
Medicare

Provider Reimbursement Manual

Part 1 - Chapter 8, Purchase Discounts; Allowances; Refunds of Expenses

Department of Health &
Human Services (DHHS)
Centers for Medicare &
Medicaid Services (CMS)

Transmittal 456

Date: March 8, 2013

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CLARIFIED/UPDATED MATERIAL--*EFFECTIVE DATE: NOT APPLICABLE*

Introduction, is added to clarify that the policies in the manual apply to providers in completing the Medicare cost report.

DISCLAIMER: This revision date and transmittal number applies to the red italicized material only. All other material was previously published and remains unchanged.

CMS-Pub. 15-1-8

CHAPTER 8

PURCHASE DISCOUNTS; ALLOWANCES; REFUNDS OF EXPENSES

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

800. PRINCIPLE

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

802. DEFINITIONS

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

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

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

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

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

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

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

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

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

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

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

804. ACCOUNTING TREATMENT

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

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

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

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

805. GROUP PURCHASING ORGANIZATIONS

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

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