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COUNTY OF LOS ANGELES
DEPARTMENT OF HEALTH SERVICES
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July 29, 2003

TO: Each Supervisor

FROM: Thomas L. Garthwaite, MD
Director and Chief Medical Officer

SUBJECT: HEALTH DEPARTMENT BUDGET COMMITTEE OF THE WHOLE

I am writing to provide an update on the fiscal outlook for the Department of Health Services (DHS) and the status of efforts to implement Scenario III of the DHS system redesign proposal.

DHS Fiscal Outlook

Attachment I provides an update of the Department's Fiscal Outlook since the last Health Department Budget Committee of the Whole on April 1, 2003. The Department's anticipated budget surplus for Fiscal Year 2002-03 has increased from $81.7 million, as presented to your Board on April 1, to the current amount of $185.0 million. The increase of $103.3 million in the operating surplus for the just-ended fiscal year is the result of a number of changes, which are detailed in Attachment II. The number and variety of these changes testify to the inherent difficultly in definitively forecasting the Department's financial status.

When the additional funding detailed in Attachment I is included, the cumulative year-end budget surplus for Fiscal Year 2002-03 increases from the $332.7 million presented to your Board on April 1 to $381.0 million in the July 9 fiscal outlook.

Despite the improved fiscal forecast for Fiscal Year 2002-03, as you can see from Attachment I, the outlook for Fiscal Year 2007-08 has actually worsened. In Fiscal Year 2007-08, the cumulative budget shortfall grows from an estimated $649.4 million, as presented in April, to $767.8 million.

Accordingly, the Department's Fiscal Outlook will continue to evolve over time. It is likely that the forecast will change again in August as more definitive information is available after the County completes its final "book-closing".

Status of Strategic Plan Implementation

Although the Department has achieved much of what was set forth last June in its system redesign proposal, there are a number of goals that have not yet been achieved. Additionally, as you know, the court's actions have prevented the closure of Rancho Los Amigos National Rehabilitation Center and the 100 beds at LAC+USC Medical Center. The fiscal impact of this action is noted in the Department's fiscal outlook, as discussed above.

Psychiatric Services

The Department's strategic plan also recommended the restructuring of psychiatric services at DHS facilities in order to eliminate the estimated $20 million shortfall that exists between the variable cost associated with providing emergency and inpatient psychiatric services and the amount of funding provided by the Department of Mental Health (DMH) to support this care.

DHS has spent considerable time evaluating potential cost savings, efficiencies, and revenue opportunities to address this budget shortfall. Based on this analysis, the most that could be saved through decreasing denied days, increasing Medi-Cal enrollments, and other efficiencies is $3 million per year; clearly far short of the $20 million shortfall that presently exists. The fact is, the problem that exists with regard to the provision of emergency and inpatient psychiatric patients is the same that is facing the entire Department – too little revenue for the number of patients seeking services.

The Department and DMH collaborated to the transfer the operation of Augustus F. Hawkins outpatient psychiatric program at King/Drew Medical Center to DMH, which was effective in May. This shift resulted in an annual savings of $2.4 million to DHS. The Department is in the initial stages of a similar transfer of responsibility for outpatient psychiatric services at LAC+USC Medical Center.

Despite these efforts, the fact remains that the amount of reimbursement provided by DMH falls short of the Department's cost to provide services to indigent psychiatric patients. It is DHS' position that DMH should provide increased funding to support the direct provision of care in DHS facilities or this responsibility should be shifted to

DMH, either through the direct provision of services by DMH staff in DHS facilities or through contracts with private hospitals. I will keep you apprised of the status of the discussions with DMH.

Community Health Plan

The Department has been in extended negotiations with L.A. Care Health Plan regarding the outsourcing of the CHP's administrative functions. Much of these negotiations have centered on the applicability and potential impact of language in L.A. Care's enabling legislation pertaining to the recognition of the County's current Memorandums of Understanding with its labor unions in relation to the contracting of services to L.A. Care. While the parties have reached agreement on the other issues associated with establishing this agreement, the L. A. Care Board of Governors has indicated its strong preference to enter into a Joint Powers Agreement with the County and create a separate entity that would assume the contract for the CHP administrative functions, rather than have L.A. Care perform these activities directly.

As a result of this issue, the negotiations with L.A. Care have stalled. We have negotiation discussions scheduled with LA Care over the next several days to reach a final disposition to this matter and will report to your Board in three weeks with a final recommendation on whether to proceed. Additionally, DHS is exploring other options including putting the identified administrative functions out to competitive bid.

Despite the delay in coming to closure on this initiative, the Department has achieved the $2.3 million in Fiscal Year 2002-03 savings for the Office of Managed Care as a result of overall operational savings.

Related Issues

Finally, I would like to bring to your attention several other issues related to the Department's efforts in Sacramento and Washington, DC, that impact its fiscal outlook.

Managed Care Rate Increase

In November 2002, Governor Davis announced that the State would be seeking a rate increase for public Medi-Cal managed care plans throughout the California. This could be a significant source of on-going revenue for DHS through the CHP. However, these efforts appear stalled as the Federal Center for Medicare and Medicaid Services (CMS) has not approved the rate increase for San Mateo County, which was the first rate increase

submitted by the State. CMS has voiced concerns over the funding mechanism for this rate increase. The Department is working with the CAO, Legislative Strategist, and Washington, DC, advocates to develop a strategy to continue pursuing this rate increase.

DSH Flexibility

The Department submitted its proposal for DSH flexibility to the State, which in turn forwarded it to CMS in May. CMS posed a series of technical questions about the proposal, to which DHS forwarded its responses to the State. It is important to note that the direct financial benefit of this proposal has been substantially lowered as a result of the Court's actions related to the inpatient reductions at Rancho Los Amigos National Rehabilitation Center and LAC+USC Medical Center. The annual value of this proposal is currently estimated to be approximately $9 million in Fiscal Year 2004-05. (Please note: This $9 million figure assumes that Rancho Los Amigos is either closed or not part of DHS in Fiscal Year 2004-05.) The Department continues to pursue this proposal for the strategic importance rooted in its policy goal of removing the financial disincentive associated with moving more procedures and services to the outpatient setting.

FQHC Application

The Department has submitted an application to the Federal Health Resources and Services Administration (HRSA) for a grant under the Public Housing Primary Care Program. HRSA has indicated that a decision on this round of grant applications will be made in mid-August. If the County receives a Public Housing Grant, it also will be conferred FQHC status. Under the 1115 Waiver, set to expire on June 30, 2005, the Department presently receives cost-based reimbursement for services provided to Medi-Cal patients in DHS outpatient settings. With FQHC status, the Department would continue to receive this important source of revenue, which is worth an estimated $100 million annually. I will keep you updated on the status of the grant application.

Please let me know if you have any questions.

TLG:ak

Attachments

c: Chief Administrative Officer
County Counsel
Executive Officer, Board of Supervisors

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES

FISCAL OUTLOOK - 7/9/2003

($ IN MILLIONS BASED ON FY 02-03 SUPPLEMENTAL BUDGET RESOLUTION)

	FISCAL YEARS						
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	TOTAL
Surplus/Deficit as of June 26, 2002		($326.6)	($549.2)	**($709.4)**			
Scenario III Reductions / Use of Designation Funds	*(see note)	267.8	327.8	357.5			
Original Fiscal Stabilization Revenue Request to help fund Scenario III (Not Budgetary Shortfall by FY)	*(see note)	($58.8)	($221.4)	($351.9)	($387.3) [a]	($423.7) [a]	($1,443.1)
Forecast Update	$185.0	$58.8	($122.2)	($6.3) [b]	($114.2)	($151.8)	($335.7) [c]
Increasing LAC + USC Medical Center Equipment ACO Fund in FY 02-03	**($55.0)**	**($55.0)**	**$ -**	**$ -**	**$ -**	**$ -**	**($55.0)** [m]
Current Surplus/(Shortfall) without Additional Funding	**$130.0** [d]	**($55.0)**	**($343.6)**	**($358.2)**	**($501.5)**	**($575.5)**	**($1,833.8)** [m]
Additional Funding							
Measure B	-	$146.0 [e]	$146.0	$146.0	$146.0	$146.0	$730.0
Acceleration of Rancho Alternative Governance or Closure	-	58.6	-	-	-	-	58.6
Current law DSH redistribution if Rancho and High Desert Closed	-	-	6.7	6.7	6.9	7.1	27.4
State/Federal Transition Agreement							
SPCP/UPL (SB 1255)	80.0	70.0 [f]	50.0	? [g]	? [g]	? [g]	200.0
Outpatient Lawsuit Settlement - Federal Share	50.0	-	-	-	-	-	50.0
Subtotal Additional Funds	$130.0	$274.6	$202.7	$152.7	$152.9	$153.1	$1,066.0
Annual Surplus/(Shortfall) [g],[h]	$260.0	$219.6	($140.9)	($205.5)	($348.6)	($422.4)	($422.4)
Beginning Current Fiscal Year Fund Balance	$121.0 [i]	$130.0 [i]	$349.6	$208.7	$3.2	($345.4)	($345.4)
Cumulative Year End Fund Balance/(Shortfall) [g],[h]	**$381.0**	**$349.6**	**$208.7**	**$3.2**	**($345.4)**	**($767.8)**	**($767.8)**
Impact of June 30, 2003 Rancho closure (207 beds) deferment to July 1, 2004	**$ -**	**($58.6)**	**$ -**	**$ -**	**$ -**	**$ -**	**($58.6)**
Impact to Beginning Current Fiscal Year Fund Balance	**-**	**-**	**(58.6)**	**(58.6)**	**(58.6)**	**(58.6)**	**N/A**
Adjusted Cumulative Year End Fund Balance/(Shortfall)	**$381.0**	**$291.0**	**$150.1**	**($55.4)**	**($404.0)**	**($826.4)**	**($826.4)**
Impact of LAC+USC Medical Center100 Acute Bed Reduction deferment to July 1, 2004 [k]	**$ -**	**($16.1)**	**$ -**	**$2.0**	**$ -**	**$ -**	**($14.1)**
Impact to Beginning Current Fiscal Year Fund Balance	**-**	**-**	**(16.1)**	**(16.1)**	**(14.1)**	**(14.1)**	**N/A**
Adjusted Cumulative Year End Fund Balance/(Shortfall)	**$381.0**	**$274.9**	**$134.0**	**($69.5)**	**($418.1)**	**($840.5)**	**($840.5)**

Notes:

* The $56.8 million of FY 02-03 service cuts are efficiencies already in the FY 02-03 Budget base at this point in time and; therefore, doesn't appear on this schedule.

(a) These amounts are extrapolations from the original 90% Medicaid block grant request used to determine the fiscal stabilization revenues for the June 2002 DHS Strategic Plan, which only extended through FY 05-06.

(b) Reflects release of $96.1 million trust fund reserve.

(c) Of this amount, $266.0 million is the difference between FY's 06-07 and 07-08 original fiscal year stabilization revenue request (see note (a)) and our actual current operating deficit forecast for these fiscal years.

(d) Includes $50.0 million in to be reserved for the New LAC+USC Medical Center equipment ACO Fund.

(e) Per FY 03-04 Board Adopted Budget.

(f) Up to $20M of the FY 03-04 SPCP-UPL dollars may require DSH flexibility to be retained.

(g) Per State DHS, CMS may "re-base" the Medicaid Upper Payment Limit **(UPL)** beginning FY 05-06. The impact on County DHS of this potential action is estimated to result in reductions of Medicaid revenues from FY 02-03 levels. These estimated reductions totaling **$374.6M,** are **$97.6M, $124.9M,** and **$152.1M,** for FYs 05-06, 06-07 and 07-08, respectively, and are not reflected in the above. When the UPL is fully implemented, the value could be as high as $198M. There is also a non-hospital clinic UPL, which the State has yet to compute, that could further reduce County DHS' Medicaid revenues. Further, the full realizability of the Scenario III savings, future State and Federal Budgets, accelerating healthcare inflation, and the President's Medicaid Relief Proposal create significant uncertainty regarding the Department's Fiscal Outlook.

(h) These amounts are potentially improved by managed care supplement and DSH flexibility proposals currently being worked on with the State and Federal governments.

(i) FY 02-03 Supplemental Budget Resolution includes $245.9M of prior year's ending fund balance, leaving a residual of $121.0M.

(k) Defer to July 1, 2004 LAC+USC Medical center 100 bed reduction. Reduce 100 beds for FY 04-05 and future years. Due to delay impact of DSH we will receive $2.0 M in FY 05-06.

(l) Please note that $251.0 million of the $381.0 million is already included in the "Forecast Update" line for the Fiscal Year 2003-04 forecast to consistently show where the Department would be without the "Additional Funding" items.

(m) Represents the cumulative total change starting with the first year a net surplus is not realized on the "Current Surplus/(Shortfall) without Additional Funding" line (FY 03/04).

M:\Excel\Projects\Scorecard\FY02-03\-13- July 2003\July 9 2003\[OutlookSummaryc.xls]6.6.03

Attachment I

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES
EXPLANATION OF FORECAST UPDATE
APRIL 1, 2003 TO JULY 9, 2003
($ IN MILLIONS)

					Post Waiver			
		FY 02-03	FY 03-04	FY 04-05	FY 05-06	FY 06-07	FY 07-08	TOTAL [1]
	SURPLUS / (DEFICIT) as of April 1, 2003	$ 81.7	$ (87.9)	$ (310.1)	$ (309.6)	$ (446.4)	$ (531.4)	$ (1,685.4)
1	Reduce LACERA Credit	-	(5.7)	(14.3)	(21.4)	(28.9)	(28.9)	(99.2)
2	Estimated Salary COLA & Variable EBs Adj.	-	(9.1)	(13.0)	(17.4)	(21.8)	(26.3)	(87.6)
3	Fixed Employee Benefits	-	(1.6)	0.6	3.7	8.2	14.4	25.3
4	Services and Supplies COLA Update	-	-	(1.7)	(3.5)	(5.3)	(7.1)	(17.6)
5	Pharmacy Costs	-	0.8	0.8	0.8	0.8	0.8	4.0
6	CRM Implementation	13.6	0.5	0.5	0.6	0.4	0.5	2.5
7	Other County Departments	-	(1.2)	(1.2)	(1.2)	(1.3)	(1.4)	(6.3)
8	Interest Revenue/Expense	1.0	-	-	-	-	-	-
9	Medical Malpractice	6.9	(1.0)	(0.4)	0.2	0.8	1.4	1.0
10	Capital Projects (Includes SB 1953 Planning & Evaluation)	-	(4.0)	-	-	-	-	(4.0)
11	Prior Years' PFSW Surplus	0.7	-	-	-	-	-	-
12	Prior-Year Settlements	(0.9)	-	-	-	-	-	-
13	SB 855 BIPA 2000/DSH COLA	(21.0)	(8.3)	(3.8)	4.6	12.1	19.4	24.0
14	Federal Medicare Changes (BIPA 2000 and COLA)	-	-	(12.4)	(12.4)	(12.4)	(12.3)	(49.5)
15	Scenario III - Operation reductions	-	(6.1)	(14.7)	(25.2)	(29.5)	(34.4)	(109.9)
16	CHIP	(4.8)	(19.1)	(19.1)	(19.1)	(19.1)	(19.1)	(95.5)
17	Vehicle License Fees	6.5	(0.2)	(0.4)	(0.6)	(0.8)	(1.0)	(3.0)
18	Current/Prior Year Operations	67.4	15.8	15.8	15.8	15.8	15.8	79.0
19	I&R Maximum 80 hour Workweek	-	(7.4)	(7.4)	(7.4)	(7.4)	(7.4)	(37.0)
20	Employee Benefits	(1.1)	-	-	-	-	-	-
21	CBRC	35.0	32.0	33.1	34.2	35.3	36.5	171.1
22	Bioterrorism Costs (Measure B)	-	(6.0)	(6.0)	(6.0)	(6.0)	(6.0)	(30.0)
23	QueensCare - Rancho	-	2.4	-	-	-	-	2.4
24	RLANRC Closure	-	-	0.4	2.6	1.4	8.0	12.4
25	General County Overhead Adjustment	-	3.1	3.1	3.1	3.1	3.1	15.5
26	Change in Designation Used / (Not Used) to Balance Budget	-	103.0 *	6.6	-	(0.5)	-	109.1
	Net SURPLUS / (DEFICIT) as of July 9, 2003	$ 185.0	$ -	$ (343.6)	$ (358.2)	$ (501.5)	$ (575.4)	$ (1,778.7)
		-	-	-	-			
27	New LAC+USC ACO	(55.0)	(55.0)	-	-			$ (55.0)
		-	-	-	-			
	Adjusted SURPLUS / (DEFICIT) as of July 9, 2003	130.0	(55.0)	(343.6)	(358.2)	(501.5)	(575.4)	(1,833.7)

* This amount is supplanted by Measure B funds in the FY 2003-04 budget. It does not equal the $146 million Measure B funds included in the FY 2003-04 budget, because the Fiscal Outlook reflects more current forecast information than the adopted FY 2003-04 budget. For example, CBRC revenue is $36 million higher in this forecast than in the FY 2003-04 budget.

Attachment II

(1) Represents the cumulative total change starting with the first year a net surplus is not realized on the" Adjusted SURPLUS/(DEFICIT) as of July 9, 2003" line (FY 03-04).