Economic Impact Analysis
Virginia Department of Planning and Budget

22 VAC 40-25 – Auxiliary Grants Program

Department of Social Services

November 12, 2004

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

Section §63.2-800 of the Code of Virginia authorizes the State Board of Social Services to prepare and implement a plan for a state and local funded auxiliary grants program to provide assistance to certain individuals ineligible for benefits under Title XVI of the Social Security Act and to certain other individuals for whom benefits provided under Title XVI of the Social Security Act are not sufficient to maintain the Board-established minimum standards of need.

The proposed regulation (1) no longer requires assisted living facilities to submit annual cost reports and instead requires them to submit annual audited financial reports, (2) modifies the rate setting process for auxiliary grant reimbursement rates for assisted living facilities, and (3) stipulates that assisted living facilities sign and submit a provider agreement as a condition of participation in the auxiliary grants program.

The proposed regulation also includes changes that make the regulation consistent with current practice. It establishes procedures and requirements for adult foster care providers receiving auxiliary grant payments. These requirements are based on current policy and practice. The proposed regulation also adds clarifying language, modifies existing language, and deletes redundant language. These changes are intended to provide clarification and make the regulation consistent with the Code of Virginia and other Department of Social Services (DSS) and Department of Medical Assistance Services (DMAS) policies and regulations.

Estimated Economic Impact

The auxiliary grants program is state- and locally-funded financial assistance program to provide supplemental financial assistance for social security income recipients and other individuals who would have been eligible for social security income but for excess income who reside in assisted living facilities (ALF) or adult foster care homes (AFC). The auxiliary grant has two components: a monthly reimbursement rate per resident for ALFs and AFCs and a personal needs allowance for an auxiliary grant recipient residing at an ALF or an AFC. The maximum monthly reimbursement rate for ALFs and AFCs is established by state regulations and set forth in the Appropriations Act. Under the existing regulation, licensed ALFs are required to submit regular cost reports. Based on the operating cost and expense data detailed in the cost report, a reimbursement rate is determined. This rate is then compared to the maximum monthly rate, and the lesser of the two is chosen as the auxiliary grant reimbursement rate. The cost to the state and to localities of the auxiliary grants program is the auxiliary grant reimbursement rate less the recipient's countable income plus the personal needs allowance. The state's share of the supplemental financial assistance is 80% and local share is 20%. In fiscal year 2003, approximately $24 million was spent on auxiliary grant payments (80% general funds and 20% local matching funds). Currently, the maximum monthly rate is $894 (it is $1,028 in Northern Virginia)[1]. In fiscal year 2004, the state share per payment was $251 and local share per payment was $63.

(1) The proposed regulation no longer requires ALFs to submit annual cost reports and instead requires them to submit annual audited financial reports. The reports for each year are to be submitted by June 30 of the following calendar year. Licensed ALFs with 20 or more beds

[1] As of January 1, 2004, social security income (included as part of a recipient's countable income) was $564.

are required to submit an audited financial report. Smaller ALFs (19 or fewer beds) are required to submit an abbreviated audit report that only includes the following information: validation that resident funds are being held separately from the facility's funds, the number of resident beds occupied during the reporting period, the facility's operating revenues and expenses, and the facility's average monthly cost per resident. All audit reports are required to account separately for the personal needs allowance of auxiliary grant recipients.

As discussed above, the existing regulation requires licensed ALFs to submit annual cost reports in order to determine their auxiliary grant reimbursement rate. However, the usefulness of cost reports in setting auxiliary grant rates is moot. A 1997 Joint Legislative Audit and Review Commission (JLARC) report[2] concluded that the cost reporting and rate setting process had almost no effect on the auxiliary grant budget. In 1995, all but two out of 425 licensed adult care residences (defined as ALFs in the proposed regulation) that applied for an auxiliary grant were approved for the maximum monthly rate. Thus, cost reports were found in most cases to yield a monthly cost per resident greater than the maximum authorized monthly rate. In addition, the report found the existing rate setting process to be flawed. For example, an adult care residence's reported operating costs are arbitrarily increased by 14% during the rate setting process in order to account for inflation and growth. The report concludes that the current rate setting process used to determine auxiliary grant rates for individual adult care residences is not needed and could be abolished. The report recommends that auxiliary grant reimbursement rates be set through the state's budget process. A 1998 study[3] submitted to DMAS and DSS also recommended that the state consider eliminating the filing of cost reports by adult care residences, and base auxiliary grant reimbursement rates on federal maintenance of effort requirements. The state could conduct periodic studies to determine whether auxiliary grants need to be increased beyond federal requirements. The study found that, based on cost verification of 30 adult care residence cost reports with the reporting year ending in 1997, the detail and accuracy of accounting records at adult care residences were inadequate to prepare a cost report that reasonably reflected the cost of providing care to residents. In addition, the

[2] Services for Mentally Disabled Residents of Adult Care Residences, 1997, *Joint Legislative Audit and Review Commission Report*, House Document No. 4.
[3] A Study of the Costs of Adult Care Residences Serving Auxiliary Grant Recipients in Virginia, 1998. *Prepared by CHPS Consulting and Clifton Gunderson, P.L.L.C., and submitted to the Commonwealth of Virginia Department of Medical Assistance Services and Department of Social Services*.

design of the cost report prevented the collection of sufficiently detailed information to accurately determine the cost of care to residents. The maximum monthly rate was found to be adequate for adult care residences with over 30 beds. Small adult care residences had costs well above the maximum monthly rate, but some of them were government or not-for-profit facilities with residents having special needs and special sources of payment to meet those needs. Most adult care residences were found to have revenues sufficient to cover their costs.[4]

The usefulness of cost reports in enforcing the requirements of the regulation and preventing the exploitation of residents at adult care residences is also moot. The 1997 JLARC report noted that cost reports are not based on audited financial information. A review of cost reports filed in 1995 revealed numerous discrepancies between the data reported in the cost report and the adult care residence's general ledger system. While DSS can retroactively adjust the reimbursement rate upon finding such discrepancies, the report found that this provision had not been enforced. The lack of enforcement was partly because the agency believed that even if the errors were to be corrected the facility would still qualify for the maximum monthly rate. The report did recognize the necessity of some financial data collection. It recommended that DMAS collect appropriate financial data for prospective rate setting for assisted living services, and take steps to improve the financial information reported by adult care residences, including requiring audited financial reports from facilities above a certain size threshold.[5] The 1998 CHPS Consulting and Clifton Gunderson study also found that adequate safeguards and procedures were not in place in the areas of cost documentation and compliance with regulatory standards. For example, many adult care residences could not account for resident funds in their keeping, especially the personal needs allowance provided to residents under the auxiliary grants program. The study recommended that the state consider ways of enforcing requirements concerning the safeguard of resident funds held by adult care residences.

In response, DSS has decided to modify the rate setting process (discussed later in the analysis) and require ALFs to submit audited financial reports in place of cost reports on an annual basis. The proposed regulation does not require AFCs to submit annual audit reports. An AFC is a facility that provides room, board, supervision, and special services for up to three

[4] The median ratio of revenue to cost was 1.08.
[5] The 1997 JLARC report looked at a subset of the adult care residence population, i.e., mentally disabled residents of adult care residences.

adults with physical or mental needs. AFCs are currently not required to submit cost or audit reports. DSS does not believe the audit requirement to be necessary for such facilities.

The requirement for ALFs to submit annual audited reports is likely to impose economic costs and produce economic benefits. ALFs will incur additional costs in preparing and submitting annual audited financial reports. However, some of this additional cost is likely to be offset by ALFs no longer being required to prepare and submit an annual cost report. Based on information collected by DSS from a sample of ALF administrators, the cost of an independent financial audit is estimated to range from $400 to $700, depending on the size and scope of the facility. The cost of preparing a cost report was found to vary widely across facilities, from $50 to $2,000. DSS does not believe that the proposed requirement is likely to impose significant additional costs on ALFs. Many of these facilities are already conducting financial audits on an annual basis. A DSS phone survey of a pool of randomly selected ALFs found that all facilities surveyed reported preparing or hiring someone to prepare an annual audited financial report.[6] According to DSS, facilities contacted were supportive of the idea of replacing cost reports with audited financial reports, as long as the submittal date was consistent with their tax-filing deadline. Thus, facilities already preparing audited financial reports will not incur any additional costs as a result of the proposed requirement and will, in fact, realize cost savings from not having to prepare and submit separate cost reports. Facilities not currently preparing audited financial reports will have to incur the additional costs of preparing and submitting an audited financial report. However, some of this additional cost will be offset by not having to prepare and submit a cost report.

The proposed change is also likely to produce some economic benefits. According to DSS, there have been instances of exploitation of residents in ALFs, such as the co-mingling of a resident's personal needs allowance with the facility's funds, residents not receiving the services being paid for by the auxiliary grant, and public pay residents being charged more than the auxiliary grant rate. The 1997 JLARC report and the 1998 CHPS Consulting and Clifton Gunderson study found cost reports to be inadequate for the purposes of enforcing existing requirements and recommended that the state consider taking steps to improve enforcement. DSS believes that replacing cost reports with audited financial reports will provide better enforcement of existing requirements, better protection for ALF residents, and ensure better accountability and utilization of state and local resources. To the extent that the proposed change achieves these goals, it is likely to produce economic benefits.

The net economic impact of the proposed change will depend on whether the additional costs associated with the proposed change are greater than or less than the additional benefits. It is not possible to precisely estimate the costs and benefits of the proposed change at this time. However, the additional cost to ALFs of the meeting the proposed requirement does not appear to be very large. Most ALFs already appear to conduct annual financial audits and, to that extent, not having to prepare and submit a separate cost report is likely to provide them with cost savings.[7] For those ALFs not currently conducting annual financial audits, the additional cost of replacing the cost report with an audit report is not likely to be very large. Thus, to the extent that the proposed change allows for better enforcement of existing requirements without imposing significant additional costs on ALFs, it is likely to have a net positive economic impact.

(2) The proposed regulation modifies the rate setting process for auxiliary grant reimbursement rates for ALFs. As discussed above, auxiliary grant reimbursement rates for ALFs is the lesser of two rates, the maximum authorized monthly rate and the reimbursement rate calculated based on an ALF's cost report. However, as discussed in the previous section, the usefulness of cost reports in rate setting is moot. The 1997 JLARC report found that the cost report-based rate setting process was flawed and had almost no effect on the auxiliary grant budget. The report recommended setting reimbursement rates through the state budget process. The 1998 CHPS Consulting and Clifton Gunderson study found that cost reports were not adequate for the purpose of accurately determining the cost of providing care to ALF residents. The study recommended basing the reimbursement rates on federal maintenance of effort requirements. Under the proposed regulation, the auxiliary grant reimbursement rate for ALFs is the maximum monthly rate (as established in state regulations and set forth in the Appropriations Act or as set forth by changes in the federal maintenance of effort formula). The auxiliary grant

[6] The number of ALFs selected for the survey within each bed capacity range was proportional to the actual number of ALFs within that range.
[7] A precise estimate of the number of ALFs that do or do not conduct annual financial audits is not known.

amount will be the maximum monthly rate less the recipient's countable income plus the personal needs allowance.[8]

The proposed change is likely to have a small net positive economic impact. According to DSS, most ALFs are already being reimbursed at the maximum monthly rate. Thus, the proposed change is not likely to affect either auxiliary grant payments received by ALFs or the state and local auxiliary grant budget. However, to the extent that the rate setting process is simplified and made less burdensome, it is likely to produce economic benefits. For example, ALFs are currently required to submit cost reports within a year of when their auxiliary grant reimbursement rate was last established. The cost report is then used when establishing a new reimbursement rate (usually the maximum monthly rate). It can take more than a month after the cost report has been submitted for the new reimbursement rate to become effective. Thus, in order to ensure that they are reimbursed at the appropriate rate, ALFs need to keep track of when their reimbursement rate was last established and submit their cost report such that there is enough time for the new reimbursement rate to come into effect. Under the proposed regulation, the maximum monthly rate will be applied automatically in determining the auxiliary grant payment to ALFs. Thus, ALFs will be able to receive the same auxiliary grant payments as before, but with a lot less paperwork and a lot fewer administrative requirements.

While the proposed rate setting process is an improvement over the existing process, ways of improving the rate setting process even further should be considered. For example, evaluation of the maximum monthly rate by DSS on a regular basis and differentiation in the maximum monthly rate between ALFs of different sizes could lead to improvements in the rate setting process. Currently, the state is only required to meet federal maintenance of effort requirements. This requirement stipulates that when social security income increases, the state must maintain and not reduce the state supplement, ensuring that the entire amount of the social security income increase reaches the recipient. Failure to meet this requirement could jeopardize the state's federal Medicaid funding. As discussed above, the 1998 CHPS Consulting and Clifton Gunderson study found that there was no demonstrated need at the time of the study for across-the-board increases in the auxiliary grant rate other than to meet federal maintenance of

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[8] Under the existing regulation, the auxiliary grant amount is the minimum of the maximum monthly rate and the reimbursement rate calculated based on an ALF's cost report less the recipient's countable income plus the personal needs allowance.

effort requirements. The median cost per resident for the 30 facilities subject to cost verification was on average 5.8% higher than the maximum monthly rate. The median revenue to cost ratio was 1.08 and the mean revenue to cost ratio was 1.06.

However, there was a wide variation in costs between facilities depending on their size. For example, the maximum rate was found to be reasonably adequate for adult care residences with more than 30 beds, but was significantly lower than costs for adult care residences with less than 30 beds. Some of the smaller facilities had residents with special needs and special sources of funding, but others did not. In addition, the study found that there might be auxiliary grant overpayments to some adult care residences. Of the 30 adult care residences subject to cost verification, all reported costs higher than the maximum monthly rate. The cost verification process reduced the cost of nine of the 30 adult care residences to below the maximum rate (even with a 10% profit add-on).[9] Thus, conducting periodic studies to determine the average monthly cost to ALFs of different sizes of providing services to residents (both with and without special needs) may be useful in the rate setting process. Information from such studies combined with federal maintenance of effort requirements could be used to determine the maximum monthly rate and could lead to improvements in the rate setting process.

(3) The proposed regulation stipulates that assisted living facilities sign and submit a provider agreement as a condition of participation in the auxiliary grants program. The provider agreement is to be signed and submitted to DSS at the time an ALF applies for licensure. The proposed regulation establishes the conditions to be agreed to by an ALF as part of the provider agreement. These conditions are based on existing requirements. According to DSS, the proposed change is similar to the provider agreement requirement in DMAS's assisted living program.

The proposed change is not likely to have a significant economic impact. The additional cost to ALFs of signing and submitting a provider agreement is not likely to be significant. DSS does not intend to charge ALFs any fees relating to the provider agreement. On the other hand, the agency expects the provider agreement to reinforce existing laws and requirements. To the extent the proposed change improves the understanding, implementation, and enforcement of the

[9] It should be noted that approximately one-third of the costs reduced were due to a lack of documentation. Thus, it is possible that with appropriate documentation some of these costs would not have been disallowed.

proposed regulation, it is likely to produce some economic benefits and could have a small net positive economic impact.

The proposed regulation also includes changes that make the regulation consistent with current practice. It establishes procedures and requirements for adult foster care providers receiving auxiliary grant payments. These requirements are based on current policy and practice. According to DSS, the reimbursement, assessment, and recordkeeping requirements are the same as current practice. Prior to July 2003, AFCs received an auxiliary grant rate that was lower than the ALF auxiliary grant rate. Since then AFCs have received the same auxiliary grant reimbursement rate as ALFs. As the procedures and requirements for adult foster care providers established in the proposed regulation are already part of current practice, they not likely to have a significant economic impact.

The proposed regulation also adds clarifying language, modifies existing language, and deletes redundant language. These changes are intended to provide clarification and make the regulation consistent with the Code of Virginia and other Department of Social Services (DSS) and Department of Medical Assistance Services (DMAS) policies and regulations. To the extent that these changes improve understanding and implementation of the regulation, they are likely to have a small net positive economic impact.

Businesses and Entities Affected

The proposed regulation applies to all assisted living facilities and adult foster care providers accepting auxiliary grant residents. As of April 2004, there were 643 licensed ALFs operating in Virginia, with approximately 373 accepting auxiliary grant residents. In addition, there are 63 approved adult foster care homes currently operating in Virginia.

Assisted living facilities will now be required to submit annual audited financial reports in place of annual cost reports, accept reimbursement for auxiliary grant residents at the maximum monthly rate established by state regulations, and sign a provider agreement at the time of licensure. The requirements for adult foster care remain unchanged compared to current practice.

Localities Particularly Affected

The proposed regulation applies to all localities in the Commonwealth.

Projected Impact on Employment

The proposed regulation is not likely to have a significant impact on employment in the Commonwealth.

Effects on the Use and Value of Private Property

The proposed regulation is not likely to have a significant impact on the use and value of private property. Assisted living facilities will now be required to submit annual audited financial reports in place of annual cost reports, accept reimbursement for auxiliary grant residents at the maximum monthly rate established by state regulations, and sign a provider agreement at the time of licensure. However, the net economic impact of these changes on the use and value of private property is not likely to be significant.