COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-2766
PHONE: (213) 974-8301 FAX: (213) 626-5427

J. TYLER McCAULEY
AUDITOR-CONTROLLER

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To: Supervisor Michael D. Antonovich, Mayor
Supervisor Zev Yaroslavsky, Chair Pro Tem
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Don Knabe

From: J. Tyler McCauley
Auditor-Controller

Subject: **Department of Health Services Strategic Plan Projected Savings**

In October, the Department of Health Services (DHS) presented to the Board their Strategic Plan for the 1115 Waiver extension. On December 12, 2000, DHS will present their Implementation Plan which identifies specific areas where the Department plans to achieve savings to address a projected $884 million deficit during the five-year Waiver extension.

When DHS presented their Strategic Plan, your Board requested the Auditor-Controller to review and evaluate the estimated cost savings proposed by DHS. We have reviewed DHS' plan and found that, in its current state, it is not specific enough in significant areas to provide a basis for an evaluation of the projected cost savings. In addition, at the present time, there is doubt whether the savings can be achieved in several of the general areas identified.

DHS has indicated they are aware that some savings may not be achieved and the plan states that, if expected savings are not achieved, the Department's budget will be balanced with additional personnel and service reductions. DHS has not yet identified these additional reductions.

Details of our findings are included in the attached report. If you have any questions, please call me at (213) 974-8301 or have your staff call Pat McMahon at (213) 974-0301.

JTM:PM:js

c: Mark Finucane, DHS
David E. Janssen, CAO

Attachment

Department of Health Services Strategic Plan
Review of Projected Savings

DHS' Implementation Plan includes significant savings from eliminating budgeted positions, closing health centers, reducing information systems and non-medical services and supplies, outsourcing some functions and generating an average operating surplus of $50 million each fiscal year. The plan also includes some smaller savings from reductions in consultant fees, outside legal counsel, travel and memberships.

DHS has divided the planned savings into three categories: Increased Reengineering Savings, the Austerity Plan and the Strategic Plan. We focused our review of DHS' planned savings on the following areas with the highest planned savings amounts.

Reduction in Budgeted Positions (FY 00-01 savings $300,000, Five year savings of $171.4 million)

DHS plans to eliminate 2% of the budgeted funded positions in each of the five years of the Waiver extension. The Department has eliminated 153 vacant positions this year with projected savings of approximately $3 million.

We could not review the potential for future savings in this category because DHS has not identified specific positions to be cut. It should be noted that cutting positions is a complicated matter because of concerns regarding the effect on patient care, the impact of employees being moved (cascading) to different facilities and the almost certain objections from the unions and public. If the savings are to be realized, specific detailed plans will need to be prepared and presented to the Board and other stakeholders well in advance of the planned cuts.

Closing Health Centers (No planned FY 00-01 savings, Five year savings of $57 million)

DHS' plan indicates that savings will be achieved by eliminating inefficient health centers and contracting with private providers for patient services. Savings will only be achieved if the cost of contracting is less than the County's avoidable cost for the services. At this time, the Department has not identified specific clinics to be closed and is still developing the workload and cost information. After that, DHS will have to complete an RFP process before any cost savings can be determined. Without County or contract cost information, we could not determine if DHS' savings estimates were reasonable.

Outsourcing Trauma and Lab Services (No planned FY 00-01 savings, Five year savings of $68 million)

Savings from outsourcing trauma and lab services will only be achieved if the cost of contracting is less than the County's avoidable cost for the services. DHS' savings estimates for both of these efforts are based on what the Department hopes to save and are not based on a comparison of the County's avoidable cost to possible contract cost. As with closing health centers, savings will not be known until the Department completes their County cost analysis and obtains bids from private providers through an RFP.

In addition, while DHS believes that contracting for trauma services should be pursued, there appears to be some doubt about whether outsourcing in this area will result in savings. Some medical staff indicated that outsourcing trauma services is very unlikely to produce any material savings. It is unknown if any level one trauma center has successfully contracted out for this service. There are also issues regarding resident employment contracts that would need to be resolved before savings could be realized.

With regard to lab services, DHS has attempted to reduce lab cost by consolidation and/or contracting a number of times over the last twenty years with no results.

Reducing Information Systems (FY 00-01 savings $3 million, Five year savings of $28.8 million)
Reducing Non-Medical Services and Supplies (FY 00-01 savings $6 million, Five year savings of $68 million)

Savings in these areas are to result from reductions in expenditures. DHS has advised the units involved that their budgets will be reduced to achieve these savings. However, DHS has not identified specific areas to be reduced and currently there is no specific plan by which the reasonableness of the reductions can be judged.

It should be noted that reducing expenditures in some areas could increase costs in others. For example, reductions in information systems could prevent the Department from realizing efficiencies offered by new systems. Reductions in non-medical services and supplies (e.g., not purchasing new office equipment) could increase expenses in other areas (e.g., equipment maintenance costs). These reductions may actually be temporary expenditure deferrals rather than true savings. DHS will need to consider these issues in developing their specific plan.

$50 Million Average Annual Surplus

DHS' plan includes operating the Department with an average $50 million surplus each year. While DHS does not have specific plans to reduce expenditures or increase revenue to achieve these surpluses, the Department has generated surpluses in the past and expects to continue to do so.

Given the lack of a specific plan, at this time, it is very difficult to evaluate whether DHS will achieve the planned surpluses. In addition, as noted in the Department's plan, some of the past surpluses were due to extraordinary events that cannot be predicted (e.g., audit settlements, legislative changes, etc.).

DHS' ability to generate future surpluses may become more difficult as other savings areas reduce the potential for surpluses. For example, DHS' past surpluses were due in part to savings in Salaries and Employee Benefits (S&EB). As the Department reduces budgeted funded positions, the surplus in S&EB will be reduced, making it harder for DHS to continue to achieve overall operating surpluses. Specifically, under the Implementation Plan, DHS will cut S&EB by $34 million in FY 02-03. That cut will exceed the Department's FY 99-00 S&EB surplus of $31.8 million.

<u>Other Measures (No planned FY 00-01 savings, Five year savings of $240 million)</u>

DHS' plan indicates that the Department will conduct a comprehensive evaluation of hospital services and recommend major cost-saving or revenue generating proposals. This area, which accounts for approximately 27% of the total projected savings, is not expected to provide any savings until FY 02-03. DHS is still developing specific ideas to generate savings.

DHS' plan indicates that they expect to complete their preliminary report on the potential reductions in December 2001. Developing plans for these possible reductions is a time-consuming, complex process. However, because this area represents 27% of the total savings and the savings will not begin until FY02-03, there is a high risk of not achieving the savings if appropriate plans are not developed and implemented timely.