

Rule No. 560-X-42-.08 Interest Expense

(1) Necessary and reasonable interest expense is an allowable cost. In order to be considered necessary, the interest must be incurred on a loan made to satisfy a financial need directly related to resident care. Loans which result in excess funds or which are not related to resident care are not considered to be necessary. In order to be considered reasonable, the interest rate cannot be in excess of that which a prudent borrower would agree to pay, and the lender must not be related to the borrower. The provisions of HIM-15 (Medicare Provider Reimbursement Manual) shall be applicable in determining whether a loan is between related parties. Interest paid by the provider to owners, partners, stockholders, or other persons related to the provider is not an allowable cost. However, the principal amount of such loans will be included in equity capital for the purpose of computing the return on equity payable to proprietary providers. This will be done in computing a proprietary provider's return on equity, by eliminating the liability from the deduction from assets, thereby increasing the equity.

(2) Bond discounts or premiums will be amortized over the life of the bond issue using the straight line method and such amortization will be treated as interest. Amortization will be added to interest expense in the case of discounts and deducted from interest expense in the case of premiums.

(3) (a) Interest incurred during the period of construction on funds borrowed to construct or enlarge existing facilities must be capitalized as a part of the cost of the facility. The period of construction is considered to extend to the date the facility is put into use for resident care. Where a bond issue is involved, any bond discount and expense, or bond premium amortized during the period of construction must be capitalized and included in the cost of the facility constructed.

(b) If a debt which was incurred to finance the construction, expansion, renovation or acquisition of an ICF/~~MRIID~~ facility is refinanced, allowable interest on the refinanced portion of the original loan will be limited to the interest which would have been allowed under the original financing arrangement, and any additional interest on the refinanced portion will be an unallowable cost.

(4) If the provider incurs a prepayment penalty on the early extinguishment of an interest bearing debt, the amount of such interest penalty shall be allowable and treated as interest expense using the following guidelines:

(a) If accumulated interest plus penalty is less than the amount of interest that would have been incurred had the debt not been paid off, then all the interest and penalty can be claimed.

(b) If the interest and penalty exceed the amount of interest that would have been claimed had the debt not been paid off, then only the amount that would have been claimed during a reporting year can be included in the cost report. The excess penalty will be carried on the balance sheet as an asset and written off in subsequent years in a manner such that annual interest claimed does not exceed what the actual expense would have been.

(5) The payment of a lease payment to a Medical Clinic Board under a lease agreement containing a purchase option at a price below the fair market value is generally not allowable as a true lease payment, therefore the portion of the "lease payments" equal to the interest payments

in the underlying bonds is subject to the limitations on reimbursement of interest expenses normally allowable as an interest expense.

(6) Interest must be reported on the cost report in two distinct areas: working capital interest, in the administrative cost center, and other interest reported in the property cost center.

(a) Working capital interest is limited to short term loans taken out to meet immediate needs of daily operations. If no evidence of repayment of these loans is apparent and a note is merely renewed or continued throughout the year, Medicaid will not consider these notes to be bona fide working capital loans, and interest expense will not be reimbursable. If these short term notes are repaid or a genuine effort has been made to repay them, interest expense will be limited to 90 days interest on two months of the provider's average allowable cost adjusted for depreciation and/or rent expense. The interest rate used for this computation will be the average rate charged by the lender during the year.

(b) Other interest includes mortgage interest and interest on loans to purchase equipment. The provider is required to have on file records to support the date, amount, and purpose of each loan. If the loans are of the installment type, an amortization schedule should also be available for inspection.

(7) Only interest expenses incurred and payable to a lender, as evidenced by a signed loan agreement, will be considered for reimbursement. Additional interest expense created by restatement of a loan agreement, under generally accepted accounting principles or created by imputing interest is not reimbursable. For example, an imputed interest expense resulting from the application of Accounting Principles Board Opinion No. 16 or No. 21, or any similar accounting principle, and any other imputed interest expense shall not be recognized as an interest cost for purposes of computing the provider's allowable Medicaid reimbursement.

(8) If financing is obtained to purchase a facility, only the portion of the loan which pertains to the allowable purchase price, as defined by Medicaid, will be allowable. If this financing is a combination of assumed debt and other debt, the priority of allowability is as follows:

- (a) Assumed debt at the stated rate
- (b) Additional debt at the stated rate
- (c) Other debt

(9) If loans are made to related parties during the reporting period and working capital loans are created or remain outstanding during any period in which the related party loans are outstanding, then the interest on the portion of the principal amount of such working capital loans equal to the principal amount of such related party loans is not reimbursable.

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Statutory Authority: State Plan; Title XIX, Social Security Act, 42 C.F.R. Section 447.250-.255.

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