A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Department of Health Services

Division of Licensing Services—Healthcare and Child Care Facility Licensing Fees

January • 2009
REPORT NO. 09-01

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

The Joint Legislative Audit Committee

Representative **John Nelson**, Chair

Representative **Tom Boone**
Representative **Jack Brown**
Representative **Peter Rios**
Representative **Steve Yarbrough**
Representative **Jim Weiers** (ex-officio)

Senator **Robert Blendu,** Vice Chair

Senator **Carolyn Allen**
Senator **Pamela Gorman**
Senator **Richard Miranda**
Senator **Rebecca Rios**
Senator **Tim Bee** (ex-officio)

Audit Staff

Melanie M. Chesney, Director

Shan Hays, Manager and Contact Person
Jeremy Weber, Team Leader
Steven Meyeroff

Copies of the Auditor General's reports are free.
You may request them by contacting us at:

Office of the Auditor General
2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:
www.azauditor.gov

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

January 7, 2009

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Ms. January Contreras, Acting Director
Department of Health Services

Transmitted herewith is a report of the Auditor General, a Performance Audit of the Department of Health Services, Division of Licensing Services—Healthcare and Child Care Facility Licensing Fees. This report is in response to an October 5, 2006, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department of Health Services agrees with the finding and plans to implement all of the recommendations directed to it.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on January 8, 2009.

Sincerely,

Debbie Davenport
Auditor General

Attachment

2910 NORTH 44th STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

SUMMARY

The Office of the Auditor General has conducted a performance audit of the Department of Health Services (Department), Division of Licensing Services (Division)—Healthcare and Child Care Facility Licensing Fees, pursuant to an October 5, 2006, resolution of the Joint Legislative Audit Committee. This is the first in a series of three reports on the Department and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. This report focuses on licensing fees for healthcare and child care facilities. The other two reports will focus on the Department's substance abuse treatment programs and the 12 statutory sunset factors.

As of October 1, 2008, the Department licensed 4,476 healthcare facilities (such as hospitals, nursing homes, and assisted living centers) and 2,740 child care facilities (child care centers and group homes). In fiscal year 2008, the Department conducted 15,110 inspections of these facilities and handled more than 3,300 complaints against them. These regulatory activities cost about $10.9 million in General Fund monies. Like other states, Arizona charges fees for state licensure. Most of these fees are set or capped in statute and deposited into the General Fund, partially offsetting regulatory costs. In fiscal year 2008, the Division collected less than $1.1 million in licensing-fee revenue for these facilities.

Licensing fees could be modified to cover more regulatory costs (see pages 9 through 21)

As of fiscal year 2008, the General Fund subsidized about 90 percent of the State's cost of regulating healthcare and child care facilities. Licensing fees, which cover the remaining 10 percent, have remained largely unchanged since the 1970s and 1980s. Although the Legislature authorized the Department to increase licensing fees to generate an additional $600,000 in fee revenue in fiscal year 2009, even after this increase, the General Fund will still subsidize about 85 percent of regulatory costs.[1] Further, the regulatory workload has increased significantly—the number of licensed facilities alone has increased by 19 percent between fiscal years 2003 and 2008—and this increased workload will likely further increase the need for General Fund monies.

1 The increased revenue will not increase the Department's overall funding because the General Fund appropriation for licensing was reduced by $600,000 for fiscal year 2009.

Rather than paying for regulatory costs from the General Fund, some states and some other Arizona regulatory programs set their licensing fees to cover regulatory costs. Arizona's licensing fees for healthcare and child care facilities are considerably lower than those in two states that have set healthcare licensing fees to fully cover regulatory costs. For example, California and Nevada, which both charge hospitals a licensing fee that covers the full regulatory cost, have licensing fees of $25,776 and $8,000, respectively, for a 100-bed hospital, while Arizona's fee for a hospital of the same size is $2,850. In Arizona, licensing fees fully fund regulatory activities for such professions as allopathic physicians, and within the Department itself, licensing fees fully fund regulation of environmental laboratories and hearing and speech professionals.

Although the Department does not have the authority to raise licensing fees for healthcare and child care facilities, it is the logical place to start in developing a proposal for possible fee increases. Licensing fees for these facilities are set in statute, and therefore, the Legislature would need to approve any fee changes. However, the Department is in the position to determine regulatory costs, and therefore to develop a fee proposal that could reduce or eliminate the General Fund subsidy. The Department should develop and implement a systematic approach to regularly evaluate its licensing costs and propose new fees that would cover more, if not all, of its costs. As part of this approach, the Department should consider factors that affect costs, including licensed capacity, the time it takes to regulate different types of facilities, and a facility's compliance with requirements. The Department should also assess the efficiency of its operations to ensure costs are as low as possible, assess the adequacy of its information systems for measuring its costs, and obtain input from the regulated facilities regarding proposed licensing fees. Finally, the Department should develop a proposal for legislative consideration. After receiving the Department's proposal, the Legislature should consider modifying licensing fees through revising the statutory caps, authorizing the Department to set fees in rule, or establishing a mechanism in statute for determining fees.

TABLE OF CONTENTS

continued

TABLE OF CONTENTS

concluded

INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Health Services (Department), Division of Licensing Services (Division)—Healthcare and Child Care Facility Licensing Fees, pursuant to an October 5, 2006, resolution of the Joint Legislative Audit Committee. This is the first in a series of three reports on the Department and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. This report focuses on licensing fees for healthcare and child care facilities. The other two reports will focus on the Department's substance abuse treatment programs and the 12 statutory sunset factors.

Department licenses healthcare and child care facilities

The Department is responsible for protecting the health and safety of Arizonans in healthcare and child care facilities by establishing and enforcing rules for the licensure and regulation of these facilities. The Department also contracts with the federal Centers for Medicare and Medicaid Services (CMS) and the Arizona Health Care Cost Containment System (AHCCCS), the State's Medicaid program, to regulate healthcare facilities that participate in Medicare or Medicaid programs.

The Department performs these regulatory functions through its Division of Licensing Services. As of October 1, 2008, the Division licensed 4,476 healthcare facilities (such as hospitals, nursing homes, and assisted living centers) and 2,740 child care facilities (child care centers and group homes). Regulatory activities include:

- **Issuing licenses**—The Division issues initial and renewal licenses to qualified applicants. Licenses for healthcare facilities are valid for 1 year, while licenses for child care facilities are valid for 3 years. The Division also issues 3-year licenses to hospitals accredited by a nationally recognized accrediting organization. Further, the Division issues provisional, change of ownership, and amended licenses as needed. In fiscal year 2008, the Division issued 3,759 initial, renewal, and other licenses to healthcare facilities and 717 licenses to child care facilities.

- **Conducting compliance surveys**—The Division conducts on-site inspections, called surveys, to determine if licensed facilities comply with applicable rules. For most facilities, the Division conducts a survey for each initial or renewal license issued to a facility. It does not generally conduct surveys for accredited healthcare facilities, but may do so if the accreditation does not cover the entire 3-year license. If the Division finds that a facility is not in full compliance, it prepares a statement of deficiencies report, requires the facility to develop and implement a plan of correction, and conducts follow-up and other monitoring surveys as needed. In addition, the Division conducts additional surveys for changes that affect a license, such as changes in ownership or the number of licensed beds, and conducts annual inspections of child care facilities. In fiscal year 2008, the Division conducted approximately 4,209 initial and renewal license surveys and 10,901 follow-up and other monitoring surveys for healthcare and child care facilities.

Survey—On-site inspection of a facility, conducted by a team of one or more surveyors led by a survey team leader, to determine compliance with laws and rules.

- **Handling complaints**—The Division receives complaints and investigates specific allegations of noncompliance with laws or rules against licensed facilities. In fiscal year 2008, the Division received 2,119 complaints for healthcare facilities and 1,182 complaints for child care facilities.

- **Enforcing compliance**—The Department takes enforcement actions against facilities that are in noncompliance with applicable rules. Most enforcement actions are civil penalty agreements, but other actions can include denying a license application, suspending or revoking a license or certificate, and obtaining a court-ordered injunction that prohibits a facility from continuing a specific act that violates rules. In fiscal year 2008, the Division imposed 349 civil penalty agreements and collected $512,565 in penalties against healthcare and child care facilities, which are deposited in the General Fund. It also denied seven license applications.

- **Educating consumers**—The Division provides the public with information on its Web site regarding licensed facilities, survey results, enforcement actions, and how to select appropriate care facilities.

In addition to regulating healthcare and child care facilities, the Division also licenses hearing aid dispensers, audiologists, speech and language pathologists, nonnurse midwives, and group homes for people with developmental disabilities. As of October 1, 2008, the Division licensed 3,310 individual professionals and 975 group homes for people with developmental disabilities. The Division also reviews architectural plans for construction projects related to licensed facilities and provides technical assistance. As shown in Table 1 (see page 3), the Division carries out its various duties through six licensing programs.

Table 1: Licensing Programs, Descriptions, and Number of Licensees As of October 1, 2008

Licensing Program	Description	Number of Licensees[1]
Healthcare Facility Programs		
Assisted living licensing	Licenses assisted living homes and centers, adult foster care homes, and adult day healthcare facilities.	1,930
Long-term care licensing	Licenses nursing care institutions and Intermediate Care Facilities for the Mentally Retarded (ICFs/MR).	150
Medical facilities licensing	Licenses medical facilities, including hospitals, home health agencies, hospices, and ambulatory surgical and outpatient treatment centers.	1,577
Behavioral health licensing	Licenses behavioral health facilities, including inpatient, residential, and outpatient facilities, and adult therapeutic homes.	819
Child Care Facility Licensing Program		
Child care licensing	Licenses and certifies child care centers and group homes.	2,740
Other Licensing Programs		
Special licensing	Licenses hearing aid dispensers, audiologists, speech and language pathologists, nonnurse midwives, and group homes for people with developmental disabilities. Also performs other licensing-related duties such as architectural reviews of healthcare and child care facilities.	4,285

1 The numbers include only licensees with active licenses.

Source: Auditor General staff analysis of licensing information from the Division's Web site, the *Arizona Department of Health Services 2006-2007 Annual Report*, and data on the number of licensees provided by division staff.

Licensing fees

Most license fees are set or capped in statute.

Like other states, Arizona charges fees for state licensure.[1] Most of these fees are set or capped in statute and deposited into the General Fund, partially offsetting the cost of licensure. Fees for licensing hearing and speech professionals, however, are set in administrative rule, deposited into the Hearing and Speech Professionals Fund, and cover the cost of licensing these individuals. Licensed facilities and individuals

1 The Department does not charge fees for licensing group homes for people with developmental disabilities.

pay the applicable fee(s) each time they submit an application for an initial or renewal license. As shown in Table 2 (see page 5), fees for healthcare facilities vary based on licensed bed capacity.

Budget and staffing

The Division receives both state and federal funding. State funding consists primarily of General Fund appropriations. Although most licensing fees are deposited into the General Fund, fees deposited into the Hearing and Speech Professionals Fund are appropriated to the Division for regulating hearing and speech professionals.[1] The Division also receives federal Title XVIII and Title XIX monies from CMS and AHCCCS for Medicare and Medicaid certification. In addition, it receives federal Child Care and Development Fund and Maternal and Child Health Services grant monies from the U.S. Department of Health and Human Services to help pay for the cost of regulating child care facilities and nonnurse midwives, respectively. Table 3 (see page 6) shows the Division's revenues and expenditures for fiscal years 2006 through 2008. The Division's largest expenditures are for salaries and employee-related expenses.

The Division is led by an assistant director who reports to the Department's director. Division staff also include a deputy assistant director, program managers, surveyors, survey team leaders, administrative and support staff, and architects. As of November 2008, the Division had 254.58 full-time equivalent positions, of which 31 were vacant.

Scope and objectives

This performance audit focused on determining the extent to which licensing fees for healthcare and child care facilities cover the regulatory costs. This report has one finding:

- Licensing fees for healthcare and child care facilities could be modified to cover more of the State's regulatory costs. The Department should develop a cost-based method for calculating fees, including direct and indirect licensing and monitoring costs, and propose new fees to the Legislature based on this method. The Legislature should consider modifying licensing fees through revising the statutory caps, authorizing the Department to set fees in rule, or establishing a mechanism in statute for determining fees.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings

1 Laws 2008, Chapter 291, §12, authorizes the Department to generate an additional $600,000 in licensing-fee revenue in fiscal year 2009 (see Finding 1, pages 9 through 21). The law appropriates the $600,000 directly to the Department.

Table 2: Licensing Fee Descriptions, Fee Amounts, and Authorizing Statutes
As of October 1, 2008

Fee (license period)	Fee Amount			Statute Establishing Fee
Healthcare Facilities (1 year, 3 years for accredited hospitals)				
Assisted living, long-term care, medical (including hospitals), and behavioral health facilities				
Application fee	$ 50			A.R.S. §36-405
License fee	0 beds	$100 base fee		
	1-59 beds	$100 base fee	plus $25/bed[1]	
	60-99 beds	$200 base fee	plus $25/bed[1]	
	100-149 beds	$300 base fee	plus $25/bed[1]	
	150 or more beds	$500 base fee	plus $25/bed[1]	
Child Care Facilities (3 years)				
Child care centers				
Application fee	$150			A.R.S. §36-882
Late filing fee	50			
Child care group homes				
Application fee	$30			A.R.S. §36-897.01
Late filing fee	25			
Other Licensing Programs				
Hearing aid dispensers (1 year)[2]				
License fee	$350	($250 application fee, $100 license fee)		A.R.S. §36-1908
Reciprocity license	200	($100 application fee, $100 license fee)		
Organization license	200	($100 application fee, $100 license fee)		
Temporary license	200	($100 application fee, $100 license fee)		
Renewal license	100			
Late filing fee	25			
Duplicate license fee	25			
Audiologists and speech-language pathologists (1 year)[2]				
Application fee	$200	($100 application fee, $100 license fee)		A.R.S. §36-1908
Renewal fee	100			
Late filing fee	25			
Duplicate license fee	25			
Nonnurse midwives (2 years)				
Application fee	$25			A.R.S. §36-758
Initial licensing fee[3]	25			
Renewal fee[3]	25			
Testing fee[3]	100			
Duplicate license fee	10			
Architectural drawing review				
Fee	Project cost:			A.R.S. §36-405
	$0-$99,999	$50		
	100,000-499,999	100		
	500,000 and over	150		

1 Although statute establishes a $10 bed fee, the Department increased the bed fee to $25 in September 2008 in response to Laws 2008, Chapter 291, §12, which authorized the Department to increase fees.

2 Fees for these licensees are authorized in statute, but the fee amounts are set by the Department in the Arizona Administrative Code.

3 A.R.S. §36-758 authorizes the Department to charge up to $50 for a license and up to $250 for testing.

Source: Auditor General staff analysis of applicable Arizona Revised Statutes, Arizona Administrative Code, and session laws.

Table 3: Division's Schedule of Revenues, Expenditures, and Other Financing Sources and Uses Fiscal Years 2006 through 2008 (Unaudited)

	2006	2007	2008
Revenues:			
State General Fund appropriations	$ 7,793,273	$ 9,468,913	$ 9,841,641
Federal grants and contracts	5,577,109	4,964,529	5,959,894
Licensing fees	1,347,391	1,484,052	1,443,467
Fines, forfeits, and penalties	614,661	688,808	802,581
Other	35,104	12,647	17,074
Total revenues	15,367,538	16,618,949	18,064,657
Expenditures:[1]			
Personal services and related benefits	11,110,201	13,035,897	14,037,597
Professional and outside services	116,690	38,995	52,152
Travel	418,209	431,114	400,651
Aid to organizations	122,307	176,907	362,999
Other operating	471,517	532,019	530,642
Equipment	121,790	224,943	81,905
Total expenditures	12,360,714	14,439,875	15,465,946
Excess of revenues over expenditures	3,006,824	2,179,074	2,598,711
Other financing sources (uses):			
Remittances to the State General Fund[2]	(1,525,168)	(1,633,142)	(1,598,618)
Net operating transfers in (out)	(883,783)	(546,622)	(1,671,959)
Total other financing sources (uses)	(2,408,951)	(2,179,764)	(3,270,577)
Excess (deficiency) of revenues and other sources over expenditures and other uses	$ 597,873	$ (690)[3]	$ (671,866)[3]

1 Administrative adjustments are included in the fiscal year paid.

2 As required by A.R.S. §35-146 all licensing fees; fines, forfeits, and penalties; and other revenues collected by the Division, except those deposited into the Hearing and Speech Professionals Fund and the Nursing Care Revolving Fund, are remitted to the State General Fund.

3 According to the Division, the deficiencies in 2007 and 2008 resulted primarily from timing differences between receipt of revenues and the use of those monies. The deficiencies were funded from unexpected prior years' revenues.

Source: Auditor General staff analysis of the Arizona Financial Information System Accounting Event Transaction File for fiscal years 2006 through 2008.

and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the Acting Director of the Department of Health Services and her staff for their cooperation and assistance throughout the audit.

FINDING 1

Licensing fees could be modified to cover more regulatory costs

The licensing fees charged to healthcare and child care facilities cover only a small part of the State's costs of regulating the facilities and could potentially be changed to cover more of these costs. As of fiscal year 2008, the General Fund subsidized about 90 percent of the State's cost to license and monitor these facilities. The fees that cover the remaining 10 percent have been largely unchanged since the 1970s and 1980s, and are not adequately based on relevant cost factors. Arizona's fees are considerably lower than those in two states that have set fees to fully recover regulatory costs. Although decisions about the fees rest ultimately with the Legislature, the Department of Health Services (Department) should take steps to develop and propose fees that would more fully and accurately recoup regulatory costs. These steps include adopting a systematic method for periodically measuring costs, ensuring that information systems can collect the necessary data for determining costs, and proposing appropriate fees, including obtaining input from regulated facilities.

General Fund subsidizes cost of licensing and monitoring healthcare and child care facilities

The General Fund subsidizes the majority of the State's costs for licensing and monitoring healthcare and child care facilities. Licensing-fee revenue, which helps offset these costs, covers only a small portion of what the State spends. The portion covered by fees has been made even smaller by the Department's inability to issue some licenses within statutory time frames because the Department must refund the fee if it does not issue a license on time. Although legislation passed in 2008 will increase fee revenue and may improve the Department's efficiency in processing renewal license applications, the State will likely continue to subsidize a large portion of licensing costs. In addition, growth in the Department's workload and the complexity of the licensed industries will likely create a need for additional General Fund monies in the future.

In fiscal year 2008, the State collected fees equal to less than 10 percent of the total amount spent to regulate healthcare and child care facilities.

State's costs exceed licensing-fee revenue—In fiscal year 2008, the State spent over $10.9 million in General Fund monies to regulate healthcare and child care facilities but collected less than $1.1 million in fee revenue. This is less than 10 percent of the total amount spent. Arizona uses the General Fund to pay the majority of the State's costs for licensing and monitoring healthcare and child care facilities.[1] Although licensing fees collected from these facilities are deposited into the General Fund and help defray the State's costs, most of the General Fund money spent to regulate the facilities comes from general taxes and other revenues.

The subsidy has increased in recent years. Figure 1 (see page 11) shows how the total cost of licensing and monitoring these facilities compares with licensing-fee revenue for fiscal years 2006 through 2008. As shown in the figure, costs have increased by more than $2.5 million over the past 3 years, while fee revenue has remained relatively flat. As a result, the percentage of total costs recouped by fee revenue has dropped from approximately 12.1 percent in fiscal year 2006 to 9.7 percent in fiscal year 2008.

Moreover, fee revenue that the Department is required to refund when it does not issue licenses within established time frames increases the state subsidy. Arizona Revised Statutes (A.R.S.) §41-1077 requires state agencies to refund licensing fees if license applications are not processed within established time frames. For example, in fiscal year 2008, the State actually received almost $1.4 million in fee revenue, but refunded over $297,000 (approximately 22 percent) because of missed time frames. Most of the refunds were for assisted living and long-term care facilities.

Recent legislative changes will have limited effect on subsidy—The Legislature took two separate actions in 2008 that will increase fee revenues, but these changes are not likely to have much impact on reducing the General Fund subsidy. Specifically:

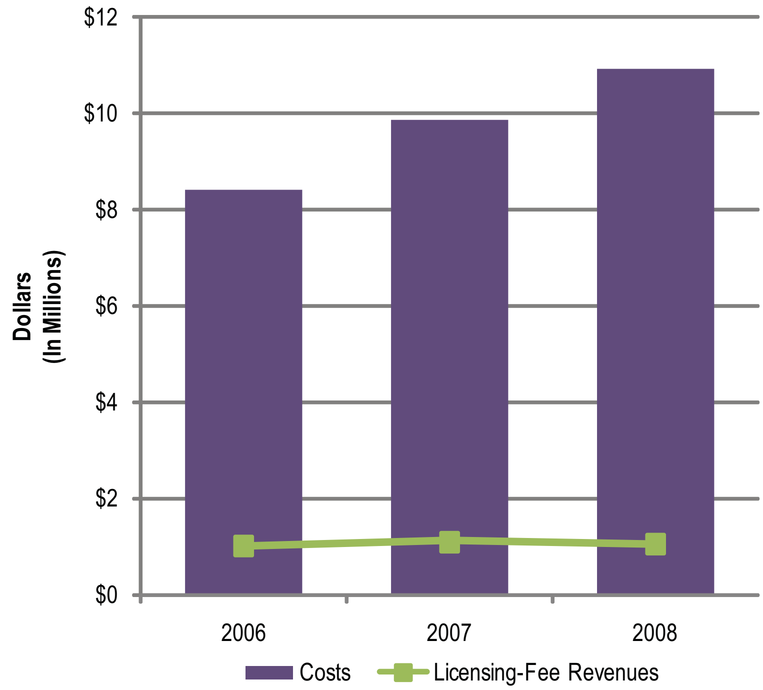
2008 legislation authorized the Department to increase fees by a total of $600,000 in fiscal year 2009.

- Laws 2008, Chapter 291, §12, authorized the Department to increase any of its fees to generate $600,000 in additional revenue during fiscal year 2009.[2] The Department decided to raise licensing fees for healthcare facilities with inpatient beds, such as hospitals, nursing homes, and assisted living centers, by increasing the per-bed portion of the fee to $25 from the previous amount of $10. The fee increase went into effect for all licenses that expired on or after

1 General Fund monies also pay for the cost of state matching requirements for federal Title XIX funding the Department receives for performing Medicaid certification duties related to healthcare facilities. The State matches $1 for every $1 of Title XIX monies received for assisted living and behavioral health programs, and $1 for every $3 of Title XIX monies received for the long-term care program.

2 The increased revenue will not increase the Department's overall revenues because the General Fund appropriation for licensing was reduced by $600,000 for fiscal year 2009.

Figure 1: Comparison of General Fund Costs[1] and Licensing Fee Revenues
Fiscal Years 2006 through 2008
(Unaudited)



1 Amounts include indirect costs incurred by the Division and the Department for regulating healthcare and child care facilities. Amounts also include General Fund monies used for state matching requirements for Title XIX funding for Medicaid certification. The state matching portion of the costs was approximately $1 million in fiscal year 2006, $1.2 million in fiscal year 2007, and $1.3 million in fiscal year 2008.

Source: Auditor General staff analysis of data from the Arizona Financial Information System Accounting Event Transaction File and the Department's cost-allocation rates for indirect and data-processing costs for fiscal years 2006 through 2008.

September 30, 2008. However, the fee increase will have limited impact on total revenue. Although department officials believe the fee increase will generate the full $600,000 in additional revenue authorized by the law, the amount is less than 6 percent of the total General Fund cost of regulating healthcare and child care facilities in fiscal year 2008. Moreover, the fee increase does not affect facilities that do not have inpatient beds, such as outpatient treatment centers. As of October 2008, almost 43 percent of state-licensed healthcare facilities had no inpatient beds.

- Laws 2008, Chapter 66, allows the Department to conduct the on-site compliance survey for healthcare and child care facility renewal licenses at any time during the license period, instead of having to conduct the survey before issuing the license. Division of Licensing Services (Division) management believes this change will help licensing staff schedule their work more efficiently, particularly for surveys that require travel, and issue renewal licenses within established time frames, thereby reducing refunds. However, even a complete elimination of refunds would have a limited impact on the General Fund subsidy. The $297,000 refunded in fiscal year 2008 is less than 3 percent of the General Fund cost of regulating healthcare and child care facilities in that year.

Increased workload will likely affect need for General Fund monies—

Even with these legislative changes, growth in the volume and complexity of work the Division performs will likely increase the need for General Fund monies. The Division's workload grew significantly between fiscal years 2003 and 2008. According to division data, the average number of healthcare and child care facilities with active licenses increased over 19 percent between fiscal years 2003 and 2008, from 5,857 to 6,978 facilities. Most of this growth occurred in the assisted living, medical facilities, and child care programs. In addition, the number of hospitals that do not have accreditation and thus require an annual compliance survey for licensure has grown from 11 out of 76 hospitals in 2000 to 30 out of 89 hospitals in 2008.

The average number of licensed facilities increased over 19 percent between fiscal years 2003 and 2008.

Besides the growth in number of facilities, surveys have become more complex and enforcement actions have increased. According to division management, licensed healthcare facilities are providing more complex and sophisticated patient care than ever before. Management believes that this increase in the complexity of patient care and other factors have led to lengthier, more complex surveys and complaint investigations, and increased enforcement actions. These factors include nursing and child care staff shortages in the healthcare and child care industries, an increase in lawsuits that rely on the results of complaint investigations, and greater public awareness of the Division's regulatory role. Division management also reported that a slight increase in the number of complaints against unlicensed facilities and an increase in the number of private doctors who are joining their practices with medical facilities are also increasing the Division's workload. Overall, division data shows that the number of enforcement actions against healthcare and child care facilities combined increased 158 percent over the past 5 years, from 212 actions in fiscal year 2003 to 547 actions in fiscal year 2008. The assisted living, long-term care, and child care programs had the greatest increase in the number of actions. Enforcement actions can require significant amounts of staff time.

Department and division management believe these trends have and will continue to increase the need for additional General Fund monies. State financial data shows that the Division's General Fund appropriations increased nearly 43 percent since fiscal year 2003, from over $6.5 million that year to over $9.3 million in fiscal year 2009.

Arizona's licensing fees outdated and not based on relevant cost factors

Arizona's licensing fees for healthcare and child care facilities had not been updated for many years until some fees were increased in September 2008, and as discussed previously, this increase will not substantially change the subsidy. In addition, Arizona's fees are not adequately based on factors that affect cost.

Licensing fees have not changed in several years—Arizona has not updated its licensing fees for child care facilities in at least 20 years, and its fees for healthcare facilities had not changed for nearly that long until the legislative change that took effect in September 2008. The licensing fee for child care centers was last updated in 1976 when it increased from $25 to $50 per year. The fee for child care group homes has remained $30 for a 3-year certificate since it was established in 1988.[1] Until the bed fee increased in September 2008, licensing fees for healthcare facilities had not changed since they were established in 1989. However, although the bed fee has increased from $10 to $25 per bed, the base and application fees have not changed. Consequently, the fee increase does not affect the 43 percent of facilities without licensed beds, such as outpatient treatment centers.

According to division management, the Department has had internal discussions about proposing fee increases in the past, but these discussions have never led to a legislative proposal because of concerns that there would be a lack of support.

Year in which Arizona's licensing fees for child care and healthcare facilities were last modified

Facility Type	Year
Child Care Facilities	
Child Care Centers	1976
Child Care Group Homes	1988
Healthcare Facilities	
Application Fee	1989
Base Fee	1989
Bed Fee	2008

Sources: Auditor General staff analysis of Arizona Revised Statutes and session laws.

Licensing fees not based on costs—The State's licensing fees for healthcare and child care facilities are not adequately based on factors that can affect the costs of regulating a particular facility. Some factors that can affect costs include:

- **Licensed capacity**—The Division's costs may vary depending on licensed capacity. For example, the survey for a child care center with a licensed capacity of several hundred spaces may take longer than the survey for a center with a licensed capacity of 20 spaces. Although Arizona's fees for healthcare facilities vary based on capacity, fees for child care facilities do not. Consequently, a child care center with several hundred licensed spaces pays the same fee as a center with 20 licensed spaces.

- **Type of facility**—Regulatory costs may also vary depending on the type of facility and the applicable rules and regulations. Some facilities require more time to regulate than others. For example, according to division data, a

The Division's regulatory costs may vary depending on the facility type.

1 Although the licensing fees have not changed, in 1992 the Legislature added a late application fee of $50 for child care centers and $25 for child care group homes.

renewal survey for state licensure of an assisted living center, which has a typical licensed capacity of 70 beds, can take approximately 21 person-hours, while the survey for a home health agency, which has no licensed capacity, can take 33 person-hours. Consequently, capacity may not fully account for differences in survey times resulting from differences in facility types. Although Arizona charges different fees for different types of child care facilities, healthcare facilities with the same capacity pay the same fee regardless of facility type.

In addition, A.R.S. §§36-885 and 36-897.05 require the Division to conduct annual inspections of child care facilities, but these facilities have 3-year licenses. Thus, regulatory costs are incurred annually, while revenue is only collected every 3 years.

- **Facilities' compliance with requirements**—The Division's costs may also vary depending on a facility's compliance with rules and regulations. Noncompliance can result in follow-up inspections, complaint investigations, and enforcement actions, which increase the cost of regulating facilities. In Arizona, facilities that require follow-up inspections and complaint investigations do not pay more for their licenses than facilities that comply with requirements.

Arizona's healthcare and child care facility licensing fees are not adequately based on relevant cost factors.

Because fees do not account for all of the factors that may affect costs, the General Fund subsidizes some licensing programs more than others. As seen in Table 4 (see page 15), although none of the Division's healthcare and child care licensing programs' revenues cover the programs' costs, some programs' revenues covered more costs than others'. Further, the average costs to regulate facilities vary by program. Thus, although all of the programs were subsidized, fees that do not account for differences in costs might be inequitable.

Some states go further than Arizona in basing fees on costs

To provide points of comparison with Arizona's fees and practices, auditors contacted eight Western states.[1] Nearly all of these states go beyond Arizona in taking facility type and capacity into account in their fee structures, and some go beyond Arizona in attempting to recover regulatory costs.

Other states' fees take relevant cost factors more into account—

Compared with Arizona's fee structure, fees in the eight other states generally had greater differentiation based on the type and size of facilities. Specifically:

1 The eight states—California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington—were selected based on their geographic and demographic similarity to Arizona.

Table 4: General Fund Costs and Licensing Fee Revenues by Program
Fiscal Year 2008
(Unaudited)

	Assisted Living Program	Long-Term Care Program	Medical Facilities Program	Behavioral Health Program	Child Care Program	Total
Number of facilities[1]	2,044	152	1,618	881	2,929	7,624
Costs	$2,933,782	$1,303,751	$1,212,180	$1,469,562	$4,012,855	$10,932,130
Licensing fee revenue	431,593	80,820	221,310	178,550	150,565	1,062,838
Average costs per facility	1,435	8,577	749	1,668	1,370	1,434
Average revenue per facility	211	532	137	203	51	139
Revenue as a percentage of costs	14.7%	6.2%	18.3%	12.1%	3.8%	9.7%

1 The number of facilities is based on the average number of facilities with active and pending licenses for the fiscal year. The numbers may include a small number of facilities that do not pay licensing fees because they are exempted from doing so by statute or because they are federally certified but not state licensed.

Source: Auditor General staff analysis of data from the Arizona Financial Information System Accounting Event Transaction File, the Department's cost-allocation rates for indirect and data-processing costs, and data on licensees from the Division's performance measures for fiscal year 2008.

- **Licensed capacity**—In Arizona, fees for child care facilities do not vary by capacity. Seven of the eight comparison states charge renewal licensing fees for child care centers that vary based on capacity.

- **Type of facility**—Although Arizona's fees for healthcare facilities do not vary by facility type, fees in all eight comparison states often do. (see Table 6 in Appendix A, pages a-i through a-v). Two of these states, California and Nevada, set fees for different healthcare facility types based on the time it takes to regulate them.

- **Facilities' compliance with requirements**—Two of the states that auditors reviewed—Washington and California—have additional fees for non-compliance. Specifically, Washington has established fees for on-site surveys resulting from substantiated complaints and other follow-up surveys for some of its healthcare facilities. Additionally, for assisted living and child care facilities, California has established probation-monitoring fees for facilities that are on probation and plan-of-correction fees for facilities that fail to implement corrective plans by a specified date.

Arizona's licensing fees are much lower than two Western states where fees are set to cover full regulatory costs.

Some states have set fees to cover full regulatory costs—Arizona's licensing fees are considerably lower than those in two states that set their fees to fully recover regulatory costs. Table 5 (see page 16) compares Arizona's fees with eight other states' fees using example fees for seven types of facilities, including hospitals, nursing homes, and child care centers.[1] Auditors based the example

1 See Table 6 in Appendix A (pages a-i through a-v) for a more complete comparison of renewal licensing fee schedules across all nine states.

Table 5: Comparison of Renewal Licensing Fees in Arizona and Eight Western States for Various Facility Types at Specified Capacity Levels[1, 2] Fiscal Year 2009

Hospital (100 beds)		Inpatient Hospice (10 beds)		Psychiatric Hospital (45 beds)		Nursing Home (120 beds)		Home Health Agency[3]		Assisted Living Center (70 beds)		Child Care Center (100 spaces)	
California	$25,776	California	$1,875	California	$11,599	California	$34,440	California	$4,159	Nevada	$7,622	California	$800
Washington	11,300	Nevada	1,702	Nevada	6,350	Washington	33,000	Nevada	1,517	Washington	5,530	Washington	400
Nevada	8,000	Texas	875	Texas	4,510	Nevada	4,700	Washington	1,081	**Arizona**	**2,000**	Oregon	200
Oregon	2,900	Oregon	750	Washington	3,150	**Arizona**	**3,350**	Texas	875	Colorado	1,760	Utah	175
Arizona	**2,850**	Washington	721	Colorado	2,155	Utah	1,640	Utah	755	California	1,126	Colorado	160
Colorado	2,615	**Arizona**	**400**	**Arizona**	**1,275**	Texas	725	Oregon	600	Utah	900	Nevada	150
Texas	1,960	Colorado	360	Oregon	1,000	New Mexico	720	**Arizona**	**150**	Texas	450	Texas	135
Utah	1,700	Utah	320	Utah	875	Oregon	450	New Mexico	100	New Mexico	150	New Mexico	55
New Mexico	600	New Mexico	100	New Mexico	270	Colorado	360			Oregon	30	**Arizona**	**50**

1 The table compares renewal licensing fees for the following states: Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington. Auditors selected at least one facility type from each of Arizona's facility licensing programs. Auditors selected the bed capacities based on typical capacities for Arizona's facilities. See Table 6 in Appendix A for a comparison of the renewal fee schedules for all nine states.

2 The fees include all application, capacity, and other fees charged for renewal licenses in these states. In addition, auditors have adjusted the fees to account for differences in licensure periods. The table compares the annual portion of each state's fees.

3 Home health agencies have no bed capacity. In 2008, Colorado passed legislation to begin licensing home care agencies by June 2009.

Source: Auditor General staff analysis of data on licensed capacities for the selected facilities provided by the Division and information obtained from the selected states' statutes, Web sites, administrative codes, and officials and staff in these states.

fees on typical licensed capacities for such facilities in Arizona. As the table shows, compared to all eight states, Arizona's licensing fees are relatively low for inpatient hospices, psychiatric hospitals, home health agencies, and child care centers, but at or above the middle fee for assisted living centers, nursing homes, and hospitals.

Most notably, Arizona's fees were often much lower than fees in three states—California, Nevada, and Washington. Two of these states, California and Nevada, have set fees for licensed healthcare facilities so that fee revenue covers the cost of regulating them.[1] For example, California passed legislation in 2006 that requires the agency that regulates healthcare facilities to be entirely supported by federal funding and fee revenue, unless General Fund monies are specifically appropriated. Consequently, California has set fees to cover the cost of regulating licensed healthcare facilities, such as hospitals and nursing homes. According to a state official, California's General Fund is not expected to subsidize any of the estimated $91 million cost to regulate healthcare facilities in fiscal year 2009. Nevada has also set fees to cover the costs of regulating healthcare facilities, including hospitals, and does not rely on General Fund appropriations.

Department should propose raising licensing fees to cover more of regulatory costs

Although the Department does not have the authority to raise licensing fees for healthcare and child care facilities, it is the logical place to start in developing a proposal for possible fee increases. Licensing fees for these facilities are set in statute, and therefore, the Legislature would need to approve any fee changes. However, the Department is in the position to determine regulatory costs, and therefore to develop a fee proposal that could reduce or eliminate the General Fund subsidy. Arizona relies entirely on fee revenue to cover costs for some other regulatory activities. To propose fees that would more fully and accurately recoup regulatory costs, however, the Department would need to adopt a systematic method for periodically measuring costs, ensure that information systems can collect the necessary data for determining costs, and obtain input from regulated facilities. The Legislature could then consider various options for implementing the proposal, if it so chooses.

Arizona 90/10 Board—A board, usually a regulatory board, that keeps 90 percent of its revenue and remits 10 percent to the General Fund. The revenue kept by the board finances 100 percent of the board's regulatory costs.

Source: Auditor General staff analysis of information from the Arizona Department of Administration's General Accounting Office Web site.

Raising fees to cover costs is an option—

Using fees to fully cover regulatory costs occurs in Arizona and other state governments. For example, in Arizona, 90/10 boards, such as the Arizona Medical Board, which regulates allopathic physicians, are entirely funded by revenue derived from the

1 Another comparison state, Colorado, also passed legislation in 2007 to fund the regulation of its healthcare facilities solely with fee revenue. Colorado has revised fees to cover the costs of regulating hospitals and psychiatric hospitals, but is still in the process of revising fees for other facilities.

Arizona's 90/10 boards and some other licensure programs have fees that fully cover regulatory costs.

regulated entities. Within the Department itself, licensing fees fully fund the Arizona State Laboratory's environmental laboratory licensure program as well as the Division's regulation of hearing and speech professionals. In addition, as mentioned previously, some states, such as California and Nevada, use licensing-fee revenue to pay for the cost of regulating some facilities, and Colorado is currently moving toward doing so.

Department should evaluate fees and propose adjustments as needed—The Department should develop or adopt a structured approach to evaluate its licensing fees and propose new fees that would cover more, if not all, of its costs. Mississippi's Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER) developed an approach for evaluating and setting fees that the Department might find useful.[1] PEER's approach consists of a decision model for establishing or increasing government fees, called the Theory of Fee Setting in Government, as well as guidance on implementing new fees.[2] Figure 2 (see page 19) summarizes key concepts from PEER's approach.

As part of its approach, the Department should develop an appropriate method for calculating fees based on direct and indirect costs for licensing and monitoring healthcare and child care facilities. In doing so, the Department might want to consider contacting other states, such as California and Nevada, to determine how they calculate their fees and what effect raising fees to cover costs had on their licensed facilities. In addition, the Department should do the following:

The Department should seek to minimize costs where possible.

- **Assess efficiency of operations**—The Department should assess the efficiency of its operations to ensure costs are as low as possible and document the results of its assessment. The Department should seek to minimize costs where possible.

- **Develop fees based on relevant cost factors**—To make fees more equitable, the Department should consider charging fees based on licensed capacity and the time it takes to regulate different facilities for both healthcare and child care facilities. In addition, the Department should determine an appropriate method for including the cost of follow-up inspections, complaint investigations, and other monitoring activities that result from noncompliance with licensing rules. For example, the Department could consider charging separate fees for these activities.

- **Assess adequacy of current information systems**—The Department should assess the adequacy of its current systems for tracking direct and indirect cost data related to its licensing activities. It should also track time spent on licensing and monitoring activities for all of its licensing programs. The Department uses a federal information system to track time spent on activities

1 Joint Legislative Committee on Performance Evaluation and Expenditure Review: *State Agency Fees: FY 2001Collections and Potential New Fee Revenues*. Jackson, MI: Joint Legislative Committee on Performance Evaluation and Expenditure Review, Dec. 2002.

2 According to PEER, the approach was based on a review of academic literature, economics theory, and policies and procedures from various states and the United States and Canadian governments.

Figure 2: Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review Structured Fee-Setting Process Developed for State Government

Determine whether fees or taxes should fund the service

Who benefits from the service: individuals, the public, or both?

- Fees should be used to finance services that benefit individuals.
- Taxes should be used to finance services that benefit the public.
- When both individuals and the public benefit from a service, financing can come from both fees and taxes.

Identify and analyze legal issues

- Are fees limited by statute?
- If so, is legislation required to change them?
- Should administrative rules be revised?

Identify the purpose of the fee

- Should the fee cover the cost of providing the service?
- Should fees be set to influence behavior?
- Should fees be set to encourage compliance with program regulations and goals?

Assess factors influencing the fee amount

- What effect will the fee have on those who pay the fee?
- What effect will the fee have on annual revenue?
- What do similar states charge for the service?
- Will the public accept the necessity of the fee?
- Is the Department subsidizing other government operations?

Determine appropriate methodology for setting fees

- Determine if there is a comprehensive cost-accounting system.
- Seek to reduce costs as much as possible.
- Measure direct and indirect costs of the time staff spends in service activities.
- Determine economic impact on regulated entities.

Implement fees

- Obtain amended legislation and regulations as needed.
- Prepare those who pay fees for changes by providing advance notice and by explaining the purpose and reasons for new fees.
- Train staff to answer questions regarding the new fees.

Periodically reassess revenue, costs, and program outcomes to update fee amounts

Source: Auditor General staff analysis of fee-setting model included in the *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues* report prepared by the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review.

for the assisted living, long-term care, and medical facilities programs, but does not regularly collect data for the behavioral health and child care programs. The Department should enhance or develop cost-data systems as needed and as resources are available.

The Department should obtain facilities' input in developing the fees.

- **Consider the effect of fee changes on licensed facilities**—The Department should determine the effect of fee changes on the licensed facilities, particularly smaller facilities, and obtain facilities' input in developing the fees. If proposed fees are significantly higher than the current fees, the Department might recommend increasing fees gradually.

Once developed or adopted, the Department should use the approach to assess its fees and propose new fees to the Legislature as appropriate. In addition, the Department should develop and implement policies and procedures for using the method to periodically reassess revenues, costs, and program outcomes to update fees as needed. Moreover, the Department may wish to consider using the method to assess and propose any adjustments to the Division's other fees, which include architectural review fees and licensing fees for hearing and speech professionals and nonnurse midwives.

Healthcare and child care facilities fee increases would require legislative approval.

Legislative action needed to revise fees—Because licensing fees for healthcare and child care facilities are set in statute, the Legislature would need to approve any fee increases or new fees the Department proposed. In considering any proposed fee changes, the Legislature may also wish to consider the following actions:

- **Allow fees to be set by rule**—The Legislature could consider removing the fee amounts from statute and giving the Department authority to set fees by rule, similar to statute governing the Department's fees for the environmental laboratory licensure program at the Arizona State Laboratory. A.R.S. §36-495.06 authorizes the Department to establish fees for licensing environmental laboratories by rule, but stipulates that fees should not exceed the Department's licensing costs. This revision would allow the Department to increase fees to cover more or all of the regulatory costs and periodically adjust fees as needed, while maintaining some legislative control over the fee amounts.

- **Establish a statutory fee-setting method**—Alternatively, the Legislature could consider replacing fee amounts in statute with a statutory method for setting fees. For example, California uses a statutory method to set licensing fees for healthcare facilities each year. California's Health and Safety Code §1266 requires California to determine the fee for different types of healthcare facilities by dividing the total cost for licensing each type of facility (based on projected workload and budgeted costs) by the number of licensed beds (for inpatient facilities) or the number of licensed facilities (for outpatient facilities).

Recommendations:

1.1. The Department should develop or adopt a structured approach to evaluate its current licensing fees for healthcare and child care facilities. As part of its approach, the Department should develop a cost-based method for calculating fees that includes all direct and indirect costs. In developing this method, the Department should do the following:

   a. Assess the efficiency of its operations to ensure costs are as low as possible and document the results of its assessment. The Department should seek to minimize costs where possible.

   b. Develop fees that address factors that influence cost, including licensed capacity, the time it takes to regulate different facility types, and additional work resulting from noncompliance with licensing rules.

   c. Assess the adequacy of current systems for tracking direct and indirect cost data for all of its licensing programs. The Department should enhance or develop new systems as needed and as resources are available.

   d. Consider the effect fee increases may have on different facilities and obtain their input in proposing new fees. If proposed fees are significantly higher than current fees, the Department might recommend increasing fees gradually.

1.2. Once the Department has developed its approach, it should evaluate its licensing fees for healthcare and child care facilities and propose new fees to the Legislature that would cover more, if not all, of its regulatory costs.

1.3. After receiving the Department's proposal, the Legislature should consider modifying licensing fees through revising the statutory caps, authorizing the Department to set fees in rule, or establishing a mechanism in statute for determining fees.

1.4. The Department should develop and implement policies and procedures for using the approach to periodically reassess revenues, costs, and program outcomes to update fees as needed.

APPENDIX A

Table 6: Renewal Licensing Fee Schedules for Arizona and Eight Western States by Facility Type
Fiscal Year 2009

State	License Period	Base Fee (Fee Schedule)		Capacity Fee (Fee Schedule)	Other Fees (Fee Schedule)
Hospital					
Arizona	1 year	0 beds 1-59 beds 60-99 beds 100-149 beds 150 or more beds	$100 100 200 300 500	$25 per bed	$50 application fee
California	1 year			$257.76 per bed	
Colorado[1]	1 year	1-50 beds 51-150 beds 151 or more	$ 900 1,400 2,000	$12 per bed	$15 Health Care Availability Act charge
Nevada	1 year		$5,000	$30 per bed	
New Mexico	1 year			$6 per bed	
Oregon	1 year	0-25 beds 26-49 beds 50-99 beds 100-199 beds 200 or more beds	$ 750 1,000 1,900 2,900 3,400		
Texas	2 years			$39 per bed	$20 Online subscription fee
Utah	2 years		$400	$30 per bed	$200 per satellite location $20 per free standing residential treatment center
Washington	3 years			$113 per bed per year	
Inpatient Hospice					
Arizona	1 year	0 beds 1-59 beds 60-99 beds 100-149 beds 150 or more beds	$100 100 200 300 500	$25 per bed	$50 application fee
California	2 years		$1,875.41 per year		
Colorado	1 year		$360		
Nevada	1 year		$782	$92 per bed	
New Mexico	1 year		$100		
Oregon	1 year	0-25 beds 26-49 beds 50-99 beds 100-199 beds 200 or more beds	$ 750 1,000 1,900 2,900 3,400		
Texas	2 years		$1,750		
Utah	2 years		$400	$24 per bed	
Washington	2 years	0-5 beds 6-10 beds 11-15 beds 16-20 beds	$ 720 1,442 2,162 2,883		

1 Colorado charges a maximum fee of $8,000 for hospital renewal licenses.

Table 6: Renewal Licensing Fee Schedules for Arizona and Eight Western States by Facility Type Fiscal Year 2009 (Continued)

State	License Period	Fee Schedule: Base Fee		Fee Schedule: Capacity Fee	Other Fees
Psychiatric Hospital					
Arizona	1 year	0 beds	$100		
		1-59 beds	100		
		60-99 beds	200		$50
		100-149 beds	300	$25	Application
		150 or more beds	500	per bed	fee
California	1 year			$257.76 per bed	
Colorado[1]	1 year		$1,600	$12 per bed	$15 Health Care Availability Act Charge
Nevada	1 year		$5,000	$30 per bed	
New Mexico	1 year			$6 per bed	
Oregon	1 year	0-25 beds	$ 750		
		26-49 beds	1,000		
		50-99 beds	1,900		
		100-199 beds	2,900		
		200 or more beds	3,400		
Texas[2]	2 years			$200 per bed	$20 Online subscription fee
Utah	2 years		$400	$30 per bed	$200 per satellite location $20 per free standing residential treatment center
Washington	1 year			$70 per bed	
Nursing Home					
Arizona	1 year	0 beds	$100		
		1-59 beds	100		
		60-99 beds	200		$50
		100-149 beds	300	$25	Application
		150 or more	500	per bed	fee
California	1 year			$287 per bed	
Colorado	1 year		$360		
Nevada	1 year		$1,100	$30 per bed	
New Mexico	1 year			$6 per bed	
Oregon	1 year	1-15 beds	$120		
		16-49 beds	175		
		50-99 beds	350		
		100-199 beds	450		
		200 or more beds	580		
Texas	2 years		$250	$10 per bed	
Utah	2 years		$400	$24 per bed	
Washington	1 year			$275 per bed	

1 Colorado charges a maximum fee of $8,000 for psychiatric hospital renewal licenses.

2 Texas requires a minimum fee of $6,000 for psychiatric hospitals.

Table 6: Renewal Licensing Fee Schedules for Arizona and Eight Western States by Facility Type
Fiscal Year 2009
(Continued)

State	License Period	Fee Schedule			
		Base Fee		Capacity Fee	Other Fees
Home Health Agency					
Arizona[1]	1 year		$100		$50 application fee
California	1 year		$4,159.42		
Colorado	Not state licensed				
Nevada	1 year		$1,517		
New Mexico	1 year		$100		
Oregon	1 year		$600 + $600 for each subunit		
Texas	2 years		$1,750		
Utah	2 years		$400		$1,150 agency fee plus $200 per branch
Washington[2]	2 years	1-5 FTEs	$2,162		
		6-15 FTEs	3,041		
		16-50 FTEs	3,460		
		51-100 FTEs	4,361		
		101 or more FTEs	4,491		

1 Arizona's home health agencies have no beds. Therefore, they pay only a $50 application fee and a $100 base fee.

2 Washington bases its licensing fee for home health agencies on full-time equivalent employee positions.

Table 6: Renewal Licensing Fee Schedules for Arizona and Eight Western States by Facility Type Fiscal Year 2009 (Continued)

State	License Period	Base Fee		Capacity Fee	Other Fees
		Fee Schedule			
Assisted Living Center					
Arizona	1 year	0 beds	$ 100		
		1-59 beds	100		
		60-99 beds	200		
		100-149 beds	300	$25	$50
		150 or more beds	500	per bed	application fee
California	Nonexpiring	1-3 beds	$ 375 per year		
		4-6 beds	375 per year		
		7-15 beds	563 per year		
		16-30 beds	750 per year		
		31-49 beds	938 per year		
		50-74 beds	1,126 per year		
		75-100 beds	1,314 per year		
		101-150 beds	1,502 per year		
		151-200 beds	1,751 per year		
		201-250 beds	2,000 per year		
		251-300 beds	2,250 per year		
		301-350 beds	2,500 per year		
		351-400 beds	2,750 per year		
		401-500 beds	3,250 per year		
		501-600 beds	3,750 per year		
		601-700 beds	4,250 per year		
		701 or more beds	5,000 per year		
Colorado[1]	1 year			$23 per bed	$150 application fee
Nevada	1 year	1-10 beds	$1,085	$92	
		11 or more beds	1,182	per bed	
New Mexico	1 year	2-29 beds	$100		
		30-50 beds	125		
		51-100 beds	150		
		101-150 beds	175		
		151-200 beds	200		
		201 or more beds	225		
Oregon	2 years		$60		
Texas[2]	1 year		$200	$10 per bed	
Utah	2 years		$400	$20 per bed	
Washington	1 year			$79 per bed	

1 Colorado's assisted living centers pay $15 if they have at least 35 percent of licensed beds occupied by Medicaid enrollees, based upon claims data.

2 Texas charges a maximum fee of $1,500 for assisted living centers.

Table 6: Renewal Licensing Fee Schedules for Arizona and Eight Western States by Facility Type
Fiscal Year 2009
(Concluded)

State	License Period	Fee Schedule: Base Fee		Capacity Fee	Other Fees
Child Care Center					
Arizona	3 years				$150 application fee
California	1 year	1-30 spaces 31-60 spaces 61-75 spaces 76-90 spaces 91-120 spaces 121 or more spaces	$ 200 400 500 600 800 1,000		
Colorado	Nonexpiring	5-20 spaces 21-50 spaces 51-100 spaces 101-150 spaces 151-250 spaces 251 or more spaces	$ 70 per year 110 per year 160 per year 245 per year 340 per year 480 per year		
Nevada	1 year	5-6 children 7-12 children 13-50 children 51-100 children 101-150 children 151-200 children 201 or more children	$ 20 60 100 150 200 250 300		
New Mexico	1 year				$55 application fee
Oregon	1 year			$2 per space	
Texas	Nonexpiring		$35 per year	$1 per child per year	
Utah	1 year		$25	$1.50 per child	
Washington[1]	3 years			$4 per child per year	

1 Washington child care centers with less than 13 licensed spaces pay a flat fee of $48.

Source: Auditor General staff analysis of renewal licensing fees in Arizona, California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington obtained from state statutes, Web sites, administrative codes, and information provided by officials and staff in these states.

APPENDIX B

Methodology

Auditors used several methods to study the issues in this report. General methods included interviewing Department of Health Services (Department) and Joint Legislative Budget Committee (JLBC) staff, and reviewing statutes, bills, administrative code, department-prepared documents and reports, federal contract awards, and Division of Licensing Services (Division) policies and procedures. In addition, auditors used the following specific methods:

- **License Fees**—To identify the Division's total General Fund costs and licensing fee revenues, auditors obtained and analyzed direct cost and revenue data from the Arizona Financial Information System (AFIS) and calculated indirect costs using the Department's cost-allocation rates for indirect cost and data-processing costs for fiscal years 2006 through 2008. To identify average General Fund costs and licensing fee revenues per facility within each licensing program for fiscal year 2008, auditors also used data from the Division's fiscal year 2008 performance measures on the number of facilities with active and pending licenses.

  To document growth in the Division's licensing workload, auditors analyzed data from reports generated from the Division's Automated Survey Processing Environment (ASPEN) database, which is a federally mandated database used to implement the Division's survey process, and the Division's Time and Effort (T&E) database, which records surveyors' and team leaders' day-to-day activities in 15-minute increments for the assisted living, medical facilities, and long-term care programs. From the ASPEN database, auditors analyzed data from reports on the average number of facilities with active licenses and the number of enforcement actions for fiscal years 2003 through 2008. From the T&E database, auditors reviewed an average-hours report that summarized the average time spent on licensing activities for different facilities in federal fiscal year 2007. Auditors also reviewed internal and system controls for the ASPEN and T&E databases and concluded that the data from these databases was valid for use in drawing conclusions. In addition to reports from these two databases, auditors reviewed division studies on average times spent on licensing activities for the child care and behavioral health programs and other data the Division provided on the number of accredited hospitals between fiscal years 2000 and 2008.

To identify a systematic method for determining appropriate fees, auditors reviewed literature, including a report by Mississippi's Joint Legislative Committee on Performance Evaluation and Expenditure Review entitled *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues*.[1]

To determine how Arizona's licensing fees for healthcare and child care facilities compare to other states', auditors researched and compiled licensing fees and other information for eight Western states (see the Appendix A bullet below).[2] To compare fees, auditors determined typical licensed capacities for Arizona's facilities based on data provided by division staff, and used these capacities to calculate example fees for selected facilities in all the comparison states.[3]

- **Introduction and Background**—To develop information for the Introduction and Background section, auditors compiled unaudited information from AFIS, the Division's performance measures, staffing-level documents, JLBC appropriations reports for the Department for fiscal years 2008 and 2009, state laws, Arizona Administrative Code, the Department's fiscal year 2007 annual report, the Department's Web site, and other agency-provided documents.

- **Appendix A**—To create Table 6, which lists renewal licensing fees and licensing periods for nine states and seven facility types, auditors compiled information from various sources, including other states' Web sites, statutes, administrative codes, state-prepared documents, and officials and staff in relevant agencies.

1 Joint Legislative Committee on Performance Evaluation and Expenditure Review: *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues*. Jackson, MI: Joint Legislative Committee on Performance Evaluation and Expenditure Review, Dec. 2002.

2 Auditors selected eight states to compare with Arizona—California, Colorado, Nevada, New Mexico, Oregon, Texas, Utah, and Washington—based on their geographic and demographic similarity to Arizona.

3 Auditors selected hospitals, psychiatric hospitals, home health agencies, assisted living facilities, nursing homes, and child care facilities. Auditors chose these facilities to represent the five main division programs.

AGENCY RESPONSE

Arizona Department of Health Services

Office of the Director

150 North 18th Avenue, Suite 500
Phoenix, Arizona 85007-2670

(602) 542-1025
(602) 542-1062 FAX

JANET NAPOLITANO, GOVERNOR
JANUARY CONTRERAS, ACTING DIRECTOR

December 31, 2008

Debbie Davenport
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport,

Thank you for the opportunity to review the report of the performance audit of the Arizona Department of Health Services (ADHS), Division of Licensing Services, Health Care and Child Care Facility Licensing Fees, conducted as part of the sunset review process prescribed in Arizona Revised Statutes § 41-2951 et seq.

The findings and recommendations contained in your report have been carefully reviewed by the staff of ADHS. In accordance with the instructions contained in your letter of December 29, 2008, the attached response is provided.

ADHS agrees with the Auditor General's Report regarding the increased workload, both in quantity and complexity, including a 19 percent increase in the average number of facilities since 2003 and a 158 percent increase in disciplinary actions since 2003. In the past five years, the ability to meet this workload has suffered, causing delays in the issuance of new licenses for businesses. This has resulted in child care and health care facility openings to be postponed. Most of the time staff for these facilities has already been hired, causing businesses to generate a payroll without revenues. Health care and child care programs are not able to inspect facilities within the licensing period in a timely manner or investigate all complaints within department guidelines, resulting in potential health and safety issues. Finally, ADHS has not been able to provide the necessary technical assistance needed to assist facilities to remain in compliance with the rules, thereby protecting health and safety.

ADHS appreciates the hard work and professionalism exhibited, as well as the insight, provided by your staff during the audit process. Your staff conducted extensive research regarding licensing fee models other states have used, and gave the time and effort to learn the very complicated licensing process. Your work on this audit will be of great value to ADHS and ultimately to the State.

We are working diligently to develop a proposal that is both consistent with the report recommendations, and that can enable ADHS to better recruit and retain qualified licensing staff to ensure that our mission is accomplished timely and professionally. Progress on both of these fronts will be key to continuing to improve ADHS's work to protect the health and safety of Arizonans.

Sincerely,

January Contreras
Acting Director
Arizona Department of Health Services

Enclosure

Arizona Department of Health Services
Responses to Recommendations of the Auditor General's Preliminary Draft Report
Division of Licensing, Healthcare and Child Care Facility Licensing Fees

Recommendation 1.1: The Department should develop or adopt a structured approach to evaluate its current licensing fees for healthcare and child care facilities. As part of its approach, the Department should develop a cost-based method for calculating fees that includes all direct and indirect costs. In developing this method, the Department should do the following:

a. Assess the efficiency of its operations to ensure costs are as low as possible and document the results of its assessment. The Department should seek to minimize costs where possible.
b. Develop fees that address factors that influence cost, including licensed capacity, the time it takes to regulate different facility types, and additional work resulting from noncompliance with licensing goals.
c. Assesses the adequacy of current systems for tracking direct and indirect cost data for all of its licensing programs. The Department should enhance or develop new systems as needed and as resources are available.
d. Consider the effect fee increases may have on different facilities and obtain their input in proposing new fees. If proposed fees are significantly higher than current fees, the Department might recommend increasing fees gradually.

Response: The recommendation of the Auditor General is agreed to and the recommendation will be implemented.

Recommendation 1.2: Once the Department has developed its approach, it should evaluate its licensing fees for healthcare and child care facilities and propose new fees to the Legislature that would cover more, if not all, of its regulatory costs.

Response: The recommendation of the Auditor General is agreed to and the recommendation will be implemented.

Recommendation 1.3: After receiving the Department's proposal, the Legislature should consider modifying licensing fees through revising the statutory caps, authorizing the Department to set fees in rule, or establishing a mechanism in statute for determining fees.

Response: The recommendation of the Auditor General is agreed to; however, the Department can only submit a proposal and cannot implement this recommendation without legislative approval.

Recommendation 1.4: The Department should develop and implement policies and procedures for using the approach to periodically reassess revenues, costs, and program outcomes to update fees as needed.

Response: The recommendation of the Auditor General is agreed to and the recommendation will be implemented.

Performance Audit Division reports issued within the last 24 months

07-01 Arizona Board of Fingerprinting
07-02 Arizona Department of Racing and Arizona Racing Commission
07-03 Arizona Department of Transportation—Highway Maintenance
07-04 Arizona Department of Transportation—Sunset Factors
07-05 Arizona Structural Pest Control Commission
07-06 Arizona School Facilities Board
07-07 Board of Homeopathic Medical Examiners
07-08 Arizona State Land Department
07-09 Commission for Postsecondary Education
07-10 Department of Economic Security—Division of Child Support Enforcement
07-11 Arizona Supreme Court, Administrative Office of the Courts—Juvenile Detention Centers
07-12 Department of Environmental Quality—Vehicle Emissions Inspection Programs
07-13 Arizona Supreme Court, Administrative Office of the Courts—Juvenile Treatment Programs
08-01 Electric Competition
08-02 Arizona's Universities—Technology Transfer Programs
08-03 Arizona's Universities—Capital Project Financing
08-04 Arizona's Universities—Information Technology Security
08-05 Arizona Biomedical Research Commission
08-06 Board of Podiatry Examiners

Future Performance Audit Division reports

Arizona Department of Juvenile Corrections—Rehabilitation and Re-entry Programs

Arizona Sports and Tourism Authority

Maricopa County Special Health Care District