



BOARD OF SUPERVISORS
AGENDA LETTER

Agenda Number:

Clerk of the Board of Supervisors
105 E. Anapamu Street, Suite 407
Santa Barbara, CA 93101
(805) 568-2240

Department Name: ADMHS
Department No.: 043
For Agenda Of: June 23, 2015
Placement: Departmental
Estimated Time: 45 minutes
Continued Item: No
If Yes, date from:
Vote Required: Majority

TO: Board of Supervisors

FROM: Department Alice Gleghorn, PhD, Director
Director(s) Alcohol, Drug, and Mental Health Services, (805) 681-5233
Contact Info: Christie Boyer, Associate Director of Finance, (805) 681-5231

SUBJECT: ADMHS Liabilities Update

County Counsel Concurrence

As to form: Yes

Other Concurrence: N/A

As to form: No

Auditor-Controller Concurrence

As to form: Yes

Recommended Actions:

That the Board of Supervisors:

- A. Receive and file the report updating known and estimated liabilities of the Alcohol, Drug, and Mental Health Services Department (ADMHS).
- B. Approve Budget Revision Requests (BRRs # 0003925, 0004012) to increase appropriations of \$4,939,770 in the ADMHS Mental Health Fund for the FY 2007/08 -2008/09 Audits, as funded by positive audit settlements from the State (\$175,749), Deferred Revenue (\$1,005,628) and an Operating Transfer from the Audit Exception Reserve (\$3,758,393). This funds the net liabilities for the FY 2007/08-2008/09 audits amounting to \$4,764,021, which consists of total payments due the State of \$4,939,770 less positive settlements due the County of \$175,749.
- C. Approve Budget Revision Request (BRR # 0004013) to increase appropriations of \$1,109,551 in the ADMHS Mental Health Services Fund for the FY 2009/10- 2010/11 estimated audit settlements (nominal fee provider) and FY 2011/12 estimated cost report settlement funded by an Operating Transfer from the Audit Exception Reserve. Operating transfer to occur once actual invoices are received and approved.
- D. Return in February 2016 to provide an update on changes in liabilities to prepare for the FY 2016/17 budget.
- E. Determine that these activities are exempt from California Environmental Quality Act review per CEQA Guideline Section 15378(b)(4), since the recommended actions are government fiscal

activities which do not involve commitment to any specific project which may result in a potentially significant physical impact on the environment.

Summary Text:

On December 10, 2013, ADMHS presented information to the Board of Supervisors regarding the Department's known and projected financial liabilities of \$9.5 million, as of September 30, 2013. The liabilities in the 2013 update primarily resulted from self-disclosed activities, prior year cost report settlements (FY 2009/10-2010/11), audit settlements (FY 2005/06-2006/07), and Multi-Agency Integrated System of Care (MISC/CEC) partner agency disallowances. Generally Accepted Accounting Principles (GAAP) require that liabilities be recorded in the financial statements when they are probable and measurable. Probable is generally interpreted as "likely to occur" and is not limited to a certain percentage threshold. As part of FY 2014/15 fiscal year end close, the Auditor-Controller identified liabilities that satisfy GAAP recognition criteria and therefore must be recorded in the County's financial statements. When a liability is recorded the corresponding expenditure is also recorded which requires the liability to be funded (in either the Mental Health Fund or the General Fund) at the time of recognition. Some of ADMHS' liabilities are current (payable within one year) and some are long term (payable beyond one year); however, all must be funded in the year that the initial liability is recognized. This Board Letter provides an update on ADMHS' extinguished, known and estimated liabilities as of May 31, 2015 that must be recorded and funded for fiscal year end close.

Background:

Mental Health has many external funding sources that account for 97% of revenue received, and as a result has high audit exposure. Each source has specific guidelines and restrictions and is audited separately. Funding sources often have both financial and programmatic audits. The Department is often challenged with lengthy delays to receive funding, as in the case of recent SB 90 unfunded mandate payments, which were received more than a decade after the services were provided, as well as delays in the audit settlement and appeals process. It takes an average of 7.3 years for ADMHS to reach full resolution on cost report audit settlements through the appeal process. Audits must be paid up front although the vast majority of State findings are appealed. The Department's largest liability exposure relates to cost report settlements and audits for Federal Financial Participation (FFP). The remaining liabilities on the balance sheet as of May 31, 2015 all relate to cost report settlements and audits for prior periods.

The Department had liabilities amounting to \$19.4M as reported in May 2012. Outstanding liabilities were reduced to \$9.6M in the December 2013 update. Established funding sources as of December 2013 were \$8.9M and the Department was able to identify \$0.7M in additional funding sources to address the \$9.6M in liabilities. The following table represents changes in the liabilities from September 30, 2013 through May 31, 2015, with information on the funding status. These changes are due to adjustments in estimated amounts as settlements are finalized, liabilities are extinguished (paid), and new/updated liabilities resulting from the completion of audits and cost reports as well as audit risks becoming audit certainties.

Known and Estimated ADMHS Liabilities (In Millions)	As of September 2013	Adjustments	Extinguished/ Paid	Updated	As of May 2015	Funded	Unfunded*
Self Disclosures	\$0.8	\$0.0	-\$0.8	\$0.0	\$0.0	\$0.0	\$0.0
Prior Year Audits (FY 2005/06-2010/11)	\$1.3	-\$0.3	-\$1.0	\$3.7	\$3.7	\$1.4	\$2.3
Prior Year Cost Report Settlements (FY 2009/10-2011/12)	\$2.2	-\$0.1	-\$0.5	\$0.4	\$2.0	\$1.6	\$0.4
Other Settlements	\$0.4	\$0.0	-\$0.4	\$0.0	\$0.0	\$0.0	\$0.0
Total ADMHS Liabilities	\$4.7	-\$0.4	-\$2.7	\$4.1	\$5.7	\$3.0	\$2.7

Partner Agency Liabilities (millions)

Multi-agency Integrated System of Care (MISC/CEC)	\$4.8	-\$1.0	-\$2.0	\$0.0	\$1.8	\$1.8	\$0.0
Total ADMHS and Partner Agency Liabilities	\$9.5	-\$1.4	-\$4.7	\$4.1	\$7.5	\$4.8	\$2.7

*During the June 2015 Budget Hearings, the Board authorized the appropriation of unanticipated SB 90 funds of \$3.7M into the Audit Exception Fund Balance.

After updating the remaining liabilities based on actual finalized amounts (-\$1.4 million), extinguishing \$4.7 million in liabilities, and adding new liabilities (\$4.1 million), ADMHS has known and estimated liabilities totaling \$7.5 million as of May 2015. The predominant change between the 2013 update and the present update is that the \$2.7 million nominal fee provider exposure reported previously is now probable and must now be recorded and funded as a liability. This will be discussed in detail in the "Updated Liabilities" section.

Adjusted Liabilities:

\$1.4 million in liabilities were updated based on new information and actual finalized amounts, including:

- The FY 2005/06 ADP cost report audit amounting to \$0.1 million was successfully appealed and is no longer owed by the County.
- The \$0.2 million EPSDT settlement for FY 2008/09 is a remote liability and it is unlikely that it will be collected.
- The FY 2009/10 Cost Report settlement was finalized at \$0.1 million less than previously anticipated.
- The CEC/MISC portion of the 2007/08 and 2008/09 audits was finalized at \$1 million less than previously estimated. The County is appealing this assessment and will continue to vigorously

defend its position that CEC/MISC was a Medi-Cal reimbursable program. It is unknown at this time how successful the County will be in this effort since none of the prior appeals that were completed had a judicial ruling on the issue.

Extinguished/Paid Liabilities:

\$4.7 million in liabilities were paid or intercepted by the State, including:

- The remaining balance of self disclosed liabilities amounting to \$0.8 million.
- Prior audits of \$1 million including the remaining \$0.4 million owed for the 2006/07 Cost Report Audit and \$0.6 million in SB 90 mandate reimbursement funds that were unearned.
- The 2009/10 cost report settlement of \$0.5M was paid.
- Other settlements of \$0.4 million were extinguished including amounts related to the PHF inpatient chart review and Medicare disallowances.
- Partner agency liabilities of \$2 million were paid including \$1.9 million for the CEC/MISC portion of the FY 2006/07 audit and \$0.1 million in legal fees.

Updated Liabilities:

Below are ADMHS liabilities amounting to \$4.1 million that were not accounted for in the December 2013 Board Letter, since they were either not known at the time, there were no estimates available, or they didn't meet the financial criteria necessary for liability recording.

Updated Liabilities (In Millions)	Status	Amount
Prior Year Audits:		
FY 2007/08 Audit (Net of CEC/MISC)	Actual	\$ 0.3
FY 2008/09 Audit (Net of CEC/MISC)	Actual	\$ 2.7
FY 2009/10 - 2010/11 Audits (Nominal Fee Provider)	Estimated	\$ 0.7
		\$ 3.7
Prior Year Cost Report Settlements:		
FY 2011/12 Cost Report Settlement	Estimated	\$ 0.4
		\$ 4.1
Total Updated Liabilities		\$ 4.1

The updated liabilities are primarily a result of audit adjustments related to nominal fee provider as detailed on the following page. ADMHS has improved its processes to reduce the magnitude of cost report settlements. Processes and staff were in place by FY 2009/10 and, as demonstrated in the table below, it is anticipated that cost report settlements in future periods will not be as large as in prior years. A positive settlement is expected in FY 2012/13.

	ACTUALS					ESTIMATED		
	FY05/06	FY06/07	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13
Cost Report Settlements (In Millions)	\$ 1.5	\$ 2.5	\$ 3.1	\$ 0.9	\$ 0.5	\$ 0.8	\$ 0.4	\$ (0.3)

Cost report settlements are a result of differences in the rates used for interim/provisional claiming and the final rates calculated in the cost report. Some degree of cost settlement should be expected and budgeted each year due to slight variability in costs and service levels as expected in the normal course of business.

In addition, although the Department has implemented controls and processes, audit results can vary greatly each year and are often contingent upon the State's interpretation of regulations. The administrative appeal judges ruling on the auditor's interpretation of those regulations are employed by DHCS. ADMHS and other counties face challenging audits due to DHCS auditors' interpretation of law, audit protocol, and pervasive errors in audit reports.

In the FY 2013-15 Recommended Budget Policies, additional funding of the Audit Exception Reserve was recommended for such future State settlements and audits and a strategy of adding \$1 million per year to the reserve was adopted with the Fiscal Years 2014-16 Budget Development Policies. The Department is recommending that these policies be implemented.

Nominal Fee Provider Exposure

The FY 2007/08 and FY 2008/09 audits both included adjustments to remove the County's nominal fee provider exemption. ADMHS is reimbursed at the lower of (1) its actual costs; or (2) its customary charges if it does not qualify as a nominal fee provider. If it qualifies, the lower of cost or charge principle does not apply and the customary charge, which is nominal in nature, is removed as a reimbursement option. Denial of ADMHS's qualification as a nominal fee provider resulted in a significant liability as the Department had not updated its published charges from 2000-2009, making its customary charges less than its costs. As reported in the December 2013 liability update, the County estimated the nominal fee liability exposure at approximately \$2.7 million for the period of FY 2006/07 – FY 2010/11. Two million dollars of that amount is included in the liability amounts for the FY 2007/08-2008/09 audits and the remaining exposure of \$0.7M for FY 2009/10 – 2010/11 is considered a new/updated liability. ADMHS believes that there is appropriate documentation to support the nominal fee provider exemption and has appealed the State's audit adjustments for these years. Although these adjustments are under appeal, the Auditor-Controller is recommending liabilities for the future periods amounting to \$0.7 million be recorded in the County's financial statements since it is "probable" that the nominal fee provider exemption will be removed in the audits and the amount is measurable. The Department does not anticipate any exposure for nominal fee provider beyond FY 2010/11 as published charges have been updated annually since 2010.

Funding Sources for Current Liabilities:

\$4.8 million has been set aside to fund ADMHS' currently known liabilities and \$2.7 million in liabilities did not initially have an approved funding source. During the June 2015 Budget Hearings, the Board of Supervisors authorized an increase to the Audit Exception Fund Balance of \$3.7 million which will provide the necessary funding and establish an additional \$1.0 million reserve for future audit settlements. The \$2.7 million is comprised of the following:

1. FY 2008/09 Audit (Final): \$1.6 million of the \$3 million audit is unfunded
2. FY 2009/10 & FY 2010/11 Nominal Fee Provider Liabilities (Estimated): \$0.7 million
3. FY 2011/12 Cost Report Settlement (Estimated): \$0.4 million

ADMHS therefore requests an increase in the Mental Health Fund's operating budget in the amount of \$6.1 million to be funded by the use of deferred revenue (\$1 million), positive audit settlements (\$.2M), and a transfer from the Audit Exception Reserve for amounts currently due (\$3.8 million). \$1.1M will

remain in the Audit Exception Reserve for estimated settlements not currently due. As mentioned above, the CEO recommended that a portion of prior year's unanticipated SB 90 funds be transferred to the Audit Exception Reserve in the FY 2014/15 budget and this was approved by the Board at the June 10 hearing.

Looking Forward:

The Department anticipates that future liabilities related to cost report settlements will be minimal (1-2% of budget) due to improved processes including:

- Quarterly rate reviews of contractor costs.
- Aligning interim provisional claiming and cost report processes.

Additional controls were also implemented to reduce future audit settlements including:

- Employed a CPA to oversee cost reports, audits, and appeals.
- Held biweekly accounting meetings with the Auditor-Controller and CEO.
- Attended statewide meetings to identify risks, themes, and resolutions impacting local county mental health agencies.
- Consulted with County Counsel, other counties, and CBHDA on unadjudicated items.
- Hired consultants to prepare financial reports in specialized areas.
- Developed an internal reporting system unique to Santa Barbara County, to track and report on client services.
- Adjusted cost reports to remove agreed upon errors identified in the audits.

The Department anticipates that future audit settlements will be less; however this is largely contingent on State audit procedures and interpretations. All counties are currently facing challenging audits due to State interpretations of law and audit protocol.

ADMHS will return in February 2016 to provide an update on changes in liabilities.

Performance Measure:

Fiscal and Facilities Impacts:

Budgeted: No The above recommendations have the following fiscal impacts: The above actions will require additional funding of \$2.7 million.

2. There will be an Audit Exception Reserve account balance of \$2.1 million to be used for future cost report and audit settlements, including any potential liabilities from the nominal fee issue described above for FY's 2009/10 – 2010/11.
3. The balance of deferred revenue on the Mental Health Balance Sheet will be \$0 after using \$1 million to fund outstanding liabilities.

Fiscal Analysis:

Discussed above

Key Contract Risks:

There are no contract changes or risks associated with this action.

Staffing Impacts:

Legal Positions:

FTEs:

There are no staffing impacts associated with this action.

Special Instructions:

None

Attachments:

ADMHS Liabilities Presentation

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cc:

Robert Geis, Auditor-Controller