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NURSING HOMES, through their associations, have for many years been negotiating with their state departments of public welfare about the rate-setting methods used to pay for services rendered. With a few exceptions, providers of care to publicly assisted recipients have been paid arbitrarily determined daily rates that apply to all equally without regard to actual costs; rates have also been paid that might vary according to the degree of care required by the patient—that is, skilled, technical, personal, or custodial. Sometimes the amount paid has been determined by the rating of the physical plant and apparent ability to provide the services required.

In many states the licensing function is a duty assigned to the department of public health and this department may impose standards concerning qualifications of personnel, fire, safety, and nutrition. The added costs of adopting new or more stringent standards may not be currently recognized by the departments providing public assistance in their payments to providers of care.

Nursing homes and their associations have generally resisted requests for information concerning costs of providing care. Proprietary nursing homes dominate this field of health care, and reluctance to disclose financial information to anyone other than internal revenue is understandable. Grocery and hardware stores are not required to prove their costs or to justify their charges. Operating a nursing home for a legitimate profit does not adversely affect the quality of care provided. However, the big volume purchasers of nursing home care today are state governments. The distribution of state funds is made by a department financed by appropriations based on a budget that must be explained to the legislature, examined by its committees, and supported and approved by committee majorities.

Medical assistance to the aged in the State of Colorado is provided under a law that says

> The State Board shall establish a price schedule for nursing home and other medical services related as nearly as possible to the cost of such services rendered to the recipient or the level of services utilized. . . .

In addition, the prices established are to provide reasonable compensation for the services rendered and are to be subject to periodic adjustment. The new medicare act provides for payments to providers of hospital and extended care services for the "reasonable cost of the covered services" they furnish under the hospital insurance programs.

ACCOUNTING PRINCIPLES

Obviously, self-reporting of the net expenses incurred in providing services and of statistical data descriptive of such services is now necessary. Principles of payment for hospital care are so well established that they are printed in a leaflet bearing that name, published by the American Hospital Association, in which the accepted principles are even numbered! We have no comparable, established principles for payment of nursing home care, no clear-cut definitions of "reasonable costs," and no nationally announced guidelines for resolving "reasonable compensation."

How many of you read and understand the certified public accountants' report or opinion accompanying financial statements? The financial statements are the representations of the company—not of the accountants. The accountants may state that

> In our opinion, the accompanying financial statements present fairly the financial position of the company at September 30, 1965 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

This opinion is attesting to the fairness of the presentation by management. The references to "generally accepted accounting principles" and to "consistency" are very important. They are a prelude to later comments on the difficulties encountered in developing a reimbursement formula presenting costs of services rendered to welfare recipients.

Unlike the hospitals, the nursing homes have not adopted standard definitions and a uniform chart of accounts. The management of each nursing home decides, and properly so, the accounting methods to be employed, the degree of presentation of detail, and what tax-effect accounting options to elect.

The expression *generally accepted accounting principles* means to an accountant that the accounting records have been maintained on the accrual basis and, particularly, that income is recognized when earned and expenses when incurred. Costs of providing care for the month of September can be compared with income earned in that month. Many nursing homes maintain records only of cash transactions. Assets and liabilities arising from cash transactions are recorded, but the profit and loss picture is represented by revenues collected and expenses disbursed. If the projected income tax payments appear to be too high, billings for care can be delayed, with a corresponding delay in collections; or expense entries can be advanced by paying bills early, even though this might put thirteen months' expenses into one tax year. In cash-basis accounting a personal administrative control can be exercised to distort a cost presentation. Comparability of financial statements can be affected by a change in accounting principles employed and this is why we have a concern for consistency. A change from a pay-as-you-go basis to the accrual basis for an existing pension plan would be an example of a change between two accepted accounting principles.

NURSING HOMES' ACCOUNTING

Nursing homes should be encouraged to maintain their accounting records on the accrual basis in conformity with generally accepted accounting principles. However, changes from previously elected cash-basis or modified cash-basis methods would, for proprietary nursing homes, require prior approval of the Internal Revenue Service.

The forms developed with the coöperation of officers of the Colorado Associated Nursing Homes, and of their accountants, are intended to provide for self-reporting accurate cost data based on financial and statistical records that are capable of verification. Reimbursement related to cost is dependent on knowledge of the procedures used in providing the data. The Public Health Service of the U. S. Department of Health, Education, and Welfare describes accounting procedures in its publication *A Suggested System of Uniform Expense Accounting for Nursing Homes and Related Facilities.* The Reynolds & Reynolds Co. publishes a *Manual of Accounting Procedure for Nursing Homes and Related Facilities* that is more complete and contains a uniform chart of accounts. Publications such as these should be used as guides in compiling financial and statistical data. The uniform chart of accounts presents a model based on functional departmentalization and minimum subclassification of the objects of expenditure. Salaries, supplies, etc., are classified into accounts on the basis of the function for which the particular expenditure was made.

Need for Rules

No specific accounting method or system should be imposed, but the accounting classifications utilized should be sufficient to permit preparation of a prescribed uniform annual report with a minimum of difficulty. The owners of nursing homes are entitled to use the income tax elections and all other business operating techniques or devices their attorneys and accountants can suggest. There is, however, a need for a set of rules that can be applied in preparing financial and statistical reports submitted to third party payors for the purpose of arriving at reasonable costs, the rules must preclude deliberate financial manipulation and be fair and equitable for all parties concerned. The guidelines suggested to obtain fairness and comparability may require adjustments to operating expense or to operating income, or may require consideration of other factors. Some of these are discussed in the paragraphs that follow.

Operating Expense

Nursing homes operated as partnerships or proprietorships often do not include compensation to working owners among expenses. A comparable value for services of owners, and of members of religious orders not fully compensated, should be included in operating expenses. Comparable value in hospitals does not exceed amounts paid other employees for similar work.

Salaries paid to working stockholders or their relatives similarly should not exceed amounts paid other employees for the same or similar work. Higher salaries may, of course, be paid to such persons but adjustments downward should be made within the cost report. In a study of nursing-home costs made by the State of Washington for the year 1959, an amount of $9.40 a bed a month (for capacity) to a maximum of 100 beds was determined to be fair for the administrator's salary. The amount of $10 a month per licensed bed, with a monthly minimum of $400 and maximum of $1000, has been accepted in Colorado. Salaries paid non-working officers should not survive in the cost report.

Accelerated methods of computing depreciation of buildings and equipment are frequently used. These methods result in expenses greater then normal in early years with a tapering-off to a point after which the expense is less than normal. Cost-reimbursement systems for hospitals provide for computation of depreciation in equal, annual amounts over the expected life of the property. A chart of estimated lives by specific items of equipment is provided by the American Hospital Association in its publication *Uniform Chart of Accounts and Definitions for Hospitals* and this chart should be applicable in most instances for nursing homes.

Particular consideration must be given to amounts paid as rent whenever the lessor also has a financial interest in the operation of the nursing home. Frequently, a necessary financing device for the nursing home is the leasing arrangement. Leases, however, are often related in years and amounts to the mortgage-payment schedule accepted by the owner, resulting in inclusion in operating expenses of the full cost of the leased property in a period of years usually less than the expected property life (15 to 20 years' loan on a building versus expected life of 40 to 50 years). Leases are sometimes used as a means of withdrawing profits and in these instances can inflate operating expenses. Control over rent expense can be exerted by adopting a maximum property expense per bed, related to bed capacity.

Certain expenses are excluded from operating expenses in the cost report on the theory that the expenses are not necessary for the care of welfare patients or are of a nature that the state would not ordinarily incur. Suggested exclusions are:

Provision for income taxes.

Promotion.

Travel and entertainment, other than for professional association meetings and direct operations of the home. Entertainment of physicians and country club dues and fees are examples of intended exclusions.

Part-time officers' salaries.

Fees paid board of directors.

Expenses related to services or supplies for which reimbursement is received from other welfare programs, such as prescriptions paid for by the department (or by relatives).

Interest paid to stockholders of amounts in excess of interest amounts payable at commercial rates.

Bad debts, discounts, and allowances should be accounted for as a reduction of income.

Donations.

Expenses of non-nursing home facilities.

Operating Expenses

Income or receipts should be sufficiently classified in the accounts to reflect gross revenue from routine service (room and board), special services, expense recoveries, and services of a miscellaneous nature. The following items frequently recorded in gross income should be set out separately for application, in the cost report, as a reduction of a related operating expense:

Purchase discounts (if recorded).

Revenue from telephone service.

Revenue from employee and guest meals.

Rental of rooms to employees.

Revenue from supplies sold employees and others, except patients.

Interest or investment income earned on funds borrowed and on which interest is paid.

Beauty- and barber-shop income and recorded receipts for patients' personal purchases if expenses are recorded.

Laundry receipts, sale of scrap, expense refunds, rebates on purchases, and any other income items that should be offset against expense accounts.

Other Considerations

It is impossible to foresee all items that now or in the future may be considered an expense of a nature not patient-related. A general reservation should be made concerning unusual expenses occurring so infrequently as to warrant only specific consideration or agreement.

In the event that reimbursement is to be made to each nursing home based on its costs, consideration should be given to the following:

Should there be an adjustment of costs for under-utilization of bed capacity?

Should depreciation be funded?

Should depreciation be allowed on Hill-Burton share of cost?

How should reimbursement be made for nursing homes in operation less than one year when there may be cost distortion due to atypical costs during first year of operation?

Preparing to Allocate "Reasonable Costs"

Extended-care facilities that plan to participate in the medicare hospital insurance program should consider the implications of the law's provisions concerning "reasonable costs"; specifically, the law stipulates that the regulations to be issued shall

> . . . take into account both direct and indirect costs of providers of services in order that, under the methods of determining costs, the costs with respect to individuals covered by the insurance program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs.

Further, no payment may be made under the plan where the expenses incurred are for custodial care. It seems obvious that cost allocation studies will be required of extended-care facilities operated by hospitals, and of extended-care facilities accepting patients after their hospital discharge and providing them with skilled nursing care that may also provide custodial care for other patients. Cost allocation studies are not difficult to make but must be based on accurate statistical data. Unless the routine gathering of all the necessary statistics has been planned for, the statistics may not be available when needed.

SUMMARY

Accountants will agree that the primary purpose of a nursing home is to provide the degree of service required by its patients and not for maintaining records just for the auditors. However, nursing homes are economic enterprises and generally are organized for profit. In order to make enough profit to stay in business, good accounting records and accurate statistics are a necessary adjunct. Without them the accounting function of applying statistics to financial statements for assisting the management processes of planning and maintaining control over operations would be without substance.