

Department of Public Health:

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

June 2010 Report 2010-108



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Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR

Bureau of State Audits

555 Capitol Mall, Suite 300

Sacramento, CA 95814

916.445.0255

916.327.0019 fax

www.bsa.ca.gov

June 17, 2010

2010-108

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the Department of Public Health's (Public Health) management of the State and Federal Health Facilities Citation Penalties Accounts (state and federal accounts) and the effectiveness of its collection of Civil Money Penalties (monetary penalties) imposed on long-term health care facilities (facilities). The report concludes that Public Health and the former California Department of Health Services have overstated the fund balances for the federal account on the fund condition statements since at least fiscal year 2004–05. Of particular note is that Public Health's budget section overstated the federal account's ending fund balance by \$9.9 million for fiscal year 2008–09. Errors made in the fund condition statements have masked the fact that the federal fund is now nearly insolvent and this condition may adversely affect services provided by the Department of Aging's Long-Term Care Ombudsman Program designed to help protect residents of facilities from abuse and neglect.

Revenue for the state and federal accounts is derived from citations imposing monetary penalties that Public Health's Licensing and Certification Division (division) or the Centers for Medicare and Medicaid Services issue depending on whether the violation cited is with state or federal requirements. Although the division generally collects payments for all of the citations it issues for which the facilities choose not to appeal that are collectable, the amounts it ultimately collects are less than those originally imposed mainly because state law permits a 35 percent reduction to the monetary penalty if it is paid within a specified time frame. Specifically, during the nearly seven-year period we reviewed, the division imposed \$8.4 million in monetary penalties but collected only \$5.6 million. Furthermore, a significant amount of monetary penalties imposed by the division are stalled in the appeals process. From fiscal year 2003–04 through March 15, 2010, facilities appealed citations totaling \$15.7 million in monetary penalties. Of this amount, citations comprising nearly \$9 million were still under appeal and some of these citations were contested roughly eight years ago. The large number of citations stalled in the appeals process is likely due to incentives the appeals process offers facilities, including the delay of payment until the appeal is resolved and the potential that the monetary penalty will be significantly reduced. In fact, 71 percent of the citations issued, appealed, and resolved in the time period we reviewed received reductions to the original amount imposed. In particular, of the \$5.3 million imposed by citations that were appealed and ultimately reduced, facilities were required to pay only \$2.1 million.

Finally, we identified several opportunities for Public Health to increase revenue for both the state and federal accounts by seeking changes to state law and by ensuring the division adheres to current law. For instance, Public Health should seek the authority to revise the monetary penalties specified in state law—some were last revised in 2001 and others in 1985. We estimate that had the monetary penalties for citations been revised at the rate of inflation, Public Health could have collected nearly \$3.3 million more in revenue for the state account.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The Department of Public Health (Public Health) is responsible for licensing and monitoring certain health facilities, including more than 2,500 long-term health care facilities (facilities). Teams of evaluators from Public Health's Licensing and Certification Division (division) inspect facilities to ensure that they meet applicable federal and state requirements and that they investigate any complaints made against a facility. Generally, if a team finds during a survey or complaint investigation that a facility is not in compliance with a state requirement, the division may impose a Civil Money Penalty (monetary penalty), and if the team finds noncompliance with a federal requirement, it may make a recommendation to the Centers for Medicare and Medicaid Services (CMS) that it impose a monetary penalty. Monetary penalties collected from facilities are deposited into either the State Health Facilities Citation Penalties Account (state account) or the Federal Health Facilities Citation Penalties Account (federal account), depending on the nature of the noncompliance. Public Health uses the funds in these accounts primarily to pay for temporary management companies, which are firms it appoints to take control over a facility that violates applicable requirements. In addition, in recent years, the Department of Aging (Aging) has received an appropriation from the federal account for its Long-Term Care Ombudsman Program (ombudsman program), which is charged with investigating and seeking to resolve complaints made by, or on behalf of, facilities' residents.

However, members of the Legislature have raised concerns about the solvency of the federal account and whether it will be able to support existing services that protect residents of facilities. Specifically, since at least fiscal year 2004–05, Public Health or its predecessor¹ has overstated the fund balances for the federal account on the fund condition statements that are included in the governor's budget each year. Of particular note is that Public Health's budget section, which is responsible for preparing the fund condition statements, overstated the federal account's ending fund balance by \$9.9 million² for fiscal year 2008–09. These errors occurred in large part because the budget section did not include Aging's fund balance for the federal account when the budget

¹ On July 1, 2007, the California Department of Health Services (Health Services) was reorganized and became two departments: the California Department of Health Care Services and Public Health. Before it was reorganized, Health Services administered the state and federal accounts. Public Health now administers these accounts.

² A *fund balance* is the amount of money in a fund that is available for appropriation, and in the governor's budget, three fund condition statements present the summary of the operations of a fund for the past, current, and budget year.

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.*
 - *With a projected fund balance of \$345,000 by the end of this fiscal year, the federal account is nearly insolvent.*
- » *Although Public Health generally collects all nonappealed monetary penalties it inappropriately granted reductions to some.*
 - *For 135 citations it inappropriately granted monetary penalty reductions, decreasing revenue collected by approximately \$70,000.*
- » *In part, due to a lengthy appeals process, Public Health collects a significantly lower portion of monetary penalties for appealed citations.*
 - *Of more than 1,400 citations appealed over the period we reviewed, about 1,000 remained unresolved and amounted to nearly \$9 million in monetary penalties.*

continued on next page . . .

- *Just 6 percent of appealed citations resolved during the period we reviewed were dismissed in favor of facilities.*
 - *Public Health reduced monetary penalties for the appealed citations resolved during the nearly seven-year period we reviewed by an average of 59 percent, which amounted to more than \$2.7 million.*
- » *Opportunities exist for Public Health to increase revenue for both the state and federal accounts.*
- *It could have collected nearly \$3.3 million more if the monetary penalties had been adjusted to reflect the rate of inflation.*
 - *It is not conducting all state surveys within the periods specified by law and therefore may not be identifying noncompliance that may result in monetary penalties.*

section prepared the fund condition statements, which masked the fact that the federal account is now nearly insolvent. In fact, Public Health estimates that the fund balance for the federal account will be approximately \$345,000 by June 30, 2010, and will decrease to \$249,000 by June 30, 2011. Had Public Health established strong internal controls—including an adequate procedure manual that directed staff to include all applicable amounts when preparing the fund condition statements—and performed sufficient supervisory review of these statements, significant errors in the fund balance for the federal account may not have occurred.

A primary concern with the financial condition of the federal account is the fact that in recent years it has funded Aging’s ombudsman program. To address the potential adverse effects of the federal account’s insolvency on the ombudsman program, Public Health entered into an interagency agreement with Aging to provide it with up to \$700,000 in fiscal year 2009–10, and Public Health has proposed eliminating the division’s expenditures from the federal account in fiscal year 2010–11 to help the account avoid insolvency. Certain members of the Legislature are also taking steps to address funding for the ombudsman program. Specifically, Assembly Bill 2555, introduced in February 2010, seeks to appropriate \$1.6 million from the state account to Aging for its ombudsman program. As of June 16, 2010, the Senate is considering this bill. However, because Public Health uses money from the state account to fund temporary management companies, and because these expenditures can fluctuate greatly from year to year depending on need, such an appropriation could strain the resources in the state account and potentially limit the division’s ability to pay for temporary management companies.

Although CMS is generally responsible for issuing citations resulting from facility noncompliance with federal requirements and for collecting the related monetary penalties, Public Health’s division is responsible for issuing citations that result from facility noncompliance with state requirements. For the period covering fiscal year 2003–04 through March 15, 2010, the division collected the monetary penalties for nearly 98 percent of the *nonappealed citations*—or citations not contested by the facilities—that the division issued. This high proportion of collections is likely due to a state law that requires the division to reduce monetary penalty amounts paid by facilities within certain time frames. Specifically, state law grants a facility an automatic 35 percent reduction in the monetary penalty amount originally imposed by the division if the amount is paid within the required time frame—either 15 or 30 business days, depending on the type of citation and facility. Further affecting the total amount that the division ultimately collects is the fact that facilities are more likely to pay citations that involve lower monetary penalties. Thus, most of the

nonappealed citations consist of citations issued for less severe violations of noncompliance with state requirements than for more severe violations.

State law allows for reductions to monetary penalties paid and not contested within certain time frames; however, during the period covering fiscal year 2003–04 through March 15, 2010, the division inappropriately granted a monetary penalty reduction of 35 percent for 135 citations. As a result, the division improperly decreased the amount of revenue ultimately collected for the state account by approximately \$70,000. This inappropriate reduction was due mainly to inaccurate programming of the system that the division uses to track the citations it issues to facilities.

Facilities may contest a monetary penalty by requesting a citation review conference, administrative hearing, arbitration, or they may challenge the penalty in court. Due to the appeals process, Public Health takes significantly longer to collect the monetary penalties for *appealed citations*, or citations contested by facilities, than it does for nonappealed citations. Specifically, of the more than 1,400 citations appealed by facilities that were issued by the division between the beginning of fiscal year 2003–04 and March 15, 2010, roughly 1,000,³ or 69 percent, were still awaiting final decisions at the end of this period. The monetary penalties corresponding to these appealed citations amounted to nearly \$9 million. State law specifies that facilities are not required to pay monetary penalties on contested citations that have not been resolved, and this specification creates an incentive for facilities to appeal citations.

Another significant incentive for facilities to appeal citations is the potential that the monetary penalty will be reduced by more than the 35 percent reduction they would have received if they did not contest the monetary penalty and paid it on time. In fact, 313, or 71 percent of the 439 appealed citations resolved during our review period received reductions to the original monetary penalties imposed. Of the 313 appealed citations, Public Health reduced 243 amounting to \$2.7 million, or an average of 59 percent, of the original amount imposed. Not surprisingly, citations issued by the division for the most egregious facility violations, referred to as *Class AA and A violations*, which impose the highest monetary penalties, are often appealed by facilities. One potential way to deter facilities from needlessly appealing citations would be to require them to pay their monetary penalties at the time they contest their citations. This possible change in requirements is particularly relevant to the delays in Public Health's collecting

³ This amount includes appealed citations waiting for citation review conferences.

penalties from facilities with appealed citations; during the nearly seven-year period that we reviewed, just 6 percent of the resolved appeals were dismissed in favor of the facilities. Because citations can remain in the appeals process for several years, the State loses potential revenue, and facilities cited for violations, which can include patient or resident deaths, essentially do not have to pay the respective monetary penalties for their violations until decisions are reached to uphold or modify the penalties.

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 (Legal Services) makes a determination on whether to uphold, modify, or dismiss the citation. Because of Public Health's staffing issues and workload priorities, more than 600 citations—with corresponding monetary penalties amounting to nearly \$5 million—were awaiting citation review conferences as of February 2010. According to Public Health's deputy director of Legal Services, delays in the process for citation review conferences may encourage facilities to appeal citations and request citation review conferences as a way to delay paying their monetary penalties. An option that could assist Public Health in collecting monetary penalties more promptly from those facilities seeking to contest citations by way of citation review conferences is to align the State's process more closely with the process used by CMS. The current federal process does not delay the payment of any monetary penalties imposed by CMS. If the State's process were more similar to that used by CMS, Public Health could better ensure the timely collection of monetary penalties. In addition, it is likely that fewer facilities would request citation review conferences, since doing so would not delay their payment of monetary penalties.

In reviewing Public Health's process for issuing and collecting monetary penalties, we identified several opportunities for Public Health to increase revenue for both the state and federal accounts by seeking changes to state law and by ensuring that the division adheres to current state law. For example, the monetary penalty amounts specified in state law have not been updated regularly to reflect the rate of inflation. We adjusted the monetary penalty amounts that the division actually collected from fiscal year 2003–04 through March 15, 2010, to reflect the rate of inflation, and we determined that the division could have collected nearly \$3.3 million more. The largest revenue increase, totaling more than \$2.2 million, would have resulted if state law had adjusted the penalty amounts for Class B violations. Citations for Class B violations are issued for the least severe violations and are issued much more frequently than Class AA or A violations for noncompliance with state requirements. Had the monetary penalty amounts been adjusted, Public Health could have increased revenue

for the state account. Further, the division is not conducting all state surveys within the periods specified by law. Because surveys may result in the division's identifying noncompliance with state and federal requirements and imposing monetary penalties, the division is probably not assessing as many monetary penalties as it could.

Recommendations

To ensure that the governor's budget does not overstate funds available for appropriation in the federal account, Public Health should do the following:

- Include text in the budget section's procedure manual requiring staff to reconcile the 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.
- Ensure the performance of a supervisory review of the reconciliation of the fund condition as supported by Aging's and Public Health's accounting records to the fund condition statement prepared for inclusion in the governor's budget.

To increase revenue for the state account, Public Health should take these steps:

- Update the system it uses to track citations that it issues to facilities so that it makes sure that it is using the correct time frames specified in law when granting 35 percent reductions to nonappealed monetary penalties.
- Seek legislation authorizing it to require facilities that want to contest their monetary penalties to pay the penalties upon their appeals. Public Health could then deposit the penalties into an interest bearing account. The original monetary penalties deposited, plus interest accrued in the account, should then be liquidated by Public Health in accordance with the terms of the decisions on the appeals.

To ensure consistency with federal guidance related to federal requirements, and that it is not creating incentives for facilities to appeal citations issued for noncompliance with state requirements, Public Health should 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. If Public Health believes instances occur when it is appropriate to reduce a monetary penalty by more than 35 percent, it should document which statutory or regulatory factors that formed the basis for concluding that the original class of citation and corresponding monetary penalty amount were no longer considered valid or relevant.

To make certain that Legal Services completes citation review conferences expeditiously, Public Health should do the following:

- Continue to take steps to eliminate its backlog of appealed citations awaiting citation review conferences.
- Seek legislation amending its process for citation review conferences to reflect the federal process more closely by prohibiting facilities from seeking delays on the payment of monetary penalties because Legal Services has not completed the citation review conferences before the effective dates of the monetary penalties.

To increase revenue for the state or federal accounts, Public Health should take the following steps:

- Seek legislation authorizing it to revise periodically the penalty amounts to reflect an inflation indicator, such as the Consumer Price Index.
- Ensure that it conducts all state surveys of facilities every two years, as required by state law.

Agency Comments

Public Health generally agrees with most of our recommendations and states that it will take corrective action to address them. However, Public Health did not agree with our recommendation related to settling appealed monetary penalties for a better term than had the facility paid the monetary penalty in time to receive the 35 percent reduction. Public Health partially agreed with our recommendations related to assessing interest on late payments and increasing its coordination with CMS.

Introduction

Background

The mission of the Department of Public Health (Public Health) is to protect and improve the health of all Californians by administering a broad range of population-based public and environmental health programs. With a \$3.4 billion budget for fiscal year 2009–10, Public Health strives to achieve that mission by administering more than 80 health programs. Public Health is also responsible for licensing and monitoring certain health facilities, including more than 2,500 long-term health care facilities (facilities). In addition to ensuring that these facilities comply with state requirements, Public Health has a cooperative agreement with the Centers for Medicare and Medicaid Services (CMS), an agency within the U.S. Department of Health and Human Services, to ensure that facilities accepting Medicare and Medicaid payments meet federal requirements. (In California, Medicaid is referred to as the *California Medical Assistance Program*, or *Medi-Cal*.)

Public Health has assigned the tasks required to oversee facilities to its Licensing and Certification Division (division). The division is responsible for licensing facilities operating in the State, for recommending to the federal government certification for facilities that have met the requirements to receive funding under the Medicare and Medi-Cal programs, and for conducting recertification surveys of facilities that are already federally certified. In addition, facility evaluators are charged with investigating the complaints of facility stakeholders, who include physicians, residents and their families, and other concerned citizens.

Civil Money Penalties

One enforcement remedy used to address noncompliance found during an inspection—referred to as a survey—or complaint investigation of a facility is the Civil Money Penalty (monetary penalty). Monetary penalties may be imposed on facilities in a wide range of noncompliance situations. These include less serious situations, such as when the division finds the potential for minimal harm to a patient or resident; instances in which actual harm has occurred; and the most severe situations, in which noncompliance has already led, or could lead, to serious injury, harm, impairment, or death. Further, depending on the significance and severity of the noncompliance, monetary penalties vary by the type of violation and amount.

When the division identifies that a facility is out of compliance with state requirements, it may issue a citation that imposes a monetary penalty. State law categorizes the violations associated with monetary penalties into three classes: AA, A, and B. Class AA consists of the most severe instances of noncompliance. The penalty amounts for these three classes range from \$5,000 to \$100,000 for Class AA violations, \$1,000 to \$20,000 for Class A violations, and \$100 to \$1,000 for Class B violations. When the division finds that a facility is not complying with federal requirements, it may recommend to CMS that it impose a federal remedy, which may include a monetary penalty. Federal requirements categorize the associated violations as levels, which include the levels D through L, with Level L designating the most severe instances of noncompliance. CMS may impose a monetary penalty on a facility in accordance with the specific level of noncompliance, and penalty amounts can range from \$50 to \$10,000 per day until the facility is found to comply with federal requirements, or they can range from \$1,000 to \$10,000 per instance, rather than per day, of noncompliance.

Issuance and Collection of Monetary Penalties

Although the division is responsible for determining whether facilities are complying with applicable state and federal requirements, it generally issues and collects monetary penalties resulting from noncompliance with state requirements only. If the division identifies a facility that is not complying with federal requirements, and if such noncompliance warrants imposing a monetary penalty, the division generally recommends that CMS impose a monetary penalty or other enforcement remedy.⁵ CMS may impose, modify, or waive the division's recommended remedy. Regardless of the course of action that CMS takes on the division's recommendation, the division is involved only as necessary because CMS is responsible for assessing and collecting any monetary penalties resulting from noncompliance with federal requirements. Additionally, in some instances, the division may identify a facility's noncompliance with both state and federal requirements. In these cases, the division may issue a citation for a monetary penalty and recommend that CMS impose an enforcement remedy other than a monetary penalty. State law prohibits the division from issuing a citation for a monetary penalty and recommending to CMS that it impose an additional monetary penalty on the facility.

⁴ There are other types of violations that can result in a monetary penalty such as willful material falsification and willful material omission; however, citations for these violations are infrequent.

⁵ According to the chief of Public Health's Provider Certification Unit, the division may assess a citation for a monetary penalty resulting from noncompliance with federal requirements only if the facility is funded solely through Medi-Cal. Just more than 2 percent of facilities meet this criterion.

When the division or CMS imposes a penalty on a facility, the facility has a certain number of days—depending on whether the monetary penalty is a result of noncompliance with state or federal requirements—either to file a request for an appeal or to waive its right to an appeal. When the division issues a citation that imposes a monetary penalty, the facility must send a written request or notification to Public Health, depending on the manner in which the facility wants to contest the citation, within 15 business days. When CMS issues a citation imposing a monetary penalty, the facility has 60 days to file a request for an appeal or to send a request to waive its right to an appeal. The monetary penalty generally becomes due 15 days after the 60 days has expired or when an appeal decision is made in favor of CMS.

Regardless of whether the division or CMS issues the citation for a monetary penalty, state and federal laws permit a facility to receive a 35 percent reduction in the amount if it pays the penalty within specified time frames and if it waives its right to appeal. If a facility does not appeal the citation but pays the monetary penalty after the deadlines specified in law, the full amount of the original citation is due. If a facility appeals a citation and the resulting decision upholds or modifies the monetary penalty, state law requires the facility to pay the monetary penalty within 30 days of the date that the decision becomes final. However, state law does not specify the deadline by which the facility must pay the monetary penalty if it neither contests the citation nor pays the monetary penalty within the legally specified time frame that would allow the facility to receive a reduction to the monetary penalty. On the other hand, according to the division's policies and procedures, a nonappealed citation is due and payable 15 business days after issuance. The division's policies and procedures state that unpaid, nonappealed citations for Class B violations are delinquent 30 business days after the citations are issued. The policies and procedures further note that citations for Class AA and A violations are considered delinquent after 60 business days without facilities' payments or requests for appeal. In cases in which a facility does not submit payment or an appeal waiver by the required deadline, the division requests that the California Department of Health Care Services (Health Care Services), the State's Medicaid agency, withhold Medi-Cal payments from the facility, or CMS notifies Health Care Services to withhold Medicare and Medi-Cal payments until the facility pays the balance.

Appeals of Monetary Penalties

Facilities have the right to contest survey findings, including monetary penalties, resulting from noncompliance with both state and federal requirements. In cases in which the division has issued

a citation imposing a monetary penalty, the facility has the option to contest the citation through methods including a citation review conference, an administrative hearing, arbitration, or an appeal through the judicial system. The citation review conference is an informal proceeding presided over by an independent hearing officer within Public Health's Office of Legal Services (Legal Services) who makes a determination whether to uphold, modify, or dismiss the citation or monetary penalty. Generally, the division may not collect an appealed monetary penalty until a decision is reached to uphold or modify the monetary penalty or until a final decision is adjudicated in favor of Public Health. When CMS imposes a monetary penalty, a facility also has the right to contest the division's survey findings through an administrative appeal. CMS may not collect the amount due for an appealed monetary penalty until a final decision is reached in favor of CMS. A facility may also contest a CMS imposed monetary penalty by way of an informal dispute resolution, which, unlike an administrative appeal, does not delay the payment of the monetary penalty.

Deposit and Expenditure of Penalty Account Funds

Monetary penalties collected from citations issued for noncompliance with state requirements are deposited into the State Health Facilities Citation Penalties Account (state account), and monetary penalties for noncompliance with federal requirements are deposited into the Federal Health Facilities Citation Penalties Account (federal account). Because the division is responsible for collecting monetary penalties resulting from noncompliance with state requirements, it is also responsible for depositing the money collected into the state account. In contrast, CMS, which is generally responsible for collecting monetary penalties resulting from noncompliance with federal requirements, remits to Public Health only the money that it collects from *dually participating facilities*, which are facilities that are participating in both Medicare and Medi-Cal. Specifically, CMS transfers to Public Health the money it collects from dually participating facilities based on the number of beds actually in use by facility residents who are funded by Medi-Cal on the date that the monetary penalty begins to accrue. According to the chief of Public Health's Provider Certification Unit, the only circumstance in which the division will deposit into the federal account the money resulting from a monetary penalty occurs when the division receives payment from a facility funded solely by Medi-Cal for a monetary penalty resulting from facility noncompliance with federal requirements.

Upon appropriation of funds by the Legislature, state and federal law authorizes Public Health to spend funds from the penalty accounts to protect the health or property of residents of facilities,

including for the purposes listed in the text box. According to the chief of the administrative services branch within the division, its annual expenditures from both the state and federal penalty accounts are used primarily for temporary management companies. Public Health has the statutory authority under the California Health and Safety Code to appoint a temporary management company to take control of a facility that fails to comply with federal or state requirements. Public Health may use state and federal account funds to help pay for the temporary management company to operate the facility after all other facility revenues have been exhausted. Additionally, since fiscal year 2003–04, the Department of Aging (Aging) has received an annual budget act appropriation from the federal account for its Long-Term Care Ombudsman Program (ombudsman program). The primary responsibility of the ombudsman program is to investigate and seek to resolve complaints made by, or on behalf of, individual residents in long-term care facilities. Although the ombudsman program receives funding from the federal account, Public Health is the administering agency responsible for reporting on the financial condition of both the state and federal accounts. The Appendix provides detailed financial information on the revenues, expenditures, and fund balances of the state and federal accounts for fiscal years 2003–04 through 2008–09.

Purposes for Which State and Federal Account Funds May Be Used

- Relocation expenses incurred by the State, in the event that a facility closes.
- Maintenance of a facility's operation pending correction of deficiencies or closure. Such maintenance may include temporary management or receivership if the facility's revenues are insufficient.
- Reimbursements to residents for personal funds or property lost at a facility.

Sources: California Health and Safety Code and the Code of Federal Regulations, Title 42.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) conduct an audit of the state and federal accounts, including their revenues and expenditures and whether they are being properly managed by Public Health. In addition to reviewing and evaluating the laws, rules, and regulations significant to the audit objectives, we were asked to do the following:

- Determine the penalty accounts' revenues, expenditures, and fund balances for each fiscal year since 2003–04. To the extent possible, review and assess the reasons for any significant changes in these accounts or adjustments that may have affected fund balances.
- Evaluate Public Health's methods for collecting fines on citations it has issued to facilities and assess the adequacy of these methods.

- Determine whether Public Health has effectively collected fines that it has issued to facilities. Specifically, for each fiscal year since 2003–04, the bureau is to identify the proportion of citations that Public Health issued for which it ultimately collected the monetary penalties and deposited them into the penalty accounts. If applicable, determine why Public Health has not fully collected the fines owed and, if appropriate, recommend corrective practices.

To determine the state and federal accounts' revenues, expenditures, and fund balances for fiscal years 2003–04 through 2008–09, we obtained the financial statements for fiscal years 2005–06 and 2006–07 from Health Care Services and the financial statements for fiscal years 2007–08 and 2008–09 from Public Health. Because neither Health Care Services nor Public Health retained financial statements for fiscal years 2003–04 and 2004–05, we obtained the cash basis revenues and expenditures from the Appropriation Control Ledger of the State Controller's Office and assembled revenues and expenditures equivalent to the accrual basis amounts reported by the former California Department of Health Services (Health Services)⁶ at year-end. We were able to obtain the fiscal year 2004–05 ending fund balance from the financial statements provided by the State Controller's Office. By subtracting revenues and adding expenditures, we derived the beginning fund balance for fiscal year 2004–05. We used this same process for fiscal year 2003–04, starting with the fiscal year 2004–05 beginning fund balance. However, we could not differentiate the revenues and expenditures collected and paid for prior appropriation years versus the current appropriation year. Therefore, we do not present any prior-year adjustments for fiscal years 2003–04 and 2004–05; instead, we include all expenditures in a single amount as well as all revenues, as the Appendix shows. Additionally, to ensure that we captured all applicable expenditures and fund balances, we obtained Aging's financial statements for fiscal years 2003–04 through 2008–09. Further, we reviewed the fund condition statements reported in the governor's budgets for fiscal years 2005–06 through 2010–11 for the state and federal accounts.

To verify the accuracy of the fund condition statements for the federal account, we performed an internal control assessment of the process used to prepare fund condition statements by the former Health Services and by Public Health. As part of this assessment, we interviewed key personnel in Public Health's budget section and the division. Further, we reviewed Public Health's procedure

⁶ On July 1, 2007, Health Services was reorganized and became two departments: Health Care Services and Public Health. Before it was reorganized, Health Services administered the state and federal accounts. Public Health now administers these accounts.

manual pertaining to preparation of the fund condition statements that, according to key personnel in the budget section, were in place since at least fiscal year 2003–04. Additionally, we contacted an official at the Department of Finance who told us that it generally relies upon information provided and verified by Public Health, which the Department of Finance uses to finalize the fund condition statements. To assess the reasons for significant changes in the state and federal accounts, we reviewed financial statements prepared by Public Health and the former Health Services. From this information, we determined that some large fluctuations in expenditures have occurred. We interviewed key personnel from the division and reviewed supporting documentation for a sample of 16 expenditures for fiscal year 2004–05 through April 2010 to determine the cause for the fluctuations. In the Appendix we describe this information further.

To verify that Public Health’s method for projecting revenue for the state and federal accounts was appropriate, we reviewed Public Health’s revenue projection methods. We projected future revenues using a method that takes into account when revenues are actually recorded in the accounting system used by Public Health. We found that the method used by Public Health aligns with the method that we determined produces accurate revenue projections.

To assess Public Health’s methods for collecting monetary penalties that it has imposed and to determine its effectiveness in collecting those penalties, we interviewed key personnel from the division and from Legal Services. We also obtained and reviewed policies and procedures relative to the division’s survey and enforcement process as well as its collection methods. As the Audit Results section of this report explains, for fiscal year 2003–04 through March 15, 2010, the division generally collected all of the nonappealed citations that it could collect. Thus, using our review of this data and of policies and procedures related to the division’s collection methods, as well as interviews with key personnel from the division, we determined that Public Health’s methods for collecting monetary penalties on nonappealed citations are generally adequate. However, as described in the Audit Results, we identified that the division inappropriately granted—after the deadline specified in law had passed—35 percent reductions to some monetary penalties.

Additionally, we interviewed key personnel from the division and Legal Services to gain an understanding of the appeals process for monetary penalties resulting from facility noncompliance with state requirements. We also reviewed state laws and regulations pertaining to the appeals process. Further, we obtained and reviewed a listing of citations awaiting citation review conferences and interviewed key personnel from Legal Services to determine

the reasons for which the citations had not yet undergone citation review conferences. In doing so, we identified the steps Public Health has taken, or plans to take, to address the backlog of citations. In performing this work, we identified strategies to improve the collection of monetary penalties for appealed citations.

In conducting our audit work, we learned that Public Health is generally not responsible for imposing and collecting monetary penalties resulting from facilities' noncompliance with federal requirements. Therefore, to ascertain CMS's collection methods and the appeals process for monetary penalties imposed by CMS for facility noncompliance with federal requirements, we interviewed key personnel from CMS, the entity responsible for assessing and collecting these penalties. We also reviewed relevant federal laws, regulations, and CMS's *State Operations Manual* for conducting facility surveys as well as reports from the U.S. Department of Health and Human Services' Office of Inspector General. However, because CMS does not fall within the scope of this audit, we did not evaluate the effectiveness of its collection methods. Further, CMS maintains data regarding the monetary penalties it imposes on facilities but officials from the CMS regional office in San Francisco told us that it does not specifically track the proportion of citations it issues and ultimately collects, nor does it formally track the number of federal surveys that facilities appeal. As a result, we focused our review only on those citations that Public Health issued as a result of facility noncompliance with state requirements, the citations for which it ultimately collected the penalties, and those that it deposited into the state account. However, CMS did provide us with the amount of monetary penalties it collected from facilities, including interest it charged on late payments, from July 2003 through April 2010. In our Audit Results, we discuss the interest that CMS charged facilities for late payments.

To grasp the division's process for tracking citations it issues to facilities as well as recommendations it makes to CMS to impose monetary penalties, we gained an understanding of two databases that are used to maintain citation related data: the Electronic Licensing Management System (ELMS), which is managed by Public Health and is used, in part, to track facilities' enforcement penalties resulting from noncompliance with state requirements, and the Automated Survey Processing Environment (ASPEN), which is managed by CMS, and is used by the division to upload recommendations to CMS resulting from its surveys of facilities. Although we did not obtain key data from ASPEN because it is managed by CMS and is outside the scope of our audit, we did obtain key data from ELMS for the period covering fiscal year 2003-04 through March 15, 2010. Specifically, we used key data from ELMS to determine the number of citations for which penalties were imposed and collected, the amounts of the penalties

imposed and collected, the number of appeals and the monetary amounts associated with them, and the timeliness of payments. We evaluated only class AA, A, and B citations in our analysis. We further excluded withdrawn citations from all analyses and all citations that Public Health determined to be uncollectable from our analysis of appealed citations.

To determine whether Public Health could increase revenue for the state and federal accounts, we performed various audit procedures. Specifically, we reviewed state and federal laws to identify the years in which monetary penalty amounts were last revised and adjusted these amounts to reflect the rate of inflation by using the U.S. Bureau of Labor Statistics' Consumer Price Index. Further, in conducting our audit work, we learned that the division was not regularly conducting state surveys of facilities within the time frame specified in state law, and we interviewed key personnel from the division to determine how it plans to comply with state survey requirements. We also interviewed an official from the State Controller's Office to determine whether the state and federal accounts could earn additional revenues by Public Health's requesting that they be included in the State's Surplus Money Investment Fund. Finally, we interviewed key personnel from CMS's regional office in San Francisco to determine whether it assesses interest on late payments and whether the division could use ASPEN for tracking the recommendations that the division makes to CMS.

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 Health Services had weak controls over its disbursement of funds from the state account and that Health Services 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 its 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. These procedures included obtaining logs of payments to temporary management companies and selecting a random sample of seven payments that Public Health made to temporary management companies during fiscal years 2007-08 through 2009-10. We then reviewed supporting documentation to ensure that these payments were justified. We also obtained and reviewed the policies and procedures Public Health created in 2008 to address the concerns noted in the bureau's report regarding temporary management companies.

The U.S. Government Accountability Office (GAO), whose standards we follow, requires us to assess the sufficiency and appropriateness of computer-processed data. To determine the number of citations for which penalties were imposed and collected, the amounts of the penalties imposed and collected, the number of appeals and the monetary amounts associated with them, and the timeliness of payments, we used the information from Public Health's Electronic Licensing Management System (ELMS). We assessed the reliability of ELMS by performing accuracy testing, data set verification procedures, and electronic testing of key data elements. To test the accuracy of the data, we selected a random sample of 46 case files and traced key data elements to source documents. We found one error in the sample of 46, but we do not consider this error to have significantly affected the accuracy of the data. Additionally, in our electronic testing of key data elements, we identified seven instances where ELMS indicated that a citation had received a decision by Public Health or an external party, but was not coded as having first appealed the citation. Further, other ELMS coding issues prevented us from determining which entity (i.e., Public Health or an external party) rendered a decision on 48 appealed citations. We did not conduct completeness testing because the source documents required for this testing are stored at the division's 18 district offices located throughout the State. Therefore, we concluded that these data were of undetermined reliability for the purposes of determining the number of citations for which penalties were imposed and collected, the amounts of the penalties imposed and collected, the number of appeals and the monetary amounts associated with them, and the timeliness of payments.

Audit Results

Fund Condition Statements for the Federal Health Facilities Citation Penalties Account Have Overstated Funds Available for Appropriation

At least as far back as fiscal year 2004–05, the fund condition statements for the Federal Health Facilities Citation Penalties Account (federal account) had overstated the funds available for appropriation by the Legislature. The 2010–11 Governor’s Budget published in January 2010 overstated by \$9.9 million the federal account’s fund balance⁷ as of June 30, 2009. The fund balance was overstated because the budget section within the administration division of the Department of Public Health (Public Health) did not reconcile the federal account’s financial condition, as supported by accounting records, to the fund condition statement prepared for the governor’s budget. When this error was discovered, the budget section took steps to correct the overstatement by releasing in January 2010 a revised fund condition statement that was materially correct, this revision in turn caused members of the Legislature to express concern regarding the financial outlook of the federal account.

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. As described in the Introduction, Aging’s Long-Term Care Ombudsman Program (ombudsman program) receives funds from the federal account. The former California Department of Health Services (Health Services) was responsible for the errors in the federal account’s fund condition statements for fiscal years 2004–05 through 2006–07. Once the administration of the federal account transferred to Public Health in July 2007, Public Health continued to make similar errors in the federal account’s fund condition statements for fiscal years 2007–08 and 2008–09.

⁷ A *fund balance* is the amount of money in a fund that is available for appropriation, and in the governor’s budget, three fund condition statements present the summary of the operations of a fund for the past, current, and budget year.

The governor's budget, which is largely based on the fund condition statements, includes the fund balances to show the balance of money in a fund that is available for appropriation. However, as Table 1 indicates, the ending fund balances for the federal account for fiscal years 2004–05 through 2008–09 were greatly overstated. The inaccurate reporting of the federal account's fund balance led to an overstatement of \$9.9 million as of June 30, 2009. Although less significant, we also found errors in the fund condition statement related to the federal account's revenues and expenditures. These errors are explained further in the Appendix. In January 2010 Public Health submitted to various parties, including legislative staff, a revised fund condition statement that was materially correct for fiscal year 2010–11. This revised statement reduced the fund balance for the federal account from the overstated amount of \$11.9 million to the correct balance of \$1.9 million as of June 30, 2009.

Table 1
Inaccuracies in the Fund Balances for the Federal Health Facilities
Citation Penalties Account
Fiscal Years Ending June 30, 2005 Through June 30, 2009
(In Thousands)

FISCAL YEAR END	INACCURATE FUND BALANCE REPORTED IN THE GOVERNOR'S BUDGET	ACCURATE FUND BALANCE	OVERSTATEMENT OF FUND BALANCE
June 30, 2005	\$10,829	\$7,043	\$3,786
June 30, 2006	8,517	6,267	2,250
June 30, 2007	5,758	347	5,411
June 30, 2008	5,139	2,511	2,628
June 30, 2009	11,865	1,931	9,934

Sources: Governor's budgets for fiscal years 2006–07 through 2010–11 and financial statements provided by the Department of Public Health, the California Department of Health Care Services, the Department of Aging, and the State Controller's Office.

Errors in the Fund Condition Statements Have Concerned Members of the Legislature That the Federal Account is Nearing Insolvency

Before discovering the omission of Aging's fund balances, the budget section was making significant prior-year adjustments in an attempt to resolve the discrepancies between the funds actually available in the federal account and the fund condition statements. Prior-year adjustments are a regular occurrence in fund condition statements and often include adjusting amounts for prior-year revenues and expenditures. The prior-year revenue and expenditure adjustments made by the budget section in the years we reviewed were small in comparison to the adjustments made to compensate for the exclusion of Aging's fund balance. After discovering the error, in January 2010 the budget section made a large prior-year

adjustment to the fiscal year 2008–09 ending fund balance of the federal account to bring it into alignment with the actual fund balance by including Aging’s fund balance for the federal account. This adjustment caused concern among members of the Legislature as to whether the federal account was running out of money and whether it could be relied upon to fund existing services, such as the ombudsman program, to help protect residents of long-term health care facilities (facilities) from abuse and neglect.

In fiscal year 2008–09, an appropriation from the State’s General Fund that had been provided to Aging’s ombudsman program was eliminated through the governor’s veto. In response, in August 2009 the Legislature appropriated \$1.6 million from the federal account to Aging to fund the ombudsman program. This appropriation was in addition to the \$2.4 million already appropriated from the federal account in the fiscal year 2009–10 budget act for both Aging’s ombudsman program and for Public Health. The Legislature made both of these appropriations before Public Health released the revised fund condition statement for the federal account in January 2010. Combined, these appropriations allowed for a total of roughly \$4 million in expenditures from the federal account during fiscal year 2009–10. However, the actual fund balance for the federal account as of June 30, 2009, was slightly more than \$1.9 million. This balance did not include \$788,000 that Public Health estimated it would collect in revenues during fiscal year 2009–10 or the planned savings of approximately \$1.7 million, which includes the \$1 million fiscal year 2009–10 appropriation from the federal account that Public Health chose not to spend because of the lack of funds available in the federal account. These amounts and the June 30, 2009, fund balance bring the amount of resources available as of June 30, 2010, to approximately \$4.4 million. Despite these actions, the combined appropriations from the federal account during fiscal year 2009–10 will put the fund in jeopardy of becoming insolvent. By June 30, 2010, Public Health estimates that the federal account’s fund balance will be approximately \$345,000. Furthermore, Public Health projects the fund balance will likely decline to roughly \$249,000 by June 30, 2011.

In January 2010, after Public Health notified various parties, including legislative staff, that the federal account was nearly insolvent, members of the Legislature attempted to provide funding to the ombudsman program from a source other than the federal account. Specifically, Assembly Bill 2555, introduced in February 2010, and as of June 16, 2010 was being considered by the Senate, seeks to appropriate \$1.6 million in fiscal year 2010–11 from the State Health Facilities Citation Penalties Account (state account) to fund Aging’s ombudsman program. Although Public Health’s projected fund balance for the state account during fiscal

Despite Public Health’s attempts to resolve the discrepancies between the funds actually available in the federal account and the fund balance, the federal account balance will be near insolvency—Public Health projects the fund balance to decline to roughly \$249,000 by June 30, 2011.

year 2010–11 indicates that the state account should be able to support this appropriation, Public Health’s expenditures from this account generally are not predictable. These expenditures can fluctuate a great deal depending on Public Health’s need to pay for temporary management companies, which are firms appointed by Public Health to take control of facilities that fail to comply with federal or state requirements. If Public Health needs to increase its expenditures for temporary management companies, the funds available in the state account would decrease proportionally. Thus, if Assembly Bill 2555 becomes law and if Public Health needs to increase expenditures for temporary management companies, not only could it put a strain on the state account’s solvency, but Public Health’s Licensing and Certification Division (division) could also lack the resources to pay for temporary management companies should the need for such firms arise.

Public Health has recently considered steps it can take to ensure that the federal account remains solvent and that the ombudsman program continues to receive adequate funding. Specifically, in its finance letter sent to the Department of Finance in May 2010, Public Health stated that it would not spend its fiscal year 2009–10 appropriation from the federal account, and it proposed not spending its fiscal year 2010–11 appropriation so that it can address the federal account’s cash flow and solvency issues. Further, to make up the funding shortfall in the federal account for fiscal year 2009–10, Public Health stated in its finance letter that through an interagency agreement, it will pay up to \$700,000 of Aging’s ombudsman program costs from its current year excess salary savings in its General Fund appropriation. Public Health also proposed in its finance letter to reduce by \$680,000 the General Fund transfer to the Licensing and Certification Special Fund for state-owned facility costs, so that these funds could be appropriated to Aging for the ombudsman program in fiscal year 2010–11. However, these proposals are short-term in nature and do not guarantee a viable, secure source of funding for the ombudsman program in the future. As we discuss later in this report, opportunities exist for Public Health to increase future revenue for the federal account.

Public Health’s proposals to make up the funding shortfall in the federal account are short-term in nature and do not guarantee a viable, secure source of funding for the ombudsman program in the future.

Weak Internal Controls and a Lack of Experienced Staff Contributed to the Errors in the Fund Condition Statements

Until March 30, 2010, the procedure manual used by the analysts in Public Health’s budget section when preparing the fund condition statements did not instruct staff to include Aging’s fund balance for the federal account. According to a manager in the budget section, former Health Services’ budget staff used this same procedure manual when preparing the fund condition statements before the

department was reorganized in July 2007. Specifically, the procedure manual 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, nor did the manual require the budget section's staff to contact Aging. As a result, budget section staff did not reconcile the fund condition of the federal account, as supported by Aging's and Public Health's accounting records, to the fund condition statement prepared for inclusion in the governor's budgets for fiscal years 2006–07 through 2010–11.

According to a manager in Public Health's budget section, the budget section did not have a sufficient number of analysts and managers necessary to ensure that fund condition statements were accurately prepared, and the staff present after the creation of Public Health did not have adequate knowledge or skills to prepare the fund condition statements. According to a manager in the budget section, after the reorganization of the former Health Services and the creation of Public Health and the current California Department of Health Care Services in July 2007, Public Health's budget section suffered a large staff shortage. She explained that Public Health hired some additional budget analysts and managers after the reorganization and that it filled a number of its vacant positions. Further, she stated that many of the analysts and managers who were hired during the first year after the reorganization had little or no experience in budgeting. She also indicated that managers did not perform an adequate review of the fund condition statements prepared by staff. Finally, the manager stated that the procedure manual had not been amended since at least fiscal year 2003–04 when Aging began to receive appropriations from the federal account. Therefore, the inadequate procedure manual probably also contributed to the inaccuracies in the fund condition statements. Because Public Health did not have strong internal controls, errors were not identified and inaccurate amounts were ultimately reported in the governor's budgets. Moreover, if Public Health does not address all of its internal control weaknesses, it risks perpetuating errors in future fund condition statements.

If Public Health does not address all of its internal control weaknesses, including those that allowed errors to go undetected and inaccurate amounts to be reported in the governor's budgets, it risks perpetuating errors in future fund condition statements.

The Division Collects a High Proportion of the Monetary Penalties It Imposed On Facilities That Chose Not to Appeal, but Some Penalties Were Reduced Inappropriately

Although the division generally collects all of the Civil Money penalties (monetary penalties) that are collectable for the citations it issues to facilities that decide not to appeal, the original penalty amounts are often substantially decreased before the facilities make their payments. These decreases are generally due to current state law, which grants facilities an automatic 35 percent reduction in the monetary penalty amounts originally imposed by the division if the penalties are paid and

not contested within time frames specified in law. Although state law allows for this 35 percent reduction in monetary penalties, the division inappropriately granted the reduction to some facilities that paid their monetary penalties after the time frame specified in law. These inappropriate reductions deprived the state account of roughly \$70,000 in revenues that it was otherwise due.

State law provides an incentive to facilities to pay their monetary penalties within specified time frames by allowing each cited facility to pay 65 percent of the amount specified in the citation, or 35 percent less than the monetary penalty originally imposed by the division. This incentive is likely the main contributor to the division's high collection rate for nonappealed citations. As Table 2 shows, the division collected the penalties associated with nearly 98 percent of the nonappealed citations it issued to facilities from fiscal year 2003–04 through March 15, 2010. However, the amount that the division ultimately collected for these citations totaled \$5.6 million, or 66 percent of the more than \$8.4 million in monetary penalties that the division originally imposed. Most of the unpaid portion, more than \$2.3 million, correlates to reductions in monetary penalties. Further affecting the amounts ultimately collected are 69 monetary penalties totaling more than \$400,000 that were uncollectable for various reasons. The reasons for the uncollectable amounts include citations that have been dealt with in bankruptcy court and facility change of ownerships that have occurred and the division has no collection options available.

Table 2
The Number of Citations Issued for Which Facilities Chose Not to Appeal and the Number, Dollar Amount, and Percentage of Related Monetary Penalties Imposed, Collected, and Deemed Uncollectable
Fiscal Year 2003–04 Through March 15, 2010

FISCAL YEAR	NUMBER OF CITATIONS ISSUED	NUMBER OF CITATIONS COLLECTED	PERCENTAGE COLLECTED	MONETARY PENALTIES ISSUED	MONETARY PENALTIES COLLECTED	PERCENTAGE COLLECTED	UNCOLLECTABLE CITATIONS*	UNCOLLECTABLE MONETARY PENALTIES
2003–04	473	472	99.8%	\$1,068,350	\$710,557	66.5%	2	\$8,150
2004–05	420	408	97.1	993,250	702,520	70.7	11	11,400
2005–06	390	381	97.7	914,475	647,849	70.8	9	20,000
2006–07	510	482	94.5	1,535,150	893,135	58.2	30	269,340
2007–08	600	598	99.7	1,539,900	1,058,737	68.8	14	79,088
2008–09	513	510	99.4	1,371,850	986,729	71.9	3	18,921
2009–10 [†]	303	288	95.0	1,017,900	603,833	59.3	–	–
Totals	3,209	3,139	97.8%	\$8,440,875	\$5,603,360	66.4%	69	\$406,899

Source: Bureau of State Audits' analysis of the Department of Public Health's (Public Health) Electronic Licensing Management System (ELMS).

Note: Due to coding errors in Public Health's ELMS, we included seven citations in this table that appear to have been appealed. However, since the monetary penalties issued are immaterial, we did not remove them.

* Some of the monetary penalties the Licensing and Certification Division imposes are ultimately uncollectable for various reasons, including facility bankruptcy filings that have been dealt with in bankruptcy court or a change of facility ownership in which Public Health has no collection option available. Additionally, some citations may be partially uncollectable and thus appear twice in the table. For example, one of the citations in fiscal year 2003–04 made a partial payment before becoming uncollectable due to a change in ownership.

† Data presented in this row represents the status of nonappealed citations as of March 15, 2010.

Facilities receiving citations involving lower monetary penalties were less likely to appeal than were facilities that received citations imposing higher monetary penalties. In fact, citations issued for Class B violations represented 90 percent of the nonappealed citations during fiscal year 2003–04 through March 15, 2010, while citations for Class AA and A violations collectively represented just 10 percent of nonappealed citations. The division issues fewer citations for Class AA and A violations than it does for Class B violations, as we describe later in this report. However, facilities appeal the majority of citations for Class AA and A violations, whereas facilities appeal less than 25 percent of citations for Class B violations. As Figure 1 shows, citations issued for Class AA and A violations involve larger monetary penalties than do Class B violations. Therefore, it is not surprising that facilities are more likely to appeal citations issued for Class AA and A violations.

Figure 1
Civil Money Penalties by Class of Violation and Monetary Penalty Range

Class of Violation	Monetary Penalty Range
<p>Class AA: Violations that the Department of Public Health (Public Health) determines have been a direct proximate cause of death of a patient or resident of a long-term health care facility (facility).</p>	<ul style="list-style-type: none"> • Long-term health care facilities: \$5,000 to \$25,000 • Skilled nursing facilities or intermediate care facilities:* \$25,000 to \$100,000
<p>Class A: Violations that Public Health determines present either (1) imminent danger that death or serious harm to the patients or residents of the facility would result or (2) a substantial probability that death or serious physical harm to patients or residents of the facility would result.</p>	<ul style="list-style-type: none"> • Long-term health care facilities: \$1,000 to \$10,000 • Skilled nursing facilities or intermediate care facilities: \$2,000 to \$20,000
<p>Class B: Violations other than Class AA or A that Public Health determines have a direct or immediate relationship to the health, safety, or security of facility patients or residents.</p>	<p>All facilities: \$100 to \$1,000</p>

Source: California Health and Safety Code.

* Skilled nursing facilities and intermediate care facilities are two types of facilities.

Although state law permits reductions in monetary penalties under certain circumstances, the division inappropriately granted reductions for some monetary penalties it imposed. State law specifies that in lieu of contesting a citation for a Class AA or A violation, skilled nursing facilities and intermediate care facilities⁸ that transmit payments to the division within 30 business days

⁸ Skilled nursing facilities and intermediate care facilities are two types of facilities.

We found that from fiscal year 2003–04 through March 15, 2010, Public Health inappropriately granted reductions in monetary penalties for 135 citations resulting in a loss of revenue of approximately \$70,000 due to a calculation its system uses.

after the issuance of the citation may receive a 35 percent reduction in the monetary penalty imposed. The law also specifies that a facility must pay the monetary penalty imposed for a Class B violation within 15 business days after the issuance of the citation to receive the 35 percent reduction. However, we found that from fiscal year 2003–04 through March 15, 2010, the division granted reductions in monetary penalties for five citations issued for Class A violations even though it received the corresponding payments after the 30-day time requirement. These reductions resulted in a loss of revenue to the state account of roughly \$25,000. Further, during the same time period, the division granted reductions in monetary penalties for 130 citations issued for Class B violations for which it received late payments, resulting in a loss of revenue of nearly \$45,000 to the state account. If the division had not inappropriately granted these reductions, it could have deposited approximately \$70,000 in additional revenue to the state account.

The division's granting of inappropriate reductions in monetary penalty amounts is due mainly to the calculation its system uses to determine whether a facility's payment was received in time to warrant a 35 percent reduction. Specifically, as described in the scope and methodology section of this report, Public Health uses the Electronic Licensing Management System (ELMS), in part, to track the enforcement penalties the division issues to facilities that are not complying with state requirements. State law specifies that depending on the type of facility and the class of violation, facilities must pay monetary penalties within 15 or 30 business days after the *issuance* of a citation to receive the 35 percent reduction; however, the chief of the administrative services branch within the division stated that ELMS is not programmed to use the dates that the citations were issued. She explained that ELMS is programmed instead to use the date that a facility certifies it received the citation imposing the monetary penalty, and this date can be several days after the date the citation was issued. As a result, the division has granted reductions in monetary penalties for citations for which it received payments after the deadlines specified in state law. To the extent that the division does not modify ELMS to ensure that it calculates reductions in accordance with the time frames specified in state law, the division will continue to grant inappropriate reductions for monetary penalty payments that arrive after the statutory deadlines.

Further, the monetary penalty assessment form that the division sends to a facility when issuing a citation incorrectly references state law. Specifically, the form states that payment of the monetary penalty is due within 15 or 30 business days after *service* of the citation rather than after *issuance* of the citation. This incorrect reference may give facilities the impression that they have more

time in which to make their payments to receive the 35 percent reduction than they actually have under state law. The chief of the administrative services branch within the division stated that Public Health will either modify ELMS and its citation issuance form to reflect state law, or Public Health will seek changes to state law. However, because the division incorrectly notified facilities as to the deadline by which they must make payments of the monetary penalties to qualify for the discount, it is unlikely that Public Health could seek repayment of the penalties for which it inappropriately granted the reduction of 35 percent.

Prompt Collection of Monetary Penalties Is Affected by Appealed Citations and the Backlog of Facilities Awaiting Citation Review Conferences

The division 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. As the Introduction details, state law allows a facility to contest a citation issued by the division through such methods as requesting a citation review conference, administrative hearing, arbitration, or appealing through the judicial system. Further, a facility is not required to pay contested monetary penalties until a decision is reached to uphold, modify, or settle the monetary penalty, which can take several years. 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. However, a solution may exist that could deter facilities from appealing citations simply to delay or reduce payment, and it could therefore increase revenue for the state account. As of February 2010 more than 600 citations were backlogged awaiting citation review conferences, and some of these citations were contested by facilities roughly eight years ago. This backlog is further delaying Public Health's receipt of revenue for the state account.

A Large Proportion of Potential Revenue for the State Account Remains Uncollected Due to the Appeals Process

A significant amount of the monetary penalties imposed by the division is stalled in the appeals process. Specifically, facilities appealed citations issued during fiscal year 2003–04 through March 15, 2010, associated with roughly \$15.7 million in monetary penalties. As of March 15, 2010, citations comprising nearly \$9 million in monetary penalties were still under appeal. Depending on the resolution of the appeals, the division may ultimately collect

Because they can defer payments of penalties and possibly reduce the original amounts imposed, facilities may view this as an incentive to appeal citations. As of March 15, 2010, citations comprising nearly \$9 million in monetary penalties were still under appeal.

these penalties.⁹ Further, as Table 3 shows, these amounts involve 994 of the 1,433 citations issued during fiscal year 2003–04 through March 15, 2010, and appealed by facilities. Of these, 72 citations were issued by the division in fiscal year 2003–04, and they were still under appeal nearly seven years later. Citations can remain under appeal until resolutions are reached which, as previously discussed, is a process that can take several years. The amount of time that monetary penalties remain in the appeals process not only delays the deposit of revenue into the state account but also negatively affects the potential interest that could have been earned had the amounts been deposited sooner.

Table 3
The Number of Appealed Citations and the Number, Dollar Amount, and Percentage of Related Penalties Imposed, Collected, and Pending
Fiscal Year 2003–04 Through March 15, 2010

FISCAL YEAR	APPEALED CITATIONS*	APPEALED CITATIONS COLLECTED	PERCENTAGE COLLECTED	MONETARY PENALTIES APPEALED	MONETARY PENALTIES COLLECTED	PERCENTAGE OF MONETARY PENALTIES COLLECTED	APPEALED CITATIONS PENDING	APPEALED MONETARY PENALTIES PENDING	PERCENTAGE OF APPEALED CITATIONS PENDING
2003–04	215	134	62%	\$1,377,500	\$640,130	46%	72	\$153,100	33%
2004–05	149	75	50	1,802,150	953,801	53	72	281,450	48
2005–06	147	55	37	1,320,950	422,373	32	91	508,550	62
2006–07	216	82	38	2,561,750	700,225	27	131	676,850	61
2007–08	262	57	22	3,206,700	407,770	13	205	2,465,500	78
2008–09	262	10	4	3,180,950	92,650	3	241	2,589,600	92
2009–10 [†]	182	0	0	2,284,700	0	0	182	2,287,300	100
Totals	1,433	413	29%	\$15,734,700	\$3,216,949	20%	994	\$8,962,350	69%

Source: Bureau of State Audits' analysis of the Department of Public Health's (Public Health) Electronic Licensing Management System (ELMS).

Note: Due to coding errors in Public Health's ELMS, we excluded seven citations in this table that appear to have been appealed. However, since the monetary penalties issued are immaterial, we did not remove them.

* There are 26 appeals that were dismissed that are not included in either the collected or pending information.

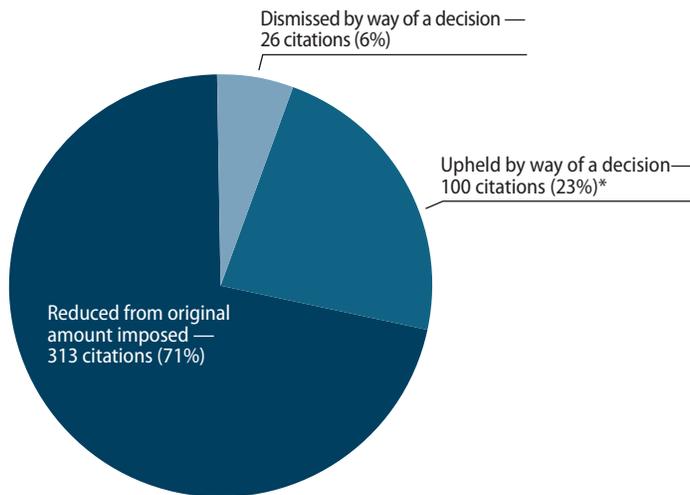
† Data presented in this row represents the status of appealed citations as of March 15, 2010. No citation issued during this time had received a decision as of March 15, 2010.

Generally, a facility has no disincentives for appealing a citation, with the exception of the legal costs that it may incur during the appeals process and any negative public opinion that might be created from such citations remaining unresolved. This lack of disincentives likely contributes to the high proportion of citations appealed by facilities. In fact, facilities may actually have some incentives to appeal citations because the associated monetary penalties are not due until decisions are reached on the appeals to

⁹ The term *resolution* encompasses appeals that are upheld, modified, settled, or dismissed by decisions reached through the judicial process, citation review conferences, arbitration, settlements or administrative hearings.

uphold, modify, or settle the appeals. Not only can facilities defer having to pay a monetary penalty, they also have the incentive that more often than not the monetary penalty will be reduced from the original amount imposed. In fact, 313, or 71 percent of the 439 citations issued, appealed, and then resolved from fiscal years 2003–04 through 2008–09, received reductions to the original monetary penalties imposed. Figure 2 shows that citations issued by the division were rarely dismissed because of the appeals process—occurring in about 6 percent of all penalties resolved during our review period—a fact that further indicates that some facilities may be appealing citations to delay payment or to reduce the monetary penalties imposed.

Figure 2
The Number and Percentage of Appealed Citations for Which the Corresponding Monetary Penalties Were Upheld, Reduced, or Dismissed Fiscal Years 2003–04 Through 2008–09



Source: Bureau of State Audits’ analysis of the Department of Public Health’s Electronic Licensing Management System.

Note: We did not include data for fiscal year 2009–10 because none of the appealed citations issued during this fiscal year had received a decision as of March 15, 2010.

* The number of upheld appeals include monetary penalties that were increased.

Both Public Health and external parties, such as arbitrators or administrative law judges, significantly reduce monetary penalties; however, Public Health reduces more appealed citations than external parties, which has resulted in millions of dollars of reductions. Specifically, as Table 4 on the following page shows, Public Health reduced 243 of the 313 appealed citations. The reductions granted by Public Health amounted to a total of \$2.7 million, or an average of 59 percent, of the original monetary penalty amount imposed by the division. Because facilities are only eligible to receive a 35 percent reduction to the original monetary

Table 4
Number, Amount, and Percentage of Appealed Citations Ultimately Reduced by Either Public Health or an External Party
Fiscal Years 2003–04 Through 2008–09

FISCAL YEAR	DECISIONS REACHED BY PUBLIC HEALTH				DECISIONS REACHED BY AN EXTERNAL PARTY*				DECISIONS REACHED BY EITHER PUBLIC HEALTH OR AN EXTERNAL PARTY†			
	NUMBER OF APPEALED CITATIONS REDUCED	AMOUNT OF APPEALED CITATIONS ON WHICH A DECISION WAS REACHED TO REDUCE THE MONETARY PENALTY	PERCENTAGE REDUCED	NUMBER OF APPEALED CITATIONS REDUCED	AMOUNT OF APPEALED CITATIONS ON WHICH A DECISION WAS REACHED TO REDUCE THE MONETARY PENALTY	PERCENTAGE REDUCED	NUMBER OF APPEALED CITATIONS REDUCED	AMOUNT OF APPEALED CITATIONS ON WHICH A DECISION WAS REACHED TO REDUCE THE MONETARY PENALTY	PERCENTAGE REDUCED	NUMBER OF APPEALED CITATIONS REDUCED	AMOUNT OF APPEALED CITATIONS ON WHICH A DECISION WAS REACHED TO REDUCE THE MONETARY PENALTY	PERCENTAGE REDUCED
2003–04	73	\$942,150	57%	10	\$23,950	77%	9	\$8,400	40%	243	\$4,607,950	59%
2004–05	38	822,500	63	3	3,000	51	11	169,000	50	204	\$2,735,952	63
2005–06	39	674,100	56	6	90,000	66	1	750	30	203	\$2,735,952	56
2006–07	58	1,480,550	64	7	158,200	65	6	95,550	16	221	\$2,735,952	64
2007–08	33	570,650	46	6	27,000	65	8	29,000	53	200	\$2,735,952	46
2008–09	2	118,000	70	3	121,000	85	–	–	–	5	\$118,000	70
Totals	243	\$4,607,950	59%	35	\$423,150	72%	35	\$302,700	39%	243	\$4,607,950	59%

Source: Bureau of State Audits' analysis of the Department of Public Health's (Public Health) Electronic Licensing Management System (ELMS).

Note: Fiscal year 2009–10 is not included in this table because none of the appealed citations issued during this fiscal year had received a decision as of March 15, 2010.

* External parties include those parties that are independent from Public Health, such as an arbitrator or an administrative law judge.

† The data contained in ELMS did not allow us to identify whether these decisions were reached by Public Health or an external party.

penalty imposed if they waive their right to an appeal and pay the monetary penalty within the specified time frame, facilities may benefit more by appealing monetary penalties due to the likelihood that penalties will be reduced by more than 35 percent. In reviewing several settlement agreements, we identified instances when Public Health significantly reduced some monetary penalties. One instance of an unusually large reduction related to an appealed citation issued for a Class AA violation, which are issued for violations that result in direct proximate causes of patient or resident death. Although the citation review conference upheld the Class AA violation, the terms of the subsequent settlement agreement reduced this Class AA violation to a Class B violation. In doing so, the original monetary penalty amount imposed was reduced by 99 percent—from \$100,000 to just \$1,000. Had the facility in this example chosen instead to pay the monetary penalty within the time frame specified in law to receive a reduction, the facility would have paid \$65,000. Although Public Health may avoid the legal costs associated with entering into court proceedings for appealed citations by entering into settlements, facilities that commit the most egregious violations may not be penalized in accordance with the violation.

Table 4 shows that external parties reduce fewer appealed citations—likely because they review fewer; however, when they do, they also make significant reductions to the original monetary penalty amounts imposed. As illustrated in Table 4, external parties reduced appealed citations by roughly \$304,000, or an average of 72 percent of the original monetary penalty amount imposed. No laws prohibit reducing appealed citations by more than the 35 percent reduction facilities can receive if they do not contest the citation and pay the monetary penalty within the time frame specified in law. Regardless, such reductions to the original monetary penalty amounts imposed create a significant incentive for facilities to appeal their citations. Interestingly, CMS's *State Operations Manual*, which provides guidance related to citations issued for noncompliance with federal requirements, specifies that if a decision is made to settle, the settlement should not provide a better term than if the facility had chosen the 35 percent reduction. If Public Health had similar guidance and followed it when feasible, Public Health could increase revenue for the state account and possibly deter facilities from needlessly appealing citations.

One potential solution that could help Public Health to increase revenue for the state account and to deter some facilities from appealing citations solely to defer or reduce payments of their monetary penalties is to seek changes to state law authorizing Public Health to require facilities to pay their monetary penalties at the time they contest their citations. Specifically, Public Health could submit a request to the State Controller's Office to establish

Public Health reduced one appealed citation imposing a \$100,000 monetary penalty to just \$1,000—representing a 99 percent reduction.

an account within the special deposit fund in which it would deposit appealed monetary penalties it receives from facilities at the time they contest their citations. To accrue interest, this account would need to be included in the Surplus Money Investment Fund (SMIF), for which the State Controller's Office publishes interest rates on a quarterly basis. Using these interest rates and the length of time that a monetary penalty is in the account, Public Health could determine the amount to disburse according to the decision on the appeal. For example, if a decision reduced a \$50,000 monetary penalty to \$30,000, Public Health could remit to the facility \$20,000 plus the corresponding interest earned for the length of time that the monetary penalty remained in the account. We believe that if Public Health were to establish such an account, it could probably generate more than enough interest revenue to outweigh the costs to administer the account such as personnel expenses related to tracking the time that monetary penalties remain in the account.

If Public Health could establish an interest-bearing account in which it would deposit appealed monetary penalties at the time the citations are contested, we estimate that Public Health could have generated nearly \$95,000 in interest from the nearly \$6.7 million in monetary penalties under appeal as of June 30, 2009.

As mentioned previously, a significant amount of the monetary penalties imposed by the division is stalled in the appeals process, but appeals result in dismissal only about 6 percent of the time. The SMIF interest rate was 1.5 percent for the fiscal year ending June 30, 2009, which was the last full fiscal year preceding our review. Using this interest rate and the average percentage of appeals that were not dismissed from fiscal years 2003–04 through 2008–09, the state account could have generated nearly \$95,000 in interest from the nearly \$6.7 million in monetary penalties under appeal as of June 30, 2009. If Public Health were to establish such an account, it would generate interest revenue annually. Recent changes to federal law will require the Secretary of the U.S. Department of Health and Human Services to issue regulations that may provide for the collection of monetary penalties imposed by CMS and appealed by facilities using an approach similar to the one we propose in this paragraph.

Not surprisingly, facilities appeal the majority of citations issued by the division for Class AA and A violations, which involve higher monetary penalties than do citations issued for Class B violations. Specifically, as Table 5 indicates, facilities appealed 102 of the 123 citations that the division issued for Class AA violations during fiscal year 2003–04 through March 15, 2010. These appealed citations imposed original monetary penalties totaling more than \$8 million. Table 5 also shows that facilities appealed 406 of the 697 citations issued by the division for Class A violations, amounting to nearly \$6.6 million in monetary penalties. In contrast, facilities appealed 925, or 24 percent, of the 3,822 citations issued by the division for Class B violations. Although the number of citations for Class B violations appealed exceeds the number of appeals for Class AA and A violations combined, the monetary

penalties associated with the appealed citations for Class B violations totaled just under \$940,000. When citations remain in the appeals process for several years, not only is the state account deprived of revenues that it might otherwise collect, but facilities cited for the most egregious violations, which can include patient or resident deaths, do not have to pay the respective monetary penalties until decisions are reached to uphold, modify, or reduce the penalties.

Table 5
Issued and Appealed Citations by Class of Violation
Fiscal Year 2003–04 Through March 15, 2010

FISCAL YEAR	NUMBER OF CITATIONS ISSUED FOR CLASS AA VIOLATIONS	NUMBER OF CITATIONS APPEALED FOR CLASS AA VIOLATIONS	MONETARY PENALTY AMOUNT FOR APPEALED CLASS AA VIOLATIONS	NUMBER OF CITATIONS ISSUED FOR CLASS A VIOLATIONS	NUMBER OF CITATIONS APPEALED FOR CLASS A VIOLATIONS	MONETARY PENALTY AMOUNT FOR APPEALED CLASS A VIOLATIONS	NUMBER OF CITATIONS ISSUED FOR CLASS B VIOLATIONS	NUMBER OF CITATIONS APPEALED FOR CLASS B VIOLATIONS	MONETARY PENALTY AMOUNT FOR APPEALED CLASS B VIOLATIONS
2003–04	12	10	\$620,000	76	40	\$614,000	600	165	\$143,500
2004–05	19	15	1,005,000	77	45	699,000	473	89	98,150
2005–06	13	9	669,000	66	41	553,500	458	97	98,450
2006–07	19	17	1,380,000	119	63	1,037,500	588	136	144,250
2007–08	21	19	1,715,000	134	77	1,324,500	707	166	167,200
2008–09	20	19	1,665,000	145	80	1,334,500	610	163	181,450
2009–10*	19	13	1,180,000	80	60	999,000	386	109	105,700
Totals	123	102	\$8,234,000	697	406	\$6,562,000	3,822	925	\$938,700

Source: Bureau of State Audits' analysis of the Department of Public Health's Electronic Licensing Management System.

* Figures for fiscal year 2009–10 represent data as of March 15, 2010.

The Significant Backlog of Appealed Citations Awaiting Citation Review Conferences Has Delayed the Collection of Monetary Penalties

According to documentation provided by the division, as of February 2010, more than 600 citations appealed by facilities were awaiting citation review conferences. Nearly \$5 million in monetary penalties were associated with these citations. Facilities had appealed some of these citations as early as 2002 and were still awaiting their citation review conferences roughly eight years later. As the Introduction explains, state law allows a facility to contest a monetary penalty by requesting a citation review conference in which an independent hearing officer from Public Health's Office of Legal Services (Legal Services) determines whether to uphold, modify, or dismiss the citation. However, state law prohibits Public Health from collecting the monetary penalty associated with the appealed citation until the penalty is resolved in one of the ways previously discussed. Further, according to Public Health's deputy director of Legal Services, delays in the process for citation review conferences may encourage facilities to appeal citations and to

According to the deputy director of Legal Services, other types of hearings take precedence over citation review conferences; thus, Public Health always has had a backlog of appealed citations awaiting citation review conferences.

request citation review conferences so that the facilities can delay paying their monetary penalties. Thus, Legal Services' backlog of appealed citations awaiting a citation review conference has potentially delayed the collection of nearly \$5 million in monetary penalties had Legal Services conducted the citation review conferences in a timely manner and had the facilities paid their respective monetary penalties sooner.

Public Health attributes the backlog of appealed citations awaiting citation review conferences primarily to an increase in workload without a corresponding increase in hearing officers. According to the deputy director of Legal Services, other types of hearings take precedence over citation review conferences; thus, Public Health has always had a backlog of appealed citations awaiting citation review conferences. Beginning in 1992, federal law required hearing officers to conduct other types of hearings for residents of facilities, including involuntary transfer and discharge appeal hearings. The deputy director of Legal Services explained that these hearings receive priority over citation review conferences because such residents require 24-hour skilled nursing services and are in situations involving compromised health or safety. Not until 2006 did Legal Services submit a budget change proposal to request additional positions to address the backlog of appealed citations awaiting citation review conferences. According to the deputy director, although the budget change proposal included four hearing officer positions with two-year limited terms—and these positions received approval—Legal Services was unsuccessful in filling these positions due, in part, to the lack of competitive pay. She explained that as a result, the positions authorized by the budget change proposal expired at the end of the term.

According to the deputy director of Legal Services, the steps taken by Legal Services and the division to reduce the backlog of appealed citations awaiting citation review conferences have included hiring and training retired annuitants and entering into an interagency agreement with the Office of Administrative Hearings (OAH) to conduct citation review conferences for certain types of appealed citations. Specifically, as the deputy director explained, Legal Services plans to complete citation review conferences for all appealed citations for Class AA violations by late August or early September 2010, and it will take steps to process all appealed citations for Class B violations in a timely manner. Further, the deputy director of Legal Services explained that Public Health has entered into an interagency agreement with OAH to conduct citation review conferences for all appealed citations for Class A violations. Further, she also stated that the interagency agreement was delivered to the Department of General Services in mid-May 2010 for approval. She explained that the interagency agreement specifies that unless an extension is granted to the facility appealing the citation, OAH will commence each hearing

no later than 120 to 180 days after Public Health's filing of a written request to set the hearing. Further, she stated that the interagency agreement specifies that OAH shall issue a decision on the appealed citation within 30 days of the citation review conference. Although Public Health has recently begun seeking assistance to decrease its backlog of appealed citations awaiting citation review conferences, it will need to monitor its progress in processing appealed citations for Class AA and B violations as well as OAH's progress in processing appealed citations for Class A violations to ensure the timely collection of monetary penalties.

Another option that could assist Public Health in collecting in a timely manner the monetary penalties from those facilities that seek to contest their citations by requesting citation review conferences is to more closely align the State's process with CMS's process. Specifically, 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, an informal dispute resolution does not require that an independent hearing officer conduct the conference and does not delay the payment of any monetary penalties imposed by CMS. Specifically, federal law prohibits a facility from seeking a delay of any enforcement action that 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,¹⁰ the facility must still pay the monetary penalty.¹¹ If the State's process were more similar to the federal informal dispute resolution process in not allowing facilities to delay payment of their monetary penalties, Public Health could better ensure the timely collection of monetary penalties. Moreover, it is likely that fewer facilities would request citation review conferences.

Public Health could more closely align the State's citation review conference process with the federal process—according to that process, 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.

Opportunities Exist to Increase Revenue for the State and Federal Accounts

In reviewing the issuance and collection process for monetary penalties resulting from facility noncompliance with state and federal requirements, we identified various opportunities for Public

¹⁰ As the Introduction explains, a facility that receives a citation from CMS because of the facility's noncompliance with federal requirements, has 60 days to formally appeal the monetary penalty or to waive its right to appeal. Although there is no requirement that an informal dispute resolution be completed within 60 days, doing so is beneficial because the outcome of the informal dispute resolution could affect a facility's decision to pursue a formal appeal.

¹¹ A recent federal law, effective March 2011, in certain instances will require the Secretary of the U.S. Department of Health and Human Services to issue regulations to prohibit the imposition of a monetary penalty before the completion of an informal dispute resolution.

The division could have collected nearly \$3.3 million more than it actually collected if state law had adjusted monetary penalties to reflect the Consumer Price Index.

Health to increase revenue for the state and federal accounts, some of which require Public Health to seek changes in state law. Other strategies currently exist to increase revenue that the division could begin to employ immediately without seeking changes in state law; these methods include conducting state surveys of facilities within the time frames specified in law, a practice that could lead to the issuance of additional monetary penalties. By taking advantage of this and other opportunities, Public Health may be able to better ensure the solvency of the federal and state accounts.

Public Health could increase revenue for the state account by requesting the Legislature to revise the monetary penalty amounts specified in state law. Monetary penalty amounts for Class AA, A, and B violations have not been updated regularly to reflect the Consumer Price Index (CPI). Specifically, monetary penalties for Class AA and A violations for skilled nursing and intermediate care facilities were last revised in 2001, while monetary penalties for Class AA and A violations for all other types of facilities were last revised in 1985. This is the same year in which monetary penalties for Class B violations for all types of facilities were last revised. To determine the amounts that the division would have collected if the monetary penalties had been adjusted for inflation, we consulted the CPI to obtain the average rate of inflation since 1985 as well as since 2001, and we applied these rates to the amounts that the division collected on citations it issued from fiscal year 2003–04 through March 15, 2010. As Table 6 demonstrates, if state law had adjusted the monetary penalties to reflect the CPI, the division could have collected nearly \$3.3 million more than it actually collected, thereby increasing revenue for the state account. The largest potential revenue increase—more than \$2.2 million—would have resulted from adjusting the penalty amounts for Class B violations, which constitute the most frequently issued class of violation. The table also shows that revenues resulting from adjusting the monetary penalty amounts for Class AA and A violations would have increased revenue for the state account by roughly \$378,000 and nearly \$658,000, respectively.

Similar opportunities to increase revenue for the federal account might also exist. Specifically, the monetary penalty amounts for facility noncompliance with federal requirements were implemented in federal regulations issued in 1995, and these amounts have not been updated for about 15 years. Although revising these monetary penalty amounts would require changes to federal regulations, Public Health could encourage CMS to seek such changes. For example, federal regulations define the upper range of monetary penalties as \$3,050 to \$10,000 per day for facility noncompliance with federal requirements that constitute immediate jeopardy to patients or residents. Using the same approach described previously for updating the State's monetary penalty amounts, we determined that if this upper range

Table 6
Monetary Penalties Imposed on Long-Term Health Care Facilities and
Collected by the Department of Public Health by Class of Violation,
Adjusted for Inflation
Fiscal Year 2003–04 Through March 15, 2010

	MONETARY PENALTIES FOR CLASS AA VIOLATIONS	MONETARY PENALTIES FOR CLASS A VIOLATIONS	MONETARY PENALTIES FOR CLASS B VIOLATIONS	TOTALS
Fiscal Year 2003–04				
Adjusted for inflation	\$441,318	\$656,123	\$649,563	\$1,747,004
Actual	413,750	615,137	370,000	1,398,887
Difference	27,568	40,986	279,563	348,117
Fiscal Year 2004–05				
Adjusted for inflation	\$849,958	\$714,841	\$579,518	\$2,144,317
Actual	770,750	648,225	319,284	1,738,259
Difference	79,208	66,616	260,234	406,058
Fiscal Year 2005–06				
Adjusted for inflation	\$500,395	\$415,397	\$709,954	\$1,625,746
Actual	439,583	364,915	378,924	1,183,422
Difference	60,812	50,482	331,030	442,324
Fiscal Year 2006–07				
Adjusted for inflation	\$494,940	\$983,411	\$737,500	\$2,215,851
Actual	422,750	839,975	382,725	1,645,450
Difference	72,190	143,436	354,775	570,401
Fiscal Year 2007–08				
Adjusted for inflation	\$315,782	\$961,205	\$862,042	\$2,139,029
Actual	259,750	790,650	430,815	1,481,215
Difference	56,032	170,555	431,227	657,814
Fiscal Year 2008–09				
Adjusted for inflation	\$154,452	\$860,995	\$719,702	\$1,735,149
Actual	127,500	710,750	360,963	1,199,213
Difference	26,952	150,245	358,739	535,936
Fiscal Year 2009–10*				
Adjusted for inflation	\$296,054	\$189,727	\$426,218	\$911,999
Actual	240,500	154,125	210,363	604,988
Difference	55,554	35,602	215,855	307,011
Potential Revenue	\$378,316	\$657,922	\$2,231,423	\$3,267,661

Sources: Bureau of State Audits' analysis of the Department of Public Health's Electronic Licensing Management System for fiscal year 2003–04 through March 15, 2010, and the Bureau of Labor Statistics' Consumer Price Index.

Notes: Monetary penalty amounts for citations issued for Class AA and A violations were last updated in January 2001, so we used this date as the starting point for adjusting these classes of violations for inflation.

The monetary penalty amounts for citations issued for Class B violations were last updated in January 1985, so we used this date as the starting point for adjusting this class of violation for inflation.

This table only reflects monetary penalties for citations issued to skilled nursing facilities and internal care facilities, which are two types of long-term health care facilities.

* Figures for fiscal year 2009–10 represent data as of March 15, 2010.

Public Health should conduct all inspections of facilities in accordance with the time frames specified in state law—it has not surveyed the majority of facilities to ensure their compliance with state requirements.

of monetary penalties were revised to reflect the rate of inflation, CMS could impose monetary penalties in the range of \$4,363 to \$14,305 per day. These amounts are nearly 50 percent higher than the amounts established in 1995. According to the manager of the Long-Term Care Survey, Certification, and Enforcement Branch of the CMS regional office in San Francisco (branch manager), the topic of amending the law to increase the penalty ranges has been discussed in the past; however, these discussions have never resulted in a change in the law. Nonetheless, she believes that increasing the current monetary penalty ranges would be beneficial. As described in the Introduction, CMS remits payment to Public Health for monetary penalties it collects from dually participating facilities. If federal monetary penalty amounts are revised, revenue for the federal account would increase and potentially help to ensure its solvency.

Another opportunity for Public Health to increase revenue for the state account is to ensure that the division conducts all inspections of facilities in accordance with the time frames specified in state law. According to state law, the division must conduct *state surveys* of facilities once every two years to determine compliance with state requirements. In addition, federal regulations generally require the division to conduct *federal surveys* of facilities every 15 months to determine the facilities' compliance with federal requirements. Before 2007 state surveys were not conducted regularly. Recognizing that Public Health's predecessor, the former Health Services, had not developed survey protocols for examining facility compliance with state requirements, legislation effective July 1, 2007, required the division 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, a Public Health field operations branch chief stated that during fiscal year 2008–09, only about 10 percent of the surveys conducted by the division were dual-purpose, and she estimated that just 25 percent to 50 percent of surveys conducted by the division in fiscal year 2009–10 will be dual-purpose. She explained that the division hopes that ultimately all surveys it conducts will be dual-purpose. As a result, although the division currently surveys facilities for compliance with federal requirements, it has not specifically surveyed the majority of facilities in the State to ensure their compliance with state requirements. Thus, it is likely that facility noncompliance with state requirements has gone undetected and that citing this noncompliance could have resulted in the division imposing monetary penalties, thereby increasing revenue for the state account.

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 SMIF. Currently, both accounts are included in the Pooled Money Investment Account and earn interest for deposit into the General Fund. According to a special legislative

analyst from the State Controller's Office's division of accounting and reporting, Public Health may request that the state and federal accounts be included in the SMIF. To do so, he explained, Public Health would need to send a request letter to the Pooled Money Investment Board and, if approved, this board would forward the request to the State Controller's Office for its review of the legality of the accounts being included in the SMIF. He stated that the accounts, once approved, would be officially included in the SMIF and begin earning interest that is returned to the respective accounts. The special legislative analyst explained that during his cursory review, he did not identify any exclusionary language in law to prevent the state and federal accounts from being included in the SMIF.

According to the CMS branch manager, California is one of the few states whose laws prohibit the state Medicaid agency or its designee, 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. As the Introduction mentions, when the division identifies that a facility is out of compliance with federal requirements, it may recommend that CMS impose a monetary penalty. However, in some instances, the division may identify that a facility is out of compliance with both state and federal requirements. In these cases, the division may issue a citation for a monetary penalty and recommend that CMS impose a nonmonetary enforcement remedy. Because some portion of monetary penalties resulting from the division's recommendations to CMS are deposited into the federal account, by prohibiting Public Health from both imposing a monetary penalty and recommending that CMS impose a monetary penalty, this law limits the amount of revenue deposited into the federal account.

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 expressly 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 but does not pay in time to receive the 35 percent reduction. Because state law is unclear as to the time frame in which the facility must pay the monetary penalty, we received a report from CMS officials in the San Francisco regional office that identifies the amount of revenue it received from assessing interest on late payments for violations of noncompliance with federal requirements. According to this report, for monetary penalties collected between July 2003 and April 2010, it assessed interest on late payments amounting to roughly \$27,000. If state law prescribed a time frame within which a nonappealed citation that

Although CMS collects interest on the monetary penalties it imposes on facilities that are not paid on time for noncompliance with federal requirements, there is no similar authorization in state law for Public Health.

did not qualify for the 35 percent reduction 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 for facility noncompliance with federal requirements. Public Health does not currently have an effective system in place to perform this tracking. The system Public Health currently uses—the Automated Survey Processing Environment (ASPEN)—is a federal system intended to improve states' capability for tracking and managing enforcement. However, according to Public Health's chief of field operations for the division, although ASPEN has a module intended to assist states in scheduling and collecting data resulting from surveys, Public Health has elected not to use it for tracking purposes because of glitches in the system. According to CMS's branch manager, after conferring with CMS regional offices throughout the country, the regional office in San Francisco became aware that ASPEN's tracking tool capabilities were not being maximized by its users. She further stated that CMS recently hired an individual to assist states in using ASPEN as a tracking tool, and plans to offer training to states within the next two years. Without complete data on the results of its recommendations to CMS, Public Health is not able to assess the adequacy of its federal surveys or identify areas for improvement in its processes, potentially affecting the amount of revenue generated for the federal account.

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 we 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, which included recommendations related to the state account. Specifically, the report concluded that the former Health Services had weak controls over its disbursements of funds from the state account. For example, between fiscal years 2001–02 and 2005–06, Health Services disbursed more than \$14.7 million from the state account. Although most of those funds paid for temporary management companies, we reported that Health Services did little to ensure that the payments it made were necessary or reasonable and recommended that it take steps to gain assurance from temporary management companies that the funds they received were necessary. In addition, we reported concerns about Health Services' process for selecting temporary management companies and recommended that it take steps to expand its pool of qualified temporary management companies to ensure that

it has sufficient numbers of these companies available and receives competitive prices. Finally, we reported that Health Services did not maintain adequate support for \$581,000 in state account funds that it used to purchase computers for the division. We recommended that when Health Services charges these general support items to the state account, it document its rationale for doing so.

During our follow-up review, we found that Public Health has fully implemented some of the recommendations in our prior report. In particular, we confirmed that Public Health adequately justifies the payments it makes to temporary management companies and has expanded its pool of temporary managers. However, Public Health has not fully implemented the recommendation that it document its rationale for charging general support items to the state account. Specifically, the chief of the administrative services branch within the division notified us that 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. She explained that these charges were the result of posting errors made by Public Health in its accounting system and that the erroneous charges were subsequently corrected. The chief of the administrative services branch within the division stated that expenditure reports are reviewed by an associate accounting analyst within the division on a monthly basis to determine whether all charges apply to temporary manager payments and that any charges that do not are questioned and assessed. However, she also stated that there are no written procedures requiring this review or the manner in which this review is conducted. Without such procedures, Public Health risks that erroneous charges will be made to the penalty accounts and that these errors will not be caught and subsequently corrected. The administrative services branch within the division stated that since fiscal year 2007–08, the division has ceased paying for general support items from the state and federal accounts, and will continue its practice not to charge any general support items to the accounts. However, the chief of the administrative services branch within the division explained that staff have not been formally instructed in writing not to charge general support items to these penalty accounts. As a result, Public Health cannot provide assurance that general support items will not be charged to the state and federal accounts in the future.

Although Public Health implemented the bureau's two recommendations regarding temporary management companies, in conducting our follow-up review we identified some additional concerns about Public Health's procedures for overseeing these 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, when we asked Public Health's deputy director of Legal Services whether

Public Health has not fully implemented a recommendation in our prior report—that it document its rationale for charging general support items to the state account.

these regulations had been developed, she noted that although Public Health has identified the need for these regulations, to date they have not been developed. Rather than using formally adopted regulations, the division uses 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 the division follows internal policies that were developed without the process of public review, Public Health has violated state law prohibiting agencies from enforcing regulations that have not been adopted in accordance with the act. By not adopting these required regulations, Public Health has bypassed public transparency and has precluded temporary management companies, facilities, and other interested parties from providing input on the regulations that affect them. As a result, Public Health's procedures for overseeing temporary management companies may not be complete, leaving the possibility for additional procedural oversights to occur.

Recommendations

To ensure that the governor's budget does not overstate funds available for appropriation for the federal account, Public Health should take the following steps:

- 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.
- Ensure that supervisory review is performed of the reconciliation of the fund condition as supported by Aging's and Public Health's accounting records to the fund condition statement prepared for inclusion in the governor's budget.

To increase revenue for the state account, Public Health should do the following:

- 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, the division should update its monetary penalty assessment form to ensure it contains language that is consistent with state law. 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.

- Seek legislation authorizing it to require facilities that want to contest the monetary penalty to pay the penalty upon its appeal, which could then be deposited into an account within the special deposit fund. The original monetary penalty deposited, plus interest accrued in the account, should then be liquidated in accordance with the terms of the decision.

To ensure consistency with federal guidance related to federal requirements, and that it is not creating incentives for facilities to appeal citations issued for noncompliance with state requirements, Public Health should 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. If Public Health believes instances occur when it is appropriate to reduce a monetary penalty by more than 35 percent, it should document which statutory or regulatory factors that formed the basis for concluding that the original class of citation and corresponding monetary penalty amount were no longer considered valid or relevant.

To ensure that citation review conferences are completed expeditiously, Public Health should take these steps:

- Continue to take steps to eliminate its backlog of appeals awaiting a citation review conference.
- 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 on the grounds that the citation review conference has not been completed before the effective date of the monetary penalty.
- Monitor its progress in processing appealed citations for Class AA and B violations as well as the OAH's progress in processing appealed citations for Class A violations.

To increase revenue for the penalty accounts, Public Health should do the following:

- Seek legislation authorizing it to revise periodically the penalty amounts to reflect an inflation indicator, such as the CPI.
- Encourage CMS to seek changes to federal regulations authorizing CMS to revise periodically the monetary penalty amounts imposed on facilities to reflect the rate of inflation.
- Ensure that it conducts all state surveys of facilities every two years, as required by state law.

- Submit to the Pooled Money Investment Board a request that the board approve including both the state and federal accounts in the SMIF in order to increase revenue for both accounts.
- Seek authorization from the Legislature both to impose a monetary penalty and to recommend that CMS impose a monetary penalty when the division determines that a facility is not complying with both state and federal requirements.
- 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.
- Increase its coordination with CMS to ensure that it can track CMS's implementation of the recommendations that the division makes to CMS for the period before receiving training from CMS, and that it effectively use ASPEN to track recommendations after the training.

To make certain that it fully implements the recommendations made in our April 2007 audit report, Public Health should create written procedures specifying that expenditure reports should be reviewed monthly by an accounting analyst within the division to determine whether all charges 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.

To ensure that it complies with current state law and increases transparency, Public Health should adopt regulations for the administration of temporary management companies.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: June 17, 2010

Staff: Laura G. Boll, Project Manager
Kathleen Klein Fullerton, MPA
Michelle J. Baur, CISA
Richard W. Fry, MPA
Evelyn Garcia, MA
Ryan Grossi, JD
Dan Motta

Legal Counsel: Scott A. Baxter, JD

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

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Appendix

DEPARTMENT OF PUBLIC HEALTH'S FUND CONDITION STATEMENTS FOR THE STATE AND FEDERAL HEALTH FACILITIES CITATION PENALTIES ACCOUNTS CONTAINED VARIOUS ERRORS DURING FISCAL YEARS 2003-04 THROUGH 2008-09

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) determine the revenues, expenditures, and fund balances for the State Health Facilities Citation Penalties Account (state account) and the Federal Health Facilities Citation Penalties Account (federal account) for each fiscal year since 2003-04. Table A beginning on page 48 presents this information and provides a comparison between the fund condition statements of the Department of Public Health¹² (Public Health), as presented in the governor's budgets for fiscal years 2005-06 through 2010-11, and its or its predecessors financial statements for fiscal years 2003-04 through 2008-09.

The audit committee also asked the bureau, to the extent possible, to review and assess the reasons for any significant changes in these accounts or adjustments that may have affected fund balances. As noted in the Audit Results, Public Health failed to include the fund balance for the Department of Aging (Aging) in the fund condition statement for the federal account, which, as shown in Table A, led to an overstatement in the federal account's fund balance for fiscal years 2004-05 through 2008-09.

A fund balance is the balance of money in a fund that is available for appropriation, and in the governor's budget three fund condition statements present the summary of the operations of a fund for the past, current, and budget year. The fund condition statements are updated annually as part of the governor's budget, which is published in January of each year. The fund condition statement consists of various pieces of information, including the beginning fund balance, revenues, expenditures, prior-year adjustments, and the ending fund balance.

In general, the fund balance for the federal account is a cumulative amount of revenues deposited into the account less expenditures made by Public Health and Aging since the account was established. Because Aging does not collect or receive revenue for deposit into the federal account, Aging's expenditures cause

¹² On July 1, 2007, the California Department of Health Services (Health Services) was reorganized and became two departments: the California Department of Health Care Services and Public Health. Before it was reorganized, Health Services administered the state and federal Health Facilities Citation Penalties accounts. Public Health now administers these accounts.

its financial statements to reflect a negative fund balance for the federal account. In contrast, as the Introduction describes, because Public Health receives revenue from the Centers for Medicare and Medicaid Services, which it deposits into the federal account, Public Health's financial statements generally reflect a positive fund balance for the federal account. Consequently, when Public Health does not combine the two fund balances when preparing the fund condition statement for inclusion in the governor's budget, a large portion of the accumulated expenditures are not included as part of the federal account's overall fund balance. The result is a fund condition statement that reflects an overstated fund balance, which incorrectly indicates to decision makers that there is more money available for appropriation than is actually the case.

To determine the magnitude of the errors in the fund balance for the federal account resulting from Public Health's omission of Aging's fund balance for the federal account, we compared the fund condition statement, as reported in the governor's budgets for fiscal years 2005–06 through 2010–11 to Aging's and Public Health's financial statements.¹³ As shown in Table A, the federal account's fund balance reported in the governor's budgets was overstated for each fiscal year since 2004–05. This is not surprising given that fiscal year 2003–04 was the first year in which Aging received an appropriation from the federal account and was therefore the first year that Aging had a fund balance for this fund. In the fund condition statement for fiscal year 2004–05, Public Health made a prior-year adjustment of \$6.2 million, causing the ending fund balance of the federal account to match only Public Health's financial statement fund balance, which was \$10.8 million as of June 30, 2005. In doing so, Public Health excluded Aging's fund balance, which comprised the expenditures for fiscal years 2003–04 and 2004–05, making it appear that the expenditures never occurred and causing the fund balance to be overstated.

Further, Public Health made significant prior-year adjustments to the federal account for fiscal years 2004–05 through 2008–09, due, in part, to its omission of the federal account's fund balance as reported on Aging's financial statements. A large prior-year adjustment was made when Public Health recognized its oversight and subsequently corrected its fund condition statement in January 2010. As shown in Table A, this correction resulted in a prior-year adjustment to the federal account of negative \$2.6 million, reduced from a positive \$7.3 million, effectively

¹³ A state agency's *financial statements* are the uniform financial reports prepared by that agency's accounting division and sent to the State Controller's Office. The statements contain comprehensive financial information for each of the same categories presented in the fund condition statements reported in the governor's budget.

offsetting the overstatement of \$9.9 million that it had reported in the fund condition statement for fiscal year 2008–09, which was included in the fiscal year 2010–11 Governor’s Budget. In contrast, the fund balances for the state account were materially correct for fiscal years 2004–05 through 2008–09, likely because the state account does not include an appropriation to Aging and the preparation of the state account’s fund condition statements does not require Aging’s financial information.

We also noticed errors related to the revenues and expenditures reported by Public Health in the fund condition statements for the state and federal accounts. These errors affected the prior-year adjustments Public Health made to both the state and federal accounts. For example, as shown in Table A, Public Health reported a prior-year adjustment to the state account of \$2.3 million in fiscal year 2004–05. This adjustment is to correct an erroneous ending fund balance reported by Public Health in its fiscal year 2003–04 fund condition statement and included in the fiscal year 2005–06 Governor’s Budget. The ending fund balance was the result of Public Health erroneously understating revenues and expenditures by \$5.2 million in fiscal year 2003–04. This amount includes the current revenues and expenditures reported as understatements in Table A amounting to \$3.94 million in operating income and an understatement of \$1.24 million for a prior-year adjustment. The result is an understatement of nearly \$2.6 million in the state account’s fund balance during fiscal year 2003–04. To correct these errors, including its \$244,000 overstatement of operating income in fiscal year 2004–05, Public Health posted a prior-year adjustment of roughly \$2.3 million in fiscal year 2004–05. As shown in Table A, for fiscal year 2004–05, this prior-year adjustment reconciled the ending fund balance as reported in the governor’s budget with the balance reported in the financial statements.

Finally, Table A shows significant fluctuations between fiscal years in expenditures for both the state and federal accounts, occurring most notably between fiscal years 2005–06 and 2007–08. According to the Licensing and Certification Division’s (division) chief of administrative services, most of Public Health’s expenditures from both the state and federal accounts pay for temporary management companies. Because of this situation, the expenditures can fluctuate a great deal from year to year, depending upon Public Health’s need for temporary management companies. For example, as Table A indicates, from fiscal years 2005–06 to 2006–07, expenditures in the federal account increased dramatically from \$1.5 million to \$5.5 million. According to Public Health’s chief of the administrative services branch within the division, this change occurred because Public Health needed more temporary management companies that year.

Table A
Comparative Analysis of Department of Public Health and Department of Health Services' Fund Condition
Statement Amounts to the Departments' Financial Statement Amounts
(In Thousands)

	STATE			FEDERAL		
	GOVERNOR'S BUDGET	FINANCIAL STATEMENTS	OVERSTATEMENT OR (UNDERSTATEMENT)	GOVERNOR'S BUDGET	FINANCIAL STATEMENTS	OVERSTATEMENT OR (UNDERSTATEMENT)
Fiscal Year 2003–04*						
Beginning fund balance	\$10,397	\$7,778	\$2,619	\$7,941	\$9,790	(\$1,849)
Revenue	2,676	2,748	(72)	511	514	(3)
Expenditures	(5,002)	(1,134)	(3,868)	(3,264)	(2,420)	(844)
Operating income	(2,326)	1,614	(3,940)	(2,753)	(1,906)	(847)
Prior-year adjustment	(1,242)	0	(1,242)	279	0	279
Ending fund balance	6,829	9,392	(2,563)	5,467	7,884	(2,417)
Fiscal Year 2004–05*						
Beginning fund balance	\$6,829	\$9,392	(\$2,563)	\$5,467	\$7,884	(\$2,417)
Revenue	1,882	1,864	18	870	904	(34)
Expenditures	(2,109)	(2,335)	226	(1,709)	(1,745)	36
Operating income	(227)	(471)	244	(839)	(841)	2
Prior-year adjustment	2,319	0	2,319	6,201	0	6,201
Ending fund balance	8,921	8,921	0	10,829	7,043	3,786
Fiscal Year 2005–06						
Beginning fund balance	\$8,921	\$8,921	\$0	\$10,829	\$7,043	\$3,786
Revenue	1,114	1,114	0	733	733	0
Expenditures	(4,645)	(4,645)	0	(1,523)	(1,545)	22
Operating income	(3,531)	(3,531)	0	(790)	(812)	22
Prior-year adjustment	(245)	(245)	0	(1,522)	36	(1,558)
Ending fund balance	5,145	5,145	0	8,517	6,267	2,250
Fiscal Year 2006–07†						
Beginning fund balance	\$5,145	\$5,145	\$0	\$8,517	\$6,267	\$2,250
Revenue	2,410	2,410	0	1,067	1,066	1
Expenditures	(5,012)	(5,012)	0	(5,515)	(5,515)	0
Operating income	(2,602)	(2,602)	0	(4,448)	(4,449)	1
Prior-year adjustment	(360)	(360)	0	1,689	(1,471)	3,160
Ending fund balance	2,183	2,183	0	5,758	347	5,411
Fiscal Year 2007–08						
Beginning fund balance	\$2,183	\$2,183	\$0	\$5,758	\$347	\$5,411
Revenue	1,870	1,743	127	1,086	1,038	48
Expenditures	0	0	0	(1,535)	(1,566)	31
Operating income	1,870	1,743	127	(449)	(528)	79
Prior-year adjustment	0	127	(127)	(170)	2,692	(2,862)
Ending fund balance	4,053	4,053	0	5,139	2,511	2,628

	STATE			FEDERAL		
	GOVERNOR'S BUDGET	FINANCIAL STATEMENTS	OVERSTATEMENT OR (UNDERSTATEMENT)	GOVERNOR'S BUDGET	FINANCIAL STATEMENTS	OVERSTATEMENT OR (UNDERSTATEMENT)
Fiscal Year 2008–09						
Beginning fund balance	\$4,053	\$4,053	\$0	\$5,139	\$2,511	\$2,628
Revenue	2,045	2,045	0	993	992	1
Expenditures	(1,276)	(1,276)	0	(1,583)	(1,582)	(1)
Operating income	769	769	0	(590)	(590)	0
Prior-year adjustment	(5)	(5)	0	7,316	10	7,306
Ending fund balance	4,817	4,817	0	11,865	1,931	9,934

Public Health's Revised Fund Condition Statement for Fiscal Year 2008–09 Submitted January 2010

Beginning fund balance	–	–	–	\$5,139	\$2,511	\$2,628
Revenue	–	–	–	993	992	1
Expenditures	–	–	–	(1,583)	(1,582)	(1)
Operating income	–	–	–	(590)	(590)	0
Prior-year adjustment	–	–	–	(2,618)	10	(2,628)
Ending fund balance	–	–	–	1,931	1,931	0

Sources: The Department of Public Health's (Public Health) year-end financial statements, the California Department of Health Services' (Health Services) year-end financial statements, the Department of Aging's year-end financial statements, the governor's budgets for fiscal years 2005–06 through 2010–11, and the Appropriation Control Ledger from the State Controller's Office.

Note: On July 1, 2007, Health Services was reorganized and became two departments: the Department of Health Care Services and Public Health. Health Services administered the state and federal Health Facilities Citation Penalties accounts (state and federal accounts) before it was reorganized. Public Health now administers these accounts.

* The financial statements for these years are not available. Instead, we used the Appropriation Control Ledger from the State Controller's Office, which contains actual cash-basis amounts to generate revenues and expenditures on an accrual basis. The fund balances were derived working backwards from the fiscal year 2005–06 beginning fund balance.

† The fiscal year 2006–07 amounts for the state and federal accounts are transposed in the governor's budget. We have corrected them for presentation here.

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(Agency comments provided as text only)

June 9, 2010

California Department of Public Health
MS 500
P.O. Box 997377
Sacramento, CA 95899-7377

Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

The California Department of Public Health (CDPH) has prepared its response to the Bureau of State Audits (BSA) draft report entitled, "Department of Public Health: It Reported Inaccurate Financial Information and Can Likely Increase Revenues for the Federal and State Health Facilities Citation Penalties Accounts June 2010 Report 2010-108." The CDPH appreciates the opportunity to provide the Bureau of State Audits with a response to the draft report.

If you have any questions, please contact Karen Petruzzi, CDPH Audit Coordinator (916) 650-0266.

Sincerely,

(Original signed by Kevin F. Reilly for)

Mark B Horton, MD, MSPH
Director

Enclosure

* California State Auditor's comments begin on page 61.

CDPH Response to: Draft Report- Department of Public Health:
It Reported Inaccurate Financial Information and Can Likely Increase Revenues for
the Federal and State Health Facilities Citation Penalties Accounts
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Recommendation 1:

To ensure that the governor's budget does not overstate funds available for appropriation for the federal account, Public Health should:

- 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.

CDPH Response 1:

CDPH agrees/concurs with the BSA audit's recommendation on the Federal Health Facilities Citation Penalties Account (FHFCPA) that the Budget Section include text in its procedure manual requiring staff to reconcile the revenues, expenditures, and fund balance prior to inclusion of the fund condition statement in the Governor's Budget.

Timeline for Corrective Action: The Budget Section will enhance its policies and procedures by August 2010 and annually schedule staff training to review the fund condition statement process.

Recommendation 2:

- Ensure that supervisory review is performed of the reconciliation of the fund condition as supported by Aging's and Public Health's accounting records to the fund condition statement prepared for inclusion in the governor's budget.

CDPH Response 2:

CDPH agrees/concurs with the BSA audit's recommendation on the FHFCPA that the Budget Section shall ensure that supervisory review is performed on the reconciliation of the fund condition statement for the FHFCPA, based on the final financial statements of CDPH and the Department of Aging.

Timeline for Corrective Action: By October 2010 the Budget Section managers will review and approve the fund condition statement with a signature and date. Only after this supervisory review will the department submit the fund condition statement to the Department of Finance for inclusion in the Governor's Budget.

Recommendation 3:

To increase revenue for the state account, Public Health should:

- 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.

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It Reported Inaccurate Financial Information and Can Likely Increase Revenues for
the Federal and State Health Facilities Citation Penalties Accounts
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CDPH Response 3:

CDPH agrees with the recommendation that the Department should 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.

CDPH will ensure that ELMS uses the date of issuance for the calculation of the 35% reduction.

Timeline for Corrective Action: We will make the appropriate coding changes to ELMs within the next six months.

Recommendation 4:

Further, the division should update its monetary penalty assessment form to ensure it contains language that is consistent with state law.

CDPH Response 4:

CDPH agrees with the recommendation that the division should update its monetary penalty assessment form to ensure it contains language that is consistent with state law.

Timeline- We will revise the form to be consistent with the statute by September 1, 2010

Recommendation 5:

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.

CDPH Response 5:

CDPH disagrees with the recommendation: 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.

Based on the response to number 3, CDPH does not believe it needs to amend state law.

①

Recommendation 6:

- Seek legislation authorizing it to require facilities that want to contest the monetary penalty to pay the penalty upon its appeal, which could then be deposited into an account within the special deposit fund. The original monetary penalty deposited, plus interest accrued in the account, should then be liquidated in accordance with the terms of the decision.

CDPH Response to: Draft Report- Department of Public Health:
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CDPH Response 6:

CDPH agrees/concurs with the recommendation that the Department should seek legislation authorizing it to require facilities that want to contest the monetary penalty to pay the penalty upon its appeal, which could then be deposited into an account within the special deposit fund. The original monetary penalty deposited, plus interest accrued in the account, should then be liquidated in accordance with the terms of the decision.

Timeline for Corrective Action: CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation for the 2011 Legislative session.

Recommendation 7:

To ensure the citation review conferences are completed expeditiously, Public Health should:

- Continue to take steps to eliminate its backlog of appeals awaiting a citation review conference.

CDPH Response 7:

CDPH agrees/concurs with the recommendation that the Department should continue to take steps to eliminate its backlog of appeals awaiting a citation review conference.

Timeline for Corrective Action: CDPH plans to use existing resources to complete citation review conferences for all appealed citations for Class AA violation by September 2010 and will take steps to process all appealed citations for Class B violations in a timely manner.

②

Recommendation 8:

- Seek legislation amending its citation review conference process to more closely reflect the federal process by prohibiting facilities from seeking a delay of the imposition of monetary penalties on the grounds that the citation review conference has not been completed before the effective date of the monetary penalty.

CDPH Response 8:

CDPH agrees/concurs with the recommendation that the Department should seek legislation amending its citation review conference process to more closely reflect the federal process by prohibiting facilities from seeking a delay of the imposition of monetary penalties on the grounds that the citation review conference has not been completed before the effective date of the monetary penalty.

CDPH Response to: Draft Report- Department of Public Health:
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the Federal and State Health Facilities Citation Penalties Accounts
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Timeline for Corrective Action: CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation for the 2011 Legislative session.

Recommendation 9:

- Monitor its progress in processing appealed citations for Class AA and B violations as well as the Office of Administrative Hearing's progress in processing appealed citations for Class A violations.

CDPH Response 9:

CDPH agrees/concurs with the recommendation that the Department should monitor its progress in processing appealed citations for Class AA and B violations as well as the Office of Administrative Hearing's progress in processing appealed citations for Class A violations.

Timeline for Corrective Action: On a monthly basis to begin June 1, 2010, CDPH L&C will monitor the progress in processing appealed citations for Class AA and B violations as well as the Office of Administrative Hearing's progress in processing appealed citations for Class A violations.

Recommendation 10:

To increase revenue for the penalty accounts, Public Health should:

- Seek legislation authorizing it to periodically revise the current penalty amounts to reflect an inflation indicator, such as the Consumer Price Index.

CDPH Response 10:

CDPH agrees/concurs with the recommendation that the Department should seek legislation authorizing it to periodically revise the current penalty amounts to reflect an inflation indicator, such as the Consumer Price Index.

Timeline for Corrective Action: CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation for the 2011 Legislative session.

Recommendation 11:

- Encourage CMS to seek changes to federal regulations authorizing CMS to periodically revise the monetary penalties imposed on facilities that are not compliant with federal requirements, to reflect the rate of inflation.

CDPH Response to: Draft Report- Department of Public Health:
It Reported Inaccurate Financial Information and Can Likely Increase Revenues for
the Federal and State Health Facilities Citation Penalties Accounts
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CDPH Response 11:

CDPH agrees/concurs with the recommendation that the Department should encourage CMS to seek changes to federal regulations authorizing CMS to periodically revise the monetary penalties imposed on facilities that are not compliant with federal requirements, to reflect the rate of inflation.

Timeline for Corrective Action: The Center for Health Care Quality Deputy Director will contact CMS to seek these changes within 3 months of release of the Audit Report.

Recommendation 12:

- Ensure that it conducts all state surveys of facilities every two years as required by state law.

CDPH Response 12:

CDPH agrees/concurs with the recommendation that the Department should ensure that it conducts all state surveys of facilities every two years as required by state law.

Timeline for Corrective Action: CDPH is ramping up its licensing survey activities to comply with current statute. Provided the additional resources are approved, we envision implementation in State fiscal year 2011-12. The Administration has requested resources in the May Revision that would allow CDPH to comply provided these resources are included in the Budget Act of 2010.

③

Recommendation 13:

- To increase revenue for both the state and federal accounts, Public Health should submit a request to the Pooled Money Investment Board for its approval that the accounts be included in the Surplus Money Investment Fund.

CDPH Response 13:

CDPH agrees with this recommendation to request the Pooled Money Investment Board approve the state and federal accounts to be included in the Surplus Money Investment Fund.

Timeline for Corrective Action: The requests went to the State Treasurer's Office on June 2, 2010. Once the Board approves these requests they will notify CDPH of their approval. The Accounting Section will establish the Calstars codes to record any interest revenue earned within 90 days of Board approval.

CDPH Response to: Draft Report- Department of Public Health:
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Recommendation 14:

- Seek authorization from the Legislature to both impose a monetary penalty and recommend that CMS impose a monetary penalty when the division determines that a facility is out of compliance with both state and federal requirements.

CDPH Response 14:

CDPH agrees/concurs with the recommendation that the Department should seek authorization from the Legislature to both impose a monetary penalty and recommend that CMS impose a monetary penalty when the division determines that a facility is out of compliance with both state and federal requirements.

Timeline for Corrective Action: CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation concepts for the 2011 legislative session.

Recommendation 15:

- Seek legislation specifying a timeframe within which nonappealed citations that do not qualify for a 35 percent reduction must be paid and to allow Public Health to collect interest on late payments of monetary penalties.

CDPH Response 15:

CDPH partially agrees with the recommendation that the Department should seek legislation specifying a timeframe within which non-appealed citations that do not qualify for a 35 percent reduction must be paid and to allow Public Health to collect interest on late payments of monetary penalties.

CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation specifying a timeframe within which non-appealed citations that do not qualify for a 35 percent reduction must be paid. CDPH will consider this for the 2011 legislative session.

CDPH does not agree with the recommendation to collect interest on citations that are not appealed and that do not qualify for a 35 percent reduction but rather, CDPH will include imposing a late payment penalty on these citations when it develops legislation concepts for the next legislative cycle.

④

Timeline for Corrective Action: CDPH recognizes that this would require a statutory change. CDPH will consider exploring proposed legislation for the 2011 Legislative session.

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Recommendation 16:

- Increase its coordination with CMS to ensure that it can track CMS' implementation of the recommendations the division makes to CMS for the time period before receiving training from CMS, and that it effectively use ASPEN to track recommendations after the training.

CDPH Response 16:

CDPH partially agrees to the recommendation that the Department should increase its coordination with CMS to ensure that it can track CMS' implementation of the recommendations the division makes to CMS for the time period before receiving training from CMS, and that it effectively use ASPEN to track recommendations after the training.

- ⑤ We agree to increase our coordination with CMS to track this information; however, we disagree with the assumptions in the report that improved awareness of federal data reporting will in and of itself, increase revenues for federal accounts.

Timeline for Corrective Action: CDPH L&C already has a scheduled meeting with CMS Regional Office staff in the latter part of June to discuss report generation from the ASPEN database. This recommendation will be brought forward as part of this discussion.

Recommendation 17:

To ensure that it fully implements the recommendations made in the bureau's April 2007 audit report, Public Health should create written procedures specifying that expenditure reports should be reviewed by an accounting analyst within the division on a monthly basis to determine whether any charges do not apply to temporary manager payments.

CDPH Response 17:

CDPH agrees/concurs with this recommendation: To ensure that it fully implements the recommendations made in the bureau's April 2007 audit report, Public Health should create written procedures specifying that expenditure reports should be reviewed by an accounting analyst within the division on a monthly basis to determine whether any charges do not apply to temporary manager payments.

CDPH will write a policy that is consistent with state law.

Timeline for Corrective Action: CDPH is currently in the process of drafting and finalizing the procedures and will have these completed by the end of September 2010.

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Recommendation 18:

Further, Public Health should include in its written policies and procedures that general support items should not be charged to the penalty accounts.

CDPH Response 18:

CDPH agrees/concurs with the recommendation that the Department should include in its written policies and procedures that general support items should not be charged to the penalty accounts.

Timeline for Corrective Action: CDPH is currently in the process of drafting and finalizing the procedures and will have these completed by the end of June 2010.

Recommendation 19:

To ensure that it complies with current state law and increases transparency, Public Health should adopt regulations for the administration of temporary management companies.

CDPH Response 19:

CDPH agrees with this recommendation: To ensure that it complies with current state law and increases transparency, Public Health should adopt regulations for the administration of temporary management companies.

Timeline for Corrective Action: The administration of temporary management companies has been added to the regulations priority list for CDPH. The department has a number of high priority regulation packages in the queue and we anticipate completion of this package by the end of 2015.

⑥

Recommendation 20:

To ensure that it is not creating incentives for facilities to appeal citations, Public Health should establish a policy that discourages settling appealed monetary penalties for a better term than had the facility not contested the citation and paid the penalty within the timeframe specified in law to receive a 35 percent reduction.

CDPH Response 20:

CDPH disagrees with this recommendation: To ensure that it is not creating incentives for facilities to appeal citations, Public Health should establish a policy that discourages settling appealed monetary penalties for a better term than had the facility not contested the citation and paid the penalty within the timeframe specified in law to receive a 35 percent reduction.

CDPH Response to: Draft Report- Department of Public Health:
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- ⑦ CDPH agrees there should not be incentives for the facilities to appeal. However, CDPH should maintain maximum discretion to weigh all factors.

Recommendation 21:

If Public Health believes instances occur when it is appropriate to reduce a monetary penalty by more than 35 percent, it should establish guidelines specifying factors which should be taken into consideration, such as the severity of the violation or whether the facility is a repeat offender, and clearly document that such factors were considered.

CDPH Response 21:

- ⑧ CDPH disagrees with this recommendation: If Public Health believes instances occur when it is appropriate to reduce a monetary penalty by more than 35 percent, it should establish guidelines specifying factors which should be taken into consideration, such as the severity of the violation or whether the facility is a repeat offender, and clearly document that such factors were considered.

Establishing guidelines for reduction of monetary penalties would require the adoption of regulations under the Administrative Procedures Act (APA). Such standards would hinder the Department's ability to achieve equitable settlements because it would force the Department to adhere to a set formula which may not be appropriate in all fact situations. Moreover, it would put the Department an uneven bargaining position where the facility knows the Department's settlement policy, but not vice versa.

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM CALIFORNIA DEPARTMENT OF PUBLIC HEALTH

To provide clarity and perspective, we are commenting on the response to our audit report from the Department of Public Health (Public Health). The numbers below correspond to the numbers we placed in the margin of Public Health's response.

Public Health took our recommendation out of context. We agree that, if Public Health implements our recommendation to update the Electronic Licensing Management System to use the issuance date of the citation as specified in state law when calculating whether the 35 percent reduction is warranted, our suggested alternative to seek a change to the law is moot.

①

We look forward to reviewing Public Health's 60-day response to better understand its definition of "timely manner" as it applies to processing appealed citations for Class B violations.

②

State law has required that Public Health conduct surveys of facilities' compliance with state requirements since at least 1974. Therefore, Public Health needs to ensure that state inspections are conducted in accordance with state law.

③

Our intent in recommending that Public Health impose interest on late payments was to encourage prompt payment of monetary penalties, which could in turn increase revenue for the State Health Facilities Citation Penalties Account. We agree that imposing a late payment penalty, rather than interest, would also accomplish this goal.

④

Public Health is mistaken. We did not indicate in our recommendation that improved awareness of federal data reporting will, in and of itself, increase revenue for the Federal Health Facilities Citation Penalties Account (federal account). Rather, we note on page 38 that without complete data on the results of its recommendations to the Centers for Medicare and Medicaid Services (CMS), Public Health is not able to assess the adequacy of its federal surveys or identify areas for improvement in its processes, potentially affecting the amount of revenue generated for the federal account.

⑤

State law required Public Health to adopt regulations for the administration of temporary management companies by December 31, 2001. Therefore, we do not believe that adopting

⑥

regulations by the end of 2015, nearly 14 years after the statutorily required deadline, is reasonable and Public Health should adopt such regulations immediately.

- ⑦ As shown in Table 4 on page 28, 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. Further, in the example we cite on page 29, Public Health reduced one citation issued for a Class AA violation by 99 percent. 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.

Further, as we note on page 29, CMS's policy does not require, but rather provides guidance, related to citations issued for noncompliance with federal requirements and specifies that if a decision is made to settle, the settlement should not provide a better term than if the facility had chosen the 35 percent reduction. If Public Health had a similar policy, and followed the policy whenever feasible, it would still have discretion to weigh all factors when settling appealed citations, and would only need to document those factors considered when it did not follow the policy.

- ⑧ We have revised the recommendation to clarify our intent, which is to ensure that Public Health is providing transparency when it decides to reduce a monetary penalty by more than 35 percent. We do not believe that this recommendation will inhibit Public Health's discretion in settling appealed citations. However, if Public Health believes it needs to develop regulations to implement this recommendation, it should do so.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press