REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

RECOMMENDATION FOR A RESIDENTIAL CARE RATE STRUCTURE

P-574

MARCH 1986

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Thomas W. Hayes
Auditor General

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Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning a residential care rate structure. The report recommends that the State of California use four cost categories to establish a rate for clients placed in residential care facilities. These categories are basic living costs, indirect costs of operating a facility, costs mandated by legislation or licensing requirements, and a reasonable return on investment for privately owned facilities.

We conducted this audit to comply with Chapter 1017, Statutes of 1985.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

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SUMMARY

In establishing a rate structure for clients in residential care facilities, the State of California should use the following cost categories: basic living costs, indirect costs of operating a facility, costs mandated by legislation or licensing requirements, and a reasonable proprietary return. During our audit, we noted that the number of components within these cost categories increases as the size of the residential care facility increases. If state agencies do not review residential care rates each year, the agencies should increase these rates by using an appropriate cost-of-living adjustment.

Basic living costs are applicable to all client groups and include the salaries of the staff who provide the basic care such as housekeeping, laundry, and food preparation. These costs also include the costs for food, utilities, clothing, and personal care items. Indirect costs include items such as employee benefits, supplies, special programs, repairs and maintenance, transportation, and taxes. Mandated costs are those that residential care facility owners incur as a result of legislative, departmental, or county requirements. Mandated costs include expenses such as employer training, bonding of certain employees, providing clients access to telephones, and installing facility improvements to meet safety standards. Finally, the private owners of residential care facilities should receive a return on their investment.

An annual review of the residential care rate structure ensures that the rates reflect the current cost of living. If state agencies do not review the rate for residential care each year, the agencies should use economic indices, such as the Consumer Price Index or the California Necessity Index, to adjust the rate to reflect the current cost of living.

We met with representatives of the Secretary of the Health and Welfare Agency and with representatives of the directors of the departments of Social Services, Developmental Services, and Mental Health, and they agree with our conclusions.

INTRODUCTION

Community care facilities include all nonmedical day care homes and centers for children and adults, adoptions and homefinding agencies, foster family homes, children's family and group homes, residential facilities for the elderly, and rehabilitation facilities. There are approximately 65,000 licensed community care facilities in California serving about 733,000 clients. Approximately 10,000 of these facilities are residential care facilities that can provide 24-hour nonmedical care and supervision for approximately 125,000 clients.

Persons served by residential care facilities include children and adults who are mentally disabled, developmentally disabled, aged, and "socially dependent." Generally, the clients residing in these facilities are eligible for Supplemental Security Income/State Supplementary Plan (SSI/SSP) support. Effective January 1, 1986, the monthly rate for SSI/SSP is $601 per person, which covers the basic costs of housing and food, care and supervision, and personal and incidental items.

By March 1 of each year, the Department of Developmental Services (DDS) must propose to the Legislature a rate for the residential care of the developmentally disabled. In establishing this rate, the DDS reviews cost data obtained from a statewide sample of residential facilities. Although the Department of Mental Health (DMH) does not determine a rate for the mentally disabled, Section 4681(h) of the Welfare and Institutions Code requires the DMH to establish criteria for developing higher rates for clients who are both developmentally disabled and mentally disabled. In addition, the DMH uses the residential care rates established by the DDS for mentally disabled clients who are living in residential care facilities. The Legislature has mandated that the DMH establish a residential care rate for mentally disabled clients. Further, the Legislature has mandated that the Department of Social Services submit a rate study for elderly clients by December 1, 1986.

SCOPE AND METHODOLOGY

The purpose of this audit is to recommend a residential care rate structure for residential care facilities for clients who receive SSI/SSP support. To determine the cost factors that should be considered in a rate for residential care, we visited 37 residential care facilities throughout California. We selected these facilities from a statewide listing of residential care facilities licensed by the Department of Social Services, and we included only residential care facilities for the elderly, developmentally disabled, and the mentally disabled. (Our analysis excludes foster family homes and residential care facilities operated by public agencies.) We selected our sample of residential care facilities from ten counties representing urban areas (Orange, Los Angeles, and San Bernardino counties), rural areas (Merced, Fresno, and San Joaquin counties), and a combination of urban and rural areas (Sacramento, Placer, El Dorado, and Yolo counties). In our sample, we also considered the size of the residential care facilities. These counties also represent the northern, central, and southern areas of the State. Table 1 presents a summary of the facilities we visited by client group and facility size.

TABLE 1

RESIDENTIAL CARE FACILITIES SURVEYED BY CLIENT GROUP AND FACILITY SIZE

	Number of Beds				
Client Group	1-6	7-15	16-49	50 and Over	Total
Elderly	3	2	4	5	14
Developmentally disabled	4	3	3	2	12
Mentally disabled	2	4	3	2	11
Total	9	9	10	9	37

At each facility, we met with facility owners or administrators and examined the facilities' financial statements or records to determine the cost factors associated with their operations. However, our analysis of these records revealed that the facilities' accounting or bookkeeping methods differ and that they do not always clearly or consistently describe the specific costs falling within the various cost categories.

Finally, to determine ways of incorporating a cost-of-living factor in the rate for residential care facilities, we reviewed the methodologies used by both the U.S. Bureau of Labor Statistics and the Department of Finance in developing certain economic indices.

To ensure that our survey focused on the cost factors for clients living in a residential care facility, we made the following assumptions:

- Costs result from the clients' residing in the facility;

- Clients are eligible for the residential care facility in which they are placed;

- All individuals in a facility have common basic needs, regardless of their client group; and

- Some individuals require more care and supervision than others because of their special needs.

We conducted this audit to meet the requirements of Chapter 1017, Statutes of 1985.

AUDIT RESULTS

A PROPOSED RATE STRUCTURE FOR RESIDENTIAL CARE FACILITIES

We have identified four cost categories that state agencies should consider in developing appropriate rates for clients in residential care facilities. In addition, we conclude that the size of a facility affects the rate structure and that rates should be reviewed annually to ensure that they reflect the current cost of living.

Costs That Should Be Included in the Rate Structure

The four cost categories that state agencies should consider in developing appropriate rates for clients in residential care facilities are (1) basic living costs, (2) indirect costs, (3) costs mandated by legislation or licensing requirements, and (4) proprietary fees for privately owned facilities. Appendix A summarizes the ranges in costs per month for 29 of the 37 residential care facilities in our survey according to facility size and client group. Appendices B through D present the ranges of costs reported by the facilities serving each of the three client groups in our survey.

Basic Living Costs

Basic living costs are applicable to all client groups. Therefore, a rate structure should consider each client's proportionate use of the facility's resources and corresponding costs of using the resources. Basic living costs should include the salaries of the staff who provide basic care such as housekeeping, laundry, and food preparation. Additionally, these costs should include the costs for food, utilities, clothing, and personal care items.

Indirect Costs

Indirect costs should include salaries, employee benefits, supplies, special programs, administrative services, repairs and maintenance, dues and subscriptions, transportation, and taxes. Indirect costs vary in proportion to the size of the facility, the number of staff employed by the facility, the type of ownership, and the availability of special services provided to the clients at the facility. For example, family homes usually are operated by the facility owner, who does not receive a salary. Such homes employ few, if any, salaried staff and generally do not provide specialized services to clients. Therefore, the indirect costs of family homes are low. Conversely, group homes are usually owned or operated by a sponsoring organization, employ salaried staff, and may offer specialized services to their clients. These facilities tend to have considerably higher indirect costs.

We contacted 37 residential care facility administrators to determine which indirect costs they incurred in operating their facilities. Our analysis of these costs revealed that the facilities' accounting or bookkeeping methods differ and do not always clearly or consistently define the specific costs falling within this cost category. These administrators also reported varying costs for performing similar activities. For example, two of the residential care facilities of equal size that we visited reported different monthly costs for insurance; one reported $16 per client, and the second reported $22 per client. One facility paid for two types of insurance, and the other paid for three. Further, one facility reported monthly telephone expenses of $3 per client, while the other reported $22 per client. The first facility maintained a pay telephone on the premises; the other paid for telephone service for its clients.

Additionally, some facility owners and administrators said that the counties in which they operate require them to purchase general liability insurance in addition to fire and automobile insurance. Although the State does not require general liability insurance for licensing, it is a prerequisite for counties to refer clients to their residential care facilities. The seven county risk management officers we contacted throughout the State confirmed that general liability insurance is required in these seven counties.

Costs Mandated by Legislation or State Regulations

Mandated costs should include those required by legislation, by departmental requirements for licensing, or by county requirements for placing clients in residential care facilities. These costs increase with the size of the facility and the amount of supervision required. Facilities having a large number of beds require greater expenditures for providing such things as mandatory safety requirements, full-time supervision of clients, and specialized services to clients.

Title 22, Division 6, of the California Administrative Code contains current licensing requirements for residential care facilities. For example, these licensing requirements specify that each licensee responsible for the personal funds of clients must be bonded, that all residential care facilities must have telephone service on the premises, that certain facilities have sprinkler systems that must be inspected periodically, and that facility staff be given training in cardiopulmonary resuscitation and first aid. These licensing requirements result in additional expenses for the licensee.

Proprietary Return on Investment

The private owners of residential care facilities should receive a return on their investment of time and resources. These owners could invest their time and resources in business ventures that provide a reasonable return on their investment. For example, property owners could rent their property to earn a return on their investment. Additionally, if the property owner also manages the rental property, a fee for the owner's time and services could also be charged to the renter.

Private owners who invest their resources in the residential care industry are also entitled to a reasonable return on their investment. Therefore, we recommend that a proprietary fee, based on a reasonable return on investment, be included within the residential care rate structure.

Impact of Facility Size
on Residential Rates

Our survey of 37 residential care facilities located throughout California indicated that these facilities have the following three characteristics. First, the number of specialized staff increases as the size of the facility increases. Small owner-operated facilities of one to 6 beds employ few, if any, full-time staff, while facilities with 7 beds or more employ full-time staff to provide necessary care and supervision. In some cases, state regulations require additional staff to be employed by larger facilities. For example, the California Administrative Code requires facilities with 50 beds or more to employ a qualified dietician, nutritionist, or home economist either as a staff member or as a consultant. In addition, state regulations require facilities with 50 beds or more to employ a full-time activities coordinator.

Second, the number of cost components included in the facility's rate structure increases as the size of the facility increases. Because larger facilities are required to perform specialized tasks and to provide care and supervision to a larger number of clients, facility owners or operators incur additional costs.

Finally, the client groups residing in residential care facilities require varying levels of care and supervision. We conclude from discussions with the operators of the facilities in our survey that elderly residents require the least supervision, while the developmentally disabled and mentally disabled residents require more intensive supervision. For example, the owner of one 10-bed facility for the elderly stated that the residents were independent and required only infrequent assistance in taking prescribed medications. In contrast, the owner of a 6-bed facility for the developmentally disabled stated that his residents required daily care and supervision in accomplishing basic living tasks.

Frequency of Rate Reviews

Each year, the Department of Developmental Services (DDS) proposes to the Legislature a rate for the residential care of the developmentally disabled. An annual review of the rate structure for residential care facilities ensures that the rates reflect the current cost of living. If, however, state agencies do not review the rate for residential care each year, the agencies need to consider other methods of adjusting the rate to reflect the current cost of living.

To determine other ways of establishing a cost-of-living factor in the rate for residential care facilities, we reviewed the Department of Finance's use of the Consumer Price Index and the California Necessity Index. The Consumer Price Index, annually calculated by the U.S. Bureau of Labor Statistics, measures the average changes in prices of certain goods and services purchased over a period. The Department of Finance prepares the California Necessity Index based upon five items contained in the Consumer Price Index. These items include food, rent, utilities and household fuel, transportation, and apparel. We recommend that state agencies that do not review rates for residential care each year use economic indices, such as the Consumer Price Index or California Necessity Index, in adjusting the rates to reflect the current cost of living.

In considering the cost differences among residential care facilities in different geographical areas, the DDS reviews a representative sample of facilities providing residential care to the developmentally disabled. The chief of the DDS' Community Living Arrangements Section stated that there were no significant cost differences attributable to the location of facilities. Although there may be no significant cost differences, state agencies presently developing rate studies should still consider geographical cost differences in developing a rate for the residential care of their clients. In their statewide rate studies, these agencies should include residential facilities in both urban and rural areas.

CONCLUSION

In developing a rate structure for the clients in residential care facilities, state agencies should consider basic living costs, indirect costs of operating a facility, costs mandated by legislation or state licensing requirements, and a reasonable proprietary fee for privately owned facilities. Furthermore, if state agencies do not annually review residential care rates, the agencies should adjust the rate by using an appropriate economic cost-of-living adjustment.

RECOMMENDATIONS

We recommend that the State of California, in developing a rate structure for clients in residential care facilities, use the following categories of cost: basic living costs, indirect costs of operating a facility, costs mandated by legislation or state licensing requirements, and a reasonable return on investment for privately owned facilities.

If state agencies do not review residential care rates annually, we recommend that these agencies use an economic index, such as the Consumer Price Index or the California Necessity Index, to adjust the rate to reflect the current cost of living.

Finally, to determine if there are significant differences in costs attributable to the geographic location of a facility, state agencies should include in their statewide rate studies residential facilities in both urban and rural areas.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

Date: February 28, 1986

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COMPOSITE RANGE OF BASIC COSTS AND INDIRECT COSTS PER CLIENT PER MONTH FOR 29 FACILITIES*
(UNAUDITED DATA)

Cost Factors	Facility Size (Number of Beds) 1 - 6 Low - High	7 - 15 Low - High	16 - 49 Low - High	50 - Over Low - High
Basic Costs				
Rent/Lease	$ 0 - $239	$ 0 - $122	$ 0 - $ 90	$ 0 - $206
Food	81 - 173	51 - 144	42 - 142	29 - 262
Utilities	25 - 66	21 - 56	18 - 86	22 - 63
Clothing and Personal Care	0 - 64	0 - 20	0 - 16	0 - 3
Indirect Costs				
Salaries	0 - 167	0 - 282	13 - 2,119	112 - 392
Employee Benefits		0 - 57	0 - 50	0 - 139
Insurance	20 - 86	5 - 33	0 - 49	4 - 44
Repairs and Maintenance	0 - 17	17 - 56	2 - 35	9 - 34
Laundry, Housekeeping, and Office Supplies	0 - 58	2 - 24	4 - 60	0 - 36
Special Programs and Recreation	0 - 28	0 - 17	0 - 6	0 - 7
Administrative Expenses	0 - 18	0 - 50	3 - 450	3 - 196
Dues and Subscriptions	0 - 7	0 - 12	0 - 3	0 - 2
Transportation	10 - 89	0 - 113	0 - 93	0 - 17
Taxes	0 - 27	0 - 46	0 - 101	0 - 52

*Only 29 of the 37 facilities we surveyed provided financial data that we could use in our analysis. None of the facilities provided data that we could use to analyze mandatory costs or proprietary fees.

COMPOSITE RANGE OF BASIC COST AND INDIRECT COSTS PER CLIENT PER MONTH FOR 10 FACILITIES FOR THE ELDERLY (UNAUDITED DATA)

Cost Factors	Facility Size (Number of Beds) 1 - 6* Low - High	7 - 15 Low - High	16 - 49 Low - High	50 - Over Low - High
Basic Costs				
Rent/Lease		\$ 0 - \$ 62	\$ 0 - \$ 28	\$ 99 - \$206
Food		80 - 144	57 - 92	70 - 262
Utilities		35 - 50	34 - 86	28 - 63
Clothing and Personal Care		0 - 6	0 - 6	0 - 2
Indirect Costs				
Salaries		67 - 130	191 - 2,119	145 - 392
Employee Benefits			0 - 50	0 - 139
Insurance		14 - 22	0 - 28	4 - 21
Repairs and Maintenance		34 - 56	13 - 19	9 - 25
Laundry, Housekeeping, and Office Supplies		14 - 20	9 - 23	15 - 35
Special Programs and Recreation		0 - 11	0 - 3	
Administrative Expenses		14 - 19	24 - 117	16 - 93
Dues and Subscriptions		3 - 3	0 - 3	
Transportation		18 - 46	0 - 20	0 - 2
Taxes		7 - 46	0 - 36	0 - 36

*We did not include a range of costs for facilities of one to six beds because these facilities could not provide sufficient financial data.

COMPOSITE RANGE OF BASIC COSTS AND INDIRECT COSTS PER CLIENT PER MONTH FOR 11 FACILITIES FOR THE DEVELOPMENTALLY DISABLED (UNAUDITED DATA)

	Facility Size (Number of Beds)							
	1 - 6		7 - 15		16 - 49		50 - Over	
Cost Factors	Low	High	Low	High	Low	High	Low	High
Basic Costs								
Rent/Lease	$ 0 -	$451	$ 0 -	$122			$ 0 -	$181
Food	81 -	173	51 -	83	$ 81 -	$142	53 -	70
Utilities	25 -	66	21 -	41	40 -	48	22 -	45
Clothing and Personal Care	0 -	64	0 -	3			0 -	3
Indirect Costs								
Salaries	0 -	167	0 -	282	621 -	1,000	323 -	361
Employee Benefits			0 -	57			0 -	2
Insurance	20 -	86	7 -	33	25 -	36	23 -	44
Repairs and Maintenance	0 -	17	40 -	48	2 -	25	9 -	15
Laundry, Housekeeping, and Office Supplies	0 -	58	12 -	24	20 -	60	0 -	36
Special Programs and Recreation	0 -	28	0 -	3				
Administrative Expenses	0 -	18	0 -	50	3 -	450	10 -	196
Dues and Subscriptions	0 -	7	0 -	3			0 -	1
Transportation	10 -	89	3 -	59	17 -	93	1 -	17
Taxes	0 -	27	0 -	16	9 -	101	48 -	52

COMPOSITE RANGE OF BASIC COSTS AND INDIRECT COSTS PER CLIENT PER MONTH FOR 8 FACILITIES FOR THE MENTALLY DISABLED (UNAUDITED DATA)

Cost Factors	Facility Size (Number of Beds) 1 - 6* Low	High	7 - 15 Low	High	16 - 49 Low	High	50 - Over Low	High
Basic Costs								
Rent/Lease					$ 37 -	$90	$ 23 -	$192
Food			$95 -	$127	42 -	112	29 -	61
Utilities			29 -	56	18 -	42	26 -	39
Clothing and Personal Care			0 -	20	0 -	16		
Indirect Costs								
Salaries			0 -	111	13 -	149	112 -	228
Employee Benefits								
Insurance			5 -	30	12 -	49	10 -	15
Repairs and Maintenance			17 -	24	11 -	35	21 -	34
Laundry, Housekeeping, and Office Supplies			2 -	7	4 -	12	4 -	17
Special Programs and Recreation			0 -	17	0 -	6	2 -	7
Administrative Expenses			0 -	2	4 -	6	3 -	5
Dues and Subscriptions			1 -	12	0 -	1	1 -	2
Transportation			12 -	113	11 -	29	1 -	9
Taxes			3 -	40	13 -	45	13 -	22

*We did not include a range of costs for facilities of one to six beds because these facilities could not provide sufficient financial data.

cc: Members of the Legislature
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