

der the Regulatory Review Act of 1982 (P. L. 633, No. 181). As amended by Act 238 of 1982, the Regulatory Review Act was effective March 1, 1983, and as provided by section 5(a) applies to "proposed regulations, submitted after the effective date . . . to the Legislative Reference Bureau for publication of notice of proposed rulemaking" (71 P. S. § 745.5).

Contact Person

Interested parties may obtain additional information regarding these amendments and the regulations by contacting Maynard M. Matthiesen, Acting Director, Division of Emergency Health Services, Department of Health, P. O. Box 90, Harrisburg, Pa. 17108 (telephone: (717) 787-8740).

The Department of Health funds:

1. That public notice of intention to amend the administrative regulations amended by this order has been given under sections 201 and 202 of the act of July 31, 1968 (P. L. 769, No. 240) (45 P. S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

2. That the amendment of the regulations of the Department of Health in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statutes.

3. That the amendment has been submitted to Medical Advisory Committee of the Pennsylvania EHS Council for review and recommendation.

The Department of Health, acting under the authorizing statutes, orders:

(A) The regulations of the Department of Health, 28 Pa. Code, are amended by amending § 2.13 to read as set forth in Annex A hereto.

(B) The Secretary of the Department of Health shall submit this order and Annex A hereto to the General Counsel for review and approval as to form and legality as required by law.

(C) The Secretary of the Department of Health shall submit this order and Annex A hereto to the Attorney General for review as to form and legality as required by law.

(D) The Secretary of the Department of Health shall certify this order and Annex A hereto and deposit the same with the Legislative Reference Bureau as required by law.

(E) This order shall take effect upon publication in the *Pennsylvania Bulletin*.

By the Department of Health

H. ARNOLD MULLER, M.D.,

Secretary

Fiscal Note: 10-67. No fiscal impact;
(8) recommends adoption.

Annex A

TITLE 23. HEALTH AND SAFETY

PART I. GENERAL HEALTH

CHAPTER 2. EMERGENCY HEALTH SERVICES

Subchapter A. EMERGENCY MEDICAL TECHNICIANS

§ 2.13. Authorized medications and solutions.

An EMT - paramedic may, under a medical command, administer the following parenteral medications and solutions:

- (1) Aminophylline.
- (2) Atopine Sulfate.
- (3) Bretylium.
- (4) Calcium Chloride.
- (5) Dexamethasone Sodium Phosphate (Decadron).
- (6) Dextrose.
- (7) Diazepam (Valium).
- (8) Digoxin (Lanoxin).
- (9) Diphenhydramine HCl (Benadryl).
- (10) Dobutamine.
- (11) Dopamine.
- (12) Epinephrine HCl (Adrenalin).
- (13) Furosemide (Lasix).
- (14) Hydrocortisone Sodium Succinate (Solu Cortef).
- (15) Isoproterenol HCl (Isuprel).
- (16) Lidocaine HCl (Xylocaine).
- (17) Meperidine (Demerol).
- (18) Morphine Sulfate.
- (19) Naloxone HCl (Narcan).
- (20) Nitroglycerine Tablets.
- (21) Nitrous Oxide.
- (22) Physostigmine.
- (23) Ringers Lactate.
- (24) Sodium Bicarbonate.
- (25) Sodium Chloride.
- (26) Terbutaline.
- (27) Water, Sterile.
- (28) Albumin.
- (29) Oxytocin.
- (30) Verapamil.

(Pa. B. Doc. No. 45-647 Filed May 3, 1983.
9:09 a.m.)

Title 55—

PUBLIC WELFARE

DEPARTMENT OF PUBLIC WELFARE

[55 PA. CODE CH. 1181]

Nursing Facility Care; Allowable Cost Reimbursement for Non-State Intermediate Care Facilities for the Mentally Retarded

Notice is hereby given that the Department of Public Welfare, Office of Mental Retardation, by this order, adopts amendments to 55 Pa. Code Chapter 1181, under Article IV of the Public Welfare Code (62 P. S. § 443.1(2) and (3)).

Notice of proposed rulemaking was published at 14 Pa. B. 2762 (July 28, 1984), with an invitation to submit written comments within 30 days of publication.

Portions of Chapter 1181, Subchapter C that have been changed from proposed rulemaking are listed in Annex A. Any portion of Subchapter C not listed in Annex A is adopted as it appears at 14 Pa. B. 2762.

Purpose

Amendments to Subchapter A are being adopted in order to exempt non-State operated intermediate care facilities for the mentally retarded (ICFs/MR) from certain reimbursement requirements. Sections of Subchapter A will still apply for State and non-State operated intermediate care facilities for the mentally retarded.

The Department is adopting Subchapter C in order to specify the requirements of Medical Assistant reimbursement and allowable costs for non-State operated ICFs/MR. The new Subchapter C will apply only to non-State operated ICFs/MR.

Background

The ICF/MR program is an optional service provided under Pennsylvania's State Medical Assistance Plan as part of the Medicaid program. The ICF/MR program provides intensive rehabilitative services to mentally retarded persons and persons with related conditions. Participating facilities are required to meet stringent Federal standards for licensure and certification related to program services and the environment and safety of persons served.

The Federal ICF/MR program standards are based upon the developmental model, as opposed to the nursing or custodial model which is the basis of the skilled nursing or intermediate care facility (SN/ICF) programs. Along with the developmental

model, the ICF/MR standards are based upon the principles of active treatment, normalization, and individualization.

Basically, the regulations require that each person served receive an intensive, planned, individualized, and documented regimen of program services designed to meet the specific need of the client, so as to develop each client's potential along a developmental continuum. The regulations include explicit requirements regarding the content and development as well as the monitoring of active treatment, which is the individually prescribed program of care for each client, as well as specific documentation requirements to be met. Additionally, the ICF/MR regulations require that each person's treatment occurs in a manner and in an environment which is normalizing and approximates everyday community life to the maximum extent possible.

Given the basis of the regulations in the developmental model, the focus of the ICF/MR program is upon individual clients and the unique needs of each client. Programs and services are required to be tailored to meet the individualized developmental needs of each client. Therefore, an ICF/MR typically provides a broad array of services designed to meet the varied needs of the ICF/MR clients served. Consequently, given the diverse population served, ICF/MR programs vary significantly from one another.

In contrast, SN/ICF programs are licensed and certified based upon a lowered level of service requirements. The focus of SN/ICF programs is upon the medical and custodial servicing of clients, as opposed to the ICF/MR developmental focus. Additionally, SN/ICF programs are characterized by a general, collective care of clients, as opposed to the ICF/MR focus on the individualized needs of clients. Also, staffing standards are lower for SN/ICF programs than ICF/MR, in terms of direct care and professional staff. SN/ICF programs include a relatively homogeneous client group, and services provided by SN/ICF programs are consequently similar.

As a result of the above differences, the reimbursement methodologies most appropriate for ICF/MR versus SN/ICF programs are separate and distinct. The ICF/MR reimbursement methodology must reflect the stringent Federal program standards applicable for certification. The SN/ICF reimbursement methodology reflects a less intensive level of service requirements. The ICF/MR reimburse-

ment methodology is reflective of the individual client focus, as opposed to the SN/ICF focus upon the collective care of clients. The ICF/MR methodology allows for the broad array of intensive services required under the ICF/MR program and allows for greater facility differences, as opposed to the comparatively limited range of services provided under the SN/ICF program and the relative homogeneity of SN/ICF programs.

Specifically in terms of reimbursement, ICF/MR per diem rates are generally higher than SN/ICF rates. This is a result of the more varied and more stringently regulated services provided under the ICF/MR program, as compared to SN/ICF programs. Additionally, under the ICF/MR methodology, reimbursement rates are based upon individual cost histories or budgets of each program, as compared to SN/ICF rates which are limited by statistical group comparisons or ceilings.

Also, as a result of the program differences between ICF/MR and SN/ICF programs, and the standards upon which the programs are based, the cost manuals applicable to each program differ. For example, the ICF/MR Cost Manual includes provisions related to reimbursement for the comprehensive staffing requirements of ICF/MR. However, the ICF/MR and SN/ICF Cost Manuals are similar as related to costs which are common to all long-term care programs, such as depreciation and interest costs.

The adoption Subchapter C replaces the proposed rulemaking published at 12 Pa. B. 1976 on June 19, 1982. On June 19, 1982, the Department published proposed reimbursement ceilings for non-State operated ICFs/MR. Substantial public comment was received objecting to the proposed ceilings. Providers and other interested persons submitted numerous comments and recommendations regarding alternative reimbursement changes. These new regulations do not include ceilings, but instead describe rates based upon previously submitted cost factors. Additionally, allowable costs are defined in the regulations.

In May 1983, the Department decided that the particular ceilings proposed by the Department in June 1982, were not the most appropriate and effective means to control costs and ensure quality services for mentally retarded clients. As indicated previously, ICF/MR programs are heterogeneous, and appropriate group ceilings for reimbursement rates are difficult to establish. Additionally, since ICF/MR programs are typically solely

dependent upon funding through the ICF/MR program, it is particularly important to establish an appropriate level of reimbursement for each individual facility.

Therefore, in May, 1983, the Department set aside ceilings and began to work closely with ICF/MR providers to discuss and develop a new reimbursement methodology mutually acceptable to both providers and the Department. The purposes of the new methodology were to stabilize the non-State operated ICF/MR program, and to establish cost containment and ensure the quality of program services provided under the ICF/MR program.

Following an initial meeting with all non-State operated ICF/MR providers in May, 1983, the Department established a task force, including providers and provider advocacy organizations, to work closely with Departmental representatives to develop a new reimbursement methodology.

These final regulations reflect the work of this provider task force through a series of meetings and discussions since August, 1983. Providers have extensively reviewed drafts of these regulations, and provider comments and recommendations have been incorporated throughout the regulations. Additionally, the provider task force reviewed the proposed regulations of July 28, 1984.

These regulations are needed for several reasons. First, the regulations are needed because of the increased number of non-State operated ICFs/MR and the necessity to better manage costs associated with this program. As cost histories have been established, the need to move from the current budget review methodology to a cost based methodology has become apparent.

Secondly, rates have been steadily escalating under the current budget review methodology. The Department must begin to manage the non-State operated ICF/MR program in a more cost efficient manner.

Finally, the regulations are necessary because the current budget review methodology is too costly for providers and the Department to implement in terms of time, manpower, and paperwork. The cost based methodology will significantly reduce the paperwork requirements, since the formerly mandated budget submission processes are no longer required.

The budget review methodology was the most appropriate method for the establishment of rates during the developmental stages of the non-State

operated ICF/MR program.

Under the budget review methodology, ICF/MR providers submitted budgets to the Department's Office of Mental Retardation prior to the start of each fiscal year. The budgets were submitted on forms and in accordance with instructions issued by the Department. Budgets were reviewed against an allowable cost manual and Medicare Principles (HIM-15) in order to establish reasonable cost estimates for the operation of each facility. The budget review process resulted in an approved budget level, an interim *per diem* or billing rate, and approved estimates by major objects and cost centers. Providers were instructed that the approved budget amounts were subject to confirmation of actual, allowable costs at the time of final audit.

Beginning in fiscal year 1981-82, a significant expansion occurred in the number of non-State operated ICFs/MR, as a result of a Departmental developmental initiative. As new programs were initially developed, budgets were submitted to the Department for review and rate setting. The budget review process allowed new providers to project costs while gaining experience regarding licensure and certification and it enabled ICFs/MR to establish cost histories under the ICF/MR program. During fiscal year 1982-83, the Department's developmental initiative was completed. Now that non-State operated ICFs/MR have been certified and have experience in the program, and ICFs/MR have established adequate cost histories, there is no longer a need for a mandated budget review process to reflect the costs necessary for the operation of certified facilities.

These regulations reflect a movement away from the budget review methodology and towards the establishment of a cost-based methodology, similar in some aspects to SN/ICF programs, except for unique differences related to the ICF/MR program. However, given the particular ICF/MR program emphasis upon individual client needs, the unique dependence of ICFs/MR solely upon Medical Assistance funding, and the relative newness of some ICF/MR providers, these regulations contain a provision to allow for budget review under certain defined circumstances.

The following highlights some of the major changes for reimbursement and allowable costs from the previous budget review methodology to the new Subchapter C.

(1) Previously rates were based

upon budget review. Allowable costs were determined in accordance with the Department's Manual for Allowable Cost Reimbursement for ICFs/MR, the Medicare Provider Reimbursement Manual (HIM-15), and the limits of an approved budget.

The new regulations require that rates be based on costs, projected to allow for inflation. For fiscal year 1984-85, costs will be projected in accordance with the most current full year projection as of May 1, 1984, for the Consumer Price Index-W, which is 3.7% for fiscal year 1983-84 and 4.5% for fiscal year 1984-85. In future years, the Department will use projected economic forecasts, such as the CPI-W, to adjust rate increases for cost changes that occur through the period in which the rate is to be effective. The actual economic forecast used each year will be determined by the Department and published in the *Pennsylvania Bulletin*.

Additionally, the regulations establish Subchapter C as part of the Department's Medical Assistance regulations.

(2) There is now no efficiency incentive for ICFs/MR. The new regulations allow for an efficiency incentive under certain specified conditions.

If a provider's actual audited costs are less than the projected costs established by the standard interim *per diem* rate methodology, and if there are not significant audit exceptions as defined in the regulations, a provider can earn an efficiency incentive which will be equal to one-half of the difference between actual and projected costs, up to a maximum percentage of the total audited costs of the facility. This provision will serve to reduce costs to the ICF/MR program.

(3) The previous methodology involves a complex and time-consuming process of budget review resulting in the control of costs by total approved budget, major objects, and cost centers.

The new regulations simplify and streamline the rate setting process. The need for budget review is eliminated unless exceptional circumstances occur. Under the new regulations, rates are based upon previously submitted cost reports. Allowable costs are determined in accordance with Subchapter C and a projected total operating limit. The regulations include provision for greater provider flexibility and management by providers to effect the control of costs.

(4) Under the previous budget re-

view methodology, providers were dependent upon Departmental decisions as a result of budget review.

The new regulations introduce stability to the rate setting process for the non-State operated ICF/MR program. Rates are based upon individual facility cost histories, projected forward to allow for increases specified by the Department. Providers are not required to present a budget to the Department for review.

On August 2, 1984, the Independent Regulatory Review Commission approved the proposed regulations. The Order of the Commission commended the Department and the provider community for the joint efforts and co-operation shown in the development of these regulations.

Public Comment

Written comments, suggestions, and objections were solicited within a 30-day period after the date of proposal rulemaking. The Department received seven letters concerning the proposed regulations. The Department has carefully reviewed and considered each comment. The Department would like to thank all persons and organizations who have taken the time and effort to participate in the development of these regulations. Following is a summary of the written comments received during the public comment period, from July 28, 1984 until August 29, 1984, and the Department's response to those comments.

(1) Two State provider associations wrote in support of the new reimbursement methodology. The associations prefer the new methodology in that it is more reasonable than the previous proposed methodology that utilized geographic ceilings as the criterion for reimbursement and the new methodology represents improvements over the previous budget review methodology.

(2) Several comments were received about the disallowance of retained earnings. Commentors felt that such a disallowance would preclude long term growth of the ICF/MR program, discourage proprietary agencies from entering the ICF/MR system, and make it economically infeasible to transfer the ownership of a private ICF/MR agency.

The Department's response is that return on equity or profit is not an allowable cost of service. Reimbursement for profit would only serve to increase the costs of the program and would not enhance or improve the provision of services to the mentally retarded persons served.

(3) Many comments objected to the section of proposed regulations about depreciation allowances. Although strong objection was received on the issue of depreciation, the Department was unable to make the recommended changes.

The Deficit Reduction Act of 1984 (P. L. 98-369) resulted in changes regarding payment for depreciation, interest and other costs related to the negotiation or settlement of the sale or purchase of any capital asset of any ICF/MR. The law was effective July 18, 1984 and applies to any asset that was sold on or after July 18, 1984. Changes to implement the provisions of this law have been included in the final regulations.

These changes relate to sections of the regulations addressing offset gain on the sale of assets and reimbursement limits on the step-up of depreciable assets cost basis for all changes of ownership which occur on or after July 18, 1984.

(4) Three comments were received suggesting that § 1181.412 relating to depreciation allowances on bond issues, be amended to include other similar funding sources in addition to the Industrial Development Authority.

The Department agrees with this suggestion and has incorporated the change into § 1181.412.

(5) One comment was received objecting to the provisions of § 1181.419 relating to reimbursement for return on equity and the issue of reimbursement for the principal portion of mortgage payments.

The Department does not allow a return on equity for owner/operators. Depreciation costs are allowable in accordance with § 1181.412.

(6) One comment was received suggesting that the Department should use the Consumer Price Index-W in establishing its inflation factor for rate setting. It was felt that the regulations should enable the Department to use a widely accepted predictor.

The Department will use projected economic forecasts, such as the CPI-W to adjust rate increases, however, the actual economic forecast used each year will be determined by the Department and published in the *Pennsylvania Bulletin*.

(7) A suggestion was received that the appeal process for a denial of a waiver request should be described or referenced.

Subchapter A addresses the facility's right of appeal.

In addition to the seven letters received during the public comment period, many helpful comments and suggestions were also received from the Task Group of ICF/MR providers. The Department would like to thank the individual task group members for their time, suggestions, and cooperation they have given to the Department in the development and adoption of the regulations.

Summary of Changes

As a result of public comment, suggestions from the ICF/MR Provider Task Group, suggestions from others, the Deficit Reduction Act of 1984, and the Department's identification of areas requiring minor clarification, several changes have been made from proposed rulemaking. Each of these changes has been reviewed and approved by the ICF/MR Provider Task Group. The following is a list of the changes, the reason for the change, and the group recommending the change:

(1) § 1181.302. Applicability. Under subsection (b), references to § 1181.65 have been changed to coincide with recent amendments to § 1181.65 by the Office of Medical Assistance. The Office of Medical Assistance has amended § 1181.65 to include requirements of the Deficit Reduction Act of 1984. As a result of this amendment, § 1181.65 has been renumbered. The change to § 1181.302 coincides with the amendment to § 1181.65.

(2) § 1181.304. Definitions — Depreciable assets. A definition of depreciable assets was added to the regulations. This addition was made in response to the Task Group's request for clarity of the term depreciable assets. Additionally, the dollar limit was revised to conform to HIM-15, as suggested by the task force members.

(3) § 1181.304. Definitions — direct care staff. The definition of direct care staff was changed to refer to direct responsibilities instead of hands-on responsibilities.

(4) § 1181.304. Definitions — major object of expenditure. A definition of major object of expenditure was added in order to provide clarity throughout the regulations. This change was reviewed and approved by the task group.

(5) § 1181.304. Definitions — related party. The definition of related party has been changed to clearly reflect the definition of related party in HIM-15. This change was suggested by the ICF/MR Provider Task Group.

(6) § 1181.304. Definitions — service contract. A definition of service contract was changed in order to clarify the distinction between service contracts and unit of service contracts. This change was suggested by the task group.

(7) § 1181.335. Failure to submit cost report. Changes were made to this section in order to clarify that the interim *per diem* rate will be identical to the lowest rate issued for any provider.

(8) § 1181.336(a). Establishment of standard interim *per diem* rate. In order to provide clarity, the term fiscal year was clarified to state current fiscal year.

(9) § 1181.336(b). Establishment of standard interim *per diem* rate. As a result of suggestions from the task group and others, a change has been made to clarify that 98% of the maximum number of days, based upon the certified number of certified beds, is used to calculate the standard interim *per diem* rate.

(10) § 1181.336(c). Establishment of standard interim *per diem* rate. A change was made to this subsection to more clearly state the actual procedure used to calculate the standard interim *per diem* rate. This change was reviewed and approved by the task group.

(11) § 1181.337(a) and (b). Efficiency incentive. As a result of task group comment, the language in these subsections was revised in order to correct the terminology related to total projected operating costs and actual audited allowable costs.

(12) § 1181.351. Request for waiver. As a result of suggestions made, a requirement was added so that adequate information is submitted for the establishment of an interim *per diem* rate when a provider has less than a 12-month cost report on file.

(13) § 1181.353(a). Approved waiver. A change was made to this subsection to clarify that an approved budget level is established under an approved waiver.

(14) § 1181.353(c). Approved waiver. A change was made to clarify the procedure for calculating the interim *per diem* rate under an approved waiver.

(15) § 1181.355(a). Upper limits of payment if a waiver is granted. A change was made to this subsection in order to clarify that when rate setting is based upon a budget review, approved budget levels are established

by major objects of expenditure and cost centers. Providers are to be held at the time of audit to within 10% of these approved levels unless a budget modification request is approved by the Department.

(16) § 1181.367. Operation of multiple program types. At the suggestion of the task group, a notation was added to § 1181.403 in order to provide specific reference for the development of cost apportionment plans.

(17) § 1181.394(2). Waiver of minimum occupancy rate. The term census level was changed to the number of certified beds in order to provide consistency in terminology throughout the regulations.

At the suggestion of the task group, clarification was added to more clearly state the time frame for submission of the waiver to the minimum occupancy requirement and to specify the required documentation.

(18) § 1181.407. Service contracts. A change was made to this section in order to make a clear distinction between service contracts and unit of service contracts. This change was suggested by the task group.

(19) § 1181.412(a). Depreciation allowance. As a result of task group comment, specialized equipment was added to the list of capital assets used to provide compensable services to MA clients.

(20) § 1181.412(c)(1) and (d)(1). Depreciation allowance. The phrase, "or tax exempt funding sources" was added to the requirements on bond issues in order to broaden the scope of reimbursement for depreciation. This was added as a result of public comment received during the 30-day public comment period.

(21) § 1181.412(1). Depreciation allowance. A clarification was added to this subsection to specify that gains shall offset the depreciation expense for the last 12 months prior to the date the asset was sold or retired from service.

(22) § 1181.412(m)(4)(5). Depreciation allowance. A change was made to this subparagraph in order to comply with the Deficit Reduction Act of 1984.

(23) § 1181.413(c)(1). Interest. The phrase "or tax exempt funding sources" was added as a result of public comment.

(24) § 1181.413(d)(1). Interest. The phrase "or tax exempt funding sources" was added to the requirement on bond issues. This was added in re-

sponse to public comment.

(25) § 1181.413(g). Interest. In order to comply with the Deficit Reduction Act of 1984, notes and other securities were added to this subsection.

(26) § 1181.413(j). Interest. As a result of public comment received, changes were made to permit interest received on retained nondepreciable debt (nonallowable) to offset nonallowable interest expense for those funds.

(27) § 1181.414(c). Rental costs. The task group suggested that costs of ownership as a basis for inclusion of related party rental costs be added. This change was made. A typographical error in this subsection from changes to charges was also corrected.

(28) § 1181.417. Income. The title of this section was changed to interest and offsets to allowable cost in order to clarify the content of this section.

(29) § 1181.417(a)(5)(ii). Income. As a result of discussion with the task group, a new subparagraph was added to ensure the use of food stamps for eligible clients and the proper treatment of this income.

(30) § 1181.420(d). Start-up costs. A change was made to this subsection in order to address costs attributable to changes in ownership which are not allowable as a result of the Deficit Reduction Act of 1984.

(31) § 1181.431. Costs that are not allowable. Three items were added to the list of costs that are not allowable. Membership fees were added as a result of public comments and one member of the General Assembly. This change was made in order to parallel HIM-15 provisions regarding membership. We do not anticipate any significant financial impact upon providers as a result of this change.

Secondly, expenses payable from another public agency was added to clarify that expenses payable through other programs are not allowable for ICF/MR reimbursement. Finally, an item was added about net operating or capital costs in order to comply with the Deficit Reduction Act of 1984.

(32) § 1181.441(d). Nonprofit organizations. A standard of reasonableness was added in order to ensure that distance and costs for travel expenses would be with acceptable standards.

(33) § 1181.451(a). Submission of the budget. A change was made in order to clarify that if a twelve month cost report is not available, a budget is to be submitted.

(34) § 1181.453. Cost centers within the budget. In order to provide clarity, a listing of major objects of expenditure within the budget was added.

(35) § 1181.454. Budget adjustments. In order to provide clarity, a change was made to accurately state the level of control and degree of flexibility available to providers to move funds within the budget categories.

Fiscal Impact

There will be no increases in costs to the Commonwealth as a result of these amendments. The new reimbursement methodology will control the costs of the non-State operated intermediate care facilities for the mentally retarded program, subject to limits of inflationary increases as reflected by projected economic forecasts, such as the Consumer Price Index.

Paperwork Requirements

The amendments will significantly reduce paperwork requirements as the previous budget review methodology is being replaced by a methodology of rates based upon previously supported costs.

The previously used cost reports will continue to be used. The cost reports are now used for cost settlement purposes and will now be used for rate setting as well.

Under the new methodology, budgets will only be required in the case of exceptional cost increases due to those conditions specified in § 1181.351(a).

Effective Date

This order shall take effect July 1, 1984, except for § 1181.412(m)(5) which will be effective October 1, 1984, related to the Deficit Reduction Act of 1984. The retroactive application of these regulations represents the Department's most appropriate course of action because each provider's fiscal year begins July 1 and all costs are reported and audited on an annual basis. The retroactive application of these regulations is intended to facilitate the audit process as it is consistent with rate setting for fiscal year 1984-85, which was based upon the new methodology contained in these regulations. In April, 1984, the Department forwarded copies of the currently proposed regulations to non-State operated ICF/MR providers and requested that providers comply with the now proposed regulations as the Department's rate setting policy effective July 1, 1984. Consequently, retroactive application of these regulations will not result in any significant adverse consequence or impact for providers.

Sunset Date

No sunset date has been assigned to evaluate the effectiveness of these regulations. The effectiveness of the regulations will be assessed by holding ongoing provider task force meetings and by reviewing annual cost reports and year-end audits to determine the appropriateness of and compliance with the regulations.

Contact Persons

Any questions on this regulation may be directed to: Jennifer L. Howse, Ph.D., Deputy Secretary, Office of Mental Retardation, Room 302, Health and Welfare Building, Harrisburg, Pa. 17120, telephone: (717) 783-3700; Network 8-447-3700.

Regulatory Review

Under section 5(a) of the Regulatory Review Act of 1982 (P. L. 633, No. 181), 71 P. S. § 745.5(a), on July 16, 1984, the proposed rulemaking (published at 14 Pa. B. 2762, July 29, 1984) was submitted to the Independent Regulatory Review Commission, and the Senate Public Health and Welfare and House Health and Welfare Committees for review and comment. Having received no objections from either the House or Senate Committees by August 5, 1984, the amendments were deemed approved as provided by section 5(c) of the Regulatory Review Act. The Independent Review Commission met on August 2, 1984 and approved the proposed rulemaking. The various oversight requirements of the Regulatory Review Act have been fulfilled by the review of the proposed rulemaking, and no additional review of the final order adopting the amendments and changes made to the document is required by the Regulatory Review Act.

The Department of Public Welfare finds:

1. That public notice of intention to amend the administrative regulations amended by this order has been given under the act of July 31, 1968 (P. L. 769, No. 240) (45 P. S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

2. That the amendment of the regulations in the manner provided in this order is necessary and appropriate for the administration and enforcement of the Public Welfare Code.

(3) The regulations of the Department of Public Welfare, 55 Pa. Code Chapter 1181, are hereby amended by:

Amending §§ 1181.1, 1181.2, 1181.43, 1181.45, 1181.51, 1181.53, 1181.54, 1181.61, 1181.65 — 1181.68, and 1181.71 — 1181.74 to read as set

forth at 14 Pa. B. 2762 (July 29, 1984).

Adding §§ 1181.301, 1181.303, 1181.331 — 1181.334, 1181.338, 1181.352, 1181.354, 1181.361 — 1181.366, 1181.368, 1181.391 — 1181.393, 1181.401, 1181.403, 1181.406, 1181.408 — 1181.411, 1181.415, 1181.416, 1181.418, 1181.419, 1181.442 — 1181.444, and 1181.452 to read as set forth at 14 Pa. B. 2762.

Adding §§ 1181.302, 1181.304, 1181.335 — 1181.337, 1181.351, 1181.353, 1181.355, 1181.367, 1181.394, 1181.407, 1181.412 — 1181.414, 1181.417, 1181.420, 1181.431, 1181.441, 1181.451, 1181.453, and 1181.454 to read as set forth in Annex A.

4. The Secretary of the Department of Public Welfare shall submit this order, 14 Pa. B. 2762 and Annex A hereto to the Attorney General and General Counsel for approval as to legality as required by law.

5. The Secretary of the Department of Public Welfare shall certify this Order, 14 Pa. B. 2762 and Annex A hereto and deposit the same in the Legislative Reference Bureau as required by law.

6. The order shall take effect retroactively as of July 1, 1984 in the *Pennsylvania Bulletin*, except for § 1181.412(m)(5) which will be effective October 1, 1984 related to the Deficit Reduction Act of 1984.

By the Department of Public Welfare

WALTER W. COHEN,
Secretary

Fiscal Note: Fiscal Note 14-237 remains valid for the final adoption of the subject regulations.

INDEPENDENT REGULATORY REVIEW COMMISSION

Order

On July 16, 1984, the Independent Regulatory Review Commission received this proposal from the Department of Public Welfare (DPW). This proposal will alter 55 Pa. Code Chapter 1181 by amending Subchapter A and adding a new Subchapter C. These amendments are proposed under DPW's authority contained in Article IV of the Public Welfare Code (62 P. S. § 443.1(2) and (3)). These proposed amendments were published in the *Pennsylvania Bulletin* of July 29, 1984, with a 30-day comment period.

This proposal revises the procedure used by DPW to reimburse non-State operated intermediate care facilities for the mentally retarded (ICF/MR's). In the past, DPW reimbursed these fa-

cilities based on actual costs incurred up to a limit contained in the facility's budget which was submitted to and approved by DPW. Because of the rapid growth in the number of these facilities, this system, which was based upon an individual budget review of each facility's operations, is no longer workable. In its place, DPW is proposing to adopt a system which parallels the system used to reimburse nursing homes, but takes into account the program differences related to ICF/MR's. Under this new system DPW will base interim reimbursement rates and establish ceilings by taking the previous year's actual costs and inflating them by a standard inflation factor. These proposed amendments will also, for the first time, put into regulation form the cost reimbursement manual which specifies which costs will be allowable.

We have received comments in support of these proposed amendments from the Pennsylvania Association of Rehabilitation Facilities and the Pennsylvania Association of Residences for the Retarded.

We have reviewed these proposed amendments and find them to be in the public interest. By shifting from a reimbursement system based on analysis of proposed budgets to one based on actual historical costs which are escalated by way of an appropriate index, DPW will significantly reduce the time and paperwork which facilities and DPW would have to prepare and review in order to establish reimbursement rates. This new system should help to promote rate stability for facilities and will, for the first time, provide an efficiency incentive to facilities to contain costs at a level below their allowable ceilings. Placing the cost reimbursement manual in regulation form will provide improved information to the provider community concerning which costs DPW will deem allowable, and will improve DPW's ability to enforce these requirements.

We do note that DPW has chosen to treat some of the costs incurred by ICF/MR's in a manner which is different from the way these costs are treated in the reimbursement manual for nursing facilities. However, most of these differences are due to the differences in program requirements, that is, ICF/MR's focus on active developmental programs while nursing facilities provide care of a custodial nature.

DPW and the provider community are to be complimented on the level of cooperation which was shown in the joint development of these amend-

ments by these parties. These amendments should provide fair and adequate reimbursement to ICF/MR facilities while not having any adverse effects upon the Commonwealth, local governments, or the general public. Therefore, we approved these proposed amendments as published at 14 Pa. B. 2762.

The Commission reserves the right to review these amendments if they are substantially amended prior to final publication.

IRVING G. ZIMMERMAN,
Chairman

Annex A
TITLE 55. PUBLIC WELFARE
PART III. MEDICAL
ASSISTANCE MANUAL
CHAPTER 1181. NURSING
FACILITY CARE

Subchapter C. ALLOWABLE COST
REIMBURSEMENT FOR
NON-STATE INTERMEDIATE
CARE FACILITIES FOR
THE MENTALLY RETARDED
GENERAL PROVISIONS

§ 1181.302. Applicability.

(a) This subchapter applies to all non-State operated intermediate care facilities for the mentally retarded.

(b) In addition to this subchapter, the following also apply to non-State operated Intermediate Care Facilities for the Mentally Retarded: Chapter 1101 (relating to general provisions); Subchapter A (relating to nursing facility care); §§ 1181.1; 1181.2; 1181.21 — 1181.23; 1181.41(2) and (3); 1181.43(a), (c), and (d); 1181.45(a)(1) — (3); (a)(5) — (7); and (b); 1181.51 — 1181.53(b)(3) — (6) and (c); 1181.54(a)(2), (b) — (d), (e)(2), (f), and (g); 1181.55; 1181.56(a)(1) and (2)(iii); 1181.57; 1181.58; 1181.61(a) — (6), and (8); 1181.62 — 1181.64; 1181.65(a) — (c), and (g); 1181.66(d); 1181.67(2); 1181.68(a) and (d); 1181.69; 1181.71(b); 1181.73(a); 1181.74; 1181.75; 1181.81 — 1181.86; 1181.91 — 1181.96; and 1181.101(a)(1) — (3); (a)(4)(ii), and (b) — (f).

(c) In addition to this subchapter, Chapter 1101, applicable sections of Subchapter A, as specified in subsection (b), and the Medicare Provider Reimbursement Manual (HIM-15), also apply for costs that are included in this subchapter as allowable and*for reimbursable costs that are not specifically addressed in this subchapter.

(d) If this subchapter is inconsistent with Subchapter A (relating to nursing

facility care) or HIM-15, this subchapter shall prevail.

§ 1181.304. Definitions.

The following words and terms, when used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

Allocate — To designate a specific task, service or supply to a specific cost center because of its direct relationship to client care and identifiable measure of application.

Allowable cost — The cost reimbursed under Medical Assistance, that is the facility's actual audited allowable cost after appropriate adjustments are certified by Commonwealth auditors.

Apportion — To divide costs that are necessary to program operation but that cannot be directly or entirely charged to a specific cost center.

Arms-length transaction — A transaction including independent unrelated parties (no interest such as equity, control, contracts, interlocking directorates, officers, and the like; and, a willing buyer and a willing seller).

Assets — Economic resources that are owned by a business and are expected to benefit future operations.

Budget — A plan of financial operation for some future period expressed in monetary terms.

Capital asset — An item with a useful life of more than 1 year or that would not meet Internal Revenue Service standards for non-depreciable assets. Capital assets include but are not limited to: Buildings, renovations and building improvements, and moveable items such as furniture and fixtures, computers, and transportation equipment. Land is not a depreciable capital asset.

Change of ownership — The sale or transfer of a facility and all of its assets to another person, corporation, organization, or partnership, with the expectation that the facility will continue to operate for the same purpose for which it is currently being used.

Closed audit — An audit is closed when the written audit report has been distributed and one of the following occurs:

(i) The period for appeal has passed.

(ii) An appeal has been concluded and finalized. The closed audit results in final settlement, which is either additional payments due to the provider or a repayment of funds dispersed to the provider for disallowed costs.

Compensation — The total remuneration paid to an individual employee, including wages or salaries and benefits.

Competitive bidding process — The method used to procure goods or services by obtaining three or more vendor or cost proposals and selecting the proposal with the lowest responsible bid.

Cost center — A group of services or employees, or both, or another unit or type of activity into which functions of a facility are divided for purposes of expense assignment and allocations.

Cost report — A summary of client occupancy, income, and expenses for a given period, presented in a manner prescribed by the Department. In the ICF/MR program, this is an annual preparation of a Departmental form, titled Financial and Statistical Report for Skilled Nursing and Intermediate Care Facilities, for fiscal year operation.

Cost settlement — A retroactive adjustment based on a cost report, made at the end of a reporting period, to bring the interim payments made to the provider during that reporting period into agreement with the reimbursable amount payable to the provider for the allowable services actually rendered to program beneficiaries during that period. Final adjustment is made after an audit is closed.

Current fiscal year — The fiscal year in which the interim *per diem* rate is to be used.

Depreciable assets — Equipment, buildings and fixtures that have a purchase price of more than \$500 and are expected to have a useful life of more than 1 year.

Depreciation — Apportionment of the value of an asset over its useful life.

Direct care staff — Staff assigned to perform direct responsibilities related to activities of daily living, self-help, and socialization skills. Staff involved in regularly scheduled specialized developmental programs with clients are not included in direct care staff. Professional staff may be included in direct care staff.

Efficiency incentive — A remuneration to a provider that may be earned by spending less than projected operating expenses within specified guidelines.

Facility — A non-State operated intermediate care facility for the mentally retarded.

Fair market rental appraisal — The

determination of reasonable payment to a lessor for a rented space by a qualified real estate appraiser.

Interest — The direct cost incurred for the use of borrowed funds.

Interest on capital indebtedness — The direct cost incurred for funds borrowed for capital purposes. Examples of interest on capital indebtedness included acquisition of facilities, equipment and capital improvements. Generally, loans for capital purposes are long term loans.

Interest on current indebtedness — The direct cost incurred for funds borrowed for a relatively short term, usually for purposes such as working capital for normal operating expenses.

Investment income — Return on funds not expended by the facility and placed with a third party. Investment income includes, but is not limited to, interest income from bonds and savings accounts, premiums and dividends on stock purchases, and income from trust agreements.

Major object of expenditure — A generic classification of costs within cost centers including personnel, equipment, operating costs, depreciation and interest, and apportioned costs.

Management fee — A charge for general administrative services incurred for a common or joint purpose not readily assignable to a specific cost center.

Practitioner — Salaried or contracted practitioners including, but not limited to, physicians, dentists, podiatrists, occupational therapists, and physical therapists.

Prudent buyer — A term for the price paid for items by a cost-conscious purchaser in the open market under competitive conditions.

Reasonable costs — Necessary and proper costs incurred by the provider, based on the expectation that the facility is operated efficiently and economically.

Related party — An organization related to the provider by common ownership or control. Related to the provider means that the provider, to a significant extent, is associated with, affiliated with or has control of or is controlled by the organization furnishing the services. Common ownership exists when an individual possesses significant ownership or equity in the provider and the institution or organization serving the provider. Control exists where an individual or an organization has the power, directly or indi-

rectly, significantly to influence or direct the actions or policies of an organization or institution.

Request for proposal — A formal document describing services requested that is provided to interested contractors along with information to enable the preparation and submission of proposals for evaluation and selection.

Service contract — An obligation between a provider and supplier in which the nature and cost of service is specified, and reimbursement is not based upon actual units of service provided.

Standard interim per diem rate — The rate established by the Department for the purpose of making interim payments to the facility pending a year-end cost settlement.

Start-up costs — Costs incurred by the provider in developing its ability to furnish client care services prior to certification of the facility or admission of the first client.

Unit of service contract — An obligation between a provider and supplier in which the unit is defined, a price for the unit is stipulated, the basis for the price and unit is justified, and reimbursement is based upon actual units of service provided.

STANDARD INTERIM PER DIEM RATE

§ 1181.335. Failure to submit cost report.

If the provider does not submit a cost report by September 30 of each year, or later if an extension is granted by the Department under the procedures in the cost report, the Office of Mental Retardation will establish an interim *per diem* rate for the provider equal to the lowest interim rate for any non-State operated intermediate care facility for the mentally retarded issued for the current fiscal year.

§ 1181.336. Establishment of standard interim *per diem* rate.

(a) The standard interim *per diem* rate shall be used for billing purposes throughout the current fiscal year.

(b) The standard interim *per diem* rate shall be established by dividing the total projected operating cost by 98% of the maximum possible number of days based on the number of certified beds of the facility.

(c) The total projected operating cost is derived under the following procedures:

(1) Taking the total Medical Assistance allowable costs, including adjustments for income, and comparing

this to the approved budget total, or the total projected operating costs if applicable, for the same fiscal year in order to determine the lesser amount. From the lesser amount, subtract depreciation on capital assets, limited to buildings and fixed equipment, and interest on capital indebtedness.

(2) Projecting the amount in paragraph (1) to allow for inflation for each fiscal year through the end of the fiscal year in which the rate is to be effective, using a percentage for each fiscal year specified by the Department based upon a projected economic forecast, such as the Consumer Price Index-W.

(3) Adding depreciation on capital assets, limited to buildings and fixed equipment, and interest on capital indebtedness to the total projected cost to result in the total projected operating cost.

(d) The cost report submitted by the provider, in addition to adjustments made by the Office of Mental Retardation, as specified in § 1181.334 (relating to adjustments to the cost report), shall be used for the calculation of the standard interim *per diem* rate.

§ 1181.337. Efficiency incentive.

(a) An efficiency incentive is allowable if the facility's actual allowable costs are less than the total projected operating costs, audit exceptions total no more than 6.0% of the facility's total projected operating costs, and if the standard interim *per diem* rate was used in the previous fiscal year. If the standard interim *per diem* rate was not used in the previous fiscal year, no efficiency incentive is allowed.

(b) Efficiency incentives shall be based upon actual audited allowable costs. Efficiency incentives shall be equal to 50% of the difference between actual and total projected operating costs up to a maximum of 6.0% of the total actual audited costs for the facility for the fiscal year.

(c) The Department will not require that the efficiency incentive be used to offset allowable costs.

WAIVER OF STANDARD INTERIM PER DIEM RATE

§ 1181.351. Request for waiver.

(a) The provider may submit a request for a waiver of the standard interim *per diem* rate if any of the following conditions exist:

(1) The facility has been certified as an ICF MR for less than 18 months prior to the closing date of the most recently submitted cost report.

(2) There has been an increase or decrease in the certified capacity of a facility during the current fiscal year.

(3) An increase or decrease in the certified capacity is anticipated for the next fiscal year.

(4) The characteristics of a client have changed significantly causing significant program changes, resulting in demonstrably different costs.

(5) An unforeseen circumstance has resulted in demonstrably different costs.

(6) The facility has changed ownership.

(b) The request for waiver shall be submitted to the Office of Mental Retardation in writing by March 1 preceding the fiscal year for which the waiver is being requested.

(c) A waiver request may not be submitted for more than 1 fiscal year at a time.

(d) If there is an unforeseen circumstance that affects the providers' cost, the request for waiver shall occur during the current fiscal year. The provider shall request a budget review in writing immediately after the change occurs.

(e) A written request for waiver shall include all of the following:

(1) Identification of the specific condition in § 1181.351(a) (relating to request for waiver) that exists.

(2) A proposed budget and a proposed *per diem* rate, on forms prescribed by the Office of Mental Retardation of the Department, in accordance with the budget instructions established by the Office of Mental Retardation.

(3) A detailed profile on the providers' costs prior to and after the change.

(4) Detailed justification for the waiver.

(5) The fiscal year for which the waiver is being requested.

(f) For a provider with less than a 12-month cost report who does not submit a request for waiver, an interim *per diem* rate will be established based upon § 1181.335 (relating to failure to submit cost report).

§ 1181.353. Approved waiver.

(a) If a waiver is granted, the Office of Mental Retardation will establish the total approved budget level.

(b) If a waiver is granted, the Office of Mental Retardation will establish budget levels by major object of expenditure and cost center. The budget

level will be based on this chapter and HIM-15.

(c) If a waiver is granted, the Office of Mental Retardation will establish an interim *per diem* rate by dividing the total approved budget level minus offsetting income, by 98% of the maximum potential certified occupancy or the occupancy percentage requested by the provider in the budget, whichever is higher.

(d) If a waiver is granted, the interim *per diem* rate shall be used for billing purposes throughout the fiscal year.

§ 1181.355. Upper limits of payment if a waiver is granted.

(a) If a waiver is granted and the budget is used to establish the interim *per diem* rate, the provider shall operate within 10% of the approved budget levels for major object of expenditure and cost center as defined in § 1181.453 (relating to major objects of expenditure and cost centers within the budget).

(b) Actual, allowable, and reasonable costs shall be determined at the time of the audit in accordance with this subchapter. Total reimbursement is limited to the sum of audited actual allowable costs or the total projected cost, whichever is lower.

(c) An efficiency incentive is not available if a waiver of the standard interim *per diem* rate is granted.

REIMBURSEMENT

§ 1181.367. Operation of multiple program types.

(a) If a provider operates intermediate care facilities for the mentally retarded as well as other types of programs, the provider shall document at the time of audit, or if a waiver is requested the provider shall submit with the budget a detailed account of how various costs are allocated between the multiple programs, under § 1181.403 (relating to administrative costs).

(b) The detailed account of the allocation shall include at least all of the following:

(1) All salary costs for individuals responsible for more than one program.

(2) Employee fringe benefits for individuals responsible for more than one program.

(3) All rental costs that apply to multiple programs.

(4) All motor vehicles that are used by multiple programs.

(5) All other related expenses shared by multiple programs.

BED OCCUPANCY

§ 1181.394. Waiver of minimum occupancy rate.

A provider may request a waiver of the minimum occupancy requirement at the time that a final cost report is submitted to the Department. The request for waiver of the minimum occupancy requirement shall be submitted in writing to the Deputy Secretary for Mental Retardation. Documentation shall be submitted related to one or more of the following conditions:

(1) The facility is in its first year of operation.

(2) The facility is increasing or decreasing the number of certified beds.

(3) The facility operates less than 16 beds.

ALLOWABLE COSTS

§ 1181.407. Service contracts.

Costs necessary for the operation of the facility and the establishment and maintenance of Intermediate Care Facilities for the Mentally Retarded certification are allowable to the extent that the costs do not duplicate services performed by staff on complement. Service contracts shall specify the nature and cost of the service. Documentation of service contracts shall be maintained by the facility with all documentation of services rendered.

§ 1181.412. Depreciation allowance.

(a) Depreciation on capital assets used to provide compensable services to medical assistance clients, including assets for normal, standby, or emergency use, and specialized equipment such as wheelchairs, is allowable.

(b) Except as specified in subsections (c) and (d), a facility will be reimbursed for allowable depreciation costs only if the facility is the recorded holder of legal title.

(c) Facilities that participated in the Medical Assistance Program prior to July 1, 1984, that are not part of a related organization and that are not the recorded holder of legal title to the facility, are considered to meet the recorded holder of legal title requirement and will be reimbursed for allowable depreciation on a particular project, if, at the time services were rendered, all of the following existed:

(1) The particular project was primarily funded through an Industrial Development Authority bond issue.

or tax exempt funding sources established under State statute.

(2) The facility provided the Department with all documents relating to the ownership and financial obligations relating to the facility.

(3) The facility met the standards of HIM-15, Section 110-B, with respect to virtual purchases.

(d) Facilities that participated in the Medical Assistance Program prior to July 1, 1984, that are part of a related organization and that are not the recorded holder of legal title to the facility, are considered to meet the recorded holder of legal title requirement and will be reimbursed for allowable depreciation on a particular project, if, at the time services were rendered, the following existed:

(1) The particular project was primarily funded through an Industrial Development Authority bond issue, or tax exempt funding sources established under State statute.

(2) The facility was a related organization to a corporation, person, or company which, if it operated the facility, could qualify for reimbursement for allowable depreciation costs under subsection (c).

(3) All of the documentation necessary to substantiate that the facility meets the requirements of subsection (c) and documentation and statement of the fact that the two entities are related organizations were supplied to the Department.

(4) The related organization agreed in writing as required by the Department that it and its successors will be responsible for any overpayment that the Department is unable to collect directly from the facility.

(e) The straight-line method of depreciation shall be used. Accelerated methods of depreciation are not acceptable. The amount of annual depreciation shall be determined by first reducing the cost of the asset by any salvage value and then dividing by the number of years of useful life of the asset. The useful life may be shorter than the physical life depending upon the usefulness of the particular asset to the provider. A useful life may not be less than the relevant useful life published by the Internal Revenue Service or the Uniform Chart of Accounts and Definitions for Hospitals published by the American Hospital Association for the particular asset on which the depreciation is claimed. However, the accelerated cost recovery system under Section 168(c) of the Internal Revenue Code (26

U.S.C. 168(c)) and any other accelerated life system shall not be permitted.

(f) Depreciation expense for the year of acquisition and the year of disposal is computed by using either the half-year or actual time method of accounting. The number of months of depreciation expense may not exceed the number of months that the asset was in service. If the first year of operation is less than 12 months, depreciation is allowed only for the actual number of months in the first year of operation.

(g) The method and procedure, including the assigned useful lives, for computing depreciation shall be applied from year-to-year on a consistent basis from the date of the facility's first filed cost report after July 1, 1975, and may not be changed, even if the facility is purchased as an ongoing operation.

(h) All assets shall be recorded at cost. Donated assets shall be recorded at the current appraisal value or the lower of the following if available: the construction cost, the original purchase price or the donor's original purchase price. Costs incurred during the construction of an asset, such as architectural, consulting and legal fees, interest, and fund raising shall be capitalized as a part of the cost of the asset. If an asset is acquired by a trade-in, the cost of the new asset is the sum of the book value of the old asset and any cash or issuance of debt as consideration paid.

(i) Facilities that previously did not maintain fixed asset records and did not record depreciation in prior years shall be entitled to any straight-line depreciation of the remaining useful life of the asset. The depreciation shall be based on the cost of the asset at the time of original purchase or construction. No depreciation may be taken on an asset that would have been fully depreciated if it had been properly recorded at the time of acquisition.

(j) Depreciation on facilities that have no fixed asset records and are sold will be recognized to the extent to which the prior owner would have been entitled to depreciation.

(k) Leasehold improvements shall be depreciated over the useful life of the asset.

(l) Gains on the sale of fixed and movable assets are considered to be equal to the salvage value which shall be established prior to the sale of the item. Gains on the sale of fixed and movable assets shall offset allowable costs for the period in which the gain

was realized, but the offset may not exceed the amount of the facility's total depreciation expense for the last 12 months prior to the date that the asset was either sold, retired from service, or otherwise permanently taken out of service. If the amount of the offset is greater than the total allowable cost for the period in which the gain was realized, the difference shall be refunded to the Department. Losses incurred on the sale or disposal of fixed or movable assets will not be reimbursed under the program.

(m) The cost basis for depreciable assets is determined as follows:

(1) Except as provided otherwise in this section, the cost basis of the depreciable assets of a facility that are acquired as used, shall be computed by the following method:

(i) The lower of the purchase price or the fair market value shall be established at the time of sale based on the lowest of two or more bona fide appraisals at the time of sale.

(ii) All depreciation that was taken or could have been taken by all prior owners shall be subtracted.

(iii) Subsections (r) and (s) will establish the Department's extent of participation in the payment of allowable depreciation.

(2) The cost basis for depreciable assets of a facility transferred between related parties shall be the net book value of the seller at the date of the transfer as recognized under this subchapter.

(3) The cost basis for depreciable assets of a facility acquired through stock purchase will remain unchanged from the cost basis of the previous owner.

(4) The cost basis for depreciable assets of a facility purchased in types of transactions other than those specified in paragraphs (1), (2), (3), and (5) may not exceed the seller's basis under this subchapter, less all depreciation that was taken or could have been taken by all prior owners.

(5) The cost basis for depreciation on any asset the ownership of which changes on or after July 18, 1984, shall be the lesser of the remaining allowable cost basis of the asset to the first owner of record on or after July 18, 1984, or the allowable cost basis to the new owner; however, the cost basis shall exclude costs, including legal fees, accounting and administrative costs, travel costs, or the cost of feasibility studies, attributable to the negotiation or settlement of the sale or pur-

chase (by acquisition or merger) for which payment was previously made under Title XIX of the Social Security Act (42 U.S.C. §§ 1396 — 1396q). This paragraph shall not apply to changes in ownership under an enforceable agreement entered into prior to July 18, 1984.

(n) The reasonable cost of depreciation will be recognized for the construction and renovation of buildings to meet applicable Federal, State or local laws and building codes for intermediate care facilities for the mentally retarded. Costs are allowable if the facility has either a certificate of need or a letter of nonreviewability for the project from the Department of Health under subsection (m)(1) and (2). In accordance with Federal and State regulations, the facility shall submit to the Department, the certificate of need or letter of nonreviewability, as appropriate, or the provider will not receive reimbursement for interest on capital indebtedness, depreciation, and operating expenses.

(o) If the purchase of a facility or improvements to the facility are financed by tax exempt bonds, the acquired property, plant or equipment shall be capitalized and depreciated over the life of the assets. The acquired property, plant or equipment are the only items that may be capitalized. If the principal amount of the bond issue was expended in whole or in part on capital assets that fail to meet the requirements of the subsections (m) and (n) regarding eligibility for depreciation, the includable depreciation will be proportionately reduced.

(p) The fixed asset records shall include all of the following:

- (1) The depreciation method used.
- (2) A description of the asset.
- (3) The date the asset was acquired.
- (4) The cost of the asset.
- (5) The salvage value of the asset.
- (6) The depreciation cost.
- (7) The estimated useful life of the asset.

(8) The depreciation for the year.

(9) The accumulated depreciation.

(q) The funding of all allowable depreciation shall be required for the future replacement of assets, including those assets obtained through Federal and State funds or grants, such as legacy foundation grants and Hill Burton grants. Withdrawals from a funded depreciation account may be used to reduce the principal balance of a mortgage or bond. Funding of other depre-

ciation shall be required so that funds will be available for future replacement of assets by the facility. Documentation supporting funded depreciation accounts shall be required.

(r) The Department will recognize depreciation as an allowable cost subject to the following conditions:

(1) Depreciation on new or additional beds is an allowable cost only if both of the following apply:

(i) The facility was issued either a Section 1122 approval or letter of nonreviewability in accordance with 28 Pa. Code Chapter 301 (relating to limitations on Federal participation for capital expenditures) or a certificate of need or letter of nonreviewability in accordance with 28 Pa. Code Chapter 401 (relating to certificate of need program) for the project by the Department of Health.

(ii) The facility substantially implements the project as defined at 28 Pa. Code § 401.5(j)(2) (relating to certificate of need) within the effective period of the original Section 1122 approval or the original certificate of need.

(2) Depreciation on replacement beds is allowable only if the facility was issued a certificate of need or a letter of nonreviewability for the project by the Department of Health.

(s) After July 1, 1984, allowable depreciation and interest costs for new, renovated, or purchased facilities shall be held to a per bed limitation based on construction standards obtained from published standards.

(1) For facilities governed by the Institutional Occupancy Section of the National Fire Protection Association's Life Safety Code, depreciation costs are limited to a maximum cost per bed based upon the Nursing Home Average Building Costs from "Dodge Cost Information Systems Cost for Building Construction", published by McGraw-Hill, P. O. Box 28, Princeton, New Jersey, 08540, current at the time of construction or acquisition, except as limited by other provisions of this subchapter.

(2) For facilities governed by the Lodging and Rooming Houses Section of the National Fire Protection Association Life Safety Code, depreciation costs are limited to a maximum cost per bed based upon the "Marshall Valuation for Single Family Residences — Type D," published Company, 1617 Beverly Boulevard, P. O. Box 26307, Los Angeles, California 90026 current at the time of construction or acquisition, except as limited by other provisions of this subchapter.

§ 1181.413. Interest.

(a) Necessary and proper interest on capital and current indebtedness is allowable. The Department will recognize interest as an allowable cost subject to the following conditions:

(1) Interest on new or additional beds is an allowable cost only if both of the following apply:

(i) The facility was issued either a Section 1122 approval or letter of nonreviewability in accordance with 28 Pa. Code Chapter 301 (relating to limitations on Federal participation for capital expenditures) or a certificate of need or letter of nonreviewability in accordance with 28 Pa. Code Chapter 401 (relating to certificate of need programs) for the project by the Department of Health.

(ii) The facility substantially implements the project as defined at 28 Pa. Code § 401.5(j)(2) (relating to certificate of need) within the effective period of the original Section 1122 approval or the original certificate of need.

(2) Interest on replacement beds shall be an allowable cost only if the facility was issued a certificate of need or a letter of nonreviewability by the Department of Health.

(b) Except as specified in subsections (c) and (d), a facility will be reimbursed for allowable interest on capital indebtedness with respect to assets only if the facility is the recorded holder of legal title of the assets involved.

(c) Facilities that participated in the Medical Assistance Program prior to July 1, 1984, that are not part of a related organization and that are not the recorded holder of legal title to the facility are considered to meet the recorded holder of legal title requirement and will be reimbursed for allowable interest on a particular project, if, at the time services were rendered, all of the following existed:

(1) The particular project was primarily funded through an Industrial Development Authority bond issue, or tax exempt funding sources established under State statute.

(2) The facility provided the Department with all documents relating to ownership and financial obligations relating to the facility.

(3) The facility met the standards of HIM-15, Section 110-B, with respect to virtual purchases.

(d) Facilities that participated in the Medical Assistance Program prior to July 1, 1984, that are part of a related organization and that are not the re-

corded holder of legal title to the facility, are considered to meet the recorded holder of legal title requirement and will be reimbursed for allowable interest on a particular project, if, at the time services were rendered the following existed:

(1) The particular project was primarily funded through an Industrial Development Authority bond issue, or tax exempt funding sources established under State statute.

(2) The facility was a related organization to a corporation, person, or company which, if it operated the facility, could qualify for reimbursement for allowable interest costs under subsection (c).

(3) All of the documentation necessary to substantiate that the facility meets the requirements of subsection (c) and documentation and a statement of the fact that the two entities are related organizations was supplied to the Department.

(4) The related organization agreed in writing as required by the Department that it and its successors will be responsible for any overpayment that the Department is unable to collect directly from the facility.

(e) Allowable interest on capital indebtedness shall not exceed the amount that a prudent borrower would pay. Interest on capital indebtedness will not be considered prudent if the provider cannot demonstrate that the rate does not exceed the rate available from lenders in this Commonwealth to similar borrowers at the time that the funds were borrowed. For the purpose of this section, the time that the funds were borrowed is the date of the loan commitment.

(f) To be considered allowable, necessary and proper, the interest expense shall be incurred and paid within 90 days of the close of the cost reporting period on a loan made to satisfy a financial need of the facility and for a purpose reasonably related to client care.

(g) Necessary interest on capital indebtedness applying to mortgages, bonds, notes, or other securities on the property and plant of the facility will be recognized subject to the limitation of the amount recognized for depreciation purposes. The total value of mortgages, bonds, notes, or other securities on which interest on capital indebtedness is allowed may not exceed the depreciation basis of the assets as set forth at § 1181.412(m) - (o) (relating to depreciation allowance).

(h) All investment income shall be

used to reduce allowable interest expense on capital and current indebtedness unless the investment income is from one of the following:

(1) Gifts, donations, and grants that are not restricted by the donor for payment of allowable costs.

(2) Funded depreciation if the interest earned remains in the funds.

(3) The facility's qualified pension fund if the interest earned remains in the fund.

(4) Interest income from gifts, if the funds on which the interest is derived are not commingled with funds that offset allowable costs.

(5) Fund raising efforts.

(i) Investment income that reduces allowable costs, including income on operating capital, shall be used to reduce interest expense on capital indebtedness first, then used to reduce non-capital indebtedness.

(j) Interest income on unused debt proceeds funds or bond debt reserve funds shall be used first to reduce interest payable on those funds, shall be used second to reduce interest on capital indebtedness, and shall be used last to reduce noncapital indebtedness.

(k) Interest expense shall be allowable if paid on loans from the facility's donor-restricted funds, the funded depreciation account, or the facility's qualified pension fund. The upper limit on allowable interest may not exceed the prime interest rate charged at the time funds are borrowed.

(l) Interest on capital indebtedness will be recognized on debt services incurred to finance a maximum cost per bed as defined in § 1181.412(m) and (s) (relating to depreciation allowance). If the cost exceeds the per bed limit, the interest on the portion of the cost that exceeds the limit is not allowable.

(m) Monies borrowed for the purchase or redemption of capital stock will be considered as a loan for investment purposes, and the interest paid on these borrowed funds is not an allowable cost.

(n) Interest expense on funds borrowed for capital purchases will not be allowed until all funds in the facility's funded depreciation account are fully expended.

§ 1181.414. Rental costs.

(a) Space that is justified by the program is allowable.

(b) Leasing or rental costs for buildings is allowable if parties are unrelated and the facility demonstrates

that the rental or lease is an arm's length transaction and continues as such.

(c) Exceptions to subsection (b) are allowed only upon advance approval from the Deputy Secretary for Mental Retardation or a designee. Approval will be based on a fair market rental appraisal as outlined in subsection (e), or documented costs of ownership, except that return on equity is not permitted. The provider is permitted to include documented mortgage interest charges and depreciation.

(d) The provider shall maintain adequate documentation to substantiate rental costs. Documentation shall include copies of the Deputy Secretary's approval specified in subsection (c), the lease, and bills for taxes, insurance, and interest.

(e) The facility shall maintain documentation of a fair market rental appraisal for all rental properties, from an individual who holds at least one of the following designations awarded by the Society of Real Estate Appraisers:

(1) Senior Real Property Appraiser.

(2) Senior Residential Appraiser.

(3) Senior Real Estate Analyst.

(4) Member of the American Institute of Real Estate Appraisers.

(f) A maximum allowable annual rental shall be computed in the following manner:

(1) The property value is based upon the documented market value of three similar properties including land in the same geographic area.

(2) Net equity is obtained by reducing the property value by the estimated selling costs and any outstanding debt.

(3) The rate for return on equity capital as contained in Section 5782 of HJM-15, for the beginning of the current fiscal year, will be applied to net equity.

(4) The actual cost of real estate taxes, insurance and interest on any debt, for the current fiscal year, are included.

(5) The maximum annual rental may not exceed the sum of paragraphs (3) and (4).

(g) Providers shall maintain documentation related to subsection (f).

(h) Rent is allowable up to the maximum allowable reimbursement for annual rental value.

(i) If there is a multiple year lease, rentals are determined by new apprais-

als or by updating the existing appraisals using the H1M-15, interest rate, current costs for taxes, insurance, and interest.

(j) Facilities certified on or before July 1, 1984, shall comply with this section beginning July 1, 1987, or at the expiration of the current lease agreement, whichever occurs first. Facilities certified after July 1, 1984, shall comply with this section as of the initial date of certification.

§ 1181.417. Income and offsets to allowable cost.

(a) Income from the following sources offsets allowable costs:

(1) Medical assistance reimbursement income.

(2) Client pay or assessed liability that is deducted from client billings.

(3) Gifts and donations restricted by the donor for allowable costs.

(4) Refunds and cash discounts.

(5) Grants designated for allowable costs.

(i) If the facility serves more than 50% of clients age 21 or younger, the provider shall act as sponsoring agency for participation of those clients in the residential component of the National School Lunch Program.

(ii) If clients of the facility are eligible for participation in the Food Stamp Program, it is the provider's responsibility to contact the local county assistance office and utilize food stamps accordingly.

(6) Income from space rental, vending machines, and similar items.

(7) Interest earned on items specified in paragraphs (1) — (6).

(b) Income from the following sources does not offset allowable costs:

(1) Gifts, donations, and contributions that are not restricted by the donor for allowable costs.

(2) Endowments and bequests not restricted for allowable costs.

(3) Fund raising efforts not restricted for allowable costs.

(4) Interest earned on items specified in paragraphs (1) — (3).

§ 1181.420. Start-up costs.

(a) Start-up costs shall be capitalized as deferred charges and amortized over a minimum of 5 years.

(b) Start-up costs include, but are not limited to, administrative and nursing salaries, utility costs, taxes, insurance, mortgage and other inter-

est, employee training costs, repairs and maintenance, housekeeping, and other allowable costs incident to the start-up period.

(c) Costs that are properly identifiable as organization costs or capitalizable as construction costs shall be classified as such and excluded from start-up costs.

(d) Costs related to changes in ownership as defined in § 1181.412(m) (relating to the cost basis for depreciable assets) are not allowable as start-up costs.

(e) Amortized start-up costs shall be shown on the Depreciation and Amortization Schedule that is a part of the budget submission or the cost report. The costs shall be documented on the budget narrative or the cost report. A 60-month amortization period is allowed for these costs.

NONREIMBURSABLE COSTS

§ 1181.431. Costs that are not allowable.

The following costs are not allowable:

(1) Nonworking officers' salaries.

(2) Fundraising expenses.

(3) Free care or discounted services.

(4) Parties and social activities not related to client care.

(5) Personal telephone service.

(6) Personal radio and television service.

(7) Direct and indirect costs related to nonallowable costs centers including gift, barber, beauty, flower and coffee shops, homes for administrators or pastors, convent areas and nurses' quarters.

(8) Guest meals.

(9) Pennsylvania Capital Stock and Franchise Tax.

(10) Income tax.

(11) Ambulance costs.

(12) Promotional advertising including a Yellow Page listing that is greater than the minimum insert.

(13) Late payment penalties.

(14) Penalties, fines, or late charges assigned by any source, whether or not related to the facility.

(15) Life insurance for officers and directors of the governing board, including life insurance premiums necessary to obtain mortgages and other loans.

(16) Bad debts or contractual adjustments.

(17) Collection expenses associated with bad debts.

(18) Travel expenses for members of the board of directors unrelated to the program.

(19) Depreciation and interest on capital indebtedness for costs in excess of the limitation specified in § 1181.412(s) (relating to depreciation allowance).

(20) Expenses not necessary for client care.

(21) Basic education for eligible school-age children.

(22) Vocational rehabilitation services.

(23) Personal travel for employees, including personal use of facility vehicles.

(24) Meals for employees, except for employee meals provided as part of client training activities.

(25) Living expenses for live-in employees, including lodging, meals and personal laundry.

(26) Membership fees for social, fraternal, and other organizations involved in activities unrelated to the program or an organization defined as a lobbying group under the Lobbying Registration and Regulation Act (46 P. S. §§ 148.1 — 148.9).

(27) Expenses payable from another public agency, insurance program, or health program.

(28) Net operating or capital cost, including legal fees, accounting and administrative costs, travel costs and the costs of feasibility studies, attributable to the negotiation or settlement of the sale or purchase of a capital asset (by acquisition or merger) for which payment has previously been made under Title XIX of the Social Security Act (42 U.S.C. §§ 1396 — 1396q) if the sale or purchase was made on or after July 18, 1984. This paragraph shall not apply to any asset that undergoes a transfer of ownership on or after July 1, 1984 under an enforceable agreement that was entered into prior to July 18, 1984.

CONFLICT OF INTEREST

§ 1181.441. Nonprofit organizations.

(a) A voting member of the governing board of a nonprofit organization shall disclose in writing to the Department a contract or agreement for compensation with the provider in which the voting member has a personal interest.

(b) If a voting member receives compensation from the provider, the

compensation shall be excluded from the allowable costs of the facility if both of the following apply:

(1) The voting member votes on the payment of compensation to himself or fails to disclose his interest to other members of the governing board.

(2) The organization fails to disclose the interest of the voting member.

(c) Compensation includes salaries, consultation fees, or services provided by the program, but may not include care provided to a resident of the program.

(d) Travel and related expenses, such as the cost of attending educational seminars, are allowable for members of the governing board if the expense is reasonable, related to the operation of the program, and documented in the provider's records.

§ 1181.451. Submission of the budget.

(a) For new programs that have never participated in the Intermediate Care Facility for the Mentally Retarded Program, or programs that have participated in the program for less than 12 months, a budget shall be prepared and submitted to the Department in accordance with forms and in-

structions provided by the Office of Mental Retardation.

(b) If a waiver of the standard *interim per diem* rate is requested, a budget shall be submitted to the Department in accordance with § 1181.351(e) (relating to request for waiver) and shall be prepared in accordance with forms and instructions provided by the Office of Mental Retardation.

§ 181.453. Major objects of expenditure and cost centers within the budget.

(a) The budget shall include the following major objects of expenditure:

- (1) Personnel costs.
- (2) Operating costs.
- (3) Equipment and other fixed assets.
- (4) Depreciation and interest.
- (5) Apportioned costs.

(b) The budget shall include the following cost centers:

- (1) Room and board.
- (2) Health care.
- (3) Ancillary services.
- (4) General administration.

(5) Depreciation and interest.

(6) Other.

§ 1181.454. Budget Adjustments.

(a) The provider is permitted to move funds between major objects of expenditure and cost centers, within 10% of the approved amount per major object of expenditure and cost center, during the course of the fiscal year.

(b) Movement of funds greater than 10% requires submission of budget adjustment and shall meet the following conditions:

(1) Changes shall remain within the limit of the total approved budget level.

(2) Requests for adjustment shall be filed during the fiscal year in which the rate is effective, and budget adjustments may be filed a maximum of two per fiscal year.

(3) Budget adjustments shall be submitted on forms prescribed by the Office of Mental Retardation and in accordance with applicable instructions.

[Pa. B. Doc. No. 85-397. Filed May 3, 1985.
9:00 a.m.]