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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman, Select Committee On Aging House Of Representatives

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RELEASED

Audit Of Medicaid Costs Reported By Autumn Hills Convalescent Centers, Inc., Houston, Texas

Although the central office costs reported by Autumn Hills for 1978 and 1980 included significant amounts of unallowable and questionable costs, under Texas' rate-setting methodology these amounts had no effect on what Autumn Hills and other homes in the State were or will be paid. GAO believes the State should modify its approach to auditing nursing homes to focus on those facilities whose reported costs are most likely to have the greatest impact on the payment rates.

One Autumn Hills home has had a history of inadequate nursing staff to meet State standards, and this problem was also identified during the more recent period covered by GAO.

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

B-209094

The Honorable Claude Pepper
Chairman, Select Committee
on Aging
House of Representatives

Dear Mr. Chairman:

This report responds to your June 10, 1981, request asking us to audit the central office costs of the Autumn Hills Convalescent Centers, Inc., a nursing home chain based in Houston, Texas, and of the costs of one of the chain's homes in Texas City, Texas. These costs had been reported to Texas for use in the State's development of Medicaid payment rates.

Although the costs reported by Autumn Hills included significant amounts of unallowable or questionable costs, under the State rate-setting methodology these amounts had no effect on what Autumn Hills and other homes in the State were or would be paid.

The report includes a recommendation to the Secretary of Health and Human Services. At the request of your office, we did not take time to obtain agency comments. However, we did obtain written comments from Autumn Hills concerning the allowability of most of the costs we questioned. These comments are incorporated in chapter 3 of the report.

As arranged with your office, unless you publicly announce the report's contents, we plan no further distribution of the report until 15 days from its issue date. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Philip A. Bernstein

Philip A. Bernstein
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN,
HOUSE SELECT COMMITTEE ON AGING

AUDIT OF MEDICAID COSTS REPORTED BY AUTUMN HILLS CONVALESCENT CENTERS, INC., HOUSTON, TEXAS

DIGEST

At the request of the Chairman, House Select Committee on Aging, GAO examined the allowability and reasonableness of the central office costs reported to Texas by the Autumn Hills Convalescent Centers, Inc.--a chain of 17 nursing homes participating in the Medicaid program. As requested, GAO also examined the costs reported by one of Autumn Hills' homes which has been associated with allegations of poor patient care. In Texas, the costs reported by the State's 900 Medicaid nursing homes are used to establish statewide Medicaid payment rates for the future. (See p. 7.)

For calendar year 1980, GAO questioned about $250,000 (or 18 percent) of the $1,429,000 reported central office costs. However, under the State's rate-setting methodology, these questioned costs had no impact on what Autumn Hills and other homes in the State will be paid. For 1978, the State had audited Autumn Hills' central office costs and disallowed about $139,000, but these unallowable costs also had no impact on the rates.

This is because, under the State rate-setting methodology, costs per day for various categories of expenses (e.g., patient care, food, facilities, and administration) are compiled for the 900 nursing homes in the State and assembled in data arrays from the lowest to the highest. The costs for the facility at the 60th percentile for each cost category are used to set the statewide payment rates for several levels of care. Autumn Hills' questionable or unallowable costs were in the administrative expense cost category; however, the Autumn Hills homes reported costs generally fell over the 90th percentile on the data arrays. Therefore, even after eliminating the questionable or unallowable costs, Autumn Hills' remaining administrative costs were still too high to have any effect on the State's payment rates-based on the 60th percentile. (See p. 13.)

GAO believes that under the State rate-setting methodology, it would be very difficult for individual homes or groups of homes to manipulate the payment system by overstating reported costs. GAO also believes that the State methodology provides the State with an opportunity to maximize the impact of its nursing home audit efforts by focusing greater attention on those relatively few facilities whose reported costs actually determine the payment rates. In the past, the State has not availed itself of this opportunity. Since the Federal Government is going to share in the cost of the State's Medicaid audits, GAO recommends that the Department of Health and Human Services (HHS) help the State develop a plan to maximize the impact of its audits on nursing home payments. (See p. 16.)

Reported central office costs questioned by GAO for 1980 and disallowed by the State for 1978 included the following amounts for both years:

--Personal travel expenses ($14,723).

--Personal or commingled personal and business use of motor vehicles ($121,835).

--Life insurance premiums for owners and their spouses ($61,400).

--Meals, gifts, parties, etc., for owners, employees, and vendors ($86,364).

--Consultant fees to owners ($12,000).

Autumn Hills told GAO that most of the costs GAO questioned should be considered reasonable and allowable as employee fringe benefits. Because the State's written criteria on the allowability of certain costs is vague and lacks specificity, GAO is not in a position to conclude that Autumn Hills' views are necessarily incorrect. However, in the 1978 audit, the State had disallowed costs similar to those questioned by GAO. (See p. 17.)

GAO also noted that Autumn Hills recognized that about $144,000 in central office costs for 1980 were not allowable and thus, it did not report them. (See p. 28.)

The Autumn Hills nursing home GAO reviewed also overstated allowable costs by about $3,500, but these did not affect the State's rates. More importantly, however, this home did not have enough nurses on duty to meet the State standards for about 35 percent of the days during the 3-month period in 1980 GAO tested. The State had identified similar nursing shortages at this home for 1978 and 1979, but not for 1980. The frequency of these nurse shortages raises questions about the level of nursing care actually provided to the facility's residents. Unlike another State (Oklahoma) in the HHS region, Texas does not reduce payment rates for homes that do not meet State staffing standards; therefore, Autumn Hills had no financial incentive to hire temporary nurses when nurses scheduled for duty did not report for work. (See p. 31.)

Contents

ABBREVIATIONS

GAO	General Accounting Office
HCFA	Health Care Financing Administration
HHS	Department of Health and Human Services
ICF	intermediate care facility
ICF-II	intermediate care facility, lower level
SNF	skilled nursing facility

CHAPTER 1

INTRODUCTION

In June 1981, we were requested by the Chairman, House Select Committee on Aging, to audit (1) the home office costs of the Autumn Hills Convalescent Centers, Inc., a nursing home chain 1/ with its headquarters in Houston, Texas, and (2) the costs of one of its nursing homes in Texas City, Texas, which had been associated with allegations of poor care. The chain's 17 homes participated in the federally assisted, State-administered Medicaid program which pays for health care for the poor; however, none participated in the federally financed and administered Medicare program which helps pay for the health care for the aged and certain disabled, regardless of income.

Essentially, we were asked to determine (1) whether the Autumn Hills' reported headquarters costs, as allocated to the individual facilities, were related to patient care; (2) whether the Texas City nursing home's reported costs were allowable and reasonable; and (3) the effectiveness of the State Medicaid Agency in auditing the nursing home chain's costs.

ADMINISTRATION OF MEDICAID'S NURSING HOME PROGRAM

Medicaid, authorized by title XIX of the Social Security Act, as amended, is a grant-in-aid program under which the Federal Government pays from 50 to 77 percent of the costs incurred by States in providing health care services to persons unable to pay for such care. In calendar year 1980, the State programs paid $10.3 billion for nursing home care of which about $5.7 billion was the Federal share. Medicaid is administered at the Federal level by the Health Care Financing Administration (HCFA) within the Department of Health and Human Services (HHS). HCFA's and HHS' role in the program is generally to issue regulations and guidelines, review and approve State Medicaid plans for Federal financial participation, and monitor the States' performance.

Section 249 of Public Law 92-603, enacted October 30, 1972, required that effective July 1, 1976, Medicaid nursing homes in all States be reimbursed on a "reasonable cost-related basis." Implementing regulations, however, did not require them to be in compliance until January 1, 1978. These regulations also required that all nursing homes be audited by the States within 3 years and that 15 percent of all homes be audited each year thereafter.

1/An organization comprised of two or more nursing homes linked by common ownership or control is referred to as a chain.

The Omnibus Reconciliation Act of 1980 (Public Law 96-499) modified the cost-related reimbursement requirement by providing that States pay for skilled nursing facility and intermediate care facility services by using rates which the State finds are reasonable and adequate to meet the costs that must be incurred by efficiently and economically operated facilities to provide care in conformity with applicable State and Federal laws, regulations, and quality and safety standards. The Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) modified the audit requirements by providing that, "The agency must provide for periodic audits of the financial and statistical records of participating providers."

There are two types of nursing homes eligible to participate in Medicaid. One type is called a skilled nursing facility (SNF) which is designed to care for patients whose requirements are such that the need for professional nursing services is demonstrated and documented. All States must provide SNF care under their Medicaid programs. The second type of nursing home is called an intermediate care facility (ICF) which is designed to care for patients who due to physical or mental condition require supervision, protection, or assistance. ICF care is an optional service under the Medicaid law.

Nursing home program in Texas

There are 1,085 nursing homes participating in Medicaid in Texas of which 78 are classified as SNFs, 868 are ICFs, and 139 are combination facilities. Of the 1,085 facilities, 1,019 are proprietary; 24 are private, nonprofit; and 42 are owned and operated by some governmental unit.

There are two State agencies involved in administering the nursing home program in Texas. The Texas Department of Human Resources (State Medicaid Agency) promulgates the applicable rules, develops and administers the payment system, and carries out the audit function. The Texas Department of Health, under contract with the State Medicaid Agency, makes the inspections of the homes to see that they meet the various health and safety standards required for participation in Medicaid and reviews the need for admission and level of nursing home care required by Medicaid patients.

HISTORY OF THE DEVELOPMENT OF AUTUMN HILLS

Autumn Hills Convalescent Centers, Inc. (hereafter referred to as Autumn Hills or the Company) was chartered as a Texas Corporation in 1973. It operates a chain of 17 nursing homes in 13 cities located principally in southeast and central Texas. Autumn Hills owns 12 of 17 homes operated by it and leases 5, 1 from a related organization. 1/ It owns an 18th home but leases it to an affiliate for operation. Autumn Hills is headquartered in Houston, Texas, and employs about 1,000 people.

As of December 31, 1980, Autumn Hills' homes had 1,910 beds licensed by the Texas Department of Health (Health Department). All but two of these beds were contracted out to the Medicaid Agency as "Medicaid" beds: 456 beds for skilled care patients and 1,452 for intermediate care patients. On December 31, 1980, Autumn Hills' 17 homes housed 1,710 patients or residents--1,392 Medicaid and 318 private--for an overall occupancy rate of 90 percent. The Company's President owns 79 percent of Autumn Hills' outstanding capital stock, and a local businessman owns the remaining 21 percent. The minority owner is not employed by Autumn Hills. 2/

The Company's origin can be traced back through several entities and ownership combinations to 1963 when the current majority owner purchased 1 of the existing 17 homes and began operating it the following year. An additional home was opened in 1964, 3 more were added by 1968, and the remaining 12 were added between 1972 and 1978. The latest purchase was in 1980 when the Company bought a home it had leased since 1977. (A list of the Autumn Hills' homes and when they were acquired is in app. I.) The Company currently plans to construct a 240-bed facility in Galveston, Texas, when financing can be arranged.

The Company's central office was established in 1970 to centralize payroll, accounting, and management functions, but the procurement function was not centralized until late 1980. The central office houses about 29 persons, including the Company officers and other management, financial, and administrative personnel, who direct operations at the 17 homes through individual home administrators.

In 1979 the Health Department began a system of grading individual SNF and ICF sections of nursing homes annually to identify and recognize those that were deemed superior. If either the SNF or ICF section receives a superior rating, the entire home is considered superior. Fifteen of the Autumn Hills homes have received superior ratings in at least 1 year over the period from 1979 to 1981. Three homes were rated superior all 3 years, and two have never received a superior rating.

1/This refers to organizations which are related by common ownership or control.

2/In late 1980 these two owners purchased a third owner's interest in the Company.

Autumn Hills received unqualified opinions on its 1978, 1979, and 1980 financial statements from the accounting firm of Alexander Grant and Company. These statements, which include accounts for a subsidiary and a joint venture related through common ownership, show that Autumn Hills' 1980 financial position has improved over the 1978 and 1979 levels, but its profitability during the period has declined. As of December 31, 1980, the Company had assets of $10,744,610, liabilities of $10,006,258, and equity of $738,352. The statements showed a pretax profit in 1980 of $30,539. (Apps. II and III present a more detailed balance sheet and income statement data.)

History of Texas City home

Autumn Hills purchased the 62-bed Texas City home in 1972 and constructed a 58-bed addition in 1973. It contracted with the Medicaid Agency to provide 60 SNF and 60 ICF beds. As of December 31, 1980, the home had 100 Medicaid patients (42 SNF and 58 ICF), 15 private patients, and 4 Veterans Administration patients for a total resident population of 119. It employed 79 persons at the time of our visit. Autumn Hills refinanced the home in 1978 to generate working capital. A new loan was obtained and used to pay off the existing mortgage. The balance was used for working capital.

The Medicaid Agency withheld Medicaid payments to the Texas City home on four separate occasions during 1978 and 1979 for serious deficiencies in compliance with Medicaid health and safety standards and for failure to correct the deficiencies. The deficiencies included inadequate dietary, pharmacy, and nursing services. The Health Department recommended decertification of the home in August 1979, but reconsidered after the home made a number of improvements. Serious nursing service deficiencies have kept the Health Department from awarding the home a superior rating.

OBJECTIVES, SCOPE, AND METHODOLOGY

In addition to an audit of reported costs as requested by the Committee, we added two objectives with the concurrence of the Committee staff. First, we established an objective of determining how the costs reported by Autumn Hills and audited by us affected the rate-setting methodology employed by the State and thus the Medicaid payments received by the Company and other homes in the State. Second, we established an objective of determining whether certain reported nursing care deficiencies at the Texas City home were applicable to the more current 1980 period covered by our review.

We carried out extensive audit work at the Company central office in Houston and at the State Medicaid Agency and the Health Department in Austin, Texas, and conducted more limited audit work at the HCFA Regional Office in Dallas; the Autumn Hills facility in Texas City, Texas; and the Texas Medicaid Fraud Control Unit in Austin, Texas.

In reviewing the reasonableness and allowability of Autumn Hills' reported costs, we focused on calendar years 1978 through 1980. For 1978, we examined the audit reports and related working papers prepared for the State Medicaid Agency by the accounting firm of Deloitte, Haskins, and Sells (Deloitte). These audit reports covered the Company's central office costs and the costs reported for 17 individual facilities. This enabled us to identify the types and extent of costs previously disallowed and to obtain some insight into the effectiveness of the Medicaid Agency's cost audits relating to the chain.

At Autumn Hills central office and at the Texas City facility, we originally planned to test transactions for calendar years 1979 and 1980 and project our results for each year. For 1980 we selected 2 months with extensive activity in most cost categories, examined all transactions in the accounts for the 2 months and, depending on the type of cost involved (one-time or recurring), projected the results for the year. We examined individual expenditures for reasonableness, relationship to patient care, and allowability according to Medicaid Agency criteria or, where the criteria were vague or insufficient, according to whether the State had considered such costs as unallowable in prior years. Using the amount of unallowable costs identified, we projected an annual total excluding those one-time costs included. We used the same approach for the Texas City facility except that we used only one test month because of time constraints.

After analyzing the results of our 1980 tests and the results of the audit by Deloitte for 1978, we concluded that tests of the 1979 reported costs were not warranted because we believed that the results would be about the same and, because as discussed in chapter 2, under the State's rate-setting methodology, our findings would have little or no effect on what the Company was paid.

As part of our examination of reported costs, we obtained and analyzed incorporation data from the Texas Secretary of State for about 55 company vendors and other organizations to try to determine if there were significant undisclosed related organization transactions with these vendors and organizations. Also, at the Texas City facility, we examined how the facility was managing and accounting for the patients' personal funds held in trust by the Company because our prior work had indicated that this area was a problem in many nursing homes in the country. 1/

1/"Improvements Needed in the Managing and Monitoring of Patients Funds Maintained by Skilled Nursing Facilities and Intermediate Care Facilities" (MWD-76-102, Mar. 18, 1976).

To determine how the costs reported by Autumn Hills impacted on the rate-setting methodology employed by the State, we made an evaluation of this methodology and obtained from the State Medicaid Agency information as to where the Company's reported costs as adjusted by the agency were included in the various data arrays and rate-setting computations developed by it.

To determine whether the health and safety deficiencies at the Texas City facility had been corrected, we examined Department of Health reports on inspections made at the home for 1978, 1979, 1980, and 1981 to quantify the nature and type of deficiencies identified by the State. We also examined time and attendance reports for licensed nurses employed at Texas City for 3 months in calendar year 1980 to see whether the nurse staffing met the State's standards.

Our work at the HCFA regional office and the Medicaid State Fraud Control Unit was primarily to obtain general information on the operation of the program and on the Company's activities.

Our review was made in accordance with the Comptroller General's current standards for audits of governmental organizations, programs, activities, and functions.

CHAPTER 2

THE TEXAS NURSING HOME

PAYMENT SYSTEM

Texas uses a statewide prospective reimbursement or payment system to pay its nursing homes. It is prospective, in that the payment rates for a particular period of time are based on costs incurred during a prior period. In contrast to a retrospective reimbursement system, such as Medicare, the payment rates for a specified period are not adjusted based on actual cost experience. Traditionally, a prospective system has been viewed as preferable to a retrospective system since the former provides operators with a strong incentive to hold down their costs whereas the latter does not. Under the State's nursing home payment system and rate-setting methodology, none of the Company's reported costs for 1978 or 1980 which we or the State considered unallowable or questionable had any effect on what the Company was paid or will be paid.

NURSING HOME PAYMENT SYSTEM AND RATE-SETTING METHODOLOGY

The current Texas Medicaid payment system for nursing homes, which went into effect on January 1, 1979, develops per diem payment rates on a prospective basis which are uniform statewide for each level or class of service. All homes in the State receive payment based on the same rate for each respective day of skilled care and the two levels of intermediate care provided. 1/

Method of computing rates

Per diem rates are determined on a statewide basis using financial and statistical information from annual cost reports submitted by about 900 participating facilities. 2/ The allowable costs included in these reports are adjusted for such things as nonpatient revenues which offset expenses and for computed minimum occupancy levels. The costs are further adjusted to recognize inflation and other Federal or State indexes to arrive at the projected costs for a future period. The cost report years used to develop rates for specific periods of time are shown in the following table.

1/Texas plans to change to one level of intermediate care.

2/Not all nursing home cost reports are used in the State's data arrays. For example, if a facility changed ownership during the year or was in operation for only a part of a year, its reported costs would be excluded.

Annual cost reporting period	Used to establish payment rates for:
1977	Jan. 1, 1979, through Dec. 31, 1979
1978	Jan. 1, 1980, through Aug. 31, 1980
1979	Sept. 1, 1980, through Aug. 31, 1981
1980	Sept. 1, 1981, through unknown

Although there may be mid-year adjustments to the rates, they are based on the actual reported costs for the period shown.

These adjusted, projected costs are then divided into patient care costs, dietary costs, facility costs, and administrative costs, and the patient care costs are subdivided into the SNF, ICF, and ICF-II 1/ levels of care. Costs in each area and subarea are then ranked from low to high to produce six cost arrays. The actual per diem rates for each level of care are determined by selecting the 60th percentile costs from the appropriate patient care cost array and the dietary, facility, and administrative cost arrays and summing them to arrive at the statewide base rate. The procedure is repeated for the remaining levels of care. Payments for training nursing home staff are then added to the base rate to arrive at the actual per diem rates paid home operators.

This procedure is illustrated by the following table which presents the adjusted, projected costs for each level of care and cost area. These rates were based upon 1978 cost reports and were in effect from January through August 1980.

Cost areas	60th percentile adjusted costs for each level of care SNF	ICF	ICF-II
Patient care, including salaries and supplies for the nursing, housekeeping, laundry, patient activity, and social services functions and certain consultant fees	$19.33	$12.30	$ 9.33
Dietary, including raw food, food service supplies, and salaries for food service staff	4.47	4.47	4.47
Facility and operation and maintenance expense; depreciation; mortgage interest; insurance, taxes and lease/rental expenses for land, buildings, equipment, and automobiles	5.00	5.00	5.00
Administrative, including salaries for administrative, secretarial, and clerical staff and central office overhead expense	2.67	2.67	2.67
Base rate	31.47	24.44	21.47
Amounts added for training and orientation of staff	0.48	0.33	0.29
Per diem rate	$31.95	$24.77	$21.76

1/ICF-II is an intermediate care facility, lower level.

The State controls the process of determining the amount of daily Medicaid payment made to homes on behalf of Medicaid residents under the following procedure. The State Health Department examines each home resident wishing to be assisted by Medicaid and determines the level of care--SNF, ICF, and ICF-II--each resident needs. The Health Department then notifies the State Medicaid Agency of the level of care designation it established for the resident and the Medicaid Agency, using the amount of resident's personal income which can be applied to help pay for the care, determines the amount of daily payment from the Medicaid Agency.

The nursing home notifies the Medicaid Agency of the resident's location within the home and when the residents are admitted, discharged, and transferred to a hospital. Once a resident's Medicaid eligibility is established and a daily payment rate determined, the Medicaid Agency automatically pays this rate for each day's care furnished the resident during the month until circumstances change, such as changes in patient income or if the patient went to the hospital, was discharged from the home, or died.

Position of Autumn Hills nursing home costs in the State rate-setting data arrays

The following table shows where the reported costs of the various Autumn Hills nursing homes for 1978, 1979, and 1980 were located in the State's rate-setting data arrays.

Number of Autumn Hills Facilities at Respective Percentile Ranges in the Rate-Setting Data Arrays

	Patient care																	
	SNF			ICF			ICF-II			Dietary			Facility			Administrative		
Percentile	1978	1979	1980	1978	1979	1980	1978	1979	1980	1978	1979	1980	1978	1979	1980	1978	1979	1980
0-10	2			2	1		1	1										
11-20	1	3	2	8	5		9	4		1								
21-30		1	1		5	4	1	6	5	4	1							
31-40	1	1	1	2	2	6	2	3	5	5	5	1	1	1				
41-50	1	1	1	1	1	2			2	3	7	3	1	2	2			
51-60		1	2		2	3		3	3		3	8	3	1				
61-70		1			1						1	3	2	3	6			
71-80			1			2			2			2	2	3	1			
81-90													2	5	4		3	3
91-100													2	2	4	13	14	14
Total	5	8	8	13	17	17	13	17	17	13	17	17	13	17	17	13	17	17

Note: Circles denote the Texas City facility's position on each data array.

As indicated by the table the Company's patient care costs were constantly low as compared with other facilities in the State, whereas the reported costs in the facility and administrative cost categories were comparatively high. As discussed later, the Company's administrative costs were so high that under the State's rate-setting methodology it is unlikely that they would ever have an impact on Medicaid payment rates. On the other hand, the Company's costs in the dietary and facility cost areas could have some impact on the rates, but as noted on page 30, the actual overstatement of costs for 1980 we identified at the Texas City home did not affect the rates.

As shown on the following table, despite the Company's relatively high administrative costs, it was able to operate its homes within the State's overall payment rates.

	Cost category				
	Patient care (note a)	Dietary	Facility	Administrative	Total
1980 rates (note b)	$14.30	$4.47	$5.00	$2.67	$26.44
1980 costs	11.78	4.29	5.79	4.39	26.25
Difference	$ 2.52	$ .18	($ .79)	($1.72)	$ .19

a/Weighted average to give effect to Autumn Hills' patient mix.

b/For the period January 1 through August 21, 1980.

Although the prospective rate-setting methodology employed by Texas, as well as by a number of other States, does provide an incentive for nursing home operators to operate their facilities within the overall rates, this same incentive creates a need for the State Medicaid Agency to closely review the quality of patient care provided. Because patient care is the largest category of costs, it provides the greatest opportunity for cost reductions or savings. Therefore, it is important that such savings not be achieved through providing care that falls short of meeting program standards.

INDIVIDUAL HOMES CANNOT MANIPULATE THE SYSTEM

Several characteristics of the rate-setting methodology used in Texas make it highly unlikely that an individual facility, or small groups of facilities, can manipulate the system to receive higher Medicaid payments by overstating or inflating reported costs. First, the system is prospective, meaning that the costs reported for one period have no direct relationship to the rates paid for that reporting period. The costs reported are used to compute rates for some future period. Consequently, there would be no advantage in the period of reporting to overstate the costs reported. Second, the rates are based upon the cost experience of about 900 homes. These costs are desk audited, adjusted for various limiting factors, and then projected to the future rate period using various indexes.

As discussed in the preceding section, the State develops several cost arrays and then sums up the 60th percentile costs from these arrays to arrive at a payment rate for each level of care. Theoretically, the only way a facility could benefit from overreporting costs would be to change its place on one of the various cost arrays from below to above the 60th percentile and hope the "new facility" at the 60th percentile would have an adjusted cost higher than the original facility. Theoretically, facilities that overstate or inflate costs and remain either below or above the 60th percentile level have no impact upon rates since the home at the 60th percentile and its adjusted costs would remain the same.

To impact rates, the facility operator would need to know how his or her facility or group of facilities would rank on a future array. The operator would need to know for each cost category the per diem costs per resident to be incurred by all 900 or so other facilities as well as the desk audit changes that would be made in the future, the limitation factors to be used, and the inflation indexes to be used by the Medicaid Agency. We believe it highly unlikely that this could be done. Even if a facility or group of facilities inflated their cost reports in a current period hoping to impact future rates, the amount of impact generated would be relatively small. In our opinion, the amount of gain the facility would receive in the future from the higher rates is relatively small and probably not worth getting into difficulty with the State to obtain, because it could be held accountable for the resulting overpayments to all the homes in the State.

Assuming that one facility did manipulate its costs to move on the array from below to above the 60th percentile, the only difference in the rate would be the difference between the adjusted cost for the home at the 60th percentile and the adjusted cost for the home on the array immediately above the one at the 60th percentile. This is illustrated as follows using actual array figures for administrative costs for the rate period beginning September 1, 1981.

This theoretical example assumes that facility "C" had reported questionable costs, amounting to two cents per patient day, thereby causing its per diem administrative cost to move up nine places on the array. There is no rate impact since the "new" facility at the 60th percentile had an adjusted administrative cost equal to the home it replaced.

Home	Location on array with overstated costs Per diem cost	
A	$2.718	
B	2.716	
C	2.715	
D	2.712	
E	2.712	
F	2.707	60th percentile
G	2.707	
H	2.703	
I	2.702	
J	2.699	
K	2.696	

Home	Location on array without overstated costs Per diem cost	
A	$2.718	
B	2.716	
D	2.712	
E	2.712	
F	2.707	
G	2.707	60th percentile
H	2.703	
I	2.702	
J	2.699	
K	2.696	
C	2.695	

On many of the cost arrays used for setting rates, there is a fairly small difference between the cost at the 55th percentile and the cost at the 65th percentile, but these groups of homes, in our opinion, actually determine the rate components.

Cost arrays for 1980 costs used for rates effective September 1, 1981	Patient care cost array			Dietary care cost array	Facility cost array	Adminis-trative cost array
	SNF	ICF	ICF-II			
65th percentile	$21.278	$13.353	$10.079	$4.847	$5.782	$2.809
60th percentile	20.946	13.105	9.898	4.711	5.649	2.707
55th percentile	20.490	12.819	9.685	4.630	5.490	2.596
Range between 55th and 65th	0.788	0.534	0.394	0.217	0.292	0.213
Number of facilities between 55th and 65th percentiles (inclusive)	20	88	87	91	91	91

The homes between the 55th and 65th percentiles are the ones upon which we believe the Medicaid Agency should focus its audit efforts.

The results of our audit of Autumn Hills' 1980 costs demonstrate that the reporting of a considerable amount of unallowable, questionable, and undocumented administrative costs did not impact the future payment rate developed from these 1980 cost data. Practically all of the costs we had questions about were incurred at the Company's central office. These costs are allocated as administrative expenses to individual homes on the basis of patient days. In total, we had questions about central office administrative costs amounting to $250,220 or about $0.41 per patient day. The chain's average projected per diem administrative cost of $4.17, which ranked at the 93rd percentile, was $1.46 above the 60th percentile projected administrative cost of $2.71. If the $0.41 we questioned, as increased by the Medicaid Agency's indexes, had not been included in the data arrays, the chain's projected administrative costs for all 17 homes would have remained well above the 60th percentile. Consequently, the reporting of these costs for 1980 had no impact upon the rate at which Autumn Hills was paid starting September 1, 1981. The chart in appendix IV demonstrates this situation.

This same lack of rate impact is evident for 1978 costs based upon the amount of administrative costs disallowed by Deloitte. Deloitte disallowed a total of $187,246 in administrative costs incurred both at the chain central office and at individual nursing homes. As a chain this disallowance amounted to $0.34 per patient day of care provided. The chain's average projected administrative cost of $4.19, which ranked at the 95th percentile, was $1.52 above the 60th percentile projected administrative cost of $2.67. If the $0.34 per patient day Deloitte disallowed as increased by the Medicaid Agency's indexes had not been included in the data array, the chain's projected administrative cost for the 13 homes would have remained well above the 60th percentile. Consequently, the overreporting of these costs for 1978 had no impact upon the rates at which Autumn Hills and other homes in the State were paid starting January 1, 1980. The chart in appendix V demonstrates this point.

OPPORTUNITY TO MAXIMIZE IMPACT OF AUDIT EFFORT

This rate-setting methodology minimizes the number of nursing home audits needed because the costs of only a relatively few facilities determine the rates. This provides the Medicaid Agency the opportunity to focus its audit efforts upon those facilities whose reported costs could have an influence in determining rates (e.g., those between the 55th and 65th percentiles on each cost array). Under this rate-setting methodology, we see little benefit from auditing facilities near the bottom or top of each array because these facilities will have little opportunity to affect rates regardless of the costs they report or the results of the audit.

We believe it is possible for the State to focus its audit efforts because the reported costs used to set the rates cover the calendar year 8 months before the beginning of the new rate period, and facilities are required to submit their cost reports within 3 months of the end of the year. This leaves at least a 5-month period for the State to identify and audit those nursing homes whose reported costs are most likely to impact on the rates.

The State Medicaid Agency, however, has not taken advantage of this situation in developing its audit plans. This was caused at least in part by Federal Medicaid regulations, effective in 1978, which required the State Medicaid Agency to audit all participating nursing homes by the end of calendar year 1980. To accomplish this task, the agency, with contract assistance from Deloitte, audited about one-third of the homes' cost reports each year. The results obtained from audits of 1978 cost reports raise questions about the cost effectiveness of the audit work.

The Medicaid Agency and Deloitte audited 1978 cost reports for 277 facilities and identified a considerable amount of unallowable costs included in the reports. For the 17-facility Autumn Hills chain alone the amount of unallowable cost identified was $204,444--$134,150 identified at the central office and $65,294 identified at individual homes--including $187,246 in administrative costs. The Medicaid Agency put the corrected audited cost data for the 227 facilities into the data base used for rate making; recomputed the various cost arrays; and recomputed the payment rates for January 1 through August 31, 1980, based upon only those costs that should have been reported. The agency learned that the reporting of unallowable costs by these 227 facilities did cause the State to develop higher rates than it would otherwise have developed, as shown in the following table.

Per Diem Payment Rates

	From original data base	From adjusted data base	Net changes Amount	Percent
SNF	$31.95	$31.93	$-0.02	-0.06
ICF	24.77	24.68	-0.09	-0.4
ICF-II	21.76	21.66	-0.10	-0.5

The fiscal impact of reporting unallowable costs was to cause the Medicaid Agency to "overpay" facilities statewide by $1,371,808 during the 8-month period. 1/ This amounted to about 0.5 percent of total nursing home payments made during the period. The 227 audits cost the State Medicaid Agency $351,766, excluding

1/On the basis of information provided, the State did not recover this money.

State travel expenses, such as transportation, lodging, and meals. 1/ Every dollar spent auditing identified "overpayments" of $3.90. Although not fully comparable, cost reimbursement audits under Medicare have historically produced a benefit to cost ratio of about $7 or $8 to $1 spent--which in fiscal year 1981 increased to $16 to $1.

The State agency selected the 227 facilities on a statistical basis from all facilities included in the State's rate-setting data base. According to one State Medicaid official, the 227 facilities should have been distributed rather evenly throughout the various data arrays with many homes falling in the top and bottom echelons of the arrays. These are the facilities for which we believe cost reporting inaccuracy, within reason, would have little effect on the rates. As shown in the chart below, there were only 80 or fewer homes falling between the 55th and 65th percentiles on most of the cost arrays. Overall, about one-fourth of these homes were audited.

Cost arrays for 1978 costs used for rates as of January 1, 1980	Number of facilities between the 55th and 65th percentile	Number of these facilities that were audited	Percent of facilities audited
Patient care cost:			
SNF	19	5	26
ICF	78	16	21
ICF-II	75	17	23
Dietary care cost	80	18	23
Facility cost	80	20	25
Administrative cost	80	21	26

Many facilities have costs within this 55th to 65th percentile on more than one array. Our analysis showed that this range for all six arrays was comprised of 310 of the 900 facilities in the data arrays. These are the ones upon which we believe the State Medicaid Agency should direct its audit efforts in selecting facilities for an audit.

In our opinion, the Medicaid Agency would be better off from a cost/benefit standpoint by focusing its audit efforts on homes grouped around the 60th percentile because these facilities could have immediate impact upon the rates if a small amount of unallowable cost was reported and disallowed upon an audit. Now that audit requirements have been changed somewhat from "15 percent of all facilities each year" to "periodic audits," (see p. 1) the focusing of audit efforts on the fewer number of homes that could have the greatest impact on rates seems logical to us.

1/Presumably the Federal Government shared in these auditing costs at the 50-percent administrative cost sharing ratio.

CONCLUSION

In our opinion, the State Medicaid Agency should concentrate its nursing home audit activities on facilities grouped around the 60th percentile levels of each array since this group of homes is more likely to have an impact upon the State's per diem rates. We believe that the audit work conducted on this group of homes would produce a higher return and do more for data base integrity than the auditing of homes at the top and bottom of the arrays.

RECOMMENDATION TO THE SECRETARY OF HHS

We recommend that the Secretary direct the Administrator of HCFA to encourage and work with the State to develop a plan to concentrate its nursing home audits on those facilities grouped around the 60th percentile levels of each data array.

CHAPTER 3

AUTUMN HILLS' 1980 COST REPORTS CONTAIN

UNALLOWABLE, QUESTIONABLE, AND UNDOCUMENTED COSTS

The Committee requested GAO to audit the Medicaid costs reported by the Autumn Hills central office and the Texas City nursing home to evaluate their reasonableness, allowability, and relationship to patient care. Our review showed several types of costs in the administrative cost category which we question as to their allowability for inclusion in the cost reports. Many of the same types of costs were identified in the Company's 1978 cost reports by Deloitte and disallowed by the State Medicaid Agency.

For reporting purposes, we have categorized these costs as (1) clearly unallowable under the Medicaid Agency's written criteria; (2) questionable because they were considered unallowable or not reportable in the 1978 cost reports by the State or the Company, but because of the vagueness of the State's written criteria, we could not conclude that they were clearly unallowable; and (3) questionable because insufficient documentation was available to determine the reasonableness and allowability under the foregoing criteria. In any event, as indicated in the previous chapter, none of the costs for 1978 or 1980 which we or the State considered as questionable or unallowable had any impact on what the Company was paid or will be paid under the State's rate-setting methodology.

In our opinion, many of these unallowable, questionable, or undocumented costs are included in the cost reports because the Medicaid Agency's written criteria for identifying allowable and unallowable costs are written in such general language that it does not specifically address many of these costs. By clarifying and expanding these criteria, the Medicaid Agency may eliminate the reporting of some of these costs and would improve the data base used for rate setting. In contrast to Texas, many States have tied their criteria into the more definitive guidelines and specific case examples used in the Medicare program. The application of the Medicare criteria would have the effect of disallowing some of the Company's costs we questioned.

MOST UNALLOWABLE, QUESTIONABLE, OR UNDOCUMENTED COSTS WERE INCURRED AT THE CENTRAL OFFICE

Most of the 1980 reported costs which we have questions about were incurred at the Autumn Hills central office. These costs are estimated at $250,220 (or 18 percent) of the $1,429,320 total cost reported there. These costs are discussed below under the three categories into which we grouped them.

Costs clearly unallowable under
Medicaid Agency written criteria

We identified $20,319 in costs that were clearly unallowable according to the Medicaid Agency's written criteria. Many of these costs were personal or related to other business interests of the Company owners. Deloitte identified and disallowed some of the same types of costs reported for 1978.

Purpose	1980 - GAO	1978 - Deloitte
Personal travel	$ 6,485	$ 8,238
Professional service fees for other business interests	2,425	3,490
Personal use of motor vehicles	1,769	20,575
Dues and subscriptions	99	1,110
Life insurance premium for owners and a spouse not employed in the Company	2,336	-
Employee meals, parties, gifts, etc.	-	36,606
Radios and billboard advertising	-	8,432
Interest on personal loans and purchases including development of a site for expansion and purchase of bank stock	2,357	41,093
Salary for employee time spent on nonnursing home interests	1,692	12,198
Invoice paid twice	2,469	-
Donations and director fees	-	4,730
Other various items	687	2,678
Total	$20,319	$139,150

The $6,485 personal travel cost included in the 1980 report was for a trip by the majority owner and his wife to Manila, Philippines. The 1978 personal travel costs were for trips to such places as Vancouver and New York. The $2,425 professional service fee in 1980 was the cost of preparing an income tax return for an affiliated partnership consisting of the three Autumn Hills owners. The $2,336 life insurance premium was for policies on minority owners and a spouse who were not employed by the Company.

Both GAO and Deloitte audits showed that Autumn Hills had purchased rather than leased its automobiles. For 1978, Deloitte identified for the State a considerable amount of depreciation, interest, and insurance and operation expenses for vehicles not considered essential to the conduct of the business of and care of nursing home residents. Most of these vehicles were apparently used by the majority owner's family.

Costs questionable because they were disallowed or not reported as allowable in prior periods

We identified about $118,410 in reported costs which we considered questionable, but because of the vague language used by the State Medicaid Agency in describing the allowability of such costs, we could not conclude that they were clearly unallowable. However, many of such costs had been disallowed by the State Medicaid Agency for 1978 and probably would have been disallowed under the more definitive Medicare guidelines.

In contrast to Texas, about half the State Medicaid plans covering nursing home reimbursements tie-in to some degree by reference to Medicare reimbursement principles for determining allowable costs. Because these principles are supported by rather detailed guidelines and specific interpretations from decisions by the Federal courts and Medicare provider appeals mechanisms, the Medicare principles provide a degree of specificity not found in Texas' brief written criteria. The questioned costs for 1980 are summarized below.

Purpose	Amount of cost in question
Meals, gifts, parties, etc., for owners, employees, and vendors	$49,758
Premium for life insurance policies on the principal owner and spouse employed by the Company	59,064
Legal fees incurred in connection with possible chain expansion which should have been amortized	9,588
Total	$118,410

The $49,758 we estimated as entertainment includes $34,758 1/ for employee lunches, dinners, and drinks; $8,469 for employee and vendor Christmas parties; $1,623 for an employee picnic; and $4,908 1/ for various other items including flowers and liquor for employees. These costs were reported to the Medicaid Agency as home office advertising and promotional costs and allocated to the 17 Company facilities as administrative costs. According to Deloitte's audit, the same types of cost as well as costs for a hunting lease and tennis club membership were included in the 1978

1/These figures are annual estimates based upon the results of our tests.

cost report. Deloitte and the Medicaid Agency agreed at that time that most of these types of costs were unallowable. They did, however, allow the cost of one Christmas party as an employee fringe benefit.

The Medicaid Agency's written criteria for determining allowable costs do not specifically identify these costs as unallowable. The criteria indicate that some entertainment costs are unallowable, but it does not show examples. The criteria describe the following as unallowable:

> "Entertainment Expenses. For owners; partners; officers, directors; stockholders; and administrators and other employees, <u>except</u> entertainment which is an employee benefit. (Underlining added)
>
> "Expenses Incurred for Services Provided not Related to Patient Medical Care. Employee and guest meals; nonmedical rentals; barber and beauty shop; vending machines; canteen and gift shop, <u>except</u> free meal fringe benefits for employees." (Underlining added)

Autumn Hills told us the costs for meals, parties, gifts, picnic, etc., are allowable and presented the following comments to support its position.

<u>Employee meals</u> "The Company expects its senior management team to conduct business under whatever circumstances it seems appropriate. The business lunch in the Houston area is a useful as well as traditional way to conduct business. The conclusion of a morning business conference with lunch is a convenient way to wrap up the conference. Additionally, the business luncheon is an opportunity to see people, on a more ready basis, who the management must transact business with whereas it might be several days before a conference could be scheduled by either party to the luncheon at their respective offices."

* * * * *

"The Company requires the employees to report in detail the business luncheon as well as its purpose and accordingly the Internal Revenue Service standards in this area has been met.

"The GAO * * * states that 'business lunches are being disallowed because such lunches were not described in earlier discussions--as employee benefits. Those discussions are now amended to include such luncheons as benefits. The Company believes that these luncheons are an effective method of conducting the business of the Company which is to provide patient care.'"

For 1978, Deloitte and the Medicaid Agency disallowed similar meal costs.

Christmas parties for employees and vendors

"The Company has for a number of years held an annual holiday season party in December at a public facility for the purpose of bringing together all of the employees of the Company in order for * * * , the President, to provide a report to the employees on matters affecting the management of the respective health care facilities as well as present awards to various members of the health care facilities staff for achievement as determined by the several professional affiliations of the Company. The party is an opportunity to provide a discussion of ideas as to patient care and management of the homes as well as provide a re-emphasis of the Company's commitment to the professional delivery of health care to the patients. The job of providing health care is one which requires dedication and care and professional diligence which the Company believes its employees discharges. Accordingly the Company believes that the inclusion of the cost of the holiday season party is properly included in the cost report and does disagree to the disallowance of the amount of $4,061.11.

"The party given annually at (the President's) house serves patient care indirectly in that it serves to focus on acknowledging the contribution of all of the employees of the Company as well as vendors to the Company. The affair gathers together the central office people as well as all those from the health care facilities who can attend together with a selective list of vendors during a period where it is appropriate to acknowledge the contributions to those who serve the Company well.

"Accordingly, the Company does not agree to the disallowance of the amount of $4,299.62 which it deems to be the approximate cost of the 1980 party."

For 1978, the State Medicaid Agency allowed the cost of one party for the employees only.

Annual Company picnic

"The Company believes that an annual picnic is necessary and vital to the furtherance of the Company's purpose for being in business of providing patient care to those requiring it. The picnic serves as a morale booster to the employees of the Company and the time together at the picnic allows those present to exchange ideas (cross-fertilization) about effective patient care as well as overall management of the individual health care facilities. The fact that the Company codes the expenditures to advertising and promotion does not preclude the inclusion of such an expenditure into the cost report as the Company is of the opinion and judgment that such affairs benefit the Company's basic purpose of providing indirect patient care. The Company does not agree to the disallowance of $1,622.77."

Flowers and liquor

"The Company does not agree to the disallowance of expenditures of [sic] flowers * * * and * * * for liquor * * * the Company believes these items are benefits to the employees."

For 1978, Deloitte and the State Medicaid Agency disallowed similar picnic, flower, and liquor costs reported by Autumn Hills.

Under Medicare program criteria, entertainment expenses could be allowable if reasonable and related to patient care. Summaries of several provider appeals decisions by the Blue Cross Association in 1976 and 1977 stated that:

"Therefore when they (gifts, awards, etc.) are paid to employees engaged in patient-care activities and the total compensation paid is not unreasonable, they are allowable costs particularly where the gifts were commonly given by other providers * * *"

*   *   *   *   *

"Gifts and awards designed to improve employee morale may be allowable costs, even though not directly attributable to the maintenance of patient care, provided they are reasonable in cost and are common and accepted occurrences in the field of the provider's activity. The test of allowability is not whether the provider's primary patient-care responsibility would be affected if the provider eliminated these expenses.

"Therefore, in the absence of specific Manual provisions governing the items in question, such expenses as those for flowers for special events in the provider's lobbies, meals for board members when they were conducting provider business, expenses of employee award dinners, tickets to certain sporting events, and Christmas gifts and parties for employees, were allowable."

Legal fees for expansion

The Medicaid Agency's criteria for determining unallowable costs do not specifically address the allowability of legal fees incurred for expansion. The criteria describe unallowable costs as

"Business Expenses Not Related to the Provision of Patient or Resident Care. Farm or ranch operations; business investments, and other business operations."

We estimate that $9,588 in legal fees was incurred in 1980 in applying for Certificates of Need and obtaining land for possible additional nursing homes in Houston, Galveston, and LaMarque, Texas. After examining the State Medicaid Agency's criteria and the Medicare program criteria regarding these costs, we have questions about whether the costs should have been an allowable expense for 1980. According to the State criteria, business investments and other' business operations not related to providing patient or resident care are unallowable, but the criteria do not specifically address acquisition costs for additional nursing homes.

Under Medicare, however, while these costs are allowable, they should be included in the historical cost of the completed facility and amortized over some period rather than charged as an expense and reported in the year incurred. Costs of planning for new facilities which are abandoned are not allowable. 1/

1/Section 2154 of the Provider Reimbursement Manual.

Life insurance premiums

Autumn Hills did not include owner life insurance premiums in its 1978 cost reports. Deloitte, using criteria provided by the State, expressed the view that the proper treatment was to exclude such costs. After the 1978 cost reports were prepared, the State developed new criteria for determining cost allowability. These criteria, which we used in analyzing 1980 reported costs, include the following under the caption of unallowable costs:

> "Insurance. Life insurance premiums for owners, partners, officers, corporation directors, association directors, or any other person not working in the facility as an employee; * * *"

Under Medicare criteria, the allowability of premiums is dependent upon who is named as beneficiary. Section 2130 of Medicare's Provider Reimbursement Manual provides that:

> "Premiums related to insurance on the lives of officers and key employees where the provider is a direct or indirect beneficiary are not allowable costs.
>
> "Premiums related to insurance on the lives of officers and key employees where the individual's relative(s) or his estate is the beneficiary are considered to be compensation to the individual and are allowable costs to the extent such total compensation is reasonable."

Because Autumn Hills, with the concurrence of the State's auditors, did not report such costs in 1978 and did report them in 1980, and because of the differing Medicaid and Medicare criteria, we have questions about whether $59,064 in life insurance premiums for the Autumn Hills majority owner and spouse should be considered allowable in 1980. Both the owner and spouse work at the Company's central office, but the insurance policies in question name both the Company and insureds' spouse as beneficiaries.

Insufficient documentation to determine reasonableness and allowability under the foregoing program criteria

We identified $111,491 in costs included in the 1980 cost reports for which Autumn Hills did not have sufficient documentation for us to determine whether the costs were reasonable and allowable under either State Medicaid Agency or Medicare program criteria. These costs consisted of $99,491 in vehicle expenses and $12,000 in consultant fees.

Automobile expenses

Our analysis showed that in 1980 Autumn Hills paid $99,491 to about 43 employees and officers for using their personal automobiles. This amount included $61,250 in monthly automobile allowances and $38,241 in gasoline purchases made by these employees with Company credit cards. The Company controller told us that these costs were reported to the Internal Revenue Service as miscellaneous income to the employees and included the costs in the cost reports.

The Medicaid Agency's criteria for describing which gasoline and other motor vehicle costs are not allowable and which are allowable are as follows.

> "Motor Vehicles. Motor vehicles which are generally not suitable goods for transporting both patients and facility supplies such as aircraft; motor homes; sports automobiles, motorcycles; recreational type vehicles; and tractors used in farming ranching or construction. Expenses for motor vehicles such as luxury automobiles and pick-up trucks are allowable to the extent of their documented use in transporting patients and facility supplies and in conducting facility business.
>
> "Transportation equipment depreciation; motor vehicles, to the extent of their documented use in transporting patients and facility supplies and in conducting facility business. Transportation expenses which are not documented for uses as stated here are unallowable including depreciation, interest, taxes, insurance, gasoline, oil maintenance, and repairs."

Medicare criteria also require documentation for travel expenses to be allowable.

> "An intermediary properly disallowed travel and entertainment expenses where the provider had commingled personal and business expenses and had failed to produce any records permitting a segregation of these expenses." 1/

Autumn Hills does not maintain records documenting the extent to which the automobiles and gasoline were used for business purposes. In the absence of this documentation, the allowability of the $99,491 is questionable.

1/Provider appeals Decision (Blue Cross Association) No. 00-74-73.

Autumn Hills provided the following comments about the inclusion of the gasoline costs in its cost report.

> "The expenses detailed * * * principally apply to charges incurred on gasoline credit cards issued to management based at the central office facility * * *
>
> "The Company does not maintain a large fleet of automobiles rather it provides selected employees with a gasoline charge card for their use.
>
> "The employees are expected to utilize their own credit card(s) for any personal use. The cars in this category with the exception of (the President's) are generally owned by the employees. The Company does not require that the employee detail the use of the automobile. Accordingly, the Company is required by the Internal Revenue code to provide the employee with a Form 1099 with an advice copy to the Internal Revenue Service. It is the employee's responsibility to report the receipt of the money or goods or services in their respective income tax returns net of any applicable expenses. The Company is not required nor has any other obligation to ascertain if this [is] done. The entire obligation of the Company is to provide the 1099. Since the business of the employees to whom a credit card is furnished is the providing of patient care, the Company believes that the cost reflected in this category is properly allowable and included in the cost report as necessary transportation expense."

Consultant fees paid owners

The consultant fees paid to owners 1/ in 1980 consisted of monthly payments of $2,000 each to two owners for January, February, and March. The services provided by these owners were undocumented and unspecified. No records were available to show the amount of time the owners spent in consultation in return for their fees. One owner was supposed to determine what the chain's medical position should be and the other was supposed to provide business management expertise.

The State Medicaid Agency's criteria for determining unallowable costs and its medical assistance program plan (State plan) have differing interpretations as to the allowability of these costs. The criteria for determining unallowable costs are described

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1/Autumn Hills had three owners during most of 1980. In late 1980 two of the owners purchased the third owner's interest in the Company.

as "Amounts paid owners, partners, officers, directors or stockholders not working in the facility nor providing services." Since the two minority owners supposedly provided services to the Company, it could be argued that the costs were allowable. The State plan, however, views these payments to owners as compensation and prescribes a test for determining their reasonableness and therefore their allowability. It says that:

> "(1) Owners of provider organizations who often provide services as managers, administrators, or in other capacities. In such cases it is equitable that <u>reasonable compensation for the services provided be an allowable cost</u>. To do otherwise would disadvantage such owner in comparison with corporate providers or providers employing persons to perform similar services.
>
> "(2) Ordinarily, compensation paid to owners is a distribution of profit. However, where the owner provides necessary services for the facility, the facility is in effect employing his services and a reasonable compensation for these services is an allowable cost. In corporate providers, the salaries of owners who are also employees <u>are subject to the same requirements of reasonableness. Where the services are provided on less than a full-time basis, the allowable compensation should reflect an amount proportionate to a full-time basis</u>." (Underlining added)

Since Autumn Hills did not maintain documentation necessary to convert the consultant fee amounts to a full-time basis and assess their reasonableness, the payments probably should not have been included in the cost report.

Autumn Hills believes the payments should be allowed because the services paid for were considered necessary and received. During its audit of 1978 cost reports, Deloitte noted that payments to these owners were being made but that Autumn Hills did not include them in the cost report. Deloitte expressed the view that the proper treatment was to exclude these costs.

<u>Some 1980 central office costs were not reported</u>

Our examination of Autumn Hills 1980 records showed that the Company did not attempt to report all of its costs to the Medicaid Agency. Some costs the Company considers unallowable for Medicaid reporting are accumulated in accounts not used in cost report preparation. Other costs identified as unallowable during the report preparation process are also removed and were not included in the $1,429,320 cost reported to the State Medicaid Agency. Costs not reported totaled $144,432 in 1980 and included the following items.

Type of cost	Amount excluded
Federal income taxes	$79,000
Owner's salary over $100,000	49,373
Legal services related to other business interests	5,106
Penalties for late payment of mortgages	4,334
Director's fees	2,000
Travel expenses	1,950
Donations to civic groups	1,000
Bad debts	729
Various other items	940
Total	$144,432

In addition to the above, the owners of Autumn Hills, through a partnership related to Autumn Hills through common ownership, contributed $6,500 from 1978 through 1980 to the Nursing Home Administrators Political Action Committee of Texas, Inc. The partnership spent an additional $2,500 reimbursing two individuals, including one of the owners, for their contributions to the Committee. This $9,000 was not included in the home office costs reported to the State Medicaid Agency.

Autumn Hills owns a nursing home in Houston, Texas, that it does not operate but leases to another corporation. This corporation's officers and directors consist of the Autumn Hills principal owner, his wife, and his son. The central office costs Autumn Hills incurred on behalf of this nursing home were not included in the Autumn Hills cost reports.

We also examined Autumn Hills' accounting records to identify suppliers and other organizations with which it frequently conducted business. We obtained incorporation data on these organizations from the Texas Secretary of State to identify related organizations. We identified the following relationships:

--Fort Crockett Investors - partnership consisting of current and former Autumn Hills owners, also owns the Cleveland, Texas, nursing home leased and operated by Autumn Hills. Some costs associated with this partnership were included in the costs reported to the State Medicaid Agency.

--Hyde Park Service Corporation - currently a defunct subsidiary of Autumn Hills (chain of funeral homes) purchased from its majority owner. Costs associated with this corporation were not reported to the State.

--Ashford Bank - Autumn Hills president is on the Board of Directors. Costs associated with the bank were reported to the State.

--Designs by Joyce - a miscellaneous home furnishings supplier owned by Autumn Hills' president's wife. Costs associated with this company were not reported to the State.

--Lifecare Corporation - headed by Autumn Hills' president, spouse, and son, and it also leases and operates the nursing home from Autumn Hills. Costs associated with this corporation were not reported to the State.

The only one of these relationships Autumn Hills disclosed to the State Medicaid Agency was the one with Designs by Joyce.

UNALLOWABLE AND QUESTIONABLE COSTS REPORTED BY TEXAS CITY HOME

In addition to the Texas City home's portion of the central office costs discussed previously, the home's 1980 cost report contained some unallowable depreciation cost and some employee meal costs similar to those we questioned in the central office cost report.

	Unallowable costs identified in Texas City home's cost reports	
Type of cost	GAO - 1980	Deloitte - 1978
Excess building depreciation	$2,538	$ -
Employee meals	1,014	445
Advertising expenses	-	2,072
Total	$3,552	$2,517

State Medicaid Agency criteria require reporting of building depreciation computed only on a straight line basis. Autumn Hills depreciated the building addition at the Texas City facility on an accelerated rather than straight line basis. The $2,538 shown in the table above is the difference between depreciation computed by the accelerated and straight line methods. We believe this amount is clearly unallowable under State criteria. However, because of where this nursing home fell in the State's data array for rate-setting purposes for "facility costs," this adjustment had no effect on what Autumn Hills was paid for the period beginning September 1, 1981.

As with the employee meals identified in the central office cost report, we have questions about whether meal costs reported by the home are unallowable entertainment costs or personal expenses or are allowable employee fringe benefits. The Medicaid Agency considered the meal costs reported by the Company in 1978 as unallowable. In 1980 and 1978, the costs were reported as advertising and promotion expenses and included in the administrative costs. In addition, Deloitte identified unallowable newspaper and radio advertising costs and donations to a local sheriff's reserve, a high school, and the Texas National Guard.

Patients' trust funds

The patients' trust fund account at the Texas City home was audited by a Medicaid Agency caseworker in May 1980, May 1981, and December 1981. In each instance, the reconciled bank statement equaled the trust fund balances on the home's books. The May 1980 audit pointed out some recordkeeping problems and delays in making refunds for discharged or deceased patients. The later audits identified no problems with this trust fund.

We also examined the patients' trust fund for October 1980. The reconciled bank statement balance equaled the patients' trust fund balance on the home's books.

SUMMARY

Virtually all the $250,220 in home office and Texas City costs we questioned for 1980 fell into the administrative cost category, but the reporting of these costs had no effect on what Autumn Hills and other nursing homes in Texas were or will be paid during the applicable rate period.

The Company believes that most of the costs we questioned were reasonable and allowable for rate-setting purposes, and under the State's vague written criteria, we are not in a position to conclude that the Company's views are necessarily incorrect.

In any event, we believe that the State Medicaid Agency should clarify and expand its written criteria on defining allowable and unallowable costs to make it clear to nursing home operators which costs are and are not allowable in cost reports. These revisions should include more specific language as well as examples of the allowability or unallowability of frequently incurred costs, such as entertainment expenses or life insurance premiums discussed in this chapter. This clarification and expansion should result in a more accurate data base upon which to set future payment rates.

In commenting on the adequacy of the Medicaid Agency's written criteria, a State official told us that in view of the State's administrative requirements involved in modifying its reimbursement criteria, he wanted to keep the instructions as brief as possible.

CHAPTER 4

TEXAS CITY HOME DOES NOT ALWAYS

HAVE ENOUGH NURSES ON DUTY

The Texas City home has a history of not having a sufficient number of nurses on duty to meet the Medicaid Agency's standards for participation in the program, but the home has shown improvement in recent years according to Health Department analyses. Our analysis of time and attendance data for Texas City nurses, however, disclosed shortages in 1980 similar to those identified by the Health Department in 1978. The frequency of these nurse shortages raises questions about the level of nursing care actually provided Texas City home residents.

STATE'S STANDARDS FOR NURSES FOR SKILLED AND INTERMEDIATE CARE FACILITIES

The Medicaid Agency's nursing staff standards for SCFs require that a registered nurse be on duty during the day shift and either a registered or licensed vocational nurse be on duty during the afternoon and night shifts, so that residents receive 24-hour nursing service. There should be a sufficient number of nurses on duty during each 24-hour period to achieve a nurse to resident ratio of 1 nurse to every 15 residents.

The nursing staff standards for ICFS require that a nurse be on duty during the day and afternoon work shifts. Typically, these nurses are licensed vocational nurses. A registered or licensed nurse is not required for the night shift, but the person in charge must be experienced in the nursing field. According to the State standards, there should be a sufficient number of nurses on duty during each 24-hour period to achieve a nurse to resident ratio of 1 to 30.

In homes such as Texas City, with an average daily occupancy of 60 or greater and which offer both skilled and intermediate levels of care, the director of nurses 1/ may not serve as a charge

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1/The director of nurses is a registered nurse who is employed full time and is responsible for the home's total nursing service including (1) development and maintenance of nursing service objectives and standards of nursing practice and (2) determination of the number and level of nursing personnel including the charge nurses.

nurse 1/ on any of the three work shifts and may not be counted in the nurse to resident ratio. However, according to HCFA, the director of nurses may satisfy the registered nurse requirement for the day shift in the skilled care area.

Although the Medicaid Agency developed the nursing staff requirements for nursing homes, it relies upon the Health Department to inspect homes for compliance to the Medicaid standards. Texas does not assess monetary penalties for failure to meet standards. One State, however, in the HCFA region VI (Oklahoma) does impose a reduction in rates for failure to meet staffing requirements. 2/ According to the Oklahoma State Medicaid Plan, effective January 1980, the failure to meet staffing requirements for SNFs or ICFs will result in a reduction in rate of $2.50 per day per patient for the entire month.

NURSE SHORTAGES AT TEXAS CITY SINCE 1978

Our analysis of Health Department inspections and Texas City employee time cards identified several instances from 1978 through 1980 where the Texas City home failed to have a sufficient number of nurses on duty to comply with Medicaid standards. Our analysis of the nurse staffing data gathered by the Health Department during its annual recertification inspections of Texas City for 1978 through 1981 showed several days during selected 3-week periods in 1978 and 1979 where a licensed nurse was not on duty on the required shifts or the nurse to resident ratio was not met. According to a State official, during its inspections, staffing data are verified by time cards and payroll records. The number of days each period where the State reports showed that these nursing requirements were not met at the Texas City facility is summarized below.

1/A charge nurse is a registered nurse or licensed vocational nurse on each of the three work shifts in charge of the nursing service and other nurses. The charge nurse reports to the director of nurses.

2/Region VI consists of Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

Year	Staffing period (total days)	Extent of nurse shortage: Number of days	Extent of nurse shortage: Percent of days
1978	April 16 - May 6 (21 days)	11	52
1979	May 1 - 21 (21 days)	3	14
1980	April 24 - May 14 (21 days)	-	-
1981	April 10 - 30 (21 days)	-	-

We examined time cards for nurses employed at Texas City during January, June, and October 1980 and identified 32 days during the period (or 35 percent of the total days) where the home failed to meet nursing requirements--21 days in January, 7 days in June, and 4 days in October. 1/ Although we used essentially the same verification methodology as the State, we cannot explain why we identified shortages in 1980 and the Health Department did not. We noted, however, that the Department's reviews covered about the same 3-week periods during the months of April and May for each year, which would provide a facility with a good indication of the time periods to be subject to verification.

Our examination of the Texas City employee time cards showed that practically all entries were stamped with a time clock. Only a few handwritten entries were noted, usually to identify lunch breaks. We noted only one entry of the hundreds examined which might be considered as altered.

Autumn Hills comments

The Autumn Hills' Controller agreed that the Company's homes sometimes may not have the required number of nurses on duty to comply with the Medicaid standards. He said sickness, emergencies, or resignations create temporary shortages because nurses scheduled for duty do not report for work. The Autumn Hills policy, he said, was not to hire temporary nurses just to comply with Medicaid standards.

CONCLUSION

The Autumn Hills Texas City nursing home has a history of not complying with Medicaid standards for nurse staffing. On numerous occasions over the 3-year period from 1978 through 1980, the home failed to have a sufficient number of nurses on duty

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1/The director of nurses is a salaried employee; therefore, the time worked was not shown by a time card. On the days where no registered nurse worked the day shift in the skilled area, we nevertheless counted the director of nurses as on duty for the purposes of meeting the State requirement.

to provide the level of nurse staffing required by the Medicaid standards. According to our analysis for 3 selected months in 1980, the required number of nurses were available only about two-thirds of the time. In our opinion, the frequency of nurse shortages raises questions about the level of nursing care provided to Texas City home residents.

Further, the Company has little financial incentive to hire temporary nurses to meet the standards because, unlike Oklahoma, the State does not reduce payment rates when its staffing requirements are not met.

LISTING OF AUTUMN HILLS

CONVALESCENT CENTERS, INC., NURSING HOMES

Location	Initial operation date	Owned/ leased at 12/30/80	Contracted bed capacity at 12/30/80 SNF	ICF	Occupancy rate at 12/30/80
					(percent)
Janish Street Houston, Texas	1964	owned	-	119	96
Liberty South Liberty, Texas	1964	owned	-	82	74
Richmond, Texas	1965	owned	-	100	90
Hermann Park Manor Houston, Texas	1968	leased	60	125	92
Conroe, Texas	1968	owned	-	108	92
Texas City, Texas	1972	owned	60	60	a/98
Friendswood, Texas	1972	leased	61	60	89
Huntsville, Texas	1973	owned	55	54	92
Cleveland, Texas	1973	leased	-	160	84
Beaumont #1 Beaumont, Texas	1974	owned	42	42	98
Beaumont #2 Beaumont, Texas	1974	owned	-	80	78
Columbus, Texas	1974	owned	-	90	94
Giddings, Texas	1975	owned	-	50	90
Vintage Street Houston, Texas	1976	owned	-	82	94
Tomball, Texas	1977	leased	60	90	91
Liberty North Liberty, Texas	1977	leased	58	60	81
Sugarland, Texas	1978	leased	60	90	89

a/This occupancy rate would be 99 percent had we based it upon the home's nursing home monthly report instead of the annual cost report.

AUTUMN HILLS CONVALESCENT CENTERS, INC. (note a)

COMBINED BALANCE SHEETS DECEMBER 31, 1980, 1979, and 1978

Assets	1980 (note b)	1979	1978
Current assets:			
Cash	$ 147,572	$ 486,981	$ 188,680
Certificate of deposit	300,000	100,000	153,467
Note receivable - stockholder	25,000	-	-
Current maturities - notes receivable	30,876	57,995	35,060
Accounts receivable - patients and governmental agencies	1,308,183	1,375,181	1,071,087
Other	108,162	79,489	237,552
	1,416,345	1,454,670	1,308,639
Less allowance for doubtful receivables	(196,000)	(196,000)	(96,000)
Net accounts receivable	1,220,345	1,258,670	1,212,639
Prepaid expenses and other current assets	95,977	139,731	142,481
Total current assets	1,819,770	2,043,377	1,732,327
Property, plants, and equipment:			
Land	942,419	928,769	734,299
Buildings	6,185,534	5,348,293	4,486,362
Furniture, equipment, and leasehold improvements	3,507,278	3,192,179	2,610,799
	10,635,231	9,469,241	7,831,460
Less accumulated depreciation and amortization	(3,082,639)	(2,528,280)	2,031,485
Other assets:			
Investments	280,687	396,630	
Notes receivable, less current maturities:			
Sale of property, plant and equipment	546,737	397,860	411,762
Stockholders	81,010	87,602	101,840
Affiliate	-	42,748	47,865
Other	463,814	485,697	412,121
Total other assets	1,372,248	1,410,537	1,306,188
Total assets	$10,744,610	$10,394,875	$8,838,490

APPENDIX II

Liabilities	1980 (note b)	1979	1978
Current liabilities:			
Notes payable to banks	$ 140,760	$ 227,500	$ 253,001
Current maturities of long-term obligations	459,818	509,605	466,320
Accounts payable and accrued liabilities	1,423,870	1,293,762	1,134,247
Federal income taxes payable	-	79,000	-
Total current liabilities	2,024,448	2,109,867	1,853,568
Long-term obligations, less current maturities	7,777,111	7,335,359	6,320,492
Deferred Federal income taxes	135,150	117,150	50,150
Deferred gain	69,549	74,186	78,822
Total liabilities	10,006,258	9,636,562	8,303,032
Capital accounts	738,352	758,313	535,458
Total liabilities and capital	$10,744,610	$10,394,875	$8,838,490

a/Includes the accounts of Fort Crockett Investors, a joint venture related through common ownership.

b/Includes the operations of a subsidiary since acquisition on March 28, 1980.

AUTUMN HILLS CONVALESCENT CENTERS, INC. (note a)

COMBINED INCOME STATEMENTS YEAR ENDED

DECEMBER 31, 1978, 1979, and 1980

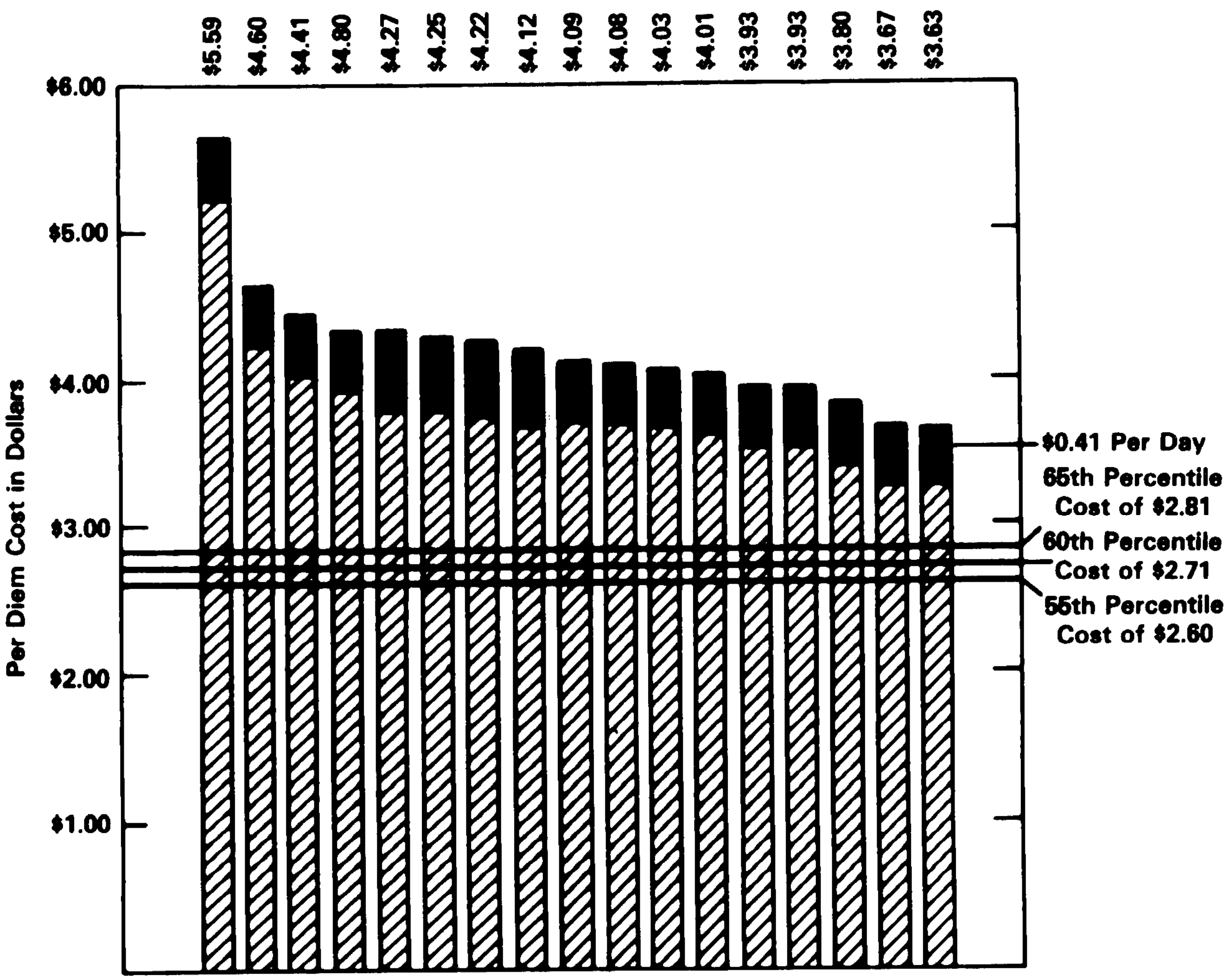
	1980 (note b)	1979	1978
Revenues:			
Patient services	$16,354,483	$14,432,986	$11,926,490
Other income	361,505	328,684	274,557
Total revenues	16,715,988	14,761,670	12,201,047
Costs and expenses:			
Operating and administrative	15,257,928	13,015,021	10,815,366
Depreciation and amortization	574,768	514,636	438,280
Interest	852,753	843,158	699,980
	16,685,449	14,372,815	11,953,626
Earnings before income taxes	30,539	338,855	247,421
Income taxes:			
Current	22,500	79,000	-
Deferred	18,000	67,000	12,113
Total income taxes	40,500	146,000	12,113
Net income (loss)	$ (9,961)	$ 242,855	$ 235,308

a/Includes the accounts of Fort Crockett Investors, a joint venture partnership related through common ownership.

b/Includes the accounts of a subsidiary since acquisition on March 28, 1980.

Chart Showing Lack of Rate Impact by Reporting Unallowable, Questionable, or Undocumented Administrative Costs for Calendar Year 1980

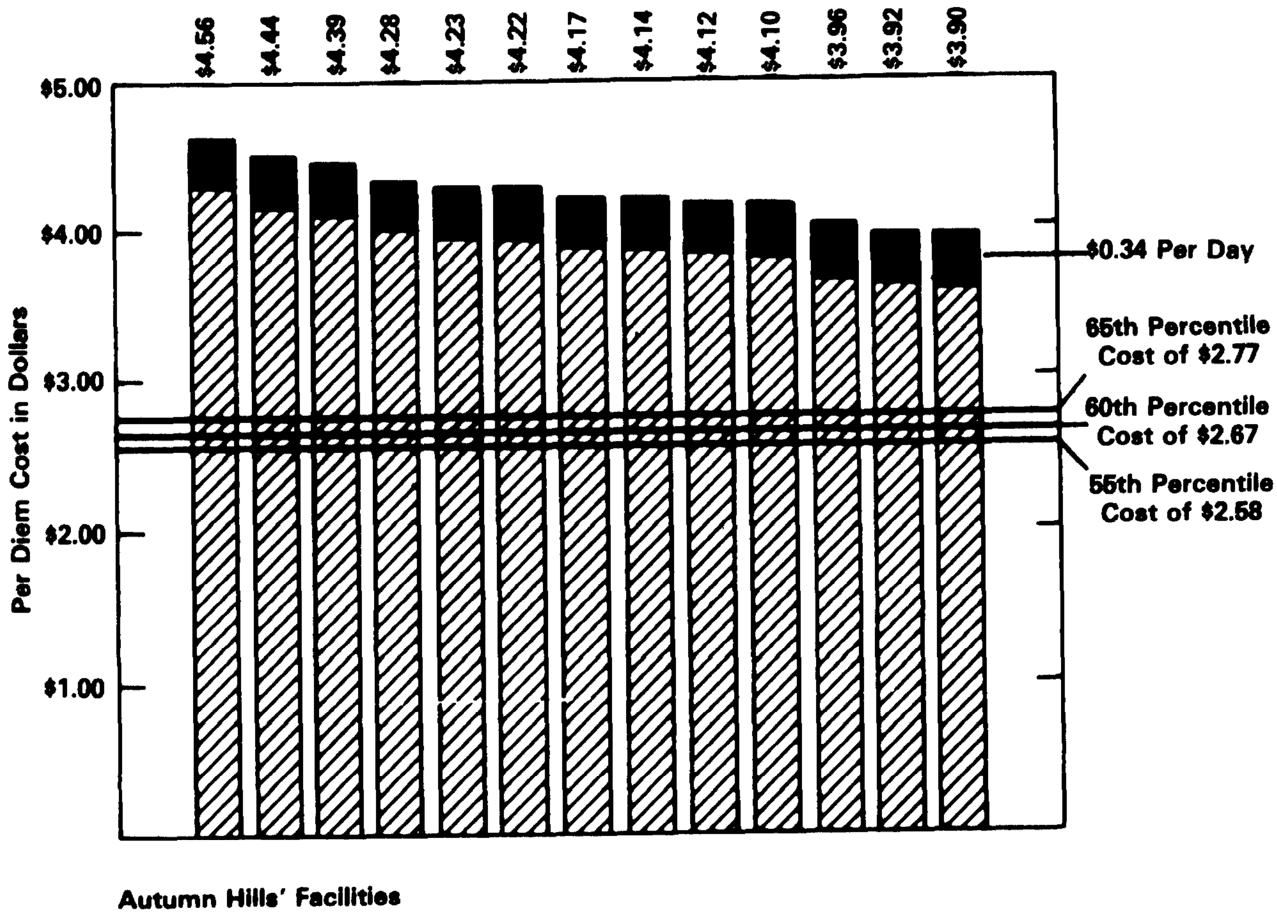
Shaded area represents the amount of administrative cost per day GAO considers unallowable, questionable, or undocumented—exclusive of inflation adjustments during rate projection process.



Autumn Hills' Facilities

Chart Showing Lack of Rate Impact by Reporting
Unallowable Administrative Costs
for Calendar Year 1978

Shaded area represents the amount of administrative cost per day Deloitte disallowed—exclusive of inflation adjustments during rate projection process.



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