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Implications of Study of Costs of Regulating Care Homes for Adults for Fee-Setting Options

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1. Introduction

This paper summarises the implications of the findings of a study of inspection units for the future level and types of fees for the regulatory function charged to care homes for adults. We focus here on the short-term implications for fee-setting under the current arrangements. The paper starts by describing the general principles adopted before identifying four different approaches to fee setting. For each approach examples are given of estimated level fee levels based on the analysis described in Netten, Forder and Knight (1999).

2. General principles

Current policy is that the costs of regulation should be borne by those who are being regulated. Here we have interpreted this as the full costs of regulation, including activities such as dealing with complaints, development support and enforcement activities. Costs relating to responsibilities of other regulatory bodies such as fire departments and environmental health agencies have been excluded.

We have used average costs reported in the survey, so are reflecting the situation at the time of the survey. This means we are assuming that on average units are satisfactory in terms of efficiency and the quality of the regulatory activities undertaken.

In order to ensure the full costs of regulation are included we have allocated the costs of those activities less easily measured (such as enforcement) on to those where we have been able to identify the resources associated with identifiable processes (primarily inspection and registration).

It is recognised that fees act as incentives and need to be affordable so options that affect costs directly may not be appropriate in policy terms. Where possible we identify potential conflicts of policy objectives and cost-related fees.

3. Annual fee setting options

The four approaches that can be used to set fees are described briefly below. These are defined in terms of their cost-contingency, that is the degree to which the fee reflects the cost.

3.1 Non cost-contingent flat rate

The simplest approach is to levy a fee that is not related to the costs of the regulatory activity. It may be conceived as an arbitrary subsidy to inspection units that would otherwise bear the full regulatory cost. This type of approach has been used in the past when policies were focused on lightening the regulatory burden on providers. As a result the current annual rate of £46 per bed could be represented as a non cost-contingent flat rate.

Current policy is that the full cost of regulation should be borne by those regulated. Should the preferred option be to uprate the fixed rate per bed approach to reflect current costs then the estimated rate based on the size of homes in the sample of inspections would be £75 per residential and £62 per nursing bed. These rates represent increases of 63 per cent and 34 per cent increases on residential and nursing bed fees respectively. Although the costs of regulating residential and nursing homes are very similar nursing homes require a lower per bed rate increase as, on average, they are larger than residential homes so are currently paying more per year.

An alternative non cost-contingent fee would be a flat rate annual fee per home. Adjusting for the national distribution of types of home and proportions in and outside of London, the predicted annual fee per home would be £1562 per year for homes inspected by local authorities, and £1813 per year for homes inspected by health authority units. This compares with current annual fees for an average sized residential home of £836 per year and for an average sized nursing home of £1,500 per year.

Setting a flat rate per bed has the advantage from the home provider perspective that fees rise directly with income, although larger homes would subsidise smaller homes. It has the disadvantage that the costs incurred by the regulatory process would not be reflected in fee income to units. For example, if a unit had a higher than average proportion of small homes, then fee income would be insufficient to cover costs incurred.

A flat rate per home would result in smaller homes subsidising larger homes as size of home does affect the costs of regulation. Moreover, an incentive would be created to increase size of home as income would rise but fees would not. Admittedly this incentive would not be very great, given the predicted fee levels. However, it would run counter to the policy to encourage small homes.

3.2 Retrospective cost-contingent fee

Another approach is to bill homes according to a direct measure of the regulatory activity's cost such as total hours of inspector contact time. The per-contact-hour fee would be the average cost of inspector time, possibly with some adjustment for locality characteristics (i.e. the fee would differ regionally). The average cost of a contact hour may or may not include complementary activities, such as time spent dealing with complaints.

This approach has analogy with billing for the services of professionals such as lawyers or consultants. The provider can be conceived in this way as buying a professional service in order to obtain registered status. A variant of this option is where an adjustment is made for the types of inputs used, for example, the seniority of the inspector.

Using this approach central government's role would be limited to identifying the hourly rate that could be charged. It may be appropriate to some elements of the regulatory function are set at a national level (such as annual fees) where others (such as dealing with pre-registration enquiries or even registrations themselves) are charged on a retrospective basis, reflecting actual time spent.

What the charge should be would depend in part on the other activities which would be regarded as complementary to the activity which was being charged for. Table 1 shows a range of rates reflecting different assumptions.

No significant difference was found between the hourly costs of health authority units in and outside of London (although it should be noted only three London units participated). However, local authority unit costs of inspector time were significantly higher in London. If regional factors were to be reflected in nationally set rates the hourly costs shown in Table 1 should be multiplied by 1.13 for London and by 0.96 for non-London areas.

The advantage of this retrospective approach would be that it would reflect costs incurred very directly. The disadvantages are the administrative systems that would be needed to implement such an approach, and that providers would not know in advance what charges

were going to be. The approach may also provide a breeding ground for disputes between units and homes.

3.3 Limited cost-contingent rate

Limited cost-contingent fees are based on the average predicted cost of the regulatory activity for a small number of identified groups of providers. Each group has a pre-determined fixed fee. Beyond the home categories, no account is made of the costs incurred for a *specific* provider. Tables 2 and 3 show three options for cost contingent fees for nursing homes and residential homes respectively. Table 4 shows the same three options also allowing for higher costs associated with London local authority units.

In each case the “limited cost contingent” fee reflects cost variations associated with client group. Option 1 is a single annual and option 2 is a per bed fee. The flat rate annual fee fees range between just over £1,500 to over £2,000 per home. Using the average fee per bed option the difference in per bed fee rates for each client group is considerable, with “other” types of home inspected by local authorities costing nearly three times the per bed rate of homes for elderly people (£145 compared with £56). These apparent anomalies are created by the relationship between size of home and cost of inspection: the average size of homes for “other” client groups is 11 places compared with 27 places in homes for older people.

Option 3 retains the client group distinction but reflects the relationship between home size and costs of inspection. In this option homes are charged an annual flat rate fee plus an additional fee per bed. Homes are divided into three overall sizes in order to allow for the non-linear relationship between the cost of inspection and size. The size groupings reflect the distribution of homes inspected¹. When comparing the fees it should be borne in mind that although the fees shown for large homes are similar or lower than those for smaller homes, the total cost of fees would usually be higher because of the larger number of beds.

As with non-cost contingent fees, the approach has the advantage of simplicity. It is straightforward for providers to identify the fees that will apply. Any very limited number of options does mean, however, that some providers will be subsidising the cost of regulating others.

3.4 Predictive cost-contingent fee

Predictive cost-contingent fees are determined according to a formula which identifies the relationship between the total costs of the regulatory activity and home and locality factors. The fee can be set in line with regulation costs by calculating the charge to each home according to the formula. This differs from limited cost-contingent fees in that a wider range of circumstances are reflected in the formula so there is less scope for cross-subsidisation among providers.

This approach is appealing in that the costs of regulation are more closely linked to fees charged. The statistical analyses described chapter 4 of in Netten, Forder and Knight (1999) could be used as a basis for such a formula. These would need to be adjusted to exclude those factors that reflect characteristics for which it inappropriate to charge providers (such as size of the inspecting unit). The formulae could reflect the relationship between home size and cost more directly and include characteristics such as providing sector and whether the inspections had been satisfactory.

¹ For both health authority units and local authority units the 33.3 percentile and 66.7 percentile cut-off points were used. As the fees here are predicted from a non-linear relationship there may be inconsistencies for particular home sizes.

The disadvantage with this approach is that it would be complex to administer with each individual home needing to be informed of the fee levels that they were liable to pay.

3.5 Adjustments to fee options

The fee options presented above include the costs of directly inspecting and of related regulatory activity (including enforcement and dealing with complaints). Two elements of cost which have not been included and which could be seen to be a legitimate cost to be included in annual fees are the costs of de-registration of homes and legal costs associated with enforcement activities.

Every home that registers could result in de-registration costs. However, if we allocate de-registration costs on to initial registration fees, new homes bear a disproportionate amount of the cost, as homes already registered are just as likely to be de-registered, but will not have borne any of the costs under previous arrangements. It would appear most appropriate, therefore, that if fees are not to be charged for de-registrations, the costs of de-registrations should be included in annual fees. As among both residential and nursing homes there were three homes de-registered per hundred homes during 1997/98 the average cost per home would be three per cent of the cost of a de-registration. As business failures were found to be more costly, we need to weight the predicted cost to reflect the proportion of de-registrations that are business failures. We do not have national data about the proportion of de-registrations that are business failures, so we have to assume that the proportion of de-registrations identified as business failures in the survey (54 per cent) reflects the national picture. This would add £51 to the annual cost for a home for older people, £47 for a home for people with mental health problems and £18 for other homes. Using the current per bed approach to fee setting this would result in just over an additional £1 per bed per year.

Legal costs associated with enforcement have proved difficult to establish so we have drawn on the evidence of case studies described in Chapter 5 in Netten, Forder and Knight (1999). Five cases resulted in cancellations of registration. The rate of cancellation of registration was 0.71 per 100 homes for local authorities and 0.10 per 100 homes for health authorities. There are two ways of estimating external legal costs. The first is to include all legal costs – an average of £26,900 per case. The second is to assume that those authorities that were able to identify total overhead costs included the costs of legal advice from other departments within the authority. The additional legal costs are then estimated as just those purchased from external sources. On average these costs were £8,500 per case.

The maximum estimate of expected legal costs per year is when we use average total legal costs from our exemplar cases and assume that the rate of cancellation is that for local authority units. This works out at £184 per year per home. The minimum is when we assume health authority rates of cancellation and just legal advice external to the authority. On this basis the expected cost is £8.50 per home. Including legal advice within the authority and health authority rates of cancellation, costs are estimated as £26 per home. Local authority rates of cancellation and external costs result in expected costs of £61 per home.

4. Registration fees

The current arrangements for registrations fees are flat-rate fees for initial registration, change of ownership and, for residential homes, change of manager where the manager is not the owner. Different rates apply for small homes, defined as those with less than four beds. Below we briefly summarise the fee levels corresponding with the different approaches to fee

setting described above. The analyses combined health and local authority units so the predicted fees apply to both residential and nursing homes.

4.1 Non-cost contingent fees

The average cost of a new registration adjusted to reflect the national distribution of home type² was £2,707, over double the current rate of £952. Residential homes cost less to register than nursing homes on average (£1,940 compared with £2,810) due to differences in the size of home registered. In the sample of new registrations the homes had an average of 39 beds. On this basis the average registration fee per bed would be £70.

National information about the reasons for changes in registration is not available, so a national average cost of a variation in registration can not be estimated. On average, in the study sample, variations in registrations cost £1380 for residential homes and £1520 for nursing homes. Variations in registrations currently cost the same as new registrations for change of ownership and £261 for registration of a manager (where the manager is not the owner). The study found that the cost of registration when there had been a change of owner was less than a new registration, although considerably higher than the current fee level. On average changes in ownership cost £1,834 very similar to the cost when there had been changes involving new build (£1,808). Changes in manager were no more costly than other reasons for varying registration: £1,019.

4.2 Retrospective cost contingent fees

The same per hour rate would apply for retrospective cost contingent fee setting as for registration as for annual fees. However, one registration-related cost, that is not reflected in the registration fee estimates, is the cost of pre-registration enquiries. The study found that 24 per cent of time spent on registrations was spent on pre-registration enquiries. One option would be to charge people who are making such enquiries a separate fee. This could be either a set fee reflecting the expected level of input to such an enquiry or it could be charged on an hourly basis as a retrospective cost-contingent fee.

4.3 Limited cost-contingent rate

Table 5 shows the three limited cost-continent options for setting fees for initial registrations based on the analysis of costs found in the survey. Health and local authority registrations were analysed together, so the rates reflect both residential and nursing homes.

The first option presented is a flat rate fee. Homes for people with mental health problems (including elderly people) and for people with learning disabilities are most costly to register, at over £3,000 and nearly £3,500 respectively. The second option, of a per bed fee, reflects the impact of average bed-size of each home, exaggerating further the cost differences between client group. The third option relates more directly to the way costs of registration vary with home size. There were no very small homes (with fewer than four places) included in the sample so it is not possible to separately identify the costs of registering these.

There are many different reasons that the registration status of a home may need to be changed in some way. The analysis suggested that significant cost variations are associated with variations or changes resulting from changes in the owner, changes involving new building works, and de-registrations as a result of business failure. Table 6 shows the predicted cost of each of these and the predicted cost of other types of variations or changes. These figures could be used as the basis for fees for each type of change or variation in

² National average estimates reflect the client groups catered for by the current stock of homes (as of March 1998) rather than the flow of new registrations.

registration. Section 3.5 above has discussed appropriate charging mechanisms for de-registrations.

4.4 Prospective cost-contingent fees

As with annual fees it would be possible to include all factors found to be associated with cost variations in a formula to predict the cost of registering a particular type of home. In addition to client group and size of home the formula could include type of providing organisation (whether a chain or single home organisation), providing sector and whether a fit person check was undertaken.

5. Dual registered homes

Dual registered homes have been increasing in recent years. At present they are charged annual fees on a per bed basis by both health and local authorities. They also need to register separately with health and local authorities. There were no indications in the analysis of any savings associated with dual registered homes, indeed they were found to be more costly for health authority inspections. Although there will be situations where joint working or joint units may be able to reduce costs by co-ordinating inspections, at present this does not appear to be a sufficiently widespread approach to allow national fee setting to assume such practice.

6. Future fee setting

The two general principles that fees should be set at a national level and that fees should be cost based imply that mechanisms should be in place to ensure that the national rates reflect current costs. All those factors found to affect the costs of regulation and inspection need to be monitored to a greater or lesser degree. For example, while the use of inspector time has a very profound effect on unit costs it would be inappropriate to monitor time use very closely. However, if, for example, policies were introduced which encouraged inspectors to spend more time supporting homes in raising the quality of care provided, it would be important to reflect the cost implications of that policy in fees.

The precise approach needed to monitoring cost related factors will depend on the fee option implemented in practice. Issues that would need to be taken into consideration would be:

- Factors found to affect costs that are not reflected in fee income rates;
- Areas where assumptions have had to be made where information was scarce or unobtainable. Perhaps the most important of these is the use of external legal expertise. The costs of this can be considerable and the information about expected costs was limited from this survey. In such areas it would be helpful if information was recorded in future to monitor whether any assumptions built into the fees were realistic.
- Distribution of fee income and costs incurred. Even if the fees do adequately meet the costs of enforcement in the long term there may be problems in the short term, especially for small units. One approach would be to build up contingency funds that can allow units to meet costs of complex enforcement actions when they occur.
- Whatever the approach used to setting fees it is clear that the bulk of the cost is of staff time. Any system for ensuring that fees continue to be cost-based would need to ensure that changes in salary levels were reflected in changes in fee levels.
- In the longer term the new arrangements which are planned would change important elements of cost such as overhead levels and, potentially, the costs of enforcement activities as a result of greater concentrations of expertise. It would be important to re-

examine the whole fee-cost relationship once the regional authorities were well established.

- The relationship between home size and cost of inspection among larger homes suggests that adding regular inspection of small homes to the responsibilities of units may have a considerable impact on workload. There may be problems in charging fees to such small homes at a level that would adequately recompense units for the input required.

7. Conclusion

Fee levels for regulating care homes for adults are set nationally by the Secretary of State for Health. If these are to reflect the costs of regulating these homes it is important that the fee structure is based on sound evidence of the comprehensive costs of all relevant activity and processes. The study has been used to predict a variety of cost-based fee options. It has not been possible to present some options due to lack of adequate data (for example, differential fees for homes inspected by health authorities in London).

Without exception, the results indicate a need to raise the average levels of fees. However, the proportionate increase varies considerably. The current fees for registration are far below the costs of the process, in some cases costs exceeding fees by a multiple of over three. At the other extreme, the results suggest that, for the average size nursing home for elderly people (found to be 38 by Netten et al. (1998)), the fees obtained would only fall short of the costs of regulating such a home by about seven per cent. The difference would be 12 per cent if allowance were also made for legal costs and de-registrations in annual fees.

This paper has focused on the immediate short-term issue of setting fee rates. There are other policy implications of the results that would warrant further discussion given the far reaching plans for changes in the way regulation is to be conducted in the future. Necessarily, the results here reflect current practice. If there are to be changes in policy about the way the regulatory function is delivered, the cost consequences need to be evaluated. The study provides a starting point for such evaluations.

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Table 1: Retrospective cost contingent fees

<i>Specification of activities allocated onto time spent on registration and inspection</i>	<i>Hourly cost of LA inspectors</i>	<i>Hourly cost of HA inspectors</i>
Exclusive: The cost of time spent on other regulatory activities, (development, dealing with complaints and enforcement) not allocated to inspection and registration time	£39	£36
Intermediate: The cost of time spent on development, but not complaints or enforcement allocated on to registration and inspection time	£45	£43
Inclusive: The cost of time spent on other regulatory activities, (development, dealing with complaints and enforcement) is allocated to inspection and registration	£53	£51

Table 2: Limited cost contingent fee options for homes inspected by health authorities

	<i>Mental Health problems</i>	<i>Elderly</i>	<i>Other</i>
Option 1 Single annual fee	£2044	£1863	£1519
Option 2 Average annual fee per bed	£59	£48	£53
Option 3 Flat rate plus per bed fees: <i>Small homes (<26 beds)</i>			
Annual fee	£1609	£1474	£1202
Per bed fee	£23	£20	£16
<i>Medium homes(26-37 beds)</i>			
Annual fee	£1592	£1463	£1201
Per bed fee	£15	£14	£11
<i>Large (> 37 beds)</i>			
Annual fee	£1531	£1411	£1162
Per bed fee	£9	£8	£7

Table 3: National limited cost contingent fee options for homes inspected by local authorities

	<i>Mental Health problems</i>	<i>Elderly</i>	<i>Other</i>
Option 1			
Single annual fee	£1833	£1518	£1530
Option 2			
Average annual fee per bed	£88	£56	£145
Option 3			
Flat rate plus per bed fees:			
<i>Small homes (<26 beds)</i>			
Annual fee	£1603	£1300	£1312
Per bed fee	£8	£6	£6
<i>Medium homes(26-37 beds)</i>			
Annual fee	£1652	£1377	£1389
Per bed fee	£8	£7	£7
<i>Large (> 37 beds)</i>			
Annual fee	£1741	£1509	£1518
Per bed fee	£9	£7	£7

Table 4: Regional limited cost contingent fee options for homes inspected by local authorities

	<i>London</i>			<i>Non - London</i>		
	<i>Mental Health problems</i>	<i>Elderly</i>	<i>Other (PWL & PWP)</i>	<i>Mental Health problems</i>	<i>Elderly</i>	<i>Other (PWL & PWP)</i>
Option 1 Single annual fee	£2071	£1782	£1782	£1788	£1499	£1499
Option 2 Annual fee per bed	£100	£65	£168	£86	£55	£142
Option 3 Flat rate plus per bed fees: <i>Small homes (<10 beds)</i>						
Annual fee	£1831	£1555	£1555	£1560	£1282	£1282
Per bed fee	£10	£8	£8	£8	£6	£6
<i>Medium homes(10-22 beds)</i>						
Annual fee	£1853	£1609	£1609	£1614	£1361	£1361
Per bed fee	£10	£8	£8	£8	£7	£7
<i>Large (> 22 beds)</i>						
Annual fee	£1902	£1706	£1706	£1710	£1495	£1495
Per bed fee	£12	£9	£9	£9	£7	£7

Table 5: Fee options for new registrations by type of home

	<i>Mental Health problems</i>	<i>Learning disabilities</i>	<i>Elderly/Other</i>
Option 1			
Single flat-rate fee	£3136	£3499	£2278
Option 2			
Fee per bed	£86	£419	£48
Option 3			
Flat rate plus per bed fees:			
<i>Small homes (<19 beds)</i>			
Flat fee	£2023	£2258	£1391
Per bed fee	£83	£100	£55
<i>Medium homes(19-51 beds)</i>			
Flat fee	£2036	£2182	£1560
Per bed fee	£42	£50	£27
<i>Large (> 51 beds)</i>			
Flat fee	£1507	£1549	£1214
Per bed fee	£25	£30	£16

Table 6: Average costs of changes in registration status by type of home

<i>Type of variation or change in registration status</i>	<i>Mental Health problems</i>	<i>Elderly</i>	<i>Other</i>
Change of owner	£2071	£2187	£1118
Changes involving new build	£2044	£2161	£1092
De-registrations resulting from business failure	£1855	£1971	£903
Other changes	£1255	£1372	£303