PERFORMANCE AUDIT REPORT

Adult Care Homes in Kansas— Administrative Costs

A Report to the Legislative Post Audit Committee
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ADULT CARE HOMES IN KANSAS—
ADMINISTRATIVE COSTS

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Summary of Legislative Post Audit's Findings

This performance audit is one of a series examining adult care home costs in Kansas. These costs are divided into four areas: property, health care, room and board, and administration. This particular audit provides information about several areas of concern related to administrative costs. The audit's more specific findings about administrative costs are as follows:

Homes vary greatly in the ways they handle administrative expenditures and report administrative costs. As a result, it is difficult to determine if most differences between categories of homes are the result of actual cost variation or the result of reporting differences. The auditors did, however, find two major kinds of administrative costs that vary between homes and that do not appear to be adequately controlled under the existing reimbursement system. These costs are administrative salaries (and in particular, owner's compensation) and central office costs.

Salary controls are complex, and they only partially fulfill their purpose. Owners can set compensation at any level for services they perform, but the State sets limits on the level of compensation that can be passed through to the reimbursement system. Those limits take into account the levels of compensation non-owner employees receive for similar work, the size of the facility, and other administrative salaries. The auditors' review of the operation of those limits showed that 60 percent of the owner-employees in 40 homes examined in detail were not fully subject to salary limits, because no limits have been established for consultative or executive job titles. Chain owners spread their compensation over several homes and receive more compensation in total than non-chain owners. Non-profit facilities and chains with non-owner executives can also operate independently of many salary controls. As a result, the current system may unintentionally offer strong incentives for chain ownership.

Central office costs are not effectively monitored under the current system. There are great differences between homes in the kinds of central office costs they report and in the way those costs are allocated between homes. The level of documentation provided for these costs also varies. Because of these differences, the reasonableness of central office costs is difficult to assess. Facilities which recently changed hands showed a 157 percent increase in central office costs, moving the average cost for this item from just under $8,300 to more than $21,000 annually for the 57 homes which were reviewed. Thus, if administrative costs are to be adequately controlled in the future, it will be necessary to give more attention to monitoring and auditing central office costs.

Steps should be taken to improve monitoring and control of administrative costs. The current system for controlling administrative costs has not kept pace with changes in the industry. Increasing chain ownership has affected the nature of work performed by owners and has led to increasing centralization of administrative operations. Ambiguity in the present system makes it more difficult to monitor, evaluate, and control administrative costs, and makes it possible for providers to take advantage of the system. Although the Department is operating with some clear drawbacks in this area, such as a lack of information about out-of-State firms, the auditors identified several areas where improvements can be made.

To address the audit's findings, it is recommended that the Department review and clarify its policies and guidelines for administrative costs, consider requiring additional reports of central office costs and requiring chain-owned affiliates to use the same fiscal year, and revise its audit and review system to provide for more cross-checking and coordination between homes in the same chain. In addition, the State of Kansas through appropriate organizations should consider urging the development of comprehensive audits of adult care home chains that operate in more than one state.

ADULT CARE HOMES IN KANSAS

ADMINISTRATIVE COSTS

This performance audit is one of a series of reports examining adult care home costs in Kansas. These audits were requested by the Special Committee on Special Care Services and by the Legislative Post Audit Committee.

At the center of this series of audits is the State's Medicaid reimbursement system. Under the Medicaid system, the State supports patients in adult care homes who cannot pay their own cost of care. In fiscal year 1983, approximately $85.5 million was spent for such support. Since fiscal year 1976, costs have risen $44.5 million, an increase of 108 percent.

The State's Medicaid reimbursement system is an attempt to balance several different goals. Through the system, the State tries to ensure a reasonable level of care while at the same time encouraging efficiency and keeping costs in line. In recent years, the situation in Kansas and other states has been complicated by considerable turnover in the ownership of adult care homes. Ownership by out-of-State interests has increased; and concern has been voiced that increasing amounts of Medicaid reimbursement are going for mortgage and lease costs and for administrative expenses--items that may have only a limited relationship to the care that residents receive.

All of these concerns were motivating factors behind the request for this series of audits. This particular report provides information about several areas of concern related to administrative costs. In particular, this audit does the following:

1. It provides an overview of the types and amounts of administrative costs associated with the operation of adult care homes, and how they differ.

2. It examines the ways in which owners can receive compensation through the administrative cost center, and it explains the inequities that can sometimes result.

3. It examines the types of central office costs which can be allocated between related facilities, and it explains problems which the differing treatment of such items can present.

4. It notes several ways in which the policies and procedures for administrative costs could be improved.

An Overview of Administrative Costs

The Medicaid program supports patients in adult care homes who cannot pay their own cost of care. It reimburses adult care homes on the basis of their costs in four areas: property, health care, room and board, and administration. Each year, homes report their costs to the Department of Social and Rehabilitation Services, which uses the reported costs to set reimbursement rates for the coming year.

The process for setting reimbursement rates is a complicated one and was described at considerable length in an earlier audit report dealing with property costs. To summarize the process briefly: the Department of Social and Rehabilitation Services uses the homes' reported costs as a starting point and subjects these costs to various exclusions, restrictions, and limitations. At the end of the process, a reimbursement rate is set for each home. Because of the cost controls, a home with very high costs probably will not be able to recover all of its costs. On the other hand, homes with relatively low costs will receive full reimbursement, and homes with the lowest costs can receive some additional money in the form of an efficiency payment.

The table below shows the historical costs reported by 258 intermediate care homes as of June 1, 1983. (In all, there are about 300 intermediate care homes, but about 40 did not have historical costs because of recent changes in ownership.) The table also shows the reimbursement limits established by the Department of Social and Rehabilitation Services. These limits were in effect from October 1, 1982 to September 30, 1983.

	Average Historical Cost Per Patient Day	Reimbursement Limit Per Patient Day
Total Cost	$26.35	$28.16
Administration	2.96	3.35
Property	4.98	6.00
Room and Board	7.49	9.75
Health Care	11.01	13.47

Costs in the administrative cost center include salaries for administrators, owner/managers, consultants, and the like. They also include most other expenses commonly associated with the operation of a business, such as office supplies, and legal and accounting fees. Certain such expenses are excluded from reimbursement because they are not related to patient care. Examples are expenses for fund raising and non-working director's fees. As the table above indicates, the average cost for administration for the 258 intermediate care facilities which the auditors reviewed was $2.96 per patient day. Administrative costs are the lowest of the four cost centers upon which reimbursement rates are established. On average, they represent 11 percent of the historical costs reported by the 258 facilities.

The reimbursement limit for administrative costs is set at the 75th percentile of facilities' allowed per patient day costs; that is, the reimbursement level is set in such a way that the homes with costs below the 75th percentile of administrative costs will receive full reimbursement, while the homes with costs above the limit will receive only the limit. For the time period which the auditors reviewed, the limit was $3.35 per patient day.

The average cost of $2.96 for administration is made up of many separate items. The individual line items and the average cost for each are shown in the table below. As the table shows, administrative salaries account for $1.03, or about 35 percent. Other items often related closely to compensation for owners and administrators (benefits, owner compensation, consulting fees, and central office costs) account for another $.85, or 29 percent. Of the remaining administrative items, the largest is insurance, at an average of $.44.

Line Item	Average Allowed Cost Per Patient Day
Administrators' Salary	$ .71
Co-Administrators' Salary	.03
Other Administrative Salaries	.29
Employee Benefits	.14
Owner Compensation	.32
Management Consulting Fees	.07
Central Office Costs	.32
Office Supplies & Printing	.11
Telephone & Communication	.12
Travel and Entertainment	.10
Advertising	.04
Licenses and Dues	.05
Legal and Accounting	.13
Insurance	.44
Interest	.14
Other	.05
Owner/Administrator Limit	-.10
Total	$2.96

In requesting this series of audits on nursing home costs, legislators asked the auditors to compare costs between various kinds of homes. The auditors divided homes into the following basic categories:

1. For-profit homes
    a. Non-chain homes (one home only)
    b. Small chains (2-5 homes)
    c. Large chains (6 homes or more)
2. Non-profit homes
    a. Government homes
    b. Church homes
    c. Other (non-profit entities independent of a church or governmental unit)

When the auditors analyzed property costs in the earlier audit, they were able to make meaningful comparisons between groups because the information was reported quite uniformly from home to home. In the administrative cost center, however, this is not the case. Homes vary greatly in the ways they handle administrative expenditures and report administrative costs. Some homes, for example, report part of their administrative costs in other cost centers, and the mechanics of the administrative cost center are such that some non-administrative expenses are sometimes moved into it. As a result, it is difficult to determine if most differences between categories of homes are the result of actual variation or the result of these shifts in reporting. Appendix A presents the auditors' findings in greater detail.

Because the information is affected by these reporting problems, few conclusions can be drawn about differences between the categories of homes. The auditors did, however, find two major kinds of administrative costs that vary generally between homes and that do not appear to be adequately controlled under the existing reimbursement system. These costs are administrative salaries (and in particular, owner's compensation) and central office costs. The following sections of this report deal with these two kinds of costs.

Salary Controls Are Complex, and They Only Partially Fulfill Their Purpose

Of the 258 intermediate care facilities with historic cost records, 125 were reimbursed by Medicaid for owner's compensation expenses. Payment to owners occurs almost exclusively in for-profit homes and is characteristic of most for-profit homes. Of the 156 for-profit homes, 121 (78 percent) had owners' compensation expense. As the following table shows, small chains are most likely to be reimbursing owners.

Type of For-Profit Provider	Number of Homes	Number Paying Owner Compensation	Percent
Non-Chain	77	61	79%
Small Chain	45	38	84
Large Chain	34	22	65

Payment to owners for work performed in their nursing homes is one of the major components of the administrative cost center. In fiscal year 1982, patient-related costs for this item amounted to nearly \$1.9 million. When owner's compensation from the remaining cost centers is added, the total rises to slightly more than \$2 million.

Because of the large number of homes which report costs for owner's compensation, and the amount of compensation involved, the auditors examined the controls that are placed on owner compensation and other administrative salaries in detail. The operation of those controls and several related concerns which were identified are described below.

Three Limits Are Placed on Owner/Administrator Salaries for Reimbursement Purposes

Owners can set compensation at any level for services they perform, but the State sets limits on the levels of compensation that can be passed through to the reimbursement system. The Department of Social and Rehabilitation Services defines owner's compensation as any compensation of owners, their spouses, and/or related parties for performance of a necessary service for the home. This is further defined in the instructions for the cost report as follows:

> Compensation may be included in allowable cost only to the extent that it represents reasonable remuneration for manageral, administrative, and professional health care services related to the operation of the nursing home facility and rendered in connection with patient care.

Examination of the owner's compensation area requires close attention to the controls and limits the Department uses to ensure that the salaries owners pay themselves constitute "reasonable remuneration." If the controls and limits are too stringent, they will serve as a disincentive for owners to be personally involved in their homes. If the controls and limits are too weak, owners may make a "profit" by paying themselves salaries in excess of the fair market value for the work performed.

Currently, three separate limits are applied to owner and/or administrative salaries. K.A.R. 30-10-13(b)(3) directs the Department of Social and Rehabilitation Services to apply two limits in determining the allowable levels of owner compensation. The regulation states as follows:

> The agency shall determine reasonable limitations for compensation paid for comparable services and responsibilities in comparable adult care homes and a percentile limitation of combined costs for administrators, co-administrators and owners. Nothing in this section shall prevent further reasonable limitations of allowable cost data.

The Owner-Spouse Salary Limitation and the Owner-Administrator Limit are controls derived directly from the mandate of the regulation. A third limit, not required by regulation, is the Total Allowable Owner's Compensation Limit. Each of these is discussed below.

Owner-Spouse Salary Limitation. To establish reasonable limits for owners' and spouses' salaries, the Department conducts a voluntary salary survey of nursing homes. The survey covers the full-time salary paid to non-owner employees for a number of occupations. The salaries for each occupation are arrayed, and the owner-spouse salary limit is set at the 90th percentile of each array. The salary limits shown below are for the year beginning October 1, 1983 and are based on a salary survey completed in May 1982.

Job Classification	Annual Full-time Salary Limit
Administrator	$ 22,032
Co-Administrator	19,500
Bookkeeper	10,800
Maintenance Supervisor	13,200
Maintenance Worker	9,600
Dietetic Services Supervisor	10,704
Dietary Kitchen Aide	7,824
Housekeeper	8,052
Director of Nursing (RN only)	18,000
Health Services Supervisor (LPN only)	15,720
Registered Nurse	16,320
Licensed Practical Nurse	12,288
Medical Records Supervisor	9,792
Resident Activity Director	9,360
Nurse Aide	7,896
Medication Aide	8,616
Physical Therapist Aide	9,156
Social Worker	12,000
Mental Retardation Professional	19,500

Total Allowable Owner's Compensation Limit. This limit adds flexibility to the owner-spouse salary maximums to make owner salaries more compatible with non-regulated salaries. This flexibility is needed because the owner-spouse salary maximums are not prorated in any way for the size of facility. Without it, the administrator of a 200-bed facility would be subject to the same limitation as the administrator of a 50-bed facility.

The limit for a facility is equal to the number of inpatient days multiplied by a standard cost figure. From this sum, actual salaries for the administrator and co-administrator and allowable salaries for owners must be subtracted. If the sum of the salaries is greater than the total allowable owner's compensation, owners are limited to the salary maximums specified in the first limit. If the sum of the salaries is less than the total allowable owner's compensation, owners may increase their allowed salaries up to the point that the total allowable owner's compensation limit is met. Larger facilities with more bed days have a larger limit for total allowable owner's compensation. A 50-bed facility with 96 percent occupancy would have a limit of $22,250. A 100-bed facility would have a limit of $44,500 under the same circumstances. In most cases, a home with more than one owner working full time will exceed the total, and the owners will not be reimbursed above the salary maximums.

Owner/Administrator Compensation Limit. This limit is applied to all homes to control top-level administrative salaries, regardless of whether an owner is employed in the home. For each home, non-owner administrator and co-administrator salaries are summed and divided by total inpatient days. The resulting per patient day costs are arrayed, with the 90th percentile set as the reimbursement limit. The current limit is $1.27 per patient day. This means that the sum of salaries for the administrator, co-administrator, and owner compensation can be reimbursed only up to the level of $1.27 per patient day.

Limits Do Control Salaries in Some Instances, but Not in Others

To assess the effects of these limits, a sample of 40 homes was examined in depth to determine the type of work performed by owners, the amount of time worked, the reported salaries, and the salary amounts allowed by the Department of Social and Rehabilitation Services. That review showed that the limits are effective in reducing allowable costs for some owners. However, there is a large and growing group of owners who are not fully subject to the limits.

The auditors identified 76 owner-employees in the 40 homes which were reviewed. Of those, 30 were subject to the owner-spouse salary limits. Analysis of the 30 owners subject to the owner-spouse salary limit indicates that the limit produced a significant reduction in allowable costs. Thirteen owners (43 percent) had salary reductions, and these reductions totaled $75,499.

Reported Salaries Subject to Limit (30 Owners)	Salary Reductions Due to Limit (15 Owners)	Percentage Savings Due to Limit
$525,625	$75,499	14.4%

The limits described above thus have an effect on salaries to some owners. However, there is a large group of owners who are not subject to this limit. In the sample of 76 owners studied in detail, the auditors found that 46, or nearly 60 percent, had job titles which placed them outside the purview of the owner-spouse salary limit. This occurs because no limits have been established for executive or consultative job titles. In addition, some owners merely listed their salaries as "owner compensation" for services provided. The following table shows the owner-employees who were subject to the owner-spouse salary limit and those who were not.

Owners Subject to Owner-Spouse Salary Limits

Job Title	Number of Owners	Full or Part-time
Administrator	16	Full
Co-Administrator	1	Full
Bookkeeper	1	Full
Registered Nurse	1	Part
Director of Nursing	1	Full
Housekeeping Employee	1	Full
Laundry Employee	1	Full
Maintenance Supervisor	1	Part
Activities Director	1	Part
Health Services Supervisor	2	Full
Administrator/Health Services Supervisor	1	Full
Bookkeeper/Maintenance	1	Full
Business Manager/Maintenance	1	Full
Co-Administrator/Laundry and Housekeeping Director/Activities Director	1	Full

Owners Not Subject to Owner-Spouse Salary Limits

Job Title	Number of Owners	Full or Part-time
Management Consultant	13	Part
Executive (President, General Manager, etc.)	18	Part
Owner's Compensation for Services Provided	12	Part
Health Care Consultant	1	Part
Management Consultant/Accountant	1	Part
Nurse Consultant	1	Part

Department officials indicate a growing trend for owners to report their activities under consultative titles which exempt them from the limit. It is this group which will continue to expand, because the owner limits impinge least on these types of job titles. The boxed example on this page illustrates the advantage to be gained in using titles not subject to the salary limits.

Examples of Limited and Non-Limited Salaries

Two individuals are employed full-time in a 100-bed nursing home of which they are part owners. One owner receives a salary of $27,648 as Administrator; the other earns $21,240 as Director of Nursing. Because both positions are subject to the owner-spouse salary limitation, Medicaid reimbursement of the salaries is limited to $22,032 for the Administrator and $18,000 for the Director of Nursing. (In some cases, an additional amount could be reimbursed.)

The part owner of an 80-bed nursing home is employed half time as a management consultant. He receives $32,500 for this function. As a consultant he is not subject to the owner-spouse salary limitation. Another control in the reimbursement process, the owner-administrator limit, will reduce Medicaid reimbursement of the salary a great deal, to approximately $14,500. The management consultant, however, is still in a substantially better position than if he had a title like Administrator or Director of Nursing as in the case above. They would be limited to Medicaid reimbursements of half-time salaries of $11,016 and $9,000 respectively.

This problem is worsened by the increase in chain ownership of homes. Most for-profit chains pay centralized owners a salary for functions in behalf of the entire chain, and payment of the salary is allocated to individual homes in the chain in proportion to the home's size, revenue, or some other factor.

Whether or not those salaries are subject to the owner-spouse salary limits depends on the job title used. For example, an owner who spends 20 percent of his time in administrative or managerial activities for a facility might show his occupation as either co-administrator or as management consultant. As co-administrator, his earnings would be limited to 20 percent of the co-administrator limit, or $3,900. As management consultant, he could set his own salary for those services. The home will be subject to the owner-administrator limit, but this limit has little or no effect when salaries are spread over several facilities.

The ability of some owners to avoid the owner-spouse salary limits because of the job titles used is a concern which should be addressed if that limit is to be equitable. That concern is amplified by the fact that the job titles which are not limited (for example, executive, consultant) imply less direct involvement with patient care than the job titles for which compensation is limited (for example, administrator, activities director).

Chain Owners Receive Less Compensation Per Home, But More Compensation in Total

The auditors determined the type of work performed and the salary received for each of the 76 owner-employees in their 40-home sample. The analysis indicates that in the movement from non-chain to large chain operations, two things happen: the likelihood that the services provided by the owner will be consultative or executive in nature increases, and the actual salary per home received by the owner decreases.

The low payments to owners of chain homes is due to the fact that these owners allocate only a small percent of their time to each individual home. To determine the total salaries received by each owner, the auditors identified all homes from which an individual owner was receiving compensation. Results of the total salary analysis, presented in the following table, clearly show the benefit of multiple home ownership.

		Percent of Owners			
Type of Ownership	Number of Owners	Subject to Owner-Spouse Limit	Not Subject to Owner-Spouse Limit	Average Salary Received Per Home	Average Salary From All Homes
Non-Chain	51	49%	51%	$ 14,381	$ 14,381
Small Chain	17	29	71	8,688	34,910
Large Chain	8	-0-	100	4,253	69,661

The fact that chain ownership results in higher total allowable owner's compensation for work which is less likely to involve direct patient involvement is one concern which is illustrated by the analysis above. A second and related concern became apparent to the auditors during the course of that analysis: because owner compensation is frequently included on a number of separate facility reports, and because no summary report is required, it is sometimes difficult to determine how much compensation an individual owner employee is reporting. If the reporting years of the various facilities from which an owner receives compensation are different, it may be possible for them to receive compensation for more than 100 percent of their time, or for working in more than one place at the same time.

Non-Profit Facilities and Chains With Non-Owner Executives Can Also Operate Independently of Many Salary Controls

The owner-administrator limit is applied to all facilities but impacts most strongly on homes that pay owner's compensation. Of the $580,159 in administrative and owner salaries that was disallowed through this limit,

$461,637 was from homes paying owner's compensation. Although they represent only 48 percent of the homes, they are responsible for over 80 percent of the disallowed salaries.

Non-profit facilities and large chains are less frequently subject to reductions caused by the owner-administrator limit for two reasons. First, although non-profit facilities have higher total administrative salaries, their costs are higher for "other administrative salaries," like secretaries and bookkeepers, which are not included in the computation of the limit. Second, large chains and some non-profit facilities also employ consultants, central office administrators, and executives, but they are not likely to be owners. As a result, their salary costs are included in central office costs and are not subjected to the limit. Although salary costs are not always clearly identified in central office costs, it is apparent from those instances which can be analyzed that salary expenses can exceed 50 percent of the central office costs reported.

Under current regulations, no attempt is made to control the level of non-owner executives' salaries. Although those salaries may be as high as $400,000 for large for-profit chains, the amount of salary costs spread to individual facilities would be very small, and may be compensated for by economies of centralization. The incentive for overall cost reduction may or may not apply to non-profit providers, however, and as a result, their local administrative salaries do not decrease as central office costs, including executive salaries, increase.

There are two concerns which relate to the administrative and executive salaries which are included in central office costs: First, regulations require that central office costs be "patient-related" and for services "normally available in the nursing home facility." It is difficult to determine if central office executives and administrative staff meet that requirement. Second, providers with highly centralized operations may be able to reduce their local administrative salaries. This would tend to lower the owner-administrator limit, and adversely affect facilities which have entirely local staff.

To address all of the concerns described so far about salary limitations, the intent of the Department's limitations should be clarified, and procedures should be revised accordingly. If the intent is to restrict the level of owner compensation to that of others who perform similar work, limits should be established for all types of work performed by owners (and thus, for all job titles). If the intent is to limit the total amount of reimbursable compensation received by owners, procedures should be established which enable the Department to identify the total amount of that compensation when it is spread among several facilities and types of work. If the intent is to control the total amount per facility which is allowable for owner and administrator salaries, it may be necessary to take central office administrative salaries into account.

Central Office Costs Are Not Effectively Monitored Under the Current System

Most providers involved in administering more than one adult care home choose to centralize at least some part of their administrative operation.

Because reimbursement rates are established on a facility basis, providers must allocate the cost of the central office to their various homes.

The Department of Social and Rehabilitation Services has developed some basic guidelines for providers who are reporting central office costs. K.A.R. 30-10-13(13) provides that all expenses reported as central office costs shall be allocated from the actual patient-related costs of the central office and shall be allowable only to the extent that the central office is providing service normally available in the nursing home facility. Additional regulations spell out specific types of costs which are allowed or disallowed. However, providers have considerable freedom to decide what parts of their business to centralize and how to allocate those costs. Providers are required, when audited by the Department, to document their central office expenditures and the method of allocation used.

In order to examine central office costs, the auditors identified the facilities with reported costs in that item. That review showed that 99 providers had allowable central office costs. The total allowed central office expense was just under $2 million. On a per-patient-day basis, it averaged $.83. Facilities with central office costs included 63 for-profits (40 percent of all for-profits), with an average per-patient-day cost of $.85 for central office costs, and 36 non-profits (35 percent of the 102 non-profits), with an average per-patient-day cost of $.81 for that item.

Central Office Costs Are Rising

One reason that central office costs are important to monitor is that they have been rising rapidly as adult care homes have been changing hands. The auditors reviewed the administrative costs of all 57 intermediate care facilities which changed providers between March 1982 and November 1983. The results of that comparison are shown below.

Average Costs for Facilities Which Changed Providers

Item	Before Change	After Change	Percent Change
Owner Compensation	$ 9,802	$ 4,256	-56.6
Other Salary Expense	24,710	29,087	+17.7
Owner Administrator Limit	(2,124)	(1,716)	-19.2
Central Office Costs	8,298	21,320	+156.9
Other Administrative Costs	32,126	30,497	-5.1
Total	$ 72,812	$ 83,444	+14.6

As the table shows, when providers changed, administrative costs increased an average of 14.6 percent, to $83,444 a year. This is substantially less than the 47 percent increase which occurred in the property cost center. However, the nature of the change which occurred is significant. Many of these homes became part of chains. Seventeen homes went from non-chain to chain ownership, and 27 changed from in-State to out-of-State ownership. With these changes, central office costs increased substantially, moving the average for the 57 homes from just under $8,300 to more than $21,000--an increase of 156.9 percent. Seventeen homes reported central office costs for the first time after they changed hands; within this group, total administrative costs rose an average of 26 percent. Thus, if administrative costs are to be adequately controlled in the future, it will be necessary to give more attention to monitoring and auditing central office costs.

One argument advanced in favor of centralized operations is that centralization can bring about greater efficiency and lower costs. Centralized purchasing, for example, can mean that supplies and materials can be bought at lower cost. To see if there was an indication that this point might be correct, the auditors divided the 258 homes with historical costs into those with central office costs and those without them. They then further divided the groups into for-profit and non-profit categories. The table below shows the average cost in each of the four cost centers for these various groups.

Average Costs Per Patient Day for Home With Central Office Costs and Homes Without

	For-Profit			Non-Profit	
Cost Center	With Central Office Cost (63)	Without Central Office Cost (93)	Mean (258)	With Central Office Cost (36)	Without Central Office Cost (66)
Administration	$ 2.78	$ 2.84	$ 2.96	$ 4.07	$ 2.67
Property	5.05	5.11	4.90	4.90	4.45
Room and Board	7.08	7.13	7.49	8.19	7.99
Health Care	10.31	10.09	11.01	12.69	12.06
Total Cost	$25.22	$25.17	$26.36	$29.85	$27.17

As the table shows, the average in the administrative cost center does not vary much between for-profit homes with central office costs and for-profit homes without them. The same is not true for non-profit homes. Non-profit homes reporting central office costs had an average patient-day cost of $4.07 in the administrative cost center, while those without central office costs had an average patient-day cost of $2.67.

The same patterns hold true in the other cost centers. For-profit homes have about the same average costs for property, room and board, and health care, regardless of whether they have central office costs or not. Non-profit homes with central office costs have higher costs in every cost center than non-profit homes without central office costs.

The auditors' findings thus lend no immediate support to the argument that centralized administration brings about more economical or more efficient operation. This possibility still cannot be ruled out, because at this point in their review, the auditors have not yet been able to assess the level of care these homes provide. In other words, the higher health care and room and board costs at homes with central office costs may reflect higher staffing or service levels. Nevertheless, these findings illustrate one clear point: in central office costs, the State needs to know what it is getting for its money.

Problems in the Current Reimbursement System Limit the Ability to Monitor Central Office Costs

The auditors found several problems with the reimbursement system's tracking of central office costs. Each of them is discussed below.

Chains vary widely in the kinds of expenses they report as central office costs. The auditors found great differences between homes in the kinds of central office costs they report to the Department of Social and Rehabilitation Services. Under Department guidelines, services performed by central offices can include one or any combination of the items generally associated with administrative costs, as well as centralized coverage of insurance, debt, payroll and employee benefits, provision of training and supervision, maintenance services, centralized purchasing, and in some cases, other costs. The costs reported for central offices also may include executive salaries and the operating costs of the office.

The homes have thus been given wide latitude to interpret what constitutes central office costs, and they have provided many different responses. Consequently, what one chain of homes reports as a central office cost may be reported in a far different way by another chain. Although most costs associated with centralized operations appear to be eventually placed somewhere in the administration cost center, some are not. At least two large chains spread some central office costs to other cost centers. For one of those chains, the amount placed in administration is only about 70 percent of the total.

Chains vary widely in the way they allocate central office costs among homes. Some chains keep central records on a per-facility basis and allocate the direct costs of specific items to the appropriate line of that facility's cost report. In other cases, providers lump the cost of certain services together for all facilities, then allocate the total among their various facilities on the basis of bed size, gross revenues, total in-patient days, or some similar measure. They may also use a combination of these methods, such as directing actual costs to line items for some things, and allocating others on a formula basis. When such a variety of methods is used, the comparability of cost data with other facilities is lost.

Here are three examples of the wide differences the auditors found in the way chains categorize their central office costs and allocate them among homes:

Chain A Maintains central office accounts for operations, finance, administration, fund development, public relations, and executives. Costs of the administration, fund development and public relations activities are not allocated to individual homes. The remaining costs are divided between the total number of homes, and within each home, the costs for the portion of those units which are not Medicaid beds are then removed. What is left remains on the central office cost line in administration.

Chain B Allocates most central office administrative costs on the basis of inpatient days per home. However, this chain records costs for each home separately for supplies, phone, travel, miscellaneous administration, accounting, advertising, and legal costs, and directs those amounts to facility line items.

Chain C Keeps central office cost records in categories comparable to those on required cost reports and removes non-allowable categories. The remaining costs are allocated to individual facilities on the basis of facility gross revenue as a percentage of total revenue of the corporation. Direct wages are placed on the owner compensation lines, and the remaining allocated amounts are then distributed to salary lines in health care, dietary, maintenance, and administration based on the proportion of salary costs of central office staff who work in those areas.

The reasonableness of central office costs is difficult to assess. Assessing the reasonableness of central office costs is of concern because of the opportunities these costs provide to increase financial gain by carrying out non-arms-length transactions, by retaining gains achieved through efficiency rather than passing them through, by removing funds from the facility to enhance the corporate headquarters' operation, or by paying high executive salaries or other benefits. It is particularly difficult to assess the reasonableness of central office costs of large out-of-State chains, due to the difficulty of auditing the corporate headquarters office.

According to a 1979 audit by the United States General Accounting Office, most states were being overcharged for central office costs by large chains. That audit recommended that the Department of Health and Human Resources' Health Care Financing Administration take additional initiative for conducting audits of corporate headquarters, or for coordinating such audits by the states where headquarters are located and disseminating the results. However, such initiative has not been taken, and efforts by the states to coordinate audits and to disseminate results have been unsatisfactory. Therefore, States are still faced with the difficult problem of auditing and monitoring out-of-State central office costs from afar.

Steps Should Be Taken to Improve Monitoring and Control Administrative Costs

So far in this report, it has been shown that the guidelines and procedures under the current reimbursement system allow costs to be interpreted and reported in a variety of ways. From Legislative Post Audit's viewpoint, this ambiguity in the system makes it difficult to monitor costs, evaluate them, and provide effective controls over them. It also makes it possible for providers to take advantage of the system. The boxed example on the next page demonstrates how this can be done. In this case, a provider has been able to negate the controls supposedly present in the system.

It also became clear to Legislative Post Audit's auditors that the current system for controlling administrative costs has not kept pace with the rapid growth of chain ownership in the industry. Many of the controls and checks used by the Department of Social and Rehabilitation Services may have worked fairly well when most providers had only one home, but they are inadequate for monitoring costs in an environment of chain ownership. The sections that follow discuss the kinds of steps the Department needs to take to resolve the problems.

Changes Needed in Administrative Cost Controls: An Example

An individual owns two adult care homes in Kansas that are about 130 miles apart. One has 50 beds; the other has slightly more than 100. On his cost report for the 50-bed home, the owner listed himself as a full-time Administrator at a salary of $19,857. On his cost report for the other home, he listed himself as President and General Manager at a salary of $20,940 for quarter-time work. He also listed himself as the sole owner of a corporation providing services to the two homes and reported $20,330 in central office costs. A Department of Social and Rehabilitation Services auditor who examined one of the homes noted that the owner ran this central office from his house and had no other central office employees.

A field audit of the 50-bed home resulted in the disallowance of $900 in central office costs. About $300 of that amount was deducted from allowable costs for the 50-bed home, but no reduction was made for the other home.

This example points out several problems in the current system:

1. Salary controls are often not very effective for persons involved with more than one home. In this case, the person was even able to receive more than full-time pay. It is doubtful that the two cost reports were checked against each other to determine the total time the person reported, because the reports were submitted at different times and covered slightly different reporting periods. (One period ended two months before the other--not different enough to explain the 125 percent of time reported.)

2. Salary limits are often inequitable. The person's salary as a full-time Administrator was close to the established limit of $22,032. There is no salary limit, however, for a position with the title of President or General Manager. Thus, the person was able to earn more money working quarter-time with that title than working full-time with the title of Administrator.

3. Reviews of homes in a chain of two or more homes are not always coordinated. When costs are disallowed, they are apportioned to individual homes if more than one home is involved. However, deductions against the other homes are often not made.

Policies and Guidelines for the Reporting of Administrative Costs Need to Be Sharpened

Many of the current policies and guidelines for reporting administrative costs can be subject to great interpretation, and providers are relatively free to move costs around. In some cases, providers may be able to benefit from the flexibility they are allowed by placing costs in other cost centers where they are below the limit. If they are above the limit in administration, this can increase their total reimbursement. In so doing, they also benefit from moving costs out of administration, because they may be able to increase their efficiency payment. In addition, they may place compensation for administrative duties in central office costs when such compensation would otherwise be subject to limitations.

The Department is aware that these kinds of manipulations can occur, and its audit section spends a considerable amount of time reviewing cost reports and making adjustments. Legislative Post Audit found, however, that the guidelines they must check against are often not consistently interpreted.

An example of this kind of problem is the handling of workmens' compensation insurance. The cost report instructions indicate that workmens' compensation is considered to be insurance and is to be included with other insurance costs on the insurance line in administration. However, the auditors' review showed that at least one large chain was spreading workmens' compensation to the employee benefit lines in other cost centers, thereby reducing total administrative costs. Such inconsistencies jeopardize the controls and the legitimate incentives built into the system.

Substantial audit resources are also spent reviewing such items as travel and entertainment expenses, and removing costs for items which are not considered to be related to patient care. However, neither the regulations nor the cost report instructions clearly state what travel and entertainment expenses are directly related to patient care. Providing clearer guidelines, such as a list of costs which are allowable and not allowable, might increase the level of compliance in this area.

Another set of policies apparently in need of review pertains to owners' salaries. As an earlier section of this report pointed out, it is possible to avoid many of the salary limitations by using a job title that is not covered under the current policy. It is also possible for someone involved with several homes to obtain much higher levels of compensation than someone who owns or operates only one home. The current system was designed more to control single ownership, and its shortcomings may unintentionally offer strong incentives for chain ownership.

To avoid such inconsistencies, prevent the inappropriate placement of administrative costs in other cost centers, and decrease the incidence of reporting of non-patient care related expenses, the Department of Social and Rehabilitation Services needs to review and clarify its policies and guidelines. If exceptions or changes are made, all providers should be informed.

More Detailed Information About Centralized Administrative Activities and Their Costs Needs to Be Obtained

Legislative Post Audit found it difficult to determine whether the amount of central office costs being allocated to a particular home is reasonable. It is particularly difficult to ascertain if costs for executive salaries and operating costs of the central office itself are reasonable, and contibute to patient care.

Kansas regulations provide that central office costs shall not be recognized or allowed to the extent that they are found unreasonably in excess of similar adult care homes in the program. However, this regulation can be difficult to enforce unless the specific content of the central office costs being allocated is known. Cost report instructions require that providers who report central office costs provide a statement showing the total central office cost and the method of cost allocation to the particular facilities. However, in reviewing central office files, it was apparent that the level of documentation of central office cost content varied considerably, especially for chain-affiliated facilities which had not recently been audited. At least one large in-State chain had furnished a report of central office costs which included items as detailed as facility cost reports, but reports from several others including large out-of-state chains were unclear. In addition, most small chains did not have central office files, and the files of homes with projected rates contained very little information.

Although additional documentation is required when field audits and desk reviews are done, audits of central office expenses are generally only done in association with audits of individual facilities. Within these audits, specific items are questioned, and some exceptions on the basis of reasonableness do result. However, a clear picture of the total central office operation does not necesssarily emerge. To obtain a clearer picture of what centralized administrative functions are being performed and their expense to the State, it would be necessary to require chains to provide a more detailed annual report. This report would contain a more detailed description of their central office costs, their content, and how those costs are allocated to facility cost reports. Requiring such a report could simplify audit procedures, make it easier to identify costs which seem to be unusually high or low, and assure that allocations are handled similarly between related facilities.

Audits and Other Reviews Need to Be Restructured to Take Chain Ownership More Fully Into Account

When homes submit their cost reports, the Department's audit section subjects the report, at a minimum, to a desk review. Each year, about 15 percent of the homes also receive a field audit. These audits and reviews are more effective for non-chain homes than for chain homes. This is because the reviews are generally done on a case-by-case basis, with little cross-referencing to cost reports of other homes in a chain. The result is an increased possibility that excessive or unallowed costs can be claimed, approved, and paid for.

This possibility is especially great for central office costs. Central office costs are generally allocated among various facilities. However, when an exception is taken to a central office expenditure during an audit of a home, only the portion of that cost which relates to the facility being audited is disallowed. Although related facilities are audited together as often as possible, it is not possible to audit all facilities in large chains. The more facilities that costs are allocated among, and the larger the central office costs in relation to other administrative costs, the greater the chances that the provider can obtain reimbursement for disallowable costs. This undermines the effectiveness of the audit, because providers have an incentive to keep putting in costs they know are not allowable, and because auditors have to devote considerable time and energy to proving an exception and allocating the amounts between related facilities, only to recover only a portion of the disallowable total.

It should be noted that the Department is operating with some clear drawbacks in this area. One problem is that related homes are not always required to submit their cost reports on the basis of the same beginning and ending date for a fiscal year. By closing their years in different months, homes within a chain can make it difficult for regulators to obtain a clear picture of the chain's financial operations. Limited audit capabilities and the lack of information about out-of-State firms also hamper the Department's efforts. Nevertheless, it would appear that more can be done. Possible steps include requiring chains to submit all cost reports for their homes on the basis of the same fiscal year, establishing better systems for coordinating reviews of chain homes, and tying audit exceptions noted in one home to others in the chain.

Recommendations

1. The Department of Social and Rehabilitation Services should undertake a thorough and systematic review of its policies and guidelines for administrative costs. Whenever possible, the Department should revise these guidelines to make them more specific and to make the reporting of administrative costs more uniform.

2. The Department of Social and Rehabilitation Services should clarify its intent behind reimbursement limits on owner's compensation and revise its policies, guidelines, and procedures to more effectively carry out that intent. For example, if its intent is to limit the total amount of reimbursable compensation, the Department should establish procedures to identify the total amount of compensation when it is spread among several facilities and types of work.

3. The Department of Social and Rehabilitation Services should consider requiring a separate annual report for adult care home chains. This report, which chains would be required to submit along with cost reports for individual homes, would contain detailed information on central office costs and would serve as the basis for determining how much of these costs should be allowed.

4. The Department of Social and Rehabilitation Services should consider requiring all adult care homes with common owner-

ship to file annual cost reports with the same ending date for the fiscal year. For homes with projected rates, the Department should develop a means by which costs for newly acquired homes can be related to the costs reported for existing homes in a chain.

5. The Department of Social and Rehabilitation Services should revise its audit and review system to provide for more cross-checking between homes in the same chain. Such cross-checking could include coordinated reviews of all homes in a chain and tying audit exceptions noted at one home to others in the chain.

6. The State of Kansas, perhaps through the auspices of the Council of State Governments, the Advisory Commission on Intergovernmental Relations, or the National Conference of State Legislatures, or other appropriate organizations, should consider urging the development of comprehensive audits of nursing home chains that operate in more than one state.

APPENDIX A

Comparative Tables of Administrative Costs

In requesting this series of audits on nursing home costs, legislators asked the auditors to compare costs between various kinds of homes. The auditors divided homes into the following basic categories:

1. For-profit homes

    a. Non-chain homes (one home only)
    b. Small chains (2-5 homes)
    c. Large chains (6 homes or more)

2. Non-profit homes

    a. Government homes
    b. Church homes
    c. Other (non-profit entities independent of a church or governmental unit)

When the auditors analyzed property costs in the earlier audit, they were able to make meaningful comparisons between groups because the information was reported quite uniformly from home to home. In the administrative cost center, however, this is not the case. Homes vary greatly in the ways they handle administrative expenditures and report administrative costs. Some homes, for example, report part of their administrative costs in other cost centers, and the mechanics of the administrative cost center are such that some non-administrative expenses are sometimes moved into it. As a result, it is difficult to determine if most differences between categories of homes are the result of actual variation or the result of these shifts in reporting.

The tables on the following pages present the results of the group-by-group comparisons. Notes accompanying the tables explain the main problems the auditors found in analyzing the results.

Table 1

Profit and Non-Profit Groups

Line Item	Mean for All Homes (258)	Non-Profit Homes (102)	For-Profit Homes (156)
Administrator's Salary	$ .71	$ .93	$ .57
Co-Administrator's Salary	.03	.06	.02
Other Administrative Salaries	.29	.45	.19
Employee Benefits	.14	.14	.13
Office Supplies and Printing	.11	.14	.10
Management Consulting Fees	.07	.05	.08
Owner's Compensation	.32	.00	.54
Allocated Central Office Costs	.32	.29	.34
Telephone and Communications	.12	.11	.12
Travel and Entertainment	.10	.08	.11
Advertising	.04	.03	.05
Licenses and Dues	.05	.05	.05
Legal and Accounting	.13	.13	.13
Insurance	.44	.57	.36
Interest	.14	.12	.14
Miscellaneous	.05	.07	.04
Owner/Administrator Limit	-.10	-.06	-.14
Total	$2.96	$ 3.16	$ 2.82

The administrative costs of for-profit and non-profit providers differ significantly in the amount and composition of salaries and in their susceptibility to the owner-administrator limit. Although the for-profit facilities have an average of 54¢ per patient day in owner compensation, that is offset by higher non-profit salaries for administrators ($.36), co-administrators ($.04) and other administrators ($.26). Since the "other administrative salaries" are not subject to the owner-administrator limit, the non-profit facilities lose $.08 less to that limit on the average.

Although office supplies and printing costs differ significantly, that difference is the product of unusually high costs for three non-profit homes, and should be disregarded. Travel and entertainment and advertising also differ significantly. The total amount of money involved is small. However, travel and entertainment do provide an opportunity for abuse, and considerable audit attention is paid to this item.

Although insurance costs vary substantially, interpretation of that difference is confounded by reporting differences. Workmens' compensation, in particular, is reported by some providers on employee benefits lines in other cost centers as well as administration. Therefore, although the insurance costs of for-profit providers may be less than those of non-profit providers, it is not possible to be certain that they are.

In sum, the significant difference in administrative costs between for-profit and non-profit providers is due to differences in administrative salary costs and in insurance costs. Other administrative costs vary little between the two groups.

Both groups report central office costs, and the amounts do not differ significantly: \$.29 for the non-profit facilities on average, and \$.34 for the for-profit providers. Those costs are discussed in greater detail in the body of the report. However, it is important to note that variations in administration and reporting of centralized costs may affect the administrative costs shown here.

Table 2

Profit and Non-Profit Chain and Non-Chain

Line Item	Non-Profit Non-Chain (74)	Non-Profit Large Chain (25)	For-Profit Non-Chain (77)	For-Profit Small Chain (45)	For-Profit Large Chain (34)
Administrator's Salary	$ .90	$1.02	$ .44	$ .70	$ .67
Co-Administrator's Salary	.08	.00	.02	.02	.03
Other Administrative Salaries	.42	.59	.21	.17	.16
Employee Benefits	.16	.11	.12	.14	.15
Office Supplies and Printing	.11	.10	.10	.10	.09
Management Consulting Fees	.05	.00	.12	.07	.00
Owner's Compensation	.00	.00	.67	.60	.14
Allocated Central Office Costs	.10	.84	.06	.38	.93
Telephone and Communications	.10	.13	.12	.12	.12
Travel and Entertainment	.08	.08	.13	.12	.06
Advertising	.03	.05	.05	.05	.04
Licenses and Dues	.05	.06	.05	.04	.03
Legal and Accounting	.16	.06	.17	.13	.04
Insurance	.51	.76	.45	.39	.12
Interest	.06	.29	.18	.18	.01
Miscellaneous	.06	.10	.04	.03	.04
Owner/Administrator Limit	-.05	-.08	-.11	-.26	-.01
Total	$2.82	$4.12	$2.82	$2.98	$2.62

Total administrative costs reported by non-chain providers in the for-profit and non-profit sectors are the same: $2.82. However, within this total, the non-profit homes have slightly higher salary costs and lower costs for other items. In other items, the primary difference is in interest expense, which is three times as great for the non-chain, for-profit group ($.18 per patient day, compared to $.06).

Figures for small chain, non-profit providers are not reported, since there were only three providers in this group.

Small chain, for-profit providers have higher administrative salary costs than non-chain for-profit providers, and they lose more to the owner-administrator limit. Their higher central office costs are only partially offset by reductions in other administrative costs.

Differences between large for-profit and large non-profit chains are a primary source of the significant difference between the non-profit and for-profit groups. The most marked difference is the substantially higher administrative salary costs of the non-profit large chains. Both groups have relatively high central office costs, but the non-profit providers have no apparent offsetting reductions in administrative line items.

Comparison of the costs of the three types of for-profit providers would indicate that large-for-profit chains may be able to decrease their costs for legal and accounting services, interest, travel and entertainment, and management consultant fees. However, to the extent that expenses have been centralized and spread to other cost centers, those economies may be overstated.

As noted earlier, the differences between various groups' insurance costs are confounded by reporting differences.

Table 3

Non-Profit Groups

Line Item	Church-Related (27)	Government-Related (25)	Other (50)
Administrator's Salary	$ .82	$ 1.04	$ .94
Co-Administrator's Salary	.08	.05	.05
Other Administrative Salaries	.65	.37	.39
Employee Benefits	.14	.20	.12
Office Supplies and Printing	.13	.12	.15
Management Consulting Fees	.03	.04	.06
Owner's Compensation	.00	.00	.00
Allocated Central Office Costs	.51	.06	.28
Telephone and Communications	.12	.12	.10
Travel and Entertainment	.08	.07	.08
Advertising	.02	.02	.05
Licenses and Dues	.05	.05	.05
Legal and Accounting	.15	.16	.11
Insurance	.46	.55	.63
Interest	.29	.02	.09
Miscellaneous	.07	.04	.08
Owner/Administrator Limit	-.03	-.07	-.06
Total	$ 3.55	$ 2.84	$3.11

Administrative costs of the church-related, government-related, and "other" non-profit facilities differ in several salary items. The total administrative costs are highest for church-related facilities, and lowest for the "other" group. Administrators' salary costs and employee benefits are greater for the government-related facilities.

In addition, these groups differ significantly in central office costs and interest, with church-related facilities' costs highest in each of these areas and government-related facilities the lowest.

Table 4

In-State and Out-of-State Providers

Line Item	In-State Providers (216)	Out-of-State Providers (42)
Administrator's Salary	$ .68	$ .90
Co-Administrator's Salary	.04	.01
Other Administrative Salaries	.28	.37
Employee Benefits	.14	.14
Office Supplies and Printing	.12	.09
Management Consulting Fees	.06	.09
Owner's Compensation	.34	.26
Allocated Central Office Costs	.27	.58
Telephone and Communications	.11	.13
Travel and Entertainment	.10	.09
Advertising	.04	.06
Licenses and Dues	.05	.05
Legal and Accounting	.13	.11
Insurance	.41	.59
Interest	.14	.12
Miscellaneous	.04	.05
Owner/Administrator Limit	-.09	-.19
Total	$ 2.86	$ 3.45

The administrative costs reported by out-of-state providers are significantly higher than those reported by in-state providers. However, several of the apparent differences between those groups are affected by the number of facilities within each group reporting those expenses.

A higher proportion of out-of-state providers report administrator salary costs, and their cost per patient day for that item is higher. Administrator salary expense averaged $.83 per patient day for the 175 in-state facilities reporting costs for that item, compared to $.84 per patient day for the 40 out-of-state facilities with administrator salary costs.

Seventy-eight percent of out-of-state providers had central office costs, compared to 31 percent of the in-state providers. When the average costs are adjusted for that difference, the central office costs of out-of-state providers are lower than for in-State providers. The 66 in-state providers' average central office costs were $.89 per patient day, compared to $.74 per patient day for the 33 out-of-state providers reporting that expense.

The advertising costs reported were higher primarily for out-of-state providers. In addition, only 86 percent of the in-State providers reported costs for that item.

Insurance costs are reported by almost all providers; however, the difference shown for that item is exaggerated by reporting variations in workmens' compensation costs.

APPENDIX B

Efficiency Payments, a Bonus for Keeping Administrative Costs Down, Go More to For-Profit Homes than Non-Profit Homes, but the Incentive Effect May Be Limited

The efficiency factor deserves comment in this report because it relates most heavily to administrative costs. It is designed to serve as a cost containment factor for the administration and property cost centers. It is, in effect, a bonus for keeping costs down in these areas. The costs in the room and board and health care cost centers are not included in the computation because of concern that rewarding cost containment on these areas might jeopardize the direct care of residents.

The efficiency factor is also intended to serve as an equalizer between efficient and inefficient operations. Without the factor, inefficient providers' higher costs could cause them to be rewarded with a higher rate, while the efficient operators would be penalized with a lower rate based on their lower costs.

The amount of the efficiency factor is determined by combining the costs in the administration cost center with the plant operating costs in the property cost center and dividing by the number of inpatient days. These per diem costs are then arrayed and the following percentiles and daily allowances are established.

Percentile Rank of Facilities	Daily Allowance
55 and under	$ .50
56 to 65	.40
66 to 75	.30
76 to 85	.20
86 to 95	.10
96 to 100	0

Under this procedure, 94 percent of the facilities received an efficiency factor payment. In fiscal year 1983, the average amount per patient day of that payment was $.32.

The auditors compared the average efficiency payment per patient day received by various types of facilities. The results of that analysis showed that 98 percent of all for-profit providers received an efficiency payment, and the average payment for that group was $.34. By comparison, 88 percent of the non-profit providers received the efficiency factor payment, and the average amount of the payment received by those non-profit homes was $.28. As the following table shows, large chain for-profit facilities received the highest average payment.

Type of Facility	Number Receiving Payment	Average Payment Amount
All For-Profit Homes	153	$ .34
Non-Chain	75	.34
Small Chain	44	.29
Large Chain	34	.40
All Non-Profit Homes	90	$ .28
Church-Related	20	.28
Government-Related	22	.28
Other	48	.29

The auditors also determined which types of providers were most likely to receive the maximum efficiency payment. That review showed that the $.50 maximum was received by 41 percent of all for-profit providers, compared to 21 percent of the non-profit providers. The maximum was received by 38 percent of all in-State providers, compared to seven percent of the out-of-State providers.

There are several concerns which should be noted about the efficiency factor, although specific recommendations about possible changes will be deferred until the remaining cost centers have been examined.

--As noted in the property cost audit, operating costs of the physical plant vary relatively little between various types of facilities. Therefore, including them in the efficiency factor may do little to discriminate between facilities. Extreme reductions in these operating costs, which include utilities and maintenance, could be detrimental to residents.

--The administrative costs upon which the efficiency factor is based are not fully comparable. Because of the kinds of reporting variations described in this report, the efficiency factor can be a reward for skillful cost placement, rather than cost containment.

--The maximum efficiency factor payment has remained constant since its introduction in 1978. Meanwhile the maximum daily reimbursement rate for intermediate care facilities has increased from $19.82 to $28.16. Thus, efficiency factor payments now represent a lower potential bonus than they originally did--1.8 percent of the current limit, compared with 2.5 percent of the limit in 1978.

APPENDIX C

Agency Response

STATE OF KANSAS
JOHN CARLIN, GOVERNOR

STATE DEPARTMENT OF SOCIAL AND REHABILITATION SERVICES

INCOME MAINTENANCE AND
MEDICAL SERVICES

ROBERT C. HARDER, SECRETARY

STATE OFFICE BUILDING
TOPEKA, KANSAS 66612

March 12, 1984

Mr Meredith Williams
Legislative Post Auditor
301 Mills Building
Topeka, Kansas 66603

Dear Mr Williams:

We have reviewed your report on the Administrative cost center of the Adult Care Home reimbursement system and have the following comments.

First, in the interest of accuracy, we would like to make some editorial changes. We recognize the complexity of the system concerning both owner/spouse and owner/administrator compensation limitations and realize that perhaps the explanation given the auditors was not as clear as it should have been. In addition, the subject of owner compensation is further complicated by the accounting and tax treatment afforded the various types of business organizations. This has made it very difficult to draft regulations, policies and procedures that are fair and equitable to the large and small facilities, the for-profit and non profit organizations, the chain and the non chain as well as the church related and city-county government operated facilities. This has also been the subject matter of many fair hearing appeals as well as litigation in the courts.

The last paragraph on page two of the report needs an editorial change. It is possible for more than 75 percent of the facilities to be under the limit and receive full reimbursement for their administrative costs. This can happen when more than one provider has the same per diem cost which happens to be the same amount as the limit.

The limits shown in the second paragraph under "Total Allowable Owner's Compensation Limit" on page six should be changed to $22,250 and $44,501 repectively. The figures shown represent the number of inpatient days at the 96% occupancy level and should be multipied by the owner/administrative per diem cost limit of $1.27 per day for facilities with 50 or more beds.

The third paragraph on page 7, in which you indicate that 60 percent of the 76 owners studied had job titles which placed them outside the purview of the owner/spouse salary limit is a cause for some concern. This should not happen. No limits have been established for executive or consultative job titles primarily because very few, if any, non owner employees perform these services even on a part time basis. However, these salaries should be limited to the amount for the job title in the schedule which most closely fits the duties performed by the consultant. In most cases, a management consultant would be limited to the salary limit of an administrator or co-administrator. This same theory should apply to chain operated homes as well. The example described in the last paragraph in the right hand column of page 8 should not happen. The mangement consultant should be limited to the salary limit for the administrator or co-administrator depending on the description of duties of both the consultant and the administrator in the home. It is true, particulary in the large chain operated facilities, that the consultant salaries will be spread over so many patient days for all the facilities that the amount allocated to a specific facility will not cause that facility to be over the limit. This is a cause for concern that the owners of a small chain or non chain facility receive fair and equitable treatment.

The first example in the box on page 8 implies that the owners would be limited to the owner/spouse salary limitation for the Administrator and Director of Nursing. This would only be true if the level of occupancy was at or below the minimum occupancy level of 85 % of the total bed days available. Any level above 86.4% in this example would permit some of salaries in excess of the owner/spouse limitation to be allowable under the owner/administrator compensation limitation. At the 100% occupancy level, an additional $6,323 of the excess owner/spouse salary would be allowed. In the second example, the part time owner should have been limited as previously described. This appears to be an error on our part and will be investigated as will the other examples cited in your report. There is some concern about which records your auditors used in making their review. Quite often our auditors will request additional information from the providers either by letter or by telephone. This information would usually be kept in the files of the Audit Section and unless the Division of Medical Programs was copied, it would not be found in their files.

The concern mentioned above also applies to the reporting of owner salaries as a part of central office costs of chain operated facilities. Documentation of central office costs is required and a schedule showing the allocation to the individual facilities is a part of that documentation. It is not required that the provider furnish a copy of this schedule for each facility involved. As a result, this schedule may be filed in a separate central office file or in one of the provider files. Owners are required to account for their time and the sum of various percentage allocations should not exceed 100%. They cannot spend 100% of their time at each of two or more facilities.

We concur with recommendation number one. However, this is much easier said than done. There are approximately 390 providers in the program, most of whom hire professional accountants or consultants to insure that they take advantage of every legitimate opportunity possible to maximize their allowable costs for rate setting purposes. Considerable time has been spent over the past ten years auditing and recouping considerable sums of money from those providers who are not quite as careful about the accuracy of their reporting.

We concur with recommendation number two. However, as previously mentioned, the reporting procedure is already in place to limit the total amount of reimbursable compensation for owners. It appears that we may not be following it on a consistant basis.

The annual report suggested in recommendation number three is, again, a currently required report at least in part. The allocation of central office costs between facilities and the methodology for the allocation is rquired. The detail may not be uniformly reported by each provider but this can be clarified and if necessary a field audit scheduled to review the documentation for any expense item. We concur with the need to continually revise procedures and polcies to obtain more uniform reporting that will permit fair and equitable treatment for all concerned.

We basically concur with recommendation number four. This is already required by the administrative regulations except in the case of projected cost reports. We are aware of the one case mentioned in the exit conference and will require that provider to change their reporting procedure. We are wondering if perhaps their is not some confusion in regard to projected cost reports. A new or different provider is required to file a projected cost report for the first twelve months of operation and a histroical cost report at the end of that period. The transition to filing historical cost reports at the end of the provider's fical year begins in the second year. This could result in a period of 23 months in which the reporting period and fiscal year are different. Due to the large number of providers currently on projection, this could easily result in confusion regarding this requirement.

We concur with recommendation number five. Desk reviews of chain organizations are usually assigned to the same auditor or small group of auditors in the same office and reviewed by the appropriate supervisor. All field audits of chain organizations are conducted by a team of auditors and reviewed by their supervisor. The exception to this would again be the projected cost reports. However, if the auditor suspects a provider is shuffling expenses between facilities the regulations provide the authority to review all records including those of facilities on projection.

We concur with recommendation number six. This would probably prove beneficial to Kansas since only a few chain organizations are headquartered in the state. However, there apparently is some reluctance on the part of other states since this would be an expensive proposition in both manpower and money.

Sincerely,

Robert C Harder

Robert C Harder
Secretary

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