

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF  
VENDOR REBATES  
PAID TO HOSPITALS**

**METHODIST GERMANTOWN  
HOSPITAL  
GERMANTOWN, TENNESSEE**



Daniel R. Levinson  
Inspector General

MAY 2007  
A-05-07-00047

# ***Office of Inspector General***

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The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



DEPARTMENT OF HEALTH AND HUMAN SERVICES  
OFFICE OF AUDIT SERVICES  
233 NORTH MICHIGAN AVENUE  
CHICAGO, ILLINOIS 60601

REGION V  
OFFICE OF  
INSPECTOR GENERAL

May 14, 2007

Report Number: A-05-07-00047

Mr. Michael Nesbit  
Vice President-Corporate Finance  
Methodist Healthcare  
1211 Union Avenue, 6<sup>th</sup> Floor  
Memphis, Tennessee 38104

Dear Mr. Nesbit:

This final report provides the results of our audit of vendor rebates totaling \$12,621 that a drug manufacturer paid to Methodist Germantown Hospital of Germantown, Tennessee. We identified the rebates through a national statistical sample of rebates.

## **BACKGROUND**

### **Methodist Germantown Hospital**

Methodist Germantown Hospital (the provider) is a 209-bed community hospital serving Germantown and the surrounding areas. The facility provides acute inpatient care and treatment, surgical services, and emergency care services for adults and children.

### **Vendor Rebates**

A vendor rebate is a retroactive discount, allowance, or refund given to a health care provider after the full list price has been paid for a product or a service. Rebates are usually paid quarterly or annually and are usually dependent on achieving a specific purchasing volume. A rebate is paid directly to a provider (e.g., a hospital) or to a nonprovider (e.g., a group purchasing organization or distributor).

Federal regulations (42 CFR § 413.98) state that rebates are reductions in the cost of goods or services purchased and are not income. The Centers for Medicare & Medicaid Services (CMS) "Provider Reimbursement Manual" (part 1, chapter 8) requires hospitals and other health care providers to report all discounts on their Medicare cost reports.

### **Medicare Cost Reports**

Some types of Medicare-certified providers, such as hospitals, skilled nursing facilities, and home health agencies, must submit an annual Medicare cost report to a fiscal intermediary. The cost report contains provider information, including facility characteristics, utilization data, costs

and charges by cost center (in total and for Medicare), Medicare settlement data, and financial statement data. A cost center is generally an organizational unit having a common functional purpose for which direct and indirect costs are accumulated, allocated, and apportioned. Providers must reduce previously reported Medicare costs when they receive rebates.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

Our objective was to determine whether the provider reduced costs reported on its fiscal year 2003 and 2004 Medicare cost reports by the \$12,621 it received for 2 vendor rebates.

### **Scope**

As part of a national statistical sample of rebates that a single drug vendor sent directly to providers, we selected a \$12,621 rebate (composed of 2 checks) that the provider received during calendar year 2003. We limited our review to identifying the rebate amount and determining whether the provider credited the amount in its accounting records and on its Medicare cost reports. We did not perform a detailed review of the provider's internal controls.

We performed our fieldwork from October through November 2005 at the drug vendor's offices in Deerfield, Illinois. We requested and received information from the provider through phone contacts, mail, and electronic mail.

### **Methodology**

To accomplish our objective, we:

- reviewed Federal regulations and CMS guidance related to rebates,
- obtained a statistical sample of rebates paid by the vendor to identify providers that received the rebates,
- requested documentation from the provider regarding the reporting of the rebate,
- determined whether the provider credited the sampled rebate amount on its Medicare cost reports, and
- quantified the dollar amount of any rebates not reported and used to reduce previously reported costs.

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

## **FINDING AND RECOMMENDATIONS**

The provider did not reduce costs reported on its fiscal year 2003 and 2004 Medicare cost reports by the \$12,621 it received for 2 rebates, contrary to Federal regulations and CMS guidance. The provider misclassified and recorded the rebates in a donation account that was not included on its Medicare cost reports. Providers must offset costs by rebates to ensure that they report the actual cost of services provided.

We recommend that the provider:

- revise and resubmit its 2003 and 2004 Medicare cost reports, if not already settled, to properly reflect the \$12,621 in rebates as credits reducing its health care costs; and
- consider performing a self-assessment of its internal controls to ensure that future vendor rebates are properly credited on its Medicare cost reports.

## **PROVIDER COMMENTS**

In its comments on the draft report, the provider agreed with our recommendations. The provider stated that it has (1) revised and resubmitted FY 2003 and 2004 Medicare cost reports, (2) reviewed all open Medicare cost reports and relevant accounts, (3) worked with its Medicare fiscal intermediary to ensure rebates were properly reflected on its cost reports, (4) undertaken a self-assessment of its internal controls, and (5) taken corrective actions to ensure vendor rebates are accurately reported in the future. The provider's written comments are included as the Appendix.

\* \* \* \* \*

A copy of this report will be forwarded to the action official noted on the next page for review and any action deemed necessary. The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please contact Jaime Saucedo at (312) 353-8693. Please refer to report number A-05-07-00047.

Sincerely,



Marc Gustafson  
Regional Inspector General  
for Audit Services

**Direct Reply to HHS Action Official:**

Mr. Roger Perez  
Regional Administrator  
Centers for Medicare & Medicaid Services  
Atlanta Federal Center, Suite 4T20  
61 Forsythe St. SW  
Atlanta, Georgia 30303

# **APPENDIX**



April 4, 2007

Marc Gustafson  
Regional Inspector General  
for Audit Services, Region V  
Department of Health and Human Services  
Office of Audit Services  
233 North Michigan Avenue  
Chicago, Illinois 60601

Re: Methodist Germantown Hospital  
Review of Vendor Rebates Paid to Hospitals  
Comments on Draft Report A-05-07-00047

Dear Mr. Gustafson:

Methodist Healthcare ("Methodist") hereby responds to the draft report of the U.S. Department of Health and Human Services, Office of the Inspector General ("OIG"), Office of Audit Services, entitled "Review of Vendor Rebates Paid to Hospitals" ("Draft Report"). Methodist appreciates the opportunity to comment on the OIG's Draft Report regarding its audit of vendor rebates paid to Methodist Germantown Hospital ("the Hospital").

During its audit, the OIG identified \$12,621 in pharmacy manufacturer rebates (representing two checks) that the Hospital had misclassified and recorded in an account that was not included in the Medicare cost report. As a result, these rebates were not offset against allowable costs, as required by Medicare regulations.

Methodist regrets that this error occurred. It has already revised and resubmitted its FY 2003 and 2004 Medicare cost reports to properly reflect the rebates in question, as recommended in the Draft Report. In addition, following the OIG's initial inquiry regarding the rebates, Methodist reviewed all open Medicare cost reports and relevant accounts and worked with its Medicare fiscal intermediary to ensure that rebates were properly reflected in the cost reports.

Furthermore, Methodist has already undertaken a self-assessment of its internal controls, as recommended in the Draft Report, and instituted the following corrective actions to ensure that vendor rebates are accurately reported in the future:

- (1) Methodist's "Vendor Rebates" policy, which explicitly states that rebates are to be applied against the department expense account containing the purchases on which they were earned, was discussed with facility CFOs

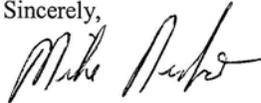
who were instructed to review appropriate rebate processing with applicable facility department leaders.

- (2) Vendors were instructed that all rebate checks should be sent to the Methodist materials management department.
- (3) The proper treatment of rebates was specifically addressed in Methodist's revised Standards of Conduct which was released in January 2007 to all Associates.

Methodist is strongly committed to ensuring that its Medicare cost reports are accurate. We regret that the rebates identified in the OIG's audit were not properly reported, and we believe that we have taken appropriate steps to ensure that rebates are properly reported in the future.

If you have any questions or need additional information, please feel free to call me at (901) 516-0721.

Sincerely,



Michael Nesbit  
Vice President-Corporate Finance

cc: Wanda Mathis, Trispan