HEALTH & SOCIAL SERVICES

LAO

65 YEARS OF SERVICE

2007-08 Analysis

MAJOR ISSUES

Health and Social Services

☑ **CalWORKs Sanction and Time Limit Proposals Not Necessary to Avoid Federal Penalties**

- In order to increase work participation to avoid federal penalties, the Governor proposes new time limits and sanctions on children whose parents cannot or will not comply with CalWORKs work participation requirements. However, under the budget's own assumptions, California will meet federal participation requirements by FFY 2008. Thus, these policy changes are not needed to avoid federal penalties, and we recommend their rejection. We offer an alternative to the Governor's full-family sanction proposal (see pages C-124 and C-132).

☑ **Enhancing In-Home Supportive Services (IHSS) Program Integrity**

- IHSS recipients are assigned hours of service by their social worker. Because there is no explicit prohibition on reallocating hours across tasks or weeks, recipients may believe that the hours they receive are flexible and treat them as a block grant. We make several recommendations that clarify IHSS program expectations and increase the likelihood that IHSS recipients will receive the care they need to avoid nursing home placement (see page C-142).

☑ **Redirect SSI/SSP COLA Funds to CalWORKs**

- For 2007-08, the budget proposes to provide COLAs for SSI/SSP recipients whose grants are currently above the federal poverty guideline, while it suspends COLAs for CalWORKs families whose grants are currently below the guideline. To more effectively utilize General Fund resources to reduce poverty, we recommend redirecting $124 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA (see page C-19).

☑

Governor's Health Care Reform Proposal Has Both Merit and Risks

- The Governor has announced a comprehensive health care reform proposal aimed at ensuring that all Californians have health care coverage. While not reflected in the budget plan, the proposal is an important starting point for discussions on health care expansion in California, although it contains a number of fiscal risks and uncertainties. (See "Part V" of *The 2007-08 Budget: Perspectives and Issues.*)

☑

Short Term Savings in Proposition 36 Could Result in Long Term Costs

- We review the administration's proposal for a net reduction of $25 million for Proposition 36 programs, discuss why this reduction might eventually result in increased prison costs, and recommend redirecting funds in order to support Proposition 36 programs at their current level (see page C-29).

☑

Department of Public Health Reorganization: Cost Neutrality Uncertain

- The budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz) that creates a new Department of Public Health (DPH) and Department of Health Care Services (DHCS) from the existing Department of Health Services. We recommend the Legislature require the administration provide additional information to ensure cost neutrality as required under Chapter 241 (see page C-63).

☑

Data Match Increases Veterans' Access to Benefits and Reduces State Costs

- We estimate a shift of veterans from Medi-Cal to the federal Veterans Administration (V.A.) health system could save the state up to $250 million annually, while providing those veterans with quality health care services. We recommend that California join 42 other states participating in a federal data matching process that would facilitate achieving these goals (see page C-42).

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Health and Social Services

OVERVIEW

Health and Social Services

Compared to the prior year, proposed General Fund spending for health and social services programs in 2007-08 remains essentially unchanged at approximately $29.9 billion (an increase of 0.2 percent). This tiny increase in spending is due primarily to a variety of caseload and cost increases that are offset by reductions in the California Work Opportunity and Responsibility to Kids (CalWORKs) grant payments for children, a shift of Proposition 98 funds for CalWORKs child care, and federal penalty relief in child support automation. The Governor's proposed health care reform is not reflected in the budget plan.

EXPENDITURE PROPOSAL AND TRENDS

Budget Year. The budget proposes General Fund expenditures of $29.9 billion for health and social services programs in 2007-08, which is 29 percent of total proposed General Fund expenditures. Figure 1 (see next page) shows health and social services spending from 2000-01 through 2007-08. The proposed General Fund budget for 2007-08 is $55 million (0.2 percent) above estimated spending for 2006-07. Special funds spending for health and social services is proposed to increase by $1.4 billion (21 percent) to about $8.1 billion. Most of this special funds growth is due to an increase in revenues dedicated by Proposition 63 for mental health services.

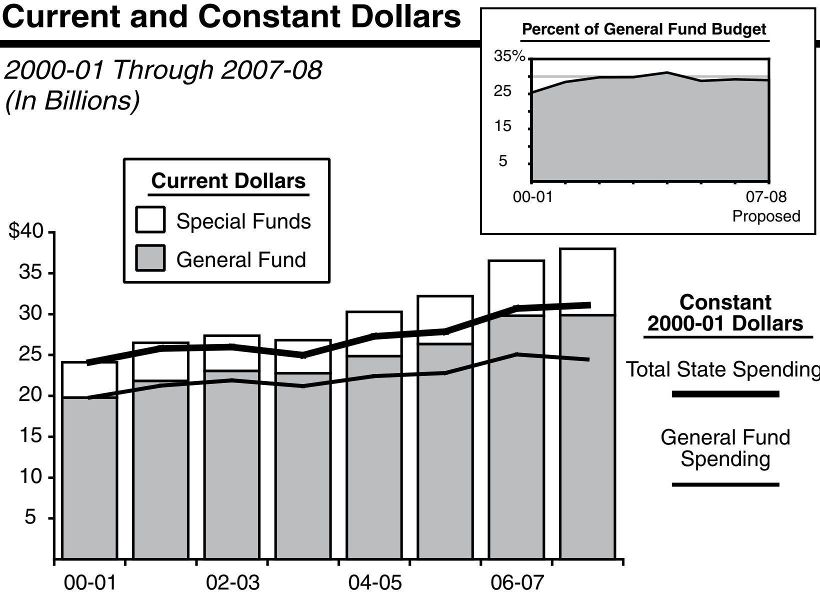
Historical Trends. Figure 1 shows that General Fund expenditures (current dollars) for health and social services programs are projected to increase by $10.1 billion, or 51 percent, from 2000-01 through 2007-08. This represents an average annual increase of 6 percent. Similarly, combined General Fund and special funds expenditures are projected to increase by about $13.9 billion (58 percent) from 2000-01 through 2007-08, an average annual growth rate of 6.7 percent.

Adjusting for Inflation. Figure 1 also displays the spending for these programs adjusted for inflation (constant dollars). On this basis, General Fund expenditures are estimated to increase by 23 percent from 2000-01

Figure 1

Health and Social Services Expenditures Current and Constant Dollars

2000-01 Through 2007-08 (In Billions)



through 2007-08, an average annual rate of 3 percent. Compared to the prior year, General Fund spending for 2007-08 is proposed to decline by 2.4 percent in constant dollars. Combined General Fund and special funds expenditures are estimated to increase by 29 percent during this same period, an average annual increase of 3.7 percent.

CASELOAD TRENDS

Caseload trends are one important factor driving health and social services expenditures. Figures 2 and 3 illustrate the budget's projected caseload trends for the largest health and social services programs. Figure 2 shows Medi-Cal caseload trends over the last decade, divided into four groups: (1) families and children, (2) refugees and undocumented persons, (3) disabled beneficiaries, and (4) aged persons (who are primarily recipients of Supplemental Security Income/State Supplementary Program [SSI/SSP]). Figure 3 shows the caseloads for CalWORKs and SSI/SSP.

Medi-Cal Caseload. The Governor's budget plan assumes that the current year caseload for Medi-Cal will fall short by almost 71,000 individuals, or 1 percent of the number assumed in the *2006-07 Budget Act.*

Figure 2

Budget Forecasts Continued Growth in Medi-Cal Caseloads

1997-98 Through 2007-08 (In Millions)

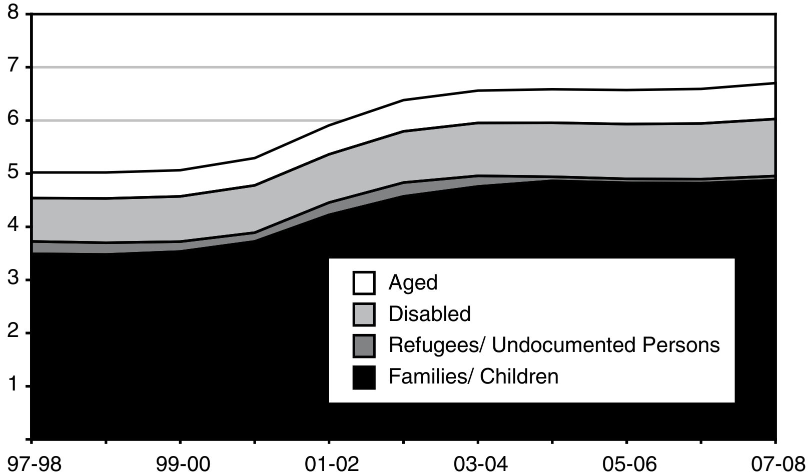
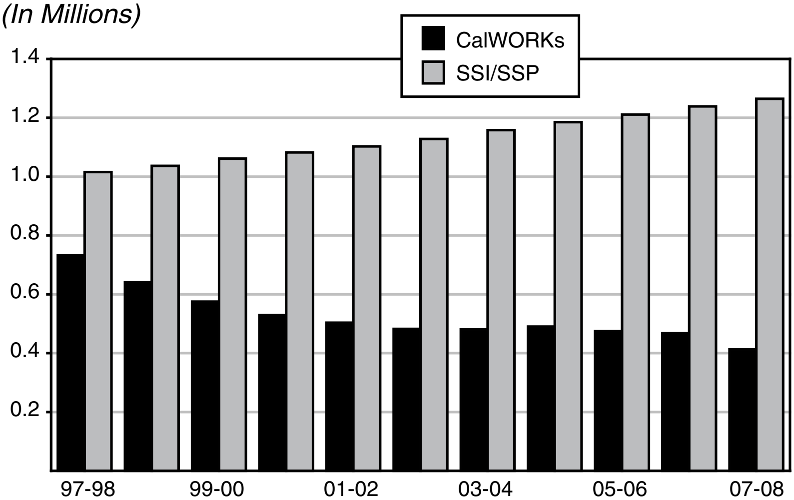


Figure 3

CalWORKs Caseload to Decline SSI/SSP Caseloads Increasing Slightly

1997-98 Through 2007-08 (In Millions)



As shown in Figure 2, the Governor's budget plan assumes that a modest increase in caseload will occur during the budget year in the Medi-Cal Program. Specifically, the overall caseload is expected to increase by about 107,000 average monthly eligibles (1.6 percent) to a total of about 6.7 million in 2007-08. This would be a higher pace of growth than the minimal growth projected for 2006-07. The caseload projections for 2007-08 take into account Medi-Cal enrollment procedure changes mandated by Chapter 328, Statutes of 2006 (SB 437, Escutia), to implement a two-county pilot program allowing for self-certification of income and assets. This change is expected to result in a caseload increase of almost 16,500 individuals in 2007-08. The Medi-Cal budget proposal also reflects growth in several eligibility categories, primarily medically needy beneficiaries and welfare families.

Healthy Families Program (HFP) Caseload. The Governor's budget plan assumes that the current-year enrollment for HFP will fall short by about 17,000 children compared to the number assumed in the *2006-07 Budget Act*. However, the spending plan further assumes that the program caseload will increase by about 74,000 children, or almost 9 percent, during the budget year. Of this increase, about 13,000 children are forecast to be due to the implementation of SB 437 which will allow the self-certification of income at annual eligibility review beginning January 1, 2008. The budget proposal estimates that a total of almost 916,000 children will be enrolled in HFP as of June 2008.

The CalWORKs and SSI/SSP Caseloads. Figure 3 shows the caseload trend for CalWORKs and SSI/SSP. The SSI/SSP cases are reported as individual persons, while CalWORKs cases are primarily families. For 2007-08, the budget assumes that CalWORKs will serve just over 1 million individuals.

As Figure 3 shows, the CalWORKs caseload declined steadily from 1997-98, essentially bottoming out in 2003-04. This period of substantial CalWORKs caseload decline was due to various factors, including the improving economy, lower birth rates for young women, a decline in legal immigration to California, and, since 1999-00, the impact of CalWORKs program interventions (including additional employment services). In 2004-05 the caseload experienced its first year-over-year increase (about 2 percent) in almost a decade. In 2005-06 the caseload resumed its decline, about 3 percent. For 2006-07 the budget projects a modest decline of 1.5 percent. In 2007-08, the caseload is projected to drop by about 12 percent mostly due to policy proposals which (1) increase sanctions on families where the parents do not meet program participation requirements and (2) impose new time limits on children.

The SSI/SSP caseload can be divided into two major components—the aged and the disabled. The aged caseload generally increases in proportion to increases in the eligible population—age 65 or older (increasing at about 1.5 percent per year). This component accounts for about 30 percent of the total caseload. The larger component—the disabled caseload—typically increases by just under 3 percent per year. Since 1998, the overall caseload has been growing moderately, between 2 percent and 2.5 percent each year. For 2006-07 and 2007-08, the budget forecasts caseload growth of 2.3 percent and 2.1 percent respectively.

SPENDING BY MAJOR PROGRAM

Figure 4 (see next page) shows expenditures for the major health and social services programs in 2005-06 and 2006-07, and as proposed for 2007-08. As shown in the figure, three major benefit payment programs—Medi-Cal, CalWORKs, and SSI/SSP—account for a large share (about 66 percent) of total spending in the health and social services area.

As Figure 4 shows, General Fund spending is proposed to increase in all major health programs except for community mental health services. The decrease in community mental health services spending between 2006-07 and 2007-08 is due primarily to a prior-year deficiency of $243 million General Fund in the Early and Periodic Screening Diagnosis and Treatment program that significantly increases the current-year funding request.

In regard to major social services programs, General Fund support will increase for SSI/SSP (9.9 percent) and In-Home Supportive Services (1.9 percent). Conversely, the budget proposes to reduce General Fund support for Child Welfare Services/Foster Care (-6 percent), Child Support Services (-48 percent), and CalWORKs (-34 percent). Overall, the budget proposes to decrease General Fund spending on social services by about $560 million (5.8 percent) compared to 2006-07. Most of this year-over-year savings is in CalWORKs and child support, as discussed below.

In contrast, most health programs would be funded in a way that is consistent with existing eligibility, benefits, and other requirements, and recent legislation expanding Medi-Cal and HFP caseloads.

Figure 4

Major Health and Social Services Program Budget Summary[a]

(Dollars in Millions)

	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Change From 2006-07 Amount	Change From 2006-07 Percent
Medi-Cal					
General Fund	$12,362.9	$13,648.9	$14,656.7	$979.8	7.2%
All funds	31,463.6	35,415.5	37,341.1	1,914.2	5.4
CalWORKs					
General Fund	$1,962.8	$2,014.2	$1,323.6	-$690.6	-34.3%
All funds	N/A	5,118.4	5,006.7	-111.7	-2.2
Foster Care/Child Welfare Services					
General Fund	N/A	$1,245.6	$1,171.2	-$74.4	-6.0%
All funds	N/A	4,052.0	4,076.3	24.3	0.6
SSI/SSP					
General Fund	$3,427.3	$3,542.8	$3,892.9	$350.1	9.9%
All funds	8,429.5	8,729.5	9,395.2	665.7	7.6
In-Home Supportive Services					
General Fund	$1,355.4	$1,443.7	$1,471.4	$27.7	1.9%
All funds	3,937.7	4,274.0	4,373.5	99.5	2.3
Regional Centers/Community Services					
General Fund	$1,831.3	$2,142.1	$2,188.6	$46.5	2.2%
All funds	2,884.3	3,314.7	3,566.0	251.3	7.6
Community Mental Health Services					
General Fund	$313.6	$1,026.7	$762.9	-$263.8	-25.7%
All funds	1,817.8	2,863.9	3,425.9	562.0	19.6
Mental Hospitals/Long-Term Care Services					
General Fund	$802.1	$1,030.0	$1,132.3	$102.3	9.9%
All funds	892.6	1,105.0	1,233.8	128.8	11.7
Healthy Families Program					
General Fund	$316.7	$359.7	$392.2	$32.5	9.0%
All funds	875.2	1,014.5	1,090.2	75.7	7.5
Child Support Services					
General Fund	$459.1	$521.9	$274.0	-$247.9	-47.5%
All funds	972.2	1,138.3	744.6	-393.7	-34.6

[a] Excludes administrative headquarters support.

N/A=not available.

MAJOR BUDGET CHANGES

Figures 5 and 6 (see next page) illustrate the major budget changes proposed for health and social services programs in 2006-07. (We include the federal Temporary Assistance for Needy Families [TANF] funds for CalWORKs because, as a block grant, they are essentially interchangeable with state funds within the program.) Most of the major changes can be grouped into five categories: (1) funding caseload changes, (2) suspending certain welfare cost-of-living adjustments (COLAs), (3) funding shifts, (4) federal penalty relief, and (5) other policy changes.

Caseload Changes. The budget funds caseload changes in the major health and social services programs. For example, the Medi-Cal budget reduces spending for lower-than-anticipated caseload in the current year but adds resources for the cost of caseload increases expected in the budget year. Also, the Medi-Cal budget would be adjusted upward by $465 million for significant growth in the baseline costs and utilization of services by various groups of eligibles, but especially the aged and disabled. General Fund support for regional centers (RCs) that serve the developmentally disabled would continue to grow due mainly to caseload growth and utilization increases in these services. Funding would be adjusted downward in the current year for HFP to reflect lower than anticipated caseload in 2006-07, but increased in the budget year for anticipated strong caseload growth.

Cash Grant COLAs. Pursuant to current law, the budget provides $217 million to fund the six-month cost of January 2008 state COLA for the SSI/SSP. The budget proposes to suspend the CalWORKs July 2007 COLA, resulting in a cost avoidance of $140 million. The budget does not provide the discretionary Foster Care COLA.

Funding and Program Shifts. The budget proposes to spend $269 million in Proposition 98 funds on CalWORKs child care. This proposal frees up TANF child care funds which are then redirected to CalWORKs grants, creating an identical General Fund savings in the CalWORKs program, with no impact on service levels. The budget achieves additional savings ($56 million) by using TANF funds to replace General Fund expenditures in child welfare services. Increases in General Fund support for RCs would be partly offset by a one-time shift of Public Transportation Account funds ($144 million) to pay the transportation costs of RC clients that previously were paid for with General Fund.

Elimination of Federal Child Support Penalty. In 2006-07, the state budgeted $220 million to pay the federal penalty for the state's failure to have a single statewide child support automation system. The Department of Child Support Services requested federal certification for an interim automation system in August 2006, and during the certification process, all penalties are held in abeyance. Accordingly, the budget reflects a savings of $220 million related to this penalty relief.

Figure 5

Health Services Programs
Proposed Major Changes for 2007-08
General Fund

Medi-Cal (local assistance)	**Requested:**	**$14.7 billion**	
	Increase:	**$1 billion**	**(+7.2%)**

+ $465 million from increases in caseload, costs and utilization of services, mainly for aged and disabled beneficiaries
+ $97 million from rate increases for certain skilled nursing facilities
+ $87 million from increased costs for premiums paid by Medi-Cal on behalf of beneficiaries who are also enrolled in the federal Medicare Program
+ $81 million from growth in the number of enrollees in Medi-Cal managed care

– $44 million from lower drug costs achieved through implementation of the federal Deficit Reduction Act of 2005
– $23 million from the state paying lower Medicare Part D “clawback” payments to the federal government

Department of Developmental Services (local assistance)	**Requested:**	**$2.2 billion**	
	Increase:	**$46.5 million**	**(+2.2%)**

+ $46.5 million primarily for increases in regional center caseloads, and costs and utilization

– $144 million from using Public Transportation Account funds in lieu of General Fund for regional center transportation costs
– $44 million from drawing down a federal funds match for Intermediate Care Facilities services previously paid for with 100 percent General Fund

Figure 6

Social Services Programs
Proposed Major Changes for 2007-08
General Fund

CalWORKs	**Requested:**	**$1.4 billion**	
	Decrease:	**$691 million**	**(-34%)**

+ $28 million for child care and services for families who comply with work requirements in response to the full-family sanction

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– $17 million in grant savings for families who remain out of compliance and experience a full-family sanction

– $42 million for caseload decrease

– $269 million by using Temporary Assistance for Needy Families funds (freed up by a Proposition 98 shift to CalWORKs child care) to offset General Fund costs for grants

– $336 million from grant savings due to imposing a five-year time limit for children whose parents cannot or will not comply with work participation requirements

SSI/SSP	**Requested:**	**$3.9 billion**	
	Increase:	**$350 million**	**(+9.9%)**

+ $217 million for providing the January 2008 state cost-of-living adjustment

+ $75 million for caseload increase

In-Home Supportive Services	**Requested:**	**$1.5 billion**	
	Increase:	**$28 million**	**(+1.9%)**

+ $79 million for caseload increase

– $45 million from full-year implementation of quality assurance initiative

Other Policy Changes

Increasing CalWORKs Sanctions. Currently, when an able-bodied adult does not comply with CalWORKs participation requirements, the family's grant is reduced by the adult portion, resulting in a "child-only" grant. The budget proposes a "full family sanction" whereby the reduced grant for the children is eliminated if an adult is out of compliance with program participation requirements for three months. In response to this increased sanction, the budget estimates that many families will enter employment, resulting in child care and employment services costs of $28 million. In cases where families do not comply, the budget estimates grant and administrative savings of $17 million, so the net cost of this proposal is about $11 million.

Time Limits for Aided Children. Currently, after five years of assistance, a family's grant is reduced by the adult portion, and the children continue to receive a child-only grant in the safety net program. The budget proposes to eliminate the safety net grant for children whose parents fail to comply with the federal work participation requirements (20 hours per week for families with a child under age 6 or 30 hours per week for families where all children are at least age 6). The budget also proposes to limit assistance to five years for most other child-only cases (such as those with parents who are undocumented or ineligible due to a previous felony drug conviction). These time limit policies are estimated to result in savings of about $336 million in 2007-08.

Limit State Participation in IHSS Provider Wages. Under current law, the state participates in IHSS provider wages up to $11.10 per hour during 2006-07, rising to $12.10 per hour in 2007-08. The budget proposes to freeze state participation in wages to the level provided in each county as of January 10, 2007. However, the administration indicates that it will continue to participate in post January 10, 2007 wage increases, until its urgency legislation proposal prospectively limiting state participation is enacted by the Legislature. The budget scores savings of $14.1 million in 2007-08.

Department of Public Health (DPH). Effective July 1, 2007, the budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), that creates a new DPH and Department of Health Care Services (DHCS) from the existing Department of Health Services. The DPH will administer a broad range of public and environmental health programs while DHCS will administer the Medi-Cal Program. This change is intended to result in increased accountability and improvements in the effectiveness of public health programs and the Medi-Cal Program by allowing each department to administer a narrower range of programs. The legislation creating the two new departments requires that the change be cost neutral to the state.

Proposition 36 Programs. The budget proposes a net reduction of $25 million General Fund for Proposition 36 drug rehabilitation programs. This would be achieved by reducing funding by $60 million for the Substance Abuse and Treatment Trust Fund (SATTF), established by Proposition 36. Funding for the Substance Abuse Offender Treatment Program—established to improve the outcomes of Proposition 36 Programs—would increase by $35 million. The increased funding would be used for drug treatment activities that are not permitted under Proposition 36 and cannot be funded through SATTF.

Eliminate Integrated Services for Homeless Adults With Serious Mental Illnesses. The Governor's budget plan proposes the elimination of the Integrated Services for Homeless Adults with Serious Mental Illnesses program in order to reduce state costs by almost $55 million from the General Fund. This program provides funding to local mental health agencies that coordinate the service needs of individuals who have a serious illness and are homeless, or are at risk of homelessness.

Governor's Proposal for Health Care Reform Independent From the Budget. On January 8, 2007, the Governor announced a health care reform proposal aimed at ensuring that all Californians have health care coverage. This proposal did not provide a timeline for implementation and is not reflected in the budget plan. However, we note that the Governor's proposal would have a significant impact on future funding for state health programs if it were enacted as proposed.

CROSSCUTTING ISSUES

Health and Social Services

EVALUATING COLAS FOR CASH ASSISTANCE PROGRAMS

For 2007-08, the Governor proposes to provide the statutory January 2008 cost-of-living adjustment (COLA) for Supplemental Security Income/State Supplementary Program (SSI/SSP) recipients and suspend the July 2007 California Work Opportunity and Responsibility to Kids (CalWORKs) COLA for low-income families with children. Under the Governor's proposal, grants for SSI/SSP recipients would move further above the federal poverty guideline while the grants for CalWORKs families would move further below the poverty guideline. In order to more effectively utilize General Fund resources to reduce poverty, we recommend redirecting $124.4 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA.

How Are COLAs Calculated?

California Necessities Index (CNI). Current law requires that CalWORKs and SSI/SSP grants be increased each year by the percentage increase in CNI. The CNI is based on the change from December to December of five components of the federal consumer price index (CPI). By statute, the five components are food, rent, fuel/utilities, apparel, and transportation. From December 2005 to December 2006, the weighted average of the costs for these components increased by 3.7 percent, based on actual data available in January 2007. (The Governor's budget, prepared prior to the release of this price data, estimated that the December to December increase in CNI would be 4.2 percent).

Timing of COLAs. The statutory COLA for CalWORKs goes into effect each July, the start of the fiscal year. The statutory COLA for SSI/SSP is provided each January, along with the federal statutory COLA, resulting in a six-month cost for the COLA. The full-year cost of the SSI/SSP COLA is double the first year cost.

Calculation of CalWORKs COLAs. The CalWORKs COLA is calculated by multiplying the CalWORKs maximum grant by the change in CNI. The CalWORKs has a system of regionalized grants. In lower-cost counties (generally inland counties with lower comparative rental costs), the grant is 4.9 percent less than in higher-cost counties. The SSI/SSP COLA calculation is more complicated, as discussed below.

Calculation of the SSI/SSP COLA. The SSI/SSP grant is comprised of two components, a federal portion known as SSI (currently $623 per month for an individual) and a state portion known as SSP (currently $233 per month for an individual). There are separate grant levels for couples and for other living situations (for example, individuals residing in non-medical boarding homes). The COLAs are funded by both the federal and state governments. The state COLA is based on the CNI and is applied to the *combined* SSI/SSP grant. The federal COLA (based on CPI for Urban Wage Earners and Clerical Workers) is applied annually to the SSI portion of the grant. The remaining amount needed to cover the state COLA on the entire grant is funded with state monies.

Governor's Proposal

The Governor proposes to provide the SSI/SSP COLA and to suspend the state CalWORKs COLA. Based on preliminary estimates of CNI (4.2 percent), the Governor's budget reflects a cost of $216.7 million to provide the SSI/SSP COLA and a cost avoidance of $140.3 million from suspending the CalWORKs COLA. Based on the actual CNI (3.7 percent), the cost for providing the SSI/SSP COLA is now estimated to be $171.6 million, a savings of $45.1 million compared to the Governor's budget. Similarly, the cost avoidance from suspending the CalWORKs COLA would be $124.4 million, rather than the $140.3 million estimated in the Governor's budget.

Figure 1 shows the maximum monthly SSI/SSP and CalWORKs grants in 2006-07 and as proposed by the Governor for 2007-08. The grants shown reflect the actual CNI of 3.7 percent and an estimated CPI (the basis for the federal SSI COLA) of 1.4 percent. Pursuant to the Governor's proposal to suspend the CalWORKs COLA, maximum monthly grants remain unchanged for CalWORKs families, however food stamps benefits increase due to federal inflationary adjustments. (The SSI/SSP recipients are categorically ineligible for food stamps. The CalWORKs families are entitled to food stamps, and their estimated maximum allotments are included in Figure 1.)

Figure 1

Maximum Monthly CalWORKs and SSI/SSP Grants Governor's Proposal 2006-07 and 2007-08

			Change	
Program/Recipient Type	**2006-07**	**2007-08**	**Amount**	**Percent**
SSI/SSP Individual				
SSI	$623	$632	$9	1.4%
SSP	233	256	23	9.9
Totals	**$856**	**$888**	**$32**	**3.7%**
SSI/SSP Couple				
SSI	$934	$947	$13	1.4%
SSP	568	611	43	7.6
Totals	**$1,502**	**$1,558**	**$56**	**3.7%**
CalWORKs Family of 3[a]				
CalWORKs grant	$723	$723	—	—
Food Stamps	319	342	$23	7.2%
Totals	**$1,042**	**$1,065**	**$23**	**2.2%**
CalWORKs Family of 3[b]				
CalWORKs grant	$689	$689	—	—
Food stamps	334	358	$24	7.2%
Totals	**$1,023**	**$1,047**	**$24**	**2.3%**

a High-cost county.

b Low-cost county.

The CalWORKs grants shown in Figure 1 assume that the state will successfully appeal the *Guillen* law suit. For a more detailed discussion of the potential impact of the *Guillen* case on CalWORKs grants, please refer to the "California Work Opportunity and Responsibility to Kids" section in this chapter.

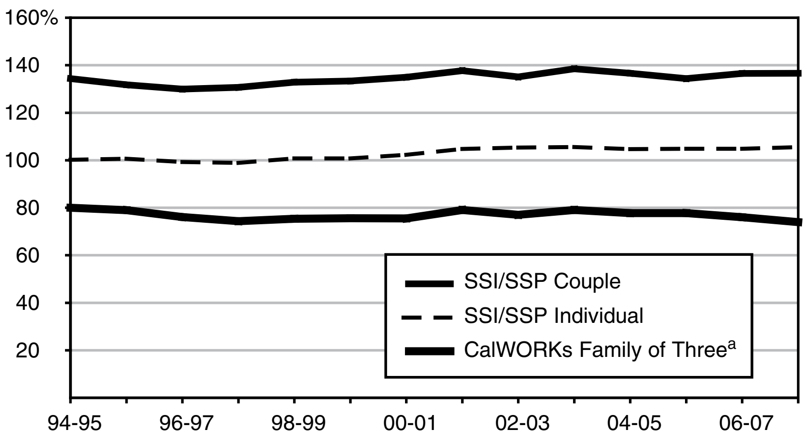
Comparing Grant Levels

One of the objectives of the CalWORKs and SSI/SSP programs is to provide recipients with a minimum standard of living. One way of assessing whether this objective is being achieved is to compare the maximum monthly grants with the federal poverty guideline. In order to make the comparison on an equal basis, maximum food stamps allotment must be added to the CalWORKs grant. Figure 2 compares CalWORKs and SSI/SSP grants to the poverty guideline from 1994-95 through 2007-08. Figure 2 shows that each recipient category has maintained a steady relationship with respect to the federal poverty guideline. By this measure, SSI/SSP couples have faired best, as their maximum grant has been typically between 130 percent and 140 percent of the federal poverty guideline. (In other words, the purchasing power of their grant was 30 percent to 40 percent above the federal poverty level.) The SSI/SSP individuals faired second best, with their maximum grant typically between 99 percent and 107 percent of the federal guideline. The CalWORKs families were the furthest below the poverty level, with combined maximum monthly grant and food stamps benefits typically in the range of 75 percent to 80 percent of the federal poverty guideline. Figure 3 summarizes in table format, the relationship of each grant to poverty as proposed for 2007-08.

Figure 2

Maximum Monthly Cash Assistance Payments As Percent of the Federal Poverty Guideline

1994-95 Through 2007-08



[a] Includes food stamps.

Targeting Anti-Poverty Funds

COLA Funding. As discussed above, the Governor's budget suspends the CalWORKs COLA and includes $217 million for the SSI/SSP COLA, based on an estimated CNI of 4.2 percent. Given the actual CNI of 3.7 percent, however, the cost of the SSI/SSP COLA has been reduced to $171.6 million. Funding of cash assistance COLAs is a policy decision for the Legislature. We discuss an approach to targeting these funds in tough budget times below.

Figure 3

Maximum Monthly CalWORKs and SSI/SSP Grants Compared to Estimated Federal Poverty Guideline 2007-08

Program/Recipient Type	Maximum Monthly Benefit	Estimated Poverty Guideline[a]	Percent of Estimated Poverty Guideline
SSI/SSP individual	$888	$851	104%
SSI/SSP couple	1,557	1,141	137
CalWORKs family of 3, high-cost county[b]	1,065	1,430	74
CalWORKs family of 3, low-cost county[b]	1,047	1,430	73

a 2007 federal poverty guideline.

b The CalWORKs benefit includes maximum food stamps allotment.

Legislative Analyst's Office (LAO) Approach. Given the state's fiscal condition, our approach to allocating assistance payment COLAs would be to target the funds to reduce poverty. Specifically, additional resources would be provided first to CalWORKs families (who are well below poverty), second to SSI/SSP individuals (who are just above the poverty guideline), and third to SSI/SSP couples (who are significantly above the poverty guideline). Using the $171.6 million as a budget guideline, greater poverty alleviation could be achieved by redirecting $124.4 million to provide a 3.7 percent CalWORKs COLA, and using the remaining $47.2 million to provide a 1.9 percent COLA for SSI/SSP individuals. The SSI/SSP couples would receive the pass through of the federal COLA, but no separate state COLA.

Comparing the LAO Approach to the Governor's Proposal. Figure 4 (see next page) compares the costs and benefits of the LAO approach, described above to the Governor's proposal. As the top portion of Figure 4 shows, under the LAO approach, benefits are higher for CalWORKs families and lower for SSI/SSP recipients than under the Governor's approach. The bottom portion of the figure compares the fiscal impact. Both approaches have identical General Fund costs of $171.6 million in 2007-08. However, in 2008-09, the LAO approach costs less than the Governor's. This is because the SSI/SSP COLA is provided in January of 2008, resulting in six months of costs. The costs for 2008-09 for the SSI/SSP COLA double to account for a full-year of paying higher benefits. Because the CalWORKs COLA is provided in July 2007 for an entire fiscal year, there is no corresponding increase in 2008-09.

Figure 4

Comparison of Governor's Budget and LAO Approach to Providing Cash Assistance COLAs

	Governor's Proposal	LAO Approach	Difference	
			Amount	Percent
Benefit Levels				
CalWORKs Benefit[a]	$1,065	$1,080	$15	1.4%
Compared to poverty	*74%*	*75%*		
SSI/SSP Individuals	888	872	-16	-1.8
Compared to poverty	*104%*	*102%*		
SSI/SSP Couples	1,558	1,515	-43	-2.8
Compared to poverty	*137%*	*133%*		
Fiscal Impacts (Dollars in Millions)				
General Fund cost 2007-08				
CalWORKs	—	$124.4	$124.4	—
SSI/SSP	$171.6	47.2	-124.4	-72.5%
Totals	**$171.6**	**$171.6**	**—**	**—**
General Fund cost 2008-09				
CalWORKs	—	$124.4	$124.4	—
SSI/SSP	$343.2	94.4	-248.8	-72.5%
Totals	**$343.2**	**$218.8**	**-$124.4**	**-36.2%**

a The CalWORKs family of 3, high-cost county.

Analyst's Recommendation

In order to more effectively utilize General Fund resources to reduce poverty, we recommend redirecting $124.4 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA. With the remaining $47.2 million, we recommend providing a partial COLA to SSI/SSP individuals, while passing through the federal COLA for both individuals and couples. This approach is budget neutral in 2007-08 and results in out-year savings of about $124 million compared to the Governor.

DEPARTMENTAL ISSUES

Health and Social Services

ALCOHOL AND DRUG PROGRAMS (4200)

The Department of Alcohol and Drug Programs (DADP) directs and coordinates the state's efforts to prevent or minimize the effects of alcohol-related problems, narcotic addiction, and drug abuse. Services include prevention, early intervention, detoxification, and recovery. The DADP administers funding to local governments and licenses, certifies, and audits alcohol and other drug programs.

The DADP administers the Drug Medi-Cal Program, which provides substance abuse treatment services for beneficiaries of the Medi-Cal Program. It also allocates other funds to local governments (including funds provided under the substance Abuse and Crime Prevention Act, the 2000 initiative also known as Proposition 36) and contract providers and negotiates service contracts. In addition to its substance abuse treatment and prevention programs, DADP oversees the Office of Problem Gambling which provides problem gambling prevention services for individuals, families, and communities.

Governor's Budget Proposal. The Governor's budget proposes almost $663 million from all funds for support of DADP programs in 2007-08, which is a decrease of $11.5 million, or almost 2 percent, below the revised estimate of current-year expenditures. The budget proposes about $285 million from the General Fund, which is a decrease of about $8.4 million, or almost 3 percent, below the revised estimate of current-year expenditures.

The budget plan includes the following proposed spending:

- ***Proposition 36.*** The spending plan proposes to reduce funding for the Substance Abuse and Treatment Trust Fund (SATTF), by $60 million General Fund and increase funding for the Substance Abuse Offender Treatment Program (OTP) by $35 million General Fund. We describe this proposal in more detail below.
- ***Substance Abuse Offender Treatment Program.*** The spending plan proposes a General Fund redirection to state operations of $305,000 in the current year for three and one-half limited-term positions to administer OTP. The costs of these positions would be offset by a corresponding decrease in local assistance for OTP.
- ***Drug Medi-Cal.*** The budget plan proposes $149 million ($78 million General Fund) for the Drug Medi-Cal Program. This is an 8.4 percent increase over the administration's revised current-year estimate due mainly to caseload increases.
- ***Comprehensive Drug Court Implementation (CDCI).*** The spending plan proposes a redirection of $341,000 General Fund from the existing CDCI local assistance appropriation for four permanent positions to administer a current-year program expansion.
- ***Licensing and Certification.*** The spending plan proposes an increase of $1.2 million to support 8 permanent staff positions and 4.5 limited-term positions to implement the second phase of licensing policy changes. The spending plan also proposes to expand DADP statutory authority to include charging fees from all licensed providers and to establish the Residential Outpatient Program Licensing Fund.
- ***Prison Inmate Aftercare Treatment Program.*** Chapter 875, Statutes of 2006 (SB 1453, Speier), requires, whenever possible, mandatory aftercare treatment for prison inmates who participate in in-prison drug treatment programs. The spending plan proposes a General Fund increase of $485,000 and authority for four permanent and two half-time limited term positions to monitor and evaluate the licensing of treatment facilities.
- ***California Methamphetamine Initiative.*** The *2006-07 Budget Act* provided $10 million for a multimedia methamphetamine public education campaign. The budget plan proposes a current-year redirection of $197,000 from existing funding for CMI to provide two limited-term positions to assist in developing and coordinating the initiative.

THE SUBSTANCE ABUSE AND CRIME PREVENTION ACT: PROPOSITION 36 UNDER POLICY CHANGE

The Legislature enacted Chapter 63, Statutes of 2006 (SB 1137, Ducheny), that made various policy changes to Proposition 36. These policy changes have not been implemented due to legal challenges. If these legal challenges are not resolved by the May Revision, we recommend that the Legislature consider placing these and other policy changes on the ballot of the next statewide election for voter consideration. We also recommend the Legislature seek legal advice from Legislative Counsel regarding potential funding streams for Proposition 36 programs.

We further recommend the Legislature provide $25 million General Fund above the administration's proposed 2007-08 budget in order to maintain funding for Proposition 36 programs at current levels, offset by a funding reduction of a like amount in the California Department of Corrections and Rehabilitation. (Increase Item 4200-105-0001 by $60 million and Reduce Item 4200-101-0001 by $35 million).

Program and Funding Background

Measure Approved by Voters in November 2000. The Substance Abuse and Crime Prevention Act of 2000 (Proposition 36) was approved by the voters in the November 2000 election and many of its provisions affecting criminal sentencing became effective July 1, 2001. The measure changed state law so that certain adult offenders who use or possess illegal drugs are sentenced to participate in drug treatment and supervision in the community rather than being sentenced to prison or jail or being supervised on probation without treatment. (Please see page *C-79* of our *Analysis of the 2006-07 Budget Bill* for more information on Proposition 36 treatment programs, and administration and maintenance of effort requirements.)

A two-thirds vote by both houses of the Legislature is required to amend Proposition 36. The measure requires that all amendments be consistent with and further its purposes. Proposition 36 is funded with General Fund monies that are transferred to a special fund called SATTF. Monies in SATTF may only be spent in keeping with the provisions of the measure, thereby potentially limiting legislative control and ability to implement policy changes.

Study Shows Proposition 36 Reduces Prison Costs. In April 2006, the University of California at Los Angeles (UCLA) completed and DADP publicly released a cost-benefit study of Proposition 36. According to the UCLA study, Proposition 36 reduced prison and jail costs as a result of fewer incarcerations thereby resulting in net savings beyond its costs. The

UCLA study concluded that costs are $2,861 lower per offender than would be expected in the absence of Proposition 36, which reflects a benefit-to-cost ratio of about 2.5 to 1. We have reviewed the study and found that its conclusions that Proposition 36 is resulting in significant net savings to the state, primarily because of the diversion of offenders from state prison, are reasonable. We discuss our own savings estimates later in this analysis.

Legislature Approved Policy Changes in 2006-07. In response to the UCLA study that found some weaknesses in Proposition 36, the Legislature enacted Chapter 63. This legislation modified Proposition 36 by requiring: (1) drug testing as a condition of probation, (2) incarceration for a specified period of time in order to enhance treatment compliance, and (3) a defendant in some circumstances to enter a residential treatment program, or be placed in a county jail for not more than ten days for detoxification purposes only. This statute also made other changes to Proposition 36 generally intended to make the program more cost-effective.

Chapter 63 was challenged in court by the original proponents of Proposition 36, who argued that the statute does not further the act and is not consistent with its purposes. Pending the resolution of the court challenge, implementation of the Chapter 63 policy changes has been suspended by a judicial injunction. At the time this analysis was prepared, the courts had not ruled on whether the policy changes to Proposition 36 can be implemented through Chapter 63. A provision in Chapter 63 would automatically place the measure on the ballot if the courts struck down the program changes contained in Chapter 63.

Chapter 75, Statutes of 2006 (AB 1808, Committee on Budget), established OTP. Under Chapter 75, funds distributed for OTP shall be used to serve offenders who qualify for services under Proposition 36. The DADP distributes funds to counties that meet various eligibility criteria including: (1) regularly scheduled court reviews of treatment progress for persons ordered to drug treatment, (2) use of drug testing to monitor offenders' progress in treatment, and (3) assessment of offenders' treatment needs and the placement of offenders at the appropriate level of treatment. Under OTP, counties are required to provide matching funds to participate in the program at a ratio of $9 (state) to $1 (local) county matching funds. A county's OTP funding allocation cannot exceed 30 percent of the funds it received from SATTF.

Proposition 36's Automatic Appropriation Has Expired. Proposition 36 required automatic annual appropriations from the General Fund to SATTF through 2005-06 for support of program activities. The measure specifically allocated $60 million in startup funds for 2000-01 and $120 million per year for 2001-02 through 2005-06. In 2005-06, about $116 million was provided to the counties for the operation of local Proposition 36 programs. In addition, about $3.9 million was provided annually to DADP to offset its administrative costs to operate the program. No appropriations were specified for the program for 2006-07 and subsequent years, leaving it to the Legislature to determine how much to appropriate for this purpose.

Annual Spending Surpassed Funding Allocations. Proposition 36 permits counties to carry over unspent Proposition 36 allocations from year to year, and a number of counties have done so. The amount of carryover funds available to counties has been dropping in recent years as programs have ramped up their expenditures.

Current annual county spending from SATTF is projected by DADP to be about $129 million in 2006-07 which is higher than the annual Proposition 36 appropriation of $120 million. This is because a number of counties have increased spending to a higher level by using the funds they have carried over from prior years. In 2005-06, almost $143 million was spent before netting out audit disallowances that would probably reduce this expenditure level modestly.

By appropriating $120 million General Fund for transfer to SATTF and $25 million General Fund for OTP, the Legislature provided a total of $145 million General Fund for support of Proposition 36 programs in 2006-07. These two appropriations, combined with carryover funds, allow counties to maintain Proposition 36 spending for 2006-07 at approximately the 2005-06 spending level of almost $143 million.

Administration's Budget Proposes a Reduction

The Governor's 2007-08 budget proposes a net reduction of $25 million General Fund for Proposition 36 programs compared to the current year. This would be achieved by reducing SATTF funding by $60 million (from $120 million in 2006-07 to $60 million in 2007-08), but increasing funding for OTP by $35 million (from $25 million in 2006-07 to $60 million in 2007-08) as shown in Figure 1 (see next page). The Governor proposes to increase funding for OTP because this will allow the implementation of policy changes that are not permitted under Proposition 36, such as short-term incarceration of an individual who had failed to comply with the treatment plan ordered by a judge.

According to the administration, OTP contains some of the Proposition 36 policy changes it seeks and increasing funding for OTP will allow the state to implement these and other policy changes that would lead to improved program performance and client outcomes. If the policy changes to Proposition 36 are not implemented, the administration has indicated that it will revise its budget proposal in the May Revision to move all funding for Proposition 36 programs to OTP and eliminate all funding for SATTF.

Figure 1

Proposition 36 Funding Governor's 2007-08 Budget Compared to Current Year

(In Millions)

	2006-07	2007-08	Difference
SATTF	$120	$60	-$60
OTP	25	60	35
Totals	**$145**	**$120**	**-$25**

SATTF = Substance Abuse Treatment Trust Fund;
OTF = Substance Abuse Offender Treatment Program.

Reduced Funding for Proposition 36 Would Increase State Prison Costs

Using data from the California Department of Corrections and Rehabilitation, we independently estimated the fiscal effect of Proposition 36 on state prison and parole operations at two points in time—in 2002-03 and in 2004-05. We estimated that the $120 million allocation per year of funding for SATTF resulted in savings to the state of $205 million in 2002-03 and $297 million in 2004-05. For 2004-05 we estimated a benefit-to-cost ratio of 2 to 1, which is slightly lower than the UCLA ratio we described above.

Based on our estimate of the benefit-to-cost ratio resulting from Proposition 36, a reduction in funding for Proposition 36 would probably eventually result in increased prison costs proportional to the amount of the reduction. Thus, implementation of the Governor's proposed net $25 million reduction to Proposition 36 spending could ultimately cost the state more than it would save.

Funding Shift to Implement Policy Changes May Meet Legal Opposition

As noted earlier, the administration has indicated that if the policy changes it is requesting to Proposition 36 are not implemented it will revise its budget proposal in the May Revision to move all Proposition 36 funding to OTP and provide no funding for SATTF. The potential advantage of this approach is that it would provide the Legislature and the administration greater control over Proposition 36 programs. This is because Proposition 36 provides that appropriations to SATTF must only be spent consistent with the provisions of the ballot measure, thereby limiting legislative control to implement policy changes such as short-term incarceration for offenders that are not complying with their drug treatment.

We do not have a programmatic objection to funding Proposition 36 programs entirely through OTP. However, we note that funding Proposition 36 programs through OTP and providing no funding for SATTF may be open to legal challenges.

If funding Proposition 36 programs exclusively through OTP is determined to be legally permissible, and if the Legislature chooses to fund Proposition 36 exclusively through OTP, it would be necessary to make changes in state law. These changes are necessary because under OTP, distribution of funds to the counties may not exceed 30 percent of the county's allocation under SATTF. This requirement would have to be changed or eliminated if a significant amount of funding for Proposition 36 programs were to be provided through OTP.

Analyst's Recommendation

Fund Proposition 36 at Current Spending Levels. In order to ensure that the state continues to achieve net savings, primarily because of diversion of offenders from state prison, we recommend the Legislature fund Proposition 36 at current spending levels. Accordingly, we recommend that the Legislature appropriate $120 million in General Fund to be transferred to SATTF. This would be an increase of $60 million above the Governor's proposed funding level of SATTF. This increase would be funded by two related actions. First, we recommend reducing the Governor's proposed 2007-08 funding for OTP to its current year level ($25 million), thereby freeing up $35 million that can be used to fund SATTF. We have no objection to funding Proposition 36 exclusively through OTP provided that it is determined to be legally permissible. Our concern is that reducing funding below the 2005-06 level of $145 million would probably eventually result in increased prison costs at least proportional to the amount of any reduction.

Further, we recommend, elsewhere in this *Analysis*, reducing the Governor's proposed probation grant program for 2007-08 by $45 million, thereby freeing up $25 million for SATTF (with the remaining $20 million reverting to the General Fund). (For more information about the Governor's probation grant program proposal and our recommendation, please see the "California Department of Corrections and Rehabilitation Local Assistance" section in the "Judicial and Criminal Justice" chapter of this *Analysis*.) Figure 2 (see next page) compares the fiscal effect of our recommendation with the Governor's for funding Proposition 36 programs.

Figure 2

Funding for Proposition 36 Programs—Two Approaches 2007-08

(In Millions)

	Governor	Analyst	Difference
SATTF	$60	$120	$60[a]
OTP	60	25	-35
Totals	**$120**	**$145**	**-$25**

[a] $35 million reduced from OTP and $25 million reduced from new probation grant program.

SATTF = Substance Abuse Treatment Trust Fund;
OTF = Substance Abuse Offender Treatment Program.

Seek Needed Legal Advice on Funding Options. In its 2006-07 budget plan the administration cited potential legal challenges to alternative funding mechanisms as a reason for funding Proposition 36 through SATTF. We recommend that the Legislature seek legal guidance from the Office of Legislative Counsel about approaches to consider for funding Proposition 36. Specifically, the Legislature should consult with Legislative Counsel about (1) whether it is legally permissible to eliminate SATTF funding and instead fund Proposition 36 programs entirely through OTP, and (2) whether it is legally permissible to offset funding reductions to SATTF with funding increases to OTP and what if any legal limitations pertain to this approach. We further recommend that if the Legislature does fund Proposition 36 programs entirely through OTP, it enact the changes in statute that we described above.

Consider Placing Policy Changes on the Ballot. Chapter 63, which would implement policy changes sought by the administration and approved by the Legislature, was challenged in court by advocates and at the time this analysis was prepared the courts had not ruled. If the legal challenge to Chapter 63 has not been resolved by the May Revision, the Legislature may wish to consider placing these and other policy changes it wishes to link to the provision of Proposition 36 funding on the statewide ballot in 2008 for voter consideration. This approach may result in a faster resolution of this issue than might be achieved through the courts.

We believe our approach of maintaining Proposition 36 funding for the budget year at its current level will ensure that prevention and treatment activities can continue and that the state would avoid prison cost increases that might eventually result from a decrease in Proposition 36 spending. Our recommendation for Proposition 36 funding is based on the most recent expenditure data available for SATTF. According to DADP, expenditure data for OTP will not be available until April 2007. We will update our recommendation as necessary at the time of the May Revision after we have analyzed the updated SATTF and OTP data.

MEDI-CAL
(4260)

In California, the federal Medicaid Program is administered by the state as the California Medical Assistance Program (Medi-Cal). This program provides health care services to welfare recipients and other qualified low-income persons (primarily families with children and the aged, blind, or disabled). Expenditures for medical benefits are shared about equally by the General Fund and by federal funds. The Medi-Cal budget also includes federal funds for (1) disproportionate share hospital payments and other supplemental payments, which provide additional funds to certain hospitals that serve Medi-Cal or other low-income patients; and (2) matching funds for state and local funds in other related programs.

Effective July 1, 2007, the budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), which creates a new state Department of Public Health and renames the existing Department of Health Services as the Department of Health Care Services (DHCS). We use the new name for the department throughout our *Analysis*.

OVERVIEW OF MEDI-CAL BUDGET PROPOSAL

The budget proposes Medi-Cal expenditures totaling $38 billion from all funds for state operations and local assistance in 2007-08. Figure 1 displays a summary of Medi-Cal General Fund expenditures in the DHCS budget for the past, current, and budget years. The General Fund portion of the spending for local assistance ($14.6 billion) increases by about $980 million, or 7.2 percent, compared with estimated General Fund spending in the current year. The bulk of this increase is for benefit costs, which will total an estimated $14 billion General Fund in 2007-08. Significant factors contributing to this increase are (1) higher costs for services provided to Medi-Cal beneficiaries and (2) required rate increases for managed care plans, nursing facilities, and certain long-term care facilities. Some of these higher rates are offset by fees assessed on those providers, which are not reflected here.

Figure 1

Medi-Cal General Fund Budget Summary[a]
Department of Health Services

(Dollars in Millions)

	Expenditures			Change From 2006-07	
	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Amount	Percent
Local Assistance					
Benefits	$12,072	$12,828	$13,765	$937	7.3%
County administration (eligibility)	674	720	763	43	6.0
Fiscal intermediaries (claims processing)	84	101	101	—	—
Totals, Local Assistance	**$12,830**	**$13,649**	**$14,629**	**$980**	**7.2%**
Support (state operations)	$131	$146	$119	-$27	-1.8%
Caseload (thousands)	6,572	6,594	6,702	108	1.6%

[a] Excludes General Fund Medi-Cal budgeted in other departments.
Detail may not total due to rounding.

The remaining expenditures for the program are mostly federal funds, which are budgeted at $22 billion, or 4.4 percent more than estimated to be received in the current year. In addition, the spending total for the Medi-Cal budget includes an estimated $607 million in local government funds for certain payments to hospitals. About $5.3 billion of total Medi-Cal spending consists of federal funds budgeted for programs operated by other departments or counties.

The 2007-08 budget proposal does not include any resources for the Governor's recently announced health care coverage expansion plan. If enacted, the coverage plan could substantially increase spending for Medi-Cal and other health care services. Although the administration has not presented a timeline for implementing its coverage plan, it appears unlikely that significant additional budget resources would be needed in 2007-08. We discuss the Governor's plan in *The 2007-08 Budget: Perspectives and Issues (Part V)*.

Key Changes in Current-Year Spending

Spending Below Budgeted Levels. The Governor's Budget projects that actual current-year spending will fall $128 million General Fund below the level budgeted by the *2006-07 Budget Act*. Significant factors contributing to the lower-than-anticipated spending include a decrease of $48 million General Fund due to lower-than-expected costs for Medicare premiums paid on behalf of Medi-Cal beneficiaries who are also eligible for Medicare. Also, costs for services provided by adult day health centers are projected to be $28 million General Fund less than budgeted due to a continuation of the moratorium on new facilities and Medi-Cal antifraud efforts. The collection of additional federal funds in the current year related to prenatal services provided in 2005-06 is expected to lower costs by an additional $18 million General Fund.

Governor's 2007-08 Budget Proposal

The Governor's proposed budget estimates that total General Fund spending for Medi-Cal local assistance will be $14.6 billion in 2007-08, a net increase of about $1 billion, or 7.2 percent, above the estimated spending for the current year. As summarized in the "Health and Social Services Overview" of this chapter of the *Analysis*, the spending plan proposes a number of significant adjustments and policy changes that are reflected in the budget-year totals.

- ***Baseline Estimates ($465 Million Cost).*** The budget plan proposes a $465 million increase in General Fund expenditures for "baseline" costs, which are costs unrelated to any change in state policy and are due to estimated increases in caseloads, costs, and utilization of services, mostly for prescription drugs and hospital inpatient care.
- ***Hospital Financing Payments ($93 Million Cost).*** Medi-Cal payments for inpatient services provided by certain public hospitals changed significantly as a result of a federal hospital financing waiver negotiated by DHCS and enacted through Chapter 560, Statutes of 2005 (SB 1100, Perata). The budget estimates that 2007-08 costs will increase by a net $93 million General Fund because payments for some inpatient care provided by these hospitals in 2005-06 and 2006-07 will be made in the budget year as a result of delays in implementing the new payment methods.
- ***Medicare Premiums ($87 Million Cost).*** The Medi-Cal Program pays the premiums for Medi-Cal beneficiaries who also are eligible for Medicare, thereby obtaining 100 percent federal funding for those services covered by Medicare. (This arrangement is favor-

able to the state because it generally has the net effect of reducing state costs for Medi-Cal.) The budget estimates that the General Fund cost of these so-called "buy-in" payments will increase by $87 million in 2007-08.

- ***Managed Care Plans Cost and Caseload Increases ($82 Million Cost).*** Medi-Cal managed care plans are expected to experience increased costs of nearly $82 million General Fund, primarily due to growth in the number of enrollees, rate increases for certain long-term care services, and the restoration of the 5 percent provider payment reduction implemented in 2003-04.
- ***Long-Term Care Rate Increases ($114 Million Cost).*** Rate increases provided to certain long-term care facilities (typically skilled nursing facilities), as required by Chapter 875, Statutes of 2004 (AB 1629, Frommer), are expected to increase General Fund expenditures by more than $93 million in the budget year, partially offset by savings of almost $17 million resulting from a proposed rate reduction of 1.5 percent to be implemented in the budget year. The Governor's budget also proposes rate increases for all other long-term care facilities of almost $38 million General Fund, in part to offset higher costs incurred by the increase in California's minimum wage.
- ***Shift in Pharmaceutical Pricing ($46 Million Savings).*** The federal Deficit Reduction Act of 2005 mandated a shift in how pharmaceuticals are priced, moving from the Average Wholesale Price to the Average Manufacturer Price as a means of setting the Federal Upper Limit. The Governor's budget expects this shift to result in General Fund savings of $46 million.
- ***Eligibility Processing Changes ($29 Million Cost).*** The budget plan reflects higher costs of $29 million General Fund as a result of two recent policy changes related to eligibility processing. Costs are expected to increase by $19 million General Fund due to the simplification of the Medi-Cal annual redetermination form approved as part of the *2006-07 Budget Act*. Also, Chapter 328, Statutes of 2006 (SB 437, Escutia), authorized a new Medi-Cal pilot program allowing applicants and beneficiaries in two counties to self-certify their income and assets. The budget plan estimates that this program, which is scheduled to begin July 2007, will increase costs by $10 million General Fund in the budget year.

Budget Projects Modest Caseload Growth

While the administration's overall Medi-Cal caseload projection is reasonable, we believe that the budgeted caseload shows risk of being slightly overstated. We will monitor caseload trends and recommend appropriate adjustments at the May Revision.

Administration's Caseload Projections. The budget projects that the average monthly caseload of individuals enrolled in Medi-Cal will remain nearly flat in the current year and grow modestly in the budget year. As regards the current year, the caseload is estimated to be nearly 71,000 below the caseload assumed in the *2006-07 Budget Act*, resulting in minimal estimated caseload growth of 0.3 percent from 2005-06 to 2006-07. The budget plan estimates caseload growth to be 1.6 percent in 2007-08, which is well above the caseload growth in 2006-07 and somewhat above the forecasted growth rate for the overall state population.

Nonwelfare Families Caseload Growth Flattening. Figure 2 shows the budget's forecast for the Medi-Cal caseload in the current year and 2007-08. Slightly over one-half of the projected Medi-Cal caseload increase in 2007-08 occurs in the families and children eligibility categories. The budget plan estimates that the caseload for this group will remain largely unchanged in the current year and increase by 1.2 percent in the budget year, although these overall changes represent the net effect of underlying trends within these categories. Nonwelfare families continue to show growth, with the budget estimating that the caseload of Medi-Cal eligible nonwelfare families will increase by 1.5 percent in the current year and an additional 1.4 percent in the budget year. However, caseload for the California Work Opportunity and Responsibility to Kids (CalWORKs) families is expected to decline by 4.8 percent in the current year and remain flat in the budget year. The budget attributes a portion of the caseload growth for families and children to the implementation of recent changes to simplify annual eligibility redetermination forms and to allow self-certification of assets and income on a pilot basis.

Moderate Growth in Medically Needy Aged and Disabled. Caseloads for the aged, blind, and disabled are expected to grow by about 27,000 beneficiaries, or about 1.6 percent, in the current year, and by an additional 50,000 beneficiaries, or about 2.9 percent, in the budget year. The increases in the current year and budget year are consistent with underlying population growth trends.

Caseload increases for the aged and disabled are being driven primarily by those aged and disabled individuals who qualify as medically needy. (The medically needy category includes those who do not quality for, or choose not to participate in, Supplemental Security Income/State Supplementary Program (SSI/SSP), such as low-income noncitizens or individuals who must pay a certain amount of medical costs themselves before Medi-Cal begins to pay for their care.) The budget estimates that in 2007-08 the aged caseload in this eligibility category will grow by about 18,000, or 8.6 percent, and that the disabled caseload will grow by about 8,000 or 7.3 percent. Some of the projected growth in the aged and disabled population that qualifies as medically needy is also expected to result from the implementation of the simplified annual eligibility redetermination form noted above.

Figure 2

Governor's Budget Estimates Flat Caseload in Current Year, Modest Growth in Budget Year

(Eligibles in Thousands)

			Change From 2005-06			Change From 2006-07	
	2005-06	2006-07	Amount	Percent	2007-08	Amount	Percent
Families/children	4,829	4,823	-6	—	4,879	56	1.2%
CalWORKs[a]	1,273	1,211	-61	-4.8%	1,211	—	—
Nonwelfare families	2,934	2,976	43	1.5	3,019	43	1.4
Pregnant women	192	198	7	3.4	203	5	2.5
Children	431	437	6	1.3	446	9	2.0
Aged/disabled	1,671	1,698	27	1.6	1,748	50	2.9
Aged	642	653	11	1.7	675	22	3.4
Disabled (includes blind)	1,030	1,045	16	1.5	1,073	28	2.6
Undocumented persons[b]	72	74	2	2.8	75	1	1.4
Totals[c]	**6,572**	**6,594**	**22**	**0.3%**	**6,702**	**107**	**1.6%**

a California Work Opportunity and Responsibility to Kids.

b Persons placed into a dedicated undocumented aid category. Other caseload groups also include undocumented persons. Services available to undocumented immigrants are generally limited to prenatal care, long-term care, and emergency care.

c Detail may not total due to rounding.

The public assistance and long-term care eligibility categories project modest growth of less than 2.2 percent for the aged, blind, and disabled in 2007-08. This growth is consistent with previous trends.

Assessing the Governor's Proposal. Our review of the most recent Medi-Cal caseload data available indicates that the Governor's 2007-08 request may be slightly overstated. While caseload forecasts are inherently subject to a certain degree of uncertainty, our review also indicates that the Governor's January budget requests have tended to overstate caseload in recent years. The requests for 2004-05 and 2005-06 overstated Medi-Cal caseload by 4.7 percent and 3.5 percent, respectively, and, as noted above, the administration has lowered its estimate for 2006-07 caseload from the level assumed in the *2006-07 Budget Act*.

Analyst's Recommendations. Our analysis indicates that the Governor's budget request is reasonable overall, but shows risk of being slightly higher than justified by the limited Medi-Cal caseload data available at this time. The updated data expected to be available at the time of the May Revision will provide additional information for the Legislature to assess the proposed Medi-Cal caseload prior to making any adjustments. Given this situation, we withhold recommendation regarding caseload at this time. We will continue to monitor Medi-Cal caseload trends and will recommend any appropriate adjustments to the budget estimate at the May Revision.

DATA MATCH INCREASES VETERANS' ACCESS TO BENEFITS AND REDUCES STATE COSTS

Our analysis indicates that there are approximately 144,000 military veterans in California who could be receiving comprehensive medical benefits from the Veterans Administration (VA) health care system but who are enrolled instead in the Medi-Cal Program funded in part by state monies. It is possible that the state could eventually save as much as $250 million General Fund annually from a voluntary shift of veterans from Medi-Cal into VA health care. We recommend that the state implement a federal data matching system which would allow California to identify veterans who could transfer to the VA health care system.

Introduction

Our analysis of population survey data indicates that approximately 144,000 veterans who are entitled to comprehensive medical care and health services through the federal Veterans Administration (VA) health care system are enrolled in the state's Medicaid Program (known as Medi-Cal in California). We believe it makes fiscal sense for the state to examine the possibility of encouraging veterans to seek medical care from the VA instead of from Medi-Cal. This might permit them to obtain comprehensive medical care in an entirely federally funded system at no expense to the state. To facilitate this process, we have identified a federal computer data matching process known as the Public Assistance Reporting Information System (PARIS).

The PARIS is a computer data matching process to help states share information with one another about individuals enrolled in state and federal health and social services programs. It identifies public assistance recipients in participating states who are eligible for federal benefits, including VA benefits. The process also identifies individuals who are simultaneously enrolled in and receiving benefits from Medicaid, SSI/SSP, Temporary Assistance for Needy Families (known as TANF or CalWORKs in California) and/or Food Stamps in more than one state.

This analysis examines how the state's participation in PARIS could benefit both the state and veterans by reducing Medi-Cal costs and increasing veterans' access to medical services. This analysis also examines how the state's participation in PARIS could improve program integrity and result in a cost reduction in certain state health and social services programs. We conclude by making recommendations that would result in state savings and improve access to services for veterans.

Background

Veterans and Their Families Are Entitled to a Range of Benefits. The Veterans Health Care Eligibility Reform Act of 1996, passed by Congress in October 1996, expanded many of the services provided to veterans. Veterans generally are entitled to a range of benefits, some of which we list below.

- California's veterans receive access to the VA system of healthcare, which includes 10 medical centers and 50 outpatient and community clinics throughout the state.
- Disabled veterans may qualify for federally funded pensions of up to $1,395 monthly.
- Disabled veterans may also qualify for Aid and Assistance payments to offset the cost of institutional and community-based care of up to $590 monthly.
- Disabled veterans may qualify for vocational rehabilitation.

Veterans' families are also generally entitled to the following benefits:

- Pensions for the widows and children of deceased veterans.
- The Civilian Health and Medical Program of the Department of Veteran's Affairs (CHAMPVA) is a VA health care benefit for the spouse, widow, widower, or children of a veteran who is or was totally disabled due to a service-connected disability, died from that disability, or died while on active duty.

- TRICARE is a Department of Defense managed health care program for retired veterans, their families, and survivors.

VA Medical Benefits Often Greater Than Those Provided by Medi-Cal. As shown in Figure 3 and discussed in the nearby box (see page 46), participation in the VA health care system provides veterans with access to a wide range of coordinated health care services. Once enrolled in the VA healthcare system, veterans may also have greater access to some medical benefits, such as mental health counseling and treatment for alcohol and substance abuse, than they would have under Medi-Cal. For example, the VA does not place a cap on the cost of dental services or limit the number of days a patient can be hospitalized for inpatient stays on a yearly basis. Unlike Medi-Cal, the VA system does not require that a beneficiary pay down his or her assets until they become "medically needy" before covering the costs of long-term care.

Medi-Cal Screens for Veterans

As part of the regular Medi-Cal eligibility screening process, workers in county welfare offices are required to ask applicants whether they have served in the armed forces and have veteran's status. If a county eligibility worker determines that an applicant is a veteran, the eligibility worker has the applicant fill out a form, which is then forwarded to a County Veterans Service Office (CVSO) where a case worker will contact the VA to determine the benefits to which the applicant is entitled. The CVSO will perform any necessary follow-up, such as notifying the county welfare office of an applicant's income status and/or contact the veteran for follow-up. The referral process is intended to ensure that all possible outside sources of income are obtained and available to help reduce costs to the Medi-Cal Program. Medi-Cal currently reimburses the CVSOs approximately $800,000 annually for these activities.

Not all veterans enroll in Medi-Cal through county welfare offices. Some Medi-Cal eligibility determinations are handled on the state's behalf by the U.S. Social Security Administration (USSSA). Many veterans, especially those who automatically qualify for Medi-Cal through the grant of SSI/SSP benefits, may not receive a referral to a CVSO from the Social Security office where they applied. Unlike county welfare offices, Social Security offices do not file any forms with the CVSOs or provide them with any notification that would alert the CVSO that it needs to perform outreach to a veteran. Instead, CVSOs have indicated that they receive walk-in referrals from Social Security offices.

Data Suggests Many Veterans Use Medi-Cal. Under federal law, the Medicaid Program is intended to be the payor of last resort, meaning that all other available sources for a beneficiary's provision of care, such

Figure 3

Federal VA Healthcare Services

	VA Healthcare	CHAMPVA	TRICARE
Who Qualifies	• Veterans	Spouse,widow(er), and children of: • Veteran rated permanently and totally disabled due to a service-connected condition at time of death. • Veteran who died of a service-connected disability. • Veteran who died on active duty.	• Active duty and retired service members. • Spouses and unmarried children of active duty or retired service members. • Widows(ers) and unmarried children of deceased active duty or retired service members.
Included Benefits			
Medically and psychologically necessary health care services and supplies, including doctors and hospital visits	x	x	x
Inpatient and outpatient mental health services	x	x	x
Durable medical equipment (including wheelchairs, prosthetics, and hearing aids)	x	x	x
Prescription drug coverage	x	x	x
Dental Care	x	x	x
Treatment for substance abuse disorders	x	x	x
Adult day health care centers	x		
Nursing home care	x		
Aid and attendance payments	x		

as private insurance or other federal programs (such as the VA), must be exhausted before Medi-Cal can provide services. Although county welfare workers are supposed to screen for veterans when processing Medi-Cal applications, a 2005 survey performed by the US Census Bureau indicates that approximately 144,000 veterans in California received Medi-Cal benefits. We estimate the cost of such benefits totals approximately $500 million ($250 million General Fund). Because approximately 90,000 of the 144,000 veterans served in World War II, the Korean War, and the Vietnam War, they likely fall into the aged and disabled category of beneficiaries. The

Quality and Access of Veterans Administration (VA) Healthcare Services

VA Health Care Rivals Private Health Care Plans. Several recent studies have shown that the VA health system currently is equal to or outperforms many privately run healthcare systems in almost all performance measures. The VA, for example, has developed software allowing doctors and nurses to quickly access a patient's records from any VA hospital or clinic the patient has used, dating back to the 1980's. This system has helped to reduce, in a dramatic fashion, the number of pharmaceutical dispensing errors, misdiagnoses, and the prescription of drugs that may interact poorly with one another. For example, after the implementation of an electronic prescription system at a VA hospital in Kansas, the hospital saw its error rate drop by over 70 percent in five years. All other VA hospitals have since adopted the same system. The system has also allowed the doctors to track and monitor systemic breakouts of illnesses, making it easier to diagnose the cause, and to easily identify the patients who might most benefit from procedures such as flu shots.

The VA Has Greatly Improved Access to Healthcare. The VA has also made significant strides in improving accessibility of care for its patients. In a recent study of waiting times for certain cardiovascular procedures, the researchers found patients in the VA system received the procedures significantly sooner than patients in some private and other government-operated health care systems such as Medicaid and Medicare. Other studies have shown the VA has drastically reduced waiting times for appointments in many clinics, in some cases by as much as 78 days.

Patient Satisfaction. The improvements in care are reflected in the level of satisfaction patients of the VA have expressed with their care. More than one survey has shown that patients of the VA system expressed higher levels of satisfaction with their care than patients of private health care systems.

costs to treat the aged and disabled are generally higher than costs to treat other groups of beneficiaries, such as children. If some portion of these veterans received medical services through the VA, the state could potentially save many tens of millions of dollars.

PARIS Could Identify Veterans Enrolled in Medi-Cal

How Does PARIS Work and Which States Participate? The U.S. Department of Health and Human Services operates PARIS and provides the data transmission and matching report at no cost to participating states. The PARIS matches public assistance recipients in participating states against various federal and state databases on a quarterly and annual basis, generating a report of duplicate Social Security numbers from the different databases.

The three databases compared under the PARIS match are:

- ***Veterans Administration***. This match determines if an individual is a veteran and whether or not the individual is collecting VA benefits.
- ***Interstate.*** This match determines if an individual is simultaneously collecting benefits in more than one state for Medicaid, SSI/SSP, TANF, and/or the Food Stamps program.
- ***Federal.*** This match determines whether an individual receiving public assistance benefits is a former federal or military employee collecting a retirement pension payment or a current federal or military employee.

States voluntarily choose to participate in the PARIS system. To do so, they must sign an agreement governing the interstate exchange of information. Currently, 42 states participate, including New York, Florida, Nevada, Arizona, and Oregon. Of the Western and Southwestern states, only California and Texas do not currently participate. In our discussions with DHCS staff, they indicate that they are currently studying PARIS implementation.

Paris Capabilities Could Be Enhanced by Improving DHCS' Computer Systems. Currently, the DHCS computer system that tracks beneficiaries, known as the Medi-Cal Eligibility Determination System (MEDS), does not identify Medi-Cal beneficiaries by their veterans' status. If the computer system had the ability to identify veterans, the DHCS could potentially provide this information to CVSOs so that these beneficiaries could be targeted for CVSO outreach efforts.

Implementing PARIS Could Lower Medi-Cal Costs Related to Veterans

The ability to identify veterans enrolled in Medi-Cal would allow DHCS to work with CVSOs to promote a voluntary shift of veterans from Medi-Cal to the VA system of healthcare. If all of the 144,000 veterans currently enrolled in Medi-Cal shifted to VA healthcare, we estimate this would result in savings to the Medi-Cal Program of about $250 million from the General Fund. However, it is more likely that there would be a more gradual shift. If 10 percent of veterans switched from Medi-Cal to VA healthcare, we estimate the state General Fund savings could be approximately $25 million.

Implementing PARIS Could Also Improve Program Integrity for Certain Health and Social Services Programs

Our analysis indicates that the greatest potential for reducing state costs through implementation of PARIS could be achieved through the voluntary shift of veterans out of Medi-Cal and into VA health care that we described above. However, program integrity in Medi-Cal, SSI/SSP, TANF, and/or Food Stamps also could be improved through implementation of PARIS.

Payments to Medi-Cal Managed Care Plans. In the Medi-Cal managed care system, the state pays Medi-Cal managed care plans an average fixed monthly payment of about $150 for each beneficiary regardless of whether the beneficiary receives any services. If a Medi-Cal beneficiary moves out of state and fails to promptly report a change of address, the state may continue to make unnecessary monthly payments to a Medi-Cal managed care plan, though the beneficiary will not use the plan's medical services. Based on other states' experiences, we estimate that cessation of these unnecessary payments could result in an estimated annual savings of $6 million ($3 million General Fund).

Other Public Assistance Programs Pay Avoidable Costs. Additional savings from the implementation of PARIS could arise from avoided costs for duplicate payments made through the CalWORKs and Food Stamp programs. Savings for the CalWORKs and Food Stamps programs are estimated to reach around $7 million ($4 million General Fund) annually. Cessation of SSP payments for the federal SSI program, which average around $300 per person monthly, could also achieve unknown savings.

Implementation Plan Key to Ensure Effectiveness of PARIS

The experience of other states in implementing PARIS has shown that a carefully planned startup can significantly affect the initial success of the program. Discussions with these states have yielded several key practices in regards to implementation.

Other States' Experiences

Designation of a Lead Department to Coordinate PARIS Implementation. To ensure that the necessary follow-up on matches occurs, other states have designated a lead agency to coordinate activities between state departments. This agency also serves as the liaison to other states researching matches.

Follow-Up Is Critical. Ensuring resources exist to provide follow-up on the matches identified by PARIS is essential. A Government Accountability Office report on PARIS found its effectiveness has been somewhat diminished because states have not adequately prioritized following up on reported matches of individuals residing in other states. States which have experienced success using the PARIS system have found that they require designated staff resources to facilitate interactions with other states and to communicate the match results to appropriate staff in the field to perform follow-up duties.

Filter PARIS Matches to Ensure Efficiency. In order to prioritize workload and ensure that staff spends their time following-up on matches with the greatest potential for savings, states commonly apply "filters" to the matched records. For example, some states have applied filters weeding out matches with benefits savings less than $50. States also utilize filters to eliminate matches that have already occurred, so that no duplicate work is performed.

Outreach Important. Washington has achieved significant success in obtaining additional benefits for veterans and their families. The success of their program is in large part due to focused outreach activities. These outreach activities include PARIS coordinators attending veteran's groups and meetings and explaining the benefits of VA healthcare, particularly emphasizing the coverage of nursing home care and payments for long-term care. Washington has also made a concerted effort to target the children and spouses of veterans to notify them of their eligibility for TRICARE and CHAMPVA. Washington State estimates that it achieved savings of $4.3 million in 2004-05 while ensuring veterans received federal benefits to which they were entitled.

Some Additional Resources Necessary to Implement PARIS

Computer Programming Costs. Computer systems at DHCS and the Department of Social Services (DSS) would require programming changes to allow interaction with the PARIS system in order to receive match data. Other states have incurred relatively low costs to change their data systems.

While California's computer systems are generally larger and more complex than those of most other states because California's programs serve a comparatively larger population, we believe the cost to perform programming changes would be modest. The first year savings generated from the avoidance of duplicate payments in the affected health and social services programs should be sufficient to offset initial start-up costs. The federal government currently offers grants to qualified states to help offset programming costs. If available, the grants would partially offset programming costs.

Staffing. The DHCS would need to hire staff to oversee the implementation of PARIS, coordinate between different departments and states, and distribute match data to the different counties for follow-up. Based on experiences in other states, including New York and Pennsylvania, we estimate two additional staff members and related operating support would be required at a cost of roughly $200,000 from the General Fund.

Once the match data is received and sorted in a central location and forwarded to counties, then county eligibility workers would perform the necessary research and follow-up. As county workers must already make periodic redeterminations, processing a match is consistent with existing workload.

Analyst's Recommendations

To ensure veterans receive the full scope of their earned benefits and ensure program integrity and the effective use of state resources, we recommend that the state participate in the PARIS computer matching process. We recommend several steps the state should take to ensure successful implementation.

Establish a Lead Agency and Determine the Entity to Review the Matches. Participating states have emphasized the need for each state to establish a central point of contact to ensure quick communication between states regarding matches. We recommend DHCS act as the lead department because the potential for savings in the Medi-Cal program resulting from successful PARIS implementation is significantly greater than potential savings for other programs.

Matched cases need prompt review to ensure success. We recommend the county welfare offices be designated to complete the follow up when a PARIS match indicates that a person is receiving duplicate benefits.

Provide Resources to Implement PARIS. Funding will be needed to make system changes in various health and social services computer programs so they can interact with PARIS. We recommend that DHCS and DSS report at budget hearings on the estimated savings that are likely to result from PARIS and the resources required at the state and local level to implement PARIS. We further recommend the departments identify federal funding available to offset these costs.

Report at Budget Hearings on Feasibility of Implementing DHCS Data System Changes. We recommend that the Legislature require DHCS to report at budget hearings on the feasibility of changing the DHCS' MEDS system to allow county eligibility workers and DHCS to flag veterans during intake and allow DHCS to flag veterans identified by PARIS. Though not necessary to the implementation of the PARIS data match process, this change would allow the state to regularly identify all of the veterans enrolled in Medi-Cal and thereby facilitate outreach to them.

Utilize the CVSOs in Outreach Efforts for Veterans. County welfare departments are supposed to refer veterans to CVSOs. However, it appears this is not always happening. We recommend DHCS report at hearings on ways to improve coordination of referrals between local county welfare departments and CVSOs.

Renegotiate MOU With Social Security Field Offices. The current memorandum of understanding (MOU) with USSSA does not require that Social Security eligibility workers refer veterans to CVSOs. We recommend that the DHCS work with DSS to modify the MOU between DSS and USSSA requiring these eligibility workers to refer all eligible veterans to CVSOs as is the practice with county eligibility workers.

SIGNIFICANT MEDI-CAL FRAUD CONTINUES

Despite a series of efforts and increased resources to combat Medi-Cal fraud since 2000-01, a recent study estimates that hundreds of millions in annual Medi-Cal costs are likely attributable to error or fraud. In order to better assess antifraud efforts by the Department of Health Care Services, we recommend that the Legislature adopt supplemental report language directing the department to submit a forthcoming evaluation of its antifraud efforts to the Legislature by August 15, 2007.

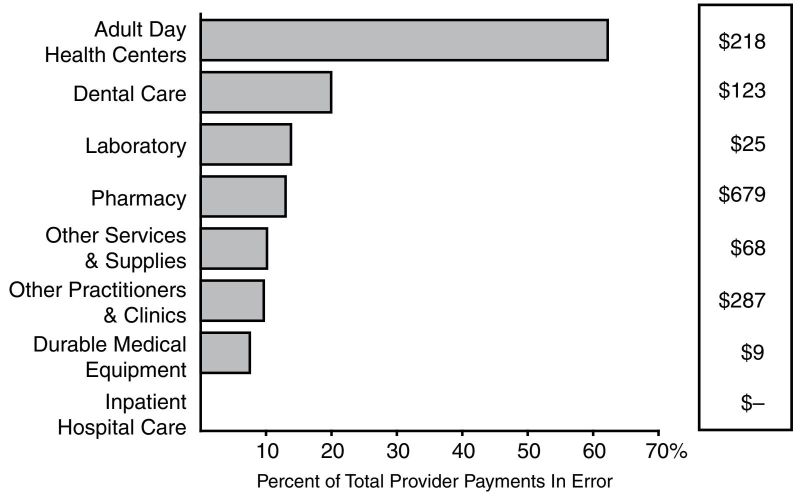
Errors and Fraud Significantly Higher in Latest Report. The Legislature provided DHCS with resources in the *2003-04 Budget Act* to conduct an annual study measuring the level of fraud in Medi-Cal fee-for-service care (in which Medi-Cal pays a health care provider for each service rendered to a Medi-Cal beneficiary). We discussed this and other antifraud issues in our *Analysis of the 2004-05 Budget Bill* (see page C-111). The department released its second such study, the 2005 Medi-Cal Payment Error Study, in July 2006. This study indicated that $1.4 billion ($700 million General Fund), or 8.4 percent, of total Medi-Cal fee-for-service dollars paid were at risk of being paid inappropriately. Of this amount, $542 million ($272 million General Fund) showed evidence of being fraudulent. These amounts were significantly higher than the 2004 study's estimates of 3.6 percent and 1.6 percent for inappropriate and fraudulent payments, respectively. The department attributes the increases to more accurate measurement of errors in the 2005 study rather than to an actual increase in erroneous payments.

Fraud Varies Significantly by Provider Type. The 2005 study indicates that the combination of errors and fraud vary greatly by type of care provider. As shown in Figure 4, payments to adult day health centers (ADHCs) showed the highest percentage of errors, while inpatient hospital care showed none. Errors in pharmacy payments accounted for the highest amount of inappropriate payments.

Figure 4

Annual Payment Error Rates and Dollar Amounts

(Dollars In Millions)



Source: California Department of Health Services, 2005 Medi-Cal Payment Error Study.

Evaluation Could Provide Useful Information. In response to the findings of the 2005 report, DHCS indicated that it expanded its antifraud activities in certain areas. Discussions with the department indicate that it has also engaged Acumen LLC, a public policy consulting firm, to evaluate its antifraud efforts. This evaluation, which is scheduled for completion by July 2007, should provide useful information regarding how the department may improve its antifraud strategy.

Analyst's Recommendation. Our review indicates that the Legislature would benefit from additional information regarding DHCS's antifraud activities. We recommend that the Legislature adopt supplemental report language to direct the department to make the report being prepared by Acumen LLC available to the Legislature by August 15, 2007. The following supplemental report language is consistent with this recommendation.

> The State Department of Health Care Services shall provide to the Joint Legislative Budget Committee, the fiscal committees, and the appropriate policy committees of the Legislature by August 15, 2007, copies of the independent consultant's evaluation of its antifraud activities and strategies.

SOME REQUESTS FOR ADDED STAFF EXCESSIVE

The budget request for the Department of Health Care Services includes $26.5 million ($16.1 million General Fund) to implement various proposals generally related to the administration of the Medi-Cal Program. We recommend that some of the funding requests for additional staff be approved, but recommend a reduction of $1.9 million General Fund because others are not justified on a workload basis. We further recommend a $2.7 million General Fund reduction in Medi-Cal local assistance to properly reflect certain county administration costs. (Reduce Item 4260-001-0001 by $1.9 million and Item 4260-101-0001 by $2.7 million.)

Governor's Budget Proposal. The *2007-08 Governor's Budget* proposes 176.5 additional staff positions and corresponding contract resources in DHCS to implement various proposals generally related to the administration of the Medi-Cal Program. Of these additional staff positions, 73.5 positions are proposed to implement legislation enacted during 2006.

This analysis examines the staff proposed for DHCS, as summarized in Figure 5 (see next page). The figure shows the general purpose of each request, the number of associated staff positions, and the total costs and General Fund amount requested.

Figure 5

Medi-Cal Administration
2007-08 Proposals for Positions and Related Funding[a]

(Dollars in Thousands)

	Position Request	General Fund	Total Funds
Resolution of drug rebate disputes	11.0	$542	$1,085
Implementation of federal Deficit Reduction Act requirements	5.0	285	571
Continuing implementation of federal health information law	19.0	565	2,349
Information technology support for third-party liability operations	5.0	182	729
Planning and development to replace the Medi-Cal Management Information System	22.0	628	2,512
Implementation of Medi-Cal self-certification pilot	3.0	147	294
Adult day health center program restructuring	46.0	1,835	3,868
California Discount Prescription Drug Program Staff	16.0	8,830	8,830
Pediatric palliative care benefit	3.0	174	408
Implementation of hospital "fair pricing" policies	4.5	252	504
Information privacy and physical security	3.0	-27	-148
County performance and coordination	2.0	97	195
Extend staffing for Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing Pilot Project	3.0	81	193
Staffing for specialty mental health waiver unit	1.0	—	108
Extension of third-party liability limited-term positions	9.0	130	517
Conversion of Health Insurance Recovery Group positions to permanent status	7.0	138	551
Continuing implementation of the hospital financing waiver	11.0	561	1,122
Implementation of supplemental reimbursement for health facilities	1.0	—	97
California Rx Prescription Drug Web Site Program staff	1.0	96	96
Medi-Cal community living support benefit waiver pilot	3.0	—	290
Medi-Cal enrollment of certified nurse practitioners	1.0	24	96
Totals	**176.5**	**$14,540**	**$24,267**

a Excludes proposals that requested only contract funding.

Evaluating the Governor's Budget Requests

Our analysis of these budget requests for DHCS included a review of the department's overall staffing resources as well as an analysis of the justification offered by the administration for these specific proposals. The information we reviewed supports some of DHCS's proposals, but raises concerns about others.

Department Already Has More Positions Than It Can Fill

High Vacancy Rate. The *2006-07 Budget Act* provided the funding to support about 3,000 positions associated with DHCS operations. It is not unusual for a portion of a department's authorized positions to be vacant during the course of a fiscal year, as staff members leave state service, transfer to other departments, or retire. The customary vacancy rate (known as "salary savings") which is incorporated into the budgets for most state staffing functions, is about 5 percent. However, based on our review of staffing data provided by the department, about 12 percent of DHCS authorized staff positions were vacant as of January 2007.

DHCS Has Some Flexibility to Meet Its Staffing Priorities. A number of factors can lead to this high staffing vacancy rate. These include a surge of staff members reaching retirement age and difficulties in recruiting for specialized positions such as pharmacists where public sector and other agency competition is high. However, this situation means that DHCS has more position authority and funding in the *2006-07 Budget Act* than it is likely to use in the current year.

Justification Lacking for Some Budget Requests

Our analysis indicates that some of the specific requests for position authority and contract resources for Medi-Cal administrative activities are not justified on a workload basis at this time. We discuss the specific budget requests about which we have concerns below and summarize our position recommendations in Figure 5. We also note that some staffing requests presented by the administration describe positions sought beginning in 2008-09, although funding and position authority for these positions are not included in the requested totals for 2007-08. It is premature at this time for the Legislature to consider these positions, and our analysis does not address them.

Resolution of Drug Rebate Disputes. The administration proposes to continue its efforts to resolve an outstanding backlog of disputes over rebates owed to the state from drug makers and to continue its efforts towards collecting current rebates by converting 5.5 limited-term positions to permanent positions and continuing another 5.5 limited-term positions for an additional year. We take no issue with the conversion of the 5.5 limited-term positions to permanent positions, but withhold recommendation on the continuation of the 5.5 limited-term positions until the time of the May Revision so that we can review whether any of these limited-term positions are vacant. The DHCS has indicated these positions have an approximately nine-month training period and a high turnover rate. At the time of the May Revision, the request should be adjusted to eliminate any vacant positions because it is unlikely that newly hired staff will become productive over a one-year period.

Implementation of Federal Deficit Reduction Act (DRA) of 2005 Requirements. The DRA requires the state to implement new policies to verify a Medi-Cal applicant's citizenship and identity. It will also require an additional asset eligibility determination when an applicant applies for long-term care and selected other services. Most of the workload related to implementing DRA requirements is one-time in nature and includes the development of policies and procedures. The *2007-08 Governor's Budget* proposes five additional positions, two permanent and three limited-term, for implementation of these new requirements. As the bulk of the workload related to implementation of the new citizenship requirements has already occurred, we believe that only three of the five positions requested are warranted, and that these three positions should be filled on a limited-term basis.

Staff to Continue Implementing Federal Health Information Law. The 2007-08 budget proposes the continuation of 13 limited-term positions and the addition of six limited-term positions to implement additional provisions of the federal Health Insurance Portability and Accountability Act. This law establishes new requirements for the privacy and use of certain health information. Our review finds that the proposed workload for one of the requested analyst positions is duplicative of workload for other analyst positions proposed in this budget. Additionally, DHCS has departmental vacancy rates for certain position classifications in this request that significantly exceed budgeted salary savings, and we find it reasonable that DHCS could redirect positions from a different unit within DHCS to fill seven of these positions. Therefore, we recommend that the Legislature reject eight of the requested positions.

Information Technology Support for Third Party Liability Medicare Operations. The Governor's budget proposes to add five new permanent positions and $180,000 for Data Center use to meet the mandates required by the federal Medicare Modernization Act in the processing of transactions for beneficiaries who are both Medi-Cal and Medicare eligible (known as dual eligibles). The staffing request does not reflect that many of the functions these five positions would perform are one-time in nature. For example, the modification of existing Medi-Cal automated systems to interface properly with Medicare Part D systems should need to occur only once. Furthermore, some of the workload cited to justify these positions should be completed before the start of the budget year. Our analysis indicates that only three of the five additional positions requested are warranted given the expected ongoing workload. We do not raise any issues with the $180,000 for Data Center use.

Planning and Development for a Replacement Medicaid Management Information System (MMIS). The 2007-08 budget requests 22 limited-term positions to complete preliminary work necessary to re-procure the Medi-Cal Fiscal Intermediary contract. The new contract will include replacement of the Medicaid Management Information System (MMIS), which pays Medi-Cal claims. The budget also requests funding for a contractor who will assist DHCS in the preliminary work. Our analysis indicates that a substantial portion of the workload DHCS staff will be required to perform will depend upon the work the contractor is able to perform and, as such, remains undetermined until the contractor begins its work. (The DHCS has indicated the contract will be awarded in April 2007.) We find that seven of the requested 22 positions are currently not justified due to uncertainty about what the workload will be in 2007-08 and therefore should be deleted.

Implementation of Medi-Cal Self-Certification Pilot Project. The Governor's budget includes three new positions to implement a Medi-Cal pilot program authorized by Chapter 328. The two-year pilot program, which is scheduled to begin in July 2007 in two counties, will allow persons submitting new applications or annual eligibility redetermination forms to self-certify their income and asset information. Our review indicates that one of the proposed positions is not justified on a workload basis. Additionally, we find that DHCS could redirect positions from a different unit within DHCS to fill the other two proposed positions. As such, we recommend that the Legislature deny the requested positions.

Our analysis also indicates that the Medi-Cal budget request does not account for local assistance savings likely to result from the reduced processing time per eligibility case associated with the self-certification pilot program. Properly reflecting these savings would lower county administration costs by $2.7 million General Fund ($5.3 million all funds).

The California Discount Prescription Drug Program. The administration proposes to establish 16 positions and appropriate $6.8 million General Fund to implement the California Discount Prescription Drug Program (CDPDP) enacted by Chapter 619, Statutes of 2006 (AB 2911, Nuñez). We believe 15 of the 16 positions requested are justified at the current time. Furthermore, one of these justified positions is only needed on a one-year limited-term basis as the functions performed are mostly one-time in nature.

The budget also includes a request for $6.8 million General Fund for operational costs involved in implementation of the CDPDP. This funding is only for vendor and systems development and does not include the cost for the "float," which is the amount of money the state will need to purchase the drugs for the program. The float is required because drug manufacturers pay rebates to the state on a quarterly basis. However, the state must reimburse pharmacies for rebates within two weeks of a consumer's purchase of a drug. Therefore, the state will be obligated to pay out rebates to pharmacies before it actually collects the rebate funds from a drug manufacturer. The DHCS estimates that the payments for drugs will be an ongoing cost as more consumers enroll in the program. At the time of this analysis, DHCS has no estimate of what the float amount might be. We do not have any concerns with the $6.8 million requested for operational costs involved in implementation of the CDPDP, but note that additional funding will be required to provide the float.

Adult Day Health Center Program Restructuring. The Governor's budget proposes additional staff to conduct antifraud activities related to ADHC services and to implement the ADHC reforms enacted by Chapter 691, Statutes of 2006 (SB 1755, Chesbro). The proposal seeks 46 full-time positions, of which 26 would be limited term. However, because 15.5 of these positions would not start until January 2008, the proposal only seeks one-half-year funding and authority in 2007-08. Our analysis indicates that a substantial portion of the proposed audit and appeal workload related to the antifraud activities would not commence until 2008-09 or later. As such, we find that 13 positions (11 full-time equivalent positions) are not justified for 2007-08.

Development of Pediatric Palliative Care Pilot. The budget plan proposes three positions to develop a pilot pediatric palliative care program authorized by Chapter 330, Statutes of 2006 (AB 1745, Chan). Our review indicates that the proposed payment rate development workload is not justified at this time, and we recommend that the Legislature deny one of the positions associated with this work.

Implementation of Hospital "Fair Pricing" Policies. The budget plan proposes 4.5 limited-term positions at DHCS to audit hospitals' compliance with new pricing policies required for licensing under Chapter 755, Statutes of 2006 (AB 774, Chan). This proposal would support the positions from the General Fund and matching federal funds. Our review indicates that it would be appropriate to fund these positions using fees assessed on hospitals for licensing activities. The department has the authority to adjust these fees to fund its staffing needs for licensing functions. Additionally, we find that the workload standard used by DHCS in determining the positions proposed for this work is lower than standards used in other proposals for auditors in recent years. Thirdly, we find that at least a portion of this workload will be ongoing in nature, rather than limited term. As such, we recommend that 3.5 of the requested positions be approved and funded by licensing fees. Two of these positions should be permanent.

Analyst's Recommendations

As noted above, some administration requests warrant approval, but others lack justification on a workload basis. In addition, the 12 percent vacancy rate now being experienced by DHCS calls into question whether the addition of a large number of staff is appropriate at this time.

Accordingly, we recommend that some of the administration proposals be approved as proposed, and that others be modified (in most cases to reduce the number of positions requested and the associated operating expenses and equipment). In summary, our recommendations would result in a reduction of 43.5 of the 176.5 requested positions. The amount of funding provided for these specific ten proposals would be reduced by $1.9 million General Fund and $4.8 million from all fund sources. However, we withhold recommendation regarding the requested extension of the 5.5 limited-term positions for the drug rebate program. Additionally, we recommend that local-assistance funding be reduced by $2.7 million General Fund and $5.3 million total funds in order to reflect lower county administration costs associated with the self-certification pilot program.

Our specific recommendations for each of the DHCS budget requests are summarized in Figure 6 (see next page).

RESIDENTIAL CARE MODELS ALLOW SHIFT FROM INSTITUTIONS TO COMMUNITY

The Department of Health Care Services has requested three positions, on a two-year limited-term basis, to develop a State Plan Amendment adding the Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing (ICF/DD-CN) pilot program as a permanent state benefit. While we take no issue with the request for positions, we recommend the Legislature adopt supplemental report language directing the Department of Health Care Services to submit a report based on a comprehensive evaluation of the ICF/DD-CN pilot program. Such an evaluation will help ensure the Legislature has sufficient information upon which to base decisions about the future of this pilot program.

We discuss our recommendations in the "Department of Developmental Services" analysis in this chapter.

Figure 6

Summary of Requested DHS Positions and LAO Recommendations

	Position Request	LAO Recommendation
Proposals With Recommended Adjustments		
Resolution of drug rebate disputes	11.0	5.5[a]
Implementation of federal Deficit Reduction Act requirements	5.0	3.0[b]
Continuing implementation of federal health information law	19.0	11.0[b]
Information technology support for third-party liability operations	5.0	3.0
Planning and development to replace the Medi-Cal Management Information System	22.0	15.0[b]
Implementation of Medi-Cal self-certification pilot	3.0	—
Adult day health center program restructuring	46.0	33.0[b]
California Discount Prescription Drug Program Staff	16.0	15.0[b]
Pediatric palliative care benefit	3.0	2.0[b]
Implementation of hospital "fair pricing" policies	4.5	3.5[b]
Totals	**134.5**	**91.0**
Recommended for Approval as Budgeted		
Information privacy and physical security	3.0	3.0[b]
County performance and coordination	2.0	2.0
Extend staffing for Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing Pilot Project	3.0	3.0[b]
Staffing for specialty mental health waiver unit	1.0	1.0
Extension of third-party liability limited-term positions	9.0	9.0[b]
Conversion of Health Insurance Recovery Group positions to permanent status	7.0	7.0
Continuing implementation of the hospital financing waiver	11.0	11.0[b]
Implementation of supplemental reimbursement for health facilities	1.0	1.0
California Rx Prescription Drug Web Site Program staff	1.0	1.0
Medi-Cal community living support benefit waiver pilot	3.0	3.0[b]
Medi-Cal enrollment of certified nurse practitioners	1.0	1.0
Totals	**42.0**	**42.0**
Totals (All Positions)	**176.5**	**133.0**

a We withhold recommendation for the extension of 5.5 limited-term positions.

b Some recommended positions are limited term. Please see text for further detail.

DEPARTMENT OF PUBLIC HEALTH
(4265)

Effective July 1, 2007, the budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), which creates a new state Department of Public Health (DPH) and renames the existing Department of Health Services (DHS) as the Department of Health Care Services (DHCS). The new DPH will deliver a broad range of public health programs. Some of these programs complement and support the activities of local health agencies in controlling environmental hazards, preventing and controlling disease, and providing health services to populations who have special needs. Others are solely state-operated programs, such as those that license health care facilities.

The Governor's budget proposes about $3 billion from all funds for state operations and local assistance for DPH in the budget year. Total proposed local assistance expenditures are about $2.3 billion, of which $278 million is from the General Fund. The General Fund amount is 51 percent less ($285 million) than the revised current-year level of spending. This decrease is largely due to the elimination of one-time funding of $180 million General Fund to build capacity to provide health care services during an emergency.

KEY BUDGET PROPOSALS

The Governor's proposed budget for public health programs includes the following significant changes:

- ***Creation of DPH.*** The Governor's budget plan implements Chapter 241, Statues of 2006 (SB 162, Ortiz), which establishes a new state DPH. Chapter 241 requires its implementation to be budget neutral. We discuss this proposal in more detail later.

- ***Emergency Preparedness.*** The Governor's budget proposes to extend 95 positions for public health emergency preparedness. These positions are fully funded through two federal grants.
- ***Licensing and Certification.*** The Governor's budget proposes $11.4 million in special and federal funds, and 77 positions to implement enacted legislation and to improve oversight of health care service providers. We discuss these proposals in more detail later in this section.
- ***Genetic Diseases.*** The Governor's budget proposes an increase of $4.7 million in special funds and six positions to implement Chapter 484, Statutes of 2006 (SB 1555, Speier), which expands research efforts and prenatal screenings for birth defects.
- ***Prostate Cancer Treatment.*** The budget plan includes $3.5 million General Fund to provide prostate cancer treatment services through the Improving Access, Counseling and Treatment for Californians with Prostate Cancer (IMPACT) program. We discuss this proposal in more detail later in this section.
- ***Foodborne Illness.*** The Governor's budget proposes $2.1 million General Fund and nine positions to enhance the state's response capabilities to foodborne illnesses such as E. coli. We discuss this proposal in more detail later in this section.
- ***Name-Based HIV Reporting.*** The Governor's budget includes $2 million General Fund for Local Assistance funding to accelerate efforts to convert California to a name-based HIV reporting system pursuant to Chapter 20, Statutes of 2006 (SB 699, Soto).
- ***Health Care Associated Infections Control Program.*** The budget plan includes $1.9 million ($1.6 million General Fund) and 14 positions to implement a health care associated infection surveillance and prevention program pursuant to Chapter 526, Statutes of 2006 (SB 739, Speier). We discuss this proposal in more detail later in this section.
- ***Biomonitoring.*** The Governor's budget proposes $1.2 million General Fund and three positions to implement an environmental contaminant biomonitoring program pursuant to Chapter 599, Statues of 2006 (SB 1379, Perata).
- ***California Electronic Death Registration System.*** The Governor's budget requests $1 million in special funds and 13 limited term positions to address the increased workload associated with the death registration and data dissemination process.

- ***County Medical Services Program (CMSP) General Fund Elimination.*** The Governor's budget proposes legislation to again suspend the state's General Fund appropriation of about $20 million to CMSP.
- ***Oral Health Assessments.*** The Governor's budget proposes $221,000 General Fund and two limited term positions to complete a report regarding the improvements in the oral health of children resulting from recently enacted legislation. We discuss this proposal in more detail later in this section.

NEW DEPARTMENT OF PUBLIC HEALTH

The Governor's budget plan implements enacted legislation that creates a new Department of Public Health. We find the administration's proposed organization structure is reasonable, but find that the department should be more transparent in its budgeting. For this reason, we withhold recommendation on this proposal pending receipt of key budget documentation.

Background

Effective July 1, 2007, the budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), which creates a new state DPH and renames the existing DHS as DHCS. The DPH will be established under the existing Health and Human Services Agency.

The DPH will administer a broad range of public and environmental health programs. These programs seek to prevent illness in, and promote the health of, the public at large. In contrast, DHCS will deliver health care services to eligible individuals, through the state's Medicaid program (known as Medi-Cal in California) and through other programs, such as the Genetically Handicapped Persons Program and the California Children's Services Program. The creation of a separate DPH is intended to elevate the visibility and importance of public health issues. It is also intended to result in increased accountability and improvements in the effectiveness of DPH programs and DHCS programs by allowing each department to administer a narrower range of activities and focus on their respective core missions. The legislation creating the two new departments requires that the change be cost neutral to the state.

Proposed New Organizational Structure

Seven Distinct Programs. As part of the creation of the new department, DPH has reorganized its structure into five programmatic centers, each of which emphasizes a distinct aspect of public health—(1) preventing chronic disease, injury, and environmental and occupational exposures; (2) combating infectious diseases; (3) regulating the environment; (4) promoting family health; and (5) providing quality services through licensed providers. These centers are intended to provide high-level visibility on important public health issues to all constituents. The other two public health programmatic functions—Emergency Preparedness and Health Information and Strategic Planning—are separate areas within DPH. The five new centers and the Emergency Preparedness and Health Information and Strategic Planning areas will report directly to the Chief Deputy Director of Policy and Programs. Figure 1 shows the programmatic organization of DPH.

Figure 1

New Department of Public Health Programmatic Organization

Center for Chronic Disease Prevention and Health Promotion

- Chronic Disease and Injury Control
- Environmental and Occupational Disease Control

Center for Infectious Disease

- Office of AIDS
- Communicable Disease Control

Center for Environmental Health

- Food, Drug, and Radiation Safety
- Drinking Water and Environmental Management

Center for Family Health

- Women, Infants, and Children
- Maternal, Child, and Adolescent Health
- Genetic Disease
- Office of Family Planning

Center for Healthcare Quality

- Licensing and Certification

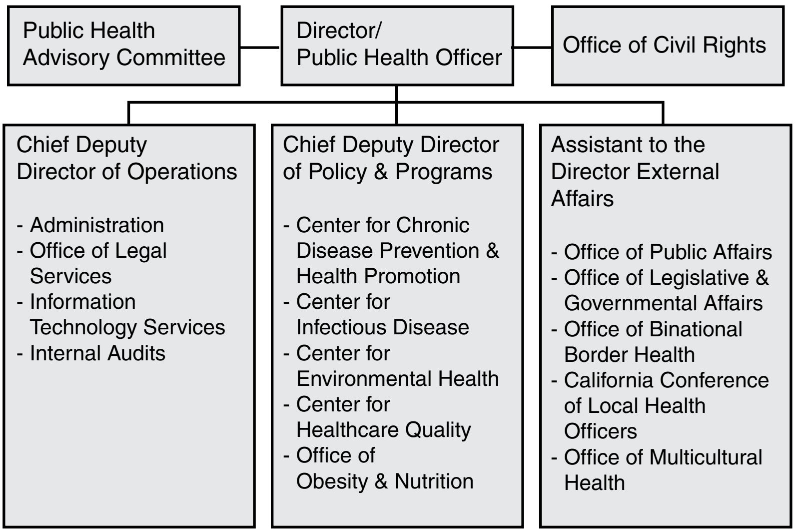
Health Information and Strategic Planning

Public Health Emergency Preparedness

Operations. The Chief Deputy Director of Operations will oversee such functions as administration, legal services, information technology services, and internal audits. In addition to the two Chief Deputy Directors, an Assistant to the Director will monitor external affairs, including DPH's interaction with the California Conference of Local Health Officers, the Office of Multicultural Health, and the Office of Binational Border Health. The Office of Women's Health will be located at DHCS, but will continue to serve the needs of DPH through an interagency agreement. Figure 2 shows the new organizational structure at DPH.

Figure 2

Department of Public Health Organization Structure



Public Health Advisory Committee. Chapter 241 also requires the establishment of a Public Health Advisory Committee. The purpose of this committee is to provide expert advice and make recommendations on the development of policies and programs that improve public health effectiveness, identify emerging public health issues, and make recommendations on programs and policies to improve the health and safety of Californians. This committee serves an advisory role to the Director of DPH.

Budget Implications

Chapter 241 Requires Budget Neutrality. As discussed earlier, Chapter 241 requires that the reorganization be budget neutral. That is, there should not be any baseline increases in state funding for either DPH or DHCS. Similarly, Chapter 241 did not allow for increases in position authority to implement its provisions. The intent of Chapter 241's budget neutrality requirement is for the fiscal impact of the reorganization to be absorbed within DHS' current resources.

Costs to Reorganize. In order to carryout the reorganization, the DHS estimates that it will incur one-time costs of $1 million in the current year for three purposes: (1) $800,000 for office construction and moving expenses, (2) $100,000 for equipment, and (3) $100,000 for a change management consultant. The DHS indicates that it is absorbing these costs within existing resources, but has not been able to provide details on how these costs are being funded. For example, it is unclear whether these reorganization costs are being funded from redirected local assistance funding or from savings generated due to vacancies in the current year.

The administration is proposing to redirect 57 positions for key management and administrative functions. The cost for these positions is approximately $5 million.

Reorganization Milestones

The administration has completed the following key reorganization milestones: (1) the development of organizational structures, mission statements, and budget details to display DPH and DHCS separately in the Governor's budget; (2) the procurement of a change management consultant to help with the reorganization; and (3) the publishing of updates on the reorganization to inform DHS staff and external stakeholders of the progress of the reorganization.

At the time this analysis was prepared the department still had to complete the following key reorganization milestones: (1) redirect, reclassify, and fill positions before June 30, 2007; (2) create the Public Health Advisory Committee; (3) split out accounting systems and IT systems between DPH and DHCS; (4) finalize plans for relocating employees associated with the new DPH; (5) create new websites; and (6) identify issues that require Interagency Agreements.

DPH's New Structure Likely an Improvement, but Accountability Still an Issue

Flattened Organizational Structure Potentially More Responsive. Historically, the public health programs, managed by DHS, existed within a more hierarchical administrative structure compared to the flatter administrative structure proposed for the new DPH. We find that the flattening out of the organization into centers that report directly to the Chief Deputy Director of Policy and Programs has the potential to expedite policy and budget decisions at DPH. Additionally, we find that the separation of chronic disease, infectious disease, and environmental health into discrete centers would allow these program areas in the organization structure to be more specialized and focus on a distinct aspect of public health. (These three areas were all contained in the Prevention Services area at DHS.) Furthermore, we find that a flatter organizational structure could increase overall responsiveness to constituency groups because each programmatic area would have a more direct reporting relationship to key policymakers.

No Increased Fiscal Accountability. As discussed earlier, the intent of creating a DPH was to increase the accountability of public health programs. However, creating a new department alone will not increase accountability. Rather the department will need to take steps to be transparent in its administration and budgeting. In past years, the administration provided supplemental schedules that gave detailed information about federal fund and local assistance expenditures, a local assistance appropriation summary, and a vacant position report soon after the budget was released. However, at the time this analysis was prepared, the local assistance appropriation summary and the vacant position report had not yet been provided to the Legislature. Without this information, it is difficult to complete a thorough analysis of the administration's budget proposal for DPH and DHCS. For example, we note that the State Controller's Office (SCO) vacancy report for DHS showed a 17 percent vacancy rate for the entire department. However, at this point, it is unclear if this same vacancy rate applies to positions which will move to DPH. Staffing information by division and branch is critical when evaluating whether or not the new department will be able to adequately perform its core functions and whether or not requested positions are justified.

Key Budget Information Unavailable. As we discussed in our *Analysis of the 2006-07 Budget Bill*, detailed information on the actual past year, estimated current year, and proposed budget year level of spending for each of the public health subprograms is not available to the Legislature in the Governor's budget documents. (Each of the five program centers we discussed above may encompass two or more subprograms.) Lack of timely and regular expenditure information about these subprograms undermines the ability of the Legislature to exercise oversight of these funds, which amount to hundreds of millions of dollars annually. This information also is critical as a benchmark by which to monitor the growth of the department over time.

Analyst's Recommendations

Withhold Recommendation on Administration's Reorganization. While we generally approve of the administration's proposed organizational structure for the new DPH, without detailed budget information it is impossible to complete a thorough review and analysis of the administration's proposal. Furthermore, pending receipt of information regarding how the department plans to absorb the reorganization costs, we cannot determine if the proposal is cost neutral to the state. Therefore, we withhold recommendation on the administration's proposal, pending receipt of the local assistance appropriation summary, vacancy report, and detailed information on how the reorganization costs will be funded.

Budget Should Include Detailed Information. We recommend that additional information detailing DPH's (1) local assistance expenditures by program and subprogram and (2) allocation of federal funds by program and subprogram be included in the Governor's budget document as a schedule. Accordingly, we recommend the adoption of the following budget bill language, Item 4265-001-0001:

> Provision X. The Department of Finance shall revise the Governor's budget documents display for the state Department of Public Health to include a display of the following information: (1) the supplemental local assistance schedule, including past year, estimated current year, and proposed budget year expenditures for each program and subprogram and (2) the supplemental federal fund/reimbursements schedule, including past year, estimated current year, and proposed budget year expenditures for each program and subprogram

We also recommend supplemental report language requiring DPH to annually submit a vacancy report to the Legislature by January 10th. As discussed earlier, the vacancy report can be used to evaluate whether or not position requests are justified and if the department is having a difficult time filling certain position types. This vacancy report shall include a listing of all filled and vacant positions in the department by division and branch. (This organizational unit information is not available in the SCO vacancy report.)

Public Health Advisory Committee Report to Legislature Annually. We recommend trailer bill language requiring the Public Health Advisory Committee to report annually to the Legislature on the state's public health priorities and ways state resources could be used more effectively to address these priorities. Having the committee report annually to the Legislature would facilitate legislative oversight not only of DPH but the overall status of public health in California.

Report at Budget Hearings on Remaining Milestones. Finally, we recommend that DHS report at budget hearings on its progress in creating the new DPH and DHCS. While some key milestones have been completed, the completion of the remaining milestones over the next few months will be critical to ensuring that the new DPH is operational July 1, 2007. For this reason, we think it is important for the Legislature to be updated on the status of at least the following activities, (1) the creation of the Public Health Advisory Committee, (2) the reclassifying and filling of positions, (3) the creation of Interagency Agreements between DPH and DHCS, and (4) the split of accounting and IT systems.

LICENSING PROPOSALS

The Governor's budget proposes a number of changes to the licensing and certification (L&C) program at the Department of Public Health (DPH) to implement recently enacted legislation and to improve the state's oversight of certain health care facilities. We recommend that some of the request for funding for additional staff be approved, but recommend a reduction of $291,000 in special funds because other components of the proposal are not justified on a workload basis. We also present an alternative for reducing the number of vacant positions, thereby ensuring that health care facilities are regularly inspected. (Reduce Item 4265-001-3098 by $291,000.)

Background

Main Responsibilities. The L&C Division within DPH is responsible for ensuring and promoting a high standard of medical care in approximately 7,000 public and private health care facilities throughout the state. These facilities include hospitals, skilled nursing facilities, and home health agencies. The L&C's primary responsibilities are to:

- Conduct annual certification surveys of facilities for participation in the federal Medicare and Medicaid (Medi-Cal in California) programs.
- Conduct state licensing reviews and ensure compliance with state law.
- Issue state citations and federal deficiencies, impose sanctions, and assess monetary penalties on those facilities that fail to meet certain requirements.
- Investigate consumer complaints about health care facilities and incidents that are self-reported by the facilities. These complaints may be received via telephone, mail, personal contact, or during a facility inspection.

2006-07 Budget Act Authorized L&C Expansion. The *2006-07 Budget Act* authorized 141 new positions in L&C for increased licensing and certification workload. Additionally, the act established a fee structure to require state-regulated facilities to pay a greater share of licensing costs through fees in order to phase-out General Fund support for licensing and certification functions. The General Fund was to provide $7.2 million in 2007-08 and $3.6 million in 2008-09.

Governor's Proposals

The *2007-08 Governor's Budget* proposes to improve the licensing efforts of DPH. The proposals include (1) 8.5 positions and $888,000 in federal and special funds for increased legal and administrative support for the 141 new L&C staff added in the *2006-07 Budget Act*, (2) 2.5 positions and $57,000 from a special fund to investigate complaints and citations of nursing home administrators, and (3) accelerated implementation of the statutory requirement for the program to become fee-supported, resulting in an estimated General Fund savings of $7.2 million in 2007-08 and $3.6 million in 2008-09.

The Governor's budget also proposes resources to implement various new laws. In part, these proposals would increase the number of Health Facility Evaluator Nurses (HFENs) by 32 positions which we discuss later in this analysis. With regard to other statutes, the budget proposes the following:

- ***Chapter 647, Statutes of 2006 (SB 1301, Alquist).*** The budget proposes 45 positions (including 21 HFENs) and $7.1 million from the Licensing and Certification Fund to implement Chapter 647 which requires the reporting of serious medical errors to DPH and establishes timeframes for both reporting and follow-up investigations.
- ***Chapter 895, Statutes of 2006 (SB 1312, Alquist).*** The budget proposes 16 positions (including 10 HFENs) and $2.5 million from the Licensing and Certification Fund to implement Chapter 895 which requires DPH to reinstate the periodic licensing of long term care facilities using state standards and to improve patient safety by authorizing financial penalties when a hospital commits a serious health and safety violation.
- ***Chapter 775, Statutes of 2006 (AB 2373, Aghazarian).*** Four positions and $592,000 in special funds are requested to implement Chapter 775 which adds nursing facilities to the list of facilities that can use an automated drug delivery system.

- ***Chapter 755, Statues of 2006 (AB 774, Chan).*** The budget plan proposes 1.5 positions (including one HFEN) and $195,000 from the Licensing and Certification Fund to implement Chapter 755 which ensures hospitals apply fair pricing to uninsured and underinsured patients.

Nursing Positions Difficult to Fill

As previously mentioned, the *2006-07 Budget Act* added 141 new positions to L&C. Of these new positions, 81 positions have been filled as of January 1, 2007. Figure 3 shows the positions that were approved last year and how many of these positions have been filled.

Figure 3

Status of Licensing Certification Positions Added in *2006-07 Budget Act*

	Positions Approved in *2006-07 Budget Act*	Positions Filled	Positions Vacant
Nurse Evaluators	94[a]	56	38
Pharmacists	7	6	1
Support Staff	40	19	21
Totals	**141**	**81**	**60**

[a] Ninety-six Health Facility Evaluator Nurses were approved in the *2006-07 Budget Act*, but two of these positions were subsequently reclassified.

Nurse Vacancies. As shown in Figure 4 (see next page), in addition to the 94 health facilities evaluator nurses (HFENs) that were added in last year's budget, the department had 22 vacancies in this classification at the beginning of fiscal year 2006-07, for a total of 116 HFEN vacancies. (A HFEN must be a registered nurse.) As of January 1, 2007, L&C had hired 56 HFENs to fill these positions, but 60 HFEN positions remained vacant including the 38 vacant positions shown in Figure 3.

The L&C has taken several steps to recruit nurses in order to fill these vacant positions. For example, L&C mailed a postcard to every registered nurse in the state in order to solicit recruits for positions at L&C. Additionally, L&C has shortened the length of time it takes to get a newly hired nurse trained and tested from 18 to 24 months to 12 to 18 months. Despite these efforts, L&C has not been able to recruit enough qualified candidates to fill these vacancies.

Figure 4

Status of Health Facility Evaluator Nurses Positions

	Positions Approved In *2006-07 Budget Act*	Vacant Positions as of July 1, 2006	Positions Filled	Positions Vacant
Health Facility Evaluator Nurses	94[a]	22	56	60

[a] Ninety-six Health Facility Evaluator Nurses were approved in the *2006-07 Budget Act*, but two of these positions were subsequently reclassified.

Filling the remaining vacant HFEN positions at L&C is likely to be difficult, given the demand for nurses and the competition from the private sector and other state departments that are currently recruiting to fill vacant nurse positions. Furthermore, we note that nurse salaries are proposed to be increased at three other departments (the Department of Veterans Affairs, the Department of Mental Health, and the Department of Developmental Services). This will create a salary differential between L&C and these departments that may make L&C less competitive in its recruitment efforts than it would be if it were able to offer salaries comparable to other state departments.

Implementing the Reinstatement of Inspections Against State Standards

The administration is proposing trailer bill language (which was not available at the time this analysis was prepared) to facilitate L&C's implementation of Chapter 895's inspection requirements.

Analyst's Recommendations

Some of the administration's position requests warrant approval, but others lack justification on a workload basis. In addition, the high vacancy rate now being experienced by L&C for HFENs calls into question whether the addition of 32 new HFENs is appropriate at this time. Based on our review, we provide an alternative to the requested HFEN positions and recommend reducing a number of the positions requested by the administration.

Alternative to Health Facilities Evaluator Nurse Positions. Based on our review, we believe that a number of the HFEN positions should be reclassified to Health Facility Evaluator I (HFEI) positions for two reasons. First, HFEI positions can be filled by licensed vocational nurses or psychiatric technicians, whereas HFEN positions may only be filled by registered nurses. Second, the training and certification required of HFEIs is the same as that required of HFENs. Both would undergo training in state licensing and federal certification requirements and would have to successfully pass a minimum qualifications test. We recognize that some of the 32 requested positions must remain HEFN given that a HFEN must be on every survey team, but the use of HEFIs is a potential means of accomplishing the Legislature's goal of timely and thorough inspections of health care facilities because these positions are likely easier to fill. Therefore, we recommend L&C report at budget hearings on the feasibility of using HFEIs and the number of HFEN positions that would be required for survey teams.

Health Facilities Reporting and Inspection Requirements. The Governor proposes two associate information system analysts to provide desktop support and system training to the staff added to implement Chapter 647. We recommend rejection of one associate information system analyst on a workload basis because we find the administration has overestimated the number of hours necessary for system training.

Automated Drug Delivery System Recommendations. The Governor proposes two one-year limited term pharmaceutical consultants, one permanent pharmaceutical consultant, and one office technician to implement Chapter 775. We recommend the approval of only one of the two requested limited term pharmaceutical consultants given that the estimated number of hours to complete specified one-time activities equates to one position. We further recommend rejection of the office technician position. We find that the workload proposed for this position can be absorbed by other newly requested positions and existing positions in L&C.

Withhold Recommendation on Trailer Bill Language. We withhold recommendation on the trailer bill language proposed to implement the reinstatement of inspections using state standards, pending receipt and review of the proposed language. The Legislature's intent is that these reinstated licensing inspections be done concurrently with federal certification inspections. From our review, it is unclear why trailer bill language is necessary given current law.

FOODBORNE ILLNESS EMERGENCY RESPONSE

The budget request for the Department of Public Health includes $2.1 million General Fund to expand emergency response capabilities to foodborne illness and to support food safety research. We recommend that $1.3 million of the funding request for additional staff and research

be approved, but recommend a reduction of $800,000 General Fund because some of the requested positions are not justified on a workload basis. (Reduce Item 4265-001-0001 by $800,000.)

Background

The DPH Has Some Responsibility for Food Safety. The Food and Drug Branch (FDB) of DPH is responsible for ensuring that certain foods are safe, are not adulterated, misbranded, or falsely advertised. One way it does this is by regulating and routinely inspecting the approximately 5,500 food processors and distributors in California. State law also gives DPH broad authority to investigate outbreaks and incidents of foodborne illness. (Foodborne illness is caused by consuming foods or beverages that have been contaminated by disease causing microbes, pathogens, poisonous chemicals, or other harmful substances.) The Emergency Response Unit within the FDB completes these investigations of foodborne illness. Under state law, DPH may take all necessary steps to investigate foodborne illnesses, including inspecting food processors and obtaining and reviewing their records, reviewing growing and harvesting practices on farms, and embargoing contaminated products. In addition to DPH, other state departments are involved in food safety issues. In Figure 5, we briefly summarize the role of these departments.

Figure 5

State Departments Responsible for Food Safety

Department	Responsibility
Department of Public Health	• Ensures safety of raw agricultural commodities.
California Department of Food and Agriculture	• Ensures safety of milk and dairy foods and of meat and poultry products exempt from federal inspection.
Department of Pesticide Regulation	• Samples fresh produce to test for pesticide residue.
University of California	• Conducts research on food safety issues.

The DPH also works closely with the Federal Food and Drug Administration (FDA) when investigating interstate foodborne illness outbreaks. To facilitate these investigations DPH and the FDA have created the California Food Emergency Response Team (CalFERT), a specially trained group of federal and state staff with expertise in farm food safety investigations whose members jointly conduct investigations and share all related records and reports. The CalFERT was established more than a year ago following investigations of E. coli outbreaks traced back to California spinach. In 2006, the FDA and DPH also launched a Lettuce Safety Initiative in response to outbreaks of E. coli associated with fresh and fresh-cut lettuce. The initiative was developed with the goal of minimizing the incidence of foodborne illness associated with the consumption of fresh lettuce and to make industry aware that the FDA and DPH are committed to and concerned about the safety of lettuce.

Recent Foodborne Illness Outbreaks. Recent foodborne illness outbreaks have been associated with California agricultural products primarily lettuce or spinach. The FDA is aware of 20 outbreaks of foodborne illness during the last 11 years that were caused by E. coli and for which fresh or fresh-cut lettuce or spinach was implicated as the outbreak vehicle. These 20 outbreaks accounted for an estimated 12,000 illnesses and at least three deaths, according to FDA. Although tracebacks to growers were not completed in all 20 outbreak investigations, completed traceback investigations of nine of the outbreaks were associated with lettuce and spinach from the Salinas Valley in California. (The Salinas Valley produces 75 percent of the nation's lettuce.)

DPH's Response to Recent Outbreaks. As a result of the outbreaks over the last decade, DPH met with the produce industry on numerous occasions from 2001 through 2005 to convey findings from previous outbreak investigations in order to identify the problem, to work with the industry in identifying needed interventions, and to encourage the industry to provide funding for research. Additionally, in late 2005 and early 2006, the department and FDA issued letters to the produce industries to reinforce their concerns regarding continuing outbreaks associated with produce from California and to encourage these industries to take action. However, despite these efforts, a comprehensive and collaborative plan to address the issue has not yet been developed.

Industry Response to Recent Outbreaks—Proposed "Seal of Approval." In response to the recent outbreaks of foodborne illness, the Western Growers Association proposed in January 2007 a seal of approval for California's leafy green vegetables. The criteria for earning this seal will not be determined until this spring, but the seal is meant to signify to consumers that leafy green vegetables have been handled properly during their journey from farm to grocery store. This program would be run by the California Department of Food and Agriculture's Marketing Branch, which is responsible for market development programs for fruit and other crops. The purpose of a marketing program is to provide agricultural producers and handlers an organizational structure, operating under government sanction, that allows them to solve production and marketing problems collectively that they could not address individually. Marketing programs are industry initiated and usually do not go into effect without approval by an industry vote. Generally, these programs focus on standards for freshness, size, and appearance and do not directly relate to food safety.

Administration Proposes More Resources for Foodborne Illness Emergency Response

The Governor's 2007-08 budget proposes $2.1 million General Fund and nine positions to expand DPH's emergency response capabilities to foodborne illnesses. The proposal would also support food safety research into risk factors and prevention measures for foodborne illness associated with ready-to-eat California produce.

This proposal would expand the DPH's FDB Emergency Response Unit and establish three trained teams of investigators to investigate foodborne illnesses and foodborne illness outbreaks. One team would be responsible for tracing the contaminated product back to a distributor, processor, and farm. The second team would be responsible for investigating the processors involved in the outbreak. The third team would be responsible for completing farm investigations. These teams would also provide training and support to local jurisdictions in the investigation of restaurant-associated foodborne illnesses.

Finally, it would add administrative and laboratory support to meet the increased workload of the unit. (The current Emergency Response Unit is composed of one team of two investigators and one scientist. Staff from other branches in the department have been redirected to assist on the recent outbreak investigations.)

Balanced Approach of Investigation and Prevention Needed

As previously discussed, for the last five years DPH has been encouraging industry to develop a plan that implements best agricultural practices to prevent or reduce the risk of food contamination. However, this plan has not yet been developed. Although industry has just recently developed a proposal for a seal of approval, the criteria for earning this seal have not yet been developed. Therefore, the state can not assess the extent to which such a seal will prevent future outbreaks. Furthermore, the plan under discussion at this point only applies to distributors and processors of leafy green vegetables, not to growers.

Assessing the Governor's Proposal. We find the Governor's proposal has merit for two reasons. First, it provides funding for research in areas related to the safety of fresh produce. This research can be used to develop possible preventative measures for reducing the risk of food contamination. Second, it expands DPH's ability to more quickly investigate an outbreak of a foodborne illness.

However, we find that, the Governor's proposal does not do enough to address the underlying problem of preventing future outbreaks. Rather, this proposal primarily focuses on responding to outbreaks by adding emergency response staff that will investigate *after* an outbreak has occurred and does not focus enough on prevention. We would note that FDA, which is responsible for food safety nationwide, has as its first objective regarding food safety to *prevent* the contamination of fresh produce.

Analyst's Recommendation

Based on our review we recommend the Legislature take the following actions.

Approve Four Positions for the FDB Emergency Response Unit. We recommend approval of four of the nine positions for the FDB Emergency Response Unit (one senior food and drug investigator, one food and drug program specialist, one research scientist, and one Food and Drug Lab scientist). This would add another team (for a total of two teams) of investigators in the FDB Emergency Response Unit and laboratory support for the team. Given that there are three outstanding outbreak investigations from 2006 and that these investigations can last over a year, we think the addition of one more team of investigators is justified. However, we think it is unnecessary to create a team dedicated to investigating food processors involved in an outbreak. This is because the department regulates and routinely inspects food processors for sanitary conditions, and as such it should be able to use this expertise on an as needed basis during outbreaks. Furthermore, we do not think that the other requested two positions for administrative and laboratory support are justified on a workload basis since we are recommending only an additional four positions to FDB. Approval of just one new team and its laboratory support would result in a savings of about $800,000 General Fund.

Approve Funding for Research. We recommend approval of the $500,000 General Fund requested for research related to the safety of fresh ready-to-eat produce from California. This research would be used to refine existing good agricultural practices to improve food safety and prevent foodborne illness outbreaks.

Require DPH to Report at Budget Hearings. We further recommend DPH report at budget hearings on its assessment of the industry proposed seal of approval for green leafy vegetables. In particular, given DPH's scientific expertise in agricultural food safety, DPH should comment on the extent to which the criteria for earning the seal will prevent the contamination of this produce.

PROSTATE CANCER TREATMENT PROGRAM

The Governor's budget includes $3.5 million General Fund to provide treatment services through the prostate cancer treatment program. We withhold recommendation on this proposal pending receipt from the administration of a statutorily required report evaluating the cost-effectiveness of the program.

Background. The Improving Access, Counseling, and Treatment for Californians with Prostate Cancer (IMPACT) program was established in 2001 and provides prostate cancer treatment for low-income and uninsured men. It was a five-year pilot program and implemented through a contract with the University of California, Los Angeles. Chapter 442, Statutes of 2005 (SB 650, Ortiz), reestablished IMPACT as a permanent program and required that the program be cost-effective. This chapter also directed DHS to report to the Legislature by July 1, 2006 evaluating the IMPACT program, including the service and delivery model and the cost-per-patient.

The *2006-07 Budget Act* included $3.5 million General Fund as one-time funding for the program. The administration proposed to evaluate the need for ongoing funding for the program after a review by the Legislature of the above-mentioned report.

Governor's Proposal. The Governor's budget includes $3.5 million General Fund in ongoing support for the IMPACT program.

Analyst's Recommendations. We withhold recommendation on the administration's request to fund the IMPACT program. At the time this analysis was prepared, the Legislature had not yet received the above-mentioned report. Without this report, the Legislature does not have key information necessary to evaluate if the program is meeting the cost-effective criteria specified in Chapter 442.

HEALTH CARE INFECTION CONTROL PROGRAM

The Governor's budget includes $2 million ($1.6 million General Fund) and 14 positions to implement a program for the surveillance and prevention of health care associated infections. We find that there is an alternative funding source to implement this program that would result in lower General Fund costs. (Reduce Item 4265-001-0001 by $1.4 million. Increase Item 4265-001-3098 by $1.4 million.)

Background. Health care associated infections (HAI) are a major public health problem in California. According to DPH, in California's 450 hospitals, HAIs account for an estimated 240,000 infections, 13,500 deaths, and $3.1 billion in excess health care costs annually. Chapter 526, Statutes of 2006 (SB 739, Speier), requires DPH to implement a HAI surveillance and prevention program for health care facilities. (Health care facilities include hospitals, long-term care facilities, nursing homes, intermediate care facilities, ambulatory surgical centers, dialysis centers, assisted living facilities, and outpatient clinics.)

Governor's Proposal. The Governor's budget includes $2 million ($1.6 million General Fund) and 14 positions to implement Chapter 526. The new program will consist of three units: one in the Division of Communicable Disease Control (DCDC) Infectious Disease Branch (IDB), one in the DCDC Microbial Diseases Laboratory Branch (MDLB), and one in L&C program. The governor proposes to fund DCDC activities with General Fund and L&C activities with the L&C special fund. Health care licensing fees are deposited into the L&C fund and this fund can only be used to support L&C program operations.

Users That Benefit Should Contribute. Consistent with the "beneficiary pays" principle—individuals or groups who directly benefit from government services should be charged fees for those services—we find that there are direct beneficiaries of this proposal and for this reason, it should be fee-supported. We find that the HAI surveillance and prevention program will directly benefit health care facilities. This new program will help ensure that the health of patients at all types of health care facilities would be protected to a greater extent from the threat of HAIs and will save health care facilities the costs associated with HAIs.

Analyst's Recommendations. We recommend approval of the administration's proposed implementation of Chapter 526. However, we recommend that activities of the IDB and MDLB be partially funded by the L&C fund, instead of General Fund as proposed by the administration. This would result in a $1.4 million General Fund savings. Accordingly, we recommend the adoption of trailer bill language that adds HAI surveillance and prevention program as one of the allowable uses of the L&C fund.

We note that state-operated health care facilities would also benefit from the new HAI surveillance and prevention program. Therefore, we estimate that HAI surveillance activities in these facilities would require General Fund support of $170,000.

ORAL HEALTH ASSESSMENT

The Governor proposes $221,000 General Fund and two limited term positions to prepare a report regarding the improvements in the oral health of children resulting from recently enacted legislation. We believe that the report be funded from other funds consistent with existing law that the department should seek private funds to prepare for this report, resulting in a General Fund savings of $221,000. (Reduce Item 4265-001-0001 by $221,000.)

Background. Chapter 413, Statutes of 2006 (AB 1433, Emmerson), requires a pupil, while enrolled in kindergarten or first grade (under certain circumstances) in a public school, to present proof of having received an oral health assessment prepared by a dentist or licensed or registered dental professional. It also requires all public schools to annually send a report to the local health officer detailing the number of pupils who are subject to this requirement, the number of pupils who received the assessment, and the number of pupils who did not receive the assessment.

Chapter 413 also requires the Office of Oral Health (OOH) at DPH to report to the Legislature by January 1, 2010 and discuss any improvements in the oral health of children resulting from these new requirements. Chapter 413 also provides that, the OOH may receive private funds or may contract with the University of California (UC) to complete this evaluation.

Governor's Proposal. The Governor's budget plan includes $221,000 General Fund and two limited-term positions to prepare the above-mentioned report.

Analyst's Recommendations. Chapter 413 provides that the OOH may receive private funds and contract with UC to prepare this report. In view of this, we recommend deletion of the $221,000 General Fund and recommend the Legislature direct DPH to seek private funds in order to support preparation of this report.

DEVELOPMENTAL SERVICES
(4300)

A developmental disability is defined as a severe and chronic disability, attributable to a mental or physical impairment that originates before a person's eighteenth birthday, and is expected to continue indefinitely. Developmental disabilities include, but are not limited to, mental retardation, cerebral palsy, epilepsy, autism, and disabling conditions closely related to mental retardation. The Lanterman Developmental Disabilities Services Act of 1969 forms the basis of the state's commitment to provide developmentally disabled individuals with a variety of services, which are overseen by the state Department of Developmental Services (DDS). Unlike most other public social services or medical services programs, services are generally provided to the developmentally disabled at state expense without any requirements that recipients demonstrate that they do not have the financial means to pay.

The Lanterman Act establishes the state's responsibility for ensuring that persons with developmental disabilities, regardless of age or degree of disability, have access to services that sufficiently meet their needs and goals in the least restrictive setting. Individuals with developmental disabilities have a number of residential options. Almost 99 percent receive community-based services and live with their parents or other relatives, in their own houses or apartments, or in group homes that are designed to meet their medical and behavioral needs. Slightly more than 1 percent live in state-operated, 24-hour facilities.

Community Services Program. This program provides community-based services to clients through 21 nonprofit corporations known as regional centers (RCs) that are located throughout the state. The RCs are responsible for eligibility determinations and client assessment, the development of an individual program plan, and case management. They generally pay for services only if an individual does not have private insurance or they cannot refer an individual to so-called "generic" services that are provided at the local level by counties, cities, school districts, and other agencies. The RCs also purchase services, such as transportation, health care, respite, day programs, and residential care provided by community care facilities. The department contracts with the RCs to provide services to more than 212,155 clients each year.

Developmental Centers (DC) Program. The department operates five DCs, and two smaller leased facilities, which provide 24-hour care and supervision to approximately 2,800 clients. All the facilities provide residential and day programs as well as health care and assistance with daily activities, training, education, and employment. More than 7,700 permanent and temporary staff serve the current population at all seven facilities.

Current-Year Deficiency. The DDS periodically estimates future caseload and utilization costs for RCs based upon historical data. The DDS has updated its projection of the cost of RC purchase of services during 2006-07 based upon the most recently available actual RC caseload and cost data. The data suggest that funding provided for this program in the *2006-07 Budget Act* will be insufficient by about $51 million General Fund. The deficiency results from two adjustments: (1) an increase of $18 million related to the recent state minimum wage increase, and (2) an increase of $33 million related to updated utilization and caseload projections for the RCs. The administration has indicated that funding for this deficiency request will be pursued through a supplemental appropriation bill.

Overall Budget Proposal. The budget proposes $4.3 billion (all funds) for support of DDS programs in 2007-08, which is a 5.7 percent increase over estimated current-year expenditures. General Fund expenditures for 2007-08 are proposed at $2.6 billion, an increase of almost $37 million, or 1.4 percent, above the revised estimate of current-year expenditures.

Community Services Budget Proposal. The budget proposes $3.6 billion from all funds ($2.2 billion General Fund) for the support of the Community Services Program in 2007-08. This represents a $47 million General Fund increase, or 2.2 percent, over the revised estimate of current-year spending. The increase is a result of caseload growth, higher utilization rates for services, the effect of the increase in the minimum wage, and other program changes. Of the total $3.6 billion in funding proposed for RC programs in 2007-08, $501 million is for RC operations and $3.1 billion is for the purchase of services. The community services budget plan includes the following proposals:

- ***Increased Federal Reimbursements for Intermediate Care Facilities for the Developmentally Disabled (ICF/DD).*** The budget plan assumes that the federal government will provide matching funds for day programs and nonmedical transportation services for RC clients residing in ICFs/DD. This would require a Medi-Cal state plan amendment which would result in a General Fund savings of approximately $44 million.

- ***Fund Shift From Public Transportation Account.*** The budget proposes a one-time allocation of $144 million from the Public Transportation Account in lieu of General Fund to provide certain transportation services to RC clients

- ***Continued Implementation of Medicare Part D.*** The budget plan proposes an increase of $708,000 in total funds ($357,000 General Fund) and eight positions to support workload associated with implementation of Part D of the Medicare Prescription Drug Improvement and Modernization Act of 2003.

Developmental Centers Budget Proposal. The budget proposes $712 million from all fund sources ($393 million General Fund) for the support of the DCs in 2007-08. This represents a net decrease of $9.9 million General Fund, slightly more than 2 percent below the revised estimate of current-year expenditures. The DC budget plan includes the following proposals:

- ***Agnews DC Closure.*** The budget plan continues to assume the closure of the Agnews DC in June 2008. In 2007-08, DC expenditures decrease by $10.4 million ($5.6 million General Fund) to reflect decreased staffing costs as Agnews' population is relocated into community placements or to other DCs. The RC budget would provide $50.7 million ($37.9 million General Fund) to reflect the costs of providing community-based services to former Agnews residents.

- ***Employee Compensation***. The budget plan also proposes $33.1 million ($19.2 million General Fund) in 2007-08 for increased employee compensation and benefits.

Headquarters Budget Proposal. The budget proposes $40 million from all funds ($26 million General Fund) for support of headquarters. About 62 percent of headquarters funding is for support of the community services program, with the remainder for support of the DC program.

Regional Center System: Rapid Spending Growth Continues

The cost to the state of operating regional centers for persons with developmental disabilities has continued to escalate at a rapid pace with total spending projected to increase by almost $1.7 billion, or about 89 percent, between 2000-01 and 2007-08. In this analysis we examine recent caseload and program spending trends, assess the Governor's caseload projections, identify an opportunity to draw down additional federal funds ($11 million in the current year), and recommend the Legislature increase oversight of the department's rate reform effort.

Background

How Do RCs Provide Services for Their Clients?

The RCs provide services to clients through two mechanisms. First, RCs purchase services directly from vendors. These services are commonly referred to as "purchase of services." Secondly, RCs assist their clients in obtaining services from public agencies. These services are commonly referred to as "generic services." We discuss both types of services further below.

Purchase of Services. The budget for purchase of services consists of ten main service categories, plus one additional category referred to as "other adjustments." (A more detailed description of these categories is provided on page C-162 of our *Analysis of the 2005-06 Budget Bill*.) Figure 1 shows the Governor's proposed spending plan for these purchase of services categories in 2006-07 and 2007-08.

Generic Services. Under state law, generic services are defined as those being provided by federal, state, and local agencies which have a legal responsibility to serve all members of the general public and that receive public funds for providing such services. There are more than a dozen different generic services that are regularly accessed by RC clients. For example, medical services for an eligible developmentally disabled person might be provided through the Medi-Cal health care program for the poor. City or county park and recreation programs also provide generic services for developmentally disabled clients. State law requires that RCs access generic services first and make purchase of services only when generic services are unavailable.

Figure 1

Regional Centers Purchase of Services Funding By Service Category

(All Funds, Dollars in Millions)

Service Category	2006-07[a]	2007-08[a]	Difference	Year-to-Year Percent Change
Day programs	$700	$754	$54	7.7%
Community care facilities	688	770	82	11.9
Support services	488	551	63	12.9
Miscellaneous	268	312	44	16.4
Transportation	203	214	11	5.4
In-home respite	165	180	15	9.1
Habilitation services	148	150	2	1.4
Health care	83	91	8	9.6
Out-of-home respite	48	49	1	2.1
Medical facilities	18	18	—	—
Other adjustments[b]	—	-44	-44	N/A
Totals	**$2,809**	**$3,045**	**$236**	**8.4%**

a Reflects Governor's revised estimate for 2006-07 and the budget proposal for 2007-08.

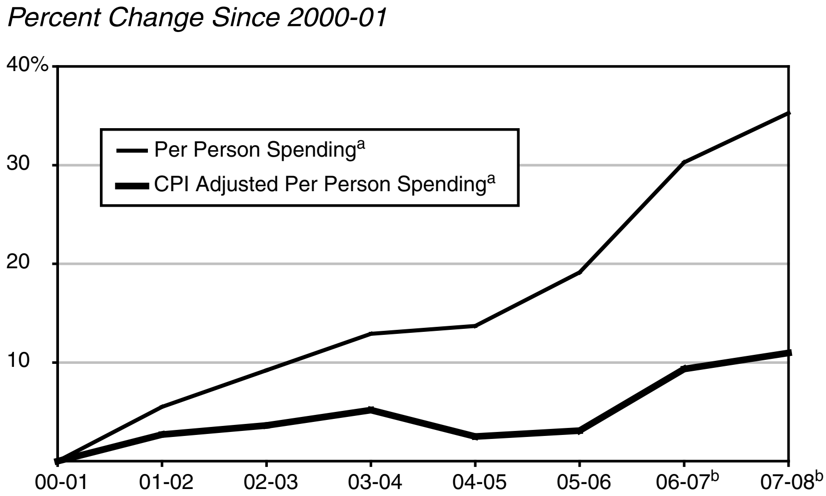
b Reflects adjustments for changes in the rate structure for Intermediate Care Facilities for the Developmentally Disabled.

Some Purchase of Services Provided Under a Federal Waiver. Under the federal Home and Community-Based Services (HCBS) waiver, federal funds can be drawn down to pay for about one-half the costs of certain community-based services for individuals at risk of institutionalization. The 2007-08 budget plan assumes that RC programs will draw down $818 million in federal funds under the HCBS waiver.

Overall Spending and Cost per Client. Between 2000-01 and 2007-08, total spending is forecast to increase by almost $1.7 billion if the administration's budget plan were adopted as proposed. During the same period, spending per person, after adjusting for inflation, would go up 11 percent and unadjusted spending per person would go up by 36 percent, as shown in Figure 2 (see next page).

Figure 2

Regional Center Spending Up Significantly



[a]Data adjusted to reflect programmatic changes.
[b]Reflects Governor's revised estimate for 2006-07 and the budget proposal for 2007-08.
CPI: Consumer Price Index

RC Caseload Below Projected Levels

Background

Between 2000-01 and 2007-08, the RC caseload is projected to grow from about 163,613 to almost 221,000, an average annual growth rate of almost 4.4 percent. The caseload trend is shown in Figure 3.

Several key factors appear to be contributing to ongoing growth in the RC caseload. Medical professionals are identifying persons with a developmental disability at an early age and referring more persons to DDS programs. Improved medical care and technology has increased life expectancies for individuals with developmental disabilities. The RC caseload growth also reflects a significant increase in the diagnosed cases of autism, the causes of which are not fully understood.

Governor's Budget Proposal

In accordance with past practice, the 2007-08 budget plan reflects DDS' updated projections for the number of RC clients for the current and budget years. The budget plan indicates that the actual caseload in the RC system in 2006-07 is tracking very closely to the original budgeted level.

Specifically the average annual caseload for the current year is estimated at 212,155, or just 70 clients less than the estimate of 212,225 that was the basis for the RC system's appropriations in the *2006-07 Budget Act*. The budget plan further estimates that the average annual RC caseload will grow to almost 221,000 in 2007-08, a year-to-year increase of 8,445 clients or 4 percent.

Figure 3

Regional Center Caseload Growth Trend

Average Annual Population		Increase From Prior Year	
Fiscal Year	Caseload	Amount	Percent
2000-01	163,613	8,651	5.6%
2001-02	172,714	9,101	5.6
2002-03	182,175	9,461	5.5
2003-04	190,030	7,855	4.3
2004-05	197,355	7,325	3.9
2005-06	203,823	6,468	3.3
2006-07[a]	212,155	8,332	4.1
2007-08[a]	220,600	8,445	4.0

[a] Administration caseload estimate.

As described above, the administration proposes to increase the level of current-year funding provided for RC purchase of services by about $33 million General Fund. This further adjustment reflects updated expenditure data on utilization and caseloads for RC purchase of services.

For 2007-08, the Govenor's budget proposes to increase spending for the RC system by about $251 million including an increase of about $46.5 million from the General Fund. This increase mainly reflects estimated growth in caseloads, costs, and the utilization of services by RC clients.

Recent Data Suggest Caseload Overstated. The Governor's budget request is based on data that was available through July 2006. However more recent data through December 2006 indicate that the average annual caseload is likely to be about 1,460 below the level that DDS has estimated in the current year and about 1,500 below the level that DDS has estimated in the budget year.

Analyst's Recommendation

Based on the most recent information available, it appears the caseload is potentially overbudgeted by roughly $14 million General Fund in the current year and $15 million General Fund in the budget year. However, the department has indicated that in some cases in the past, lower-than-anticipated caseload costs have been offset by increases in utilization. It is possible that the reduction in caseload will be offset by an increase in utilization cost. We recommend the Legislature require the department to report at budget hearings on the specific causes for increased utilization and costs. In our view, without accurate information about what is causing increased utilization and costs, the Legislature lacks the information it needs to assess the causes of the rapid growth in the RC program and determine which policies would be most effective to contain these costs.

We note that in our *Analysis of the 2006-07 Budget Bill*, (page C-156) we recommended that the Legislature direct the Department of Finance's Office of State Audits and Evaluations to conduct an audit to evaluate the accuracy and the consistency of the purchase of services data now being reported by the RCs. Because the accuracy and consistency of these data are now uncertain, the state lacks tools that are needed to exercise strong fiscal oversight over RC spending. An improvement in the way expenditure data are reported has additional potential benefits. It could improve the quality of the data used by DDS for budget forecasts, so that its budget request to the Legislature could more closely match the actual funding required to support community services programs.

The administration has indicated that it will provide updated information on the overall RC caseload trend, change in the mix of RC clients, and trends in the cost and utilization of services at the time of the May Revision. We will continue to monitor caseload trends and will recommend appropriate adjustments, if necessary, in May when DDS' updated budget request is presented to the Legislature.

ICF/DD Rate Restructure Would Leverage Federal Funds

Background. The ICF/DDs are often located in the community, sometimes in single-family houses, and provide residential services for the developmentally disabled including 24-hour personal care. In our *Analysis of the 2004-05 Budget Bill* (page C-185), we described how the state could draw down additional federal funds to offset the state costs of day programs and transportation services provided to RC clients residing in ICFs/DD by modifying the ICF/DD rate and implementing other related changes.

Specifically, in order to capture these additional federal funds, the state would have to redefine the ICF/DD program as an "all-inclusive service." Currently the ICFs/DD are paid a rate based only on the specific nursing care services they provide. Additional services that a client may receive such as transportation or a day program are generally paid for separately by the RC or provided through a generic service provider. Under this option, ICFs/DD would be redefined to be an all-inclusive service and the responsibility for providing day programs, transportation, and other assistance (in cases where generic services were unavailable) would shift from the RC to the ICFs/DD. In turn, these services would be reflected in the rates paid to ICFs/DD.

Budget Plan Assumes Savings in 2007-08. The state plan is an agreement between the federal Center for Medicare and Medicaid Services (CMS) and the state regarding the operation of the state's Medi-Cal Program. The Department of Health Care Services (DHCS) is pursuing a revision to the Medi-Cal state plan to include coverage and payment for day program and nonmedical transportation services for RC clients residing in ICFs/DD. The budget plan assumes (1) approval of the state plan amendment and an increase of $44 million in federal funds in 2007-08 and (2) a commensurate reduction in state General Fund support for day program and nonmedical transportation services. The budget plan does not assume any savings in 2006-07.

Current Year Savings Opportunity. In some cases, once a state plan amendment is approved by the federal CMS, states may submit claims and draw down federal funds retroactively to the date of submission. For example, if the DHCS submitted the proposed state plan amendment to the federal CMS in April of 2007, and it was approved in July of 2007, the state may be able to submit claims for federal reimbursement going back to the date when the state plan amendment was originally submitted.

Based on discussions with DHCS, the department has been working on developing a state plan amendment for about two years. Given the time DHCS has spent on developing this state plan amendment, we believe that it is reasonable to assume that the department will be able to submit it to the federal CMS by April.

Analyst's Recommendation. We recommend the Legislature assume that the state plan amendment will be submitted by DHCS to the federal CMS in April of 2007 and that it will be approved. We estimate that this would result in an additional $11 million in federal reimbursements for 2006-07. We recommend that the Legislature recognize a commensurate amount of state General Fund savings in the current year for RC purchase of services.

Rate Reform Progressing Slowly

Background. The Legislature has taken some actions in recent years to slow growth in state costs for the RC system. Beginning in 2003-04 and continuing through 2006-07, it acted to control costs by adopting legislation imposing rate freezes and other cost-control measures on selected community services. The rate freezes and cost-containment measures were intended to be temporary actions to help address the state's serious fiscal problems while allowing time to consider permanent and ongoing strategies to help contain RC costs such as rate reform.

Rate Reform Efforts. Historically, there has been significant variation in the way that rates are set for the RC vendors who provide services, and the rate-setting approach overall has lacked a rational and consistent approach. The *2004-05 Budget Act* provided four permanent staff positions and $500,000 in one-time funding for contract resources to enable DDS to develop standardized rates for certain types of RC vendors. As part of its review process, DDS was to evaluate the existing rate-setting methodology, identify inadequacies or drawbacks in the way rates were set, identify and develop any statutory and regulatory changes found to be necessary, and implement and monitor a revised rate-setting methodology. The rate reform activities approved by the Legislature were intended to be part of a more comprehensive cost-containment program for the RC system.

Progress to Date. The rate reform process has generally focused on those services for which rates are set through negotiations between RCs and service providers. Over a multiyear period, several RCs have been surveyed to obtain specific information about how they determine rates for 16 different services provided to RC clients. The last of three waves of surveys were sent out to the RCs in January 2006.

The DDS has developed a regulations package for rates for supported living services that is currently in the formal regulatory review process. (Supported living services consist of a broad range of services to developmentally disabled adults who choose to live in homes they own or lease in the community.) The DDS planned to circulate an initial regulations package for comment in January 2007 regarding some of the other rates included under the reform effort. At the time this analysis was prepared, these regulations were not yet available for comment.

As noted above, DDS was provided $500,000 in one-time funding for contract resources to enable DDS to develop standardized rates for certain types of RC vendors. In November 2005, DDS awarded a contract to a consultant to provide assistance with analyzing data and evaluating findings and recommendations regarding certain services purchased by RCs. The consultant completed a report and provided it to DDS in the fall of 2006.

State Savings Lost as Rate Reform Plods Along. More than two years have passed since the Legislature provided staff and funding resources to support the administration's rate reform initiative. The proposed spending plan offers no indication of when DDS will implement any significant rate reform for services other than supported living.

Analyst's Recommendation. We recommend that the Legislature require DDS to report at budget hearings on the timeline for implementation of revised rate-setting methodologies for RC services to ensure reasonable progress is made towards implementing rate reform. Specifically, the department should report on the services that are under study for rate reform, the timeline for proposing revised regulations packages and other measures, and the estimated savings for implementing rate reform for specified services. This will provide the Legislature with the information it needs as it deliberates on the continuation of temporary cost-containment measures.

DEVELOPMENTAL CENTERS PROGRAM

Residential Care Models Allow Shift From Institutions to Community

We recommend the Legislature adopt supplemental report language directing the Department of Health Care Services to submit a report based on a comprehensive evaluation of the Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing pilot program. This will help ensure the Legislature has sufficient information upon which to base decisions about the future of this pilot program.

State Shifting From Institutional Care Model to Community-Based Care

The population of the DCs has declined steadily over the last 20 years. The continuing decline in the population of the DC system is partly the result of the 1994 *Coffelt v. Developmental Services* lawsuit settlement, which required the state to make more community-based residential services available as alternatives to institutions. The DCs initially downsized in population by about 2,000 in response to the *Coffelt* settlement. The administration is currently implementing its plan to close Agnews DC, by July 2008.

The downsizing of the DCs is also partly a response to federal policies that promote community-based alternatives and a recent federal court decision. Prompted in part by the June 1999 U.S. Supreme Court decision

L.C. & E.W. vs. Olmstead ("Olmstead"), California, and a number of other states are seeking alternatives to institutional care. In the *Olmstead* case, the U.S. Supreme Court ruled that keeping persons who could transition to a community setting constituted discrimination under the Americans with Disabilities Act, notwithstanding state resources and consumer preference.

Many of the developmentally disabled individuals that reside in Agnews and other DCs are medically fragile and may require regular skilled nursing assessments and interventions due to unstable medical conditions. In response to the needs of these individuals, and a policy of providing services to the developmentally disabled in the least restrictive setting whenever possible, the Legislature in recent years has approved two pilot programs that we describe below.

Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing (ICF/DD-CN). Chapter 845, Statutes of 1999 (AB 359, Aroner), allows for implementation of ICFs/DD-CN under a pilot program. The ICFs/DD-CN provide skilled nursing supervision to clients who have continuous need for skilled nursing care. Residents of ICF/DD-CN require frequent observation and intervention for unstable medical conditions.

The ICF/DD-CN pilot program operates under a waiver approved by the federal CMS that was originally approved in 2001. Six facilities, each with six beds, are currently operating under the waiver and serve, on average, about 35 individuals. The waiver is due to expire on September 30, 2007. The DHCS expects the CMS to grant a waiver extension from October 1, 2007 through September 30, 2009.

Adult Residential Facility for Persons With Special Health-Care Needs (ARFPSHN). Chapter 558, Statutes of 2005 (SB 962, Chesbro), allows for implementation of a new type of licensed residential care facility under a pilot program. Although ARFPSHNs would provide continuous skilled nursing services similar to those provided by ICFs/DD-CN, they would provide *fewer* hours of continuous skilled nursing services than ICFs/DD-CN. The pilot program would allow for up to five residents to be placed in each facility, with a program total of a 120 beds. Unlike ICFs/DD-CN, which are privately owned and operated facilities, ARFPSHNs would be owned by a nonprofit entity. The state would contract out the provision of care for residents of these facilities. At the time this analysis was prepared, no ARFPSHN had begun operations although a few ARFPSHNs are expected to begin operations by July 2007. The pilot program is due to sunset January 1, 2010, unless extended in statute.

Reporting Requirements. Chapter 558 requires DDS to contract with an independent agency or organization to evaluate the ARFPSHN pilot program and prepare a written report to the Legislature by January 1,

2009. There is currently no requirement for a report to the Legislature evaluating the ICF/DD-CN pilot program. However, we note that DHCS has requested $250,000 total funds ($125,000 General Fund) to contract with an independent agency or organization for a final assessment of the cost-effectiveness and feasibility of making the ICF/DD-CN model a permanent new provider type.

Governor's Proposal

The *2007-08 Governor's Budget* proposes three positions, on a two-year limited term basis, for DHCS state operations to ensure compliance with waiver requirements and develop the State Plan Amendment to add the ICF/DD-CN as a state benefit.

Analyst's Assessment. We take no issue with the Governor's request for positions or for the funding request for a final assessment of the ICF/DD-CN pilot program. We note that state law requires that a report be provided to the Legislature regarding the effectiveness of the ARFP-SHN pilot program. However, no such reporting requirement exists for the ICF/DD-CN pilot program although DHCS is requesting funds for a consultant to evaluate the program. Without a report evaluating the effectiveness of the ICF/DD-CN pilot program the Legislature will likely have insufficient information to determine whether this model for residential services should be discontinued, maintained, or expanded.

Analyst's Recommendation

In order to better evaluate how residential models can best serve the needs of medically fragile DDS clients, the Legislature needs to be fully informed about the cost-effectiveness of the two pilot programs currently underway. Given that DHCS will contract for an evaluation of the ICF/DD-CN, we recommend the evaluation be provided to the Legislature and that the evaluation assess the same issues addressed by the ARFPSHN evaluation.

The following Supplemental Report Language is consistent with this recommendation:

> It is the intent of the Legislature that the Department of Health Care Services (DHCS) shall submit a report to the Legislature evaluating the Intermediate Care Facility for the Developmentally Disabled-Continuous Nursing (ICF/DD-CN) pilot program. This evaluation and subsequent report in writing shall at minimum address the following: (1) the number, business status, and location of all the treatment facilities; (2) the number and characteristics of the residents served; (3) the effectiveness of the pilot program in addressing residents' health care and intensive support needs; (4) the extent of residents' community integration and satisfaction; (5) the

consumers' access to, and quality of, community-based health care and dental services; (6) the types, amounts, qualifications, and sufficiency of staffing; (7) the costs of all direct, indirect, and ancillary services; and (8) recommendations for improving the ICF/DD-CN model. The DHCS shall report its findings on this matter by January 1, 2009 to the Chair of the Joint Legislative Budget committee and the chairs of the fiscal committees of both houses of the Legislature.

DEPARTMENT OF MENTAL HEALTH
(4440)

The Department of Mental Health (DMH) directs and coordinates statewide efforts for the treatment of mental disabilities. The department's primary responsibilities are to (1) provide for the delivery of mental health services through a state-county partnership, (2) operate five state hospitals, (3) manage state prison treatment services at the California Medical Facility at Vacaville and at Salinas Valley state Prison, and (4) administer various community programs directed at specific populations.

The state hospitals provide inpatient treatment services for mentally disabled county clients, judicially committed clients, clients civilly committed as sexually violent predators, mentally disordered offenders, and mentally disabled clients transferred from the California Department of Corrections and Rehabilitation (CDCR).

Budget Proposal Increases DMH Overall Budget. The budget proposes $4.8 billion from all fund sources for support of DMH programs in 2007-08, an increase of $653 million, or 16 percent, above the revised estimate of current-year expenditures due mainly to increases in the Mental Health Services Fund established by Proposition 63. The budget proposes about $1.9 billion in General Funds, which is a decrease of $217 million from the revised current-year budget. The year-over-year decrease of $217 million is due mainly to one-time funding proposed for 2006-07 to address a deficiency in the Early and Periodic Screening Diagnosis and Treatment (EPSDT) program.

State Hospitals Budget Proposal. The Governor's spending plan proposes $1.2 billion ($1.1 billion General Fund) in 2007-08, an increase of $115 million ($88 million General Fund) from the adjusted 2006-07 budget. The proposed increase is due primarily to a projected increase in caseload for sexually violent predators (SVPs) due to passage at the November 2006 election of Proposition 83, known as Jessica's law, and to comply with the Civil Rights for Institutionalized Persons Act consent decree requirements.

Community Services Budget Proposal. The Governor's spending plan proposes $3.4 billion from all funds ($763 million General Fund) for support of the Community Services Programs, an increase of $562 million (a decrease of $264 million General Fund) compared to the revised 2006-07 budget estimate.

The community services budget plan includes the following proposals:

- ***Continued Implementation of the Mental Health Services Act.*** The Governor's spending plan provides $1.5 billion from the Mental Health Services Fund for implementation of the Mental Health Services Act (MHSA). Approved as Proposition 63 in November 2004, MHSA supports local programs by expanding community mental health services to children, youth, and adults with severe mental illnesses. The Mental Health Services Fund is a special fund which is continuously appropriated and is not subject to annual Budget Act appropriation.
- ***EPSDT Program.*** The Governor's spending plan proposes $303 million General Fund for the current year to meet a deficiency of unpaid county claims. The plan proposes a $93 million General Fund increase in 2007-08 above the *2006-07 Budget Act* to pay for an increase in caseload, costs and utilization of the EPSDT program services. We discuss this proposal in more detail later in this analysis.
- ***Mental Health Managed Care Program.*** The budget plan proposes a total of $462 million ($235 million General Fund) for 2007-08, an increase of $8 million ($4 million General Fund) over the current year mostly due to increases in caseload.
- ***Integrated Services for Homeless Adults.*** The Governor's budget plan proposes to eliminate this program, for a reduction of $55 million General Fund. The program provides comprehensive services to individuals who are homeless or at risk of homelessness and have a serious mental illness.
- ***Mental Health Services to Special Education Pupils (AB 3632).*** The budget proposes $52 million in General Fund to fund mental health services provided to children enrolled in special education as directed under the AB 3632 mandate and as required by the federal Individuals with Disabilities Education Act.
- ***Healthy Families.*** The budget proposes an increase of $9.8 million ($537,000 General Fund) to provide supplemental mental health services to children enrolled in the Healthy Families program.

- ***Early Mental Health Initiative Program Expansion.*** The budget plan proposes a $5 million increase in General Fund spending to expand mental health intervention and prevention services to children in grades K-3.

COMMUNITY PROGRAM ISSUES

Early and Periodic Screening Diagnosis and Treatment Program: Estimate and Claims Processing System Need an Overhaul

The Governor's Budget proposes $303 million General Fund for the current-year to address a prior- and current-year deficit in the Early and Periodic Screening Diagnosis and Treatment (EPSDT) program. We withhold recommendation on both the funding requested for the current year and the budget year pending receipt from the Department of Mental Health (DMH) of its revised EPSDT estimating methodology. We recommend the Legislature require the Office of State Audits and Evaluations within the Department of Finance to report at budget hearings on the findings from its review of the EPSDT estimating methodology and of DMH's related administrative practices.

Background

The EPSDT, a federally mandated program, requires states to provide a broad range of screening, diagnosis, and medically necessary treatment services to Medi-Cal beneficiaries under age 21, even if the treatment is optional under the state's Medicaid plan. The requirements apply to mental health as well as physical health.

EPSDT Estimate Methodology Has Proven To Be Inaccurate. The EPSDT estimating methodology used prior to 2003-04 proved to be inaccurate. A new EPSDT estimating methodology was developed and first applied to 2003-04 expenditures at the time of the 2004 May Revision and has continued in use up to the present time. This new methodology has also proven to be inaccurate.

The DMH requested that the Office of State Audits and Evaluations (OSAE), within the Department of Finance (DOF), review the EPSDT estimating methodology as well as perform an internal control review of its fiscal systems. We are advised by DMH that it intends to present a revised estimate methodology for EPSDT in March 2007 to allow for legislative review prior to the May Revision.

DMH Awaits Federal Audit Findings. Late in 2005, DMH discovered that it had over-billed for federal matching funds for EPSDT for fiscal years 2003-04 and 2004-05. As a result, the federal Centers for Medicare and Medicaid Services (CMS) began to more closely review county reimbursement claims. In the fall of 2006, federal auditors reviewed DMH's reconciliation of 2003-04 claims, but the department had not received a final report on the federal audit at the time this analysis was prepared.

The Governor's Proposal

Budget Year. The Governor's budget plan proposes $439 million General Fund for support of the EPSDT program in 2007-08, a decrease of $210 million, or 32 percent, below adjusted current-year expenditures. This year-over-year decrease in spending is mainly due to prior- and current-year deficiencies in the EPSDT program that we describe later. The budget plan proposes an increase of about $93 million General Fund for 2007-08 to provide for increased utilization, costs, and caseload.

Current-Year Deficiency. The Governor's budget plan proposes a current-year increase of $303 million General Fund above the amount approved in the *2006-07 Budget Act*. This increase consists of two parts: (1) prior-year deficiencies from 2003-04, 2004-05, and 2005-06 of about $243 million, and (2) a current-year deficiency of about $60 million. The administration attributes the prior-year deficiencies to a combination of "misestimating" of EPSDT claims and different accounting methodologies employed by DMH and the Department of Health Services in conjunction with a technical fund shift that occurred in 2006-07 The administration attributes the current-year deficiency of $60 million to greater-than-anticipated caseload growth. The administration has indicated that it will seek funding for these deficiencies in a supplemental appropriations bill.

The DOF sent a letter to the Joint Legislative Budget Committee (JLBC) in November notifying the JLBC of the $243 million prior-year deficiencies. The DOF sent another letter in January notifying the JLBC of the current-year deficiency of about $60 million General Fund.

JLBC's Concerns

The JLBC sent a letter to DOF indicating several concerns with its proposal. First, the committee expressed its concern that the portion of the deficiency due to misestimating of provider claims and dating back to 2003-04 was not identified earlier by DMH and was not brought to the attention of the Legislature in a timely manner. The passage of more than two fiscal years before the existence of an ongoing problem with the EPSDT estimating methodology was identified indicates lax fiscal administration of this program.

The JLBC also indicated concern with the timing of the administration's presentation of the new EPSDT estimating methodology. The administration had indicated that the DMH intends to present the revised estimating methodology for EPSDT at an unspecified date in March to allow for legislative input prior to the May Revision. The JLBC's letter stressed that given the complexity of estimating annual expenditures in this program, receipt of the revised estimating methodology any later than March 1, 2007, may not allow sufficient time for legislative review. Without adequate review time, a revised estimating methodology may be adopted that does not address the causes of the misestimations that have occurred over the past three years as well as in the current year.

The JLBC's letter also indicated that the independent review being conducted by OSAE is a positive and necessary step towards improving management of the EPSDT program. However, the review should include an assessment of, and recommendations on, how to improve the cost settlement process by which county claims are reconciled. Further, the JLBC's letter urged that OSAE issue written findings and recommendations and share them with the Legislature.

Analyst's Recommendation

In view of the concerns expressed by the JLBC, we withhold recommendation on both the administration's deficiency funding request in the current year and on the budget-year request for funding for the EPSDT program. Until the administration has provided the Legislature with an updated estimating methodology, as requested by the JLBC, we do not believe the Legislature will have the information necessary to fully assess this issue. We recommend the department report at budget hearings on the potential for the prior-year EPSDT deficiency to increase due to unfavorable federal audit findings.

We further recommend that the Legislature require OSAE to report at budget hearings and testify on its review of the EPSDT estimating methodology and its review of DMH's internal control systems.

New Sexually Violent Predator Laws Drive Increased Costs

Recent legislation, Chapter 337, Statutes of 2006 (SB 1128, Alquist), and the passage of Proposition 83, also known as Jessica's law, will increase the Department of Mental Health (DMH) workload related to screening, evaluating and housing sexually violent predators (SVPs). We recommend that the Legislature recognize current-year savings of $6 million General Fund due to lower-than-projected SVP caseload. We also recommend the Legislature wait until more information is available

before taking action to fund additional administrative and caseload costs in the budget year. We will provide an updated recommendation at the time of the May Revision.

Background

Specified sex offenders who are completing their prison sentences are referred by CDCR to DMH for screening and evaluation to determine whether they meet the criteria as SVP. When DMH receives a referral it does the following:

- ***Screening.*** The DMH screens referred cases to determine whether they meet legal criteria pertaining to SVPs to warrant clinical evaluation.
- ***Evaluations.*** Two contract evaluators (Psychiatrists and/or Psychologists) are assigned to evaluate each sex offender while they are still held in state prison. Based on a review of the sex offender's records, and an interview with the inmate, the evaluators submit reports to DMH on whether or not the inmate meets the criteria for an SVP. If two evaluators have a difference of opinion, two additional evaluators are assigned to evaluate the inmate.

Those offenders who are found to meet the criteria for a SVP, as specified in law, are referred to district attorneys (DAs). The DAs then determine whether to pursue their commitment by the courts to treatment in a state mental hospital as an SVP. If a petition for a commitment is filed, the clinical evaluators are called as witnesses at court hearings. Cases that have a petition filed, but that do not go to trial in a timely fashion may require updates of the original evaluations at the DA's request. The amount of time it takes to complete the commitment process may vary from several weeks to more than a year depending upon the availability of a court venue and the DA's scheduling of cases. While these court proceedings are pending, offenders who have not completed their prison sentences continue to be held in prison. However, if an offender's prison sentence has been completed, he or she may be held either in county custody or in a state mental hospital.

Chapter 337, Statutes of 2006 (SB 1128, Alquist), and Proposition 83, Jessica's Law. Chapter 337 was approved by the Legislature and signed by the Governor in September 2006. Chapter 337 made changes in law that generally increase criminal penalties for sex offenses and strengthen state oversight of sex offenders. For example, Chapter 337 requires that SVPs be committed by the court to a state mental hospital for an undetermined period of time rather than the renewable two-year commitment provided for under previous law. Chapter 337 also requires that every person required to register as a sex offender be subject to assessment using the State-Authorized Risk Assessment Tool for Sex Offenders (SARATSO) a tool for predicting the risk of sex offender recidivism.

Proposition 83, also known as Jessica's Law was approved by the voters in the November 2006 statewide election. This measure increases penalties for violent and habitual sex offenders and expands the definition of an SVP. The measure generally makes more sex offenders eligible for an SVP commitment by (1) reducing from two to one the number of prior victims of sexually violent offenses that qualify an offender for an SVP commitment and (2) making additional prior offenses "countable" for purposes of an SVP commitment.

State Hospitals. State mental hospitals hold sex offenders who have been committed as SVPs. State mental hospitals also hold some sex offenders who have completed their prison sentences, but are still undergoing SVP evaluations for commitment proceedings. As of January 2007 the total SVP caseload was 635 with 234 patients in Atascadero, 400 patients in Coalinga and 1 in Patton. We note that both Atascadero and Coalinga state hospitals have experienced difficulties in recruiting and hiring qualified staff. At the time this analysis was prepared, Atascadero was not accepting additional patients mostly due to staffing shortages. Although Coalinga was built with a bed capacity for 1,500 SVPs, it currently houses about 450 patients (about 400 SVPs and about 50 non-SVP patients). The inability to staff the facility due mostly to its remote location, limits the number of SVPs that can be placed there.

Governor's Budget Proposal

As shown in Figure 1 (see next page) the Governor's budget plan makes several requests related to the implementation of both Chapter 337 and Proposition 83. These proposals include:

- ***Administrative Costs.*** The budget plan proposes a current-year increase of $1.6 million General Fund and 21 positions for DMH headquarters and 8 positions for Coalinga. The budget plan proposes an increase in 2007-08 of $4.8 million General Fund and 44 positions at DMH headquarters and 8 positions at Coalinga for administrative and support positions to implement Chapter 337 and Proposition 83. The positions are requested in order to (1) screen and track referrals from CDCR, (2) oversee contracts for processing SVP evaluations, (3) provide assistance to the SARATSO Committee, and (4) develop, implement and evaluate a High Risk Sex Offender treatment program in collaboration with CDCR.

- ***Evaluation Costs.*** The budget plan proposes $15 million General Fund for the current year and $25 million General Fund in 2007-08 to account for the increased amount of evaluations that will be performed.
- ***Caseload Costs.*** The budget plan proposes $12 million General Fund for the current year and $43 million General Fund in 2007-08 due to a projected increase in SVP commitments.

Figure 1

Governor's Budget Proposals for Sexually Violent Predator Programs

(In Millions)

General Fund	2006-07	2007-08
Administration	$1.6	$4.8
Evaluations	15.2	24.9
Caseload	12.1	43.3
Totals	**$28.9**	**$73.0**

Analyst's Concerns

Long-Term SVP Caseload Trend Still Uncertain. At the time this analysis was prepared, Chapter 337 had been in effect for about four months and Proposition 83 had been in effect for about three months. As a result, there is little historical data available upon which to base an estimate of future ongoing costs. Thus, the administration had minimal data to work with when it prepared its budget plan and had to make several assumptions in order to estimate the costs of implementing Chapter 337 and Proposition 83.

DMH Administrative Costs. As a result of Chapter 337 and Proposition 83, CDCR estimates that its number of sex offender referrals to DMH for evaluation determination as SVPs will increase from about 500 per year to about 5,500 in 2007-08. This estimate was based on an initial surge of referrals from CDCR to DMH immediately after the passage of Proposition 83. Based on discussions with the administration, DMH and CDCR are still developing protocols to ensure the efficient referral of sex offenders to DMH.

Our analysis indicates that CDCR will likely refer significantly more sex offenders to DMH than it did prior to the passage of Chapter 337 and

Proposition 83. Therefore some additional staff will be necessary to address the increase in sex offender referrals. However, given the recent passage of Proposition 83, the exact magnitude of the referrals and associated staff requirements is unknown.

DMH Evaluation Costs. Prior to implementation of Chapter 337 and Proposition 83, generally between 50 percent to 60 percent of referrals to DMH went on to receive full evaluations. It is uncertain the average percent of referrals that will go on to receive full evaluations under the new laws. The most recent data indicate that about 33 percent of the CDCR referrals warranted full evaluations since the new laws went into effect. This is significantly lower than the 50 percent to 60 percent that generally received evaluations under the prior standard.

Caseload Costs. Before Chapter 337 and Proposition 83, on average CDCR referred about 500 inmates per year to DMH for screening and on average about 40 of these inmates, or 8 percent, ultimately were given civil commitments to a state hospital as an SVP. The budget plan assumes that the same percentage will receive commitments under the new laws. However, as discussed above, Proposition 83 reduced from two to one the number of prior victims of sexually violent offenses that qualify an offender for an SVP commitment. Therefore, it will likely be more difficult for DAs to prove a pattern of predatory behavior and thus obtain an SVP commitment for sex offenders with only one victim compared with two or more victims. As a result, a potentially significantly lower percent of the CDCR referrals to DMH may ultimately result in an SVP commitment under the new one-victim standard.

The budget proposal assumes 271 new SVP commitments in 2006-07. The administration has indicated that this is a "worst-case scenario" and that this estimate was based upon preliminary data. Our analysis indicates that the number of new current-year SVP commitments resulting from Chapter 337 and Proposition 83 is likely to be substantially lower than assumed by the administration. In our view the administration did not adequately take into account that SVP caseload growth would likely increase at a gradual rate, if at all, during the first few months after implementation of Chapter 337 and Proposition 83. This gradual rate of increase is due to the amount of time it takes for DMH to complete SVP evaluations, for DAs to prepare their cases and for commitment proceedings to be heard by the courts.

Analyst's Recommendation

We withhold recommendation on the administration's request for additional funds and positions for administrative costs as it is not certain at this time what the level of ongoing workload will be as a result of the new laws. Similarly, we withhold recommendation on the appropriate level of funding for evaluation costs to implement Chapter 337 and Proposition 83. We will update our recommendation at the time of the May Revision.

We recommend the Legislature recognize current-year savings of $6 million General Fund to take into account that the SVP caseload will initially increase gradually due to the amount of time it takes to have a sex offender committed as an SVP. We withhold recommendation on the Governor's 2007-08 request pending further data. We believe an additional three months of data will allow a more accurate assessment of the appropriate level of state support for SVP commitments in 2007-08. We will update our caseload recommendation for both the current year and the budget year at the time of the May Revision.

Department of Rehabilitation
(5160)

The Department of Rehabilitation (DR) provides vocational rehabilitation to persons with disabilities. The purpose of vocational rehabilitation services is to place disabled individuals in suitable employment or to provide short-term, intensive vocational rehabilitation for those with developmental disabilities through supported employment and work activity programs.

In addition, the department helps legally blind clients support themselves as operators of vending stands, snack bars, and cafeterias throughout the state; provides prevocational rehabilitation services to newly blind adults; develops cooperative agreements with school districts, state and community colleges, and county mental health programs to provide services to mutually served clients; and assists community-based rehabilitation facilities such as independent living program, halfway houses, and alcoholic recovery homes.

The budget proposes $390 million from all funds for support of DR programs in 2007-08. This is an increase of about $13 million, or 3 percent, over estimated current-year expenditures. The budget proposes $58 million from the General Fund, which is $2 million, or 3 percent, above estimated current-year General Fund expenditures. The General Fund increase is the result of higher operating costs, and an increase in wages in the Supported Employment program, partially offset by new federal funds.

Automation Proposal Poses Future General Fund Risk

The Governor's budget proposes to use federal carryover funds to begin development of a new automated system for the Vocational Rehabilitation Services (VRS) program. Our review indicates that this automation proposal (1) is based on an overly optimistic development schedule, and (2) will likely require General Fund support in future years because there is no ongoing federal fund source. We recommend that the department report at budget hearings on the availability of federal funds in subsequent years and how they intend to meet their schedule.

Background. The DR proposes to develop a new Electronic Records System (ERS) to manage and track the activities of the VRS program. The VRS program assists persons with disabilities in preparing for, finding and retaining competitive employment in mainstream work settings. The department provides individual assessments, counseling, job placement, and the purchase of rehabilitation services through a network of 85 branch offices statewide. The ERS would track and report case data required by the federal government, as well as provide the ability to manage consumer and vendor financial data and issue payments. The department has been unable to comply with federal reporting requirements due to the limitations of its existing data tracking system. Inability to provide this data in future years could result in a loss of federal funds. The project is scheduled to be completed in 2010-11 with a total cost of $15.8 million.

Optimistic Project Schedule Poses Risk. The ERS project's cost is partially dependent on the proposed project schedule. Based on our review, we believe that the schedule provided in the Feasibility Study Report underestimates the time required for certain activities necessary to prepare users for the implementation of a new system. In this regard, the proposed system will require extensive user involvement, along with training, in order for staff to understand business process changes that will occur with the ERS. In addition, the new system will absorb the functionality of a number of other systems, and will require a data conversion effort in order to continue uninterrupted case services and vendor payments. For these reasons, we believe that the proposed project schedule may be significantly underestimated and that project costs will exceed the current estimate of $15.8 million, when the department revises the schedule during the procurement process.

Federal Funds Potentially Unavailable Beyond Budget Year. The department plans to use $465,640 in previously unspent federal carryover funds to support the project in 2007-08. However, because carryover funds vary from year to year, it is unclear to what extent federal funds will be available for the following year's project requirements. To the extent that federal funds are not available, it is likely that in subsequent years, General Fund support will be required in order to complete the development of the system. If no new federal funds are identified or freed up, the General Fund exposure could be $4.4 million in 2008-09 and $4.6 million in 2009-10.

Analyst's Recommendation. In order to provide the Legislature with more information regarding future General Fund costs for this automation project, we recommend that the department report at budget hearings on their estimates of the availability of federal funds for this project and their plan for meeting the project schedule.

DEPARTMENT OF CHILD SUPPORT SERVICES (5175)

The Department of Child Support Services (DCSS), created on January 1, 2000, administers California's child support program by overseeing 52 local child support offices (some small counties have joined together to form local child support agencies). The primary purpose of the program is to collect from absent parents support payments for custodial parents and their children. Local child support offices provide services such as locating absent parents; establishing paternity; obtaining, enforcing, and modifying child support orders; and collecting and distributing payments.

The Governor's budget proposes expenditures totaling $974 million from all funds for support of DCSS in the budget year. The budget proposes $274 million from the General Fund for 2007-08, which is a decrease of $236 million (46 percent) compared to 2006-07. This decrease is primarily due to the elimination of General Fund expenditures to pay federal penalties for failing to complete a single statewide automation system by the required time.

Federal Penalty Held in Abeyance

In September 2006, the Department of Child Support Services applied for federal certification of the California Child Support Automated System. Once the state applied for certification, the federal penalty for not having a single statewide automation system was placed in abeyance. We discuss the current automation system and certification process.

Current Status of Automation. The California Child Support Automated System (CCSAS) consists of two major components, the State Disbursement Unit (SDU) and Child Support Enforcement (CSE). The SDU collects, processes, and distributes child support payments. The SDU was fully implemented in May 2006. The CSE component of the project provides a central database and case management system to support child support enforcement activities in all Local Child Support Agencies (LCSAs). The CSE portion of CCSAS is being implemented in two phases. The first phase of CSE is Version 1, which created a centralized database and reporting system for two preexisting systems (referred to as legacy systems). The second phase is Version 2, which will consolidate the two preexisting legacy systems and create increased child support enforcement capabilities.

Penalty Status. Once both the SDU and Version 1 were operational in September 2006, the state applied for federal certification of this "alternative" system (alternative system refers to the joined legacy systems). This application for certification means that penalties are held in abeyance pending federal certification. The roll-out of Version 2 is scheduled to begin in May 2007, with full implementation by November 2008.

Penalty Relief and Reimbursement. Since 1998, California has paid a total of nearly $1.2 billion in penalties for failing to have a single statewide automation system. The 2006-07 budget included $220 million to pay the federal penalty for federal fiscal year 2006 (October 2005 through September 2006). As previously mentioned, the state is currently in the process of becoming certified, during which time the federal penalty is not assessed. Once the system is certified, the federal government will reimburse the state 90 percent ($198 million) of the final penalty paid in 2006-07. The Governor's budget assumes that the federal government will certify the system and reflects this reimbursement as revenue in 2007-08.

Budget Proposes to Absorb Federal Administration Fee

Pursuant to the Deficit Reduction Act of 2005, the federal government will begin to assess an annual fee on the state of $25 for most "never assisted" child support cases. This fee is deducted from California's federal funds allocation for program administration regardless of whether the state collects this fee from the affected never-assisted families. Because the reprogramming costs would exceed the expected fee revenues from families, the budget proposes to absorb the cost of the fee ($1.8 million). We review this proposal and recommend the adoption of supplemental report language requiring the Department of Child Support Services to provide a report to the Legislature in March 2008 on the costs and benefits of collecting this fee in future years.

Background. The DCSS assists families by locating absent parents; establishing paternity; obtaining, enforcing, and modifying child support orders; and collecting and distributing payments. The DCSS serves families who are currently receiving public assistance (assistance cases), along with families who formerly or never received assistance. The total child support caseload in 2005 was comprised of 26 percent assistance cases, 48 percent former assistance cases, and 26 percent never-assisted cases (the latter two types referred to as non-assistance cases).

Mandatory Fee. Beginning in January 2008, in accordance with the Deficit Reduction Act, the federal government will assess an annual fee on the state of $25 for each never-assisted child support case for which $500 or more is collected. The state may choose to recover this fee from (1) the custodial parent or (2) the noncustodial parent. Alternatively, the state can choose to absorb this cost, thereby paying it out of state funds. For 2007-08, the fee would be $1.8 million. Because California has never collected a fee related to child support, there are significant automation reprogramming costs associated with attempting a collection from the custodial or noncustodial parents.

Decision to Cover Mandatory Fee. The DCSS is currently operating the two legacy subsystems, and the single replacement system (Version 2) will not be completed until November 2008 at the earliest. As a result, collecting the fee in the budget year would require the reprogramming of three separate systems. According to the department, it is not cost-effective to make reprogramming changes at this time.

Since the fee will not be assessed until January 2008, the 2007-08 budget includes $1.8 million General Fund to cover the fee for six months. In 2008-09, the General Fund cost to cover this fee is estimated to be about $3.5 million.

Analyst's Recommendation. In order to avoid reprogramming costs for three separate systems, we concur with the decision to use state funds to cover the mandatory fee in 2007-08. However, in the long run, we believe that collecting a fee may have merit. This is because assessing a user fee on never-assisted families would allow the state to recover some of the costs of providing child support enforcement services for such families. Nevertheless, in deciding whether to collect a fee from the custodial or noncustodial parent, the Legislature should consider the automation reprogramming costs of enabling such a collection. Accordingly, we recommend that the Legislature adopt supplemental report language requiring DCSS to provide a report to the Legislature in 2008 on the costs and benefits of collecting a fee. The following supplemental report language is consistent with this recommendation:

> ***Report on the Costs and Benefits of Collecting a Fee.*** The Department of Child Support Services shall provide a report no later than March 1, 2008 on the costs and benefits of assessing an annual fee of $25 for never assisted child support cases for which $500 or more is collected.

Child Support Pass-Through Options

The Deficit Reduction Act of 2005 increases federal participation in the amount of child support passed through to families who currently receive welfare assistance. We discuss the costs and benefits associated with various pass-through options.

Background. Since the enactment of the 1996 federal welfare reform legislation, federal law has not required states to pass through to welfare families any child support collected on their behalf. However, any amount of child support that the state decides to pass through would be supported 100 percent by the General Fund, with no federal participation. Currently, California elects to pass through the first $50 per month collected from the noncustodial parent to welfare families at an annual cost of about $30 million.

Pursuant to the Deficit Reduction Act (DRA), beginning in October 2008 the federal government will share the cost of the child support that is passed through to welfare families (California Work Opportunity and Responsibility to Kids [CalWORKs] families in California) up to specified limits. Specifically, the federal government will participate in 50 percent of the pass through of up to $100 for families with one child, and up to $200 for families with two or more children.

Potential Benefits of Increased Pass Through. Research conducted on the potential benefits of increased pass-through policies is limited, and most studies focus on the effects of full rather than partial pass-through policies. However, researchers believe that more generous pass-through policies may potentially benefit the state by (1) improving child support performance on federal measures and (2) reducing the cost of welfare programs. One study examined various state pass-through levels and found that states with higher pass-through amounts were significantly associated with increases in paternity establishment and the percentage of cases with collections—two of five federal performance measures. Improving performance in federal measures results in increased financial incentives from the federal government. Additionally, researchers have found that passing through more child support to families may result in savings in other public programs such as CalWORKs, food stamps, housing, and Medi-Cal. This is because as families become more financially stable, they may eventually rely less on these other public programs.

Alternatives. Although the federal government will participate in the pass through of up to $100 for families with one child and $200 for families with two children, the state will ultimately decide how much to pass through. A decision to increase the current pass through would result in lost General Fund revenues. This is because child support not passed through would otherwise be retained by the state as General Fund revenue, partially offsetting the cost of the grant provided to CalWORKs families. Figure 1 shows the General Fund costs (revenue losses) of various pass-through options. We note that these alternatives do not account for automation costs that may result from modifying the current pass-through policy. Additionally, DCSS estimated the cost of each alternative based on a one-month sample of children currently receiving child support, so actual costs could differ from these estimates.

Figure 1

Child Support Pass-Through Alternatives

	Amount of Pass Through		General Fund Cost (In Millions)		
Alternative	1 Child	2+ Children	2008-09	2009-10	2009-10 Change From Current Law
Current Law	**$50**	**$50**	**$19**	**$15**	—
Alternative 1	50	100	24	19	$4
Alternative 2	100	100	33	27	12
Alternative 3	100	200	43	34	19

As shown in Figure 1, all pass-through alternatives cost more in 2008-09 than 2009-10. This is because the federal government will not begin participating in the pass through until October 2008, which is three months into the 2008-09 fiscal year. (We note that the cost of implementing an increased pass-through policy could be lower in 2008-09, if the Legislature decides to delay any increase until federal participation begins in October 2008.) The department indicates that a pass through policy that requires it to track the number of children in the family in order to determine the amount to pass-through would result in higher automation costs. This is because the current pass-through policy allows for the distribution of the same amount to all families, and does not require a method to track the number of children in each family.

Fiscal Impact. Currently, the cost of passing through the first $50 to families results in a General Fund cost of about $30 million per year. Because DRA results in federal participation starting in October 2008, passing through $50 to all families would cost about $15 million General Fund in 2009-10 (first full-year impact of change), a savings of $15 million to the state. Alternative 1 would pass through $50 to families with one child, and $100 to families with two or more children, and results in a annual General Fund cost of about $19 million, or about $4 million more than current law. Alternative 2 would pass through $100 to all families and would have an annual cost of about $27 million General Fund. Alternative 3 is the maximum amount the state could pass through with federal participation. This alternative would cost about $34 million annually, or $19 million more than current law.

All alternatives would require some automation changes. However, automation modifications to implement alternatives 1 and 3 are likely to cost more, since these alternatives require a method to pass through a different amount to a family with one child than to a family with two or more children.

Conclusion. By increasing federal participation in the pass through of child support payments, DRA gives the state increased flexibility when establishing its pass-through policy. In deciding the most appropriate amount to pass through to child support families, the Legislature should weigh the General Fund costs of more generous policies against the potential benefits of passing through more child support to families.

California Work Opportunity and Responsibility to Kids (5180)

In response to federal welfare reform legislation, the Legislature created the California Work Opportunity and Responsibility to Kids (CalWORKs) program, enacted by Chapter 270, Statutes of 1997 (AB 1542, Ducheny, Ashburn, Thompson, and Maddy). Like its predecessor, Aid to Families with Dependent Children (AFDC), the new program provides cash grants and welfare-to-work services to families whose incomes are not adequate to meet their basic needs. A family is eligible for the one-parent component of the program if it includes a child who is financially needy due to the death, incapacity, or continued absence of one or both parents. A family is eligible for the two-parent component if it includes a child who is financially needy due to the unemployment of one or both parents.

The budget proposes an appropriation of $4.9 billion ($1.4 billion General Fund, $136 million county funds, $35 million from the Employment Training Fund, and $3.4 billion federal funds) to the Department of Social Services (DSS) for the CalWORKs program in 2007-08. In total funds, this is a decrease of $207 million, or 4.4 percent, compared to estimated spending of $5.1 billion in 2006-07. This decrease is primarily attributable to estimated savings from the Governor's proposed policy changes to establish time limits for children whose parents cannot or will not comply with participation requirements.

General Fund spending for 2007-08 is proposed to be $690 million, 34 percent, less than estimated spending for 2006-07. This substantial reduction is due to (1) the savings from the proposed time-limit policy noted above and (2) shifting $269 million in Proposition 98 funds to CalWORKs child care. For a discussion of this fund shift, please see the "Proposition 98 Priorities" write-up within the "Crosscutting Issues" section of the "Education" chapter of this *Analysis*.

BUDGET SUSPENDS STATUTORY COLA

By suspending the statutory cost-of-living adjustment (COLA), the budget achieves a cost avoidance of $124.4 million.

Current law requires that the CalWORKs grant be adjusted each July based on the change in the California Necessities Index (CNI). From December 2005 to December 2006, the CNI increased by 3.7 percent. For a typical family of three receiving CalWORKs assistance, this COLA would increase the maximum monthly grant by about $27. Suspending the COLA eliminates this grant increase and results in cost avoidance of $124.4 million. (The Governor's budget, prepared prior to the release of the final CNI data, estimated the CNI to be 4.2 percent, and scored a cost avoidance of $140.3 million.)

Guillen *Lawsuit.* A superior court has ruled in the *Guillen* court case that the October 2003 COLA (which was tied in statute to reductions in the vehicle license fee) is required by current law. In December 2006, an appellate court heard the state's appeal and a decision is anticipated in early 2007. Unless the appellate court overturns the lower court decision, the state faces one-time CalWORKs grant costs of $434 million, plus ongoing costs of $114 million, neither of which are included in the Governor's budget. The one-time costs refer to 45 months of grant payments (October 2003 through June 2007) owed to recipients on aid during this time period. The ongoing costs of $114 million represent the cost of providing the grant increase during 2007-08. The one-time costs are typically subject to a settlement agreement and which cannot be modified by the Legislature. With respect to the ongoing costs, the Legislature could prospectively reduce grants by the amount of the October COLA, thereby avoiding the ongoing costs of $114 million.

Governor's Proposed Grant Levels Compared to Current Law. At the time this *Analysis* was prepared, the outcome of the *Guillen* lawsuit was unknown. Figure 1 compares combined cash grant and food stamps benefits under the Governor's proposal to the grant levels required by current law. The top portion of the figure shows the grants if the state prevails in its appeal of the *Guillen* case. The bottom portion shows grants if the *Guillen* case is upheld by the appellate court. Combined cash grant and Food Stamps benefits are about $15 less per month under the Governor's proposal than under current law.

Figure 1

CalWORKs Maximum Monthly Grant and Food Stamps Current Law and Governor's Proposal Family of Three

2007-08

	Current Law	Governor's Budget	Change From Current Law: Amount	Change From Current Law: Percent
Scenario 1: *Guillen* Decision Is Reversed on Appeal (Governor's Budget)				
High-Cost Counties				
Grant	$750	$723	-$27	-3.6%
Food stamps	330	342	12	3.6
Totals	**$1,080**	**$1,065**	**-$15**	**-1.4%**
Percent of poverty	*75%*	*74%*		
Low-Cost Counties				
Grant	$714	$689	-$25	-3.5%
Food stamps	347	358	11	3.2
Totals	**$1,061**	**$1,047**	**-$14**	**-1.3%**
Percent of poverty	*74%*	*73%*		
Scenario 2: *Guillen* Decision Is Upheld on Appeal				
High-Cost Counties				
Grant	$776	$748	-$28	-3.6%
Food stamps	319	331	12	3.8
Totals	**$1,095**	**$1,079**	**-$16**	**-1.4%**
Percent of poverty	*77%*	*75%*		
Low-Cost Counties				
Grant	$739	$713	-$26	-3.6%
Food stamps	336	347	11	3.3
Totals	**$1,075**	**$1,060**	**-$15**	**-1.4%**
Percent of poverty	*75%*	*74%*		

Figure 1 also compares the combined grant and food stamp benefits to the federal poverty guideline for 2007. Under the Governor's proposal, the combined cash grant and food stamps benefit would be 74 percent of the federal poverty guideline for a family of three in a high-cost county and 73 percent of the guideline for a family of three in a low-cost county (assuming the *Guillen* case is overtuned). Under current law, combined benefits would be about 1 percent closer to the federal poverty guideline than the Governor's proposal.

Redirecting SSI/SSP COLA Funding to CalWORKs

In order to more effectively utilize General Fund resources for poverty reduction, we recommend redirecting $124.4 million of the funds proposed for the Supplemental Security Income/State Supplementary Program (SSI/SSP) COLA to provide the CalWORKs COLA. Please see the "Crosscutting Issues" section of this chapter for the rationale for this recommendation.

LEADER Computer System Replacement

Rather than joining one of the other two recently completed automation consortia, the budget proposes $2 million for planning activities for replacing the Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) computer system with an entirely new system. We recommend that the Department of Social Services and the Health and Human Services Agency's Office of System Integration report at budget hearings on why joining an existing system is not feasible and the costs and benefits of an entirely new system. We further recommend that the Legislature withhold funding for planning activities until a cost-benefit analysis for a new system is provided.

Background. The Statewide Automated Welfare System (SAWS) is divided into four consortia: (1) ISAWS (Interim SAWS), comprised of 35 small and medium size counties, (2) CalWIN (CalWORKs Information Network) which covers 18 middle-sized counties that are part of the Welfare Client Data System, (3) C-IV (Consortium IV), which is comprised of San Bernardino, Riverside, Merced, and Stanislaus counties, and (4) LEADER, which is the system for Los Angeles County. These automated welfare systems support the delivery of social services programs including CalWORKs, Food Stamps, and Medi-Cal. Each system cost several hundred million dollars to develop. The ISAWS counties are in the process of migrating to C-IV. When this migration to C-IV is complete, there will be three consortia.

LEADER Replacement. The budget proposes a total of $2 million for planning activities for replacing LEADER. The stated goal is to award a contract for the new system in June 2008. Los Angles County has viewed demonstrations of the other consortia systems and has concluded these systems are inappropriate solutions for replacing LEADER. The DSS concurs with this finding, but has not provided an explanation as to why the other two consortia cannot be modified to become a LEADER replacement solution.

Analyst's Recommendation. Given the substantial costs (probably over $200 million total funds) associated with developing a new system, we recommend that DSS and the Office of System Integration (which oversees the development of human services automation systems and is part of the Health and Human Services Agency) report at budget hearings on why Los Angeles County cannot join one of the existing systems (potentially with some modifications) and the costs and benefits associated with the development of a new system. We further recommend withholding funding for additional LEADER planning activities until a cost-benefit analysis is provided to the Legislature.

TANF TRANSFER TO CWS CONTRARY TO LEGISLATIVE APPROACH

By using federal Temporary Assistance for Needy Families (TANF) block grant funds to replace General Fund support for certain Child Welfare Services (CWS) emergency assistance costs, the Governor's budget achieves General Fund savings of $56 million in 2007-08. The Legislature should assess whether this proposed fund shift meets its priorities for limited TANF block grant funds.

TANF Expenditures May Offset General Fund Costs in Other Programs. Each year California receives $3.7 billion in federal TANF block grant funds. The majority of these funds are used for the CalWORKs program. However, federal law permits the expenditure of TANF funds on a variety of programs and activities. Specifically, the TANF block grant funds may be expended on any program designed to (1) provide assistance to needy families and children; (2) end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage; (3) prevent and reduce the incidence of out-of-wedlock pregnancies; and (4) encourage the formation and maintenance of two-parent families. Moreover, TANF funds can be spent for any purpose permitted under the AFDC program or under AFDC-Emergency Assistance (EA). (For example, AFDC-EA could be used for juvenile probation.) Finally, up to 10 percent of TANF funds may be transferred to the Title XX Social Services Block Grant and then expended in accordance with the federal rules pertaining to Title XX. Unexpended TANF funds can be carried over indefinitely into future years.

Legislative Action in 2006-07. For 2006-07, the Legislature shifted $100 million in TANF funds proposed for CWS back to the CalWORKs program. This funding shift required a backfill of $100 million from the General Fund to CWS. The purpose of the shift was to ensure scarce TANF block grant funds were used in the CalWORKs program.

Governor's Proposal and Legislative Oversight. For 2007-08, the budget proposes to replace General Fund monies for CWS emergency assistance activities with $56 million in TANF federal funds. This results in General Fund savings of $56 million, but is contrary to legislative action in the current year, which used General Fund support in lieu of TANF funds for CWS.

The Governor's proposal to save $56 million General Fund by using TANF funds for emergency assistance costs in child welfare services is permissible under federal law. Whether to make this fund shift is a policy issue for the Legislature. Because TANF can be used for both CalWORKs and non-CalWORKs purposes, the Legislature should review this proposal to determine if it is consistent with its priorities for TANF and the General Fund. If the Legislature rejects the Governor's fund shift proposal, it would need to adopt some offsetting budget solution to avoid increasing the state's structural deficit.

MAINTENANCE-OF-EFFORT AND CASELOAD REDUCTION CREDIT

The budget proposes to spend above the federally required maintenance-of-effort (MOE) level, thereby achieving a caseload reduction credit (CRC) which reduces California's work participation requirement in the California Work Opportunity and Responsibility to Kids (CalWORKs) program. We review the MOE requirement, the impact of the Deficit Reduction Act (DRA) of 2005 on countable MOE spending, and the Governor's proposal to obtain a CRC.

TANF MOE Requirement. To receive the federal TANF block grant, states must meet a MOE requirement that state spending on assistance for needy families be at least 75 percent of the federal fiscal year (FFY) 1994 level, which is $2.7 billion for California. (The requirement increases to 80 percent if the state fails to comply with federal work participation requirements.) Countable MOE expenditures include those made on behalf of CalWORKs recipients, as well as for families who are *eligible* for CalWORKs but are not receiving cash assistance. Although the MOE requirement is primarily met through state and county spending on CalWORKs and other programs administered by DSS, state spending in other departments is also counted toward satisfying the requirement.

DRA Expands Definition of MOE Spending. The DRA expands the definition of what types of state spending may be used to meet the MOE requirement. Previously, countable state spending had to be for aided families or for families who were otherwise eligible for assistance. The DRA allows state expenditures designed to prevent out-of-wedlock pregnancies or promote the formation of two-parent families to count toward the MOE requirement, even if the program participants are not otherwise eligible for aid. Essentially, the act removes the requirement that countable spending for these purposes be on behalf of low-income families with children.

We would note that some states have already claimed expenditures for these types of services as part of their MOE spending. Because of this change, California can now count some existing spending on higher education tuition assistance (CalGrants and community college fee waivers) and after school programs toward the MOE requirement. The rationale for tuition assistance is that higher education is generally associated with better employment and life outcomes, which in turn may result in fewer out-of-wedlock births. Similarly, after school programs are associated with better school attendance and achievement, which in turn improves employment and life outcomes, potentially resulting in fewer teen pregnancies.

Excess MOE Spending Results in Caseload Reduction Credit. As discussed more fully in the next section, pursuant to the DRA, states must meet federal work participation rates (50 percent for all families) less a caseload reduction credit based on the decline in their caseloads since FFY 2005. Current federal regulations allow states that spend above their required MOE level to subtract out cases funded with excess MOE for the purpose of calculating the CRC. States first used this regulation during FFY 2005. Based on the amount of excess MOE spending during FFY 2006, California increased its CRC from 3.5 percent to 4.7 percent on an FFY basis. Pursuant to federal rules, the CRC percentage that is due to excess MOE spending during FFY 2006, is subtracted from the federal work participation requirement for the subsequent year (FFY 2007).

We note that the authority to increase the CRC based on excess MOE spending is part of current regulations, not current law. Accordingly, the federal administration could end this authority by changing the regulations, and some observers believe this may happen in future years. Also, the federal government has not yet approved California's methodology for determining the amount of excess MOE cases. Thus, we would caution that long-term plans for attaining compliance with federal work participation rates should not overly rely on the excess MOE caseload reduction regulations.

Figure 2 shows base MOE spending and excess MOE spending proposals for 2006-07 and 2007-08. For both years, base MOE spending will be approximately $2.7 billion. With respect to excess MOE, the budget proposes a reduction from $470 million to $203 million. Figure 2 also shows that based on the Governor's proposed spending levels, the CRC would be 12.6 percent in 2006-07, falling to 5.4 percent in 2007-08. As a point of reference, we show estimated excess MOE spending in 2007-08 under current law (if the Legislature rejects the Governor's time limit aid sanction proposals). (These CRCs are estimates on a state fiscal year basis, and will differ from the actual CRCs which are calculated on an FFY basis.)

Figure 2

CalWORKs Maintenance-of-Effort (MOE) Spending

2006-07 and 2007-08
(In Millions)

		2007-08	
	2006-07	Governor's Budget	Current Law
Base MOE Spending			
CalWORKs program	$2,033.6	$1,356.0	$1,680.4
DSS Non-CalWORKs programs	20.9	23.4	23.4
MOE from other departments	478.2	1,133.1	808.7
County spending	135.4	136.8	136.8
State support	2.8	2.7	2.7
Subtotals	($2,670.8)	($2,652.1)	($2,652.1)
Excess MOE Spending			
CDE child care programs	$30.4	$75.0	$87.1
After school programs	225.3	128.0	225.3
CalGrants	215.0	—	215.0
Subtotals	($470.7)	($203.0)	($527.4)
Estimated caseload reduction credit from excess MOE	12.6%	5.4%	14.1%
Grand Totals	**$3,141.5**	**$2,855.1**	**$3,179.5**

CalWORKs = California Work Opportunity and Responsibility to Kids;
DSS = Department of Social Services; CDE = California Department of Education.

Current Work Participation Requirement and Status

Federal law requires that states meet a work participation rate of 50 percent for all families and 90 percent for two-parent families, less a caseload reduction credit (CRC). The Deficit Reduction Act of 2005 and associated regulations significantly changed the calculation of the participation rate and the CRC.

Background

Required Hours of Work for Adults. To comply with federal work participation rates, adults must meet an hourly participation requirement each week. For single-parent families with a child under age 6, the weekly participation requirement is 20 hours. The requirement goes up to 30 hours for single parents in which the youngest child is at least age 6. For two-parent families the requirement is 35 hours per week. The participation hours can be met through unsubsidized employment, subsidized employment, certain types of training and education related to work, and job search (for a limited time period).

Work Participation Penalties for States. If a state fails to meet the work participation rates, it is subject to a penalty equal to a 5 percent reduction of its federal TANF block grant. For each successive year of noncompliance, the penalty increases by 2 percent to a maximum of 21 percent. For California, the 5 percent penalty would be approximately $149 million annually, potentially growing by up to $60 million per year. Penalties are based on the degree of noncompliance. For example, if a state is in compliance with the all-families rate, but is out of compliance for the two-parent rate, the penalty would be prorated down based on the percentage of cases that are two-parent cases.

State Impact of Penalties. States that fail to meet their work participation requirements are required to (1) backfill their federal penalty with state expenditures and (2) increase their MOE spending by 5 percent. States out of compliance may enter into corrective action plans which can reduce or eliminate penalties, depending on state progress in meeting the negotiated goals of the corrective plan.

Prior Law Work Participation Requirements for States. Prior to enactment of DRA, states had to meet two separate work participation rates—an all-families rate of 50 percent and a two-parent rate of 90 percent. Both of these rates were adjusted downward to reflect the caseload decline since FFY 1995. From 1995 through 2004, California's caseload declined by approximately 46 percent, but has been relatively stable since then. Thus, California achieved a substantial CRC pursuant to prior law. Specifically, this 46 percent reduction reduced California's required participation rate to about 4 percent (the 50 percent requirement, less the 46 percent credit).

With respect to two-parent families, prior law permitted states to create state-only funded programs, and families served in such programs were removed from TANF work participation calculations. Given this prior flexibility, California served two-parent families in a separate state-only program, and thus was not subject to the 90 percent two-parent family rate. (The two-parent families, however, are subject to state work participation requirements.)

Deficit Reduction Act Effectively Increases Participation Requirements for States

The DRA increased participation requirements on states in three different ways. First, it moved the base period for calculating the CRC from 1995 to 2005. Because California's caseload decline mostly occurred before 2005, this substantially reduces the CRC, from about 46 percent to about 3.5 percent. Second, it made families served in separate state programs subject to federal participation rates. Thus, beginning in FFY 2007 California is subject to the 90 percent federal work participation rate for two-parent families. Third, it provided the Secretary of Health and Human Services with broad authority to adopt federal regulations (which he exercised) to (1) narrow the definition of work and participation and (2) expand the number of families who are included in work participation calculations.

Figure 3 summarizes how the DRA and associated regulations changed the work participation mandate on states. The two middle columns compare prior law and regulations to the new law and regulations under the DRA. The final column summarizes the impact on the participation calculation for California. A state's actual work participation rate is calculated as follows:

$$\frac{\text{number of families meeting participation requirement}}{\text{number of families subject to participation requirement}} = \text{participation rate}$$

As Figure 3 indicates, new regulations pertaining to cases in sanction status (child-only cases where the adult is removed from aid for noncompliance), and safety net cases (child-only cases where the adult is removed from aid for hitting the five-year time limit) make an additional 86,100 cases subject to the work participation calculation. On the other hand, the state may now exclude those caring for an ill or incapacitated family member from the calculation (about 5,000 cases). Also, about 9,000 cases which have received aid for five years and are in the safety net are now counted as participating in the numerator.

Figure 3

Deficit Reduction Act of 2005
Major Changes to Work Participation Calculation

Provision	Prior Law/Regulations	Deficit Reduction Act/ Associated Regulations	Impact on Participation Rate Calculation
Calculation of caseload reduction credit (CRC)	Based on reduction since FFY 1995 (46%)	Based on reduction since FFY 2005 (3.5%)	Reduces CRC by 42 percentage points
Separate State Programs (SSP)	Cases in SSP excluded from a work participation calculation	Cases in SSP must be included in work participation calculation	State may no longer avoid 90 percent rate for two-parent families through SSP
Adults in sanction for more than 90 days	When adult is removed from case for sanction, the case is excluded from work participation calculation	Must be included in work participation calculation	Adds 40,100 cases to participation calculation (+40,100 in denominator)
Safety net for children of parent hitting five-year time limit	When adult is removed from a case for time limit, the case is excluded from work participation calculation	Must be included in work participation calculation	Adds 46,000 cases to participation calculation, 9,000 of which are meeting work requirement (+9,000 to numerator, +46,000 to denominator)
Caring for ill or incapacitated family member	Included in work participation calculation	Excluded from work participation calculation	Removes 5,000 cases from work participation calculation (-5,000 from denominator)

FFY = federal fiscal year.

Current Participation Status

The most recent participation data for California is from FFY 2005. Figure 4 (see next page) shows the calculation of the all families participation rate under prior law and under current law with DRA regulations. In both calculations, the two-parent families have been added into the numerator and denominator, pursuant to the DRA which prevents their exclusion through a separate state funded program. As Figure 4 shows, under prior rules, California's participation rate would be almost 28 percent. Under the new rules, the rate falls to just over 23 percent. Most of the decline is attributable to adding sanctioned cases and safety net cases to the participation rate in the denominator (81,153 cases). For two-parent families (not shown in Figure 4), the participation rate is 33.6 percent based on data from FFY 2005.

Figure 4

Work Participation Status—All Families[a] Under Prior and Current Law

	Prior Law and Regulations	Current Law/DRA Regulations	Change From Prior Law
Families meeting requirements	60,148	69,174	9,026
Families subject to participation	215,822	296,975	81,153
	=	=	
Participation rate	27.9%	23.3%	-4.6%

[a] Based on California data from federal fiscal year 2005.

DRA = Deficit Reduction Act of 2005.

Impact of Recent Policy Changes on Participation

In recent years, California has made significant changes in the California Work Opportunity and Responsibility to Kids program in order to increase work participation among recipients. Estimates by the administration of the participation increases associated with recent policy changes, in conjunction with the caseload reduction credit, suggest that California would likely be in compliance with federal work participation requirements in federal fiscal year 2008.

Over the past two years, the Legislature has made significant program changes that should increase work participation to some unknown extent among CalWORKs families. First, Chapter 68, Statutes of 2005 (SB 68, Committee on Budget and Fiscal Review), created the Pay-for Performance program for counties. This program creates a performance incentive system whereby counties earn a share of $40 million based on improving performance on three specified measures related to employment, earnings, and participation. Then, Chapter 75, Statutes of 2006 (AB 1808, Committee on Budget), made the following changes designed to improve program operations and engagement of clients with participation:

- ***County Plan Addenda***. Each county is required to indicate how it intends to meet program goals and work participation requirements, by amending it CalWORKs plan.

- ***County Penalty Pass-On.*** Statute requires that counties backfill their share of any federal penalties the state might receive for failing to meet federal participation requirements.

- ***Data Master Plan.*** Among other changes, the master plan prepared by the state will result in a new monthly report which tracks hourly participation rates in each country. It is anticipated that this will focus case managers and administrators on the work participation status of their caseloads.

- ***Ending Durational Sanctions***. Chapter 75 allows recipients to end their sanction immediately after coming into compliance. Under prior law, recipients being sanctioned for the second or third time would be required to remain in sanction status and, thereby, excluded from the participation rate even if they are employed.

- ***Expanding Homeless Assistance Eligibility.*** Under prior law, CalWORKs recipients were entitled to a once-in-a-lifetime assistance payment if they became homeless. Chapter 75 permits this payment to be provided upon threat of eviction. This should stabilize housing situations, enabling more families to participate in work.

- ***Temporary Assistance Program (TAP).*** Chapter 75 created a non-MOE funded TAP for CalWORKs recipients who are exempt from work participation (usually temporarily disabled). This program would have increased the participation rate and resulted in a CRC. However, as discussed below, the program cannot be implemented as intended by the Legislature.

Budget Estimate of Work Participation Impact. With the exception of the TAP program (which cannot be implemented at this time), all of the changes described above should increase work participation. The difficult question is estimating the magnitude of the impact on participation. The Governor's budget estimates that together these changes will increase California's work participation rate by just over 5 percent in FFY 2007 and 11.4 percent in FFY 2008, as shown in Figure 5 (see next page). The administration specifically estimates that the homeless assistance policy change will stabilize housing for certain CalWORKs recipients resulting in about 700 and 1,400 cases meeting work participation in FFY 2007 and FFY 2008, respectively. Based on the change in durational sanctions, the budget estimates further respective participation increases of 3,000 and 3,750 over the next two years. Finally, from all other changes, the budget anticipates 12,000 cases will meet work participation in FFY 2007 and 29,600 cases in FFY 2008. Figure 5 estimates how these policy changes will increase participation to 34.7 percent in FFY 2008.

Figure 5

Estimated Work Participation Rates—Based on Current Law

	Federal Fiscal Year			
	2007		2008	
Base participation rate		23.3%		23.3%
Projected increase from policy changes				
Homeless assistance	0.2%		0.5%	
Ending durational sanctions	1.0		1.0	
All other policies	4.0		10.0	
Subtotals		5.3%		11.4%
Total Estimated Participation Rate		**28.6%**		**34.7%**

Totals may not add due to rounding.

LAO Comments on Increased Participation Estimates. Estimating the impact of policy changes on work participation is difficult. The administration's estimates for homeless assistance stabilization (0.5 percent) and ending durational sanctions (1 percent) appear reasonable. However, the estimate that all other changes will increase participation by 10 percentage points may be overstated, given the magnitude of this estimated growth. The administration provides no specific evidence explaining how these changes will increase participation among recipients. To assume an increase of 10 percent in a single year from what are essentially better incentives for counties (pay-for-performance, potential county penalties, and better data tracking), may be risky.

California Likely to Meet Work Participation Requirements in FFY 2008

As described above, California is required to meet a work participation rate of 50 percent, less a CRC. Currently, participation is about 23 percent, but the budget assumes as existing law changes are implemented, participation will increase by 11.4 percent by FFY 2008. Figure 6 compares the net participation requirement (after CRC) to the estimated level of participation in FFY 2007 and FFY 2008. As the figure shows, California is projected to be 16.7 percent below the net requirement in FFY 2007, but to exceed the requirement by 1.7 percent in FFY 2008. Although California is projected to be in compliance as of FFY 2008, there are risks associated with this projection. First, much of the compliance is based on the "excess" MOE CRC. This credit is based on regulations, not statute, and could be terminated by the federal administration. Moreover, California's method for calculating the excess MOE credit has not yet been approved by the federal Government. Finally, California's rate of 34.7 percent is dependent on the assumption that existing policies will increase participation by 11.4 percent.

Figure 6

Estimated Work Participation Shortfall(-)/Surplus

	Federal Fiscal Year (FFY)			
	2007		2008	
Federal requirement		50.0%		50.0%
Caseload reduction credit				
"Natural" caseload decline since FFY 2005	3.5%		4.1%	
Excess MOE reduction	1.2		12.9	
Total Credit		4.7%		17.0%
Net requirement		45.3%		33.0%
Estimated participation rate (see Figure 5)		28.6%		34.7%
Estimated Participation Shortfall(-)/Surplus		**-16.7%**		**1.7%**

MOE = maintenance-of-effort.

TAP Implementation Issues

As noted above, TAP cannot be implemented as planned. Before describing the implementation issues, we discuss the potential benefits of TAP.

Potential Benefits of TAP. Currently, certain CalWORKs recipients (such as those temporarily disabled, caring for a disabled relative, or over age 60) are statutorily exempt from work participation requirements. Chapter 75 created a separate state program funded exclusively with state monies which are not used to meet the MOE requirement. The TAP would serve CalWORKs recipients who are exempt from participation. Because of the exclusive state funding, the recipients of this program are outside the federal TANF program and are excluded from the federal work participation rate calculation. If implemented, it is estimated that this program would have increased the work participation rate by about 1.5 percent. It is also estimated that the program would have resulted in a CRC of about 5 percent, because the families would have exited TANF. Given these positive impacts on participation and caseload reduction, TAP would be an effective way of achieving compliance with federal work participation requirements. The Legislature required that TAP be a voluntary program providing identical benefits and obligations for TAP recipients as for CalWORKs participants.

Child Support Issues Threaten Implementation. This voluntary program was to be implemented in April 2007. Chapter 75 authorizes the administration to delay implementation until October 2007 under specified circumstances. Since enactment of this program, a working group of legislative staff, administration representatives, county staff, and advocates have learned that federal law appears to require that TAP receive a pass-through of all child support collected on behalf of participants. Because this requirement differs from the way child support payments are treated with respect to CalWORKs families (where child support beyond $50 is retained by the government), TAP cannot be implemented as scheduled. Pursuant to Chapter 75, DSS notified the Joint Legislative Budget Committee in January 2007 that TAP implementation would be delayed indefinitely.

On a very preliminary basis, the Department of Child Support Services indicates that to resolve the child support distribution issues, substantial automation changes are necessary, and these changes could not be implemented until after Phase 2 of the child support automation project is completed in 2008. Accordingly, it is likely that implementation will be delayed beyond October 2007. Because current law requires that TAP be implemented no later than October 2007, the Legislature will need to address the issue of when and whether to implement TAP.

GOVERNOR'S SANCTION PROPOSAL

In order to increase work participation, the Governor's budget proposes new sanctions on children whose parents cannot or will not comply with California Work Opportunity and Responsibility to Kids participation requirements. We review the sanction proposal's impact on work participation, families, and the state budget. We recommend rejecting the sanction proposal because by the administration's own estimates it is not needed to meet federal work participation requirements.

The budget proposes a full-family sanction (eliminating all cash assistance) for families in which the adult has been out of compliance with program requirements for at least three months. The Governor's budget states that a stronger sanction is necessary to increase the work participation rate so that the state can avoid substantial federal penalties. However, as discussed above, based on the Governor's own assumptions about the impacts of current law and the ability of the state to obtain a CRC, it appears that this change is not necessary to attain federal compliance by FFY 2008. Below we discuss the sanction proposal in terms of its impact on the budget, work participation, and families.

Full-Family Sanction

Policy Description. Currently, when an able-bodied adult does not comply with CalWORKs participation requirements, the family's grant is reduced by the adult portion, resulting in a "child-only" grant. The budget proposes a full-family sanction whereby the reduced grant for the children is eliminated if an adult is out of compliance with participation requirements for at least three months. In order to restore the family's grant, the noncompliant adult would need to sign an agreement to come into compliance and then complete the terms of the agreement for up to 30 days.

The agreements are to address the specific reason for noncompliance. For example, if the sanction was due to failing to complete a job club/job search program, the agreement would typically require the individual to complete the job club. Once completed, aid would be fully restored back to the day the client signed the agreement. These procedures are the same as current law.

The Governor proposes that this policy would be implemented on November 1, 2007. Families would be entitled to food stamp benefits during the period that they were not receiving a grant. For a family of three, we estimate that their monthly food stamps allotment would increase by about $10 to a total of $408, after the full-family sanction was imposed.

Impact on Families. According to sample data from 2005, there are about 36,400 cases that have been in sanction status for three months or more. These cases have an average of 1.9 children, so potentially about 70,000 children could lose cash aid unless their parents met work participation requirements. The Governor's budget assumes that 70 percent of cases, facing a full-family sanction, would fully participate through unsubsidized employment or a combination of other eligible participation activities so as to avoid the sanction. The budget estimates that it will take 12 months for these changes to occur as recipients may appeal their sanctions. As of November 2008, DSS estimates that 25,450 families would have avoided the sanction through compliance and that 10,950 families would receive the full family sanction. The 10,950 families include about 21,000 children. Below, we discuss why this 70 percent success rate is overly optimistic.

Impact on Work Participation. Based on the Governor's 70 percent assumption, there are two impacts on the state's work participation rate. First, the 70 percent of families meeting work participation raise the numerator in the work participation fraction. Second, the 30 percent of families unable to meet participation will exit the program and reduce the denominator. Together, the budget estimates that these changes will increase the work participation rate by about 3 percent in FFY 2008, rising to 9.6 percent in FFY 2009. We note that regardless of the success rate of this policy in encouraging families to work, the policy will increase the work participation rate, because families who experience the full-family sanction will be excluded from the denominator. The only question is the number who will be excluded.

Impact on Budget. Because of the estimated increase in compliance and work participation, the budget estimates increased child care and welfare-to-work services costs of about $27.8 million in 2007-08. These costs would be offset by grant savings ($16.4 million) from the families that experience the full-family sanction. Thus, the Governor's budget estimates these net costs to be $11.4 million in 2007-08, rising to $81 million in 2008-09.

Comments on the Governor's Full-Family Sanction Proposal

Estimated Behavioral Response Is Overly Optimistic. We believe the Governor's assumption that 70 percent of those cases already in sanction status will meet the federal participation requirements in response to a full-family sanction is substantially overstated. Using sanction data from 1999-00, the administration developed a "sanction cure rate" of 45 percent. It obtained this compliance rate by dividing the average number families ending their sanction by the average number of new sanctions per month. This 45 percent rate is overstated, however, because it is based on aggregate data, not the individual behavior of families returning to compliance. (As we discuss below, Riverside County, tracking individual families, found that 27 percent of sanctioned families eventually came into compliance.) Moreover, "compliance" was not exclusively defined as meeting the federal work requirements (20 to 30 hours per week) but included signing an agreement and completing the required activity, such as attending orientation. It could also mean that the family was found to be exempt. Based on our review, although some families coming into compliance would participate sufficiently to meet federal requirements (20 to 30 hours per week), far less than 45 percent of those ending would be at this high level of participation. Finally, the administration presents no specific evidence that a full-family sanction would increase their estimated rate of attaining compliance from 45 percent to 70 percent.

Available Research Does Not Directly Address Relationship of Sanctions to Work Participation. There is no consensus in the research community on whether stronger sanctions correlate with better employment outcomes for families. This is mostly because there have been no controlled studies that compare the impacts of randomly assigned participants to weaker and stronger sanctions. Changes in sanction policy are typically accompanied by other changes, such as time limits and work incentives (such as allowing recipients to keep more of their cash grant even as their earnings increase). Nevertheless, there is research on the characteristics of sanctioned cases and what happens to them over time.

Longitudinal and Characteristics Data. Research from California and other states consistently finds that sanctioned cases face more barriers to employment than their nonsanctioned counterparts. Given that the sanctioned caseload faces greater barriers to employment, there is no basis to conclude that their estimated participation (assumed to be 70 percent) would be greater than the nonsanctioned caseload, which currently has a work participation rate of about 24 percent. A longitudinal study by Riverside County showed that within ten months, 27 percent of sanction cases ended their sanction and "participated." However, in this study, "participation" meant any level of participation, for example, attending job club. It did not necessarily mean participating for sufficient hours to meet federal requirements. We note that a full-family sanction represents a greater financial hardship and, therefore, a greater incentive to comply than the current "adult-only" sanction. Nevertheless, our review of the research on sanction impacts suggests that the success rate from a full-family sanction is likely to be substantially less than 70 percent.

What Happens to Sanctioned Families? Some studies indicate that families experiencing a full-family sanction have greater material hardships (such as utility shut off), than nonsanctioned families. However, none of the studies finding greater hardship could establish a causal relationship between the sanctions and the hardship.

Research from some states with graduated full-family sanctions indicates that some sanctioned families turned to other sources of support, primarily other family members when they were removed from aid.

Some observers predicted that sanctions and time limits associated with the 1996 federal welfare reform legislation would increase child welfare caseloads nationally. However, an Urban Institute study from 2001 found no such impacts.

Because there are no controlled studies of states that increased their sanction from adult only to full family, it is difficult to generalize about how a full-family sanction might impact families and work participation in California.

Analyst's Recommendation. Because the full-family sanction policy is not necessary to meet federal work participation rates and would substantially reduce the income for children in families where the adult is unwilling to participate, we recommend that the Legislature reject the Governor's proposal. Below we present an alternative approach to strengthen and improve the sanction policy.

Alternative Approach to Strengthening the CalWORKs Sanction

We recommend an in-person engagement strategy for each case that is in sanction status for three or more months. If upon being contacted by a caseworker, the family does not have good cause, cannot meet an exemption criteria, and is unwilling to participate, we recommend reducing the family's grant to one-half of its original total.

There are some CalWORKs families headed by able-bodied adults who could meet program participation requirements, but choose not to do so and accept the current sanction. In order to engage the adults in these families in work participation, we propose a reengagement strategy, in part modeled on a sanction prevention project in Los Angeles County.

Los Angeles County Approach to Preventing Sanctions. In order to improve compliance with work participation and avoid sanctions, Los Angles County developed a project designed to engage noncompliant families. Specifically, within ten days of sending the notice of noncompliance, a telephone contact is attempted. If the phone contact fails, a letter notifying them of a home visit is mailed to the recipient. (Recipients may decline the home visit.) Then, by phone or home visit, welfare caseworkers provide information about supportive services, program requirements, program exemptions, and the sanction process. Based on the discussion with the client, the caseworker attempts to resolve the pending sanction. The majority of the cases contacted in this project were able to avoid a sanction because:

- The recipient agreed to participate (20 percent) or went to work (6 percent);
- The caseworker determined that the client met the criteria for good cause for nonparticipation (20 percent), or met an exemption criteria (9 percent); or
- Compliance was met through other means (22 percent).

Long-Term Sanctions. Many cases resolve their sanction sometime after entering sanction status. Over a 24-month period, Riverside County found that 69 percent of cases never experienced a sanction while 31 percent had at least one month in sanction status. Of the 31 percent that were sanctioned, about 62 percent resolved their sanction at some point over the two years. The remaining 38 percent of sanctioned cases never ended their sanction, apparently because they were unwilling to do so.

A Stronger Sanction for Those Unwilling to Comply. We think a sanction more narrowly targeted at those unwilling to comply has merit. Specifically we believe that those in sanction status for over three months should be contacted, by phone or home visit, based on the Los Angeles County engagement model described above. If upon making contact with a caseworker, the family does not have good cause, cannot meet an exemption criteria, and is unwilling to participate, their grant could be reduced to one-half of its original total. If this stronger sanction were adopted by the Legislature, we recommend requiring DSS to report on the impacts on families of this increased sanction. Based on the results of the report, the Legislature could further modify the sanction policy.

Analyst's Recommendation

We recommend enactment of legislation (1) requiring a home visit or other in-person contact with each family who is out of compliance for three months or more, and (2) increasing the sanction to 50 percent of a family's grant if the adult refuses to comply with participation requirements.

GOVERNOR'S TIME-LIMIT PROPOSALS

In order to increase work participation, the Governor's budget proposes new time limits on children whose parents cannot or will not comply with the California Work Opportunity and Responsibility to Kids participation requirements. We review the impact of these time limits on work participation, families, and the state budget. We recommend rejecting the proposed time limits because they are not needed to meet federal work participation requirements.

Safety Net Time Limit. Currently, after five years of assistance, a family's grant is reduced by the adult portion, and the children continue to receive a child-only grant in the safety net program. The budget proposes to eliminate the safety net grant for children whose parents fail to comply with the federal work participation requirements as of November 1, 2007. Families currently on the safety net would be given 90 days to increase their work hours to remain eligible. Families unable to meet federal requirements would be terminated from aid.

Working Families Could Not Reenter Safety Net. We note that families who are unable to sufficiently increase their work participation within the 90-day window described above would generally be unable to return to the safety net even if they later worked sufficient hours. This is because the income ceiling for families applying for CalWORKs is below the income one would typically earn if one met federal participation requirements. This represents a "catch-22" because the family will be unable to return to the safety net regardless of work effort.

Child-Only Time Limit. The budget also proposes to limit assistance to five years for most other child-only cases (such as those with parents who are undocumented or ineligible due to a previous felony drug conviction). These time-limit policies are estimated to result in savings of about $336 million in 2007-08.

Time-Limit Impacts on Safety Net Recipients. In the current year, the budget estimates that there are 45,100 families in the safety net, rising to about 50,000 in 2007-08. The budget assumes that in 2007-08, 26 percent of these families—13,000 cases—will work sufficient hours to maintain eligibility for the safety net. The DSS bases this 26 percent rate on data indicating that currently about 19 percent of safety net cases are meeting the federal participation requirements, and that when faced with complete benefit termination, an additional 7 percent who are working part time would increase their hours so as to remain eligible. The budget estimates that the other 37,000 cases, with 94,400 children, would lose aid as of November 2007, rising to 39,600 cases (101,000 children) by June 2008.

Time-Limit Impacts on Other Child-Only Cases. The budget estimates that there are approximately 38,000 child-only cases with undocumented parents or parents with felony convictions making them ineligible for CalWORKs, that have received aid for five or more years. These cases have approximately 73,300 children. As of November 1, 2007, the budget proposes to eliminate the grants for these 73,300 children.

Fiscal Impacts. The budget estimates that the safety net time limit will result in savings of $176 million in 2007-08 based on part-year implementation, rising to $268 million in 2008-09. The child-only time limit is estimated to result in savings of $160 million in 2007-08 rising to $239 million in 2008-09.

Impacts on Work Participation Rate. The safety net time limit would increase participation in two ways. First, it modestly increases the number of families working enough hours to meet federal requirements (the 7 percent of families on the safety net who are working part-time and are assumed to reach the federally required levels in response to potential benefit termination). Second, those unable to meet federal participation would have their benefits terminated. By removing these cases from assistance, it reduces the denominator, thus increasing the participation rate. The budget estimates that these combined impacts will raise the work participation rate by 3 percent in FFY 2008, and just over 4 percent in FFY 2009. These estimates appear reasonable. Time limiting benefits for other child-only cases (where the parents are ineligible because they are drug felons or undocumented) has no impact on work participation. This is because they are already excluded from the work participation calculation. If the Legislature were to reject these time-limit proposals, the CalWORKs budget would increase by $336 million in 2007-08. We note that this increase in expenditures would increase the CRC by approximately 9 percent due to the additional excess MOE spending.

Analyst's Recommendation. Because the proposed five-year time limits for safety net cases and other child-only cases are not necessary to meet federal work participation rates and would substantially reduce the income for children in these families, we recommend that the Legislature reject these time limit proposals. We note that these proposals provide savings of $336 million in 2007-08, rising to $507 million in 2008-09. Rejecting these policies will require the Legislature to identify alternative budget solutions elsewhere.

Increasing Participation Through Food Stamps Benefits

By providing additional state-funded food stamps to families who are working sufficient hours to meet federal participation requirements but are not on California Work Opportunity and Responsibility to Kids, California could increase its work participation rate by nearly 10 percent.

Based on data from Los Angeles County, we estimate that there are approximately 42,000 families statewide who are working enough hours to meet federal participation requirements and are receiving food stamps but no CalWORKs grant. Some of these families are former CalWORKs families while others are not. If California were to increase the food stamps allotment for these families (for example, by $50 per month) using MOE funds, these cases would become assistance cases for purposes of calculating the federal work participation rate. By adding them to the calculation, California's work participation rate would increase by approximately 9.5 percent. We note that adding these cases would increase the caseload, thus reducing CRC by about 3.5 percent. The net benefit in terms of work participation would be about 6 percent (9.5 percent participation increase less a 3.5 percent reduction in the CRC).

Impacts on Recipients. Receiving this benefit (which does not involve a cash grant, only food stamps) would be seamless to recipients. The benefits would be added to their regular food stamps allotment which is currently provided through Electronic Benefit Transfer (EBT) cards which work like debit cards at food retailers. Recipients already complete a quarterly report regarding their income and eligibility status in order to receive food stamps. It may be necessary to make minor modifications to this form, but completing the form would not be an additional burden for recipients. Because these are state funded benefits, there would be no impact on the federal five-year time limit for receiving TANF-funded benefits.

Implementation Issues. The most significant barrier to implementation of this change is making the necessary programming changes to the EBT system and to the four welfare automation consortia. Costs for reprogramming are unknown. A DSS sponsored workgroup (comprised of state staff, legislative staff, county representatives, and advocates) is currently examining these implementation issues. The annual cost of the enhanced benefit would be about $25 million if it were set at $50 per month. The exact food stamp level would be a policy decision for the Legislature.

Analyst's Recommendation. Although the Governor's budget projects that California will attain federal compliance by FFY 2008, there are risks associated with this projection. First, attaining compliance is dependent on receiving the excess MOE CRC. This credit is part of current regulations and may be eliminated administratively in future years. Moreover, the federal government has not yet approved California's methodology for estimating the credit. If there is disagreement, the magnitude of the credit could be smaller. Second, attaining compliance assumes that current law policies will increase participation by 10 percent by FFY 2008. Although this is possible, we believe this 10 percent increase may be overly optimistic. Given the potential risk that California may not be in compliance in FFY 2008 (resulting in federal penalties of up to $149 million), the Legislature may wish to consider this strategy which would improve participation compliance by about 6 percentage points, and provide additional food stamp benefits for the working poor.

In-Home Supportive Services

The In-Home Supportive Services (IHSS) program provides various services to eligible aged, blind, and disabled persons who are unable to remain safely in their own homes without such assistance. An individual is eligible for IHSS if he or she lives in his or her own home—or is capable of safely doing so if IHSS is provided—and meets specific criteria related to eligibility for the Supplemental Security Income/State Supplementary Program. In August 2004, the U.S. Department of Health and Human Services approved a Medicaid Section 1115 demonstration waiver that made about 93 percent of IHSS recipients eligible for federal financial participation. Prior to the waiver, about 25 percent of the caseload were not eligible for federal funding and were served in the state-only "residual" program.

The budget proposes nearly $1.5 billion from the General Fund for support of the IHSS program in 2007-08, an increase of $27 million (1.9 percent) compared to estimated expenditures in the current year. This increase is attributable to caseload growth partially offset by increased savings from full implementation of the quality assurance reforms enacted in 2004-05.

IHSS Caseloads Overbudgeted

We recommend that proposed General Fund spending for In-Home Supportive Services be reduced by $26.9 million in 2006-07 and $33.9 million for 2007-08 because the caseload is overstated. (Reduce Item 5180-111-001 by $33.9 million.)

Governor's Budget. For 2006-07, the revised budget for IHSS assumes that the caseload will grow by 6.4 percent over the previous year. As a result, the budget estimates the average number of IHSS cases to be 375,000 in 2006-07, as shown in Figure 1 (see next page). The Governor's budget estimates that the IHSS caseload will reach 395,000 cases in the budget year, an increase of 5.4 percent over the current year.

LAO Estimate. Based on our review, we conclude that the Governor's caseload projections for the current and budget year are overstated. Our conclusion is based on an examination of the actual caseload for the first six months of 2006-07, which indicates that the average monthly caseload is significantly below the Governor's current estimate for that six month period. We have adjusted the budget's caseload downward to account for the most recent actual monthly caseload (December 2006). Figure 1 reflects this adjustment, and shows that the total caseload is overstated by 2 percent for 2006-07 and by 2.5 percent for 2007-08. Because the caseload is overstated, we estimate that the IHSS program is overbudgeted by $77.6 million ($26.9 million General Fund) in 2006-07, and $97.7 million ($33.9 million General Fund) in 2007-08. Accordingly, we recommend that the Legislature recognize a General Fund savings of $26.9 million in 2006-07 and reduce the IHSS budget by $33.9 million General Fund in 2007-08.

Figure 1

IHSS Caseload
Governor's Budget and LAO Estimate

Year	Governor's Budget	LAO Estimate	Difference	
			Amount	Percent
2005-06	352,386	352,386	—	—
2006-07	374,999	367,362	-7,637	-2.0%
2007-08	395,100	385,391	-9,709	-2.5

A separate analysis of unaudited monthly cash expenditures for the program indicates that IHSS savings may be even greater than indicated above. Six months into the year, monthly cash expenditures are running below where one would expect them to be, given the amount of funding appropriated for the program. The lower-than-expected expenditures suggest that the IHSS cost per case is declining. However, we are reluctant to recognize additional savings at this time because (1) the expenditures are unaudited and (2) the budget already reflects a reduction in the cost per case due to full implementation of the quality assurance initiative. We will continue to monitor expenditures and report to the Legislature on the IHSS caseload and expenditures at the May Revision.

FREEZING STATE PARTICIPATION IN PROVIDER WAGES

The budget proposes to limit state participation in provider wages and benefits. This proposal results in General Fund savings of at least $14 million in 2007-08, plus substantial cost avoidance in future years. We review current law regarding state participation in wages, describe the General Fund exposure associated with current law, and provide alternatives to the Governor's proposal.

Program Funding. The federal, state, and local governments share in the cost of the IHSS program. The federal government pays for 50 percent of program costs that are eligible for reimbursement through the Medicaid Program. Under the recently approved Medicaid demonstration waiver, about 93 percent of cases receive federal funding. The state pays 65 percent and the counties pay 35 percent of the nonfederal share of provider wages.

State Participation in Wage Increases. Chapter 108, Statutes of 2000 (AB 2876, Aroner), authorized the state to pay 65 percent of the nonfederal cost of a series of wage increases for IHSS providers working in counties that have established "public authorities." The public authorities, on behalf of counties, negotiate wage increases with the representatives of IHSS providers. The wage increases began with $1.75 per hour in 2000-01, potentially to be followed by additional increases of $1 per year, up to a maximum wage of $11.50 per hour. Chapter 108 also authorizes state participation in health benefits worth up to 60 cents per hour worked.

State participation in wage increases after 2000-01 is contingent upon meeting a revenue "trigger" whereby state General Fund revenues and transfers grow by at least 5 percent since the last time wages were increased. Pursuant to this revenue trigger, the state currently participates in wages of $10.50 per hour plus 60 cents for health benefits, for a total of $11.10 per hour. Based on current revenue estimates, the final trigger increasing state participation in wages to $12.10 per hour would be pulled for 2007-08.

Future General Fund Exposure. Although the state participates in wages up to $11.10 per hour, current county wages range from $7.50 to $13.30 per hour. Figure 2 (see next page) shows that several large counties, such as Los Angeles, San Diego, and Riverside have wages below $11.10. Given that these large counties are below $11.10, the state General Fund faces significant exposure to increased costs if counties increase wages. Specifically, if all counties were to increase their wages to $11.10 per hour, the increased annual cost to the General Fund would be about $225 million. Once the final wage trigger is pulled, allowing state participation in wages up to $12.10 per hour, the General Fund exposure increases by $125 million to a total of about $350 million annually. It is difficult to estimate how fast wages will increase, as wage increases are largely dependent on county fiscal health and collective bargaining outcomes. Nevertheless, we believe it will take several years to reach the $350 million in additional annual costs. As a point of reference, from July to November 2006, the General Fund costs from increased wages and benefits was about $20 million.

Figure 2

IHSS Hourly Wages and Benefits by County Approved by January 10, 2007

Alameda	$11.42	Orange	$9.00
Alpine	7.50	Placer	9.60
Amador	8.85	Plumas	8.75
Butte	8.75	Riverside	9.60
Calaveras	8.98	Sacramento	11.10
Colusa	7.50	San Benito	9.50
Contra Costa	11.83	San Bernardino	9.23
Del Norte	8.75	San Diego	9.67
El Dorado	9.10	San Francisco	12.30
Fresno	9.80	San Joaquin	9.53
Glenn	7.75	San Luis Obispo	9.60
Humboldt	7.50	San Mateo	11.38
Imperial	7.50	Santa Barbara	10.60
Inyo	7.50	Santa Clara	13.30
Kern	8.55	Santa Cruz	11.10
Kings	8.60	Shasta	7.50
Lake	7.50	Sierra	8.75
Lassen	7.50	Siskiyou	7.50
Los Angeles	8.96	Solano	11.10
Madera	7.50	Sonoma	11.10
Marin	11.10	Stanislaus	8.85
Mariposa	7.75	Sutter	8.85
Mendocino	9.60	Tehama	8.10
Merced	8.10	Trinity	7.50
Modoc	7.50	Tulare	8.10
Mono	7.50	Tuolumne	7.50
Monterey	11.10	Ventura	9.60
Napa	11.10	Yolo	11.10
Nevada	8.75	Yuba	9.10

Governor's Proposal. The budget proposes to freeze state participation in wages and benefits. Such a freeze results in a savings of $14 million in 2007-08. This is because some counties already pay providers over $11.10, and absent this proposal, the state would have to increase its participation in those wages. Depending on the degree to which the remaining counties would have increased wages absent this proposal, the Governor's approach would result in additional, unknown cost avoidance in 2007-08. Finally, the Governor's proposal eliminates the $350 million future exposure discussed above.

We note that the Governor's proposal does not limit the wages paid to IHSS providers; rather, it caps state participation to the level in effect on the date the freeze is enacted. Counties that elect to pay wages above what they were paying as of the wage freeze would share such wage cost increases with the federal government (50 percent county and 50 percent federal). The state would continue to pay its 65 percent share of the nonfederal costs of wages up to the county wage in place on the date of the wage freeze. This means that the counties that have higher wages in place at the time of the freeze would lock in a greater degree of state participation prospectively than the counties with lower wages as of that date.

Current-Year Wage Increases. The administration believes it has the authority to freeze state participation in wages to January 10, 2007 levels during 2006-07. However, the administration now indicates that it will continue to participate in post-January 10, 2007 wage increases until its urgency legislation proposal prospectively limiting state participation is enacted by the Legislature.

Impacts on Recipients and Providers. In the short term, we believe that freezing wages at their current levels will have minimal influence on the supply of available IHSS providers. However, in the long run, if counties decide that they cannot afford to increase wages without state participation, there may be a reduction in the supply of providers. This could impact the quality of care for IHSS recipients, as it may be more difficult to find skilled providers. Additionally, about 43 percent of IHSS providers are immediate family members, and assuming the provider lives with the recipient, a long-term wage freeze may limit the household income of the provider and the recipient.

Alternatives to the Governor's Proposal

By freezing state participation in wages, the Governor's proposal eliminates the state's current exposure of about $350 million from future wage increases. Below we present some alternatives to this proposal which offer less budgetary savings.

Alternative 1: Reject the Governor's Proposal. The Legislature could reject the proposal, and allow the final wage trigger to increase state participation in wages and benefits up to $12.10 per hour. This alternative would result in (1) costs of $14 million in 2007-08, (2) unknown additional costs in 2007-08 depending on county wage increases, and (3) a future exposure of about $350 million.

Alternative 2: Eliminate Final Wage Trigger. The Legislature could eliminate the final wage trigger, but allow state participation in wages up to the currently established combined level of $11.10 per hour. This would result in a savings of $14 million in 2007-08, and would limit future state exposure to about $225 million as counties increase their wages towards $11.10. One advantage of this alternative is that it would give all counties that are currently below $11.10 per hour an opportunity to increase wages and obtain state participation. The disadvantage is that it allows unknown additional costs in 2007-08 and leaves an exposure of $225 million, which is significantly more than the Governor's approach.

Alternative 3: Delay Final Wage Trigger. Another option is delaying the final wage increase indefinitely. This would allow all counties to receive state participation in wages up to the currently established $11.10 per hour in 2007-08, and would leave the decision of raising state participation to $12.10 to future years, when the state's fiscal health may have improved. In the short run, this would limit the General Fund exposure to $225 million. However, it adds unknown costs to 2007-08, compared to the Governor's proposal, depending on the number of counties that increase their hourly IHSS provider wage up to $11.10.

Conclusion. The Governor's proposal to freeze wages results in budgetary savings of $14 million in 2007-08. Additionally, it eliminates potential future annual costs of about $350 million for provider wages. In deciding whether to adopt this proposal, the Legislature should weigh the budgetary savings against the potential for a long term county wage freeze which may make it somewhat more difficult for recipients to find skilled providers.

ENHANCING PROGRAM INTEGRITY

Chapter 229, Statutes of 2004 (SB 1104, Committee on Budget and Fiscal Review), created an In-Home Supportive Services quality assurance (QA) initiative designed to improve the accuracy of needs assessments and program integrity. Although the QA initiative has improved the accuracy and standardization of service hour authorizations by social workers, there are limited controls assuring that recipients receive their service hours in accordance with their case plan. Furthermore,

current law and regulations are unclear as to whether recipients are permitted to reallocate their total approved hours in a way that deviates from the allocation determined by the social worker. We review the department's implementation of the quality assurance initiative, and provide recommendations to enhance program integrity and increase the likelihood that recipients receive services in accordance with their case plans.

Background

The IHSS program provides various services to eligible aged, blind, and disabled persons who are unable to remain safely in their own homes without such assistance. Figure 3 (see next page) shows specific tasks for which IHSS recipients may receive assistance. The IHSS program relies on county social workers to determine the number of hours for each type of IHSS task that a recipient needs in order to remain safely in his/her own home. Typically, social workers conduct reassessments once every year to determine whether the needs of a recipient have changed. After the social worker has determined the appropriate tasks, and time needed for each, a notice of action (NOA) is sent informing the recipient of the number of assigned hours for each task.

Quality Assurance Initiative

Chapter 229 outlined a number of quality assurance (QA) activities to be performed by the Department of Social Services (DSS), the counties, and the Department of Health Services to improve the accuracy of IHSS needs assessments, enhance program integrity, and detect and prevent program fraud and abuse. A key feature of the QA initiative is improving the accuracy of assessments for service hours. This is important because the correct assignment of service hours by task is critical if recipients are to remain in their own homes. For similar reasons, as we discuss later, it is important for recipients to *use* their authorized hours as allocated.

Below we discuss the most significant QA changes concerning the development of hourly task guidelines and county QA units.

Hourly Task Guidelines

Prior to the QA initiative, social workers relied significantly on their own judgment when determining the number of service hours to provide to IHSS recipients. As a result, IHSS recipients with similar disabilities, but residing in different counties may not have been granted similar hour allocations. Another way to identify social worker variance in assigning

Figure 3

In-Home Supportive Services Task Categories

Tasks	Examples
Domestic Services	Cleaning; dusting; picking up; changing linens; changing light bulbs; wheelchair maintenance; taking out garbage
Laundry	Sorting; washing; hanging; folding; mending and ironing
Shopping and Errands	Purchasing groceries, putting them away; picking up prescriptions; buying clothing
Meal Preparation	Planning menus; preparing food; setting the table
Meal Cleanup	Washing dishes and putting them away
Feeding	Assistance with food and fluid intake
Ambulation	Assisting recipient with walking or moving in home or to vehicle
Bathing, Oral Hygiene, Grooming	Cleaning the body; getting in or out of the shower; hair care; shaving; grooming
Routine Bed Baths	Cleaning the body
Dressing	Putting on/ taking off clothing
Medications and Assistance with Prosthetic Devices	Medication administration assistance; taking off/putting on, maintaining, and cleaning prosthetic devices
Bowel and Bladder	Bedpan/ bedside commode care; application of diapers; assisting with getting on/off commode or toilet
Menstrual Care	External application of sanitary napkins
Transfer	Assistance with standing/ sitting
Repositioning/ Rubbing Skin	Circulation promotion; skin care
Respiration	Assistance with oxygen and oxygen equipment
Protective Supervision	Ensuring recipient is not harming themselves

hours is to compare the average hour allocations per case among the ten largest counties. As shown in Figure 4, among California's ten largest counties in 2006-07, average hours per case ranged from 69 to 101 hours. We assume that these large counties are serving similar populations. Thus, differences in the average hours assigned are likely to be the result of social worker discretion and practice.

Figure 4

IHSS Service Hours Vary Substantially Across Largest Counties

2006-07

County	Average Hours Per Case[a]	Average Monthly Cases
Santa Clara	69.6	11,202
Orange	69.7	11,557
San Diego	79.7	19,027
Los Angeles	80.6	149,806
San Francisco	82.1	16,209
California	**83.9**	**344,484**
San Bernardino	86.3	14,935
Alameda	91.6	13,279
Riverside	94.0	10,229
Sacramento	98.5	16,681
Fresno	101.1	11,019

a These averages are from the IHSS Personal Care Services Program (PCSP) which is approximately 93 percent of the total IHSS caseload.

To meet the requirements of Chapter 229, DSS lead a workgroup composed of state representatives, county staff, legislative staff, and advocacy groups. The workgroup collected information from each county on the average number of hours granted per IHSS case. They then considered various levels of IHSS recipient ability, and developed corresponding ranges of times that would be appropriate to grant for each task. From this workgroup, hourly task guidelines (HTG) were created to provide social workers with a standard tool to ensure that service hours are authorized consistently and accurately throughout the state.

Since September 2006, HTG have been used statewide by social workers during their assessments. The guidelines help social workers to determine a recipient's level of ability to perform each IHSS task. After determining a recipient's level of ability, the social worker decides if the number of hours of assistance needed per week is within the HTG range for a particular task. The HTG do not take away the individualized assessment process, but instead require a social worker to provide a written justification if a recipient is assessed as needing hours that are outside (either above or below) the range established by HTG . These task guidelines increase the probability of consistent assessments throughout the state.

In a further effort to achieve uniformity, the IHSS Social Worker Training Academy was developed as a standardized method to educate social workers in QA and the proper usage of HTG. Interviews with county workers suggest that HTG and uniform training will likely increase the uniformity of assessments among counties so that IHSS recipients moving from one county to another will not likely experience large increases or decreases in their hour allocations.

County Quality Assurance Units and Reviews

Prior to the QA initiative, county efforts to review IHSS cases and hours varied. Some counties dedicated resources to reviewing cases and promoting uniformity, while others did not. Pursuant to QA requirements, each county has now established a QA unit to review and investigate cases. The *2006-07 Budget Act* funded a total of 110 QA positions, which were allocated to the 58 counties. The QA units conduct desk reviews, home visits, and targeted reviews. Although QA reviews began in 2005-06, legislative reporting requirements were not in place until 2006-07. As a result, DSS indicates that it is now compiling quarterly reports on these reviews, and these results will be available during budget hearings in 2007.

Mandatory Desk Reviews. Chapter 229 requires counties to complete 250 randomly selected desk reviews each year for each QA worker in a given county. Thus, a total of about 27,500 desk reviews will be conducted during the current year. During a desk review, a QA worker reviews a case to verify the presence and accuracy of all required forms, necessary hour calculations, and documentation. This type of review is used to ensure that caseworkers accurately apply the IHSS rules and procedures for assessing a recipient's need for services. A desk review may be supplemented with a phone call or home visit, but interaction with the program recipient is not required.

Home Visits. Counties are required to complete 50 home visits per allocated QA worker per year. A home visit requires QA workers to schedule an in-person meeting with an IHSS recipient to validate the information in the case file and verify that the services authorized are consistent with the needs of the recipient.

Targeted Reviews. Chapter 229 requires counties to develop a schedule under which QA staff will periodically perform targeted case reviews. The purpose of such reviews is to look more closely at individuals and situations that raise concerns about the delivery of IHSS services. Counties may use broad discretion in determining the types of cases to target.

Counties have used information gathered during home visits and desk reviews to determine which cases to target.

One example of cases some counties have chosen to target involves providers who are paid for delivering over 300 hours of services each month. Working over 300 hours per month is the equivalent of working 10 hour days, seven days per week. Although the program does not prevent providers from working over 300 hours, there is some concern that it would be difficult to provide this much service to a recipient if the provider does not live in the same household. As such, some counties have opted to target cases involving a provider that is paid for over 300 hours of services per month, but is not living with the recipient. These cases were chosen to verify that quality care was actually being provided in the reported amounts. Counties believed that targeting this population might yield results that could lead to IHSS improvements.

Expanding Quality Assurance to Service Delivery

Through a standardized assessment process, the QA initiative increases the likelihood that recipients with similar impairments will be provided similar service hours to meet their needs. However, there has been no parallel effort to ensure that the hours granted are being provided in accordance with how they were allocated. Current law and current practice are unclear as to whether it is appropriate for recipients to reallocate their hours among tasks, or across weeks, as long as they do not go over their total approved monthly hours. At the assessment, recipients are given documents suggesting that the intent of the program is to use hours according to the hour allocations assigned by the social worker, but there are no penalties for reallocating hours without social worker approval. Below we review current law and current practice regarding the use of authorized hours.

Current Law

State law provides that the purpose of the IHSS program is to provide supportive services to eligible aged, blind, and disabled individuals who cannot safely remain in their homes without these services. Current law further states that a recipient of IHSS services shall receive a description of "each specific task authorized and the number of hours allotted." Current law also requires that county welfare departments reassess each recipient's need for service at least once every 12 months with limited exceptions. Finally, counties must reassess "a recipient's need for supportive services anytime that the recipient notifies the county of a need to adjust" service hours.

Given current law requirements that each client (1) receive notification of the tasks and hours authorized, and (2) be reassessed anytime an adjustment in service hours is needed, it appears that legislative intent is for clients to use their hours of service as authorized. Although a recipient's reallocating hours from one task to another (for example, from bathing to domestic services) seems contrary to current statutory provisions, there is no explicit statutory prohibition against such reallocation.

Current Practice

The IHSS program is designed to provide individuals with the services necessary to allow them to remain safely in their own homes. Several documents provided to IHSS recipients and providers reinforce the intent that tasks authorized and the hours allocated should be used in the way in which they were assigned. Ultimately, however, this expectation may be unclear to recipients and providers.

Notice of Action. After a social worker completes an assessment, the recipient is notified of the number of hours for *each* IHSS task they were granted. Currently, this information is provided through a NOA that is sent *only* to the recipient. It then becomes the responsibility of the recipient to direct his or her care by informing the provider of the number of hours authorized for each task. As a result of this practice, IHSS providers may only know what their clients tell them. For example, if a recipient who is assessed as needing three hours of bathing and four hours of meal preparation per week instructs his/her provider to perform seven hours of meal preparation and no bathing, the provider would likely not know that bathing was a task approved by the IHSS social worker. We note that some counties have changed this practice, and now send providers a document that provides varying details of the hours assigned to each task. However, there is no established statewide method for counties to inform providers of the care that was authorized by the social worker. The NOA states that recipients must notify their social worker of any changes in their condition that may affect their hour allocations. However, this does not indicate that there is any prohibition on reallocating approved hours.

IHSS Recipient/Employer Responsibility Checklist. The recipient/employer responsibility checklist explains IHSS rules and responsibilities, and is intended to be discussed between the IHSS social worker, recipient (who is also considered the employer), and provider. The form provides places for these three parties to sign to indicate that they have discussed the information provided. However, the form is often only signed by the recipient and the social worker at the time of the assessment. Although DSS considers this form to be required, there are currently no consequences if a provider does not sign the form.

The form states that the "recipient has informed their provider of the services authorized and the time given to perform those services." This statement suggests that reallocating assessed hours is not allowed in IHSS, but it does not include a statement that prohibits reallocating hours across tasks or across weeks.

Time Cards. In order to receive payment, recipients and providers sign and return timecards to their counties every two weeks. These timecards require the recipient and provider to report the *total* number of hours that were provided each day of the pay period, but do not ask them to indicate the number of hours they spent on each specific task.

Since DSS regulations require that social workers assess hours per task on a weekly basis, it may be implied that hours are intended to be used weekly. In other words, a person needing 100 hours per month of a particular service would be assessed as needing that service 25 hours per week, and should presumably use their hours accordingly. However, there is currently no prohibition against reallocating hours across weeks.

We are aware of one county which is concerned about clients reallocating hours across weeks, and follows up with recipients when they see that more than 59 percent of the approved hours per month were used in any two-week period. This county acknowledges that IHSS recipients may have weeks where they need to use more or less of their approved hours, and as a result they are not overly concerned when hours vary by 9 percent or less. It is the belief of this county that when a recipient and provider claim over 59 percent of their hours in a two-week pay period, it may be possible that the condition of the recipient has changed so drastically that a reassessment is necessary.

Bottom Line: Unclear Expectations for Recipients and Providers

Program design and documents imply that hours should be used as they were allocated. However, because there is no explicit prohibition on reallocating hours across tasks or weeks, recipients and providers may not be aware that the intent of the program is to have them use their hours as assigned by the social worker. In other words, recipients may believe that the hours they receive are flexible and reallocate them amongst tasks, thereby treating them as a block grant of hours. Local officials indicate that some IHSS recipients reallocate their total approved hours between tasks without social worker approval. This practice could result in either inadequate or unneeded care. In the former case, a recipient receiving inadequate care could be in jeopardy of being placed in a nursing home if his/her condition deteriorated. In the latter case, the state would be paying for services that were unneeded.

Analyst's Recommendations

Below we recommend changes to current law and practices that are likely to result in clearer expectations for IHSS recipients, providers, social workers, and administrators. Figure 5 provides a brief summary of the proposed recommendations. If adopted, these recommendations would enhance program integrity and the delivery of services by ensuring that recipients receive the level and type of services authorized by the social worker.

Figure 5

Summary of LAO Recommendations

- ✓ ***Clarify Expectations in Statute.*** Clarify in statute that reallocation of hours across tasks is prohibited without social worker approval, and place limits on reallocation of hours across weeks.
- ✓ ***Notify Provider of Authorized Tasks.*** Require counties to inform providers of the authorized hours by task, and require providers to acknowledge receipt of this information.
- ✓ ***Inform Recipients of Program Requirements.*** Modify the recipient/employer checklist to inform In-Home Supportive Services recipients of the requirement to use services as authorized by their social worker, and require recipients to sign this form prior to the receipt of IHSS services.

Clarify Expectations in Statute

As discussed above, although current law and practice suggest that recipients should not reallocate their hours among tasks, and across weeks, such action is not prohibited. Moreover, documented reallocation is not grounds for nonpayment. Therefore, we recommend enactment of legislation that sets clear expectations for the use of authorized hours. This legislation would (1) prohibit reallocation across tasks without social worker approval, (2) limit reallocation across weeks, and (3) provide that documented misuse of hours is grounds for nonpayment. With respect to reallocation across weeks, we believe the "59 percent" approach discussed above provides sufficient flexibility for recipients to use services as needed while maintaining program integrity.

Make Certain Certifications Mandatory to Establish Payment

In order to assure that providers know the number of hours assigned to each IHSS task, we recommend (1) that providers indicate in writing that they have reviewed a document stating the hours per task and (2) that clients sign the recipient/employer checklist as a condition for processing the first payment. We discuss these certifications and our recommendations below.

Notify the Provider of Authorized Tasks. We recommend enactment of legislation requiring the provider be given a copy of the NOA, or a similar document, which identifies the tasks and the number of hours per task that were approved by the social worker. The provider would have to indicate in writing that he/she has seen the authorized hours by task, and understands that service hours are to be delivered as authorized. Currently, the provider must sign an enrollment form that provides the county with general information, such as name, address, and social security number. Because the provider must already supply the county with an enrollment form prior to receiving payment, requiring this new or modified form, would not represent an additional burden. This signed form will increase the probability that recipients will receive the services that they need to avoid institutionalization.

A further benefit of this requirement is that it would allow counties to hold providers accountable in instances of IHSS recipient neglect. Currently, because providers rely completely on the recipients to inform them of the approved tasks and hours, it is difficult to hold providers accountable when neglect occurs due to inadequate service. This is because providers can claim that they were not aware of the services authorized by the social worker, and were following the instructions given to them by the recipients. By requiring the providers to review the authorized services, counties will be able to hold providers responsible for providing those services. Additionally, providers will know when the recipients are asking for unauthorized activities, and providers will not be able to claim that they were unaware of the services they were authorized and paid to provide.

Inform Recipients of Program Requirements. As discussed earlier, there are a couple of flaws with the IHSS recipient/employer checklist. First, although recipients receive this form each time they are assessed, there is currently no consequence when either a recipient or a provider does not sign and return an IHSS recipient/employer checklist. Second, this form implies that hours should be used in accordance with the way in which they were allocated, but does not indicate that there are any consequences for reallocating such hours.

In order to address these shortcomings, we make several recommendations. First, we recommend that *recipients* be required to have these signed forms on file in order to process payment. Second, we recommend that this form be modified to only be signed by the recipient and social worker since the provider must already acknowledge their understanding of program expectations when they sign the recommended form mentioned above. Third, we recommend that this form be modified to indicate a recipient's responsibility to use hours as allocated and seek social worker approval before reallocating such hours. Finally, the form should indicate that reallocating hours across tasks and weeks without social worker approval could be grounds for nonpayment. We note that requiring recipients to sign this modified form should not create an additional burden, as it is current practice for the recipient to sign the current recipient/employer checklist form at the time of assessment and reassessment.

Setting clearer expectations for recipients and providers increases the probability that hours will be used as authorized. Ultimately, using hours as authorized by the social worker increases the likelihood that recipients will receive the services necessary for remaining in their own homes.

Fiscal Impacts. The recommendations above will most likely result in savings in payments for services, which will be partially offset by increases in workload as recipients request more reassessments and modifications. We estimate the net General Fund savings could range between $2 million and $5 million. Currently, recipients and providers claim about 96 percent of the hours they are authorized each month. We believe that most recipients want to comply with the rules of the program, and that with clearer rules against reallocating hours there will be a slight decrease in the utilization of authorized service hours. This is because when recipients do not need all of the hours assigned to a specific task in a given pay period, they will know that they are not permitted to ask their provider to spend the extra time on another task and will instead claim fewer hours in the pay period.

SUPPLEMENTAL SECURITY INCOME/ STATE SUPPLEMENTARY PROGRAM

The Supplemental Security Income/State Supplementary Program (SSI/SSP) provides cash assistance to eligible aged, blind, and disabled persons. The budget proposes an appropriation of $3.9 billion from the General Fund for the state's share of SSI/SSP in 2007-08. This is an increase of $350 million, or 9.9 percent, over estimated current-year expenditures. This increase is due primarily to caseload growth, the cost-of-living adjustment (COLA) to be provided in January 2008, and an increase in the federal administrative fee.

In 2007-08, it is estimated that there will be an average of 370,600 aged, 21,600 blind, and 872,600 disabled SSI/SSP recipients. In addition to these federally eligible recipients, the state-only Cash Assistance Program for Immigrants (CAPI) is estimated to provide benefits to an average of 11,400 legal immigrants in 2007-08, for whom federal financial participation is not available.

Budget Overestimates Cost of Providing Statutory COLA

The General Fund cost of providing the statutory Supplemental Security Income/State Supplementary Program cost-of-living adjustment (COLA) will be $45 million below the budget estimate due to a downward revision in the California Necessities Index and an upward revision of the Consumer Price Index. We recommend that proposed General Fund spending to provide the 2008 COLA be reduced by $45 million in 2007-08. (Reduce Item 5180-111-001 by $45 million.)

Background. Pursuant to current law, the Governor's budget provides the statutory COLA in January 2008. The state COLA is based on the California Necessities Index (CNI) and is applied to the combined SSI/SSP grant. It is funded by both the federal and state governments. The federal COLA (based on the Consumer Price Index for Urban Wage Earners and Clerical Workers, or the CPI-W) is applied annually to the SSI portion of the grant. The remaining amount needed to cover the state COLA is funded with state monies. Based on its assumptions concerning both the CNI and CPI-W, the budget includes $217 million for providing the statutory COLA for six months, effective January 2008.

The CNI Revised. The January 2008 COLA is based on the change in the CNI from December 2005 to December 2006. The Governor's budget, which is prepared prior to the release of the December CNI figures, estimates that the CNI will be 4.2 percent, based on partial data. Our review of the actual data, however, indicates that the CNI will be 3.7 percent.

The CPI Underestimated. The January 2008 federal SSI COLA will be based on the change in the CPI-W from the third quarter (July to September) of calendar 2006 to the third quarter of calendar 2007. The Governor's budget estimates that the change in the CPI-W for this period will be 1.2 percent. Based on our review of the consensus economic forecasts for 2007, we estimate that the CPI-W will be 1.4 percent. This increase in the CPI-W (compared to the Governor's budget) slightly reduces the state cost of providing the statutory COLA because it effectively increases federal financial participation toward the cost of the state COLA.

Cost of Providing COLA Is Overestimated. Taken together, the changes in CNI and CPI-W (in relation to the Governor's budget) decrease the General Fund cost of providing the statutory COLA by approximately $45 million. Accordingly, we recommend that the Legislature reduce the SSI/SSP budget by $45 million in 2007-08, to reflect a more recent estimate of the amount of funds needed to fund the SSI/SSP COLA.

Redirecting SSI/SSP COLA Funding to the California Work Opportunity and Responsibility to Kids (CalWORKs)

In order to more effectively utilize General Fund resources for cash assistance program COLAs to reduce poverty, we recommend redirecting $123.7 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA. Please see the "Crosscutting Issues" section of this chapter for the details of this recommendation.

SSI/SSP Grant Levels

Figure 1 shows SSI/SSP grants on January 1, 2008, for both individuals and couples as displayed in the Governor's budget and adjusted to reflect the actual CNI and our estimate of the CPI-W. As the figure indicates, grants for individuals will increase by $32 to a total of $888 per month, and grants for couples will increase by $56 to a total of $1,558 per month. As a point of reference, we note that the federal poverty guideline for 2007 is $851 per month for an individual and $1,141 per month for a couple. Thus, the grant for an individual would be 4 percent above the

2007 poverty guideline and the grant for a couple would be 37 percent above the guideline.

Figure 1

SSI/SSP Maximum Monthly Grants Governor's Budget and LAO Projections

(January 2007 and January 2008)

		January 2008		LAO Projection Change From 2007	
Recipient Category	**January 2007**	**Governor's Budget**	**LAO Projection[a]**	**Amount**	**Percent**
Individuals					
SSI	$623	$630	$632	$9	1.4%
SSP	233	262	256	23	9.9
Totals	**$856**	**$892**	**$888**	**$32**	**3.7%**
Percent of poverty[b]	101%	105%	104%		
Couples					
SSI	$934	$946	$947	$13	1.4%
SSP	568	619	611	43	7.5
Totals	**$1,502**	**$1,565**	**$1,558**	**$56**	**3.7%**
Percent of poverty[b]	132%	137%	137%		

a Based on actual California Necessities Index increase (3.7 percent) and projected U.S. Consumer Price Index increase (1.4 percent).

b 2007 U.S. Department of Health and Human Services Poverty Guidelines. The guidelines are adjusted annually for inflation.

Caseload Overstated for CAPI

We recommend that proposed General Fund spending for the Cash Assistance Program for Immigrants be reduced by $5.3 million in 2006-07 and $3.3 million for 2007-08 because the caseload is overstated. (Reduce Item 5180-111-001 by $3.3 million.)

Background. Pursuant to current law, since September 2006, sponsored immigrants who have lived in the United States for at least ten years no longer have their sponsor's income counted when determining their eligibility. If they meet the financial eligibility rules for SSI/SSP, and have not attained citizenship, they became eligible for CAPI.

Budget Estimate. The *2006-07 Budget Act* assumes that the end of the ten-year deeming period would result in approximately 250 sponsored noncitizens becoming eligible for CAPI each month beginning in September 2006. This increase in the CAPI caseload results in a General Fund cost of $13 million in 2006-07, and $46 million in 2007-08.

Actual Caseload. Our review of the actual CAPI caseload from July through November 2006 indicates that these sponsored immigrants have not yet joined the CAPI program. Specifically, the CAPI caseload through November 2006 is about 750 cases (4 percent) below the budgeted caseload.

LAO Caseload Estimate. We have adjusted the budget's caseload trend downward to account for the most recent actual data. To account for the possibility that some sponsored immigrants may enter the caseload later than expected, our revised forecast adds back 250 such cases in the spring and fall of 2007. After these adjustments, we estimate that the CAPI caseload is overstated by 5.6 percent in 2006-07, and 2.6 percent in 2007-08. Based on our revised caseload, we further estimate that CAPI is overbudgeted by $5.3 million in 2006-07 and $3.3 million in 2007-08. Therefore, we recommend that the Legislature recognize a General Fund savings of $5.3 million in the current year, and reduce the CAPI budget by $3.3 million in 2007-08. We will continue to monitor the CAPI caseload and report to the Legislature at May Revision on any changes.

CHILD WELFARE SERVICES

California's state-supervised, county-administered Child Welfare Services (CWS) program provides services to abused and neglected children, children in foster care, and their families. The CWS program provides (1) immediate social worker response to allegations of child abuse and neglect; (2) ongoing services to children and their families who have been identified as victims, or potential victims, of abuse and neglect; and (3) services to children in foster care who have been temporarily or permanently removed from their family because of abuse or neglect.

The *2007-08 Governor's Budget* proposes $2.4 billion from all funds and $714 million from the General Fund for the Child Welfare System. This amount includes an estimated $1.4 billion in federal funds. This represents an increase of slightly less than 1 percent in total funds and a decrease of 8 percent General Fund from the current year. The General Fund decrease is primarily due to the budget proposal to use $56 million in Temporary Assistance for Needy Families (TANF) funds to offset a like amount of CWS General Fund costs in 2007-08.

DESPITE SUBSTANTIAL IMPROVEMENT, FEDERAL FINANCIAL PENALTIES LIKELY IN 2007-08

Federal law requires California to improve its performance on outcome measures established for the child welfare system. We provide an update on the state's recent improvement on federal outcome measures, and an estimate of the risk of penalties based on current performance.

Federal Review System for Child Welfare and Foster Care

The federal Adoption and Safe Families Act (ASFA) of 1997 made significant changes to state CWS and foster care programs. Among other changes, ASFA required that the federal Department of Health and Human Services develop a set of outcome measures and create an ongoing state performance review process for these programs. The Child and Family Service Reviews, resulting from ASFA directives, include: (1) a focus on outcomes for children and families, (2) the use of multiple quantitative and qualitative measures to evaluate outcomes and performance, and (3) joint federal and state review teams.

Federal Child Welfare Performance Requirements. In 2002, the federal Administration for Children and Families (ACF) conducted its first performance review of California's child welfare system. At the time of the review, California failed all seven of the outcome measures pertaining to child safety, well-being, and permanency. Child safety outcomes focus on the protection of children from abuse. Permanency outcomes measure the state's success at providing stable foster care placements for a child and/or permanent resolutions for children who cannot return home. Finally, well-being outcomes pertain to meeting children's educational, physical, and mental health needs, and maintaining connections to their family and communities. Each outcome may contain a number of subgoals, all of which must be met in order to receive a "passing" grade for the measure.

Corrective Action. Because California failed the 2002 federal review, the state was required to develop and implement a Performance Improvement Plan (PIP) in order to avoid penalties in the form of reductions in federal funding. In our *Analysis of the 2006-07 Budget Bill*, we reviewed the most recent data available, from the second quarter of 2005, and found that at that time the state was still failing all seven of these measures.

California's Current Performance

The federal government will review the state's performance on its PIP in April 2007 (examining data from the 3rd quarter of 2006). Because 3rd quarter data are not yet available for review, we have compared the state's performance in the 2nd quarter of 2005 with the same quarter in 2006. Figure 1 shows that the state has made notable improvement and is now passing in four of seven outcome areas, while continuing to fail in the remaining three.

Partial Credit for Permanency Outcome? As Figure 1 shows, within the permanency outcome (#3), the state is passing four and failing two out of the six required subgoals. As mentioned above, normally, all subgoals within an outcome must be met in order for the state to "pass" the outcome measure. However, it is possible that California could receive partial credit for this outcome. The precedent for this occurred with the review of the District of Columbia, where federal penalties were decreased based on the number of subgoals that the district had met at the time of its final PIP review. From this perspective, California could be determined to have passed four of the outcomes completely, and one (permanency) partially.

Figure 1

Child Welfare Services
California's Performance Improvement Status

Performance Outcomes	Performance Second Quarter 2005 Result	Pass/Fail	Performance Second Quarter 2006 Result	Pass/Fail
Safety				
(1) Children are protected from abuse and neglect (two goals)		**F**		**P**
Children with repeat maltreatment ↓	8.7%	P	8.4%	P
Maltreatment of children in foster care ↓	0.78	F	0.66	P
(2) Children are safely maintained in their homes		**F**		**P**
Children with repeat maltreatment ↓	22.6%	F	22.1%	P
Permanency				
(3) Children have permanency and stability in their living situations		**F**		**F**
Children who reenter foster care after exit ↓	10.7%	F	10.9%	F
Children/family reunified within 12 months ↑	68.2	P	68.2	P
Children adopted within 24 months ↑	29.3	P	29.7	P
Children with two or less placements in 12 months ↑	85.2	F	85.7	F
Timely establishment of permanency goals ↑	74.3	P	77.8	P
Proportion of children with goal of long-term foster care ↓	31.3	P	28.8	P
Well-Being				
(4) Children whose family relationships and connections are preserved		**F**		**P**
(5) Families have enhanced capacity to provide for their children's needs		**F**		**F**
(6) Children receive appropriate services to meet their educational needs		**F**		**F**
(7) Children receive adequate services to meet their physical and mental health needs		**F**		**P**

↑ ↓ Arrows indicate direction of desired performance improvement.

Estimate of Penalty Exposure. Figure 2 (see next page) presents our estimate of the potential federal penalties facing California. Our estimate is based on the most recent performance data from the second quarter of 2006, and it is possible that California will improve further in the third quarter of 2006. We calculate the state's penalty exposure, assuming there is no improvement.

Figure 2

**Potential Federal Penalties
Child Welfare Services Program**

(In Millions)

Federal Fiscal Year	Estimated Annual Penalty	Interest Owed[a]	Total Estimated Penalty With Interest
2002	$4.5	$0.6	$5.1
2003	5.0	0.6	5.6
2004	4.7	0.6	5.2
2005	4.4	0.5	4.9
2006	4.4	0.5	4.9
Totals	**$23.0**	**$2.8**	**$25.8**

[a] Based on federal Department of Health and Human Services Office of Finance interest rate of 12.25%.

The federal penalties are assessed based on whether the state meets its goal for each outcome. For each outcome not met, a penalty of 1 percent is assessed on a portion of the state's federal fund allocation. This penalty formula is applied to each year's federal funding, beginning with federal fiscal year 2002. Because the state has a PIP, the federal government holds these penalties in abeyance until the final review, however, interest and the penalties continue to accumulate for each year. We estimate that the full penalty amount for the failure of three outcome measures (along with interest) to be about $26 million, as shown in Figure 2. This estimate does not reflect the possibility of receiving partial credit for the Permanency outcome subgoals, as discussed earlier. If the state received partial credit, penalties would be reduced to approximately $20 million.

When Will Penalties Be Applied? Once ACF receives the final data for review of the PIP in April, sanctions and penalties could be applied as soon as May or June 2007. The state may at that time begin an appeal of these sanctions. We cannot estimate how long an appeal would take. However, during appeal, interest on any penalties will continue to accrue at a rate of 12.25 percent.

Another Federal Review to Occur in 2008. The federal government is scheduled to conduct another review sometime in 2008. Although there will be some significant changes to the design of the review's outcome standards, the state will still be held responsible for outcomes not met under the first review and PIP. Once the second review is completed, penalties for outcome areas still below federal standards double to 2 percent for each outcome area not in compliance. Because of the ongoing risk of penalties, the Legislature should continue to monitor closely the state's performance on federal child welfare outcomes.

Balancing the Risk and Potential of the Federal IV-E Waiver Project

Over the next five years, the state will participate in a federal IV-E funding waiver demonstration project. The waiver caps the amount of federal funding available to the state during this period, while also providing an opportunity for the state to use these federal funds more flexibly. However, the limit on federal funding could pose some risk to the state. We review the implementation status of the waiver project, and recommend adopting budget bill language in order to better balance the risks to children with the opportunities to improve outcomes.

Federal Funding of CWS

Federal IV-E Funds Provide Limited Flexibility. Title IV-E of the Social Security Act, provides the majority of the federal funding dedicated to child welfare programs, such as foster care, adoptions assistance, and independent living. These funds are normally an open-ended entitlement which may be used to cover costs for board, care, and related administration for eligible children in foster care (including social worker salaries and support). Federal IV-E funds may be used for case management activities, including referral to services, but not for services themselves, such as counseling or treatment that would be used to prevent child abuse, speed reunification, or maintain safety for children who remain in their homes. There are other federal funds, (those authorized under Title IV-B) that may be used for these types of services and prevention activities. However funding under IV-B is capped, and the majority of these funds are usually spent by the end of the second quarter of each fiscal year.

IV-E Funding Waiver Granted. On March 31, 2006, the federal government approved the state's request to waive certain provisions of Title IV-E under a IV-E waiver demonstration project. Under the terms of the federal IV-E waiver, up to 20 counties can participate, using federal funds for services that would not normally be eligible for federal reimbursement. The purpose of the waiver is to encourage and allow the use of innovative strategies or intensive services in order to prevent or limit placement in foster care. Two counties have chosen to opt into the waiver demonstration, Los Angeles and Alameda. Together these two counties account for 37 percent of the child welfare caseload in California.

Waiver Opportunity. The waiver presents a unique opportunity for the state to end what is described by some as a perverse funding incentive. This perverse incentive results from the availability of *uncapped* federal funding for the costs of foster care placement while capping federal funds for services that might avoid foster care placements. These services usually involve mental health and substance abuse assessment and treatment, or other types of family supports that address underlying causes of abuse and neglect. The waiver will allow the state to use IV-E funds for such services. Foster care placement is generally the most costly intervention for a case of child abuse or neglect. As a result, if the waiver project successfully decreases the use of foster care placement it will result in savings which the participating counties may re-invest in a broader variety of services for children.

How Will the Title IV-E Waiver Work?

Capped Allocation. Participating counties will receive a capped allocation of IV-E funds. The allocation amount is an average of the county's IV-E expenditures for federal fiscal years 2003 through 2005. The capped allocation of federal funds is combined with the state's contribution of General Fund support to create a "block grant" to the participating counties to fund child welfare and foster care services. The participating counties may not claim more than this annual allocation. Any unspent allocation will be available to the county in the subsequent year.

For the two counties who have chosen to participate in the waiver, this funding allocation is higher than it otherwise would be without the waiver. This is because both counties have experienced a decrease in their IV-E-eligible foster care caseload relative to the amount of block grant funding established under the waiver. We estimate that approximately $81 million in additional flexible funds will be available over the five-year waiver period for both counties.

Year-to-Year Funding Growth. The state's agreement with the federal government allows the funding amount for the counties to increase by 2 percent for each of the five years of the waiver period. In addition, counties may opt to use up to 5 percent of their year-five allocation during their first year for start-up related expenses.

Legislative Direction. Chapter 75, Statutes of 2006 (AB 1808, Committee on Budget), authorized the department to develop memoranda of understanding (MOUs) with participating counties, which would include among other provisions, the allocation methodology for state funds and the required county share of cost. Chapter 75 provided broad authority to the administration to manage the implementation of the waiver, including the elements of the agreements between the counties and the state. These agreements define how the state and the counties share the risks posed by a capped allocation and the state's total funding commitment over the five years.

Risks and Opportunities

Opportunities of Waiver Project. Increased funding flexibility offers an opportunity to "lock in" an historical amount of federal funds that is higher than current baseline estimates, and to provide more preventive services, using savings generated from lowering dependence on foster care. Further, if these strategies are successful, the waiver project will likely improve the system's performance on both federal and state outcome measures.

Alameda County's plan provides a good example of how the waiver may present an opportunity to improve performance on these outcome measures. Currently, Alameda County performs well on its rate of timely reunification for children in its foster care system. However, the county also has a high rate of reentry to foster care. The county plans to expand the services it offers to support children and families after reunification, in an attempt to prevent a reoccurrence of abuse or neglect. If successful, the county's waiver project will impact the county's performance on the related federal and state outcome measure, as well as avoid additional costs of subsequent foster care placements for a child.

Similarly, Los Angeles County plans an expansion of assessments and access to mental health or substance abuse services, at the initial investigation of abuse or neglect. Such assessments, now used on a limited basis, would be eligible for funding under the IV-E waiver. This type of service, conducted early in a case, can identify when an underlying issue might be present that, if left untreated, could affect the safety of a child remaining at home. The early identification of such issues may also reduce the time it otherwise might take for the county social worker to identify these issues, thus decreasing the amount of time a child spends in foster care. If successful, this intervention could improve both safety and permanency measures.

Financial Risk. Because the waiver shifts funding from an open ended entitlement to a capped allocation, it could pose a financial risk to participating counties. If project strategies do not produce the anticipated reduction in foster care and resulting cost avoidance, participating counties may be unable to provide the foster care services within the capped funding level. Some of this risk is the result of external factors, over which neither the state nor the counties have any control. For example, significant increases in a particular type of substance abuse or other unforeseen social or policy changes could create conditions leading to higher rates of child abuse and neglect or demand for foster care placement during the five-year period. If this occurs, and a participating county overspends its cap, there could be pressure on the state to make up the difference. Though the final MOUs with the counties had not yet been completed at the time this analysis was prepared, it appears that the Department of Social Services (DSS) has placed the liability for all costs that exceed the federal cap on the counties.

Child Safety Risk. Another potential risk stems from capped funding for foster care placement in the event of a caseload spike. To the extent that limited funding creates an incentive to reduce caseload, there is a risk that the county could favor the use of other interventions instead of removal from the home when removal might be the most appropriate alternative to prevent further abuse or neglect.

Balancing Risks and Opportunities. The federal funding waiver presents a significant opportunity for the state to meet a number of its most important goals with respect to child welfare programs. With the increased funding flexibility, the counties can potentially provide a mix of services to families and children that will enable them to improve their performance on child welfare outcomes. As discussed earlier in this chapter, the consequences of not improving on federal outcomes is federal penalties. Moreover, a continued decrease in the use of costly foster care placement is a longer term financial benefit to counties as well as the state.

Thus far, the Legislature has provided broad authority to the administration to define the terms of the waiver and manage the opportunities and risks. Below we describe the elements of the state's plan, as they were available at the time this analysis was prepared. We also recommend ways the Legislature could mitigate potential risks and increase its oversight of the waiver project in general.

Current Plans for State Implementation

Amount of State General Fund Provided for the Waiver Project. Normally, state funds are provided for foster care and the administration of child welfare programs based on caseload. Like the federal funds described earlier, these funds are not capped and increase based on the number of cases the county is managing. Under the IV-E waiver project, DSS will freeze the state General Fund portion of foster care grant payments going to the participating counties at the 2005-06 levels, while providing an annual growth rate of 2 percent for child welfare administrative costs. This is in contrast to the federal funds, which will increase for both types of costs, by 2 percent each year. By freezing the General Fund allocation for foster care, the state's plan decreases the pool of flexible funds available to the participating counties for reinvestment in waiver services, while conserving state General Fund resources.

Provisions to "Opt-Out" of Capped Allocation. The counties participating in the waiver project may opt-out if the demonstration is unsuccessful and the capped allocation proves to be insufficient to meet the counties' costs for services and grants. There are two main features of the opt-out policy: (1) a county must provide six-month notice to the state of its intention to opt-out of the waiver project and (2) the county is responsible for reimbursing any federal fund liabilities for services that would not have normally been eligible for IV-E funding. This feature of the state's plan shifts to the counties any risk that these additional costs would pose to the state General Fund.

Most Risk Is Shifted to Counties. Both the arrangement for state General Fund allocation and the opt-out policies essentially shift the financial risks of the capped allocation to the counties. Because the benefits from successful use of the waiver would accrue to both the counties and the state, we think that the Legislature should modify these policies to ensure that the children in the child welfare system benefit as much as possible from the waiver's opportunities, while controlling General Fund exposures.

Analyst's Recommendation

Provide Reserve for State Foster Care Allocation. Overall, the state's cost for foster care assistance payments is forecast to increase over the next five years by slightly less than 1 percent each year. In a county that is not participating in the waiver, these additional funds will support increases in foster care payments. Under the current arrangement, waiver counties will not receive this additional funding each year, which somewhat limits the advantages to them of participating in the project. The Legislature could offer to the waiver counties these growth funds (an average of $1.4 million each year, over the five years) as an "emergency reserve" that could be triggered by an increase in foster care caseload, if it occurs. Absent such a reserve, counties would have to absorb these costs. Thus, this reserve would alleviate some of the program risks to child safety described earlier. Accordingly, we recommend the adoption of budget bill language that establishes this reserve fund and sets out conditions for its use.

Monitor Outcomes for Increased Safety Risk. Though it is likely that participating counties will monitor caseload and outcome changes, we believe the potential impacts of the waiver on children merit further attention. Accordingly, we will review reported outcomes for Alameda and Los Angeles Counties and notify the Legislature of significant changes.

CWS BUDGET METHODOLOGY

Although statute requires the Department of Social Services to provide the Legislature with an updated budget methodology for child welfare services by February 1, 2007, this methodology had not been provided at the time this analysis was prepared. We withhold recommendation on the methodology, pending receipt of this proposal. We provide key issues for the Legislature to consider when reviewing the department's proposal.

Current CWS Budget System

Funding for the CWS program comes from a variety of state, federal, and local sources. Listed below are the main components of state funding for core CWS.

- ***CWS Base Funding.*** The state currently allocates base funding to CWS by applying caseload standards (that is, number of cases handled by a caseworker) to average monthly case counts to determine the number of workers necessary to provide services in the program. The current methodology uses caseload standards agreed upon in 1984.
- ***Hold Harmless Funding.*** In preparing the budget for CWS, DSS adjusts funding upward when the caseload increases, but does not adjust funding downward when the caseload declines. The practice of not adjusting the budget to reflect caseload decline is known as the "hold harmless" approach and provides substantial additional funding to counties with declining caseloads.
- ***CWS Augmentation.*** The Legislature has been concerned about the size of social worker caseloads and its effect on services. As a result, the Legislature established the CWS augmentation in 1998, increased the amount available in 2000, and added an additional $98 million in 2006-07 to be continued on an ongoing basis. There is no county matching requirement for these funds.

Concerns About High Social Worker Caseloads

There has been an ongoing effort to determine how many cases a social worker can carry and still effectively do his or her job. In 1984, the County Welfare Directors Association and DSS established an agreed upon level of cases per social worker. In 2000, the Child Welfare Services Workload Study, required by Chapter 785, Statutes of 1998 (SB 2030, Costa), determined that social workers carried too many cases to effectively ensure the safety and well-being of California's children. The SB 2030 Study, as it is commonly called, proposed minimum and optimum caseload standards for social workers. The state has yet to adopt these standards for caseload budgeting, although the other funding adjustments described above have been made with the intention of decreasing caseload sizes.

Legislature Requested Review of Budgeting

Chapter 75 required DSS to report to the Legislature with a new methodology for budgeting CWS funds. The legislation requires that the department's review include the SB 2030 study, other research literature, as well as models from other states. Moreover, the legislation requires that the revised methodology be incorporated into the May Revision of the Governor's budget for implementation in 2007-08.

Key Questions for Assessing CWS Budgeting Changes

Because the details of the administration's proposal are not yet available, we cannot comment on the proposed changes at this time. However, we recommend that the Legislature consider the following questions in assessing this proposal.

How Does the Plan Adjust for the Effects of the Hold Harmless Policy? County funding through the hold harmless policy varies widely. Some counties may already have significantly lower caseload ratios as the result of hold harmless gains, and as a result, may reach recommended caseload standards with less additional funds. It would be more cost effective for the state to target its resources on counties with the greatest caseloads per worker than to provide increases regardless of current county caseloads.

Does the Proposal Connect Funding and Performance on Outcome Measures? Chapter 75 states that the $98 million for outcome improvement "be linked to improved outcomes." Given the Legislature's interest in outcome improvement, does the proposal link the allocation of funds to a county's CWS outcomes?

Community Care Licensing

The Community Care Licensing (CCL) Division of the Department of Social Services (DSS) develops and enforces regulations designed to protect the health and safety of individuals in 24-hour residential care facilities and day care. The CCL oversees the licensing of about 86,000 facilities, including child care centers, family child care homes, foster family and group homes; adult residential facilities; and residential facilities for the elderly. Counties who have opted to perform their own licensing operations monitor approximately 11,000 of these facilities.

The Governor's budget proposes total expenditures of $119.9 million ($38.2 million General Fund) for CCL in 2007-08. This is an increase of 18 percent, or slightly less than $6 million in General Fund from the current year. Most of the increase is due to the addition of staff for more facility inspections. This is pursuant to a requirement in current law that triggers increased random inspections if violations increase by more than 10 percent from the prior year.

Automation Project Does Not Meet Legislature's Goals

The Governor's budget proposes $1.7 million ($1.5 General Fund) in 2007-08 and $1.4 million ($1.2 million General Fund) in 2008-09 for an automation project that is part of an overall Information Technology Strategic Plan for the Community Care Licensing (CCL). We find that the project does not meet the schedule set out in the strategic plan and as a result, will not address the Legislature's concerns. We recommend that CCL report at budget hearings on the costs and time that would be required to adhere to the schedule in the strategic plan.

Background

Legislative Interest. The Legislature has expressed interest in two areas with regard to CCL. These are (1) ensuring that CCL is effectively monitoring and enforcing facility safety and (2) providing facility compliance information on the Internet. In 2006-07, CCL could not provide key information related to enforcement activities with noncompliant facilities. As a result, in the *Supplemental Report of the 2006 Budget Act,* the Legislature required that the department provide a report on the costs to track this information in the future. In the same year, the Legislature added $366,000 to the budget in order to place facility inspection reports on the Internet. These funds were subsequently vetoed by the Governor.

CCL Information Technology Strategic Plan. The CCL has provided to the Legislature an Information Technology Strategic Plan that describes upgrades to automation that will improve its operations and enable it to address the concerns of the Legislature mentioned above. The plan estimates that this improvement will take a total of four years, and will be completed in two phases. Phase One is scheduled to be complete in 2008-09.

According to the strategic plan, CCL lacks sufficient automation infrastructure to accurately report on its monitoring activities. The plan cites the May 2006 Bureau of State Audits report, which indicates that because of flawed collection and tracking of licensing data, the information reported to the Legislature regarding visits and violations in the past may have been unreliable. The first two years of the plan (Phase One) would correct these problems, allowing CCL to accurately track data, access necessary management reports, and manage the activities of licensing field analysts. Phase One of the plan also includes developing the ability to display facility inspection reports and file facility complaints on the Internet. Phase Two adds functions such as online fee payment and access to licensing information for licensees.

Automation Project. The governor's budget proposes $1.7 million ($1.4 million General Fund) in 2007-08 and $1.4 million ($1.2 million General Fund) in 2008-09 for the Licensing Automation Reform Project. The proposal includes ten positions and approximately $800,000 in consulting contracts to upgrade CCL's existing automated systems. According to CCL, the automation project is the first phase of the strategic plan.

Automation Project Misses Key Legislative Goal. The goal of the strategic plan is to improve the management and efficiency of CCL. If implemented, some of the key features outlined in the plan would address the concerns of the Legislature. Specifically, the automation proposal indicates that by October of 2008, CCL will be able to track the effectiveness of monitoring and enforcement. However, the proposed automation project does not include providing access to any licensing information via the Internet, which is also a key interest of the Legislature. The department contends that because it must first make fundamental improvements to the basic tracking and management of licensing operations, providing information on the Internet cannot be done within current fiscal constraints. As such, this automation project will not meet the schedule outlined in the strategic plan, and will not address a key legislative goal.

Analyst's Recommendation

Because the automation project does not completely address the Legislature's goal of providing public information regarding licensing compliance, we recommend that DSS report at budget hearings on the estimated time and cost to complete all of the features outlined in Phase One in the strategic plan, including making licensing information available on the Internet.

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Crosscutting Issues

Evaluating Cost-of-Living Adjustments (COLAs) For Cash Assistance Programs

C-19 ■ **Targeting Anti-Poverty Funds.** In order to more efficiently utilize General Fund resources for cash assistance program COLAs, we recommend redirecting $124.4 million of the funds proposed for the Supplemental Security Income/State Supplementary Program COLA to provide the California Work Opportunity and Responsibility to Kids COLA.

Alcohol and Drug Programs

C-29 ■ **Proposition 36 Under Policy Change. Increase Item 4200-105-0001 by $60 Million, Reduce Item 4200-101-0001 by $35 Million.** Recommend increase General Fund appropriation for transfer to the Substance Abuse and Treatment Trust Fund by $60 million and reduce funding to the Substance Abuse and Treatment Program by $35 million. Further recommend the Legislature seek legal guidance from Legislative Counsel about Proposition 36 policy changes.

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Medi-Cal

C-40 ■ **Budget Projects Modest Caseload Growth.** We find that the budget's overall estimate for the Medi-Cal caseload is reasonable but shows risk of being slightly higher than justified. We will continue to monitor the caseload trends and will recommend any appropriate adjustments to the caseload estimate at the May Revision.

C-42 ■ **Data Match Increases Veterans' Access to Benefits and Reduces Cost of Health and Social Services Programs.** We recommend the Legislature appropriate the necessary funds to implement the federal Public Assistance Reporting Information System (PARIS) matching process, provided that the costs of implementing PARIS and the ongoing cost of participating in PARIS are offset by reduced costs in certain health and social services programs, resulting in net savings. We further recommend the Legislature require the Department of Health Care Services (DHCS) to report at budget hearings on the estimated costs for implementing the federal Public Assistance Reporting and Information System.

C-51 ■ **Significant Medi-Cal Fraud Continues.** Recommend that the Legislature adopt supplemental report language requiring the department to submit to the Legislature the antifraud evaluation report being prepared by a consultant by August 15, 2007.

C-53 ■ **Requests for Added Staff Excessive. Reduce Item 4260-001-0001 by $1.9 Million and Item 4260-101-0001 by $2.7 Million. Increase Item 4260-001-0995 by $504,000 and Item 4265-001-3098 by $504,000.** The budget request for DHCS includes various proposals for additional staff and contract funding generally related to the administration of the Medi-Cal Program. Recommend that some of the requests for funding for additional staff and contract resources be approved, but that others be reduced or deleted because they are not justified on a workload basis.

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Department of Public Health (DPH)

C-63 ■ **New DPH.** The Governor's budget plan implements enacted legislation that creates a new DPH. We find the administration's proposed organization structure to be reasonable, but find that the department should be more transparent in its budgeting. For this reason, we withhold recommendation on this proposal pending receipt of key budget documentation.

C-69 ■ **Licensing and Certification Proposal. Reduce Item 4265-001-3098 by $291,000.** The Governor's budget proposes 77.5 additional staff to implement enacted legislation and to implement the administration's proposals to improve the state's oversight of certain health care facilities. Recommend the Legislature approve the proposals, but reduce the level of staff proposed.

C-73 ■ **Foodborne Illness Proposal. Reduce Item 4265-001-0001 by $800,000.** We recommend a reduction on a workload basis of five of nine positions requested to expand emergency response capabilities to foodborne illness. We recommend approval of four positions and research funds to prevent foodborne illness outbreaks.

C-78 ■ **Prostate Cancer Treatment Program.** The Governor's budget includes $3.5 million General Fund to provide treatment services through the prostate cancer treatment program. We withhold recommendation on this proposal pending receipt from the administration of a statutorily required report evaluating the cost-effectiveness of the program.

C-78 ■ **Health Care Infection Control Program. Reduce Item 4265-001-0001 by $1.4 million and Increase 4265-001-3098 by $1.4 million.** The Governor's budget includes $2 million ($1.6 million General Fund) and 14 positions to implement a health care associated infections surveillance and preven-

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tion program. We find that there is an alternative funding source to implement this program that would result in lower General Fund costs.

C-80 ■ **Oral Health Assessment. Reduce Item 4265-001-0001 by $221,000.** The Governor proposes $221,000 General Fund and two limited term positions to complete a report regarding the improvements in the oral health of children resulting from recently enacted legislation. We recommend denial of the proposal and find that the department should seek private funds to contract out for this report resulting in a General Fund savings of $221,000.

Developmental Services

C-86 ■ **Regional Center (RC) Caseload Below Projected Levels.** The administration is requesting an additional $33 million General Fund to address a deficit in the current-year funding for the RC system due to cost increases and utilization of services. We recommend the Legislature require the department to report in budget hearings on the specific causes for increased utilization and costs.

C-88 ■ **Intermediate Care Facility for the Developmentally Disabled (ICF/DD) Rate Restructure Would Leverage Federal Funds.** We recommend the Legislature assume that the ICF/DD state plan amendment will be submitted by the Department of Health Care Services (DHCS) to the federal Center for Medicare and Medicaid Services in April of 2007 and that it will be approved. We estimate that this would result in an additional $11 million in federal reimbursements for 2006-07 and allow for a commensurate reduction in state General Fund support for the RC system.

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C-90 ■ **Rate Reform Progressing Slowly.** We recommend that the Department of Developmental Services report at budget hearings on the implementation of the rate reform initiative including the timeline for proposing revised regulations packages and the estimated savings for implementing rate reform for specified services.

C-91 ■ **Residential Care Models Allow Shift From Institutions to the Community.** We recommend the Legislature adopt supplemental report language requiring DHCS to report on the intermediate care facility for the developmentally disabled-continuous nursing pilot program.

Department of Mental Health (DMH)

C-97 ■ **The Early and Periodic Screening Diagnosis and Treatment (EPSDT) Projection Methodology Is Broken.** We withhold recommendation on both the funding requested for the current year and the budget year until DMH presents their revised EPSDT estimate methodology. We recommend the Legislature require the Office of State Audits and Evaluations within the Department of Finance to report at budget hearings on the findings from their review of the EPSDT estimate methodology and DMH's administrative practices.

C-99 ■ **New Sexually Violent Predator (SVP) Laws Drive Increased Costs.** We recommend the Legislature recognize current-year savings of $6 million General Fund due to lower-than-projected SVP caseload. We also recommend the Legislature wait until more information is available before taking action to fund additional administrative and caseload costs.

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Department of Rehabilitation

C-105 ■ **Automation Proposal Poses Future General Fund Risk.** Our review indicates that this automation proposal (1) is based on an overly optimistic development schedule, and (2) will likely require General Fund support in future years because there is no ongoing federal fund source. Recommend that the department report at budget hearings on the availability of federal funds in subsequent years, and how they intend to meet their schedule.

Department of Child Support Services (DCSS)

C-107 ■ **Federal Penalty Held in Abeyance.** In September 2006, DCSS applied for federal certification of the California Child Support Automated System. Once the state applied for certification, federal penalties were placed in abeyance. We discuss the current automation system and certification process.

C-108 ■ **Budget Proposes to Absorb Federal Administration Fee.** Pursuant to the Deficit Reduction Act (DRA) of 2005, the federal government will begin to assess an annual fee on the state of $25 for most never assisted child support cases. We review the decision to use state funds to cover the fee in 2007-08, and recommend supplemental report language requiring the department to provide a report to the Legislature in 2008 on the costs and benefits of collecting this fee.

C-110 ■ **Child Support Pass-Through Options.** The DRA increases federal participation in the amount of child support passed through to families who currently receive welfare assistance. We discuss the costs and benefits of various pass-through options.

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California Work Opportunity and Responsibility to Kids (CalWORKs)

C-114 ■ **Budget Suspends Statutory Cost-of-Living Adjustment (COLA).** By suspending the statutory COLA, the budget achieves a costs avoidance of $124.4 million.

C-116 ■ **LEADER Computer System Replacement.** Rather than joining one of the other two recently completed automation consortia, the budget proposes $2 million for planning activities for replacing the Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) computer system with an entirely new system. Recommend that the Legislature withhold funding for planning activities until a cost-benefit analysis for a new system is provided.

C-117 ■ **TANF Transfer to CWS Contrary to Legislative Approach.** By using federal Temporary Assistance for Needy Families (TANF) block grant funds to replace General Fund support for certain Child Welfare Services (CWS) emergency assistance costs, the Governor's budget achieves General Fund savings of $56 million in 2007-08. The Legislature should assess whether this proposed fund shift is consistent with its priorities for limited TANF block grant funds.

C-118 ■ **Maintenance-of-Effort (MOE) and Caseload Reduction Credit (CRC).** By spending above the federally required MOE level, the budget proposes to achieve a CRC which has the effect of reducing California's work participation requirement for CalWORKs families. We review the MOE requirement, the impact of the Deficit Reduction Act (DRA) of 2005 on countable MOE spending, and the Governor's proposal to obtain a CRC.

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C-121 ■ **Current Work Participation Requirements and Status.** Federal law requires that states meet a work participation rates of 50 percent for all families and 90 percent for two-parent families, less a CRC. The DRA and associated regulations significantly changed the calculation of participation rates and the CRC.

C-124 ■ **Impact of Recent Policy Changes on Participation.** California has made significant changes in the CalWORKs program in order to increase work participation among recipients. Estimates by the administration of the participation increases associated with recent policy changes, in conjunction with the caseload reduction credit, suggest that California would likely be in compliance with federal work participation requirements in federal fiscal year 2008.

C-128 ■ **Governor's Sanction Proposal.** In order to increase work participation, the Governor's budget proposes a full-family sanction for children whose parents cannot or will not comply with CalWORKs participation requirements. We review the impact of the Governor's sanction proposal on work participation, families, and the state budget. We recommend rejecting the sanction proposal because it is not needed to meet federal work participation requirements.

C-132 ■ **Alternative Approach to Strengthening the CalWORKs Sanction.** Recommend enactment of legislation (1) requiring a home visit or other in-person contact with each family who is out of compliance for three months or more, and (2) increasing the sanction to 50 percent of a family's grant if the adult refuses to comply with participation requirements.

C-133 ■ **Governor's Time-Limit Proposals.** In order to increase work participation, the Governor's budget proposes new time limits on children whose parents cannot or will not comply with CalWORKs participation requirements. We review the impact of these time limits on work participation, families,

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and the state budget. We recommend rejecting the proposed time limits because they are not needed to meet federal work participation requirements.

C-135 ■ **Increasing Participation by Enhancing Food Stamps Benefits.** By providing an additional state-funded allotment of food stamps to families who are working sufficient hours to meet federal participation requirements but are not on CalWORKs, California could increase its participation rate about 10 percent. We review the costs and benefits of this approach.

In-Home Supportive Services (IHSS)

C-137 ■ **IHSS Caseloads Overbudgeted.** Reduce Item 5180-111-001 by $33.9 Million. Recommend that proposed General Fund spending for IHSS be reduced by $33.9 million for 2007-08 due to an overstatement of the caseload.

C-139 ■ **Freezing State Participation in Wages.** The budget proposes to freeze state participation in provider wages and benefits, resulting in General Fund savings of at least $14 million in 2007-08, plus substantial cost avoidance in future years. We review current law regarding state participation in wages, describe the General Fund exposure associated with current law, and provide alternatives to the Governor's proposal.

C-142 ■ **Enhancing Program Integrity.** Although the quality assurance (QA) initiative has improved the accuracy and standardization of service hour authorizations by social workers, there are limited controls assuring that recipients receive their service hours in accordance with their case plan. We review the department's implementation of the QA initiative, and provide recommendations to enhance program integrity and increase the likelihood that recipients receive services in accordance with their case plans.

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Supplemental Security Income/ State Supplementary Program

C-153 ■ **Budget Overestimates Cost of Providing Statutory Cost-of-Living Adjustment (COLA). Reduce Item 5180-111-0001 by $45 Million.** Recommend that proposed General Fund spending for the 2008 COLA be reduced by $45 million in 2007-08 due to a downward revision of the California Necessities Index and an upward revision of the Consumer Price Index.

C-155 ■ **Caseload Overstated for CAPI. Reduce Item 5180-111-0001 by $3.3 Million.** Recommend that proposed General Fund spending for Cash Assistance Program for Immigrants be reduced by $3.3 million for 2007-08 due to an overstatement of the caseload.

Child Welfare Services

C-157 ■ **Despite Substantial Improvement, Federal Financial Penalties Likely in 2007-08.** We provide an update on the state's recent improvement on federal outcome measures and an estimate of the risk of penalties based on current performance.

C-161 ■ **Balancing the Risk and Potential of the Federal IV-E Waiver Project.** We review the implementation status of the waiver project, and recommend adopting budget bill language in order to better balance the risks to children with the opportunities to improve outcomes.

C-166 ■ **Child Welfare Services Budget Methodology Proposal.** We withhold recommendation, pending details of this proposal. However, we suggest key questions for the Legislature to consider when reviewing the department's proposal.

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Community Care Licensing (CCL)

C-168 ■ **Automation Project Does Not Meet Legislature's Goals.** We find that the project does not meet the schedule set out in the strategic plan and, as a result, will not address the Legislature's concerns. We recommend that CCL report at budget hearings on the costs and time that would be required to adhere to the schedule in the strategic plan.