

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

283

NEED FOR REDUCTION OF
EXCESS ACUTE CARE HOSPITAL BEDS

FEBRUARY 1977



Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature



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February 28, 1977

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of
the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report on excess hospital bed capacity in California.

The Auditor General charges the Director of Health with failure to comply with state law to limit bed capacity, resulting in \$26.5 million dollars being illegally expended. The Director responds that the report supports the Department's continued efforts to control excess bed capacity which has grown from 11,318 in 1971 to 19,007 in 1976. If the Director were in the United States Marine Corps, his enlistment would not be extended.

By copy of this letter the Department is requested to advise the Joint Legislative Audit Committee within 60 days of the status of implementation of the recommendations of the Auditor General that are within the statutory authority of the Department.

The auditors are Robert M. Neves and G. Dan Turner.

Respectfully submitted,

MIKE CULLEN, Chairman
Joint Legislative Audit Committee

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SUMMARY

Excess bed capacities and, in our opinion, inefficient management increase hospital costs and result in higher hospital rates to both private and Medi-Cal patients. Hospitals are reimbursed for the "reasonable" costs of providing services to Medi-Cal patients. "Reasonable", as used in the law, is subject to broad interpretation. Therefore, the incentive is to increase hospital costs to the "reasonable" limit to maximize revenues.

California legislation enacted in 1969 and amended in 1976 has provided a mechanism to attempt to control increasing excess bed capacities; however, its effectiveness has been minimal. We reviewed the changes in the acute care hospital bed capacities throughout California for the five-year period from April 1, 1971 through March 31, 1976. The results show that legislation has not prevented increases in unneeded acute care hospital beds. Excess hospital beds statewide have increased from 11,318 in 1971 to 19,007 in 1976.

The 1976 legislation provides that no hospital which adds unauthorized beds shall be entitled to receive, or shall receive, any payment whatsoever from the Director of the Department of Health, or from any prepaid health plan, for services rendered to a Medi-Cal program beneficiary if the health facility has commenced construction of a project

after January 1, 1977, and the health facility has failed to obtain a certificate of need covering such project issued pursuant to the Health and Safety Code. The Director shall notify the hospital in writing of termination of all payments for any services rendered in any portion of the facility after 30 days from the date the notice is mailed.

Eight hospitals were identified as having increased bed capacity without proper authorization and as of June 30, 1976 had received \$15.4 million in Medi-Cal payments in violation of the Welfare and Institutions Code.

Two Alameda hospitals were identified as having added 17 beds for which neither the Department of Health nor the hospitals are able to produce documentation substantiating the approval.

Three additional hospitals in Orange County received approval for 231 beds after the Superior Court ruled against the State Advisory Health Council denial.

INTRODUCTION

In response to a resolution of the Joint Legislative Audit Committee we have examined the Department of Health's efforts to curtail the increase in hospital bed capacity above need. This review was conducted under authority vested in the Auditor General by Section 10527 of the Government Code.

Chapter 1451 of the 1969 Statutes provides for voluntary area planning programs to guide communities in constructing and expanding hospitals. The purpose of planning is to obtain more effective service and to save substantial amounts in capital costs and operating expenses. Companion legislation^{*} requires the Director of the Department of Health to stop Medi-Cal payments to hospitals that do not comply with the planning requirement. Specifically, a hospital increasing bed capacity without authorization is not to receive Medi-Cal payments from the Department of Health or a prepaid health plan.

Substantial revisions were made to the laws relating to health planning by Assembly Bill 4001, which was approved by the Governor on September 9, 1976.

* Chapter 1452 of the 1969 Statutes added Section 14105.5 of the Welfare and Institutions Code.

A 1974 report entitled The Financial Impact of Hospital Overbedding prepared by the Regional Health Planning Council of the North Central Texas Council of Government, estimated that an unoccupied hospital bed costs \$20,000 annually. This estimate, if applied to the approximately 20,000 beds in California in excess of projected need represents an additional annual cost of \$400,000,000, which is passed on to government programs, insurance companies and patients.

AUDIT RESULTS

GROWTH IN EXCESSIVE BEDS

In 1969 California legislation sought to curtail increases in unneeded hospital beds, yet the number of excess beds has continued to grow. Notwithstanding additional restrictive legislation enacted in 1976, this condition continues, and there are no provisions to reduce the existing excess beds.

Legislation enacted in 1969 provided that Medi-Cal payments could not be made to any hospital which had increased its bed capacity without appropriate health planning agency approval. The health planning agencies were required to consider the need for additional beds in their geographic area in determining whether to approve proposed expansion projects. Exempt from the agency approval are (1) applications for additional beds submitted prior to January 1, 1970, and (2) conversions from other uses, such as skilled nursing to acute care.

The 1970-72 California State Plan for Hospitals estimated that the statewide need for acute care beds would be 65,166 in 1977. The number of acute care beds needed was based upon an average occupancy rate of 85 percent with allowance being made for estimated population increases.

As of March 31, 1971, 76,484 acute care beds were licensed in 557 hospitals; 11,318 beds in excess of the 1977 estimated need. As of March 31, 1976, 84,173 acute care beds were licensed in 566 hospitals; 19,007 in excess of the estimated need. During the five-year period, 165 hospitals added 11,808 acute care beds, and 135 hospitals reduced their acute care capacities by 4,119 beds, resulting in the net increase of 7,689 acute care beds since 1971. Based upon the estimated 1977 need, the number of excess beds had increased by over 67 percent during the five-year period.

The following table identifies the conditions under which 165 hospitals added 11,808 acute care beds:

<u>Hospital Beds Added Through Statutory Authority</u>	<u>Number of Beds Added</u>	<u>Percentage of Beds Added</u>
Applications filed prior to January 1, 1970	5,260	44.6
Approved by health planning agencies	4,122	34.9
Conversion of beds from another use	1,870	15.8
<u>Hospital Beds Added Through Other Means</u>		
Without approval	308	2.6
Approval cannot be substantiated	17	.1
By Superior Court action	<u>231</u>	<u>2.0</u>
Totals	<u>11,808</u>	<u>100.0</u>

The population has not increased as anticipated. Therefore, the number of acute care beds needed has been revised downward. The current estimate of acute care bed needs in 1981 is 62,072, which is less than 1977 needs. Therefore, 22,101, or 26 percent of the 84,173 acute care beds licensed as of March 31, 1976, are in excess of 1981 estimated needs.

Legislation enacted in 1976 added license revocation or denial as a consequence for not obtaining proper authorization for bed additions and transferred approval authority from the area health planning agencies to the State Department of Health. Authorization is obtained through a certificate of need issued by the Department or qualification under exemptions contained in the law. The Department of Health's decisions may be appealed to the Advisory Health Council.

The 1976 legislation allows special consideration or exemption for hospitals adding beds under certain conditions. Special consideration is given for the development of comprehensive community services; needs of special populations, including prepaid health plan service providers and religious bodies; and facilities which provide a substantial portion of their services to individuals not residing in the hospital's service area. Exemptions are provided for hospitals (1) to rebuild their facilities up to their existing licensed capacity (expires in 1986), (2) to convert up to five percent of their licensed capacity from one type of service to another, and (3) to receive bequests of property other than money. Comprehensive

group practice prepayment health care service plans, accommodating at least 50 physicians, are also effectively exempt. Acute care beds may be added under these exemptions without establishing an existing need in the area.

Hospital rates for Medi-Cal patients are not determined by competitive pricing; rather, payments are made to reimburse the hospitals for costs incurred, which fosters construction of excess capacity and provides little incentive for efficiency. The overhead costs of unused beds are prorated among facilities being occupied. Hence, hospital rates charged to users include a factor for the cost of excess beds.

The California Health Facilities Commission has proposed a system of state regulations to "retard inflationary hospital costs and price increases in California." The Commission concluded that current regulatory activities intended to limit health facilities' expansion have been inadequate. The Commission recommended adopting rates based upon budget and cost review and approval as a means of encouraging hospitals to provide services more efficiently. (See Appendix A.) Hospital rates would be established in advance based upon budget review rather than the current cost-reimbursement method. The Commission concluded that this rate-setting method would eliminate duplication and overbedding. Further increases in unneeded beds would be curtailed by eliminating the exemptions and special considerations which are contained in the present law.

The Hospital Educational Foundation of California prepared a report Prospective Incentive Payment Experiment (PIPE) for the Social Security Administration. The PIPE report proposes:

1. Compensating owners for closing down current excess capacity -- facilities and services.
2. Requiring certificate of need for expansion, modernization and replacement.
3. Under certain limited circumstances, using the rate-setting mechanism for reducing capacity; for example, where necessary reductions involve only parts of institutions.

The PIPE report notes that excess hospital facilities may be especially adaptable to a number of other uses.

CONCLUSION

More than 19,000 acute care beds, or 23 percent of the total hospital beds in California, are in excess of 1977 estimated needs, and more than 22,000 beds are in excess of projected needs for 1981. No measures have been taken to reduce these excess beds.

Legislation has attempted to restrict future increases in excess beds; however, the addition of more unneeded beds is fostered by special considerations and exemptions contained in the Health and Safety Code.

Alternative solutions have been suggested for the elimination of existing unneeded beds.

RECOMMENDATIONS

We recommend that the Senate and Assembly Health Committees consider legislation to:

- Suspend addition of any acute care hospital beds in areas which do not have a demonstrable need for more beds.
- Require the California Health Facilities Commission to conduct a study and advise the Governor and the Legislature on available alternatives to effect the delicensing of existing excess beds and the costs and benefits of each alternative.

SAVINGS

Implementing these recommendations could save Californians hundreds of millions of dollars annually that otherwise will be spent for unneeded hospital beds.

MEDI-CAL PAYMENTS HAVE BEEN MADE
FOR UNAUTHORIZED HOSPITAL BED
ADDITIONS

The Department of Health has allowed Medi-Cal payments totaling \$15.4 million to eight hospitals which added 308 acute care beds without receiving health planning agency approval. This violated Section 14105.5 of the Welfare and Institutions Code. Approximately \$2.2 million of the total payments is attributable to the unauthorized beds. Four of the hospitals are in Orange County, and four are in Los Angeles County. (Table 1)

The Department has also allowed Medi-Cal payments to two hospitals in Alameda County totaling \$11.1 million which added 17 beds. (Table 2) Approximately \$348,000 of the Medi-Cal payments is attributable to the added beds. The hospitals contend that health planning agency approval was granted for the additions; however, neither the Department of Health nor the hospitals are able to produce documentation substantiating the approval. The health planning agency is now defunct, and their records cannot be located.

Three other Orange County hospitals added 231 beds and received Medi-Cal payments totaling \$2.9 million. These beds were approved locally by the health planning agency; however, approval was subsequently reversed and denied upon appeal by the State Advisory Health Council. Still later, the Sacramento Superior Court ruled against the denial, thereby re-establishing the local approval of bed additions. (Table 3)

TABLE 1

Hospitals Adding Beds Without Approval

	<u>Total Number of Beds</u>	<u>Total Medi-Cal Payments</u>	<u>Number of Unapproved Beds</u>	<u>Percentage of Beds Unapproved</u>	<u>Date Unapproved Beds Licensed</u>	<u>Approximate Medi-Cal Payments Relative to Unapproved Beds</u>
<u>Orange County</u>						
Fountain Valley Hospital	214	\$ 1,455,031	100	46.73	3/ 6/74	\$ 679,936
Mercy General Hospital	215	866,307	101	46.98	5/28/75	406,991
Pacifica Hospital	109	350,001	29	26.61	4/26/74	93,135
Placentia-Linda Community Hospital	114	362,887	16	14.04	11/ 7/74	50,949
<u>Los Angeles County</u>						
Alhambra Community Hospital	157	315,905	7	04.46	11/21/74	14,089
Beverly Hospital	212	3,461,871	2	00.94	6/ 6/73	32,542
Dr. David Brotman Memorial Hospital	413	4,404,850	19	04.60	7/23/75	202,623
Paramount General Hospital	184	4,135,345	34	18.48	10/11/73	764,212
	<u>1,618</u>	<u>\$15,352,197</u>	<u>308</u>			<u>\$2,244,477</u>

TABLE 2

Hospitals Adding Beds For Which Approval Cannot Be Substantiated

	<u>Total Number of Beds</u>	<u>Total Medi-Cal Payments</u>	<u>Number of Questioned Beds</u>	<u>Percentage of Beds Questioned</u>	<u>Date Questioned Beds Were Licensed</u>	<u>Approximate Medi-Cal Payments Relative to Unapproved Beds</u>
<u>Alameda County</u>						
Alameda Hospital	168	\$ 2,203,266	6	03.57	1/ 1/72	\$ 78,657
Samuel Merritt	364	8,935,136	11	03.02	4/28/71	269,841
	<u>532</u>	<u>\$11,138,402</u>	<u>17</u>			<u>\$ 348,498</u>

TABLE 3

Hospitals Adding Beds For Which Approval Was Denied
But Allowed By Superior Court Action

	<u>Total Number of Beds</u>	<u>Total Med-Cal Payments</u>	<u>Beds Denied and Reapproved by Courts</u>	<u>Percentage Denied and Reapproved</u>	<u>Date Beds Were Licensed</u>	<u>Approximate Medi-Cal Payments for Reapproved Beds</u>
<u>Orange County</u>						
Mission Community Hospital	212	\$ 569,784	86	40.57	1/ 1/74	\$ 231,161
Tustin Community Hospital	203	950,261	89	43.84	2/15/75	416,594
Westminster Community Hospital	182	1,353,721	56	30.77	6/ 7/74	416,540
	<u>597</u>	<u>\$ 2,873,766</u>	<u>231</u>			<u>\$1,064,295</u>

Licensing of Unapproved Beds

The Department of Health was aware that seven Orange County hospitals added acute care beds without health planning agency approval. The hospitals had applied for approval and were denied by either the local area health planning agency or the State Advisory Health Council on appeal. However, by waiting one year after denial and applying the provisions of Section 1265.5(e) of the Health and Safety Code, the hospitals received licenses for the unapproved beds. The status of these additions is uncertain since the Department of Health has had difficulty in determining its legal authority under Section 14105.5 of the Welfare and Institutions Code. The unresolved issues are (1) should payments to the hospitals cease immediately, or does due process require that suspension hearings first be pursued and concluded, and (2) should payments be withheld for the previously authorized beds or only for the unauthorized beds?

The Department decided to initiate suspension hearings against the seven Orange County hospitals. Three of the seven hospitals had obtained approval from the Orange County Health Planning Agency. Approval was reversed and denied upon appeal by the State Advisory Health Council. The Sacramento Superior Court has ruled against the denial by the Advisory Health Council, thereby re-establishing the local approval of bed additions. The Advisory Health Council and the Department of Health have decided not to appeal the court's decision.

The remaining four Orange County hospitals were denied approval for their bed additions by the Orange County Health Planning Agency. Three of these hospitals have obtained restraining orders requiring the State Department of Health to continue Medi-Cal payments. All four hospitals are continuing to receive Medi-Cal funds. The legal status of payments to these hospitals has not been resolved.

The Department of Health's inventory records of hospital beds indicates that two hospitals in Alameda County added beds after January 1, 1970. A review of the Department's files indicates that files of these two hospitals are incomplete. The Department stated that ". . . no records are available through the Department to substantiate . . . their increase in bed capacity" as the hospital records have been lost. The Department contacted the hospitals who also are unable to produce documentation to verify when these increases occurred.

The Department of Health was unaware that the four Los Angeles hospitals had added unapproved beds. Three of the Los Angeles hospitals were authorized to add beds but added beds in excess of their authorization. In their relicensing and recertification process, the Department did not detect that more beds had been added than authorized. The fourth hospital, Paramount General Hospital, added beds in a manner similar to the Orange County hospitals. The local health planning agency denied Paramount's application to add 34 beds. Paramount waited one year, added the beds and applied for their license. The Los Angeles office of the Department of Health licensed the beds but did not inform headquarters that the Medi-Cal certification should be withdrawn.

Department of Health Authority Strengthened

The 1976 legislation provides that no health facility which adds unauthorized beds shall be entitled to receive, or shall receive, any payment whatsoever from the Director of the Department of Health, or from any prepaid health plan, for any services rendered to any Medi-Cal program beneficiary if the health facility has commenced construction of a project after January 1, 1977, and the health facility has failed to obtain a certificate of need covering such project issued pursuant to the Health and Safety Code. The Director shall notify the facility in writing of termination of all payments for any services rendered in any portion of the facility after 30 days from the date the notice is mailed. These provisions clarify the Director's authority after January 1, 1977.

Severe Penalties

The Director's authority is now more explicit; however, the disproportionately severe penalty for non-compliance relative to the potential public loss could continue to make the statute difficult to enforce. For example, Beverly Hospital was erroneously licensed for two additional beds beyond what it should have been on June 6, 1973. Since that time it has received \$3.5 million in Medi-Cal payments; only about \$32,500 is attributable to the two beds added. Under the 1976 legislation, the Director is not to make any payment whatsoever for any services rendered to any Medi-Cal beneficiary. Therefore, none of the \$3.5 million would have been paid had the Director terminated payments as required, even though the violation is the erroneous addition of only two beds. It does not appear that the public economic injury in the form of higher medical bills resulting from two excess hospital beds could ever approach this amount.

Penalties are more likely to induce the desired compliance if they are swift and fair. However, the courts are more likely to review the Director's actions if a hospital loses \$3.5 million because of the addition of two beds, than if the penalty were commensurate with the violation and resulting increased cost to the public. An appropriate amount for the Director to deduct would be a percentage of the Medi-Cal billing amount determined by relating the number of excess beds to the total number of beds. If the statutes established a penalty that related the unauthorized beds to the total number of beds, the 10 hospitals in question would have been penalized \$2.6 million. This type of penalty would be more equitable than the total Medi-Cal payment of \$26.5 million which would be the penalty under the present statutes.

CONCLUSION

Total Medi-Cal payments to the eight hospitals which collectively have added 308 acute care beds without planning agency approval, were \$15.4 million since these additions were made; approximately \$2.2 million of which is attributable to the excess beds. Medi-Cal payments totaling \$11.1 million were made to two hospitals which added 17 acute care beds; health planning agency approval for the added beds cannot be substantiated. Legislation in 1976 clarified the authority of the Department of Health to refuse Medi-Cal reimbursement to such hospitals. There is, however, no relation between the severity of this penalty and the potential public injury (higher medical bills) resulting from excess hospital beds. Continued legal problems with enforcement are likely.

RECOMMENDATION

We recommend that the Senate and Assembly Health Committees consider legislation which would establish a penalty for the construction of excessive hospital capacity at amounts which relate to the resulting public economic injury.

BENEFIT

Legal difficulties with enforcing penalty provisions would be diminished by such legislation.

AUDITOR GENERAL'S STATEMENT CONCERNING
THE DEPARTMENT OF HEALTH'S RESPONSE TO THIS REPORT

The Department's response to this report is in general agreement with our findings and conclusions. As a result of a conference held with Department officials to discuss the draft report, additional evidence was presented to us which clarified certain issues raised in their letter.

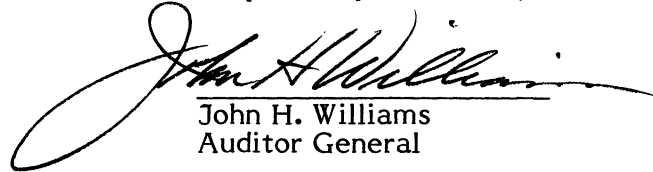
The most significant exception to our draft report concerned the actual number of unauthorized acute care beds added. We had identified 557 beds in 14 hospitals based on information provided during our examination by hospitals, health planning agencies, county offices and the Department. The Department believes that 299 bed additions, rather than 557, could be considered as being in violation of Section 14105.5 of the Welfare and Institutions Code. We analyzed the additional data which they provided and concluded that:

- 308 beds were added without area health planning agency approval, and subject to Section 14105.5
- 17 beds were added for which no documentation is available to substantiate that health planning agency approval had been granted
- 231 beds were added for which approval had been denied by the State Health Advisory Council and subject to Section 14105.5. Administratively, these hospitals were determined not authorized to add beds, however, the courts intervened and upheld the bed additions
- 1 bed was added, for which additional documentation provided indicates that non-approval was an administrative error.

Total 557 Beds

For purposes of clarification, the draft report was revised to categorize the circumstances under which acute care hospital beds were added. In light of the circumstances surrounding the hospital which added one bed, we deleted it in the final report.

Respectfully submitted,



John H. Williams
Auditor General

February 24, 1977

Staff: Robert M. Neves
G. Dan Turner

DEPARTMENT OF HEALTH

714 P STREET
SACRAMENTO, CALIFORNIA 95814
(916) 445-1248



February 17, 1977

Mr. John H. Williams
Auditor General
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Williams:

FEBRUARY 1977 REPORT: "NEED FOR REDUCTION OF EXCESS ACUTE CARE HOSPITAL BEDS"

Your report to the Legislature supports this Department's continued efforts to obtain strong certificate of need legislation to control excess health facility capacity of beds, services, equipment and capital expenditures related thereto. Chapter 854, Statutes of 1976 provides partial regulation of health facility expansion until stronger legislation is enacted.

Despite this Department's agreement with the report's general remarks on the need to control excess beds, we would like to comment on the following specific points:

1) Audit Results -- Growth in Excessive Beds. (Last line, page 5.)

The report analysis of 1976 legislation (AB 4001) appears to be erroneous in that it indicates that there is an exemption for hospitals which add beds which are financed by bequests. While Health & Safety Code Sec. 437.10(e)(2) does authorize exemption of an acquisition by bequests of a facility or part thereof or of equipment, when the acquisition would have been a capital expenditure (as defined in Sec. 437.10(e)) if there had been an acquisition by purchase, it does not allow hospitals unrestricted authority to use bequests in the form of money to add beds. The exemption applies only if the bequest itself were a facility or part thereof containing licensed beds. The exemption allows hospitals to accept bequests which are in the form of property other than money. Thus, if a hospital receives bequests in the form of money, it cannot qualify for an exemption by using these funds to finance an addition.

2) Audit Results -- Growth in Excessive Beds. (Page 6, paragraph 1)

The report states that current Medi-Cal hospital rates foster construction of excess capacity and provide little incentive for efficiency. The Department is aware of this and is actively engaged in efforts to change the current method of reasonable cost reimbursement for inpatient hospitalization.

The Department instituted a 10 percent annual limitation on hospital reimbursements in 1976 which was ruled illegal by the Federal District Court in Los Angeles. As a result, departmental staff is studying various formulas for inpatient reimbursement which will address the issues of incentives for cost containment and occupancy of hospital beds. One such proposal involves a prudent buyer approach to the purchase of inpatient hospital services with a selected number of hospitals on a prospective reimbursement basis. This proposal would limit the number of hospitals participating in the program, thereby reducing Medi-Cal payments for unused beds and strengthening control over utilization of service and program abuse.

Other proposals are under consideration by the Department and it is expected that a policy decision will be made in this area in the very near future. Any policy decision made by the Department to change the current cost reimbursement system for inpatient hospitalization will have to be approved by HEW as the current cost reimbursement system is mandated by the federal government. Further, this decision will require approval of the Legislature.

3) Audit Results -- Growth in Excessive Beds. (Paragraph 2, page 6.)

The report refers to California Health Facilities Commission recommendations for a new rate-setting methodology. At the same time that the Commission requested a contract from the Social Security Administration to develop that methodology, the Department of Health also requested a contract for a feasibility study on the establishment of a prospective reimbursement system for hospitals. The Social Security Administration chose the Department's proposal over that of the Commission and awarded a grant for the project. Work has been delayed on the study because the Legislature denied a Section 28 proposal in order to schedule hearings on the matter.

4) Audit Results -- Growth in Excessive Beds. (Page 8 - Recommendations)

The report suggests that the Legislature require that the California Health Facilities Commission conduct a study on available alternatives to delicense beds. The Department of Health is the appropriate authority to conduct this study because it is the licensing authority and it performs all health facility regulatory activities other than administering the Health Facilities Disclosure Act.

It should also be noted that the effected reduction in cost by delicensing beds would not be significant, as this would not include fixed costs for maintenance of the facility. Alternatives which should be considered are:

- (1) Reduction in the supply of beds by acquisition of entire facilities.

- (2) Long-range planning and control allowing the need to catch up with the supply.
- (3) Establishment of rates to allow hospitals to assume an appropriate share of the cost for excess capacities.

As stated above, this Department is currently working on Alternative 3. All of these alternatives would require legislation.

5) Audit Results -- Medi-Cal Payments Have Been Made for Unauthorized Hospital Bed Additions. (Top of page 9. See also pages ii, 4, and 11, and Table 1.)

The report suggests that some 14 California hospitals have added a total of 557 acute care beds without receiving the necessary health planning agency approval. The Department's most current information indicates that this statement may not be totally correct.

Reference is made to Table 1 which lists the subject 14 hospitals. It now appears that only six of these facilities listed on Table 1 can properly be considered to have added bed capacity under circumstances which would bring them within the provision of Sec. 14105.5 of the Welfare and Institutions Code. These facilities are:

<u>Name</u>	<u>No. of Unauth- orized Beds</u>
Fountain Valley Hospital	100
Mercy General Hospital	101
Pacifica Hospital	29
Placentia Linda Community	16
Dr. David Brotman Memorial Hospital	19
Paramount General Hospital	<u>34</u>
Total	299

The three Orange County hospitals which received approval from the local planning agency and had that approval reversed by the State Advisory Health Council cannot be considered to be subject to Sec. 14105.5. As noted in the report, the action of the State Advisory Health Council was invalidated by the Sacramento Superior Court and that decision has become final. As a matter of law, therefore, these three hospitals have received the necessary health planning approval.

With the exception of Brotman and Paramount Hospitals listed below, it appears that none of the other hospitals listed in Table 1 for Los Angeles, Alameda, or Monterey counties, are subject to the provisions of Sec. 14105.5. Recently completed investigations conducted by Department of

Health personnel indicate that the additions occurred under circumstances which would qualify for the grandfather provision in Sec. 14105.5 or merely reflect the correction of clerical error. For example, the report on Salinas Valley Memorial Hospital indicates that the alleged addition in 1973 of one unauthorized bed was actually a correction for an error which occurred some time in the 1950's. The Department has copies of these reports and will make them available to you upon request.

There also appears to be some question regarding the addition of 19 beds by the Brotman Hospital. According to an explanation received from that facility, this addition was a result of a relocation of licensed beds from a separate facility which was located across the street from the existing hospital. This resulted in the combining of the two licenses under one license. The Department is currently reviewing this matter further in order to determine the applicability of Sec. 14105.5.

Of the remaining five hospitals, legal action is pending against the four in Orange County. Those hospitals continue to receive Medi-Cal payments as a result of the restraining orders mentioned in your report. The Department will be conferring with the Attorney General's Office to determine appropriate action with respect to Paramount General Hospital.

6) Audit Results -- Medi-Cal Payments Have Been Made for Unauthorized Hospital Bed Additions. (Pages 13, 14, and 15.)

The suggestion is made that while the 1976 legislation (AB 4001) has apparently clarified the Director's authority to discontinue Medi-Cal payments to facilities which add unauthorized beds in the future, the statute may be difficult to enforce because it may result in a penalty which is disproportionate in relation to the actual economic injuries suffered by the public. The recommendation is made that the Legislature consider establishing a penalty for the construction of excessive hospital capacity "at amounts which relate to the resulting public economic injuries."

We agree that there may still be problems in enforcing these provisions if they relate to additions which have occurred prior to January 1, 1977. The Department will soon be proposing corrective legislation to cure inconsistencies which exist in the current statutory scheme. We question the wisdom, however, of making any changes to the law as it applies to additions occurring after January 1, 1977. The Department now has clear statutory authority to terminate all Medi-Cal payments to any facility which adds unauthorized beds after this date. We do not, at this time, anticipate any problems with the enforcement of this provision. While the penalty may be severe, the law appears to be clear and unambiguous.

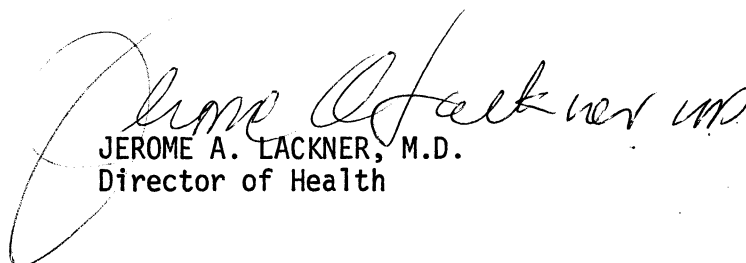
We believe that any facility which attempts to circumvent its provision would be found by the courts to have assumed the risk of incurring the statutory penalty. Hopefully, the severity of the State's remedy will discourage any facility from attempting to add unauthorized beds. We believe that the Legislature should not attempt to restructure these provisions without first giving them a chance to operate. It would be premature to make a change before there has been an opportunity to determine whether or not the current system will be effective.

We would also like to point out that any penalty which is less than a complete cut-off of Medi-Cal funds may involve its own pitfalls. An approach which simply disallows payment for certain unauthorized beds can result in the discriminatory treatment of Medi-Cal beneficiaries. Disallowance of Medi-Cal payments for treatment in new unauthorized facilities would mean that the hospital would merely relegate all Medi-Cal beneficiaries to the older portions of the hospital. If carried to their logical extremes, we have found that other forms of cost disallowance may actually result in little or no loss of revenue to the facility. Thus, any penalty less than complete removal of Medi-Cal benefits must be carefully considered in order to avoid undesirable results.

Thank you for the opportunity to comment on this report.

Please be assured of the Department's continued support and commitment to the needs for the reduction of excess acute care hospital beds.

Sincerely,



JEROME A. LACKNER, M.D.
Director of Health

Excerpts from the California Health Facilities Commission
Annual Report to the Governor and Legislature of the State
of California, November 1, 1976

Health Facility Budget and Rate Review Approval

On March 29, 1975 the Commission submitted its report to the Legislature proposing an economic stabilization program for health facilities. The development of this report was required by the Legislature in 1973 under AB 2123 by Assemblyman Richard Hayden. At that time, all health facilities were under the restrictions of the Federal Economic Stabilization Program. However, it was anticipated that those controls would be lifted and that the State should be prepared to apply its own controls on health facility costs. The Commission's report contained four basic recommendations:

1. Public disclosure of health facility budgets and charges.
2. Implementation of a budget and rate review and approval program when Federal and State Governments concur in supporting a payment system which does not shift costs from one category of purchaser to another.
3. Regulation of health facility capital expenditures.
4. Preparation of economic impact analyses of proposed State legislation, government regulations, and local planning recommendations.

In response to a Request for Proposal from the Social Security Administration for development of rate setting systems at the state level, the Commission filed its proposal on January 15, 1976. The proposal contained a detailed system design which would be the subject of two years of development before possible implementation. Essentially, that development would have lead to the creation of a budget and rate review and approval system that was designed to contain the rate of rising costs in California's hospitals.

THE COMMISSION'S PROPOSAL WAS BASED ON THE POSITION THAT HEALTH FACILITY COST CONTAINMENT SHOULD INVOLVE A REVIEW OF INDIVIDUAL FACILITY BUDGETS, WITH AN ANALYSIS OF EXCEPTIONS TO COST CEILINGS, CONDUCTED BY AN IMPARTIAL INDEPENDENT STATE BODY.

The Commission recommended that if its judgment on a rate to be paid to a facility or group of facilities was not acceptable to the Medi-Cal program, the Legislature, or the Governor, in terms of the desired level of appropriations for the next budget year, then that fact would be a matter of public record. The result would be a public acknowledgment of the facility's right to transfer that cost in the form of higher charges to other third-party and individual payors.

The California Health Facilities Commission will not receive a contract from SSA in large part because there is no authority for the Commission to implement the system at the conclusion of development. However, pursuant to the Commission's authority to make recommendations to the Legislature regarding "cost-effectiveness" programs, the Commission will continue to

investigate, through the process of special studies, the practical alternatives to various techniques of administering cost controls. As a result of the data available from the disclosure reports and the Commission's continued activities in the area of cost containment, the Commission is prepared to furnish the Legislature with information, data and analyses and expert testimony on matters related to the cost of providing health facility services in California.

Office of the Auditor General

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