

Department of Public Health

It Reported Inaccurate Financial Information and Can Likely Increase Revenues for the State and Federal Health Facilities Citation Penalties Accounts

REPORT NUMBER 2010-108, JUNE 2010

Department of Public Health's response as of December 2010

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) conduct an audit of the Department of Public Health's (Public Health) management of the State Health Facilities Citation Penalties Account (state account) and the Federal Health Facilities Citation Penalties Account (federal account), into which monetary penalties collected from long-term health care facilities are deposited.

Finding #1: Public Health prepared fund condition statements for the federal account that overstated funds available for appropriation.

The federal account's fund condition statements for fiscal years 2004–05 through 2008–09, which appeared in the governor's budget, contained significant errors. Specifically, Public Health and its predecessor excluded financial information concerning the Department of Aging (Aging) when preparing the fund condition statements for the federal account, causing the fund balance to be overstated each year. The inaccurate reporting of the federal account's fund balance led to an overstatement of \$9.9 million as of June 30, 2009.

The fund balance overstatements occurred in large part because Public Health's budget section excluded financial information concerning Aging when preparing the fund condition statements for the federal account. Since fiscal year 2003–04, Aging has received an annual budget act appropriation from the federal account for its Long-Term Care Ombudsman Program (ombudsman program). Until March 30, 2010, the procedure manual used by staff in Public Health's budget section when preparing the fund condition statements did not indicate that preparation of the fund condition statement for the federal account required merging the activity associated with the financial statements from Aging's ombudsman program. Further, according to a manager in Public Health's budget section, the section did not have a sufficient number of qualified staff to ensure that the fund condition statements were accurately prepared. As a result, Public Health prepared inaccurate fund condition statements for inclusion in the governor's budget.

We recommended that Public Health include text in its budget section procedure manual requiring staff to reconcile the revenues, expenditures, and fund balance as supported by Aging's and Public Health's accounting records to the fund condition statement prepared for inclusion in the governor's budget. We also recommended that a supervisory review be performed of the reconciliation of the fund condition to Aging's and Public Health's accounting records.

Audit Highlights . . .

Our review of the Department of Public Health's (Public Health) management of the state and federal Health Facilities Citation Penalties accounts (state and federal accounts) over a nearly seven-year period revealed the following:

- » *Public Health's poor internal controls led to significant errors in the fund balance for the federal account—for at least five years, it or its predecessor overstated the fund balances that are included in the governor's budget.*
- » *The federal account's ending fund balance for fiscal year 2008–09 was overstated by \$9.9 million.*
- » *Although Public Health generally collects all nonappealed monetary penalties, it inappropriately granted reductions to 135 citations.*
- » *In part due to a lengthy appeals process, Public Health collects a significantly lower portion of monetary penalties for appealed citations.*
- » *Opportunities exist for Public Health to increase revenue for both the state and federal accounts.*

Public Health's Action: Corrective action taken.

Public Health stated that the budget section procedures manual has been updated with the revised fund condition statement procedures, which include obtaining financial statements from other departments and performing a supervisory review of the reconciliation. Further, Public Health stated that the budget section performed the internal review of the fund condition statements in October 2010.

Finding #2: Public Health collects a high proportion of the monetary penalties it imposed on facilities that chose not to appeal, but some penalties were reduced inappropriately.

Although we found that Public Health generally collected all of the monetary penalties that were collectable for the citations it issued to facilities that decided not to appeal monetary penalties imposed from fiscal year 2003–04 through March 15, 2010, the original penalty amounts were often substantially decreased before facilities made their payments. These decreases were generally due to state law, which grants facilities an automatic 35 percent reduction in original monetary penalty amounts if the penalties are paid and not contested within time frames specified in law. We found that Public Health inappropriately granted reductions to facilities that paid their penalties after the time frames specified in law, depriving the state account of roughly \$70,000 in revenues that it was otherwise due. These inappropriate reductions were mainly due to the inaccurate calculation made by the Electronic Licensing Management System (ELMS), the system used by Public Health to track facilities' enforcement penalties resulting from noncompliance with state requirements to determine whether a facility's payment was received in time to warrant a 35 percent reduction. Depending on the type of violation, state law specifies that to be eligible for a reduction, a facility must pay the monetary penalty within 15 or 30 business days after the issuance of the citation. However, ELMS was programmed instead to use the date that a facility certifies that it received the citation imposing the monetary penalty. In addition, we also noted that the monetary penalty assessment form that Public Health sends to a facility when issuing a citation incorrectly referenced state law, potentially giving facilities the impression that they have more time in which to make their payments to receive the reduction than is allowed under state law.

We recommended that Public Health update ELMS to use the issuance date of the citation as specified in state law when calculating whether a facility's payment was received in time to warrant a 35 percent reduction. Further, we recommended that Public Health update its monetary penalty assessment form to ensure it contains language that is consistent with state law. Finally, we recommended that to the extent Public Health believes state law should be revised to reflect the date on which the facility received the citation, rather than the date the citation was issued, it should seek legislation to make such a change.

Public Health's Action: Partial corrective action taken.

Public Health stated that it is finalizing the enhancement of the ELMS to calculate the 35 percent reduction based on the issuance date of the citation. Further, Public Health stated that the monetary penalty assessment form was updated in September to contain language consistent with state law. Finally, Public Health stated that it does not believe it needs to revise state law to reflect the date on which the facility received the citation, rather than the date the citation was issued. Thus, our related recommendation is not applicable.

Finding #3: Prompt collection of monetary penalties is affected by appealed citations and the backlog of facilities awaiting citation review conferences.

Public Health is unable to collect millions of dollars in monetary penalties that it imposed on facilities over the past several years because facilities have appealed the citations. Specifically, facilities appealed more than 1,400 citations issued from fiscal year 2003–04 through March 15, 2010, associated with roughly \$15.7 million in monetary penalties. Of these, as of March 15, 2010, nearly 1,000 citations

comprising nearly \$9 million in monetary penalties were still under appeal. Public Health may not collect appealed monetary penalties until a decision is reached to uphold, modify, or settle the monetary penalty. As a result, there are incentives for facilities to appeal citations, particularly those involving higher penalties, because facilities can defer payments of the penalties and possibly reduce the original amounts imposed.

Further, both Public Health and external parties, such as arbitrators or administrative law judges, may significantly reduce monetary penalty amounts. Public Health reduced monetary penalties by over \$2.7 million from fiscal year 2003–04 through March 15, 2010. This resulted in an average reduction of 59 percent of the originally imposed citations that were appealed, much more than the 35 percent reduction allowed by state law for facilities that do not contest a penalty and pay it within a specified time frame. Rather than pursuing an appeal through the judicial system, a facility may request a citation review conference, in which an independent hearing officer from Public Health's Office of Legal Services makes a determination on whether to uphold, modify, or dismiss the citation. More than 600 citations were awaiting a citation review conference as of February 2010, with corresponding monetary penalties amounting to nearly \$5 million. According to the deputy director of Legal Services, at the time of our audit, Public Health had begun taking steps to reduce the backlog of appealed citations awaiting a citation review conference, including hiring and training retired annuitants and entering into a contract with the Office of Administrative Hearings (OAH) to conduct citation review conferences for certain types of appealed citations.

Current federal law provides facilities the opportunity to refute any enforcement remedies, including monetary penalties, by way of an informal dispute resolution. Unlike the citation review conference, federal law prohibits a facility from seeking a delay of any enforcement action that the Centers for Medicare and Medicaid Services (CMS) has taken against it, including the imposition of a monetary penalty, on the grounds that the informal dispute resolution has not been completed before the effective date of the monetary penalty. Thus, if a facility has requested an informal dispute resolution that has not yet been completed by the due date of the penalty, the facility must still pay the monetary penalty.

We recommended that Public Health seek legislation authorizing it to require facilities that want to appeal a monetary penalty to pay the penalty upon its appeal, which could then be deposited into an account within the special deposit fund. In addition, we recommended that Public Health provide guidance to its staff that discourages settling appealed monetary penalties for a better term than had the facility not contested the citation and paid the penalty within the time frame specified in law to receive a 35 percent reduction, and, in instances where such a settlement did occur, document the factors that formed the basis for such a reduction. Further, we recommended that Public Health continue to take steps to eliminate its backlog of appeals awaiting a citation review conference and seek legislation amending its citation review conference process to more closely reflect the federal process by prohibiting facilities from seeking a delay of the payment of monetary penalties. Finally, we recommended that it monitor its and OAH's progress in processing appealed citations.

Public Health's Action: Partial corrective action taken.

Section 1417.5, added to the Health and Safety Code in October 2010, requires Public Health to develop recommendations to streamline its citation appeal process, and to collect citation penalty amounts upon appeal of the citation and place those funds into a special interest bearing account. The recommendations must be presented to the fiscal and policy committees of the Legislature no later than March 1, 2011.

Public Health stated that it disagrees with our finding related to establishing a policy that discourages settling appealed monetary penalties for a better term than had the facility not contested the citation, and will therefore not implement our recommendation. Additionally, Public Health stated that it will not implement our recommendation related to documenting the factors that formed the basis for reducing a monetary penalty by more than 35 percent. While Public Health agreed there should not be incentives for facilities to appeal citations, it asserted that it must maintain maximum discretion to weigh all factors in a final settlement. However, as we describe in the finding, using its discretion

in reducing monetary penalties has resulted in Public Health granting an average reduction to monetary penalties of 59 percent of the amount originally imposed over the past six years. Therefore, it appears that the manner in which Public Health is currently exercising its discretion to reduce monetary penalties could be an incentive to facilities to appeal citations.

To address the backlog of appeals awaiting a citation review conference, Public Health stated that it conducted citation review conferences for nearly all Class AA citations, which impose the highest monetary penalties. Further, Public Health set six citation review conferences and stated that 227 still need to be set for a conference. Finally, Public Health began transitioning the Class A violation citation review conferences to OAH in August 2010.

Finally, Public Health established a project manager position for the OAH interagency agreement and the coordinator of the citation review conferences. Public Health also developed a tracking system for following the progress of hearing the citations.

Finding #4: Opportunities exist to increase revenue for the state and federal accounts.

Monetary penalty amounts for three types of violations have not been updated regularly to reflect the Consumer Price Index (CPI). If state law had adjusted the monetary penalties to reflect the CPI, Public Health could have collected nearly \$3.3 million more than it actually collected. Similar opportunities to increase revenue for the federal account might also exist. Although revising these monetary penalty amounts would require changes to federal regulations, Public Health could encourage CMS to seek such changes. Another opportunity for Public Health to increase revenue for the state account is to ensure that it conducts all inspections of facilities in accordance with the time frames specified in state law. Legislation effective July 1, 2007, required Public Health to incorporate both federal and state requirements into its federal survey process and thus conduct dual-purpose surveys. Although this law has been in effect for nearly three years, only about 10 percent of the surveys conducted by Public Health were dual-purpose. As a result, although Public Health currently surveys facilities for compliance with federal requirements, it has not surveyed or imposed the resulting monetary penalties for the majority of facilities in the State to ensure their compliance with state requirements. Further, Public Health may have the opportunity to increase revenue for both the state and federal accounts by requesting that they be included in the state's Surplus Money Investment Fund (SMIF). Currently, both accounts are included in the Pooled Money Investment Account and earn interest for deposit into the General Fund. The penalty accounts would earn interest that is returned to the respective accounts rather than the General Fund if they were included in the SMIF.

California is one of the few states whose laws prohibit Public Health from assessing a monetary penalty for noncompliance with state requirements and then recommending that CMS also impose a monetary penalty for noncompliance with federal requirements. Because some portion of monetary penalties resulting from Public Health's recommendations to CMS is deposited into the federal account, this law limits the amount of revenue deposited into the federal account. Further, although CMS collects interest on the monetary penalties it imposes on facilities that are not paid on time for noncompliance with federal requirements, state law does not authorize Public Health to do so. In addition, state law does not specify a time frame within which a monetary penalty must be paid if a facility elects not to appeal the citation. If state law prescribed a time frame within which a nonappealed citation must be paid, and if it authorized Public Health to collect interest on monetary penalties paid after that date, it too could collect additional revenues. An additional opportunity for Public Health to increase revenue for the federal account is by working more closely with CMS to track the outcomes of the recommendations it makes to CMS. Public Health does not currently have an effective system in place to perform this tracking.

To increase revenue for both the state and federal accounts, we recommended that Public Health seek legislation authorizing it to revise periodically the penalty amounts to reflect an inflation indicator, and encourage CMS to seek changes to federal regulations authorizing CMS to revise the monetary penalty amounts to reflect the rate of inflation. Further, we recommended that Public Health ensure

that it conducts all state surveys of facilities every two years. We also recommended that Public Health submit to the Pooled Money Investment Board a request that the board approve including both the state and federal accounts in the SMIF. Additionally, we recommended that Public Health seek authorization from the Legislature both to impose a monetary penalty and to recommend that CMS impose a monetary penalty, and to seek legislation specifying a time frame within which facilities with nonappealed citations that do not qualify for a 35 percent reduction must pay their monetary penalties and allowing Public Health to collect interest on late payments of monetary penalties. Finally, we recommended that Public Health increase its coordination with CMS to ensure that it can track CMS's implementation of the recommendations that Public Health makes to CMS.

Public Health's Action: Partial corrective action taken.

Section 1417.5, added to the Health and Safety Code in October 2010, requires Public Health to develop recommendations to increase penalty amounts, including late penalty fees, and to annually adjust penalty amounts to reflect an inflation indicator. The section also requires Public Health to recommend revisions to state law to enable the department to recommend that CMS impose a monetary penalty when Public Health determines that a facility is out of compliance with both state and federal requirements. The recommendations must be presented to the fiscal and policy committees of the Legislature no later than March 1, 2011. Additionally, Public Health stated that, in January 2011, it will forward to CMS a copy of our audit report with a cover letter that encourages CMS to periodically revise the monetary penalties.

Public Health concurs that it should conduct all state surveys of facilities every two years as required by state law. However, Public Health stated that it is unable to meet this standard at this time due to limited staffing resources.

Public Health did not entirely agree with our recommendation to seek legislation specifying a time frame within which facilities with nonappealed citations, that do not qualify for a 35 percent reduction, must pay their monetary penalties and collecting interest on late payments of monetary penalties. However, Public Health will explore proposed legislation for the 2011 Legislative Session that specifies a time frame within which nonappealed citations that do not qualify for a 35 percent reduction must be paid.

Public Health stated that it submitted a request to the Pooled Money Investment Board to include the penalty accounts in the SMIF in June. The request was approved and the penalty accounts began to accrue interest for the fourth quarter of fiscal year 2009–10.

Finally, Public Health also noted in its 60-day response that it met with CMS in June regarding tracking CMS's implementation of the recommendations that Public Health makes, and has initiated the process to track this information. In its six-month response, Public Health stated that it will request continued assistance from CMS to enable Public Health to more closely track the outcome of its recommendations.

Finding #5: Public Health has not fully implemented all 2007 audit recommendations related to the state account, and our follow-up audit identified additional concerns.

In April 2007 the bureau issued a report titled *Department of Health Services: Its Licensing and Certification Division Is Struggling to Meet State and Federal Oversight Requirements for Skilled Nursing Facilities*, Report 2006-106. This report concluded that the Department of Health Services had weak controls over its disbursement of funds from the state account and did little to ensure that the payments it made to temporary management companies were necessary or reasonable. As part of our review of Public Health's internal controls over expenditures, we performed follow-up procedures to determine whether Public Health had implemented controls over its disbursement of both state and federal account funds and whether it had taken steps to ensure that payments were necessary and reasonable.

During our follow-up review, we found that Public Health had not fully implemented the recommendation that it document its rationale for charging general support items to the state account. Specifically, Public Health made some erroneous charges totaling \$15,000 to the penalty accounts, including charges for car rental expenses, in fiscal years 2007–08 and 2008–09. These charges were the result of posting errors made by Public Health in its accounting system. We also identified some additional concerns about Public Health's procedures for overseeing temporary management companies. For example, the California Health and Safety Code, Section 1325.5 (m), requires Public Health to adopt regulations for the administration of temporary managers. However, to date, they had not been developed. Rather than using formally adopted regulations, Public Health used internal procedures to guide its oversight of temporary management companies. The Administrative Procedure Act (act), which defines the process for adopting regulations, requires agencies to accept comments from interested parties regarding the proposed regulations and to hold public hearings if requested. Because Public Health followed internal policies that were developed without the process of public review, Public Health violated state law prohibiting agencies from enforcing regulations that have not been adopted in accordance with the act.

We recommended that, to ensure that it fully implements the recommendations made in the bureau's April 2007 audit report, Public Health create written procedures specifying that expenditure reports be reviewed by an accounting analyst within Public Health on a monthly basis to determine whether any charges do not apply to temporary manager payments. Further, Public Health should include in its written policies and procedures that general support items should not be charged to the penalty accounts. Finally, to ensure that it complies with current state law and increases transparency, Public Health should adopt regulations for the administration of temporary management companies.

Public Health's Action: Partial corrective action taken.

Public Health stated that it finalized and implemented the procedures specifying that expenditure reports should be reviewed by an accounting analyst within Public Health on a monthly basis. Additionally, in June 2010, Public Health circulated written policies and procedures to staff, which noted that general support items should not be charged to the penalty accounts. Finally, Public Health also stated that it will complete the regulations for the administration of temporary management companies by 2016.