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WILLIAM T FUJIOKA
Chief Executive Officer

July 26, 2010

To: Supervisor Gloria Molina, Chair
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

2010-11 ADOPTED BUDGET PLACEHOLDER ADJUSTMENTS

During deliberations of the Fiscal Year 2010-11 County Budget, your Board instructed the Chief Executive Officer (CEO) to take the following actions:

1. Immediately brief each Board office on the status of the Health Budget and how the County will address any deficits should a portion or all of the federal funding not come through;

2. Report back to the Board in open session at the meeting of July 6, 2010 with a plan of options to meet those needs;

3. Form a "Red Team" to immediately follow-up with the funding sources until the County receives a definitive response on the Health-funding issues related to the Hospital Provider Fee and the Federal Medical Assistance Percentages (FMAP) extension; and

4. Report back on services that are mandated, but are not compensated.

In addition to the items listed above, this report will also provide you with a full accounting of all placeholder adjustments included in the recently adopted 2010-11 County Budget as requested during the 2010-11 Budget Deliberations, and present your Board with the latest information on other budget issues that may impact both Fiscal Year (FY) 2009-10 and FY 2010-11.

BUDGETED PLACEHOLDER

Historically, placeholder adjustments have been used in the Health Department's budget to account for yet to be identified reductions in funding while maintaining a balanced budget. Generally, the placeholders included in the 2010-11 Adopted Budget for the General Fund reflect a combination of net County cost (NCC) placeholder adjustments, and placeholders used to balance a departmental structural deficit. NCC is the portion of the County budget that is financed with County discretionary funding (also known as locally generated revenues).

Net County Cost Placeholders - $155.1 Million

Faced with a $510.5 million NCC budget gap in the 2010-11 Proposed Budget, the County assumed $115.0 million in NCC savings through a combination of labor-management savings options. Any significant labor-management savings would require negotiations with County labor unions. In addition, the County also assumed that the FMAP rate increase would be extended for the last six (6) months of FY 2010-11. The FMAP rate increase temporarily lowers the County's contribution to the In-Home Supportive Services (IHSS) program. Since the County's portion of the IHSS program is funded with NCC, the estimated savings from the FMAP rate increase ($40.1 million) was used as a countywide budget solution. Given the Board's policy not to backfill any federal/State reductions, this $40.1 million will be addressed through various program adjustments.

We are optimistic that the State will approve the FMAP extension, and we continue to work with labor to negotiate meaningful savings, however should we not be successful, the County would face a budget gap of $155.1 million.

Our office continues to monitor locally generated revenues and, given the pace of the current economic recovery, new revenue solutions and year-end closing fund balance could offset a material portion of this gap. In addition, we are continuing our dialogue with County labor leaders.

Placeholders and Potential Solution Scenarios

Department of Health Services

On June 11, and again on June 24, 2010, my office briefed Board deputies on the status of the Health Department Budget and potential solutions to address any deficits should federal funding not become available.

The DHS' placeholders are divided into revenue placeholders of $102.3 million and appropriation placeholders of $286.7 million for a total of $389.0 million. These placeholders are being used to close the department's structural budget gap while funding initiatives are sought.

- **Revenue Placeholders - $102.3 million**
  The revenue placeholder reflects $68.5 million in revenues based upon the assumption that the Provider Fee will be enacted by the Centers for Medicaid and Medicare during the period July 2010 through December 2010. The department's budget also assumes $33.8 million additional revenues from the extension of the FMAP rate increase for the second half of FY 2010-11.

- **Appropriation Placeholders - $286.7 million**
  The appropriation placeholder reduces expenditures by $286.7 million, primarily as reductions to the department's services and supplies budget, in order to bring their budget into balance.

  As you know, the department has been working on a number of initiatives that could be used to offset the placeholders included in the DHS Adopted Budget, refer to Attachment I – Department of Health Services, Placeholder Supplement, for additional information.

Department of Mental Health
The DMH placeholder of $25.0 million reflects the assumption that the increased FMAP rate will be extended until June 30, 2011. If not extended, the department would address the funding shortfall with some combination of Mental Health Services Act (MHSA) transformation and potential changes in service levels. The department will develop specific details with stakeholders and community partners and reflect refinements to the plan in future phases of the budget process.

Department of Children and Family Services (DCFS)
The placeholder included in the DCFS budget consists of $1.5 million in savings from the extension of the FMAP rate increase. Funding has been set aside in the Provisional Financing Uses budget that can be used to offset this reduction should the FMAP extension not be approved. This would result in no overall budget impact.

<u>Placeholders with Assumptions Pending Decisions</u>
Included in the Adopted Budget for Department of Public Social Services and the Department of Public Health are assumptions that federal and/or State approval will be granted, thus providing funding for a particular program. Fortunately, these types of requests have been granted by either federal or State officials in the past and, based on this historical practice, we are optimistic that approval will be granted.

Department of Public Social Services (DPSS)
The placeholder amount of $4.8 million in NCC savings ($9.6 million in appropriation) is for the Food Stamp program waiver request that is pending State approval. Although we have preliminary indications that the waiver will be approved, there is a chance that it will be denied. If not approved we will return to your Board with a plan to address this possible loss of funding.

Department of Public Health (DPH)
The DPH's 2010-11 Adopted Budget reflects $6.5 million in carryover funding for H1N1 activities pending approval from the Centers for Disease Control and Prevention (CDC). These funds are an unspent portion of $39.9 million awarded by the CDC to the County for H1N1 response activities including planning, laboratory services, epidemiology, and mass vaccination. The CDC awarded the funds for the period of July 31, 2009 through July 30, 2010. The H1N1 funds are a supplement to the DPH's $23.0 million CDC grant for bioterrorism and emergency preparedness and response, and represent a component of the Department's revenue solution to address its projected FY 2010-11 deficit. In past years, CDC has routinely approved carryover of preparedness grant funds. Carryover H1N1 funds would allow DPH to continue flu activities in FY 2010-11.

The carryover request is pending approval by the Office of Management and Budget (OMB) and the CDC will notify grantees of the OMB decision. On a related note, there is an effort in the House to identify domestic budget savings, of which H1N1 funds may be a part, in order to fund federal fiscal relief to states for education. DPH is working closely with the County's Washington, D.C. advocates and other jurisdictions to urge OMB approval of the carryover and oppose the House effort to shift public health funds to education.

FEDERAL AND STATE ADVOCACY

A task force was put in place to address issues related to federal health care reform in August 2009. The CEO's office led this task force made up of Ryan Alsop (CEO), John Schunhoff (DHS), Allan Wecker (DHS), Carol Meyers (DHS), Mark Tajima (CEO), Jonathan Freedman (DPH), Burt Margolin and Susan White. This task force developed and advocated federal health reform priorities, all with the Board's involvement. FMAP was included in that advocacy.

We currently have a team in place to address federal jobs legislation, which we have been working on since December. The CEO's office leads this team, made up of Ryan Alsop (CEO), Burt Margolin, Mark Tajima (CEO), Phil Ansell (DPSS) in Los Angeles, and Reggie Todd (CEO), Greg Campbell, Susan White, Randy Davis and Angie Buckingham Melton in Washington, D.C. All of the work we have done has been and continues to be reported out to stakeholders, including your Board offices, on a regular basis. Our work centers on several priority policy items that were shaped with the involvement of the Board. The issues this task force is covering include: 6-month FMAP extension, extension and increased funding of Temporary Assistance for Needy Families – Emergency Contingency Fund (TANF-ECF), Summer Youth Program extension and increased funding, and the extension of Build America Bonds, as well as some other lower priority items.

We have a team in place focused on the Medicaid Waiver and Hospital Provider Fee, led by DHS's John Schunhoff and Allan Wecker, with the close involvement of Burt Margolin, Jonathan Freedman, Susan White (in Washington, D.C.), Dan Wall (in Sacramento) and Ryan Alsop. John Schunhoff has been the primary team leader and contact for the County in discussions on strategy and policy, with the close involvement of Burt Margolin who is representing the CEO.

LEGISLATIVE UPDATE

Although legislative actions are fluid and continue to change, described below is our current assessment.

FMAP Extension Status

Earlier this year, both the House and Senate separately passed bills that would extend the American Recovery and Reinvestment Act's (ARRA) temporary increase in the Federal Medical Assistance Percentage (FMAP) for an additional six months through June 30, 2011. Both houses also have passed separate bills, which would extend ARRA's Build America Bonds, Economic Recovery Zone Bonds, and Temporary Assistance for Needy Families Emergency Contingency Fund (TANF ECF). However, both houses have not yet been able to send legislation with such language to the President. The main obstacle has been increased opposition, especially by Republicans in the Senate, to enacting such legislation without offsetting spending cuts and/or revenue increases to ensure that the federal budget deficit will not be increased. The Congressional Democratic leadership and the Obama Administration are continuing to try to extend the FMAP increase before Congress begins its month-long August recess.

State Budget Status

The FY 2010-11 State Budget stalemate continues in Sacramento as negotiations between the Governor and Legislative Leaders to address the projected $19.1 billion deficit are slow with no signs of progress being made. The Budget Conference

Committee continues its work to reconcile differing budget actions between the two houses, but the Committee has not acted on any major State Budget issues to date.

As previously reported, the Governor's Budget proposal relies heavily on program reductions to health and human services to address the $19.1 billion shortfall and it does not contain any tax increases to solve the deficit. The Assembly Speaker introduced a proposal which would generate $8.7 billion in one-time revenue by securitizing against the California Beverage Recycling (CBR); however, the Attorney General has indicated that securitizing the CBR Fund may violate provisions of Proposition 58 of 2004 which prohibits borrowing to balance a State Budget deficit. As a result, the Speaker's proposal has been scaled back to sell only about $4.0 billion in bonds.

In addition, Senate Democrats released their own proposal which would shift $3.2 billion to $4.3 billion in program responsibilities for various public safety, health and human services from the State to counties. The proposal would be financed by new revenues through the enactment of an oil severance tax, continuing the Vehicle License Fee (VLF) increase set to expire on June 30, 2011, using projected county savings from the implementation of Federal health care reform, providing bridge funding by delaying corporate tax breaks, and providing a portion of State sales tax increases to counties in FY 2012-13. According to Senate Democrats, the restructuring proposal would help ease the State's revenue shortfall, result in fewer devastating program cuts to safety net programs, and provide a more stable funding source and spending flexibility to help counties tailor programs to local needs. The Chief Executive Office is working closely with the California State Association of Counties and affected County departments to provide feedback to the Senate Democrats on the proposed realignment or restructuring of program responsibilities from the State and counties.

MANDATED v. COMPENSATED HEALTHCARE SERVICES

Your Board also ordered a report back on services provided by DHS that are mandated, but are not compensated. Welfare and Institutions Code Section 17000 obligates the County to assure the provision of subsistence health care services to certain County residents who cannot otherwise provide for such care. These services are partially funded through State Realignment funds, Disproportionate Share Hospital funding, and the 1115 Waiver Safety Net Care Pool.

OTHER FINANCIAL ISSUES

Probation Department - $36.8 Million

Although the Probation Department's 2010-11 Adopted Budget does not contain any placeholder adjustments, it does pose a financial risk to the County. The Probation Department's budget remains materially unchanged from the current-year budget (FY 2009-10). Currently, the department is forecasting a $36.8 million deficit in FY 2009-10. Since this budget deficit was not addressed when the FY 2010-11 budget was adopted, it is likely that the deficit would reappear if no action is taken.

We plan to address this deficit with a five-part plan that reduces the deficit by $19.0 million. The primary components of the plan are listed below:

- Attrition Savings from the Hard-Hiring Freeze – $4.5 million
- Centralize the Camp Purchasing Process - $2.0 million
- CAL-EMA Evidence-Based Probation Supervision Program (Transfer 76 employees to revenue offset positions) – $7.5 million
- Increase Revenue Projections – $1.6 million
- Relocation of Reception Center from Nidorf Hall to Challenger Memorial (This plan component would result in layoffs) – $3.4 million

We are still exploring plans to close the remaining $17.8 million budget gap. Those plans would include changing the staffing model at probation camps. These adjustments may require Department of Justice approval and may result in the layoff of County employees.

Cost-Based Reimbursement Clinics (CBRC) - $172.1 million

As reported to your Board on June 3, 2010, DHS received CBRC revenue from the State for hospital and non-hospital based ambulatory care services visits for Medi-Cal patients. The State compensates the County via an interim reimbursement rate. The process requires the County to submit an annual cost report that is audited by the State. The audit results are used to determine if an additional amount is owed to the County. Based upon the audit, the interim reimbursement rate may be adjusted.

State staffing cutbacks and furloughs have delayed CBRC audits and resulted in significant delays in receiving final audit settlement payments. The interim reimbursement rate has not been adjusted since FY 2004-05 and the last completed audit was for FY 2005-06. DHS estimates that the State owes the County $221.5 million for FYs 2006-07 through 2009-10.

This delay in reimbursement payment from the State has not only strained the County cash position, but it will likely require the General Fund to establish a long-term receivable as a backstop so that DHS is able to establish accounts receivables totaling approximately $172.1 million. County fiscal policy does not allow County departments to establish a revenue accrual at year end unless the amount of the accrual is measurable and will be collected within 12 months. This policy was established to ensure the reliability of funding to meet current obligations. To fund this long-term receivable the County would have to tap into current reserves or capital program funding. Once the State paid the County for the CBRC revenues, the long-term receivable could be released by the General Fund.

Property Tax Administrative Fee (PTAF) Lawsuit - $41.3 Million

A lawsuit (Alhambra v. County) brought by 47 cities argues that the County's methodology to apportion property tax administrative fees is inappropriate. The County prevailed at the trial court; however, the cities appealed the case. At this time, we are awaiting a decision from the State Court of Appeals. If the case is reversed at the appeals level, the County is at risk of losing $14.3 million in ongoing PTAF revenues and $27.0 million potential back payments to cities. PTAF revenue is used to offset costs in the Assessor ($12.0 million), Auditor-Controller ($0.8 million), Assessment Appeals Board ($0.2 million), and Treasurer and Tax Collector ($1.3 million).

Unincorporated Areas Storm Water Compliance - $11.7 Million

The 2010-11 Adopted Budget includes $2.2 million in one-time funding for storm water compliance issues for the unincorporated areas. Full-year program costs for this effort have been estimated as high as $13.9 million. Our office, in conjunction with the Department of Public Works, is reevaluating the program with respect to the priority of legal requirements to determine if the funding shortfall can be minimized.

If you have any questions or need additional information, please let me know or you may contact Shelia Shima, Kathy House, Jacqueline White or Sid Kikkawa of my office.

WTF:SK:CA
AB:MM:yf

Attachment

c: Executive Office, Board of Supervisors
   County Counsel

DEPARTMENT OF HEALTH SERVICES
PLACEHOLDER SUPPLEMENT

Healthcare Reform

The implementation of the Patient Protection and Affordable Care Act (healthcare reform) legislation will have a profound effect on DHS over the next several years. Currently, 70 percent of the Department of Health Services (DHS) and Public Private Partnership (PPP) patients are uninsured (515,000 patients). Under healthcare reform, approximately 319,000 of these patients will be eligible for Medi-Cal (250,000 of these patients receive services at DHS facilities and 69,000 receive services only at a PPP clinic) and another 5,000 patients will be eligible for subsidized coverage under an insurance exchange structure. Nearly all of these newly insured patients will likely be assigned to managed care plans. Additional patients who are currently covered by Medi-Cal may also be shifted to managed care plans under the State's proposal for the next 1115 Waiver. Financing streams and incentives are expected to shift accordingly.

DHS envisions continuing to be a major provider of healthcare after healthcare reform is implemented, serving as both a managed care delivery system for 200,000 or more enrolled individuals and a contractor to health plans for hospital-based services (inpatient and high-end diagnostic and specialty care services).

In anticipation of these changes, DHS has been actively planning for a shift to a greater emphasis on primary and specialty care, more strongly integrated services with most patients assigned to medical homes, case management services, etc. Several workgroups have been formed and initiatives are under way to prepare DHS for this shift in emphasis, including planning for how DHS will meet access standards required under managed care.

As the focus of the system transitions to an emphasis on preventive care, medical homes, and integrated service delivery, it will be imperative to maintain existing ambulatory care capacity in order to remain viable.

Budget Shortfall

DHS is projecting a significant budget deficit of $389 million in Fiscal Year (FY) 2010-11. Additionally, due to other pending items included in the DHS Fiscal Outlook that may impact the DHS budget, the deficit could be as high as $429 million. Several potential revenue solutions are being pursued which would help address this deficit:

1. 1115 Waiver on Medicaid payments;

2. Six-month extension of the temporary Federal Matching Assistance Percentage (FMAP); and

3. The Hospital Provider Fee.

Additionally, DHS is committed to organizational and structural changes that will help reduce the deficit. These include changes to the nurse staffing models in both inpatient and outpatient settings, implementation of supply chain and procurement improvements, changing the funding model for the PPP program from fee-for-service to capitation, and evaluating opportunities for hospital centers of excellence. All options include corresponding reductions in administrative functions and costs, and potential reductions in other health services provided to other County departments.

Revenue Risks

There is great concern that the three potential revenue sources that would help close DHS' budget deficit will not materialize. The value to DHS of an enhanced FMAP six-month extension at the current enhanced rate is $33.8 million in FY 10-11, however, Congress has been unable to get the FMAP extension passed. There is a good possibility that the FMAP extension may not be readdressed by Congress until after the November elections, if at all.

The Hospital Provider Fee has still not been approved by the Centers for Medicare and Medicaid Services (CMS). In response to CMS concerns, the model was revised resulting in an overall reduction to the value of the fee. The estimated annual value to DHS would be reduced from $137 million to $115 million. Although the sponsors of the fee believe that CMS will approve this revised fee model, there could be additional changes required by CMS that could further reduce the value. In addition, implementing legislation would need to be enacted before the Legislature adjourns August 31, 2010.

Waiver negotiations are continuing between the State and CMS. It will not be known until the negotiations conclude what additional funding DHS may receive. Until the key components of the Waiver are negotiated, i.e., budget neutrality, the proposed 150% upper payment limit, the coverage initiative, and the delivery improvement pool, the value of the Waiver to DHS cannot be determined. The State expects to complete the negotiations by August 31, 2010, when the current Waiver expires.

Advocacy on behalf of the noted revenue solutions is critical as major service reductions would severely hamper DHS' ability to perform in the role envisioned after healthcare reform is implemented.

Service Impacts

DHS currently provides service to approximately 730,000 patients annually and service to these patients will be impacted should advocacy efforts fail to secure some or all of the noted revenue solutions.

Until the final resolution of each of these potential revenue sources, the impact to DHS cannot be determined. However, DHS believes that if one or more of these revenues fail to materialize, a reduction of up to approximately 128,000 (27 percent) inpatient days and 75,000 (26 percent) emergency room visits would need to be implemented. In addition, a reduction in DHS and PPP ambulatory care visits ranging from 400,000 to 1.8 million visits (14 to 64 percent) would be required. Overall, the current patient population of 730,000 would have to be reduced by between 260,000 to 420,000 patients (36 to 58 percent).

There are also additional costs associated with delaying implementation of service reductions, which will become necessary if the revenue streams fail to materialize. This could increase the amount of services that DHS will need to reduce or eliminate in order to balance its operating budget over a shorter time period during FY 2010-11.