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To: All County Social Service Directors and Fiscal Officers

From: CWDA Staff

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RE: State Budget Update #2 – LAO Releases Analyses of the 2015-16 Health and Human Services Budgets

The Legislative Analyst's Office (LAO) released its analyses of the health and human services components of the Governor's proposed 2015-16 budget yesterday. Following is a summary of the main points.

Fair Labor Standards Act (FLSA) Regulations

The Governor's proposed 2015-16 budget includes funding for FLSA-related costs in IHSS for both 2014-15 and 2015-16, including funding for changes to CMIPS II. The Administration finalized their January budget prior to the federal court ruling that blocked implementation of the FLSA regulations. In light of that ruling, CDSS has stopped implementation, although the U.S. Department of Labor (DOL) is appealing the federal court decision. It is the LAO's understanding that the appeal proceedings will occur on an expedited schedule such that it is possible that the court case could be resolved within 2014-15 or in the beginning of 2015-16. If DOL prevails in its appeal, the FLSA regulations would be required to be implemented.

Since there is still uncertainty about whether the FLSA regulations will be implemented, the LAO recommends the Legislature wait until the May Revision before making a decision on the $717 million ($319 million GF) in FLSA-related funding proposed for 2015-16. For the current year funding of $439 million ($200 million GF), the LAO recommends that the Legislature specifically revert those funds to make them available for other Legislative priorities or for the reserve since the funds will not be needed in 2014-15 for implementation of the FLSA regulations. The LAO also recommends that CDSS report at budget hearings on the plan for and fiscal impact of changes to CMIPS II in both cases, if the FLSA regulations remain invalidated and if they are upheld.

IHSS

The LAO's analysis of the rest of IHSS is largely a summary of the Governor's proposed budget. The LAO generally concurs with the Governor's other IHSS budget and caseload assumptions and does not recommend any adjustments at this time. They find that the Governor's overall concept of the new MCO tax to be a reasonable approach for raising the revenues needed to restore the 7 percent reduction to IHSS services hours. (See below for more on the LAO's analysis of the MCO tax.)

CalWORKs

The LAO's analysis of the CalWORKs program is largely a summary of the Governor's proposed budget. They find that the Administration's estimates are reasonable and consistent with current policy. They note that some recipients will begin to hit the 24-month time limit during 2015, but the impact of the 24 month time limit on the number of recipients and the state budget is uncertain at this point and that there should be more data to assess the impacts at the May Revision.

Continuum of Care Reform (CCR)

The CDSS released its CCR report with the proposed 2015-16 budget in January. The proposed 2015-16 budget also included $3.8 million ($2.8 million GF) for counties to increase outreach, recruitment, and support of foster parents and $5.8 million ($4.2 million GF) to increase the social worker component of the FFA rate by 15 percent, which begin implementation of two of the report's 19 recommendations.

The LAO finds that the CCR report recommendations are broadly consistent with legislative intent and address the key issues raised by the Legislature. They note, however, that the report lacks key details necessary for implementation, including how the recommendations would be financed. With respect to the proposed funding, the LAO states that it is appropriate to focus first on building capacity in home-based settings, but that it is not clear how the proposed funding fits into the broader CCR implementation and how the funding would help achieve CCR objectives. The LAO recommends that CDSS justify the budget proposal in the context of the broader implementation of CCR.

In its analysis of the CCR recommendations, the LAO notes the challenges to implementation posed by 2011 Realignment. If the CCR recommendations are to be implemented and required statewide, there are likely to be new and possibly significant costs to counties. On the other hand, there will be county savings over time as foster children are transitioned from more costly group home placements to less costly family-based placements. Whether CCR implementation is mandatory, whether any savings are used to offset state costs, and how any county savings will be determined are questions that the LAO identifies and needing to be answered.

Community Care Licensing (CCL)

The Governor's proposed 2015-16 budget proposes a multiyear, multistage plan to further reform the CCL program and includes an increase of 28.5 positions and $3 million GF to hire and begin training staff to increase the frequency of facility inspection and make other changes to strengthen enforcement capacity. Stage 1 of the proposed plan would increase inspection frequency for all facilities to once every three years; Stage 2 would increase inspection frequency for residential care facilities to at least once every two years; and Stage 3 would increase inspection frequency for adult and senior care facilities to at least annually.

The LAO finds that the proposed plan addresses legislative interest in increasing inspection frequency, but they recommend the Legislature only approve the first stage of the proposal at this time. They also recommend that CDSS be directed to develop a data-driven model to determine the appropriate frequency of inspection for the future stages of the plan. They recommend that inspection frequency not be based solely on broad facility type, but that inspection resources be targeted to individual facilities with the greatest likelihood of improving compliance based on the data-driven model.

<u>Medi-Cal</u>

The LAO's analysis of the proposed Medi-Cal budget focuses largely on DHCS's caseload estimates. While they think that the Administration's base caseload and optional expansion caseload estimates seem reasonable at this time, they find that the mandatory expansion caseload estimates are more uncertain. They withhold making any recommendations on possible caseload adjustments until the May Revision, but they do recommend that the Legislature require the Administration to resume the monthly caseload reports that they suspended one year ago.

<u>MCO Tax</u>

The LAO provides comprehensive analysis of the Administrations' proposed new MCO tax. The Administration is proposing a new MCO tax to replace the existing tax, which has been determined to be out of compliance with existing federal Medicaid law. To be compliant with federal law, a health care related tax, like the MCO tax, must meet three requirements: it must be broad-based and imposed on all providers within a specified class; be uniform and applied at the same rate for all payers of the tax; and not guarantee directly or indirectly the providers receive their tax payment back or be held harmless. The new MCO tax would replace the existing 3.9 percent tax on Medi-Cal managed care plans total operating revenues with a tiered tax on all MCOs (with specified exemptions) based on member months of enrollment. The tiered tax is intended to put a disproportionate share of the tax's burden on those MCOs the participate extensively in Medi-Cal managed care, since those MCOs will continue to receive rates that include funding to cover the tax as they do now. The tiered tax is also intended to lessen the proportionate impact on small and large MCOs. The restructured tax would no longer be connected to the sales tax as the current MCO tax is, so it would be formally administered by DHCS instead of the Board of Equalization. The Administration is seeking permanent authorization of the new MCO tax effective July 1, 2015 even though the current MCO tax remains in effect until July 1, 2016. The Administration cites the settlement agreement related to the 7 percent reduction in IHSS as the reason for the need to adopt the new MCO tax now – the deadline under the settlement agreement for the state to submit an "assessment" to CMS to draw down additional federal funds to restore the 7 percent reduction is April 1, 2015.

The LAO makes the following findings and recommendations on the Administration's new MCO tax proposal:

- They believe that it is likely to be federally permissible under federal Medicaid law. The state will need to get a waiver of the uniformity requirement, but they believe the proposed tax will meet the requirements necessary to get such a waiver. The proposal satisfies the broad-based and no hold harmless requirements of federal law.

- Weighing the fiscal merit of the proposal against the social costs, the LAO finds on balance that the restructured tax is reasonable and that the Legislature adopt by August 2015 a restructured MCO tax that includes the core features of the Administration's proposal.

- But there would be MCOs, those that have little or no Medi-Cal enrollment, that would have a new tax liability and thereby increased costs as a result of the restructured tax. They estimate the total value of that liability to be $658 million. They speculate that the MCOs may pass those higher costs onto consumers in the form of higher premiums, although the effect would likely be slight.

- They recommend that the Legislature enact the same tiered tax for a five-year period. They find the current proposal to be vague on what the revenue targets for the tax are for the out years and express administrative and budgetary concerns about the possibility of the tax tiers being adjusted each year.

For more detail, the full LAO analyses can be found at the following links:

- Analysis of 2015-16 Human Services Budget
- Analysis of 2015-16 Health Budget