy directly, whichever results in the greater savings.

Although using a GPO generally results in increased discounts or rebates, a provider, as a prudent and cost-conscious buyer, is always to seek the greatest available GPO discounts, considering the cost to belong to the GPO and the discounts or rebates it receives on its purchases. Likewise, a prudent provider seeks to reduce its costs of purchases to the lowest level by seeking the maximum revenue distributions or other returns available from the GPO.

If a provider is unable to clearly document to the satisfaction of its contractor that it has been a prudent buyer by seeking to incur the lowest net cost available for its purchases either by

- *buying directly, or*
- *using a GPO, considering the cost of belonging to the GPO and the purchase discounts, rebates, or other returns available from the GPO,*

costs incurred which are greater than net costs determined by applying discounts which a provider's contractor finds are reasonably available to the provider are not reimbursable costs for Medicare purposes.

806. CONTRIBUTIONS BY VENDORS

Medicare considers payments to a provider by its vendor as discounts, refunds, or rebates in determining allowable costs under the program even though these payments may be treated as contributions or unrestricted grants by the provider and the vendor.

However, such payments may represent a true donation or grant, for example, when: they are made by a vendor in response to building or other fund raising campaigns in which community-wide contributions are solicited; they are in addition to discounts, refunds, or rebates which have been customarily allowed under arrangements between the provider and the vendor; the volume or value of purchases is so nominal that no relationship to the contribution can be inferred; or the contributor is not engaged in business with the provider, or *with* a facility related to the provider *as defined in Chapter 10, Cost to Related Organizations*. Where any of *the aforementioned* conditions are *present*, the payments *are* subject to the provisions of Chapter 6, Grants, Gifts, and Income from Endowments.

807. REBATES TO PROVIDER OWNERS OR OFFICIALS

Where an owner or other official of a provider directly receives from a vendor monetary payments or goods or services for his own personal use as a result of the provider's purchases from the vendor, the value of such payments, goods, or services constitutes a type of refund or rebate and *is* applied as a reduction of the provider's costs for goods or services purchased from the vendor.

808. REBATES IN CENTRAL PURCHASING ACTIVITIES

Where the purchasing function for a provider is performed by a central unit or organization, all discounts, allowances, refunds and rebates *are* credited to the costs of the provider in accordance with the instructions above. *They are not* treated as income of the central purchasing function or used to reduce the administrative costs of that function. *However, the* administrative costs are properly allocable to the facilities serviced by the central purchasing function.

809. "RENTAL" AND "COLLECTION FEE" PAYMENTS BY SUPPLIERS TO PROVIDERS

Amounts paid by a supplier for the use of space or equipment in a hospital or *other provider* ordinarily constitute a form of discount, whether paid as a percentage of charges or as a flat amount per bed or per time period.

EXAMPLE: A supplying pharmacy "leases" a room in a *skilled nursing facility (SNF)* in which to store drugs used by *the SNF's* inpatients. Charges by the pharmacy to the *SNF* for drugs are \$10,000, and, at the same time, *the pharmacy pays* \$2,000 back to the *SNF* as rent. The cost incurred by the *SNF* for this space (i.e., depreciation, maintenance, etc.) is \$500. Allowable drug costs *are* \$10,000 plus \$500 - \$2,000 equals \$8,500.

Payments made by a supplier to a provider in recognition of the fact that the supplier is relieved of the need to collect individual bill *payments* from the patients of the provider -- sometimes called "accounting fees" or "collection fees" -- are considered a form of discount, refund, or rebate and reduce the costs of the goods or services purchased from the supplier.

810. REDUCTION OF COST THROUGH COURT DECISION, SETTLEMENT, OR OTHER LEGAL ACTION

810.1 General.--Monetary damages received by a provider as a result of a court decision, settlement, legal action, or other claim for damages are considered *a* reduction of cost if they represent recoveries of previously allowed costs. *Damages* specifically designated *as* punitive damages by the court are not treated as *a* reduction of cost. Amounts received which are related to cost periods prior to the provider's participation in the program *for costs* which have not been reflected in allowable cost under Medicare are not treated as *a* reduction of cost.

810.2 Allocation of Recoveries to Periods of Medicare Participation.--There may be situations where a monetary award or settlement includes damages for periods before and after the provider's entry into the program. If the amount of damages in the award or settlement is *allocated* to specific periods or if the provider can allocate the recovery to particular cost periods based on its own records, the amounts used to reduce allowable cost shall be limited to the amounts incurred during the cost periods reported under Medicare. *Follow the* accounting treatment discussed in §804. Where a provider's allocation of a recovery to a time period is not supported by *its* records or by *the terms of the* award, *use* the following formula to allocate the recovery to the period(s) of participation in Medicare:

Formula: The fraction of months represented by Medicare cost reports divided by total months applicable to legal action, multiplied by amounts received (excluding punitive damages) equals amounts used to reduce costs.

Illustration

In 1967, the Justice Department won an anti-trust suit against certain defendants for the period 1953 through November 1966 (a 167-month period). The decision paved the way for numerous law suits by providers to recover excessive amounts paid for certain drugs. A settlement, however, was made out of court to all parties concerned. One provider *participating* in Medicare since July 1, 1966, (*and which* filed a cost report covering the period July 1, 1966, to June 30, 1967) recovered \$8,350 but did not have records to support allocation of this recovery to reduce costs in specific time periods. *Using the* above formula, the amount of recovery that shall reduce Medicare allowable costs *is by* \$250. *That is, the fraction of five divided by one hundred sixty seven, multiplied by \$8,350 = \$250.*