



MAJOR ISSUES (February 1994)

%Budget Proposes to Restructure State-County Responsibilities. The budget proposes to increase the county share of cost for various health and social services programs, thereby shifting \$3.3 billion in spending from the state General Fund to the counties. In order to make the proposal fiscally neutral, it would be accompanied by a shift to the counties of sales tax, property tax, and other revenues, and state assumption of a higher share of trial court costs. (See page C-14 and our companion volume, *The 1994-95 Budget: Perspectives and Issues*.)

%Shifting State Costs to the Federal Government Entails Risk of Budget Shortfall. The budget assumes over \$1 billion in General Fund savings in various health and social services programs by anticipating the federal enactment of legislation that would increase federal funding for these programs. The two largest shifts are (1) increasing the federal share of costs for the Medi-Cal and AFDC Programs and (2) reimbursing the state for the costs of providing federally required services to refugees and undocumented immigrants. To the extent these federal funds do not materialize, there will be a budgetary hole in these programs. (See pages C-13, C-100.)

%Expansion of Managed Care in its Current Form Should Be Reevaluated. The department's "strategic plan" for expanding managed care assumes that nearly half of all Medi-Cal beneficiaries will be enrolled in such programs by the end of 1994-95. We recommend that the Legislature reevaluate the broad

authority it has granted to the department for this expansion because, as currently planned, these efforts are likely to result in additional costs to the Medi-Cal Program, rather than savings. (See page C-31.)

%Proposal to Eliminate Medi-Cal Optional Benefits Has Fiscal and Program Implications. The budget proposal to eliminate nine optional benefits is estimated to result in net General Fund savings of \$154 million in 1994-95, but could place additional fiscal burdens on county indigent health programs. We recommend that if the Legislature chooses to reduce benefits, it consider an approach based on treatments or diagnoses rather than entire categories of benefits. Such an approach would reduce cost-shifting and better target the service reductions. (See page C-41.)

%Expanding Medi-Cal, Instead of the AIM Program, Would Save State Funds. The Access for Infants and Mothers (AIM) Program provides health insurance for pregnant women, and their infants, whose incomes are up to 250 percent of the poverty level. We recommend that instead of relying on the AIM Program to accomplish this, the Medi-Cal Program be expanded to serve AIM-eligible persons. This would permit the use of Overviewfederal funds and the reallocation of Cigarette and Tobacco Products Surtax Fund monies, resulting in a state General Fund savings of approximately \$73 million in 1994-95. (See page C-53.)

%Budget Proposes Major Welfare Policy Changes. One of the Governor's stated reasons for proposing to reduce Aid to Families with Dependent Children (AFDC) grants and place a time limit on their availability is to make work an attractive alternative to the AFDC Program. We conclude that some families will be able to compensate for the grant reductions through work. Other families, however, probably will not be able to fully offset the grant reduction due to low levels of education and employment experience, as well as a potential lack of job opportunities. (See page C-76.)





TABLE OF CONTENTS

Overview	C-5
Expenditure Proposal and Trends	C-5
Caseload Trends	C-7
Spending by Major Programs	C-9
Major Budget Changes	C-11
Departmental Issues	C-17
Secretary for Health and Welfare (0530)	C-17
Office of Statewide Health Planning and Development (4140)	C-19
Department of Alcohol and Drug Programs (4200)	C-23
California Medical Assistance Program (Medi-Cal) (4260)	C-24
Public Health	C-48
Managed Risk Medical Insurance Board (4280)	C-53
Department of Developmental Services (4300)	C-59
Department of Mental Health (4440)	C-65
Employment Development Department (5100)	C-69

Department of Social Services—	
State Operations (5180)	C-72
Aid to Families With Dependent Children	C-74
Supplemental Security Income/ State Supplementary Program	C-100
County Administration of Welfare Programs	C-106
Child Welfare Services	C-121
In-Home Supportive Services	C-125
Adoptions Programs	C-126
List of Findings and Recommendations	C-129



OVERVIEW

General Fund expenditures for health and social services programs are proposed to decrease significantly in the budget year. The savings would be achieved primarily by (1) shifting some of the state's costs of certain programs to the counties, funded by a transfer of revenues to the counties and county savings from state assumption of a higher share of trial court costs, (2) shifting some of the state's costs of certain programs to the federal government, (3) reducing grants provided under the Aid to Families with Dependent Children (AFDC) Program, and (4) eliminating certain Medi-Cal benefits.

EXPENDITURE PROPOSAL AND TRENDS

The budget proposes General Fund expenditures of \$10.1 billion for health and social services programs in 1994-95, which is 26 percent of total proposed General Fund expenditures. The budget proposal represents a reduction of \$3.5 billion, or 26 percent, from estimated expenditures in the current year. Most of this net reduction is due to shifting state costs to the counties and federal government.

Figure 1 shows that General Fund expenditures for health and social services programs are projected to decrease by \$274 million, or 2.6 percent, between 1987-88 and 1994-95. General Fund expenditures increased significantly until 1991-92, when realignment legislation shifted \$2 billion of health and social services program costs from the General Fund to the Local Revenue Fund, which is funded through state sales taxes and vehicle license fees. This shift in funding accounts for the significant increase in special funds starting in 1991-92, as shown in Figure 1. General Fund spending declined in 1992-93, due to various

program reductions (the largest being welfare grant reductions). As discussed below, the budget proposes a significant General Fund reduction in 1994-95, partly offset by a sharp increase in special fund expenditures.

Combined General Fund and special funds spending is projected to increase by 36 percent between 1987-88 and 1994-95. This represents an average annual increase of 4.5 percent.

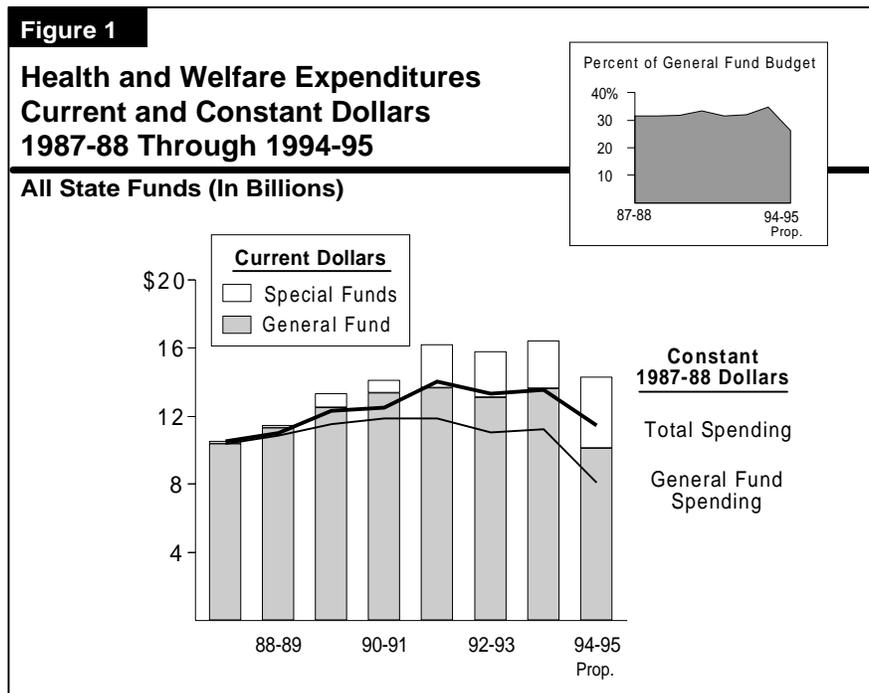


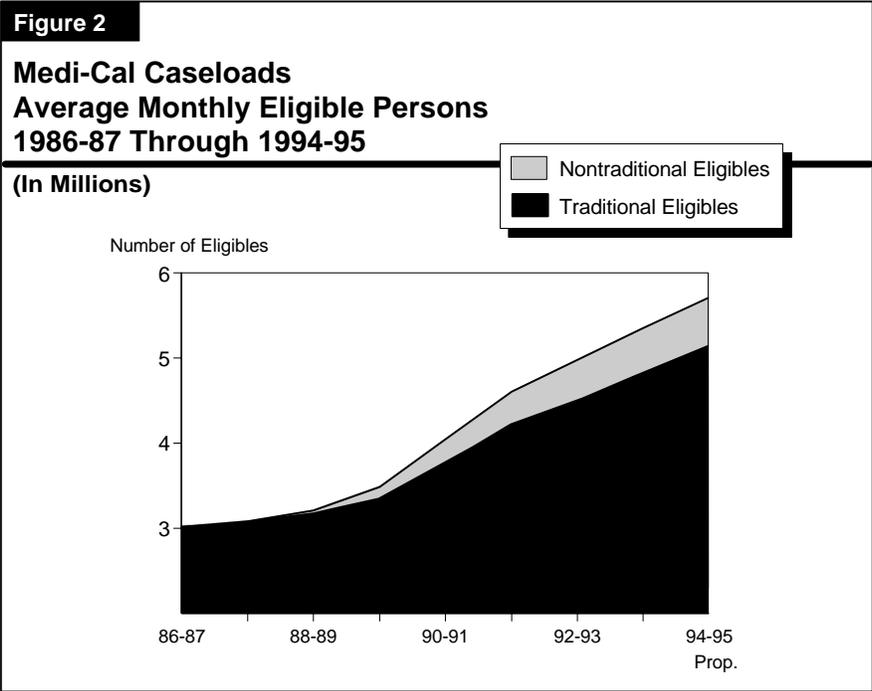
Figure 1 also displays the spending for these programs adjusted for inflation. On this basis, General Fund expenditures decreased by 22 percent between 1987-88 and 1994-95. Combined General Fund and special funds expenditures are estimated to increase by 8.7 percent from 1987-88 to 1994-95, on a constant dollar basis. This is an average annual rate of increase of 1.2 percent.

As noted previously, the 1991 realignment legislation significantly altered the financing of health and social services programs by transferring funding for all or part of several mental health, public health, and social services programs to the counties. The sales tax and vehicle license fee revenues dedicated to realignment amounted to \$2 billion in 1991-92, which was \$239 million short of the amount that was initially estimated. The budget estimates that realignment revenues will be

\$2.2 billion in the current year, and the budget proposes an increase to \$3.6 billion in 1994-95 as part of a broader “restructuring” proposal. We note that these state special fund expenditures do not reflect the proposed shift of \$1.1 billion in property tax revenues from public schools to health and welfare programs in the counties, which is also part of the 1994-95 restructuring proposal. (Because the budget proposes to replace these revenues with General Fund monies, this will be reflected as a state expenditure for education programs.)

CASELOAD TRENDS

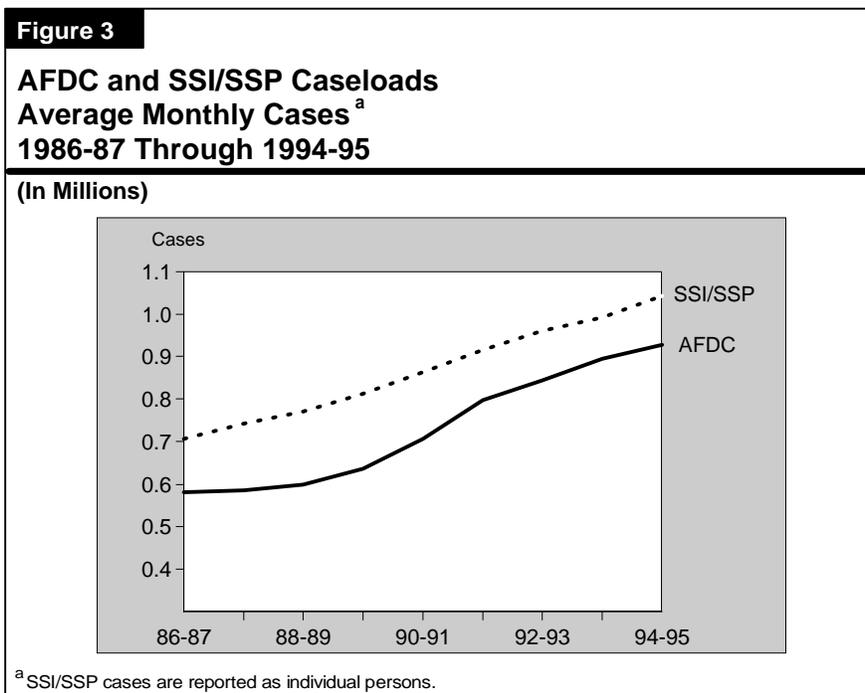
Figures 2 and 3 illustrate the caseload trends for the largest health and welfare programs. In both programs, significant increases coincide with the onset of the recession in 1990. Figure 2 shows the Medi-Cal caseload growth, broken out by “traditional” eligibility categories—primarily AFDC and Supplemental Security Income/State Supplementary Program (SSI/SSP) recipients—and “nontraditional”



eligibles—groups recently made eligible by state and federal law, including newly legalized immigrants, undocumented persons, and pregnant women.

Figure 2 shows there was a significant upswing in the rate of increase in the Medi-Cal caseload, beginning in 1989-90. This occurred primarily because of rapid growth in both the AFDC Program and in the nontraditional categories of Medi-Cal recipients. (For a more detailed discussion of this caseload growth, please refer to our *Analysis of the 1992-93 Budget Bill*, page V-90.)

Figure 3 shows the caseload trend for the AFDC (Family Group and Unemployed Parent) and SSI/SSP Programs. While the number of cases in the SSI/SSP Program is greater than in the AFDC Program, there are more persons in the AFDC Program—about 2.6 million compared to about 1 million for SSI/SSP. (SSI/SSP cases are reported as individual persons, while AFDC cases are primarily families.)



Caseload growth in these two programs is due, in large part, to the growth of the eligible target populations. The increase in the rate of growth in the AFDC caseloads in 1990-91 and 1991-92 was partly due to the effect of the recession. Since then, the caseload has continued to

increase but at a slower rate of growth. This slowdown, according to the Department of Finance, was due partly to (1) certain population changes, including lower migration from other states, and (2) a lower rate of increase in “child-only” cases (including citizen children of undocumented and newly legalized persons), which was the fastest growing segment of the caseload until 1993-94. (For a discussion of other factors affecting the AFDC caseload, please see our report on the program in *The 1991-92 Budget: Perspectives and Issues*, page 189.)

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. This component of the caseload accounts for about one-third of the total. The larger component—the disabled caseload—has been growing faster than the rate of increase in the eligible population group (primarily ages 18 to 64). This is due to several factors, including (1) the increasing incidence of AIDS-related disabilities, (2) changes in federal policy that liberalized the criteria for establishing a disability, (3) a decline in the rate at which recipients leave the program (perhaps due to increases in life expectancy), and (4) expanded state and federal outreach efforts in the program.

SPENDING BY MAJOR PROGRAMS

Figure 4 shows expenditures for the major health and social services programs in 1992-93 and 1993-94, and as proposed for 1994-95. As shown in the figure, the three major benefit payment programs—Medi-Cal, AFDC, and SSI/SSP—account for a large share of total spending in the health and social services area.

Figure 4**Major Health and Welfare Programs Budget Summary^a
1992-93 Through 1994-95****(Dollars in Millions)**

	Actual 1992-93	Estimated 1993-94	Proposed 1994-95	Change From 1993-94	
				Amount	Percent
Medi-Cal					
General Fund	\$5,373.3	\$5,784.2	\$4,544.2 ^b	-\$1,240.0	-21.4%
All funds	13,888.5	16,843.1	17,056.4 ^b	213.3	1.3
AFDC (FG&U)					
General Fund	2,696.4	2,789.8	1,183.9	-1,605.9	-57.6
All funds	5,638.0	5,785.3	5,040.7	-744.6	-12.9
AFDC (FC)					
General Fund	259.1	282.6	0.7	-281.9	-99.8
All funds	695.3	954.7	1,039.0	84.3	8.8
SSI/SSP					
General Fund	2,295.3	2,081.9	2,120.4	38.5	1.8
All funds	5,082.6	5,305.9	5,904.4	598.5	11.3
County welfare administration					
General Fund	347.8	383.7	314.7	-69.0	-18.0
All funds	1,415.4	1,626.1	1,748.0	121.9	7.5
In-Home Supportive Services					
General Fund	159.1	251.1	—	-251.1	-100.0
All funds	818.1	884.5	916.7	32.2	3.6
Regional centers					
General Fund	526.2	528.7	445.3	-83.4	-15.8
All funds	668.2	743.7	848.3	104.6	14.1
Developmental centers					
General Fund	29.9	32.9	35.9	3.0	9.1
All funds	566.7	590.7	594.5	3.8	0.6
Child welfare services					
General Fund	254.2	160.4	141.9	-18.5	-11.5
All funds	615.9	635.5	714.3	78.8	12.4
State hospitals					
General Fund	143.9	147.1	153.8	6.7	4.6
All funds	399.0	412.7	417.0	4.3	1.0

^a Excludes departmental support.^b Includes \$60 million General Fund and \$129 million all funds proposed for federally required long-term care rate increases but not reflected in the Budget Bill.

MAJOR BUDGET CHANGES

Figures 5 and 6 illustrate the major budget changes proposed for health and social services programs in 1994-95. Generally, the major changes can be grouped into the following categories:

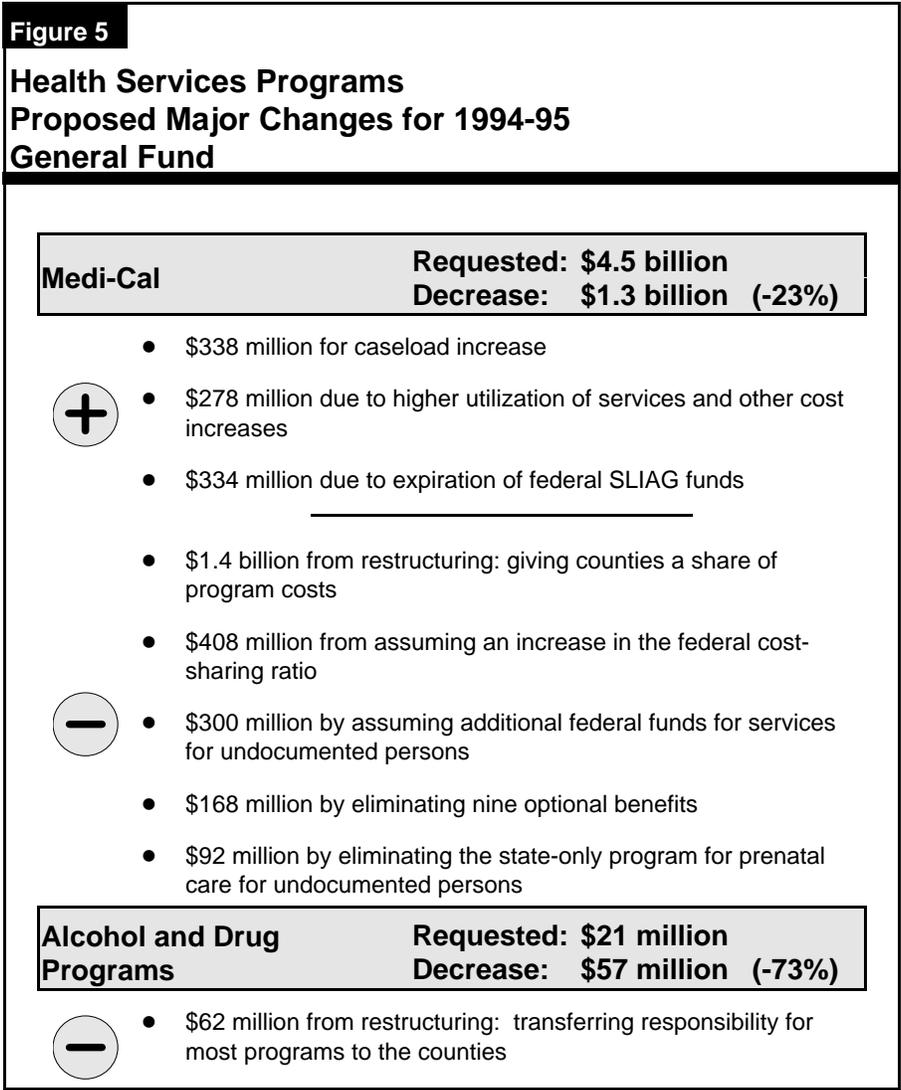


Figure 6

**Social Services Programs
Proposed Major Changes for 1994-95
General Fund**

AFDC	Requested: \$1.2 billion Decrease: \$1.9 billion (-61%)
-------------	--

-  • \$148 million to fund AFDC (FG&U) basic caseload increase

- \$1.3 billion from restructuring: increasing county share of costs
- \$282 million from 10 percent grant reduction
- \$184 million from welfare reform: 15 percent grant reduction after six months, maximum family grant, and reduced pregnancy benefits
-  • \$170 million from an assumed increase in the federal cost-sharing ratio
- \$40 million from assumed federal reimbursement for refugee costs

SSI/SSP	Requested: \$2.1 billion Increase: \$38 million (+1.8%)
----------------	--

-  • \$156 million to fund basic caseload increase
- \$50 million due to expiration of federal SLIAG funds

-  • \$64 million for full-year effect of not "passing through" January 1994 federal cost-of-living adjustment to recipients
- \$37 million for full-year effect of current-year grant reduction

IHSS	Requested: — Decrease: \$251 million (-100%)
-------------	---

-  • \$251 million from restructuring: increasing county share of costs

1. *The Budget Proposes to Fund Caseload Increases.* This includes funding for projected caseload increases of 6.7 percent in the Medi-Cal Program, 3.7 percent in the AFDC Program, and 5.2 percent in the SSI/SSP Program in 1994-95.

2. *The Budget Proposes to Shift a Significant Amount of State Costs to the Counties.* This would be accomplished as part of the Governor's restructuring proposal (\$3.3 billion General Fund savings in health and social services programs, offset by state special fund (realignment) costs for health and social services and General Fund costs for trial courts and backfilling of property tax reductions for education programs).

3. *The Budget Proposes to Shift a Significant Amount of State Costs to the Federal Government.* This would be accomplished by the following actions:

- Assume enactment of federal legislation to increase the federal Medicaid sharing ratio for California from 50 percent to 54.4 percent of total costs for Medi-Cal, AFDC, and certain other programs, effective October 1, 1994 (\$599 million General Fund savings in 1994-95).
- Assume legislation for federal assumption of the costs of (1) federally required Medi-Cal services to undocumented immigrants; (2) Medi-Cal, AFDC, and SSI/SSP services provided to refugees during the first 36 months of residence; and (3) administering SSP cases in the SSI/SSP Program (total General Fund savings of \$454 million in 1994-95).

4. *The Budget Proposes Major Program Reductions in the Medi-Cal and AFDC Programs:*

- Eliminate nine optional Medi-Cal benefits (net state savings of \$154 million in 1994-95, after accounting for offsetting costs to maintain these benefits for developmentally disabled persons served by the Regional Centers). Most of the savings would result from elimination of adult dental services.
 - Adopt a welfare reform package (net state savings of \$460 million in 1994-95, including costs for administration). Most of the savings would result from across-the-board reductions in the AFDC maximum aid payment (MAP).
 - Eliminate the state-only Medi-Cal program for prenatal care for undocumented persons, effective February 1, 1994 (state savings of \$14 million in 1993-94 and \$92 million in 1994-95).
-

5. *The Budget Proposes State Funding to Compensate for the Expiration of Federal Funds From the State Legalization Impact Assistance Grant (SLIAG).* Under federal law, federal funding from the SLIAG will not continue in the budget year, resulting in a General Fund cost of \$400 million in 1994-95, primarily in the Medi-Cal and SSI/SSP Programs.

State and Local Restructuring

The Governor's restructuring proposal involves a shift of \$3.3 billion in spending for various health and welfare programs from the state General Fund to the counties. In order to make the shift fiscally neutral, it would be accomplished by a shift to the counties of sales tax and property tax revenues, state hospital patient revenues, trial court fines and penalties revenues, and state assumption of a higher share of trial court costs.

As shown in Figure 7, the spending shift would be accomplished by giving counties a share of the costs of the Medi-Cal Program (with some components excluded); increasing the county share of costs for the AFDC Program, the IHSS Program, the county services block grant program, and county welfare program administration; and shifting spending for most alcohol and drug programs to the counties.

We discuss the restructuring proposal in more detail in our companion volume, *The 1994-95 Budget: Perspectives and Issues*.

Elimination of Medi-Cal Optional Benefits

The budget assumes that the Legislature will enact legislation to eliminate 9 of the 28 optional service categories in the Medi-Cal Program, for a General Fund savings of \$168 million in 1994-95. These savings would be partially offset by additional costs of \$14 million in the Department of Developmental Services in order to maintain these services for regional center clients.

The services that would be eliminated are adult dental, nonemergency transportation, medical supplies (excluding incontinence), speech and audiology, psychology, acupuncture, podiatry, chiropractic, and independent rehabilitation centers. The budget proposes to continue these services for children under age 21, persons in long-term care facilities, and developmentally disabled clients.

Figure 7

**State and County Restructuring Proposal
Expenditure Shift to Counties
Health and Social Services Programs
1994-95**

(Dollars in Thousands)

Programs	Share of Nonfederal Costs				General Fund Expenditure Shift
	Current Law		Proposed		
	State	County	State	County	
Medi-Cal ^a	100%	—	77%	23%	\$1,352,903
AFDC grants	95	5%	50	50	1,041,774
AFDC and Food Stamps county administration	70	30	50	50	100,185
IHSS	65	35	—	100	364,460
AFDC-Foster Care	40	60	—	100	323,821
Alcohol and drug ^b	90	10	—	100	62,258
County services block grant	70	30	—	100	16,204
Other programs ^c	95	5	50	50	5,158
Total					\$3,266,763

^a Proposal is for counties to assume 11.51 percent of total costs, which equates to 23 percent of nonfederal costs. Excludes state hospitals and developmental centers, targeted case management, and supplemental payments to disproportionate-share hospitals.

^b Applies to various programs; excludes perinatal substance abuse programs. No match is currently required for small counties.

^c Miscellaneous AFDC-related components of other programs: child care, Cal Learn administration, employment services, and staff development.

Welfare Reform

The Governor's proposed welfare reform package is summarized below:

- **Across-the-Board Grant Reductions.** The budget proposes a 10 percent reduction in the AFDC maximum grant levels and an additional 15 percent reduction for families that have an able-bodied adult and are on aid more than six months. The impact of the reductions would be primarily on nonworking recipients—those who currently get the maximum grants. The grant reductions would be partially offset by increases in federally funded food stamps.
- **Maximum Family Grant.** Under this proposal, the MAP, which increases with family size, would not increase for a child born after the parent has been on aid for nine months. (In effect, the MAP

would not increase for children conceived while the family is on aid.)

- **Reduction in Pregnancy Benefits.** AFDC pregnancy-related payments would be eliminated except for the federally assisted program, which provides payments during the last trimester of pregnancy. Specifically, the budget proposes to eliminate (1) grants provided to pregnant women without other children during the first six months of pregnancy and (2) a \$70 monthly supplement that is provided to all pregnant women who are receiving AFDC.
- **Teen Parent Provisions.** The budget proposes to require parents under age 18, with some exceptions, to reside with their parents, legal guardian, or adult relative in order to receive AFDC.
- **Time-Limited Aid.** The budget proposes legislation to provide that AFDC grants for families with an able-bodied adult will be reduced by the amount of the grant associated with the adult, once the family has been on aid for more than two years cumulative time. These grant reductions would not affect the 1994-95 budget year but would be implemented beginning July 1, 1996.



DEPARTMENTAL ISSUES

SECRETARY FOR HEALTH AND WELFARE (0530)

The Secretary for the Health and Welfare Agency (HWA) is directly responsible to the Governor for general policy formulation in the health and social services area. The Secretary also oversees the operations of the departments in the agency's jurisdiction.

The budget proposes \$1.8 million (\$1.3 million General Fund) to support the agency in 1994-95. The General Fund amount represents an increase of \$138,000, or 12 percent, over estimated current-year expenditures from this funding source.

Federal Funds Potentially Available

We recommend that the HWA report, during the budget hearings, on the feasibility of obtaining additional federal funds for health and social services programs and the potential state and county savings from securing these funds.

In February 1994, the Department of Finance convened a meeting of legislative and executive staff to explore the possibility of obtaining additional federal funds for health and social services programs, for the purpose of saving state and county funds. We believe that some of the options presented are worth further consideration, including the following:

- ***Emergency Assistance Funds for Mental Health.*** Under Title IV-A of the Social Security Act, federal funds are provided for aid to families in emergency situations. The state currently claims these Emergency Assistance (EA) funds for certain services provided by county probation departments and county welfare departments. It is also permissible, however, to claim these funds for mental health services.
- ***Extend Period of Eligibility for Emergency Assistance Funds.*** Under the existing approved state plan for claiming EA funds for services provided by county probation and welfare departments, payment is made for a maximum of 6 months of services during a 12-month period. At least one state, however, has received approval to obtain EA funds for 12 months of services.
- ***Medicaid Funds for Foster Care Group Home Services.*** Los Angeles County is presently exploring the possibility of obtaining federal Medicaid funds for certain treatment services provided to children residing in foster care group homes. Currently, these specific services are funded entirely by state and county funds.

We recommend that the HWA report, during the budget hearings, on the feasibility of obtaining additional funds not reflected in the budget, and the potential state and county savings from doing so.

OFFICE OF STATEWIDE HEALTH PLANNING AND DEVELOPMENT (4140)

The Office of Statewide Health Planning and Development (OSHPD) (1) develops state health plans, (2) administers demonstration projects, (3) operates health professions development programs, (4) reviews plans and inspects health facilities construction projects, and (5) collects health cost and utilization data from health facilities.

Cal-Mortgage Reserves Are Inadequate

We recommend that the OSHPD report during budget hearings on measures that could be taken to either increase the fund reserve levels in the Cal-Mortgage Loan Insurance Program or otherwise ensure that the General Fund is protected against unreasonable risk.

Background. The Cal-Mortgage Loan Insurance Program was established in 1969 to administer, without cost to the state, an insurance program for health facility construction. Cal-Mortgage guarantees the amounts borrowed by health facilities for capital needs and pays off the lender in the event that a health facility defaults on a loan. The program is funded through annual premiums paid by health facilities based on a specified percentage of the outstanding principal of each insured loan. The premiums are deposited into the Health Facility Construction Loan Insurance Fund (HFCLIF).

As of November 30, 1993, the HFCLIF reserve was approximately \$118 million with loan guarantees totaling \$2 billion. The state General Fund is the ultimate guarantor of the loans if the HFCLIF reserve is not adequate to cover defaults.

Low Reserves Pose Potential Risk to the General Fund. During the first 20 years of operation, the program experienced no defaults. However, economic conditions and specific changes affecting funding for health care facilities, such as managed care and restrictions on government spending, have combined to increase the environment of risk for the Cal-Mortgage Program. In 1991-92 the fund paid out \$4.5 million on its first default. In the current year, the program experienced a major default of \$167 million and the OSHPD has identified additional projects that have not defaulted but may require assistance in making payments.

It is our understanding that the current-year default and other identified pressures on the fund will be covered by payments on a monthly basis from the premiums and interest earned by the fund. We are concerned, however, about the increase in defaults in the past few years and the uncertainty regarding future defaults. Since the General Fund is the ultimate guarantor for the program, we believe that alternatives should be examined to ensure that the state is protected against unreasonable risk.

In an April 1993 evaluation of the HFCLIF reserve, an accounting firm recommended that Cal-Mortgage "adopt reserve levels consistent with those that would be required by an insurance company" and concluded that the HFCLIF reserves as of September 30, 1992 were too low by \$55 million. In September 1993, the OSHPD revised this amount to \$96 million based on the methodology used in the report. The inadequate reserve level as well as the current loan default were cited by the office as reasons for a moratorium on new loan guarantees imposed in September 1993. Staff at Cal-Mortgage, however, indicated that the moratorium may be lifted in February 1994.

In our review of the program, the OSHPD was not able to justify reserve levels lower than those normally required in private industry. We believe that given the current fiscal condition of the General Fund and the apparent increase in risk related to the Cal Mortgage program, evidenced by the recent loan defaults, the Legislature may want to consider whether current reserve levels in the HFCLIF are sufficient. We recommend that the OSHPD report during budget hearings on the risk to the General Fund in the budget year as well as discuss the impact of various options to reduce the risk. Such options could include statutory changes to increase the premiums charged to health facilities that borrow funds or to limit the number of new guarantees provided under the program.

Proposition 99 Funds Could Be Used to Address Primary Care Provider Shortage

We recommend enactment of legislation to appropriate \$2 million from the Cigarette and Tobacco Products Surtax Fund for the Song-Brown Family Physician Training Program in order to help address the shortage of family physician assistants and nurse practitioners.

Background. Shortages in primary care medical personnel continue in the state and nationwide. Furthermore, the demand for primary care providers has been projected to double in the state by the year 2000.

The use of nurse practitioners and physician assistants can be a cost-effective means of providing health care. According to the Department of Health Services, primary care nurse practitioners and physician assistants can provide 80 percent of the services currently provided by primary care physicians, with considerable reductions in the cost of care as well as the cost of training these providers.

Nurse practitioners can work independently of physicians but have restrictions on their ability to write prescriptions and admit patients. Physician assistants work under the supervision of a licensed physician. Most clinics operated by nurse practitioners have a physician on contract.

Both nurse practitioners and physician assistants are used extensively in primary care clinics and county health care systems, especially in underserved areas. Rural areas, for example, rely heavily on nurse practitioners and physician assistants for primary care. These areas often cannot attract primary care physicians, either due to location or lack of funding.

Song-Brown Program. The Song-Brown Family Physician Training Program, administered by the OSHPD, was established in 1974 in response to the shortage of primary care medical personnel. The program provides financial support to medical schools, teaching hospitals, and other training programs to increase the supply of primary care physicians, physician assistants, and nurse practitioners, particularly in medically underserved areas. Studies have shown the program to be effective in increasing the number of these professionals who are trained in California.

The budget proposes \$3.3 million (\$2.9 million General Fund) for the Song-Brown program in 1994-95. This is a reduction of \$900,000, or 21 percent, from estimated current-year spending. The reduction is due to one-time funding from the Cigarette and Tobacco Products Surtax Fund in the current year for physician assistant training programs. In the current year, program funding was allocated to physician residency programs (\$2.3 million), nurse practitioner and physician assistant training programs (\$1.4 million), and special projects (\$500,000).

Recommendation. Considering the lower cost of training primary care nurse practitioners and physician assistants, relative to physicians, and the potential savings in delivery of health care services, we believe that additional funding to train nurse practitioners and physician assistants is an efficient method for reducing the shortage of primary care providers in the state. Accordingly, we recommend that the program be augmented by \$2 million in 1994-95. We estimate that

\$2 million would allow training of an additional 130 nurse practitioners and physician assistants.

Because of the constraints on the General Fund, we recommend that the additional funding be appropriated—either in legislation reauthorizing Proposition 99 funds or in a separate bill—from the Cigarette and Tobacco Products Surtax Fund. As discussed in our analysis of Proposition 99 funding (Public Health), the budget proposes a reserve level of 5.4 percent of expenditures (5 percent of revenues) for this fund in 1994-95. Appropriating the \$2 million from the reserves would still leave the fund with an estimated reserve of 5 percent of expenditures (4.7 percent of revenues), which we believe is sufficient.

DEPARTMENT OF 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 effect of alcohol-related problems, narcotic addiction, and drug abuse.

The budget proposes \$260 million from all funds for support of DADP programs in 1994-95, which is a decrease of 23 percent from estimated current-year expenditures. The budget proposes \$25 million from the General Fund in 1994-95, which is \$57 million, or 69 percent, below estimated current-year expenditures from this funding source. This is due to a proposed shift of most of the state-funded drug and alcohol programs to the counties, as part of the Governor's restructuring proposal. We discuss the restructuring proposal in detail in our companion volume, *The 1994-95 Budget: Perspectives and Issues*.

CALIFORNIA MEDICAL ASSISTANCE PROGRAM (MEDI-CAL) (4260)

The California Medical Assistance Program (Medi-Cal) is a joint federal-state program to provide health care services to public assistance recipients and to other individuals who cannot afford to pay for these services themselves.

The budget proposes Medi-Cal expenditures of \$17 billion (\$4.5 billion General Fund and \$1.4 billion county funds) in 1994-95. This represents a General Fund decrease of \$1.2 billion, or 22 percent, below estimated current-year expenditures. (These figures include \$129 million all funds and \$60 million General Fund for a mandatory long-term care rate increase, which has been reflected in the budget's overall expenditure totals but does not appear in the Budget Bill.) Regarding the proposed General Fund decrease, \$1.4 billion is due to a shift from the General Fund to the counties as part of a proposed restructuring of state and local programmatic and funding responsibilities.

At the state level, the Department of Health Services (DHS) administers the Medi-Cal Program. Other state agencies, including the California Medical Assistance Commission (CMAC) and the Departments of Social Services, Developmental Services, Alcohol and Drug Programs, and Mental Health perform Medi-Cal-related functions under agreements with the DHS. At the local level, county welfare departments determine the eligibility of applicants for Medi-Cal and are reimbursed for those activities. The federal Health Care Financing Administration oversees the program to ensure compliance with federal law, and must approve significant policy changes.

Generally, program expenditures are supported on a 50 percent General Fund, 50 percent federal funds basis under current federal law.

CASELOADS AND EXPENDITURES

Who Is Eligible for Medi-Cal?

Persons eligible for Medi-Cal fall into four major categories:

- **Categorically Needy.** Families or individuals who receive cash assistance under two programs—Aid to Families with Dependent Children (AFDC) and Supplemental Security Income/State Supplementary Program (SSI/SSP)—comprise the “categorically needy.” The categorically needy automatically receive Medi-Cal eligibility cards and pay no part of their medical expenses.
- **Medically Needy.** This category includes (1) families with dependent children and (2) aged, blind, or disabled persons with incomes higher than the June 1991 AFDC payment level (\$694 for a family of three). These individuals pay no part of their medical expenses if their incomes are between 100 percent and 133⅓ percent of the AFDC payment level for their household size. Individuals with higher incomes can become eligible for Medi-Cal if their medical expenses require them to “spend down” their incomes to 133⅓ percent of the June 1991 AFDC payment level. These persons are said to have a “share of cost.” (Medically needy beneficiaries who reside in long-term care facilities are required to pay all but \$35 of their monthly income toward the costs of their care.)
- **Medically Indigent.** Under this category, the Medi-Cal Program provides services to pregnant women and children under the age of 21. Also, these services are available to persons in long-term care facilities who (1) do not belong to families with dependent children and are not aged, blind, or disabled but (2) meet income and share-of-cost criteria that apply to the medically needy category.
- **“Nontraditional” Eligibles.** Federal and state law extend coverage under the Medi-Cal Program to newly legalized and undocumented persons, and to pregnant women and children who meet various income criteria.

Figure 8 summarizes the various eligibility categories for the Medi-Cal Program. The first four categories are required by federal law—that is, the Medi-Cal Program must provide services to individuals meeting these criteria in order for the program to receive federal funds. The remaining eligibility categories are optional—the state has discretion over whether to provide services to individuals in these categories, though it receives federal funds to the extent it chooses to do so.

Figure 8			
Who Is Eligible for Medi-Cal?			
(Dollars in Millions)			
Income Level	Other Characteristics	Number Eligible	1994-95 General Fund Expenditures^a
Federally Required Categories			
Categorically Needy			
AFDC or SSI/SSP income standard	<ul style="list-style-type: none"> Families with dependent children Aged, blind, or disabled persons 	4,169,000	\$3,943
Other Women and Children			
Percent of federal poverty level:			
Up to 185%	<ul style="list-style-type: none"> Pregnant women and their infants 	177,700	164
Up to 133%	<ul style="list-style-type: none"> Children ages 1 to 6 		
Up to 100%	<ul style="list-style-type: none"> Children ages 7 to 9 		
Newly Legalized Persons and Refugees			
<ul style="list-style-type: none"> Up to 133% of June 1991 AFDC payment level Persons with higher incomes may "spend down" to this level 	<ul style="list-style-type: none"> Persons meeting any Medi-Cal criteria receive emergency and pregnancy related services only Aged, blind, and disabled persons and children to age 19 receive all services 	8,800	16
Undocumented Persons			
Same as newly legalized persons	<ul style="list-style-type: none"> Persons meeting any Medi-Cal criteria may receive emergency services only, including labor and delivery 	390,000	400
Additional Categories in California			
Long-Term Care			
Persons of any income must "spend-down" to \$35 per month	<ul style="list-style-type: none"> Require skilled nursing care 	72,700	1,064
Medically Needy			
<ul style="list-style-type: none"> Up to 133% of June 1991 AFDC payment level Persons with higher incomes may "spend down" to this level 	<ul style="list-style-type: none"> Families with dependent children Aged, blind, or disabled persons 	614,500	853
Medically Indigent			
Same as medically needy	<ul style="list-style-type: none"> Pregnant women Children to age 21 	294,900	212
Other Women and Children			
186% to 200% of federal poverty level	<ul style="list-style-type: none"> Pregnant women and their infants 	4,000	6
Undocumented Persons			
Same as medically needy	<ul style="list-style-type: none"> Pre- and postnatal services 	NA	92

^a Figure assumes current law. Budget assumes \$753 million less than amount shown due to requested increases in federal funds and \$1.4 billion less due to a proposed county share of the program's costs.

What Benefits Does Medi-Cal Provide?

Federal law requires the Medi-Cal Program to provide a core of basic services, including hospital inpatient and outpatient care, skilled nursing care, doctor visits, laboratory tests and X-rays, family planning, regular examinations for children under the age of 21, and services in rural health clinics. Many Medi-Cal services require prior state authorization and may not be reimbursed unless the service is determined by the department's field offices to be medically necessary.

In addition, the federal government provides matching funds for optional services. California currently provides 28 of these 31 optional services, but the budget proposes to eliminate nine of them. We discuss this proposal in more detail below.

Proposed Changes for 1994-95

The major General Fund changes proposed for the Medi-Cal Program in 1994-95 are in four categories: (1) \$616 million for caseload, utilization, and cost increases; (2) \$334 million to replace federal funds that were previously available under the State Legalization Impact Assistance Grant (SLIAG); (3) \$1.4 billion due to a proposed county share of the program's costs; and (4) \$837 million in various program changes.

The proposed program changes include the following:

- ***Assumed Receipt of Federal Funds (Savings of \$753 Million General Fund).*** The budget assumes receipt of \$753 million in additional federal funds to offset state expenditures. Specifically, the budget assumes receipt of (1) an additional \$408 million in federal funds by assuming congressional action to adjust the formula by which Medicaid funding is distributed among the states, (2) \$300 million in federal funds to offset the state's share of expenditures for services to undocumented persons, and (3) \$45.1 million to fully cover the costs of serving refugees who are eligible for Medi-Cal because they meet AFDC criteria.
- ***Elimination of Optional Services (Net Savings of \$154 Million General Fund).*** The budget proposal assumes that the Legislature will enact legislation to eliminate nine optional services—adult dental, nonemergency transportation, psychology, podiatry, acupuncture, independent rehabilitation centers, chiropractor, speech and audiology, and certain medical supplies. We discuss this proposal in more detail below.
- ***County Administration Underclaiming Adjustment (Combined Current- and Budget-Year Savings of \$58 Million General Fund).*** The budget proposes to reduce General Fund support for county administration in both the current year and the budget year

because it assumes that current underclaiming of these funds will continue.

- **Statutory COLAs for Providers (\$144.2 Million General Fund and County Funds).** The budget contains \$121 million (\$60.1 million General Fund) for an 8.9 percent increase on drug ingredients and \$48.3 million (\$24.1 million General Fund) for a 7.9 percent increase for noncontract hospital inpatient services. The budget also proposes a federally required COLA for long-term care facilities (\$60 million General Fund), although this amount is not reflected in the Budget Bill.
- **Elimination of Prenatal Services for Undocumented Women (Combined Current- and Budget-Year Savings of \$181 Million General Fund and County Funds).** The budget proposal assumes that the Legislature will enact legislation to eliminate prenatal services for undocumented women by February 1, 1994. We discuss this proposal in more detail below.
- **Pharmacy Contracting (Savings of \$33.9 Million General Fund and County Funds).** The budget assumes enactment of legislation authorizing the department to contract with an outside organization to manage the prescription drug program, effective January 1, 1995. We discuss this proposal in more detail later in this analysis.

Budget Proposes County Share of Program Costs

The budget proposes a General Fund reduction of almost \$1.4 billion in the state's share of costs for the Medi-Cal Program and a corresponding 11.5 percent county share of total program costs as part of a broader restructuring proposal. In our companion volume, *The 1994-95 Budget: Perspectives and Issues*, we recommend that the Legislature not adopt an across-the-board county share of the Medi-Cal Program because the program's costs are heavily influenced by economic and demographic forces that are largely beyond the counties' ability to control.

In lieu of the administration's proposal, however, we recommend:

- A 50 percent share of nonfederal long-term care costs (and a 50 percent share of the In-Home Supportive Services Program).
- A 100 percent share of nonfederal Medi-Cal costs for mental health and substance abuse services.

- The development of outcome-based fiscal incentives, such as payments by counties for substance-exposed infants.

In addition, we recommend in this analysis a number of specific steps that the state could take to achieve efficiencies in the Medi-Cal Program.

Medi-Cal Program Growth

Growth in California's Medi-Cal Program over the last few years has been dramatic. As background for the recommendations that follow, we review some of the principal reasons for growth in the program and the department's efforts to control Medi-Cal expenditures.

As Figure 9 indicates, Medi-Cal General Fund expenditures have increased from \$3 billion in 1988-89 to an estimated \$5.8 billion in 1993-94, reflecting an increase of about \$2.7 billion over the five-year period, or about 14 percent annually. Federal funding for the program has increased at a significantly higher rate largely due to the "SB 855" Program, which provides payments to disproportionate-share hospitals, begun in 1991-92. The purpose of these payments is to recognize the financial burden of uncompensated care on "safety net" hospitals that serve a high number of indigent persons. These payments, and the required county match, comprise \$1.8 billion of the total expenditure figures for 1991-92 and 1992-93 and \$2.9 billion for 1993-94.

Figure 9							
Medi-Cal Expenditures^a							
1988-89 Through 1993-94							
(Dollars in Billions)							
	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	Average Annual Increase
General Fund	\$3.0	\$3.5	\$4.1	\$5.8	\$5.4	\$5.8	14.1%
All funds	6.2	7.2	8.8	13.8	13.9	16.8	22.1

^a Figures for 1991-92 have been adjusted to eliminate one-time costs for change from cash to accrual accounting. Figures for 1993-94 are estimated.

Reasons for Increased Medi-Cal Expenditures

The dramatic increase in Medi-Cal expenditures over the last five years has resulted largely from caseload increases, which in turn reflect economic and societal changes, medical care inflation, and court decisions. We discuss these factors below.

Caseload Increases. The largest single factor driving program expenditures is the significant increase in the number of persons eligible

for Medi-Cal. In 1985-86, 2.9 million persons (one out of ten persons in the state) were eligible for the program, while in the current year the number of eligibles is estimated to reach 5.4 million persons (more than one out of every six residents). As a point of comparison, the number of persons who receive health care coverage through Medi-Cal is now greater than the number of children enrolled in California's public school system.

In general, three factors account for the increase in the number of eligible participants. The "traditional" recipients of Medi-Cal services—primarily AFDC and SSI/SSP recipients—have been increasing significantly during the last few years, largely as the result of economic and demographic changes. In addition, the Medi-Cal Program caseload has increased as a result of state and federal changes that have expanded eligibility to "nontraditional" recipients of these services. Specifically, the federal government has mandated that the state provide medical services to newly legalized and undocumented persons and expand eligibility for pregnant women and children. Similarly, the state has elected to extend coverage to pregnant women and their infants beyond the federal requirements. Expenditures due to these state and federal policy changes account for about one-third of total expenditure growth since 1989-90.

Societal Changes. One societal change that has affected the Medi-Cal Program is the emergence of the AIDS epidemic. Medi-Cal expenditures for AIDS-related illnesses were estimated to be \$140 million during 1992-93. In addition, the growth in the number of unmarried teenage women having children, citizen children born to undocumented women, and children born to substance-abusing mothers also has increased expenditures. The extent to which these changes have contributed to expenditure growth is difficult to quantify, but it is likely that it is substantial.

Medical Care Inflation. Medical care costs increase at rates that generally exceed other types of inflation. For example, medical care inflation has averaged 7.4 percent annually in California over the last three years, which is more than twice the rate of inflation for all other types of goods and services. Medi-Cal payment levels for some services (such as for physician services) are discretionary, while others are automatically adjusted pursuant to statute (such as for generic drugs and nursing facilities). Hospital inpatient rates generally are negotiated, but the state has little practical alternative to recognizing at least a portion of the cost increases that hospitals experience. Accordingly, because expenditures for hospital inpatient services, long-term care, and drugs account for the vast majority of Medi-Cal expenditures, medical care inflation has played a significant role in the program's expenditure growth over the last several years.

Court Decisions Concerning Provider Rates. Under federal law, the state must offer access to services comparable to those which are available in the community. The courts have interpreted this provision to require rate increases for certain services. For example, the state recently was

ordered to increase rates substantially for dental services, because the courts found that low Medi-Cal rates had the effect of denying access to those services. The administration estimates that this court decision will result in additional General Fund expenditures of \$228 million in the current year. (Similar court cases are pending that could affect rates for *all* outpatient services.)

MANAGED CARE

Department Continues Major Expansion of Managed Care

Under the department's strategic plan, almost half of all Medi-Cal beneficiaries would be enrolled in a "managed care" arrangement by the end of 1994-95.

In 1993, the department released a "strategic plan" intended to rapidly move the Medi-Cal Program toward a "managed care" approach to providing Medi-Cal services throughout California. In this section, we review existing managed care arrangements and the department's strategy for expansion of managed care, and offer comments and recommendations for the Legislature's consideration.

Background. The Legislature and the department have, for several years, attempted to increase the number of Medi-Cal beneficiaries enrolled in managed care arrangements. In particular, legislation accompanying the 1992 Budget Act gave the department broad authority to expand managed care in California, with the goals of improving beneficiary access to care and making the Medi-Cal Program more cost-effective. Currently, approximately 600,000 out of 5.4 million Medi-Cal beneficiaries are enrolled in a managed care arrangement. The department anticipates this number will increase by 300,000 to a total of 900,000 beneficiaries in 1994-95. In addition, the department proposes the mandatory implementation of managed care in 13 counties by late 1994-95 or 1995-96, which will affect an additional 2.5 million beneficiaries.

Under *managed care arrangements*, the Medi-Cal Program attempts to control costs by generally reimbursing providers on a “capitated,” or per-person basis regardless of the number of services any given individual uses. In addition, the use of specialists and high-cost services requires a physician referral. This approach contrasts with the *fee-for-service system*, where Medi-Cal pays providers for each service they provide, and the beneficiary has his or her choice in selecting providers. In fee-for-service, utilization is controlled by requiring prior authorization from the Medi-Cal field offices for the more expensive medical services.

The principal managed care arrangements are:

- ***Prepaid Health Plans (PHPs)***. Medi-Cal contracts with private PHPs to provide care to AFDC-linked beneficiaries. The PHPs are paid a monthly capitation payment, based on an estimate of the costs of serving beneficiaries in the fee-for-service system. CIGNA Health Plan, Foundation Health, and Kaiser Permanente are among the PHPs that have existing Medi-Cal contracts. The department generally has not entered into contracts to enroll SSI/SSP-linked beneficiaries in PHPs because it believes they are more likely to have existing relationships with primary care physicians.
- ***County-Organized Health Systems (COHS)***. Under this approach, the county acts as a prepaid plan, serving all Medi-Cal beneficiaries in the county. The COHS receive a capitated rate for each beneficiary in the county, and assume full financial risk. Currently, Santa Barbara and San Mateo Counties have fully implemented this approach, and two additional counties—Solano and Santa Cruz—will begin operations in 1994. (Orange County will begin operations in 1995-96.) Federal law prohibits additional county-organized systems in California beyond these five.
- ***Geographic Managed Care (GMC)***. Under this approach, the Medi-Cal Program negotiates contracts directly with providers to accept beneficiaries within a specified area, again paying a monthly rate based on the estimated cost of providing services to similar beneficiaries under the fee-for-service system. The department will begin implementation of this approach in Sacramento County in April 1994.
- ***Primary Care Case Management (PCCM)***. PCCM plans are paid a fixed monthly fee (per person) to manage the care of the Medi-Cal beneficiaries enrolled in the plan. They approve referrals to specialists, nonemergency hospitalizations, and other high-cost procedures. If the costs of care for enrollees in a PCCM plan are less than the estimated fee-for-service cost would have been for similar beneficiaries, the PCCM plan receives a payment equal to half the estimated savings.

In addition, the department is implementing a program to provide case management services to "high-risk" beneficiaries directly. Beneficiaries included in this program are selected on the basis of the expected cost of treating persons with certain diagnoses and demographic characteristics (for example, children with severe infections). The department began implementation of this program in February 1993.

Figure 10 summarizes the budgeted fiscal effect for 1994-95 of managed care expansion efforts the department will initiate in the current and budget years. Although it shows anticipated General Fund savings of \$8.8 million in the budget year, we note that some of these efforts had not been implemented at the time this analysis was prepared and the magnitude of savings ultimately realized may be less.

Figure 10		
1994-95 Impact of Current- and Budget-Year Managed Care Expansion Efforts		
(Dollars in Thousands)		
	Affected Beneficiaries	General Fund Savings
Prepaid health plans	36,425	\$830
Primary care case management	35,070	2,849
County-organized health systems		
Santa Cruz	26,522	—
Solano	44,923	—
Sacramento County Geographic Managed Care	160,000	5,085
Totals	302,940	\$8,764

Principal Components of the Strategic Plan. The department's strategic plan and the budget propose to enroll nearly half of all beneficiaries (2.5 million out of an estimated 5.7 million) in a managed care arrangement by late 1994-95.

The plan proposes to expand the number of beneficiaries served under managed care arrangements in the following ways:

- Continue current expansion efforts to enroll a total of about 570,000 beneficiaries in PHPs or PCCM plans by July 1995. This is an increase of approximately 80,000 beneficiaries over current enrollment levels.

- Begin operation of COHS in Solano and Santa Cruz Counties, and the GMC project in Sacramento County. These three efforts will serve approximately 230,000 beneficiaries.
- Require the expansion of managed care in 13 additional counties, by a combination of (1) a "local initiative" to serve up to 70 percent of most AFDC-linked Medi-Cal beneficiaries (and medically indigent children) and (2) a single prepaid health plan to serve the remaining AFDC-linked beneficiaries. Additional eligibility categories (such as SSI/SSP beneficiaries) may be included at the county's option. If the county declines to develop a "local initiative," the strategic plan envisions the implementation of GMC in that county. The department indicates that the 13 selected counties will be "closed" to fee-for-service reimbursement (for services to AFDC-linked beneficiaries) effective March 1, 1995, unless the counties request an additional one-year extension to begin implementation.

The counties identified for mandatory expansion are shown in Figure 11.

Figure 11	
Counties Designated for Mandatory Implementation of Managed Care in 1993-94 and 1994-95	
	Affected Beneficiaries^a
Alameda	133,100
Contra Costa	61,600
Fresno	151,800
Kern	79,200
Los Angeles	1,105,500
Riverside	127,600
San Bernardino	227,700
San Diego	239,800
San Francisco	57,200
San Joaquin	89,100
Santa Clara	115,500
Stanislaus	61,600
Tulare	67,100
Total	2,516,800

^a Figures are LAO estimates for 1994-95, based on September 1992 caseload.

Managed Care Implementation Should Be Reevaluated

We recommend that the Legislature reevaluate the broad authority it has granted the department to expand managed care because we believe these efforts, as they are presently being pursued, are likely to result in additional costs to the Medi-Cal Program, rather than achieve savings. We offer specific recommendations to change the department's approach.

The department's effort to reform the Medi-Cal Program through a rapid expansion of managed care has been noteworthy. The department has noted, correctly in our view, that managed care is likely to increase the availability of primary care and reduce the use of emergency room and acute care. As discussed below, however, we have serious reservations about the potential for the department's current strategic plan to achieve savings, which was a primary goal of the Legislature in granting the department broad authority to expand managed care. More specifically, we are concerned that the department's efforts, as they are currently being pursued, are resulting in additional *costs* to the Medi-Cal Program and may continue to do so unless the department's approach is changed.

Of particular concern is the department's reliance on prepaid health plans as a tool to achieve cost containment in the Medi-Cal Program. The department's strategic plan assumes a single prepaid health plan in each of the 13 counties to provide services to between 30 and 40 percent of AFDC-linked beneficiaries as an alternative to a county-operated "local initiative." We have two concerns with this approach. First, the use of prepaid health plans does not appear cost-effective at existing reimbursement rates. Second, the reliance on one plan in each region does not ensure the competitive element the department seeks. We discuss these concerns in detail below.

In addition, we believe that the cost-containment potential of managed care in the 13 counties would be enhanced by (1) encompassing all Medi-Cal beneficiaries, rather than only those who are linked to the AFDC Program, and (2) changing the methodology through which about \$1 billion in supplemental payments are made in support of county indigent health programs.

Reliance on PHPs Currently Not a Viable Cost-Containment Option

We recommend that the Legislature (1) reduce the reimbursement rate the department pays to PHPs to ensure that they are less expensive to the General Fund than serving the same beneficiaries in the fee-for-service portion of the Medi-Cal Program, for a General Fund savings of \$18 million in 1994-95, and (2) enact legislation that generally limits the proportion of Medi-Cal beneficiaries that may be enrolled in any

individual PHP within a given geographic area. (Reduce Item 4260-101-001 by \$18 million.)

Existing PHP Rates Result in Net Costs Rather Than Savings. The department acknowledges that its existing reimbursement rates for PHPs are *higher* than the General Fund cost of serving similar beneficiaries in the fee-for-service Medi-Cal Program. Accordingly, we do not see how the use of prepaid health plans can serve as an effective tool to control costs in the program.

Background. Medi-Cal contracts with private PHPs to provide managed care, generally to AFDC-linked Medi-Cal beneficiaries. The plans receive a monthly capitated payment for services they provide to beneficiaries. These payments are determined by estimating the fees that the Medi-Cal Program would pay if a plan's enrollees were served under the fee-for-service system. *Under state and federal law, PHPs must be reimbursed at rates below those paid under the fee-for-service system.*

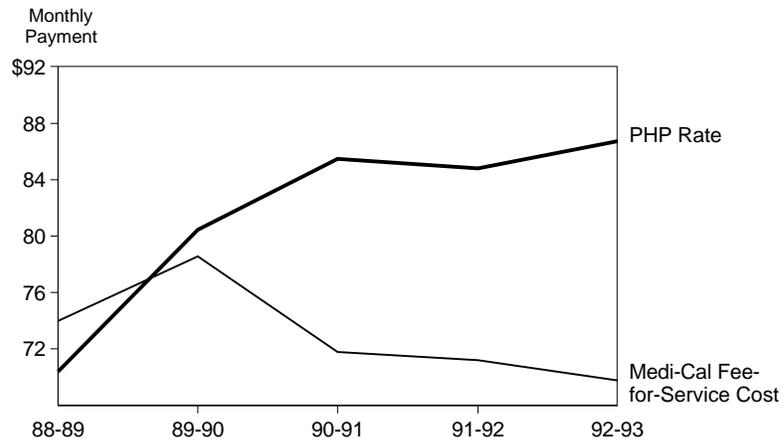
Analysis and Recommendation. Prior to 1990-91, the Medi-Cal Program paid PHPs a rate roughly equal to 97 percent of the fee-for-service equivalent for each beneficiary enrolled in the plans. Plan rates were increased in 1990-91 and have been frozen at the 1990-91 level in the years since. The budget proposes to continue this reimbursement level for 1994-95.

Beginning in 1990-91, however, the cost *per eligible* has gone down in the fee-for-service Medi-Cal Program. This has occurred largely because the number of eligibles receiving services under the fee-for-service system has increased at a significantly higher rate than have costs. As a result, the department acknowledges that General Fund costs now *exceed* the cost that Medi-Cal would experience if it did not contract with PHPs to serve Medi-Cal beneficiaries. The relationship between PHP rates and Medi-Cal fee-for-service equivalent costs are shown in Figure 12. Based on data provided by the department for the current year, we estimate that if PHP rates for 1994-95 were computed using the same methodology as that used *prior* to 1990-91 (97 percent of the fee-for-service equivalent), total expenditures for PHP services would be reduced by about 8 percent, or about \$36 million (\$18 million General Fund).

Accordingly, because PHP rates exceed the ceiling established by the Legislature, and unless changed indicate that PHPs are not a viable cost-containment option, we recommend that the Legislature reduce expenditures for PHP services by \$36 million (\$18 million General Fund) because the rates paid to such plans have not been adjusted to reflect 97 percent of costs that would be incurred if the beneficiaries were served through the fee-for-service providers.

Figure 12

**Payments to Prepaid Health Plans Exceed
Fee-for-Service Medi-Cal Costs
1988-89 Through 1992-93**



PHPs Should Not Be Granted Monopolies. As discussed above, the department's strategic plan generally assumes that a single nongovernmentally operated PHP will serve as the alternative provider network to the county-organized "local initiative" in each of the 13 counties. The department indicates that it relies on the PHP alternative to ensure competitiveness in the Medi-Cal Program, and thereby to control costs over time. We note, however, that a single alternative to the county-organized "local initiative" in no way assures competitiveness. In contrast, in certain situations, it may provide a recipe for *increases* in rates over time. This is because in future years, the department's chosen private alternative plan (the "single" PHP) may in effect be in a monopoly situation by virtue of its enrollment size. The single PHP could use this leverage to demand higher rates. This in turn would create comparable rate pressure for the county-based plan.

Accordingly, we recommend the enactment of legislation to prohibit the enrollment of the entire noncounty caseload in a single PHP within a given geographic area, unless a multi-year bid demonstrates that such a step is the most cost-effective option.

Alternatives May Be Needed. Absent actions to reduce PHP rates and limit the number of Medi-Cal beneficiaries enrolled in any single plan, we

are concerned that continued implementation of the department's strategic plan to expand managed care in the Medi-Cal Program will result in increased General Fund *costs* for the program over time, rather than achieve savings as the Legislature intended. If, on the other hand, the Legislature reduces PHP rates and this has the effect of resulting in an insufficient number of PHPs that are willing to provide managed care services to Medi-Cal beneficiaries, it would be necessary to explore alternative cost-containment strategies.

Targeting AFDC-Linked Beneficiaries Ignores Demonstrated Savings Potential

We recommend enactment of legislation requiring that managed care expansion in 13 counties include SSI/SSP-linked beneficiaries, rather than be at the counties' option as the department proposes.

The department's strategic plan focuses on services provided to AFDC-linked beneficiaries and medically indigent children. Additional eligibility categories may be included at the counties' option. However, as the department has stated, roughly 17 percent of all Medi-Cal beneficiaries—including many who are not required to be incorporated in managed care—account for 80 percent of the program's cost. In contrast, AFDC-linked beneficiaries are among the *lowest cost* groups served by the Medi-Cal Program.

In addition, the department has provided information demonstrating that SSI/SSP-linked beneficiaries are among the eligibility groups where counties are most likely to achieve savings through managed care. According to the department, capitation rates paid to both San Mateo and Santa Barbara Counties in 1992-93 for their county-organized health systems *exceeded* the fee-for-service equivalent for AFDC-linked beneficiaries, but were significantly *below* the fee-for-service equivalent for SSI/SSP-linked beneficiaries. These capitation rates suggest that these counties have been able to achieve savings among the higher-cost beneficiaries—generally those who are linked to the SSI/SSP Program.

Accordingly, we believe that the department's efforts to expand managed care neglect an area where savings potential exists: the high-cost groups of recipients. We recommend, therefore, the enactment of legislation requiring the inclusion of SSI/SSP-linked beneficiaries in the 13 counties' local initiatives, rather than allowing their inclusion at the counties' option as the department proposes.

OTHER MEDI-CAL PROGRAM ISSUES

Per-Discharge Payments Would Reduce Medi-Cal Costs

We recommend enactment of legislation to implement a “per-discharge” reimbursement system for “disproportionate share hospital” (DSH) payments for a General Fund savings of \$10.4 million. (Reduce Item 4260-101-001 by \$10,400,000.)

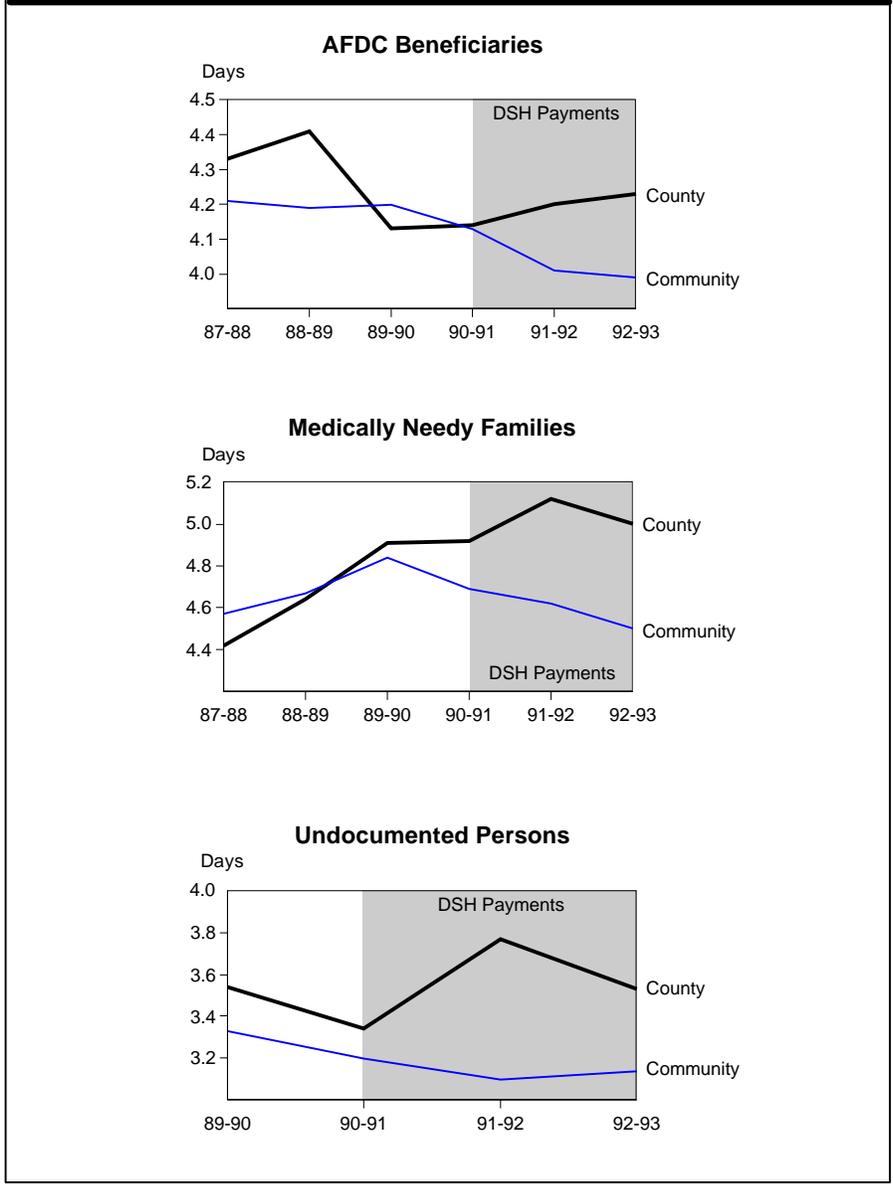
Background. The Medi-Cal Program makes supplemental payments to hospitals with a large, or “disproportionate share,” of indigent persons under Ch 279/91 (SB 855, Robbins). These payments effectively provide approximately \$1 billion in federal revenues, primarily to county hospitals, to offset the costs of services provided to uninsured persons who are not eligible for Medi-Cal. The amount of supplemental revenues each hospital receives under this program is determined in part by the number of days Medi-Cal beneficiaries are hospitalized in that facility. Accordingly, these facilities have a strong fiscal incentive to keep Medi-Cal beneficiaries hospitalized.

While an incentive to increase the frequency and length of hospital stays would always be a cause for concern, they are particularly so in light of the department's efforts to achieve cost containment through managed care. Because hospital inpatient services represent such a large portion of medical expenses (they account for about one-third of the fee-for-service Medi-Cal Program), there is little practical way to achieve savings through more efficient delivery systems without reducing unnecessary utilization of these services.

DSH Payments Have Increased the Lengths of Stay in County Hospitals. Our review indicates that, prior to the enactment of the disproportionate-share program in 1991, the average length of hospital stay for Medi-Cal beneficiaries was declining in both county and community hospitals. At essentially the same time that the DSH program was enacted, however, the average lengths of stay in county hospitals—which receive the vast majority of supplemental revenues under the program—began to increase significantly. The effect is particularly strong in 1991-92, the first year of the program. In contrast, the average lengths of stay in community hospitals, which receive proportionately much less from the DSH program, appear unaffected by the payments. This pattern is shown for three large groups of Medi-Cal beneficiaries in Figure 13 below. (The reduction in the average length of stay in county hospitals for two of these groups in 1992-93

Figure 13

**Average Length of Inpatient Stays
County and Community Hospitals
Major Medi-Cal Eligibility Categories**



probably reflects a resumption of the general trend toward shorter hospital stays due to technological advancements in diagnosis and treatment.)

Recommendation. Because it appears that DSH payments have increased the average length of hospital stays, we recommend legislation to modify the current methodology for making supplemental DSH payments in order to reduce the counterproductive fiscal incentive that these payments currently represent. Specifically, we believe that these payments should be made on a “per-discharge,” rather than a per diem basis. Under a per-discharge approach, hospitals would receive the same supplemental payment, irrespective of the number of days a Medi-Cal beneficiary is hospitalized. This would not reduce the amount of DSH payments for the hospitals, but they would no longer face an incentive to keep patients hospitalized for longer periods.

We estimate that this change will result in General Fund savings of approximately \$10.4 million in 1994-95 through a reduction in hospital inpatient costs. We believe that this will also strengthen the cost-containment potential of the department's efforts to implement more efficient county-organized service delivery systems through managed care.

Elimination of Optional Services

With respect to the department's proposal to eliminate certain optional services, we make the following findings: (1) the proposal could place an additional burden on county indigent health programs; (2) although the department's estimate does attempt to account for potential cost shifts resulting from the proposal, its savings estimate probably is still somewhat optimistic, due to the requirement that Medi-Cal provide necessary transportation; and (3) if adult dental services are not eliminated, continuation of this benefit would result in a General Fund cost of \$201 million, rather than the \$120 million estimated in the budget, due to a recent court decision.

We also recommend that if the Legislature chooses to ration services, as the administration effectively proposes, the Legislature consider basing its approach on identifying specific medical diagnoses or treatments that will no longer be covered rather than eliminating entire categories of benefits.

The budget assumes that the Legislature will enact legislation that will result in savings of \$341.5 million (\$168.1 million General Fund) in the budget year by eliminating the following optional service categories from coverage through Medi-Cal for most beneficiaries:

- Adult dental services.
-

- Medical supplies, excluding incontinence supplies. Examples are bandages and syringes for diabetics.
- Outpatient psychology services.
- Chiropractic services.
- Acupuncture services.
- Podiatry services.
- Speech and audiology services.
- Nonemergency transportation.
- Services provided at independent rehabilitation centers, including audiology, speech, occupational, and physical therapy.

The budget proposal would continue to provide these services for developmentally disabled regional center clients, children to age 21, and persons in long-term care. The department indicates that it is proposing elimination of these services solely to reduce Medi-Cal costs. (An identical proposal was included in last year's budget, and was rejected by the Legislature.)

Figure 14 lists the department's estimate of the Medi-Cal savings from eliminating each of these services and an estimate of the average number of Medi-Cal beneficiaries who currently use these services each month.

“Necessary Transportation” Is Required. Even if optional benefits are eliminated, federal law requires Medi-Cal to provide “necessary transportation” to Medi-Cal beneficiaries. Accordingly, we do not believe the budgeted savings attributable to the elimination of medical transportation provided in vans can be achieved. Absent legislative action to augment the budget, we estimate that this will result in a General Fund deficiency of at least \$21 million for 1994-95.

Costs May Shift to Other Services. Actual savings from elimination of the proposal's remaining eight optional benefits would depend on behavioral changes on the part of Medi-Cal beneficiaries. In some cases, elimination of optional services clearly will result in savings. In other cases, the savings may be offset because beneficiaries may substitute other Medi-Cal services for the service being eliminated or they may delay receiving treatment and ultimately require more acute care. The budget assumes cost shifts such as these ranging from 0 to 90 percent, depending on the service. The extent to which cost shifts will actually occur, however, is unknown.

Figure 14

**Proposed Elimination of Optional Medi-Cal Services
General Fund Savings
1994-95**

(Dollars in Millions)

Service	Average Monthly Users	Estimated Savings 1994-95
Adult dental	101,500	\$119.7
Nonemergency transportation	10,400	20.8
Medical supplies	32,600	19.5
Psychology	10,400	3.6
Acupuncture	12,800	2.1
Podiatry	12,000	1.5
Speech and audiology	5,900	0.5
Chiropractic	4,200	0.3
Independent rehabilitation centers	80	0.04
Totals	— ^a	\$168.1

^a Total monthly users cannot be estimated, since one beneficiary may use more than one optional service.

Cost Shifts to Counties May Result. We note that counties are the provider of last resort for health services. Accordingly, they may experience increased demand for services they provide, to the extent that beneficiaries are unable to receive care under the Medi-Cal Program.

Adult Dental Services. Due to a recent court decision barring the state's practice of limiting certain adult dental procedures, begun in 1993-94, the cost of restoring funding for adult dental services would be higher than estimated in the budget. Accordingly, we note that if the Legislature chose to continue adult dental services as a Medi-Cal benefit, the General Fund cost to do so would be approximately \$201 million in 1994-95, rather than the \$120 million estimated in the budget.

Rationing Services. Finally, we note that by proposing to eliminate optional benefits, the administration effectively proposes to limit services for Medi-Cal beneficiaries. If the Legislature chooses to limit services in order to achieve a given level of General Fund savings, we recommend that it instead consider adopting an approach based on identifying specific medical diagnoses or treatments that will no longer be covered, rather than eliminating entire categories of benefits. Such an approach has been implemented in Oregon.

We believe that such an approach has important advantages over that proposed by the administration. First, we note that the administration's

approach indiscriminantly affects beneficiaries with greatly different levels of illness. For example, the proposal to eliminate medical supplies applies equally to both diabetics who require syringes to inject insulin, and a beneficiary who needs to purchase bandages. In contrast, a proposal to limit services based on diagnoses could cover medically necessary care for the treatment of diabetes but exclude coverage for minor injuries.

In addition, the administration's approach will result in some unknown amount of cost-shifting, as discussed above. By eliminating coverage for certain diagnoses, the Legislature could more effectively achieve a given level of General Fund savings because the potential for cost-shifting would be significantly reduced.

Budgeted Rate Increases Can Be Avoided

We recommend enactment of legislation authorizing the DHS to direct the California Medical Assistance Commission (CMAC) to negotiate reimbursement rates for skilled nursing facilities. We further recommend a reduction of up to \$73 million from the General Fund by assuming that the CMAC can negotiate lower-than-projected reimbursement rate increases for hospital inpatient and skilled nursing facility services. (Reduce Item 4260-101-001 by \$73,000,000.)

The budget proposes expenditures of \$43 million from the General Fund for rate increases for hospital inpatient services that the department expects will be negotiated by the CMAC. In addition, the budget proposes \$60 million from the General Fund for anticipated rate increases for long-term care services provided in skilled nursing facilities.

Hospital Inpatient Services. The CMAC negotiates on behalf of the Medi-Cal Program to establish rates for hospital inpatient services provided to Medi-Cal beneficiaries. It is generally acknowledged that the CMAC has been successful in negotiating rates that are lower than those which would otherwise be provided. For example, the 1993 Budget Act assumed about \$37 million would be paid for rate increases, which was \$50 million lower than the projected level. The commission indicates it will likely succeed in achieving this target.

We believe the primary reason the CMAC is able to negotiate savings is due to generally low occupancy rates in California hospitals (frequently less than 50 percent). In effect, the low occupancy rates result in a "buyer's market" for hospital inpatient services, which the CMAC has used to its advantage in negotiating reimbursement rates. We note that occupancy rates in the state continue to be low. In addition, the CMAC currently contracts for about four times the capacity that Medi-Cal

requires to serve its beneficiaries. Accordingly, because there continues to be an excess supply of hospital beds in the state, and because the CMAC's contracted capacity appears to give it additional "bargaining room," we believe that CMAC will be able to negotiate rate decreases in some areas and relatively low increases in others. It would be reasonable, in our judgment, to assume that on net, no additional funds will be needed for rate increases. Consequently, we recommend that the budgeted increase for hospital reimbursement rate increases be deleted for a General Fund savings of \$43 million in 1994-95.

Skilled Nursing Facility Services. Currently, the CMAC does not negotiate rates for long-term care services. We note, however, that like hospitals, skilled nursing facilities in some areas of the state have excess capacity. (For example, occupancy in Orange County is 79 percent of licensed capacity.) To take advantage of these market conditions, we recommend the enactment of legislation authorizing the department to (1) designate regions of the state where it believes savings can be achieved without adversely affecting access to services and (2) direct the CMAC to negotiate rates on its behalf in those areas. If, for example, the CMAC were able to hold rates constant for one-fourth of the nursing facility volume, about \$15 million in General Fund savings would be achieved in 1994-95.

To the extent rate *reductions* could be negotiated—for example, in rates paid to "distinct-part" nursing facilities (those which are connected to acute-care hospitals), which have significantly higher reimbursement rates than "freestanding" facilities—the savings figure would be higher. Although we do not have a basis on which to estimate the precise magnitude of savings that could be achieved through CMAC-negotiated contracting for long-term care services, we believe it is reasonable to assume General Fund savings of up to \$30 million for 1994-95—one-half the amount budgeted.

This proposal would require a federal waiver. We note, however, that the state has obtained such a waiver to negotiate rates with hospitals.

Mandatory Drug Rebates Should Be Reinstated

We recommend the enactment of urgency legislation to reestablish supplemental rebates from pharmaceutical manufacturers, for a General Fund Savings of \$10 million. This will permit the state to realize savings until the supplemental rebates are replaced by implementation of the budget proposal to contract with a pharmacy management company to assume programmatic and financial responsibility, effective January 1995, for the Medi-Cal prescription drug program. (Reduce Item 4260-101-001 by \$10,000,000.)

The budget proposes expenditures of approximately \$1.2 billion from all funds in 1994-95 to provide prescription drugs and other pharmacy

services for Medi-Cal beneficiaries. This amount reflects savings from ongoing activities, such as negotiated rebates from pharmaceutical manufacturers, and a new proposal to select a pharmacy management company to assume financial and programmatic responsibility for the Medi-Cal prescription drug program, effective January 1, 1995. The department estimates that the contracting proposal will result in savings of \$67.8 million (\$33.9 million General Fund) in 1994-95.

Budget Proposes Pharmacy Contracting. Under the department's proposal, which requires legislation, a contractor would be selected, by competitive bids, to (1) negotiate dispensing fees with pharmacies that wish to serve Medi-Cal beneficiaries, (2) assume the "prior authorization" function that currently is carried out by the department's field offices for certain drugs, (3) negotiate with pharmaceutical manufacturers to secure additional rebates, and (4) establish additional utilization controls, such as limits on the number of prescriptions that may be provided to a Medi-Cal beneficiary in a given time period. The contractor will be required to assure that the provider network it establishes meets a "community standard" regarding access, and that the access is sufficient to assure that travel time to participating pharmacies generally does not exceed 30 minutes.

At the time this analysis was prepared, a number of details regarding the proposal were lacking. For example, the department had not indicated whether the pharmacy management company selected for the contract would have the authority to impose more stringent limits than the existing ten prescriptions per month. In addition, it is not clear how the company's financial risk will be structured.

Although the Legislature will need additional information to fully evaluate this proposal, we believe that the concept of pharmacy contracting has merit. Many private-sector insurers have entered into similar arrangements and have achieved savings as a result. Accordingly, if the proposal is structured so as to produce savings through more efficient operations and bulk purchasing, as opposed to reductions in benefit levels for Medi-Cal beneficiaries, we believe that it should be adopted.

We note, however, that if the proposal is adopted by the Legislature, it will not become effective until January 1995 at the earliest. In order to achieve prescription drug savings in the interim, and to improve the long-term savings potential of the department's proposal, we recommend that the Legislature take an additional step in this area. We discuss this below.

Interim Step Would Result in Savings. In legislation accompanying the 1992 Budget Act, the Legislature directed the department to begin "therapeutic category reviews" to identify a relatively few number of drugs in each therapeutic category (for example, antibiotics) that the department judged favorably in terms of efficacy and price. Within each category, the department was authorized to impose prior authorization

requirements on drugs that were not judged favorably. In this way, the legislation allowed Medi-Cal to bargain for discounted prices in the drug program and achieve General Fund savings. The department was to complete these reviews by 1997.

In addition, however, because significant savings from these reviews would not be realized for a number of years, the legislation also directed the DHS to seek rebates to the Medi-Cal Program of between 5.5 and 10 percent for a 15-month period, which expired September 1993. (Specifically, the legislation authorized the department to place prior authorization requirements on any drug for which the requested rebate was not provided.)

Analyst's Comments and Recommendations. Since the enactment of this legislation, the department has completed reviews in 3 therapeutic categories, out of more than 100 categories. The department indicates that an additional 5 categories will be completed in the current and budget years. Accordingly, because completion of therapeutic category reviews have been completed in a relatively few instances, we recommend that the supplemental rebate requirement enacted in 1992 be reestablished for 1994-95 until the department's pharmacy contracting proposal, if it is adopted by the Legislature, is implemented.

We note that, in addition to the immediate savings that this action would achieve, a temporary reestablishment of supplemental rebates could significantly strengthen the long-term savings potential of the department's pharmacy contracting proposal by improving the contractor's "bargaining position" with respect to negotiating future pharmaceutical rebates.

We estimate that reestablishment of supplemental rebates will result in savings of approximately \$10 million from the General Fund in the first half of 1994-95. It is important to note that existing state law requires that beneficiaries be notified 60 days before a drug is placed on prior authorization. Accordingly, if the Legislature wishes to achieve the full extent of these savings, it would need to enact this legislation on an urgency basis by mid-April, or include in the legislation a waiver of some portion of the 60-day notification requirement.

PUBLIC HEALTH

The Department of Health Services administers a broad range of public health programs, including (1) programs that complement and support the activities of local health agencies controlling environmental hazards, preventing and controlling disease, and providing health services to populations who have special needs and (2) state-operated programs such as those which license health facilities and certain types of technical personnel.

The budget proposes \$1.3 billion (\$289 million General Fund) for public health local assistance. This represents an increase of 3.4 percent (12 percent General Fund) over the current year. For state operations, the budget proposes \$372 million (\$101 million General Fund), which is an increase of 9.2 percent (13 percent General Fund) over the current year.

Low-Level Radioactive Waste Disposal Site Still Not On-Line

We recommend that the department report at budget hearings on the status of the low-level radioactive waste disposal facility project, including an update on when the facility is anticipated to be on-line, a contingency plan for waste disposal if the facility is not operational by June 30, 1994, and the feasibility of repayment of a \$500,000 General Fund loan.

Background. State law requires that a low-level radioactive waste facility be developed in California. In 1993, the Department of Health Services issued a license to a private company to construct and operate such a facility. The department estimates that the facility will be operational ten months after the start of construction. However, two issues are delaying the start of construction.

First, the department is litigating two lawsuits challenging the licensing of the facility. One of the cases is not yet scheduled for hearing, and the hearing on the other case has been tentatively set for April 1994. The second issue involves the purchase of the land from the federal government. Prior to making a decision to sell the land to the state, the federal government is requiring the state to hold a formal hearing regarding the safety of the proposed site. The hearing has not been scheduled since the lawsuits challenging the licensing decisions must first be resolved. Based on these factors, it appears likely that construction will not start until sometime in 1994-95 and that the facility will not open until 1995-96.

Federal law provides for a federal "rebate" to states for the development costs of low-level radioactive waste facilities if the facility is on-line by January 1, 1993, or if the state provides a plan for waste disposal. The department has stated that the requirements for the rebate, amounting to \$3 million, have been met through submission of a plan. However, the federal government is currently in the process of reviewing policies related to the rebate and has not made a determination as to whether California qualifies.

Program Funding. The budget proposes \$1.6 million from the Low-Level Radioactive Waste Disposal Fund in 1994-95 for activities related to the development of a low-level radioactive waste disposal site. The program is currently funded by annual licensing fees from the company that will be operating the facility and from a \$500,000 loan from the General Fund. The 1992 Budget Act requires repayment of the loan by March 31, 1994, but repayment has not yet been made.

The budget assumes (1) the receipt of the \$3 million rebate from the federal government for deposit to the Low-Level Radioactive Waste Disposal Fund in the current year, (2) that the site will be fully operational during the budget year with collection of \$1.3 million in user fees, and (3) that the General Fund loan will not be repaid. Under these assumptions, the year-end balance for the Low-Level Radioactive Waste Disposal Fund would be \$1.6 million.

Recommendation. As noted above, it is not clear when or whether the state will receive the rebate, and the facility probably will not be on-line until 1995-96. Additional information concerning the likelihood of the receipt of the federal rebate and the time frame for completion of the project should be available in the spring. Consequently, we recommend that the department report at budget hearings on the status of the project, a contingency plan for interim storage in the event the facility is not on-line by June 30, 1994, and the feasibility of repaying the \$500,000 General Fund loan in 1994-95.

Reauthorization of Proposition 99 Funding

Statutory authority for appropriating Proposition 99 funds expires June 30, 1994. The budget includes a plan for appropriating these funds in 1994-95.

Proposition 99 of 1988, the Tobacco Tax and Health Protection Act, established a surtax on cigarettes and tobacco products. The proposition allocates the proceeds from the surtax to six accounts within the Cigarette and Tobacco Products Surtax Fund (C&T Fund) based on specified percentages, with expenditures from each account limited to specific activities. Figure 15 identifies the estimated 1994-95 revenues projected for each account and the statutory restrictions on their use. Funds in the Research and Public Resources Accounts are appropriated in the Budget Act and funds in the other accounts are appropriated by separate legislation—Ch 278/91 (AB 99, Isenberg) and Ch 1170/91 (SB 99, Watson), which sunset on June 30, 1994.

Figure 15

Proposition 99 Programs Distribution of Revenues

(Dollars in Millions)

Account	1994-95 Estimated Revenues ^a	Percent of Total Revenues	Use of Revenue by Account
Health Education	\$88.9	20%	Programs for prevention and reduction of tobacco use
Hospital Services	155.6	35	Payment to public and private hospitals for patients who cannot afford treatment
Physician Services	44.5	10	Payment to physicians for patients who cannot afford services
Research	22.2	5	Tobacco-related disease research
Public Resources	22.2	5	In equal amounts for (1) wildlife habitat programs and (2) recreation resources
Unallocated	111.1	25	Any of the uses identified above
Totals	\$444.5	100%	

^a Excludes \$889,000 allocated to the State Board of Equalization.

C&T Fund revenues have steadily declined since 1990-91. In anticipation of declining revenues, Chapter 278 authorizes the Department of Finance to make program reductions on a pro rata basis to reflect changes in revenue, with the exception of five programs protected by the legislation from reductions—the Access for Infants and Mothers (AIM) Program, the Major Risk Medical Insurance Program, the

Medi-Cal Perinatal Program, the Child Health and Disability Program (CHDP), and the County Medical Services Program (CMSP).

Reductions in revenue are anticipated to continue, due partly to education and prevention programs designed to reduce tobacco consumption. In addition, recent legislation, Ch 660/93 (AB 478, Barbara Friedman), increased the tax on cigarettes by two cents per package, effective January 1, 1994. The impact on C&T revenues of this additional tax as well as the potential for an additional federal tax on cigarettes is unknown but could have a significant impact on the revenue stream.

Proposed Funding Allocation. The budget anticipates enactment of legislation authorizing expenditure of Proposition 99 funds through 1995-96. The budget proposes expenditures of \$437 million from the C&T Fund, which represents a 17 percent reduction from the revised current-year expenditure level. The budget also proposes a fund reserve level of 5 percent of total revenues (5.4 percent of expenditures) for 1994-95, compared to 2 percent in the current year.

The budget estimates that annual revenues will decline by 4.8 percent between the current and budget years. The revenue projections are based on an assumption that per capita consumption of cigarettes will continue to decline in 1994-95, but at a lesser rate.

We note the following features of the proposed C&T Fund allocation:

- The budget proposes to maintain the current-year level of spending for those programs currently "protected" under Chapter 278, as well as media campaigns administered by the Department of Health Services. The rationale cited by the administration for maintaining the expenditure level for the media campaigns is the program's success in reducing smoking. The budget also proposes to increase funding for CHDP health screening by \$2.3 million to fund increased caseload.
- Under Proposition 117 (The California Wildlife Protection Act of 1990), 10 percent of the funds in the C&T Fund Unallocated Account must be transferred to the Habitat Conservation Fund (HCF) for expenditure on natural resources programs. The budget instead proposes to allocate \$8.6 million for the Department of Water Resources' Mono Lake Project. To accomplish this, the budget indicates that an amendment to Proposition 117 will be submitted to the voters in 1994 to eliminate the HCF.

- A bill (AB 816, Isenberg) has been introduced to authorize expenditures of C&T Fund monies in 1994-95, pursuant to the provisions of Proposition 99. At the time this analysis was prepared, the bill did not specify how the funds will be allocated.

Analyst's Comments. In our review of the budget's proposed expenditure plan, we note the following concerns:

- **Proposition 117 Suspension.** While the budget anticipates suspension of Proposition 117, this action will require a vote of the electorate. We discuss this in more detail in our analysis of the use of the HCF for resources programs (see Resources Crosscutting Issues).
- **Impact on Health Programs.** The budget proposes to maintain the current-year level of spending for certain public health programs. Since Proposition 99 revenues are expected to continue to decline, other programs would be reduced disproportionately. For example, the California Healthcare for the Indigent Program (CHIP) would be reduced by 16 percent rather than maintained at current levels.
- **Potential Use of Reserves.** As mentioned above, the budget proposes a reserve of 2 percent in the current year and 5 percent in the budget year. In our analysis of the Office of Statewide Health Planning and Development, we recommend the use of \$2 million of the reserve monies to fund increased training of primary care providers. This would reduce the projected year-end reserves to \$21.7 million, or 4.7 percent of revenues (5 percent of expenditures), a level that we believe is reasonable. If the May Revision of revenues projects an increase in budget-year reserves, the Legislature may want to consider appropriating additional reserves for programs that qualify for Proposition 99 funding. For example, the Legislature could restore funding for programs that have been reduced as a result of declining C&T Fund revenues, such as the CHIP. This program provides funding to counties for care of indigent persons.

MANAGED RISK MEDICAL INSURANCE BOARD (4280)

The Managed Risk Medical Insurance Board (MRMIB) administers (1) the Major Risk Medical Insurance Program (MRMIP), which provides health insurance to California residents who are unable to obtain it for themselves or their families because of pre-existing medical conditions; (2) the Small Employers Purchasing Pool Program, which will establish and operate a health insurance purchasing pool for small employers; and (3) the Access for Infants and Mothers (AIM) Program, which provides coverage for women seeking pregnancy-related and neonatal medical care.

The budget proposes \$130.9 million from all funds for support of MRMIB programs in 1994-95, which is virtually the same level as estimated current-year expenditures. The budget proposes legislation to appropriate \$38.5 million from the General Fund in 1994-95 and \$12.5 million in the current year for the AIM Program. We discuss these proposed General Fund augmentations below.

Expanding Medi-Cal, In Lieu of the AIM Program, Would Save State Funds

We recommend that the Legislature not adopt the budget proposal to continue the AIM Program and instead expand the Medi-Cal Program to serve AIM-eligibles, thereby securing additional federal funding for services to pregnant women and their infants and realizing General Fund savings of about \$73 million in 1994-95.

Background. The AIM Program is a health insurance program under which the state enters into contracts with private insurance plans to provide health services to pregnant women, and their infants up to two years after birth, who:

- Have no health insurance coverage for their pregnancy.
 - Have incomes below 250 percent of the federal poverty level.
 - Are not eligible for services through the Medi-Cal Program.
-

Women enrolled in the AIM Program receive health coverage from the time of enrollment until 60 days after birth. Program participants pay an initial fee of 2 percent of their family income toward the costs of services received by the mother and the infant (up to the infant's first birthday). In 1993, for example, a pregnant woman with an annual income of \$18,860 (200 percent of the federal poverty level) would pay a fee of \$377. An additional fee of \$100 is assessed to continue the infant's health coverage through the second year.

Under current law, the AIM Program is funded through revenues from the Cigarette and Tobacco Products Surtax (C&T) Fund established by Proposition 99. The AIM Program's funding will sunset on June 30, 1994 unless reauthorized by the Legislature. However, the administration estimates that the program's funding for new enrollees in the current year will be exhausted in January 1994. Consequently, the budget proposes legislation to appropriate additional funds for the program in the current as well as budget years, as explained later in this analysis.

Evaluation of the AIM Program. The program was established as an alternative approach to the Medi-Cal Program for providing health care to pregnant women and their infants. In contrast to Medi-Cal, the AIM Program offers a simplified eligibility determination process, including the ability to receive and fill out applications at one's home, and an "insurance model" approach to services, with the beneficiary paying a portion of costs, rather than the "welfare model" of the Medi-Cal Program where the recipient generally does not pay a share of costs. The AIM Program also pays higher reimbursement rates to service providers than does the Medi-Cal Program.

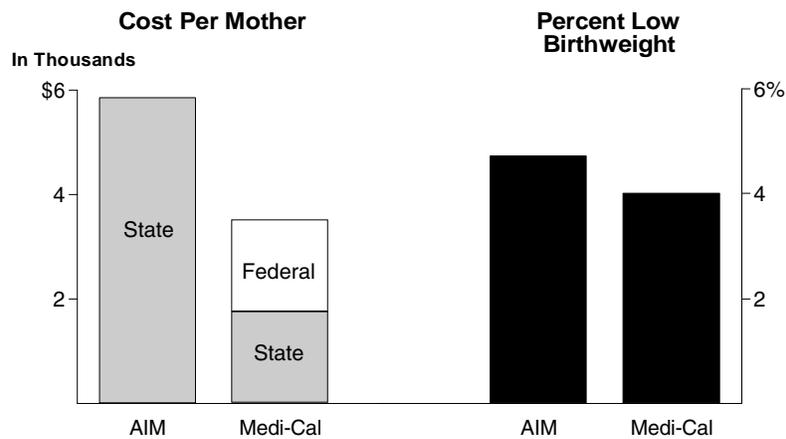
In authorizing the AIM Program, the Legislature required the board to report on birth outcomes of program participants and other factors in order to evaluate the program's effectiveness. In reviewing the report, we believe that its most significant outcome measures are those which compare AIM Program participants to a similar income group in the Medi-Cal Program.

According to the report, the program compares favorably to the Medi-Cal Program on some measures, such as the number of prenatal visits program recipients receive (an average of 12.5 visits in AIM versus 9.5 visits in Medi-Cal). However, the AIM Program did not result in improved birth outcomes as compared to Medi-Cal, even though it is significantly more expensive per case when compared to a comparable group of Medi-Cal participants. (For example, the cost per mother for AIM is \$5,857, versus \$3,500 for Medi-Cal). In addition, we note that Medi-Cal costs to the *state* are lower still, because 50 percent of Medi-Cal Program expenditures are offset by federal funds. Figure 16 shows what we believe

are the two key measures to assess the AIM Program: its costs and birth outcomes as compared to those for Medi-Cal recipients (women with incomes between 185 and 200 percent of poverty).

Figure 16

**Comparison of AIM and Medi-Cal Program^a
Costs and Outcomes**



^a Medi-Cal figures are for beneficiaries between 185 and 200 percent of poverty.

Budget Proposal. The budget proposes legislation to continue the AIM Program through the remainder of 1993-94 and 1994-95. In addition, the administration proposes to expand the Medi-Cal Program to cover individuals who would otherwise be eligible for the AIM Program. Under these proposals, an additional 1,000 pregnant women and infants with family incomes between 200 and 250 percent of poverty will be served each month by (1) appropriating General Fund and C&T Fund monies to continue the AIM Program and (2) implementing an "asset test" waiver in Medi-Cal, effective February 1, 1994, which would allow individuals to qualify for Medi-Cal who could not otherwise be served by the program due to excess assets. (Without such an asset waiver, these individuals could be served only under the AIM Program at entirely state expense.)

Figure 17 shows the General Fund and C&T Fund costs of the administration's proposal for both the AIM and the Medi-Cal Programs for the current and budget years, and the number of enrollees that would be served by each.

Figure 17				
Managed Risk Medical Insurance Board Budget Proposal to Continue AIM Program 1993-94 and 1994-95				
(Dollars in Millions)				
	C&T Fund	General Fund	Total State Funds	New Enrollees per Month
1993-94				
AIM ^a	(\$57.6)	\$12.5	\$70.1	750
Medi-Cal	—	2.5	2.5	250 ^b
Totals, 1993-94^a	(\$57.6)	\$15.0	\$72.6	1,000
1994-95				
AIM ^a	\$57.6	\$38.5	\$96.1	750
Medi-Cal	—	5.5	5.5	250 ^b
Totals, 1994-95	\$57.6	\$44.0	\$101.6	1,000

^a 1993-94 C&T Fund expenditures were appropriated under current law.

^b Medi-Cal caseload figure is an estimate, since the asset waiver creates a new entitlement.

As Figure 17 indicates, the administration's proposal will result in General Fund costs of \$44 million for 1994-95 in the AIM and Medi-Cal Programs. Of this amount, \$38.5 million will be in the AIM Program, supported entirely from the General Fund. This represents an increase of 67 percent over total AIM Program expenditures authorized for 1993-94.

Analyst's Comments and Recommendations. We are concerned that the administration proposes to continue the AIM Program despite the fact that it is considerably more costly to the state and results in no commensurate improvement in birth outcomes. (In fact, as noted above, the AIM Program recorded a slightly lower percentage of successful birth outcomes than the comparison portion of the Medi-Cal Program, as measured by the percent of newborns with birthweights above five pounds eight ounces.) Accordingly, we recommend an alternative to the adminis-

tration's proposal that would result in similar service levels at reduced General Fund cost.

Under provisions of federal law, several states have expanded Medicaid coverage beyond the levels previously considered reimbursable with federal funds. Specifically, a 1988 federal law change allows states to implement "less restrictive criteria" for Medicaid eligibility with respect to pregnant women and children.

We recommend that instead of adopting legislation to continue the AIM Program, the Legislature expand the Medi-Cal Program to cover pregnant women and their infants with family incomes between 200 and 250 percent of poverty, thereby serving the same target population that would be served under the administration's proposal. We note however, that the AIM Program provides coverage for infants to age two, while Medi-Cal covers infants only to age one.

We further recommend that the Legislature redirect the C&T Fund expenditures proposed for the AIM Program, which would be freed up by our recommendation, to other programs that currently are funded through the General Fund and eligible for C&T funds. Examples of such programs include: the Office of Family Planning, the Child Health and Disability Prevention Program, tuberculosis prevention, and immunization assistance (all within the Department of Health Services), Early Mental Health Intervention (Department of Mental Health), various programs in the Department of Developmental Services, and health services provided in state-funded correctional programs such as the Parole Outpatient Clinic.

We estimate that adoption of these recommendations would result in approximately \$73 million in net General Fund savings, due primarily to lower program costs and the availability of federal funds under Medi-Cal. This consists of an estimated General Fund increase of about \$23.3 million in the Medi-Cal Program, elimination of the proposed \$38.5 million for the AIM Program, and the replacement of \$57.6 million General Fund support with C&T funds in various programs.

The administration has expressed concern that higher-than-projected caseloads could result if services are made available to pregnant women in this income range under the Medi-Cal Program, which is an entitlement, as opposed to the AIM Program, where enrollments can be cut off if funding is not available. To address this concern, we recommend that legislation authorizing the Medi-Cal expansion set a "ceiling" of 250 percent of poverty (or a lesser amount), and allow the administration discretion to adjust the income limit annually. In this way, the Legislature will assure that costs and services are controlled on the basis of family

income levels, rather than by cutting off enrollments when an appropriation limit is reached. This latter method, which currently is used by the AIM Program, randomly excludes some persons with incomes *lower* than others who are served because they happen to apply for services at an earlier date in the fiscal year.

In addition, we recommend that the legislation incorporate the AIM Program's enrollment fee provision for Medi-Cal beneficiaries between 200 and 250 percent of poverty, which is also permitted by federal law, provided that it is paid on a monthly basis. The enrollment fee provision would help to control caseload growth, thereby increasing the likelihood of achieving a given level of General Fund savings.

DEPARTMENT OF DEVELOPMENTAL SERVICES (4300)

The Department of Developmental Services (DDS) administers services in the community (through regional centers) and in state developmental centers for persons with developmental disabilities. A developmental disability is defined as a disability related to certain mental or neurological impairments originating before a person's 18th birthday that is expected to continue indefinitely and that constitutes a substantial handicap.

The budget proposes \$1.5 billion from all funds for support of the DDS programs in 1994-95, which is an increase of 6 percent over estimated current-year expenditures. The budget proposes \$504 million from the General Fund in 1994-95, which is \$79 million, or 14 percent, below estimated current-year expenditures from this funding source. This reduction in state costs is primarily due to a \$131 million increase in federal reimbursements for the regional centers, thereby reducing General Fund support.

Court-Approved Settlement of *Coffelt* Lawsuit

Background. The plaintiffs in the lawsuit *Coffelt v. Developmental Services* claimed that the DDS had not placed developmental center (DC) residents in community services despite the fact that they desired such placement and were entitled to these services. Approved in January 1994, a settlement requires the DDS and four defendant regional centers to provide alternative community living arrangements for 300 regional center (RC) "target group" persons and to reduce the DC population by 2,000 residents. The department is also required to make a "good faith effort" to improve the variety of living options in other regional centers in order to achieve the DC population reduction goal by 1997-98.

Settlement Actions. In order to reduce the developmental center population, five major tasks will be undertaken by the DDS and the regional centers:

- Develop and implement consumer assessment/placement planning materials.

- Provide additional funding for case management services.
- Increase the availability of community living options.
- Enhance the availability of crisis intervention services.
- Develop and implement a statewide quality assurance system for residential services and support.

Financial Obligations. The budget for regional centers proposes expenditures of \$38 million from all funds (\$29 million General Fund) for statewide implementation of *Coffelt*-related activities in 1994-95. We note, however, that the obligation to meet the conditions of the settlement is contingent upon the department's ability to receive increases in federal fund participation (FFP). The settlement recognizes that state support is subject to appropriations by the Legislature. Existing FFP, if continued at the current level, would be sufficient to fund the requirements of the settlement.

Case Management Services Augmentation Not Justified

We recommend a reduction of \$5.1 million from the General Fund requested to augment case management services for regional centers because (1) the budget contains sufficient funds for case management to address the needs of DC clients transitioning to community living and (2) this amount is not justified on a workload basis. (Reduce Item 4300-101-001 by \$5,073,000.)

The budget proposes expenditures of \$10.1 million from the General Fund in 1994-95 to provide funding to “enhance” case management services in the regional centers in response to the *Coffelt* lawsuit settlement. This amount is in addition to other funds budgeted for regular caseload increases. This is an increase of \$5,073,000, or 100 percent, over the current-year amount of \$5.0 million, which was budgeted by the Legislature for the *Coffelt* lawsuit.

We recommend deletion of the proposed \$5.1 million augmentation, for the following reasons:

- The *Coffelt* settlement, in effect, requires that *up to* \$10 million be expended for “enhanced” case management. In other words, it does not require the Legislature to appropriate \$10 million from the General Fund for this purpose. As we indicated above, the Legislature appropriated \$5.0 million in the current year for the *Coffelt* lawsuit, and the budget proposes to continue this amount into 1994-95. We believe that this amount is adequate to provide
-

additional services to *Coffelt*-related clients and other regional center clients.

- The proposed \$10 million is *not* tied to services needed by, or provided to, *Coffelt*-related clients. Instead, the additional case management would be apportioned to all regional centers as an across-the-board augmentation. (Other funds proposed in the budget would provide targeted services.)

As a general principle, we believe that funds to comply with this lawsuit should be used to target services to *Coffelt*-related clients. In this respect, we note that the entire \$10.1 million budgeted for enhanced case management is *not* targeted to these clients. Nevertheless, we would delete only the \$5.1 million increase over the current-year amount in deference to the action taken by the Legislature in the 1993 Budget Act in anticipation of the *Coffelt* settlement. An alternative would be to reduce this amount to \$1 million, which—if targeted to *Coffelt* clients—would reduce the client/case manager ratio from about 88:1 to about 18:1 for these clients.

Supplemental Client Services Expenditures Not Justified

We recommend the deletion of \$5.7 million from all funds (\$2.8 million General Fund) proposed to support supplemental services for developmental center clients placed in regional center programs because other funding increases proposed in the budget are sufficient to provide the services needed by the clients. (Reduce Item 4260-101-001 by \$2,830,000.)

The budget proposes expenditures of \$11.1 million from all funds for the regional centers in 1994-95 to provide services for DC clients who are expected to transition to community living, including clients affected by the *Coffelt* settlement. This amount consists of \$5.4 million based on amounts that the department has budgeted in prior years, pursuant to a placement plan developed by the department, for placing non-*Coffelt* clients (that is, prior to the court case) from the developmental centers to community living arrangements. In addition, the budget includes \$5.7 million because the department believes that the *Coffelt*-related clients will require more intensive services when being transitioned into the community.

The department, however, has not been able to substantiate its claim that *Coffelt*-related clients will require a more intensive level of service. Even if these clients do require an intensive level of service, we believe that the \$5.4 million is adequate because it assumes that a relatively

intensive level of care and service would be provided to clients. Specifically, it assumes that 86 percent of clients are placed in intermediate care facilities (licensed medical facilities) and in the highest service category ("level 4") of community care facilities.

Because of this lack of justification, and the relatively intensive level of care that can be provided with the allocation of \$5.4 million, we conclude that the additional funds are not necessary. Accordingly, we recommend a reduction of \$5.7 million in all funds (\$2.8 million from the General Fund).

DC Caseload-Related Staffing Adjustments Not Reflected in the Budget

We recommend that the DDS develop and implement in 1994-95 a plan to reduce non-level-of-care staff at all developmental centers where such reductions are warranted by declining caseloads, for an estimated General Fund savings of \$6 million. (Reduce Item 4300-003-001 by \$690,000 and reduce Item 4260-101-001 by \$5,302,000.)

The DC population is projected to decrease from an estimated 6,191 residents at the end of 1993-94 to an estimated level of 5,690 residents at the end of 1994-95. This is a decrease of 501 residents, or 8.1 percent, from the current year.

Non-Level-Of-Care Staffing Reductions Should Be Implemented in Budget Year. Level-of-care (LOC) staffing at developmental centers is primarily based on licensure and certification requirements, changes in client population, and the severity of the clients' disabilities. The budget has included annual adjustments in LOC staff to correspond to changes in the client population. However, non-level-of-care (NLOC) staff, which includes administrative and nondirect client services, is not based on a caseload formula and is not automatically adjusted for changes in population.

We found that the budget proposal for support of the DCs contains no plan for NLOC staffing reductions related to past and projected population declines at the DCs. The department has established a working group to examine NLOC staffing at each DC and develop recommendations for staffing adjustments. The work group plans to present its recommendations in March 1994 and expects staffing adjustments to be incorporated into the May revision of the 1994 Budget Bill. The department indicates that projected savings due to the NLOC staffing adjustments are not available at this time.

Using historical LOC and NLOC staffing data and population projections as a guide, we estimate that the NLOC staffing reductions would result in a General Fund savings of \$6 million (\$690,000 in the DDS budget and \$5.3 million in the Medi-Cal budget due to reduced reimbursements to DDS.) Consequently, we recommend that the budget be reduced to reflect these caseload-related reductions in NLOC staffing. The department should be prepared to provide a more precise estimate during budget hearings.

Expenditure Plan for Quality Assurance System Not Submitted

We withhold recommendation on \$2.8 million from the General Fund to support the implementation of a statewide quality assurance system to evaluate community living facilities, pending submission of an expenditure plan by the department.

The budget proposes expenditures of \$2.8 million from the General Fund in 1994-95 to support the implementation of a quality assurance system to evaluate community care facilities and supportive living agencies. The system will contain standards to measure consumer satisfaction and quality of life as well as corrective action procedures for the facilities.

While we agree with the objectives of the proposal, we note that the department has not provided a specific plan for the use of these funds. According to the department, a task force plans to release the standards in April 1994 and then propose an expenditure plan. Without an expenditure plan, the Legislature cannot determine whether this proposal is a cost-effective use of these funds.

Therefore, we withhold recommendation on the \$2.8 million expenditure request to support the implementation of a quality assurance system pending review of an expenditure plan, which the DDS expects to provide prior to the May revision.

Crisis Intervention Project Lacks Plan

We withhold recommendation on \$8.1 million in total funds (\$4.5 million from the General Fund) proposed for local crisis intervention facilities and services, pending submission of an expenditure plan by the department.

The budget proposes expenditures of \$8.1 million in total funds (\$4.5 million General Fund) to provide funding for psychiatric

intervention services, crisis intervention teams, and “deflection” facilities at the local level. These facilities and services would be designed to provide an alternative to institutionalization for clients needing temporary crisis intervention. While these objectives are desirable, we note that the department has not provided an expenditure plan for the use of these funds.

According to the department, it is necessary for the regional centers to assess needed services and prepare a description of the proposed services, housing requirements, after-hours response systems, and funding levels required to implement these services before a complete proposal can be developed. The department expects this process to be completed and a detailed proposal available in June 1994. Unfortunately, this timing would be out of sync with legislative deadlines.

Until the proposal is available, the Legislature cannot evaluate whether this is a cost-effective use of these funds. Therefore, we withhold recommendation on the \$8.1 million requested to provide funding for these crisis intervention facilities and services, pending submission of an expenditure plan before legislative action on the budget is completed.

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) administer the Bronzan-McCorquodale and Lanterman-Petris-Short Acts, which provide for the delivery of mental health services through a state-county partnership and for involuntary treatment of the mentally disabled, (2) operate five state hospitals and the acute psychiatric units at the California Medical Facility at Vacaville, and (3) administer six programs directed at specific populations.

The state hospitals provide inpatient treatment services for mentally disabled county clients, judicially committed clients, and mentally disordered offenders and mentally disabled clients transferred from the Departments of Corrections and the Youth Authority.

The budget proposes \$771 million from all funds for support of DMH programs in 1994-95, which is an increase of 2 percent over estimated current-year expenditures. The budget proposes \$242 million from the General Fund in 1994-95, an increase of \$14 million, or 6.1 percent, above estimated current-year expenditures from this funding source.

Budget Does Not Reflect Caseload-Related Staffing Reductions in State Hospitals

We recommend that \$245,000 from the General Fund proposed for the department to develop alternative levels of care for clients at state hospitals be deleted because the department has not submitted a plan or any supporting justification for the use of these funds. (Reduce Item 4440-011-001 by \$245,000.)

We further recommend that the DMH develop and implement in 1994-95 a plan to reduce non-level-of-care staff at all state hospitals, where such reductions are warranted by declining caseloads, for an estimated General Fund savings of \$100,000 annually. (Reduce Item 4440-011-001 by \$100,000.)

The budget proposes expenditures of \$417 million from all funds in 1994-95 to support the state hospitals. This is an increase of \$4.4 million, or 1.1 percent, above estimated current-year expenditures. The budget proposes an appropriation of \$154 million from the General Fund for these hospitals, which is an increase of \$4.1 million, or 2.7 percent, above estimated current-year expenditures.

The state hospital population will decrease from 4,687 clients at the end of 1990-91 to an estimated level of 4,014 clients at the end of 1994-95. This population reduction of 673 clients, or about 17 percent, is due largely to the effects of the 1991-92 realignment legislation and the development of more community living alternatives.

Plan for Use of Funds Not Submitted. Level-of-care (LOC) staff provide direct services to patients at state hospitals. This staffing level is determined by a formula developed by the DMH in conjunction with the Department of Developmental Services. It is primarily based on licensing requirements and changes in patient population and level of illness. The budget has included annual adjustments in LOC staffing to correspond to changes in the state hospital population. However, non-level-of-care (NLOC) staffing, which includes administration and nondirect client services, is not based on a caseload formula and is not automatically adjusted with caseload changes.

Recently, the department completed a review of Napa State Hospital's NLOC staffing requirements. As a result of the department's review, the budget proposes a reduction of 47 NLOC positions at the Napa hospital in 1994-95. These reductions would result in a savings of \$490,000 from the General Fund and \$994,000 in realignment funds for the counties. The budget, however, proposes that the department retain one-half of the General Fund savings (\$245,000) for a one-year period to implement alternative levels, or modes, of care for patients at state hospitals.

We found that the budget proposal contains no plan specifying the alternative modes of care, nor has the department been able to provide any details on how it would spend these funds. Without this information, the Legislature cannot evaluate whether this would be a cost-effective use of these funds, even if the general objective seems reasonable. Thus, we conclude that the request for these funds is not justified. Accordingly, we recommend that the \$245,000 be deleted from the budget.

Caseload-Related Staffing Reductions Should Be Implemented in Budget Year. As stated above, the department developed an NLOC staffing model based on Napa State Hospital. In addition, the department has initiated a review of the type of programs, number of beds, and level of illness at the other state hospitals in order to develop NLOC staffing

standards. However, the DMH does not plan to implement caseload-related NLOC reductions until 1995-96.

We believe that the department has the capability of developing a plan during the current year for NLOC reductions related to past and projected caseload declines in all the hospitals. These reductions can be based on the model developed at Napa. Using this model as a guideline and applying it to caseload reductions at the other hospitals, we estimate that the NLOC staffing reductions would result in a General Fund savings of at least \$100,000 in 1994-95. The department should be prepared to provide a more precise estimate during budget hearings.

Accordingly, we recommend that the budget reflect caseload-related NLOC staffing reductions at all state hospitals, for an estimated General Fund savings of \$100,000.

School-Based Prevention Program Augmentation Should Be Redirected

We recommend (1) a reduction of \$10.3 million (\$10 million Proposition 98) in the Early Mental Health Initiative (EMHI) Program and (2) redirecting the Proposition 98 funds to a block grant in order to provide school districts with flexibility over the use of available funds. (Reduce Item 4440-102-001 by \$10 million and Item 4440-001-001 by \$330,000.)

We further recommend that the Department of Mental Health advise the budget subcommittees on (1) why it awarded more grants to local projects than the base EMHI Program budget could support and (2) the amount of funds that are likely to be available in 1994-95 from the 1991-92 statutory appropriation for the program.

The EMHI Program is supported by \$10 million from the General Fund (Proposition 98) in the current year. The budget proposes a \$10 million increase in support from Proposition 98 funds. The EMHI Program awards grants to local education agencies for projects that provide school-based early mental health intervention and prevention services for K-3 pupils.

In the K-12 education section of this *Analysis*, we recommend that the Legislature delete growth funds for most K-12 categorical programs that do not provide funding for basic instructional programs (programs that provide direct education services to students.) In addition, we recommend these funds be redirected to a categorical block grant program in order to provide local flexibility over the use of available funds.

With respect to the DMH budget, we recommend that the proposed \$10 million (Proposition 98) augmentation for expansion of the EMHI

Program be redirected and that the associated administrative costs (non-Proposition 98) be deleted, for a General Fund savings of \$330,000. Although the EMHI proposal has merit, we believe that giving schools maximum flexibility to maintain their basic educational program should take priority over most specific program augmentations.

The department indicates, however, that it may need additional funds in 1994-95 to maintain the current level of program activity. Specifically, the DMH indicates that it needs up to \$11.1 million to support current-year programs in 1994-95, or \$1.1 million over its "base" program budget. The department advises that more new project grants were awarded during 1993-94 than can be supported within its \$10 million base appropriation. The department used \$2.4 million in non-Proposition 98 funds remaining from the statutory appropriation made in Ch 757/91 (AB 1650, Hansen) to augment the \$10 million appropriated in the 1993 Budget Act.

At the time this analysis was prepared, the DMH could not advise us on the exact amount it needs to support existing local programs in 1994-95. In particular, the department is uncertain about whether additional funds from its statutory appropriation may be available during 1994-95 to pay for all or part of the \$1.1 million requested above its base budget.

Therefore, we further recommend that the DMH report to the budget subcommittees on (1) the department's justification for awarding more local grants than its existing budget could support on an ongoing basis and (2) the amount of funds from the statutory appropriation made in Chapter 757 that are likely to be available in 1994-95 to pay for the additional costs the DMH expects to incur for local programs in the budget year.

EMPLOYMENT DEVELOPMENT DEPARTMENT (5100)

The Employment Development Department (EDD) is responsible for administering the Employment Service (ES), the Unemployment Insurance (UI), and the Disability Insurance (DI) Programs. The ES Program (1) refers qualified applicants to potential employers; (2) places job-ready applicants in jobs; and (3) helps youth, welfare recipients, and economically disadvantaged persons find jobs or prepare themselves for employment by participating in employment and training programs.

In addition, the department collects taxes and pays benefits under the UI and DI Programs. The department collects from employers (1) their UI contributions, (2) the Employment Training Tax, and (3) employee contributions for DI. It also collects personal income tax withholdings. In addition, it pays UI and DI benefits to eligible claimants.

The budget proposes expenditures totaling \$6.3 billion from various funds for support of the EDD in 1994-95. This is a decrease of \$1.2 billion, or 16 percent, from estimated current-year expenditures. Of the total amount proposed, \$5.2 billion is for UI and DI benefits, and \$1.1 billion is for various other programs and administration. The budget proposes \$23.9 million from the General Fund in 1994-95, which is \$4 million, or 20 percent, above estimated current-year expenditures from this funding source. Of this increase, \$3.3 million is due to the expiration of one-time savings in the Job Agent Program reflected in the current year.

Disability Insurance Tax Rate Should Be Reduced

We recommend that the Legislature adopt Budget Bill language directing the EDD, subject to the approval of the Department of Finance, to reduce the disability insurance tax rate for 1995 by 0.1 percent because projected revenues exceed the amount needed for a prudent reserve.

State law requires private-sector employees to pay contributions to the Unemployment Compensation Disability Fund for support of disability insurance benefits made to disabled employees who experience a wage loss because of a nonoccupational illness, injury, or pregnancy. Eligible claimants receive weekly benefits of up to \$336 for a maximum of 52

weeks. A statutory formula establishes the employee contributions (tax rate), which apply to the first \$31,767 of annual earnings.

Because of concerns regarding the fund's solvency, the Legislature enacted Ch 793/91 (AB 2047, Margolin), which increased the statutory cap on the tax rate from 1.2 to 1.3 percent (the current rate). In addition, the administration used its statutory authority to decrease the maximum benefit amount from \$336 to \$266 per week from February through December of 1993.

Several steps have been taken to help stabilize the fund, including the enactment of Ch 748/93 (SB 4, Johnston), which makes various changes designed to reduce expenditures. The budget, moreover, proposes to expand efforts designed to reduce unwarranted benefit payments and eliminate fraud. The department believes that the combined effect of these changes will trigger a statutorily required decrease in the tax rate of 0.2 percent, beginning January 1995. The EDD, however, indicates that an *additional* 0.1 percent reduction in the rate would still provide sufficient revenues to maintain a prudent reserve. A reduction of this amount would result in cumulative savings of approximately \$238 million to workers making contributions to the fund in 1995, and a fund balance of \$1.3 billion, or 55 percent, of disbursements at the end of that calendar year. We note that a recent study on the fund's solvency affirmed an actuarial recommendation that the fund maintain a year-end reserve of no less than 25 percent.

We agree with the department that the tax rate could be reduced below the automatic adjustment that is triggered by the fund condition in 1995 while still maintaining sufficient reserves in the fund. Current law, moreover, authorizes the Director of the EDD to do so. Accordingly, we recommend that the Legislature adopt the following Budget Bill language in Item 5100-001-588 directing the EDD, subject to the approval of the Department of Finance, to reduce the disability insurance tax rate by the additional 0.1 percent (that is, to 1 percent) in 1995:

The Director of the EDD, subject to the approval of the Department of Finance, shall reduce the worker contribution rate for 1995 to 1 percent.

Administrative Staff Increase Not Justified

We recommend that the Legislature reject a proposed augmentation of \$395,000 in federal funds and 6.7 personnel-years in the Job Training Partnership Division (JTPD) because the need for these positions has not been demonstrated. We further recommend that the EDD report to the subcommittees, during hearings on the budget, on a plan to reallocate these funds to direct services. (Reduce Item 5100-001-869 by \$395,000.)

The 1993 Budget Act included an augmentation of \$844,000 in federal funds (11 personnel-years) for the JTPD for administrative oversight, reporting, evaluation, and policy development in 1993-94. The budget proposes an additional \$1.1 million in federal funds and 16 personnel-years in 1994-95 to establish a training unit, reorganize the program development section, and address increased administrative workload.

Our analysis indicates that the request for additional staff (6.7 personnel-years) for the program development section is not supportable on a workload basis. This section conducts administrative activities such as bill analysis, policy oversight, and data collection.

We base our conclusion on two findings. *First*, the proposal does not take into consideration the additional positions included in the 1993 Budget Act for these activities nor the program's base level of analytical staff available in the division. The current-year augmentation included five positions related to program development. *Second*, the proposal does not demonstrate a workload increase in 1994-95.

For these reasons, we recommend that the Legislature reject the proposed augmentation of \$395,000 in federal funds for the 6.7 personnel-years in the JTPD because the need for these new positions has not been demonstrated. We further recommend that the EDD report to the subcommittees, during hearings on the budget, on a plan to reallocate these funds to direct services rather than administration.

Technical Recommendation— Personal Services Are Overbudgeted

We recommend that \$989,000 be deleted from various funds because proposed new positions are overbudgeted. (Reduce Item 5100-001-184 by \$31,000, reduce Item 5100-001-588 by \$702,000, reduce Item 5100-001-869 by \$198,000, and reduce Item 5100-001-870 by \$58,000.)

State personnel policy requires departments to hire new employees by placing them at the minimum salary step of the appropriate classification. The budget, however, proposes numerous new positions in the Disability Insurance, Job Training Partnership Act, Employment Services, and Tax Collection programs at the maximum step of the salary range. Consequently, we recommend an adjustment to correct this overbudgeting, for a savings of \$31,000 to the Benefit Audit Fund, \$702,000 to the Unemployment Compensation Disability Fund, \$198,000 to the Consolidated Work Program Fund, and \$58,000 to the Unemployment Administration Fund.

DEPARTMENT OF SOCIAL SERVICES— STATE OPERATIONS (5180)

The Department of Social Services (DSS) administers income maintenance, food stamps, and social services programs. It is also responsible for (1) licensing and evaluating nonmedical community care facilities and (2) determining medical/vocational eligibility of persons applying for benefits under the Disability Insurance Program, Supplemental Security Income/State Supplementary Program (SSI/SSP), and Medi-Cal Program.

The budget proposes \$400 million from all funds (\$93.8 million from the General Fund) for DSS state operations in 1994-95. The amount proposed from the General Fund represents an increase of 6.7 percent over estimated current-year expenditures from this funding source.

Proposed Augmentation to Administer Welfare Reforms Not Fully Justified

We recommend deletion of three new positions requested to administer provisions of welfare reform legislation enacted in the current year, for a General Fund savings of \$109,000 in 1994-95, because the duties can be performed by contract services proposed for the department and by existing positions. (Reduce Item 5180-001-001 by \$109,000.)

The budget proposes \$2.6 million (\$1.3 million from the General Fund) for 22 limited-term positions and operating expenses, including contract services, to administer programs and activities established in the current year as a result of welfare reform provisions enacted in Ch 69/93 (SB 35, Senate Committee on Budget and Fiscal Review). Of the 22 positions, 9.5 five-year limited-term positions were established in the current year by Ch 1252/93 (SB 1078, Watson), and are proposed for continuation.

Review and Evaluation Bureau and Research Branch. The budget proposal includes three new positions for the department's Review and Evaluation Bureau and two new positions for the Planning and Research Branch. These positions would perform data collection and validation activities to assist in the evaluation of new programs and activities established by SB 35.

We recommend rejection of two of the positions proposed for the Review and Evaluation Bureau and one of the positions proposed for the Research Branch, for a General Fund savings of \$109,000 in 1994-95, because the duties associated with these positions can be performed by contract services to evaluate the new programs and by existing positions in the department. Specifically, we note the following:

- The budget proposes \$801,000 from all funds to contract for an evaluation of the new programs established by SB 35. Data collection and validation activities can be—and normally are—included as part of the requirements for these contract services.
- The Review and Evaluation Bureau and Planning and Research Branch have a combined staffing level of 72 budgeted positions, of which 62 are supervisory or analytical. Thus, the department should have the capacity to absorb any data collection and validation requirements that cannot be assumed under the evaluation contract and by the two new positions for which we recommend approval.

AID TO FAMILIES WITH DEPENDENT CHILDREN

The Aid to Families with Dependent Children (AFDC) Program provides cash grants to families and children whose incomes are not adequate to provide for their basic needs. Families are eligible for the AFDC-Family Group (AFDC-FG) Program if they have a child who is financially needy due to the death, incapacity, or continued absence of one or both parents. Families are eligible for grants under the AFDC-Unemployed Parent (AFDC-U) Program if they have a child who is financially needy due to the unemployment of one or both parents. Children are eligible for grants under the AFDC-Foster Care (AFDC-FC) Program if they are living with a foster care provider under a court order or a voluntary agreement between the child's parent and a county welfare or probation department.

The budget proposes expenditures of \$6.2 billion (\$1.3 billion General Fund, \$1.7 billion county funds, and \$3.2 billion federal funds) for the AFDC Program in 1994-95. This is a net decrease of \$635 million (\$1.9 billion General Fund), or 9.2 percent (59 percent General Fund), below estimated expenditures for the current year. This decrease is due to proposed grant reductions and to the Governor's state and county restructuring proposal.

Governor Proposes to Increase County Share of AFDC Program Costs

The Governor's restructuring proposal would increase the counties' share of the nonfederal cost of AFDC (FG&U) grant payments from 5 percent to 50 percent and increase the counties' share of AFDC-Foster Care payments from 60 percent to 100 percent. We discuss the proposal in detail in our companion volume, *The 1994-95 Budget: Perspectives and Issues*. In this report, we agree that counties should assume full programmatic and financial responsibility for the Foster Care Program; but instead of increasing the county share of cost for the AFDC (FG&U) Program, we suggest using a more focused approach that relies on a system of incentives and sanctions to encourage counties to get AFDC recipients off of aid.

CURRENT-YEAR STATUTORY CHANGES IN AFDC PROGRAM

Maximum Aid Payments (MAPs) Reduced by 2.7 Percent. Chapter 69, Statutes of 1993 (SB 35, Senate Committee on Budget and Fiscal Review), reduced the MAPs by 2.7 percent, effective September 1, 1993. Thus, a family of three with no other income experienced an AFDC grant reduction of \$17 per month. This family was eligible for an additional food stamps allotment of about \$5. Therefore, the net reduction in monthly benefits, including food stamps, was about \$12.

Cal Learn Program. Chapter 69 established the Cal Learn Program for parents under age 19 who receive AFDC and have not completed high school. The program provides intensive case management, supportive services such as child care and transportation, and fiscal incentives to stay in school. If these parents remain in school and maintain satisfactory progress, they receive a \$100 bonus per report card period, and a \$500 bonus upon graduation. However, participants not making satisfactory progress are subject to a sanction of \$100 per report card period.

The budget proposes expenditures of \$57 million (\$27 million General Fund) for the program in 1994-95. This is an increase of \$45 million (\$21 million General Fund), or 375 percent above estimated current-year expenditures. The current-year expenditures reflect a February 1, 1994 implementation date; therefore, a large part of the budget-year increase reflects the full-year effect of the program.

Under the Governor's restructuring proposal, the bonuses and sanctions and administrative costs of the Cal Learn Program would be realigned—the state and county would each have 50 percent of the nonfederal share of cost; however, there would be no county share of cost for the intensive case management and child care components of the program.

Earned Income Disregard. The 1993 Budget Act provided funding to implement a federal waiver to eliminate time limits on the "\$30 and one-third disregard" of earnings. This is intended to encourage AFDC recipients to work, by allowing recipients to retain, for an indefinite period, the first \$30 of their monthly earnings plus one-third of the remaining earnings without a reduction in their grant. Previously, the "one-third disregard" applied only to the first 4 months of earnings and the "\$30 disregard" only to the first 12 months.

Supplemental Child Care. The 1993 Budget Act also provided funding to cover a working recipient's child care costs up to the 75th percentile of the local market. Under prior law, the monthly child care allowance was

limited to \$175 per child two years of age and over, and \$200 per child under two years.

Other Work Support Measures. Chapter 69 included several other changes in AFDC eligibility requirements designed to encourage AFDC recipients to work. The resource (assets) limit for recipients was increased from \$1,000 to \$2,000, the automobile equity limit was increased from \$1,500 to \$4,500, and a new provision was implemented to permit a recipient to have a restricted savings account of up to \$5,000 to apply toward a child's college education or training, a down payment on a home, or starting a business.

GOVERNOR'S 1994-95 WELFARE PROPOSALS

The Governor proposes legislation to make several changes that would reduce grants in the AFDC Program, for a net General Fund savings of \$460 million in 1994-95. Most of these savings would result from a 10 percent across-the-board reduction and a 15 percent reduction after six months on aid. We review the Governor's proposals and comment on them.

The Governor's Budget proposes several major changes that would reduce grants in the AFDC Program. As Figure 18 shows, these changes would result in an estimated General Fund savings of \$460 million in AFDC grants and administration in 1994-95.

Figure 18

Governor's AFDC Grant Proposals General Fund Budget Summary 1994-95

(In Millions)

Proposal	Grants	Administration
10 percent MAP reduction	-\$281.7	—
15 percent additional MAP reduction	-157.0	\$6.8
Exclusion from MAP of children conceived while on aid	-5.6	0.2
Elimination of pregnancy-related benefits	-20.9	-2.3
Totals	-\$465.2	\$4.8

Budget Proposes AFDC Maximum Aid Payment Reductions

The budget contains five separate proposals that would have the effect of reducing AFDC grants below the levels required by current law. These are (1) a 10 percent reduction in the MAP for all AFDC recipients, effective July 1, 1994, (2) an additional 15 percent MAP reduction for AFDC recipients (with some exceptions) who have been on aid for more than six months, (3) a prohibition of MAP increases for children conceived while the parent is on aid, (4) a limit on AFDC pregnancy-related benefits, and (5) a two-year limit on AFDC eligibility for able-bodied adults.

Budget Proposes to Reduce MAPs by 10 Percent. The budget proposes legislation to reduce the MAPs by 2.3 percent for all recipients, for a savings of \$132 million (\$63 million General Fund) in 1994-95. This reduction could occur under existing federal waiver authority. The budget also proposes legislation for an additional 7.7 percent reduction of the MAPs, for a savings of \$456 million (\$218 million General Fund) in 1994-95. This reduction would require a federal waiver. The combined reduction of 10 percent would be effective July 1, 1994.

The 10 percent reduction would reduce monthly grants by \$61 for a family of three. These grant reductions would be partially offset by an increase in food stamps. Because the Governor's proposals affect only the *maximum* aid payment, recipients who have grants below the maximum—due to employment earnings, for example—would experience no grant reduction or only a partial reduction.

Proposal to Reduce MAP by 15 Percent After Six Months. The budget proposes legislation to reduce the MAP by an additional 15 percent for AFDC recipients (with some exceptions) after they have been on aid for six months, for a net savings of \$308 million (\$150 million General Fund) in 1994-95. This would require a federal waiver.

The *additional* 15 percent reduction would occur after a family (1) has been on assistance for more than 6 months or (2) went off aid after 6 months and returned to the program within 24 months. This reduction would not occur if all parents or caretaker relatives in the home are age 60 or over, disabled (receiving SSI/SSP or In-Home Supportive Services), pregnant, the caretaker is a non-needy relative, or all parents in the family (assistance unit) are under age 19 and attending high school or other equivalent schooling.

Proposal to Exclude From the MAP any Children Conceived While on Aid. The budget proposes legislation to exclude, for purposes of

determining a family's MAP, any children who are conceived while the family is on AFDC. Such children would continue to be excluded if the family leaves and returns to the program, unless the absence was for at least 24 consecutive months. Children excluded for purposes of determining the MAP would be eligible for both Medi-Cal benefits and food stamps. This proposal would require a federal waiver.

The administration estimates that this proposal would result in net savings of \$11 million (\$5.4 million General Fund) in 1994-95. Savings for 1994-95 reflect two months of caseload impact. Savings would increase significantly annually thereafter, amounting to several hundred million dollars in ten years.

Proposal to Limit Pregnancy-Related Benefits. The budget proposes legislation to limit pregnancy-related AFDC benefits, for a savings of \$34 million (\$23 million General Fund) in 1994-95. Specifically, the budget proposes to end the following benefits:

- **State-Only AFDC Program.** Under current law, the state operates a state-only (no federal financial participation) AFDC Program, whereby grants are provided to pregnant women without other children during the first six months of pregnancy.
- **\$70 Monthly Special Needs Payment.** Current law also provides for a \$70 monthly special needs payment to *all* pregnant women who are receiving AFDC.

Under the budget proposal, the state would continue to participate in the federally assisted AFDC Program for pregnant women who are in their last three months of pregnancy (and for the month in which their baby is born).

Limiting the pregnancy benefits to the last three months of pregnancy would cause about 3,000 women (those with no other children) to lose their AFDC benefits. These women could apply for general assistance in the counties where they reside. Thus, the elimination of these programs would, in effect, transfer responsibility for many pregnant women to the counties. These women would, however, be eligible both for pregnancy-related medical benefits under Medi-Cal and for food stamps.

Teen Parent's Residence. The budget anticipates legislation to require parents under age 18 who receive AFDC to live in the home of their parent, legal guardian, adult relative, or in certain other living arrangements in order to receive aid. The proposal includes exceptions under which the teen could maintain a separate residence. This program requirement is optional under the federal Family Support Act of 1988 and

would not require any federal approval other than acceptance of an amended state plan.

The budget does not reflect any savings from this proposal; however, to the extent that the teen parents stay with certain adults, such as parents or stepparents, part of the adult's income could be used to offset the teen parent's AFDC grant. This would result in unknown General Fund savings, probably less than \$500,000.

Proposal to Limit Eligibility to Two Years. The budget proposes legislation to limit the AFDC eligibility of able-bodied adults to two years, effective July 1, 1996. This would require a federal waiver. The proposal would also give priority to individuals affected by the time limit for services in the Greater Avenues for Independence (GAIN) Program.

Under the proposal, able-bodied adults on aid for more than two years would be removed from the family unit for purposes of calculating the AFDC grant. Their children would continue to be eligible to receive aid. However, these adults would still be eligible for Medi-Cal and food stamps. Participants in the GAIN Program subject to the two-year limit would also have their grants reduced but would be able to complete the program. The Department of Social Services (DSS) indicates that adults affected by the time limit could become eligible for AFDC after 24 months. We estimate that this proposal would result in annual General Fund savings of approximately \$300 million in AFDC grants, beginning in 1996-97.

The DSS estimates that 479,000 AFDC recipients will be subject to the two-year limit upon implementation of the proposal. Some of these have previously been served by GAIN; others are currently being served by GAIN or are not in need of GAIN services because they are currently employed; and some recipients are expected to refuse GAIN services. The department estimates that after excluding these persons, 272,000 recipients will need GAIN services prior to June 30, 1996. To facilitate this, the budget proposes to reappropriate unspent GAIN Program funds in 1993-94 to be available during 1994-95. In addition, the budget proposes an augmentation of the GAIN Program of \$2.7 million from all funds in 1994-95. Finally, the budget proposes performance incentives designed to increase the effectiveness of the GAIN Program.

Figure 19 summarizes the effect of the Governor's proposals on monthly grants for a family of three persons in the AFDC-Family Group Program. As the figure shows, the impact of the two-year limit would be mitigated, to some degree, by provisions of current law that restore grant reductions made in 1992-93 and provide a cost-of-living adjustment for grants, effective July 1, 1996. Taking these actions into account, the net

effect of all of the Governor's proposals on a three-person family subject to the two-year limit would be a reduction of \$197, or 32 percent, from current monthly grant levels. This reduction would be partially offset by an increase of \$59 in food stamps.

Figure 19

**AFDC Maximum Grant and Food Stamps
Family of Three^a
Current Law and Governor's Proposals**

	Maximum Grant	Food Stamps	Total	Change From Current Law
Current law	\$607	\$214	\$821	—
10 percent reduction	546	232	784	-\$37
15 percent/six months	464	257	721	-100
Two-year time limit (1996-97):				
Current law grant increases ^b	(507)	(244)	(751)	—
Proposed grant reductions ^c	410	273	683	-138

^a Assumes an AFDC-Family Group case.

^b Current law provides for restoration of 1992-93 AFDC grant reductions and resumption of annual cost-of-living-adjustments (COLAs) effective July 1, 1996. Figure assumes an estimated 3.5 percent COLA.

^c Assumes current law restoration of grants, as indicated in preceding note. Without these restorations, the two-year reduction would bring the monthly grant to \$375.

Evaluating the Proposals to Reduce AFDC Grants

In presenting his proposals, the Governor has offered several reasons why these changes are needed, including (1) the need to promote personal responsibility, (2) the need to reinforce the premise that AFDC is a temporary program, and (3) the need to make work an attractive alternative to AFDC. These are reasonable premises; but in evaluating the proposals, the Legislature needs to weigh the identified budgetary savings to government against its policy objectives for the AFDC Program and the potential impact of the proposed changes on needy families.

Impact of the Grant Reductions

Fiscal Impact on Government. The budget estimates that the proposed reforms will result in significant savings to the federal, state, and county levels of government. Net General Fund savings are estimated to be \$460 million in 1994-95. These savings would increase in subsequent years, due primarily to the two-year limit and the provision prohibiting increases in the MAP for children conceived while a family is on aid. The savings would be offset, by an unknown amount, to the extent that the

reductions in the MAPs and pregnancy benefits lead to a reduction in family incomes, which, in turn, leads to an increase in the use of other public services such as health and foster care.

Impact on Families. The grant reductions proposed by the Governor would reduce the resources available to many families. Figure 19 shows how the proposals could affect a family of three—the most common family size. We note that under current law, the combined maximum monthly grant and food stamps benefit (\$821) is equal to about 80 percent of the poverty guideline. Those subject to *both* the 10 percent and additional 15 percent reductions would have their resources reduced to \$721, or about 70 percent of the guideline if they do not have other income. Those subject to the two-year limit would have their resources reduced to \$683 if they do not have other income.

Increasing the Percentage of Recipients Who Work

The impact of the Governor's proposals will depend largely on the degree to which they result in an increase in the percentage of recipients who are employed, thereby avoiding the financial loss that would result from reductions in the MAPs.

Increasing the Work Incentive. In our 1991-92 *Perspectives and Issues* report on the AFDC Program, we concluded that the program, as structured at the time, offered relatively little financial incentive to work. There were two main sources of the work disincentives: (1) the grant levels when combined with food stamps often were higher than what could be earned by recipients through low-wage employment and (2) program rules allowed working recipients to retain, at best, only a small part of each increment of income. In addition, persons who worked were likely to weigh the possible loss of Medi-Cal benefits (after a transition period) if they lost AFDC eligibility. Since then, the combination of grant reductions, rule changes, and an increase in the earned income tax credit have, to some extent, mitigated these problems; and the additional grant reductions proposed by the Governor would further increase the financial incentive to work.

It is impossible to predict with accuracy, however, the degree to which these proposals will induce more AFDC recipients to work. Those nonworking recipients who do not compensate for the MAP reductions through an increase in earnings will suffer a reduction in their standard of living, which will be significant recognizing that these families' incomes are currently below the federal poverty guidelines. It is therefore important, in assessing the budget proposal, to consider whether the reforms are based on reasonable *expectations* that AFDC recipients can

obtain employment given their education levels and employment experience, if combined with limited job opportunities.

Are AFDC Recipients Work-Ready?

In spite of the increased work incentives provided under the Governor's proposals, it may be difficult for AFDC recipients to obtain employment due to factors such as lack of training, low education levels and work experience, and the effect of the economy on job availability.

Lack of employment-related skills, including low educational attainment, is often cited as a major impediment to AFDC recipients returning to the labor force. Some studies show that low educational attainment is associated with a higher probability of staying longer on assistance.

The GAIN Program is California's primary employment training program for AFDC recipients. It is a more complex program and is more expensive per participant than most previous programs. The program, however, is not funded at a level sufficient to accommodate all "mandatory" and voluntary participants.

The GAIN Program is currently being evaluated by an independent consulting firm. The final report is due this spring. (We discuss the GAIN Program and the evaluation later in this analysis.)

The downturn in the state's economy presents a significant challenge to existing and potential AFDC job seekers. We estimate that total nonagricultural employment will *decrease* in 1994 and will remain virtually unchanged in 1995. These projections suggest that AFDC job seekers are likely to be faced with significant competition from currently unemployed people and other new job seekers, at least in the near term.

In summary, the relatively low level of education and employment experience of the typical AFDC parent, combined with limited job opportunities, suggests that it may not be possible for all nonworking AFDC household heads to fully compensate for the proposed MAP reductions by obtaining a job.

Comments on Time-Limited Aid Proposal

The Governor's proposed two-year time limit on AFDC would not eliminate a family's eligibility for aid but, in conjunction with his other proposed changes, would reduce grants substantially for those affected. We discuss some of the advantages and disadvantages of the proposal.

The Governor's proposal for two-year time-limited aid is essentially an extension of his proposal to reduce grants by 15 percent for families who have an able-bodied adult and have been on aid for more than six months. In other words, the grant would be reduced, not eliminated altogether; and the reduction would be partially offset by an increase in food stamps. If implemented in conjunction with the proposed 10 percent and 15 percent grant reductions, it would result in a substantial loss of available income to recipients, unless offset by employment earnings. Because of this, the proposal would increase the financial incentive for recipients to work.

Underlying the concept of time-limited aid proposals is the premise that, after a certain period of time, able-bodied AFDC adults should be able to find employment and earn enough to offset any grant reduction that would be imposed or, ideally, to become self-sufficient. In this respect, it is appropriate to ensure that if such a proposal were to be implemented, recipients are given the opportunity to participate in, and complete, the GAIN Program, as the Governor proposes. This still leaves several questions unanswered, however:

- ***Will sufficient funding be made available for the GAIN Program?*** The DSS estimates that the amount proposed for the program in 1994-95, if continued at that level in 1995-96, will be sufficient to accommodate all those who subsequently would be affected by the two-year limit and who desire GAIN services. The department has not provided detail on all of its assumptions underlying this estimate.
 - ***Will employment be available for those who seek it?*** This depends, in part, on the state of the economy. The Governor's proposal does not make provision for alternatives—such as placement in community service jobs—for those unable to find employment through normal channels, although such a feature might be included in welfare reform legislation at the federal level. Recently, the President indicated that he would submit proposed legislation to Congress that would include a two-year time limit on AFDC eligibility. While details have not been provided, the administration has suggested that the proposal could include provision for community service jobs for those unable to find employment through other means.
 - ***What will be the impact on families who do not compensate for grant reductions with additional income from other sources?*** The department, for example, estimates that 29,000 persons subject to the two-year limit will refuse GAIN services, based on the number who choose to take the existing sanctions (grant reductions) in the
-

program because of refusal to participate. In addition, the current GAIN evaluation indicates that 50 percent of the persons who participated in the program did not obtain employment within the two-year time frame studied.

GAIN PROGRAM

State Will Not Reach Federal Participation Target in GAIN Program

The state will lose \$23 million in federal funds for the GAIN Program in 1994-95 because it will fall short of the requirement that at least 40 percent of AFDC-U (Unemployed Parent) adult recipients participate in specified GAIN activities. We find that this federal target acts as a disincentive for states to allocate their GAIN resources in the most effective manner.

In order to receive "enhanced" federal funding for the GAIN Program (60 to 90 percent instead of the regular 50 percent match), federal law requires that at least 40 percent of AFDC-U (Unemployed Parent) adult recipients participate in *specified* GAIN activities for at least 16 hours per week. This requirement increases to 50 percent in federal fiscal year 1995 (October 1994 to September 1995) and to 75 percent by federal fiscal year 1997.

According to the DSS, California will fall considerably short of this requirement in 1994-95. The department estimates that less than 24 percent of AFDC-U adults participate in the required program activities. As a result, the state will lose \$23 million in federal funds, effective October 1994. Federal law also includes a participation requirement that applies to AFDC cases in general, which the state probably will satisfy in 1994-95.

It is not clear why federal law imposes a participation requirement specifically for AFDC-U recipients. Such a requirement has the effect of encouraging states to place a higher emphasis on enrolling AFDC-U recipients in the GAIN Program than on AFDC-FG recipients. In doing so, states would be allocating their GAIN resources in a manner that is unlikely to give priority to recipients who are most in need of these services to obtain employment. This is because AFDC-U cases consist of two-parent families with an adult that has work experience; whereas AFDC-FG cases are single-parent (or child-only) cases, in which the parent usually has little or no work experience.

In our judgment, therefore, the federal requirement acts as a *disincentive* for states to allocate their GAIN resources in the most effective manner.

Budget Overestimates Savings From GAIN-Related “Reduced Dependency”

We estimate that the budget overstates by \$2 million the General Fund savings that would result from “reduced dependency” on AFDC due to increased participation in the GAIN Program.

The budget estimates that, because of participation in the GAIN Program, General Fund spending for AFDC grants will be \$8.2 million less than what would otherwise occur in 1994-95. This estimate of “reduced dependency savings,” however, does not account for the reduction in GAIN participation that is expected to result from the loss of federal “enhanced” funding, as discussed above. We estimate that this factor will reduce the budgeted savings by \$2 million.

Budget Proposes Performance Incentives in the GAIN Program

The budget proposes a statewide demonstration project that would provide a fiscal incentive to any county that (1) operates its GAIN Program at a high level of performance or (2) improves its performance, as measured by increased AFDC grant savings. The fiscal incentive to the county would represent 50 percent of the state savings resulting directly from the county's improved performance.

Performance would be measured in terms of a cost/benefit ratio based on the county's GAIN expenditures and AFDC grant savings. To qualify for a fiscal incentive on the basis of high performance, a county would have to exceed a statewide standard. Counties below the statewide standard could also qualify for the incentive by improving their cost/benefit ratio by a specified amount each year. The statewide performance standard would be one dollar of AFDC savings for every dollar of GAIN expenditure. We believe that this proposal has merit.

New Targeting Strategies Needed for the GAIN Program

We recommend that the Legislature (1) enact legislation to add to the list of GAIN Program target groups AFDC parents who have never been married and (2) direct the DSS to seek a federal waiver to count these program participants as a federal target group. We further recommend legislation, pending federal approval, to add to the list of mandatory GAIN participants AFDC parents whose youngest child is one or two years of age and who have never been married.

Studies have shown that families that remain on AFDC for long periods of time represent a minority of recipients but account for a majority of the program costs. It has been estimated, for example, that those on aid for ten years or more represent about 25 percent of all recipients but account for 60 percent of program expenditures.

In order to significantly reduce the public costs of the AFDC Program, therefore, it is important to reduce the incidence of long-term dependence. In recognition of this, the GAIN Program includes as one of its target groups—that is, groups to receive services if resources are inadequate to serve all eligible persons—those persons who have been on assistance for three or more years. The state target groups parallel federal legislation, which provides fiscal incentives to states that spend at least 55 percent of their program funds on specified groups.

Targeting. The use of targeting can be a cost-effective strategy, particularly in the GAIN Program where resources are not sufficient to fund all eligible persons. Giving priority to those on aid for three years or more is based on data indicating that these families are much more likely to remain on aid for very long periods than are new applicants. It also helps to ensure that program resources are not allocated for those recipients who do not need them—for example, those who will find employment and go off assistance shortly after applying for aid, without the use of the services provided by the program.

We believe that it is likely, however, that programs, such as GAIN, that are designed to reduce welfare dependence will be more effective if their services are provided at an early stage. In other words, the state should provide the services within a few months of initial receipt of aid to those applicants who, absent such services, will remain on aid for a long period of time.

One problem in adopting such an approach is the difficulty of predicting who will remain on aid for long periods. While there is no way to predict with certainty whether a particular applicant falls into this category, we note that there is research indicating that certain demographic characteristics can be used to identify groups that will have a large proportion of long-term recipients. One of the most comprehensive studies conducted to date found that 39 percent of AFDC recipients who had never been married (as distinguished from those who were separated or divorced) remained on aid for *ten or more years*. Of all the variables tested, “never been married” was by far the best predictor of long-term welfare receipt.

We believe that this finding can serve as a useful means for targeting the use of resources designed to reduce dependence and the public cost of welfare. Accordingly, we recommend legislation to add to the list of GAIN target groups AFDC parents who have never been married. In order to ensure that this will not jeopardize the receipt of federal funds, we further recommend that the DSS seek a federal waiver enabling the state to count these program participants as a federal target group or, alternatively, to hold the state harmless for purposes of meeting target group participation standards.

Mandatory Participants. Under the GAIN Program, AFDC recipients with children under three years of age are not required to participate in the program. Federal law, however, permits states to require the participation in GAIN of parents whose youngest child is one or two years of age. Given the GAIN Program's provisions for child care, we believe that it would be reasonable to expect recipients with children aged one or more to participate in this program. We also note that in the aforementioned study, 32 percent of recipients whose youngest child was under three years of age when applying for AFDC remained on aid for nine years or more.

As discussed above, the other findings in this research can provide a useful way—specifically, focusing on “never married” persons—to expand the number of “mandatory” GAIN participants so as to target resources to those who have the greatest risk of long-term dependence. Accordingly, we recommend that the Legislature direct the DSS to apply for a federal waiver to expand the group designated as mandatory GAIN participants by including AFDC recipients whose youngest child is one or two years of age, but only for those parents who have never been married. We believe that this will have the effect of targeting GAIN resources in the most cost-effective manner.

Fiscal Impact. These recommendations, if adopted, could result in a reallocation of GAIN funds rather than additional costs. In the long run, the fiscal effect will depend on the cost-effectiveness of the targeting strategies. If federal waivers are contingent on an evaluation of the new approach, the evaluation would have to be funded either by redirection of GAIN funds or by an additional appropriation.

Final Report of GAIN Evaluation Due in the Spring

The two-year interim evaluation of the GAIN Program showed that the program had an effect—particularly large in one county—in increasing participants' earnings and reducing AFDC grant expenditures. The final report is due in May 1994.

Two-Year Follow-up Findings. The Manpower Demonstration Research Corporation (MDRC) is evaluating the GAIN Program in six counties in California. MDRC's two-year interim report indicates that for AFDC-FG recipients (the largest category of recipients), the program increased average earnings by 21 percent, compared to the control group, and reduced AFDC grant expenditures by 6 percent more than the comparison group. Some counties—notably Riverside—showed substantially larger earnings gains and welfare savings. The Riverside approach tends to place more emphasis on immediate job placement than on skill-building through education and training.

The final MDRC report on the program's impact over a three-year follow-up period should be available in May 1994. This report will include data on program costs as well as savings, and will therefore provide an indication of the cost-effectiveness of the program.

Evaluation of GAIN's Basic Education Component. The MDRC recently completed a five-county interim study on the effects of the GAIN Program's basic education component. Basic education is instruction—usually provided by public school adult education programs and community colleges—in the basic skills of reading, writing, and mathematics. The study found that the basic education component of GAIN produced no statistically significant increase in basic skills, except in San Diego County.

San Diego County's performance suggests that program structure may make a difference. The county applied an alternative approach to providing adult basic education. The curriculum was designed specifically for GAIN participants and combined computer-assisted learning with lessons tailored to everyday life such as household budgets, job applications, and resume writing.

These results suggest that the San Diego approach could serve as a model for GAIN's basic education component. The MDRC, however, cautions that because of the small sample size, using the study as the basis for widespread replication would not be warranted.

CHILD SUPPORT ENFORCEMENT PROGRAM

Child Support Pilot Project Likely to Result in Additional Savings

We recommend that the department report during the budget hearings on the anticipated increase in child support collections from the Franchise Tax Board (FTB) child support pilot project and the estimated General Fund savings from these collections in the budget year.

Child support enforcement services are provided by county district attorneys to all persons who request such assistance. Collections made on behalf of AFDC recipients offset AFDC grant expenditures and therefore result in state savings, after accounting for \$50 monthly payments to the recipient and state incentive payments to the counties.

Chapter 1223, Statutes of 1992 (AB 3589, Speier), established a pilot project in which six counties forward delinquent child support cases to the FTB to attempt to recover these obligations. After conducting a test of the procedures, the FTB began full implementation in December 1993.

The FTB initially projected that collections will amount to \$13.9 million from AFDC and non-AFDC cases in 1994-95. We estimate that this level of collections would result in \$1.5 million in grant savings to the state, offset by \$700,000 in state incentive payments to the counties and the FTB, for a net General Fund savings of \$800,000 in 1994-95. The FTB, however, indicates that because of the limited data on actual collections, the board will not be able to provide a firm estimate of budget-year results until February or March of 1994.

The budget does not reflect any impact on collections from the pilot project in 1994-95. In order to account for the anticipated fiscal effects, therefore, we recommend that the department, after consulting with the FTB, report during the budget hearings on the estimated collections and resulting General Fund savings in 1994-95.

REVIEW OF THE TRANSITIONAL CHILD CARE (TCC) PROGRAM

TCC Program Funding Methodology Should Be Changed

We recommend that the Legislature adopt Budget Bill language to (1) require counties to spend a specified portion of their TCC Program administrative funds on outreach efforts and (2) revise the methodology for allocating administrative funds to counties so that the allocations are based primarily on factors related to service demand—specifically, the number of TCC eligibles and the number of program participants.

Chapter 36, Statutes of 1990 (AB 1706, Bates), requires the Legislative Analyst's Office to review the TCC Program. The purpose of the review is to assess the implementation of the TCC Program, to determine its effectiveness in enabling welfare recipients to successfully remain off of AFDC, and to recommend policy and program changes regarding the program.

Background. Federal law authorizes states to implement a TCC Program that provides subsidized child care for a maximum of 12 months after the family no longer receives AFDC. A primary goal of the program is to remove child care costs as a barrier to employment for former AFDC recipients as they transition into self-sufficiency. To be eligible for TCC, a recipient must have received aid for three of the six months before becoming ineligible for AFDC due to increased income from employment or because of increased hours of work. The 1994-95 Governor's Budget proposes \$2.7 million for TCC Program administration and \$9.3 million for TCC benefits.

Families qualifying for TCC must contribute a share of the cost of their child care determined by a fee schedule and ability to pay. The remainder of the program cost is paid by the federal government (50 percent) and the state (50 percent).

County welfare departments provide informational materials regarding the TCC Program to applicants for AFDC, and to grant recipients at annual renewal and at the time of termination from AFDC. State law also expresses legislative intent that AFDC recipients receive TCC Program information at any other time that will effectively help families in planning their child care needs.

Program Effectiveness. Data are not sufficient to allow us to measure the effectiveness of the TCC Program on AFDC recipients' decisions to leave aid or the ability of the program to further self-sufficiency among TCC participants who have left aid. An evaluation of the TCC Program's effectiveness would typically require a control group and an experimental group. The control group would include TCC-eligible persons who were denied benefits for purposes of the evaluation, while the experimental group would receive TCC Program services. Differences in outcomes—such as use of child care, AFDC discontinuations due to employment, earnings levels, and AFDC recidivism—could then be measured to determine program effectiveness. Because the TCC Program is a federal entitlement program, however, the state is unable to deny these benefits to eligible persons, thereby precluding the use of such a methodology without a federal waiver.

We note that the DSS intends to expand an evaluation on welfare reform currently in progress to include questions relating to TCC underutilization by gathering data from apparently eligible persons who did not apply for TCC. Results of that study should be available in one year.

Program Implementation. In spite of the limitation on available data, we can draw some conclusions regarding the program. TCC usage has been significantly lower than anticipated at the outset of the program, due to the difficulty of projecting usage in a new program. For example, the 1991-92 Governor's Budget proposed \$52 million for the TCC Program during its first full year of operation. However, actual program expenditures, including administrative costs, totaled \$8.6 million. In 1992-93, TCC Program expenditures totaled \$10.1 million, or an increase of 17 percent

over prior-year expenditures. Estimated spending in 1993-94 is \$11.4 million, which represents a 13 percent increase.

Program Characteristics Data. Chapter 36 also required the DSS to submit specified information to the Legislative Analyst's Office to assist in our evaluation of the program. The following is a summary of the data gathered by the department from a random sample of 426 cases in November 1990.

- Median length of time on AFDC since last application: 18 months.
- Average months from discontinuance to application for TCC: 1.1 month.
- Average monthly earnings: \$1,333.
- Average monthly child care cost per case: \$358.
- Average monthly family fee per case: \$40.

The department reported the following additional information gathered from a survey of the same cases one year later:

- Average number of months TCC benefits received: 10.
- Percent reapplied for AFDC: 21.
- Percent terminated from TCC because 12-month eligibility expired: 80.

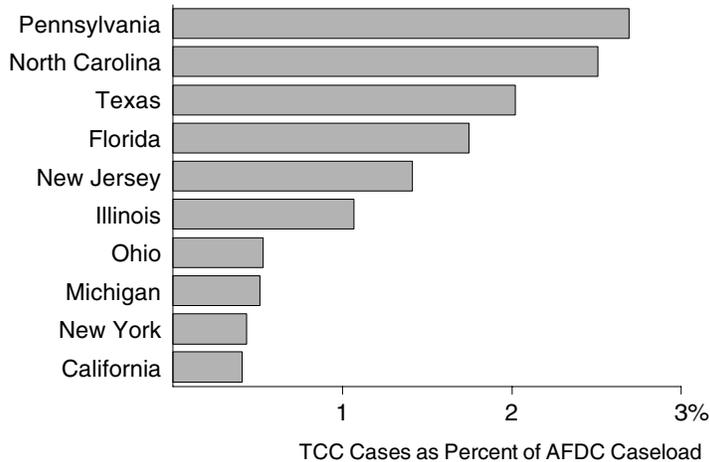
The DSS intends to perform an additional follow-up of the same recipients within the next year.

Program Participation. The best measure of program participation is the percentage of eligible persons who use TCC. Unfortunately, data on the number of eligible persons are not available. We can, however, use proxy measures—AFDC caseloads and AFDC terminations due to employment and certain other factors.

In reviewing TCC cases as a percentage of AFDC caseloads, we find that California ranked the lowest among the ten largest states in program participation in federal fiscal year 1992 (Figure 20). The General Accounting Office (GAO) also examined the TCC Program, using April 1990 through June 1991 data. Based on limited data from 20 states, the GAO reported that the percentage of eligible families receiving TCC assistance ranged from 2 to 66 percent. California's utilization rate was estimated to be 7 percent. The relatively low utilization rate in California may have been due partly to the fact that initially, the written materials prepared by the DSS and the counties were not developed in the language of all the eligible users.

Figure 20

**TCC Program Usage Lowest in California
Ten Largest States
Federal Fiscal Year 1992**



When comparing usage rates among the counties, we found significant differences as measured by the number of TCC cases per termination due to employment and other factors. As shown in Figure 21, the number of TCC cases per termination ranged from zero in Alpine County and Sierra County to 56 percent in Mendocino County. In our review, we identified two reasons that could explain this variation:

- Higher-usage counties generally went beyond the minimum notification requirements to inform potential eligibles about the program.
- Higher-usage counties tended to allocate more of their resources for administration of the program.

We found that most of the high-usage counties devoted specific time to TCC Program awareness and outreach efforts during AFDC application, at redetermination, in the GAIN Program, and with child care providers. In addition, some counties dedicated specific positions to manage all of the TCC cases. These TCC workers had reduced intake/eligibility workloads and combined the TCC Program responsibilities with other transitional programs such as transitional Medi-Cal and the at-risk child care programs to personalize the service to clients and provide a coordinated delivery of services during a client's transition to self-sufficiency.

Figure 21

**Transitional Child Care (TCC) Program Participation Rate
TCC Cases per AFDC Case Terminations^a
1992-93**

Mendocino	55.9%	Del Norte	12.7%
Amador	53.3	Glenn	12.3
Ventura	47.7	Monterey	12.0
Marin	44.1	Alameda	11.0
Yuba	38.7	Santa Clara	10.9
San Joaquin	35.1	Nevada	10.9
San Francisco	34.0	Santa Barbara	10.7
Butte	32.3	Shasta	10.6
San Mateo	32.0	Contra Costa	10.5
Santa Cruz	25.5	Madera	10.3
Sutter	25.1	Calveras	9.2
Tuolumne	23.8	Mariposa	8.2
Placer	23.6	Los Angeles	7.9
Inyo	21.4	San Luis Obispo	7.8
Modoc	19.6	San Bernardino	7.6
Sacramento	18.8	Colusa	7.5
El Dorado	18.8	Solano	5.7
Tehama	18.7	Kings	5.6
Yolo	18.2	Trinity	5.6
Siskiyou	18.1	Riverside	4.8
Humboldt	17.4	Mono	4.3
Sonoma	16.7	Orange	4.0
Lake	15.4	Imperial	2.3
Napa	15.1	Lassen	2.1
San Benito	15.0	Fresno	1.9
Plumas	14.4	Tulare	1.7
Kern	13.5	Merced	0.5
Stanislaus	12.7	Alpine	—
San Diego	12.7	Sierra	—

^a Terminations due to employment and certain other factors..

Based on 1992-93 data from the 15 largest counties, we also generally found a strong relationship between TCC usage rates and administrative spending in the program, as reflected in Figure 22. Thus, it appears that administrative spending makes a difference in TCC program usage. Allocations for administrative costs are currently based on each county's past year TCC caseload and administrative expenditures as a percentage of statewide totals. We believe that this methodology does not adequately measure the need for funds to administer the program because it does not take into account the workload for activities such as outreach. The allocation methodology should be based on measures of potential service demand. Thus, it would be preferable, for example, to incorporate a factor to measure the number of TCC eligibles.

Figure 22

**Transitional Child Care (TCC) Program
Administrative Spending and Program Usage
Among the 15 Largest Counties
1992-93**

County	Spending per Potential Case	TCC Participation Rate
Ventura	\$18.0	47.7%
San Joaquin	13.2	35.1
San Francisco	5.8	34.0
San Mateo	20.9	32.0
Sacramento	8.1	18.8
Kern	11.0	14.4
San Diego	9.0	12.7
Alameda	2.6	11.0
Santa Clara	8.3	10.9
Contra Costa	8.8	10.5
Los Angeles	6.9	7.9
San Bernardino	3.9	7.6
Riverside	3.6	4.8
Orange	3.0	4.0
Fresno	1.1	1.9

Analyst Recommendations. While data are not available to evaluate the effectiveness of the TCC Program, we can offer recommendations to enhance program participation and allocate administrative funds in a more equitable manner.

We recommend that (1) counties be required to spend a specified portion of their administrative allocation on outreach efforts based on the percentage spent by those counties which have served a high proportion of eligible persons and (2) the methodology for allocating administrative funds to the counties be based primarily on the factors related to potential service demand—specifically, the number of TCC eligibles and the number of program participants. This is designed to increase awareness

and usage of the program and distribute program allocations to counties in closer relation to the need for these funds.

To accomplish this, we recommend adoption of the following Budget Bill language for Item 5180-141-001:

1. Counties shall spend a specified portion, as determined by the department, of their Transitional Child Care (TCC) Program administrative allocation on outreach efforts.
2. The department shall allocate administrative funds in the TCC Program to counties based primarily on factors related to potential service demand—specifically including the number of TCC eligibles and the number of program participants.

To the extent these recommendations, if adopted, increase program participation, there would be costs to the state and federal governments to pay for the child care allowances. On the other hand, to the extent that the TCC Program acts as an employment incentive and helps get AFDC recipients off of aid, there would be federal, state, and county savings.

AFDC-FOSTER CARE

State-County Restructuring Proposal

The Governor's restructuring plan proposes to transfer full program and funding responsibility for foster family homes and group homes to the counties, including placement and rate-setting functions. The budget proposes expenditures of \$1.1 billion (\$0.7 million General Fund, \$402 million federal funds, and \$684 million county funds) for local assistance for the foster care program (administration and grants) in 1994-95. This represents a shift of \$324 million in General Fund costs to the counties. (For an analysis of the restructuring proposal, please see our companion document *The 1994-95 Budget: Perspectives and Issues*.)

Budget Does Not Assume Savings From Expansion of Family Preservation Services

We recommend (1) that the department report during budget hearings on how it intends to use the new federal Title IV-B funds for family preservation services and (2) a General Fund reduction of \$5 million for the foster care program to reflect anticipated savings due to the expansion of family preservation services. (Reduce proposed property tax transfer and corresponding General Fund support for school apportionments by \$5 million.)

The Omnibus Budget Reconciliation Act (OBRA) of 1993 established a new federal Title IV-B "capped" entitlement program to provide funding to states for family preservation and community-based family support services. Family preservation services are defined as services designed to help children and families at risk or in crisis such as (1) programs to help children return to families from which they have been

removed, (2) preplacement preventive services to help children at risk of foster care placement remain with their families, (3) respite care for parents and other caregivers, including foster parents, and (4) services designed to improve parenting skills. Family support services are defined as community-based services designed to promote the well-being of children and families to increase the strength and stability of families.

The OBRA of 1993 authorizes the capped entitlement funding through federal fiscal year 1998, with a 75 percent federal match. States must submit a plan for federal approval, but they have considerable flexibility to design their programs. The federal law requires that at least 90 percent of expenditures must be used for family preservation and support services and does not allow the new funds to supplant existing state and local efforts. The budget includes \$19 million in additional federal funds in the Child Welfare Services budget from the new Title IV-B program in 1994-95.

Department Proposal. The department indicates that they are currently developing a plan to implement the new family preservation and community-based family support services program. In order for the Legislature to fully evaluate the programmatic and fiscal impact of the new program, we recommend that the department report during budget hearings on its plans for implementation and how it intends to use the additional federal funds.

Budget Does Not Assume Savings in Foster Care Program. Although the budget includes an additional \$19 million in federal funds in 1994-95 for family preservation and family support activities, the budget does not assume any foster care savings that would result from preventing children from entering into foster care placements or returning children in foster care placements to their families. Because the plans for the new program are unknown at this time, it is not possible to provide a precise estimate of savings in the foster care program. However, it is reasonable to assume that there will be some savings, and these should be included in the budget. Until the department can provide a more precise figure, we estimate General Fund savings of at least \$5 million in the foster care program in 1994-95. Under the Governor's restructuring proposal, these savings would be reflected in a reduction in the amount of property taxes that would need to be transferred from schools to counties, and a corresponding reduction in the amount of General Fund support for education needed to offset the property tax shift.

Family Preservation Program Should Be Budgeted in Child Welfare Services Program

We recommend that if the Governor's restructuring proposal is adopted, funding for the Family Preservation Program be transferred from the Foster Care Program to the Child Welfare Services (CWS) Program, thereby requiring counties to pay a share of cost consistent with other CWS programs, because (1) the restructuring proposal makes the Family Preservation Program, as authorized by current law,

inoperable and (2) if these funds are to be allocated without the restrictions of current law, they should be treated as a CWS activity. This would result in net General Fund savings of \$10.5 million in 1994-95. (Reduce General Fund support for school apportionments by \$34,907,000 and increase Item 5180-151-001 by \$24,435,000.)

The Family Preservation Program was established by Ch 105/88 (AB 558, Hannigan) as a pilot program to provide intensive short-term family maintenance and family reunification services designed to avoid out-of-home placement of children or reduce the length of stay of such placements. Services include counseling, substance abuse treatment, respite care, parent training, crisis intervention, and teaching and demonstrating homemaking. In fact, family preservation services are essentially the same as services provided under the family maintenance and family reunification components of the CWS Program.

Under the Family Preservation Program, counties are authorized to "draw down" a portion of the state share of the projected foster care costs in order to fund family preservation services. If counties are successful at reducing their actual foster care costs, they receive a share of the General Fund savings; if not, they pay for the excess costs. As discussed below, these provisions would be inoperable under the Governor's restructuring proposal.

The amount advanced for family preservation services is budgeted as a separate expenditure in the Foster Care Program. Savings due to family preservation services will be reflected in the foster care caseloads, to the extent these services prevent foster care cases.

Permanent Transfer. Chapter 717, Statutes of 1992 (AB 2365, Bronzan), authorized a permanent transfer of General Fund monies in the Foster Care Program to the CWS Program, to be used for family preservation services by those counties which have operated a family preservation program for at least three years. In addition, those counties are required to pay a share of cost for these family preservation services consistent with other CWS programs.

Foster Care Restructuring Proposal. The budget proposes General Fund expenditures of \$35 million for the Family Preservation Program in 1994-95. Under the Governor's state/county restructuring proposal, counties would assume 100 percent of the nonfederal share of costs of the Foster Care Program, including the \$35 million budgeted for the state's Family Preservation Program. The statutory provisions governing the Family Preservation Program, however, would not be applicable under the restructuring plan because costs and savings in foster care would accrue entirely to the counties, making the "draw down" and the rewards/penalties concepts inoperable. In other words, if the state were to have no share of foster care costs, it would be impossible for counties to "draw down" part of the state share or to be rewarded with part of the state savings.

Analyst's Recommendation. In order to provide for continuation of the program in the counties currently operating it, we recommend that the funds be appropriated in 1994-95. We note, however, that family preservation is generally—and appropriately—considered a CWS activity, not a Foster Care Program activity. As such, we recommend that it be budgeted in the CWS Program rather than the Foster Care Program. In doing so, the counties would pay for 30 percent of the costs and the state 70 percent. If the Family Preservation Program is as effective as has been argued, counties should be willing to pay for this relatively small share of costs in order to achieve potentially substantial savings in the Foster Care Program.

Fiscal Effect. Our recommendation would reduce total spending in the Foster Care Program by \$34.9 million and increase spending in the CWS Program by the same amount. This would reduce the amount of Foster Care Program expenditures that would be transferred to the counties under the Governor's restructuring plan. This, in turn, would reduce the amount of property taxes that would have to be shifted from the schools to the counties—and the corresponding General Fund expenditures for school apportionments to backfill for this shift—by \$34.9 million.

Thus, our recommendation would result in a General Fund savings of \$34.9 million in school apportionments and a General Fund cost of \$24.4 million to pay for 70 percent of the costs in the CWS Program, for a net General Fund savings of \$10.5 million in 1994-95. The counties would assume a corresponding cost of \$10.5 million to pay for 30 percent of the program, but would benefit from any future reduction in foster care caseloads resulting from the family preservation activities.

Trial Court Judges' Training Program Should Be Funded Through Trial Court Funding Program

We recommend a General Fund reduction of \$229,000 to contract with the California Judicial Council to fund judges' training programs because funding for such trial court training programs should be provided through the Trial Court Funding Program. (Reduce Item 5180-001-001 by \$229,000.)

For a discussion of this issue, please see our analysis of the Judicial Program in the Judiciary and Criminal Justice chapter of this *Analysis*.

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 \$2.1 billion from the General Fund for the state's share of the SSI/SSP in 1994-95. This is an increase of \$38 million, or 1.8 percent, over estimated current-year expenditures.

Assuming Termination of Federal Fees Creates General Fund Risk

The budget assumes that legislation will be enacted by Congress to terminate the requirement for California to pay a fee for SSP administration, thereby creating a potential General Fund shortfall of \$43 million if federal action does not occur.

The federal Social Security Administration (SSA) administers both the SSI and SSP components of the program. Under the federal Omnibus Budget Reconciliation Act (OBRA) of 1993, the SSA began charging states a fee for administering SSP benefits, effective October 1, 1993.

The budget anticipates \$42.7 million of General Fund savings in 1994-95 by assuming a federal law change to eliminate the administrative fee. Thus, adoption of the budget entails the risk of a General Fund shortfall if this legislation is not enacted and approved by the President.

General Fund Savings From Proposed Federal Reimbursement of Refugee Costs Are Overstated

The budget overstates the General Fund savings that could be realized from the proposed federal reimbursement of refugee costs by \$5.8 million.

The budget assumes that legislation will be enacted by Congress to appropriate additional funds to California, effective October 1, 1994, to pay for the state's costs of providing Medi-Cal, AFDC, and SSI/SSP benefits during the first 36 months of residence by refugees, for a savings of \$114 million from the General Fund in 1994-95. Our review indicates

that the budgeted savings are overstated by \$5.8 million because the department overestimated the number of 36-month refugees currently receiving SSI/SSP benefits. Therefore, we recommend that if the Legislature adopts this budget assumption, the savings be reduced by \$5.8 million.

Budget Should Reflect Savings From “Deeming” Sponsor's Income

We recommend reducing the proposed appropriation for SSI/SSP grants in order to account for a statutory provision that increases the length of time a sponsor's income is considered in determining grants for immigrants, for a General Fund savings of \$4 million in 1993-94 and \$8 million in 1994-95. (Reduce Item 5180-111-001 by \$8 million.)

Federal law requires that in determining the eligibility of legal immigrants applying for SSI/SSP, the sponsor's resources and income are to be considered. After allowing for the needs of the sponsor and the sponsor's dependents, the remainder is deemed available for the support of the applicant for a certain period of time after admission as a permanent resident in the United States. A recent change in federal law increased the deeming period from three to five years, effective January 1, 1994.

This statutory provision will reduce or eliminate SSI/SSP benefits paid to immigrants in their fourth and fifth year of permanent residency. The budget, however, does not take this provision into account. Based on limited data, we estimate that the provision will result in General Fund savings of \$4 million in 1993-94 and \$8 million in 1994-95. Accordingly, we recommend that the budget be reduced to recognize these savings. We will attempt to develop a more precise estimate prior to the budget hearings and, if necessary, will modify our recommendation accordingly.

Restricting Eligibility of Substance Abusers Would Result in Shift of Costs

The budget proposal to restrict the eligibility of persons receiving SSI/SSP benefits because of drug and alcohol disabilities (1) overstates General Fund savings by \$1 million, due to a technical error, and (2) would result in a shift of costs to state and local governments for health and social services provided to those who lose benefits and are not rehabilitated.

Existing SSI/SSP eligibility criteria provide for disability payments to individuals on the grounds of drug addiction or alcoholism (DA/A). Recipients of SSI/SSP benefits are required to participate in an approved rehabilitation program when available and appropriate.

The budget proposes to (1) withhold any retroactive payments due the recipient until after he or she commences participation in a rehabilitation program, (2) apply such payments toward the cost of the rehabilitation program, (3) require participation in a rehabilitation program before future benefits may be received, (4) terminate benefits when a recipient is no longer in such a program, and (5) seek federal legislation to restrict the length of SSI/SSP eligibility to a maximum of 24 months for a DA/A disability. The department indicates that federal regulations permit implementation of all of these proposals except the two-year limit. Implementation of these proposals would be the responsibility of the federal SSA as the administering agency of the program. The budget also assumes that the federal government will fund an additional 2,600 rehabilitation slots to serve all DA/A persons affected by this proposal.

In order to assist the Legislature in its consideration of this proposal, we note the following:

- Unlike the Governor's two-year time limit proposed in the AFDC program—in which priority for the GAIN Program is given to AFDC recipients who would experience a grant reduction—this proposal does not give treatment priority to SSI/SSP recipients who would be expected to enter rehabilitation programs.
 - According to data from the Department of Alcohol and Drug Programs (DADP), of those persons discharged from DADP programs in 1992-93 (1) approximately 25 percent successfully completed treatment; (2) 13 percent left treatment early and, in the opinion of program counselors, made satisfactory progress; (3) 49 percent left treatment early and made unsatisfactory progress; and (4) 12 percent were transferred to other programs.
 - The budget assumes that 30 percent of existing and pending (DA/A) cases will be closed as a result of people refusing to participate in a rehabilitation program, for a savings of \$28 million (\$11 million General Fund and \$17 million federal funds).
 - The budget assumes savings from withholding retroactive payments due a recipient until he or she participates in a rehabilitation program. Our analysis indicates that the budgeted savings from withholding retroactive payments is overstated by \$2.4 million (\$950,000 General Fund), due to a technical error.
-

- The proposal would result in shifting costs to state and local governments in various programs that might be used to compensate for the effects of the loss of benefits to persons who are not rehabilitated. These programs include AFDC, General Assistance, Homeless Assistance, Child Welfare Services, Medi-Cal and indigent health, and the criminal justice system.
- To the extent that the proposal results in increasing the number of successful treatments, it would reduce SSI/SSP costs as well as costs to other programs that are affected by substance abuse, such as the criminal justice system.

In conclusion, we note that the decision to impose a two-year limit on eligibility is a federal one over which the Legislature has no control. The Legislature, however, does have the ability to modify eligibility criteria relating to drug and alcohol treatment programs. Accordingly, we believe that it is reasonable to expect persons receiving benefits as a result of those disabilities to seek treatment—as required by current law—and to give these persons priority for obtaining these services at the local level.

State Should Seek Federal Medicaid Funds for Providing Personal Care to SSI/SSP Recipients

We recommend that (1) the Legislature direct the DSS to seek approval to claim federal Medicaid funds for personal care services provided to SSI/SSP recipients receiving nonmedical out-of-home care and (2) the department develop an estimate of the net savings and report to the subcommittees during hearings on the budget. This could result in General Fund savings in the range of \$20 million annually.

Federal Medicaid regulations allow 50 percent federal funding to be claimed for direct services and administrative costs for personal care—that is, services needed by recipients who have an illness diagnosed to be chronic and lasting at least one year and who are unable to care for themselves safely without this assistance. Personal care services may include one or more activities, such as providing assistance or supervision with basic personal hygiene, eating, grooming, or toileting.

Of the 990,000 persons currently receiving SSI/SSP grants in California, over 65,000 reside in residential care facilities. Part of the grant paid to the facility for these beneficiaries includes an allowance for “care and supervision” that ranges from a minimum of \$275 to a maximum of \$341 per month. Some of these funds should qualify for federal Medicaid reimbursements as personal care services. This would enable the state to use funds that are 50 percent state and 50 percent federal for the SSP component of the grant, which is currently supported by state funds.

Consequently, we recommend that the Legislature direct the DSS to seek federal approval for claiming Medicaid reimbursements for personal care services provided to SSI/SSP recipients. Based on federal approval of a similar request for the In-Home Supportive Services Program, we anticipate that such a request for the SSI/SSP would be granted. While data are not available to provide a precise estimate of the savings at this time, we believe that net savings could be in the range of \$20 million annually from the General Fund, after accounting for administrative costs.

To provide a more precise estimate of the potential savings, we have asked the department to develop an estimate. We will review the estimate and report on it during the budget hearings.

Department Is Seeking Federal Funds To Establish Fraud Pilot Projects

We recommend that the department report to the subcommittees, during budget hearings, on (1) the status of its application for federal funds to support the SSI/SSP fraud pilot projects that are proposed to be supported by state funds and (2) any state and federal statutory changes necessary to implement the pilot projects.

Under the state's current contract with the federal SSA for administration of the SSI/SSP, the responsibility for fraud audits and investigations rests with the United States Department of Health and Human Services and the Office of Inspector General (OIG). According to the department, the OIG has 28 special agents to cover California and four other western states.

Post-Eligibility Fraud Pilot Project. The budget proposes \$811,000 from the General Fund to establish 11 positions for a three-year pilot project to focus on SSI/SSP fraud that occurs after a recipient has established eligibility. Initially, the pilot would conduct four financial audit/investigations per year in board-and-care facilities. In addition, the department would pursue other indications of fraud such as multiple Social Security numbers, unreported income and resources, and continued payments to "representative payees" on behalf of deceased recipients.

Early Fraud Investigation Pilot Project. The budget also proposes \$378,000 from the General Fund to establish seven positions for a three-year pilot project in a Los Angeles County Disability Evaluation Division (DED) branch office. The DED determines eligibility for SSI/SSP benefits based on disabilities. The pilot project would focus on deliberate false

representations of symptoms or medical evidence to qualify for or continue disability benefits.

Comments and Recommendations. We note that while the budget proposes to fund these projects entirely from the General Fund, the DSS has indicated that it is also requesting that the federal government support the projects as demonstration programs. In addition, the department is working with the federal government to determine if the state has the legal authority to conduct the pilots as proposed and to establish procedures to deny eligibility to applicants pending the outcome of fraud investigations. Accordingly, we recommend that the department report to the subcommittees, during hearings on the budget, on the status of the application for federal funds and the statutory changes, if any, necessary to carry out the proposals.

COUNTY ADMINISTRATION OF WELFARE PROGRAMS

The budget appropriates funds for the state and federal share of the costs incurred by counties for administering the following programs: (1) Aid to Families with Dependent Children (AFDC); (2) Food Stamps; (3) Child Support Enforcement; (4) Special Adults, including emergency assistance for aged, blind, and disabled persons; (5) Refugee Cash Assistance; and (6) Adoption Assistance.

The budget proposes an appropriation of \$315 million from the General Fund for the state's share of the costs that counties will incur in administering welfare programs in 1994-95. This represents a decrease of \$69 million, or 18 percent, from estimated current-year expenditures. This is due to the Governor's restructuring proposal, which would increase the county share of the nonfederal costs of county administration from 30 percent to 50 percent. We discuss the restructuring proposal in more detail in our companion volume, *The 1994-95 Budget: Perspectives and Issues*.

COLAs for County Administration Not Consistent With Budget's Policy in Other Programs

We recommend that the amount proposed for a cost-of-living adjustment (COLA) for county administration of welfare programs be deleted, for a General Fund savings of \$14.5 million, because funding COLAs for this program is inconsistent with the budget's overall policy toward COLAs for local assistance programs. (Reduce Item 5180-141-001 by \$14,500,000.)

While the budget submitted by the department and approved by the Department of Finance for county administration does not indicate that a COLA is included, we found that, in fact, the budget does propose funds for a COLA. This COLA amounts to 2.4 percent annually in the current and budget years, based on the actual change in salaries and benefits in the counties from 1991-92 to 1992-93.

Normally, providing funds for COLAs is a justifiable expense to recognize the effects of inflation. In this case, however, the proposal to

include a COLA for county administration of welfare programs is inconsistent with the budget's overall policy to exclude COLAs for local assistance programs in recognition of the fiscal constraints facing both the state and local governments. At the time this analysis was prepared, no justification had been submitted to treat this program differently from others. In the absence of such justification, we recommend deletion of the COLA, for a General Fund savings of \$14.5 million in 1994-95.

Welfare Program Integrity Initiative

The budget proposes a series of welfare fraud program changes—referred to as the Welfare Program Integrity Initiative (WPI)—for a General Fund savings of \$29 million in 1994-95. In addition to establishing new fraud programs, and conducting additional fraud studies and pilot projects, the WPI would revise the AFDC Homeless Assistance Program. Most of the proposed changes require legislation, emergency regulations, or federal approval. To summarize, the WPI would:

- Limit eligibility for the Homeless Assistance Program to once in a lifetime, and require that all benefit payments be made by vouchers.
 - Replace the loss of “enhanced” federal funding for fraud activities with General Fund monies to maintain existing fraud program levels.
 - Reduce the county share of cost for continuing fraud activities.
 - Continue expansion of the early fraud program.
 - Implement a new administrative hearing process for individuals who are disqualified from the AFDC Program.
 - Implement the AFIRM fingerprint system on a pilot basis to detect fraud in the AFDC Program in Los Angeles County.
 - Require parents of citizen children receiving AFDC to provide verification of their identity.
 - Intercept Unemployment Insurance and Disability Insurance payments to AFDC recipients who have outstanding AFDC grant overpayments due to fraud.
 - Conduct additional “child-only” fraud incidence studies.
-

- Establish in San Diego County a pilot project to require attendance in school as a condition of receiving AFDC for children between ages 16 and 18.

- Eliminate the \$50 monthly child support “disregard” payment when AFDC grant overpayments occur because of the failure to report the receipt of child support payments.

We discuss some of these proposals below.

Budget Proposes to Implement the AFIRM in Los Angeles County

The budget proposes \$9.2 million (\$4.6 million General Fund) to implement the Automated Fingerprint Image Reporting and Match System (AFIRM) on a pilot basis in Los Angeles County, for an estimated AFDC grant savings of \$18.6 million (\$8.9 million General Fund). The AFIRM is an automated fingerprinting system that has been implemented in Los Angeles County's General Assistance (GA) Program. The primary objective of the AFIRM is to utilize computer imaging technology as a fraud detection tool to eliminate multiple aid fraud cases (for example, one person collecting benefits under two names). Based on the estimated savings in Los Angeles County's GA Program, the 1993-94 Governor's Budget proposed a demonstration project to expand the AFIRM to the Los Angeles County AFDC caseload on a pilot basis. However, the Legislature did not adopt this proposal. The 1994-95 Governor's Budget again proposes that a demonstration of the AFIRM's application to AFDC be conducted in Los Angeles County.

Based on the results of the project in Los Angeles County's GA Program, the department estimates that 1.5 percent of the AFDC caseload would be discontinued if the AFIRM were implemented in the county's AFDC program. The budget proposes that the state pay the entire nonfederal share of the cost (\$4.6 million General Fund) of the AFIRM pilot.

Because of differences in the populations served by the GA and AFDC Programs, the results of the AFIRM project in Los Angeles County's GA Program may not be a reliable indicator of how the project will perform in the AFDC Program. Implementing the program on a pilot basis in an AFDC setting, however, should provide the data needed to answer this question. We believe that the proposal has merit as a means of evaluating this approach on a pilot basis.

Department Should Modify Approach in Conducting Proposed Fraud Studies

We recommend that before undertaking two proposed studies of fraud in "child-only" AFDC cases, the DSS modify its approach to address certain methodological shortcomings.

The budget proposes \$336,000 (\$168,000 General Fund) to conduct two studies on the incidence of fraud in child-only AFDC cases. Because these studies would be based on a similar study conducted by the DSS and the Orange County Social Services Agency in 1993, we reviewed the Orange County study.

Orange County Fraud Study. In November 1993, the DSS released the findings of the study, entitled "Child-Only Fraud Pilot Project." The study attempted to determine the cost-effectiveness of referring AFDC "child-only" cases for fraud investigation. Child-only cases are cases in which there may be a parent in the family, but the adult is not included for purposes of calculating the AFDC grant. These cases include citizen children of undocumented parents, children whose parents are receiving SSI/SSP grants, and children whose caretakers are non-needy relatives.

Methodological Shortcomings. Our analysis indicates that the Orange County study contained several methodological shortcomings. The major shortcoming of the Orange County study was that the sample of 500 cases unintentionally included cases that are not in the "child-only" category. Specifically, 123 cases, or 25 percent of the original sample, included aided adults. (The report recognized 102 such cases and we subsequently discovered an additional 21 cases.) Because of this, the sample of "child-only" cases was nonrandom and therefore did not derive statistically valid results.

Amount of Cost Avoidance Overstated. We found that the cost avoidance calculation in the Orange County study appears to be overstated because:

- The study used an invalid measure of length of time on aid for "child-only" cases.
 - Savings derived by avoiding future grant payments were not discounted to present value, thereby overstating the estimated cost avoidance in current dollars.
 - The study counted all voluntary withdrawals (subsequent to notice of investigation for possible fraud) as savings resulting from the fraud investigation process. Some of these voluntary withdrawals, however, may have occurred in the absence of the fraud process.
-

Proposed New Studies. Because of these problems, we cannot draw any statistically valid inferences from the Orange County study regarding the fraud rate among all *child-only cases*. Nevertheless, the study implies that about one-third of the child-only cases in the sample—including those with non-needy relatives or parents receiving SSI/SSP—were found to have committed “fraud,” defined as “intentional program violations.” The findings in the Orange County study, however, cannot be generalized to all child-only cases or to the entire AFDC caseload in Orange County. Accordingly, we recommend that before the DSS undertakes the proposed studies, the department modify its approach to take into account the methodological shortcomings we have described above.

County Share of Fraud Program Costs Should Be Commensurate With Share of Benefits

We recommend the enactment of legislation to adjust the state and county shares of costs of the AFDC fraud programs to correspond to the state and county shares of the costs of AFDC grants. This would allocate the costs of the fraud programs in a manner that is commensurate with the distribution of program benefits (grant savings) to the state and counties, and would result in a General Fund savings in administrative costs of \$14.4 million in 1994-95. (Reduce Item 5180-141-001 by \$14,443,000.)

We further recommend that the legislation provide that funds for the two components of the AFDC fraud programs—early and continuing fraud—be combined into a single allocation to the counties so that counties have the flexibility to allocate the funds between the two components in the most cost-effective manner.

Finally, we recommend that the department report, during budget hearings, on the cost/benefit data it collects and the cost-effectiveness of the fraud program.

The AFDC and Food Stamps fraud program is divided into two components: the Fraud Early Detection (FRED) Program, which generally operates at the application stage of the AFDC eligibility process, and the continuing fraud program, which investigates cases past the application stage. The budget proposes \$73 million (\$33 million General Fund, \$36 million federal funds, and \$4 million county funds) for the AFDC and Food Stamps fraud program in 1994-95.

Under current law, the state pays 100 percent of the nonfederal share of the FRED costs and 70 percent of the nonfederal costs of the continuing fraud program. The budget proposes legislation to increase the state share

of the nonfederal costs of the continuing fraud program to 85 percent in 1994-95.

How Should Costs Be Shared by the State and Counties? Savings from the AFDC fraud programs are in the form of grant reductions and grant cost avoidance. Thus, any savings are, in effect, distributed among the federal, state, and county levels of government in the same ratio as their respective shares of the costs of AFDC grant expenditures. It would be appropriate, therefore, to allocate the share of fraud program costs in the same manner. To accomplish this, we recommend enactment of legislation to adjust the state and county share of the nonfederal costs of the fraud programs to equal their corresponding share of AFDC grant expenditures.

Figure 23 summarizes the programs' sharing ratios under current law, the Governor's proposal, and our recommendation. Under our proposal, the state and counties would share equally in the costs of these fraud programs in a manner that is commensurate with how they share in the savings from the programs. Under the Governor's proposal, however, the state pays the bulk of the costs of these fraud programs but receives significantly less of the benefit. Figure 24 illustrates—using a hypothetical example—how the Governor's proposal would result in counties receiving a disproportionate share of the savings compared to their share of expenditures in the fraud program, and how our recommendation would distribute the share of savings on a more equal basis.

Figure 23

**AFDC and Food Stamps Fraud Program
State and County Share of Nonfederal Costs
1994-95**

	Current Law		Governor's Proposal		LAO Proposal ^a	
	FRED	Continuing	FRED	Continuing	FRED	Continuing
State	100%	70%	100%	85%	50%	50%
County	—	30	—	15	50	50

^a Assumes the Governor's state/county restructuring proposal to increase the county share of costs for the AFDC grant program. Under current law, the LAO proposal would be 95 percent state and 5 percent county.

Figure 24

**Continuing Fraud Program
State/County Distribution of Savings
Hypothetical Example:
\$1,000 Expenditures (State and County Funds)
Benefit/Cost Ratio = 5:1**

	Expenditures/Savings ^a		Savings per \$1 Cost	
	State	County	State	County
Governor's proposal	\$850/\$2,500	\$150/\$2,500	\$2.94	\$16.67
LAO proposal	\$500/\$2,500	\$500/\$2,500	\$5.00	\$5.00

^a Assumes Governor's restructuring proposal to increase county share of AFDC grants to 50 percent of nonfederal costs. State and county savings would remain equal under LAO recommendation, regardless of how grant costs are shared.

The Governor proposes to increase the county share of the nonfederal costs of AFDC grants from 5 percent to 50 percent in 1994-95. If the Governor's proposal is enacted, our recommendation would result in increasing the county share of costs of the FRED Program from 0 to 50 percent and increasing the county share of the continuing fraud program from the proposed level of 15 percent to 50 percent, for a General Fund savings of \$14.4 million in 1994-95. If the Governor's proposal is not adopted, our recommendation would increase the county share of the FRED Program to 5 percent and reduce the county share of continuing fraud from 30 percent to 5 percent, for a net General Fund cost of \$2 million in 1994-95.

How Should Funds Be Allocated Between Program Components?

Currently, the counties receive separate allocations for the FRED Program and continuing fraud program. According to the DSS, the FRED Program is significantly more cost-effective than the continuing fraud program. In fact, information provided by the department implies that costs exceed savings from the continuing program. This suggests that funds should be reallocated from continuing fraud to the FRED Program.

Rather than attempt to determine the optimal distribution of funds between the two program components, we recommend that funding for both components be combined into a single allocation, thereby permitting each county to allocate the funds between the two components at the county's discretion. This will enable counties to allocate funds between the two program components so as to maximize cost-effectiveness.

How Can the Program Be Improved? While the department has attempted to derive cost/benefit ratios for both the FRED Program and continuing components of the program, the department is in the process of verifying their cost/benefit estimates. Furthermore, the department has not made county-by-county comparisons of the cost-effectiveness of the programs. Such information would be useful to the state and the counties in order to identify the factors that determine program success. Consequently, we recommend that the department report, during budget hearings, on the cost/benefit data that it collects and the cost-effectiveness of the fraud program.

Department Should Reassess Its Approach Toward Interim SAWS

We withhold recommendation on the proposed 14-county interim Statewide Automated Welfare System (SAWS) project (General Fund costs of \$11.6 million in 1993-94 and \$15 million in 1994-95) and recommend that the DSS and the Department of Finance report, during the budget hearings, on the concerns raised in this analysis.

Background. The SAWS is a major project of the DSS to establish a statewide uniform, computer-based system for administering various health and welfare programs. With an estimated development cost of approximately \$800 million to be incurred over a 12-year period, the SAWS is the largest and most costly computer-based system ever undertaken by the state. The administration proposes that the SAWS be based on an automated welfare system developed in Napa County, referred to as NAPAS. The SAWS project will include all counties except Los Angeles County, which has been authorized by statute to implement its own system.

The SAWS is estimated to have a net General Fund *cost* of \$25 million over the 12-year period if the Governor's restructuring proposal is adopted. However, if the proposal is not adopted, the SAWS would result in a net General Fund savings of \$112 million over the 12-year project life.

The Legislature authorized the administration to transfer funds among various appropriation items in the 1993 Budget Act for the SAWS project during the current year upon approval of a feasibility study report (FSR). The report, approved by the administration on December 28, 1993, describes for the first time the specific plan for implementing the SAWS.

Interim SAWS Approach. As an initial step toward a statewide system, the DSS plans to convert 14 counties to SAWS at the Health and Welfare Data Center (HWDC), as an interim SAWS project. The data center intends to acquire the hardware, software, and consulting services on a

sole-source basis, because the Napa County system was developed to run on a specific manufacturer's computers, using a proprietary software application owned by the same manufacturer. This interim step will allow the DSS to obtain information to refine its SAWS plan, including costs and benefits, for implementing the system statewide. The interim project is scheduled for five years at a total cost of \$78 million (all funds). The budget proposes \$22 million (\$11.6 million General Fund) in 1993-94 and \$29 million (\$15 million General Fund) in 1994-95 for the interim project.

Counties would participate in the interim project in accordance with a memorandum of understanding (MOU) between each county and the DSS. These MOUs would spell out how costs would be shared, and each would have to be approved by the Department of Finance prior to execution. According to the DSS cost/benefit analysis, the interim project will result in a net General Fund cost of approximately \$11.2 million.

Current-Year Interim Project Activities. On January 3, 1994, the Director of Finance, pursuant to various provisions of the 1993 Budget Act, notified the Legislature of his intent to authorize an increase of \$8.9 million in the HWDC's expenditure authority for current-year interim SAWS activities. Approximately \$2.9 million of this amount would be used to fund 28 new positions at the HWDC and to acquire, on a sole-source basis, a new mainframe computer and related proprietary software. (Data center staffing for this project would increase to 39 positions in 1996-97.) In addition, the proposed expenditure includes \$1.5 million for a sole-source contract with a private consulting firm and the computer manufacturer for technical and consulting services, and \$2 million for a sole-source contract with the University of California, Davis for training. The remainder of the funds would be used to purchase personal computing equipment for counties and to provide other services to the DSS in support of the interim SAWS project.

Based on our review of the interim project, we have identified the following concerns.

Interim Project May Result in a Costly, Disposable New Computer. In an October 12, 1993 letter to potential bidders, the DSS reaffirmed its commitment to open competition among vendors to provide SAWS statewide in the future and invited vendors to express their concerns if they believed that the proposed interim SAWS project would jeopardize this open competition. Several vendors responded by expressing concerns regarding the possible role of the HWDC as a competitor for the statewide SAWS. In response to this concern, the state indicated that the HWDC would not compete for any services contained in the statewide request for proposal (RFP) and that, upon transition of the 14 counties in the interim SAWS to the statewide SAWS, HWDC would have to find

another use for the interim SAWS computer or dispose of it. Consequently, the administration is proposing to invest over \$25 million and 39 positions to establish a new computing infrastructure for a project which results in a net General Fund cost of \$11.2 million and which may be abandoned at the end of the interim project.

Costs of Interim Project Can Be Reduced and Still Provide Needed Information. Based on our review, we conclude that the project scope could be reduced and still provide the DSS with the information it needs in order to implement SAWS statewide. With an estimated total cost of \$78 million and *net* cost of over \$11 million to the General Fund, the interim project, as proposed, is a very costly approach to gathering information to refine cost/benefit estimates and test the statewide application of the interim system. A major reason for this high cost is the purchase of a new computer and associated equipment and the hiring of 39 new positions at the HWDC. The data center is incurring these costs because the NAPAS requires a type of computer that the HWDC does not have and has no experience supporting. We believe that these costs could be reduced—maybe reduced substantially—if the interim SAWS project involved fewer counties or if computer support were purchased from a service bureau instead of acquiring a new computer system. We believe that either one of these approaches would still allow the department to obtain the information it needs to evaluate the SAWS.

Federal Funds Only Partially Secured. The budget assumes that the state will receive federal matching funds for the proposed interim SAWS project; however, at the time this analysis was prepared, the DSS had not secured federal agreement to share in the cost of converting Kern County (one of the 14 counties in the interim project) to the NAPAS. If federal approval is not obtained, the interim project will have to be reevaluated because Kern County's welfare caseload is approximately 25 percent of the total interim caseload.

Some Major Milestones Missing From the SAWS Time Line. A project of this magnitude requires a schedule that reflects certain key action dates or “milestones.” Although the DSS has produced various schedules pertaining to both the interim and statewide SAWS, the department has not provided a scheduled date for either the evaluation of the interim SAWS or the release of the RFP for the statewide SAWS. Each is a critical date for this project because costs and benefits are determined in part by how long it takes to accomplish the many tasks necessary to implement the project.

Based on the above concerns, we withhold recommendation on the funds proposed for the interim SAWS project for 1994-95. Further, we

recommend that the DSS and the Department of Finance report, during budget hearings, on the concerns raised in this analysis.

State's Share of SAWS Development and Implementation Cost Is Too High

We recommend the enactment of legislation to increase the county share of the nonfederal costs of the SAWS project to correspond to the county's share of the benefits. This would allocate the costs of development and implementation in a manner that is commensurate with the distribution of program benefits (grant and administrative savings) to the state and counties, and would result in a General Fund savings of \$6 million in 1994-95 and over \$125 million from the General Fund over the 12-year life of the project. (Reduce Item 5180-001-001 by \$6,024,000.)

Originally, the administration assumed that the SAWS project would receive "enhanced" federal financial participation (75 to 90 percent depending on the program). However, after the original FSR was submitted to the Office of Information Technology for the statewide SAWS project, "enhanced" federal financial participation was eliminated from the project. Federal funding will now be provided at the regular sharing rate (currently 50 percent) for both the development and operational costs of the project.

How Should Costs Be Shared by the State and Counties? SAWS savings result from county administrative savings and grant recoveries and avoidance of future payments in the AFDC, Food Stamps, and Medi-Cal Programs. These savings are, in effect, distributed among the federal, state, and county levels of government in the same ratio as their respective shares of the costs of administration and program expenditures. It would be appropriate, therefore, to allocate the share of the project development and implementation costs in the same manner. To accomplish this, we recommend legislation to adjust the state and county share of the nonfederal costs of SAWS development and implementation to equal their corresponding share of benefits from savings in the AFDC, Food Stamps, and Medi-Cal Programs.

The 1994-95 Governor's Budget assumes enactment of a major state/local restructuring proposal, including changes in the state/county sharing ratios for various welfare programs. If the Governor's proposal is adopted, our recommendation would result in increasing the county share of the nonfederal cost of SAWS development and implementation from 0 to 46 percent (the estimated net county share of savings from the project), for a General Fund savings of \$6 million in 1994-95 and over \$125 million from the General Fund over the 12-year life of the project. If

the Governor's proposal is not adopted, our recommendation would increase the county share of the nonfederal cost to approximately 5 percent, for a General Fund savings of \$250,000 in 1994-95.

Statewide Implementation of the SAWS Should Provide for Competition

We recommend that the DSS report, during budget hearings, on how its RFP to implement the statewide SAWS project will maximize the state's opportunities to achieve an expeditious and cost-effective implementation.

Before the department is able to implement the SAWS statewide, it will have to release an RFP. The purpose of this document is to describe to prospective vendors the problem to be solved, or goal to be achieved, and specify the minimum acceptable functional, technical, and contractual requirements of the project. In addition, an RFP describes evaluation criteria governing the award of the contract.

The DSS approach to implementing the statewide project is based on a specific manufacturer's computers, using a proprietary software application owned by the same manufacturer. Because of this, we have been informed by the DSS that the RFP would limit the solutions that can be submitted by vendors to three alternatives. Based on our review, we believe that one of these choices is not practical as an alternative for a competitive bid, and another has not been proven to handle the capacity demands of the statewide welfare caseload. The third alternative is to use a specific manufacturer's hardware and software. Therefore, the current approach to the RFP may, in effect, restrict the solution to one alternative that can be proposed by vendors.

A review of procurements for large computer-based projects indicates that many have been delayed significantly due to protests or lawsuits challenging the manner in which the state has conducted the procurement. By restricting the solution alternatives, the DSS may have increased the likelihood of bid protests that could delay the SAWS project significantly.

Under the current approach for statewide implementation, the Legislature may never know whether the alternative selected by the DSS is the most cost-effective way to implement SAWS. The only way to obtain this assurance is through an open competition whereby vendors are allowed to propose their best solutions to the programs' functional requirements. Therefore, we recommend that the DSS report, during the budget hearings, on how its RFP for the statewide SAWS project will

maximize the state's opportunities to achieve an expeditious and cost-effective implementation.

State Should Not Pay for Relatively High County Overhead Costs

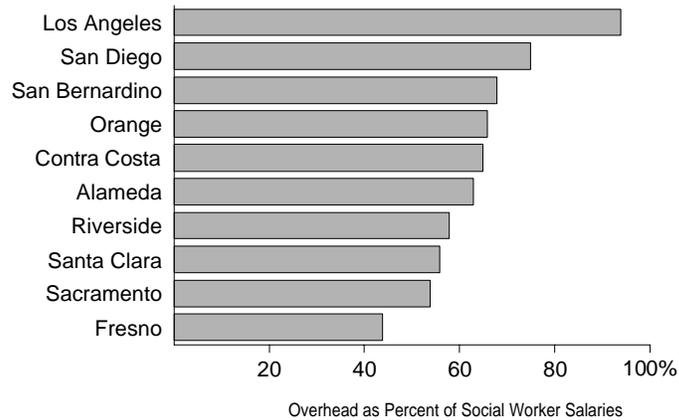
We recommend capping the amount of state funding for county administrative overhead costs for the Child Welfare Services (CWS), IHSS, AFDC, and Food Stamps Programs because the state should not pay for relatively high county overhead costs. This would result in General Fund savings of approximately \$9 million in the CWS Program and an undetermined amount in the AFDC, IHSS, and Food Stamps County Administration Program. (Reduce Item 5180-151-001 by \$8,950,000.)

Background. The proposed expenditures for the CWS Program are based on an annual social worker cost of \$92,600. This amount consists of salaries and benefits for social workers plus county overhead expenses. Overhead includes support staff costs (clerical and supervisory), travel, operating expenses, equipment, rent, contracts, and services purchased from other county departments. The \$92,600 figure is based on costs reported by each county welfare department. Similarly, budgeted expenditures for county administration of the AFDC and Food Stamps Programs are based on eligibility worker salaries and county overhead in those programs.

There Is a Large Variation Among the Counties in the Amount of Overhead Costs. Figure 25 shows that there is wide variation among the ten largest counties in the amount reported for overhead costs for the CWS Program in 1992-93, with overhead expressed as a percent of social worker salaries. As the figure shows, the overhead costs ranged from 51 percent in Fresno County (for every \$1 spent on a social worker, 51 cents was spent on overhead costs) to 97 percent in Los Angeles County. Figure 26 shows the overhead for all medium and large counties in 1992-93. The median for these counties was 63 percent. (We have excluded the 23 smallest counties because, due to their relatively high fixed costs, it would be expected that they would incur proportionately higher overhead expenses.) An even larger variation existed among the 35 counties in overhead costs for administration of the AFDC Program in 1991-92, ranging from 70 percent to 128 percent. (The percentages are higher than in the CWS Program because eligibility worker salaries are, on average, lower than social worker salaries.) Data for 1992-93 for AFDC, IHSS, and Food Stamps administration, however, were not available at the time this analysis was prepared.

Figure 25

**Child Welfare Services Program Overhead
Ten Largest Counties
1992-93**



State Is Funding Relatively High County Overhead Costs. In our review of this issue, we found no justification for the high levels of overhead reported by the counties at the upper end of the scale in Figure 26. Because the state pays for 70 percent of the nonfederal share of these costs, the state bears most of the fiscal burden for relatively high county overhead. In order to prevent this, we recommend implementing a cap on the amount of county overhead that will be funded by the state, with small counties exempted.

While the large variation among the counties suggests that overhead is relatively high in some counties, there is no formula that delineates an “appropriate” level. Given this wide variation, however, we believe that it would be reasonable to draw the line at the 80th percentile in the 35-county group—that is, to expect the 6 highest counties to bring their overhead down or fund it at their own expense. This would provide for a cap on state funding of administrative overhead at the 76 percent level, or 13 percentage points above the median in the CWS Program. Implementation of this cap would result in estimated General Fund savings of \$9 million in the CWS Program in 1994-95. Because data for 1992-93 were not available at the time this analysis was prepared, we do

not have an estimate of the savings for the AFDC, IHSS, and Food Stamps Programs. We will, however, report this estimate during the budget hearings if the data are available.

Figure 26

**Child Welfare Services Program Overhead^a
35 Largest Counties
1992-93**

Los Angeles	97%	Humboldt	62%
Santa Cruz	90	Merced	61
San Luis Obispo	82	San Mateo	61
Placer	82	Ventura	61
Santa Barbara	80	Riverside	59
San Diego	77	Stanislaus	59
Monterey	76	San Joaquin	58
San Bernardino	70	Santa Clara	58
Contra Costa	68	Tulare	56
Orange	68	Sacramento	56
Solano	67	Sonoma	56
Napa	66	Yolo	55
Butte	66	Fresno	51
Alameda	66	Kings	50
Kern	65	Shasta	49
San Francisco	65	Imperial	46
Madera	63	Marin	44
El Dorado	63		

^a Overhead as a percent of social worker salaries.

CHILD WELFARE SERVICES

The Child Welfare Services (CWS) Program provides services to abused and neglected children and children in foster care and their families. The CWS Program provides:

- Immediate social worker response to allegations of child abuse and neglect.
- Ongoing services to children and their families who have been identified as victims, or potential victims, of abuse or neglect.
- Services to children in foster care who have been temporarily or permanently removed from their families because of abuse or neglect.

The budget proposes expenditures of \$714 million (\$142 million General Fund, \$445 million federal funds, \$113 million county funds, and \$14 million in reimbursements) for local assistance in the CWS Program in 1994-95. The proposed General Fund amount represents a decrease of \$18 million, or 12 percent, from the current year. This General Fund reduction is due to the proposed redirection of federal funds from the IHSS Program to the CWS Program.

Counties Should Share Costs of Programs Proposed to Continue Beyond Statutory Termination Date

We recommend that the budget be amended to reflect county assumption of a share of the cost of continuing the "Options for Recovery" pilot project, effective January 1, 1995, because programs continued beyond the pilot stage should be funded in the same manner as other ongoing CWS programs. This would result in a General Fund savings of \$555,000. (Reduce Item 5180-151-001 by \$555,000.)

We further recommend that the proposal to continue the specialized care augmentation in 1994-95 be amended to reflect the same county share of cost as other CWS programs because there is nothing to distinguish this program from other CWS activities. This would result in a General Fund savings of \$1.3 million. (Reduce Item 5180-151-001 by \$1,349,000.)

Options for Recovery Demonstration Pilot. Chapter 1385, Statutes of 1989 (SB 1173, Royce), established the Options for Recovery pilot project to promote the recruitment, support, and training of foster family homes to care for substance-exposed and HIV-positive children. Phase I of the project includes four counties—Alameda, Sacramento, San Diego, and Los Angeles. Phase II of the project includes six counties—Contra Costa, Butte, Glenn, Shasta, Tehama, and Siskiyou. Chapter 296, Statutes of 1993 (SB 1050, Russell), extended the pilot program for Phase I counties until June 30, 1994 and Phase II counties until August 31, 1994.

The budget, however, includes funding (\$3.7 million General Fund) for the program to continue for the full year in 1994-95, to be funded entirely at state expense. In addition, the department plans to propose legislation to extend the program beyond the statutory termination date.

Chapter 296 requires the department to prepare a preliminary evaluation report on the effectiveness of the project by January 1, 1994, to serve as a basis for recommending the continuation of the program. At the time this analysis was prepared, the department indicated that they had completed an internal draft of the preliminary report. We expect to review the report when it becomes available and will comment on it during the budget hearings. Chapter 296 also requires the department to submit a final report to the Legislature by November 30, 1994.

The department has indicated that it expects to submit the final report as scheduled. Thus, the pilot stage of the program should be completed by December 1994. Pending our review of the preliminary and final reports, we believe that it would be reasonable to continue the program in 1994-95. Because the pilot stage will be completed with submission of the final report, however, we recommend that continuation of the program beyond December 31, 1994, be based on an assumption that the costs of the program be shared by the state and counties in the same manner as other ongoing CWS programs (70 percent state/30 percent counties). This would result in General Fund savings of \$555,000 in 1994-95 (half year). Annual savings in subsequent years would be about \$1.1 million.

Specialized Care Augmentation. Chapter 1294, Statutes of 1989 (SB 370, Presley), authorized a General Fund augmentation for one year (1991-92) to provide incentives and assistance to families caring for foster children with specialized care needs (physical or emotional). The funds were not appropriated until 1993-94 due to the state's fiscal constraints. The budget, however, proposes to continue the augmentation in 1994-95, in the amount of \$4.5 million from the General Fund. According to the department, these funds will be used to purchase nonrecurring items, respite care, and services not available through other fund sources. These

activities could result in increased recruitment and retention of foster family providers.

If the specialized care augmentation is to be continued, we find no reason to distinguish it from other CWS programs with respect to the manner in which it is funded. Accordingly, we recommend that the costs of the specialized care augmentation be shared by the state and counties on the same basis as other CWS programs—70 percent state and 30 percent counties. This would result in General Fund savings of \$1.3 million in 1994-95.

Positions Should Remain on Limited-Term Rather Than Permanent Basis

We recommend that 5.5 limited-term positions established to develop the Level-of-Care Assessment (LCA) instrument be continued on a limited-term (two-year), rather than permanent, basis because the workload does not justify continuation on a permanent basis.

Chapter 1294, Statutes of 1989 (SB 370, Presley), as amended by Ch 714/92 (SB 307, Royce) requires the DSS to develop and implement an LCA instrument to match the assessed needs of children in need of out-of-home care with the structure, supervision, and services offered by providers of such care. Current law does not specify a completion date for the LCA instrument. However, the law does require the department to report to the Legislature by January 1, 1995, on the progress of the project. At this time, the department indicates that they are unable to provide a date of completion for the project.

In 1990-91, 5.5 positions were established on a limited-term basis to develop the LCA instrument. These positions were later extended through June 30, 1994. The budget proposes a total of \$330,000 (\$216,000 General Fund) to continue these 5.5 positions on a permanent basis. The department indicates that the permanent positions are needed for the ongoing workload associated with (1) the LCA project and (2) other placement-related activities mandated by recent legislation.

Based on our review, we find that continuation of the 5.5 positions is needed to meet the mandates of the LCA project and other legislation, and that these positions are justified during the next two fiscal years. Beyond that, however, the extent to which the workload is ongoing is not clear. We therefore recommend continuation of the 5.5 positions on a limited-term (two-year), rather than permanent, basis. At the end of the limited term, the department could submit a proposal that more accurately assesses the need to continue the positions.

Budget Does Not Reflect Savings Anticipated From an Increase in Federal Funds

We recommend a General Fund reduction of \$7.7 million in the amount proposed for the Child Welfare Services Program in 1994-95 to reflect anticipated additional federal funds for the case management system. (Reduce Item 5180-001-001 by \$6.1 million and Item 5180-151-001 by \$1.6 million.)

Chapter 1294, Statutes of 1989 (SB 370, Presley), requires the implementation of a single statewide child welfare services case management system (CMS). The primary goal of the CMS is to provide a statewide data base, case management tool, and reporting system for the program. The department anticipates statewide implementation of the CMS by 1996-97.

The budget proposes \$9.6 million (\$8.5 General Fund and \$1.1 million federal funds) for state operations to develop the CMS in 1994-95. The budget also proposes \$2.7 million (\$2.4 million General Fund and \$300,000 federal funds) for local assistance for the ongoing costs of pilot implementation in 1994-95.

The federal Omnibus Budget Reconciliation Act (OBRA) of 1993 allows states to claim 75 percent federal funding for the planning, design, development, and installation of a statewide automated child welfare system, effective for federal fiscal years 1994, 1995, and 1996. The OBRA also allows states to claim 50 percent federal funding for the ongoing operation of the statewide automated child welfare system, effective federal fiscal year 1994.

The department is presently applying for the new federal funds and indicates that it will submit the required advance planning document in February. Upon approval, the state could claim the federal funds *retroactive* to federal fiscal year 1994, beginning October 1993. The budget, however, does not assume any savings from the anticipated increase in federal funds in the current or budget years.

We estimate that claiming the additional federal funding would result in a General Fund savings of \$3.7 million in 1993-94 and \$7.7 million in 1994-95. Accordingly, we recommend that the budget be amended to reflect these anticipated savings.

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. While this implies that the program prevents institutionalization, eligibility for the program is not based on the individual's risk of institutionalization. Instead, persons are eligible for IHSS if they live in their own homes—or are capable of safely doing so if IHSS is provided—and meet specific criteria related to eligibility for the Supplemental Security Income/State Supplementary Program (SSI/SSP) for the aged, blind, and disabled.

The IHSS Personal Care Services Program (PCSP) includes personal care services as a federally reimbursable service under the Medicaid Program. The PCSP limits eligibility to categorically eligible Medi-Cal recipients (AFDC and SSI/SSP recipients) who satisfy a “disabling condition” requirement. Personal care services include activities such as (1) assisting with the administration of medications and (2) providing needed assistance with basic personal hygiene, eating, grooming, and toileting.

The budget proposes expenditures of \$916 million (\$555 million county funds and \$361 million in reimbursements) for local assistance in the IHSS Program in 1994-95. This represents a shift of \$364 million in General Fund costs to the counties, pursuant to the Governor's restructuring proposal.

Restructuring Proposal

The Governor's restructuring plan proposes to transfer full financial and policy responsibility for the IHSS Program to the counties. The PCSP component of IHSS would continue to draw funding from federal Medicaid reimbursements. For a discussion of the restructuring proposal, please see our companion volume, *The 1994-95 Budget: Perspectives and Issues*. In that report, we recommend that the Legislature not adopt a 100 percent county share of the nonfederal costs of the IHSS Program. Instead, we recommend giving counties a 50 percent share of the nonfederal costs of IHSS and the same share of long-term care costs in the Medi-Cal Program.

ADOPTIONS PROGRAMS

Budget Does Not Assume Savings From Independent Adoptions Fee Increase

We recommend a General Fund reduction of \$600,000 for the Independent Adoptions Program to reflect increased fee revenues. (Reduce Item 5180-151-001 by \$600,000.)

Background. Under the Independent Adoptions Program, the natural parents, instead of an adoption agency, place the child directly with the adopting parents of their choice. The role of the state adoptions offices and county adoptions agencies in an independent adoption is limited to visiting the home of the adoptive parents and preparing a “home study” report. The court uses the home study in combination with other information to determine whether the adoption is in the best interest of the child, the natural parents, and the adoptive parents.

Currently, four counties operate their own independent adoptions programs—Alameda, Los Angeles, San Bernardino, and San Diego. The state provides the adoptions services in the remaining 54 counties. As budgeted, the Independent Adoptions Program is supported entirely by the General Fund in all 58 counties, although the counties may, at their discretion, provide additional local funds.

Fee Increase Not Reflected in Budget. In our *Analysis of the 1991-92 Budget Bill*, we recommended that the fee charged to prospective adoptive parents be increased from \$500 to \$2,400 in order to more fully reflect the costs of the program. We noted that (1) most of the adoptions in the program involved healthy newborn infants who tend to be the easiest children to place and (2) most of the prospective parents had relatively high incomes—the median being about \$57,000 in 1989-90. Chapter 1158, Statutes of 1993 (SB 1152, Senate Committee on Health and Human Services), authorizes state and county programs to charge a \$1,250 fee to prospective adoptive parents, with a waiver for low-income persons, beginning in 1993-94.

The budget reflects an inconsistent treatment of these fee revenues. For the *state-operated* programs, the budget assumes that the increase in fee revenues will offset program costs. For the *county-operated* programs, the increased fee revenues are allocated directly to the counties, rather than

deposited in the state General Fund. By not reducing program expenditures, therefore, the budget assumes that these revenues will be used by the counties either to offset county funds allocated to the program, if any, or to augment the program. The budget, however, does not indicate that its proposal is predicated on a "buy-out" of county expenditures or a program augmentation, and no justification for these alternatives has been submitted to the Legislature.

To summarize, (1) the budget assumes that the estimated increase in fee revenues will be used to offset program expenditures for the state-operated programs in 54 counties, (2) no justification has been submitted for supplanting or augmenting county funds in the four county-operated programs, and (3) the program's costs, in our view, should be reimbursed by fees. Consequently, we recommend that the proposed level of General Fund expenditures for the county-operated programs be reduced by \$600,000, which is the amount of estimated additional revenues that these counties will receive in 1994-95 as a result of the fee increase.

LIST OF FINDINGS AND RECOMMENDATIONS

Analysis
Page

Health and Welfare Agency

1. **Federal Funds Potentially Available.** Recommend the Health and Welfare Agency report on the feasibility of obtaining additional funds, including specific options that we identify for further consideration. C-17

Office of Statewide Health Planning and Development

2. **Cal-Mortgage Reserves Are Inadequate.** Recommend that the Office of Statewide Health Planning and Development report on various options to reduce the financial risk to the General Fund in the Cal-Mortgage program. C-19
3. **Additional Funding Needed to Train Primary Care Providers.** Recommend enactment of legislation to appropriate \$2 million from Proposition 99 fund reserves for the Song-Brown Family Physician Training Program to help address the shortage of primary care nurse practitioners and physician assistants. C-20

California Medical Assistance Program (Medi-Cal)

4. **Department Continues Expansion of Managed Care.** Under the department's strategic plan, almost half of all Medi-Cal beneficiaries would be enrolled in a "managed care" arrangement by the end of 1994-95. C-31

	Analysis Page
5. Managed Care Implementation Should Be Reevaluated. Recommend that the Legislature reevaluate the broad authority it has granted the department to expand managed care because we believe these efforts, as they are presently being pursued, are likely to result in additional <i>costs</i> to the program, rather than savings.	C-35
6. Reliance on Prepaid Health Plans (PHPs) Not a Viable Cost-Containment Option. Reduce Item 4260-101-001 by \$18 Million. Recommend that the Legislature reduce expenditures for PHP services because rates exceed fee-for-service equivalent costs. Recommend legislation limiting the number of beneficiaries enrolled in any single PHP within a geographic region.	C-35
7. Targeting Only AFDC-Linked Beneficiaries for Managed Care Ignores Demonstrated Savings Potential. Recommend legislation requiring that managed care expansion in 13 counties include SSI/SSP-linked beneficiaries.	C-38
8. Per-Discharge Disproportionate-Share Hospital Payments Would Reduce Medi-Cal Costs. Reduce Item 4260-101-001 by \$10.4 Million. Recommend legislation to implement a “per-discharge” reimbursement system for disproportionate-share hospital payments, and a budget reduction due to the resulting decrease in utilization of inpatient hospital services.	C-39
9. Elimination of Optional Services. We find the following regarding the budget proposal: (a) it will place an additional burden on county indigent health programs, (b) the savings estimate is optimistic because federal law requires that necessary transportation services be provided, and (c) if adult dental services are not eliminated, continuation would result in General Fund costs of \$201 million due to a recent court decision. Recommend that the Legislature consider eliminating services for certain medical treatments or conditions as an alternative approach if it wishes to achieve General Fund savings through rationing.	C-41

- | | Analysis
Page |
|---|--------------------------|
| 10. Budgeted Rate Increases Can Be Avoided. Reduce Item 4260-101-001 by \$73 Million. Recommend legislation authorizing the California Medical Assistance Commission (CMAC) to negotiate rates for skilled nursing facility services in certain areas. Further recommend reducing budgeted expenditures for hospital inpatient and nursing facility costs because expenditures can be reduced through CMAC negotiations due to advantageous market conditions. | C-44 |
| 11. Reinstate Mandatory Drug Rebates. Reduce Item 4260-101-001 by \$10 Million. Recommend legislation to reinstate mandatory drug rebates for the first half of 1994-95 to achieve savings until implementation of a proposal to manage the drug program under a contract with a pharmacy management company. | C-45 |

Public Health

- | | |
|--|------|
| 12. Low-Level Radioactive Waste Disposal Site Still Not On-Line. Recommend that the department report at budget hearings on the status of the low-level radioactive waste disposal facility project. | C-48 |
| 13. Reauthorization of Proposition 99 Funding. Statutory authority for appropriating Proposition 99 funds expires June 30, 1994. The budget includes a plan for appropriating these funds in 1994-95. | C-49 |

Managed Risk Medical Insurance Board

- | | |
|---|------|
| 14. Expanding Medi-Cal, In Lieu of the Access for Infants and Mothers (AIM) Program, Would Achieve Significant Savings. Recommend that the Legislature not adopt the budget proposal to continue the AIM Program and instead expand the Medi-Cal Program to serve AIM-eligibles. This would secure federal funding for similar services and achieve General Fund savings of about \$73 million in 1994-95. | C-53 |
|---|------|
-

Department of Developmental Services

15. **Case Management Services Augmentation Not Justified. Reduce Item 4300-101-001 by \$5,073,000.** Recommend a reduction of \$5.1 million from the General Fund requested to augment case management services for regional centers because (a) the budget would still contain sufficient funds for case management to address the needs of developmental center clients transitioning to community living and (b) further program enrichment is not justified by the workload. C-60
16. **Supplemental Services Expenditure Not Justified. Reduce Item 4260-101-001 by \$2,830,000.** Recommend the deletion of \$2.8 million General Fund proposed for supplemental services for developmental center clients placed in regional center programs because other funding increases proposed in the budget are sufficient to provide the services needed by these clients. C-61
17. **Developmental Center Caseload-Related Staffing Adjustments Not Reflected in the Budget. Reduce Item 4300-003-001 by \$690,000 and Reduce Item 4260-101-001 by \$5,302,000.** Recommend the DDS develop and implement in 1994-95 a plan to reduce non-level-of-care staff at all DCs where such reductions are warranted by declining caseloads, for an estimated General Fund savings of \$6 million. C-62
18. **Quality Assurance System Plan Not Submitted.** Withhold recommendation on \$2.8 million from the General Fund requested to support the implementation of a statewide system, pending submission of an expenditure plan. C-63
19. **Crisis Intervention Services Program Lacks Plan.** Withhold recommendation on \$8.1 million in total funds (\$4.5 million General Fund) proposed for local crisis intervention facilities and services, pending submission of an expenditure plan. C-63

Department of Mental Health

- | | Analysis
Page |
|--|------------------|
| 20. Funds Proposed for Alternative Modes of Care Lack Plan. Reduce Item 4440-011-001 by \$245,000. Recommend deletion of funds because the department has not justified their proposed use. | C-65 |
| 21. Caseload-Related Staffing Reductions Should Be Implemented. Reduce Item 4440-011-001 by \$100,000. Recommend the department implement non-level-of-care staffing reductions warranted by the caseload declines at all state hospitals. | C-65 |
| 22. School-Based Prevention Program Augmentation Should Be Redirected. Reduce Item 4440-102-001 by \$10 Million and Item 4440-001-001 by \$330,000. Recommend (a) a reduction of \$10.3 million (\$10 million Proposition 98) in the Early Mental Health Initiative Program and (b) a redirection of the Proposition 98 funds to a block grant. Further recommend the DMH advise the budget subcommittees on why it awarded more grants to local projects than the base program budget could support. | C-67 |

Employment Development Department

- | | |
|---|------|
| 23. Disability Insurance Tax Rate Should Be Reduced. Recommend that the Legislature adopt Budget Bill language to reduce the disability insurance tax rate for 1995 by 0.1 percent because projected revenues exceed the amount needed for a prudent reserve. | C-69 |
| 24. Administrative Staff Increase Not Justified. Reduce Item 5100-001-869 by \$395,000. Recommend that (a) the Legislature reject a proposed augmentation of \$395,000 in federal funds and 6.7 personnel-years for the program development section in the Job Training Partnership Division and (2) the Employment Development Department report to the subcommittees, during hearings on the budget, on a plan to reallocate these funds to direct services. | C-70 |
-

25. **Technical Recommendation—Personal Services Are Overbudgeted. Reduce Item 5100-001-184 by \$31,000, Reduce Item 5100-001-588 by \$702,000, Reduce Item 5100-001-869 by \$198,000, and Reduce Item 5100-001-870 by \$58,000. Recommend that \$989,000 be deleted from various funds because the proposed new positions are overbudgeted.**

**Department of Social Services—State
Operations**

26. **Proposed Augmentation to Administer Welfare Reforms Is Not Fully Justified. Reduce Item 5180-001-001 by \$109,000.** Recommend rejection of three new positions proposed to administer provisions of legislation enacted in the current year because the duties can be performed by contract services proposed for the department and by existing positions. C-72

**Aid to Families with Dependent Children
(AFDC)**

27. **Governor Proposes Several Changes That Would Reduce Grants in the AFDC Program.** These changes would result in a General Fund savings of \$460 million in 1994-95. We review these proposals and comment on them. C-76
28. **Governor's Proposed Two-Year Limit on AFDC Would Reduce Grants Substantially.** We discuss some of the advantages and disadvantages of the proposal. C-82
29. **State Will Not Reach Federal Participation Target in the Greater Avenues for Independence (GAIN) Program.** The state will lose \$23 million in federal funds. We find that the federal requirement is a disincentive for states to allocate their GAIN funds in the most effective manner. C-84
30. **Budget Overestimates Savings Anticipated From "Reduced Dependency."** The budget overstates by \$2 million the General Fund savings that would result from reduced dependency on AFDC due to the GAIN Program. C-85
31. **New Targeting Strategies Needed for the GAIN Program.** Recommend legislation to (a) add to the limit of GAIN target groups AFDC parents who have never been married and (b) add to the list of mandatory GAIN participants AFDC parents whose youngest child is one or two years of age and who have never been married. C-85

	Analysis Page
32. Two-Year Interim Evaluation of the Gain Program Shows Positive Results. The final report is due in May 1994.	C-87
33. Child Support Pilot Project Likely to Result in Additional Savings. Recommend that the department report during the budget hearings on the estimated increase in collections for AFDC cases and the resulting savings to the General Fund in the budget year.	C-88
34. Transitional Child Care (TCC) Program Funding Methodology Should Be Changed. Recommend that the Legislature adopt Budget Bill language to (a) require counties to spend a specified portion of their TCC Program administrative allocation on outreach efforts and (b) revise the methodology for allocating administrative funds in the program to increase participation and achieve a better measure of the need for these funds.	C-89
35. Budget Does Not Assume Savings From Expansion of Family Preservation Services. Reduce General Fund Support for School Apportionments by \$5 Million. Recommend that the department report during the budget hearings on plans to implement a new family preservation and family support program and how it intends to use additional federal funds. Further recommend reduction in proposed funding in the foster care program to reflect the impact of these federal funds, for a General Fund savings of \$5 million in 1994-95.	C-95
36. Family Preservation Program Should Be Budgeted in Child Welfare Services (CWS) Program. Reduce General Fund Support for School Apportionments by \$34,907,000 and increase Item 5180-151-001 by \$24,435,000. Recommend that if the Governor's restructuring proposal is adopted, funding for the Family Preservation Program be transferred from the Foster Care Program to the CWS Program and that counties pay a share of cost consistent with other CWS programs.	C-97
37. Trial Court Judges' Training Program Should Be Funded Through Trial Court Funding Program. Reduce Item 5180-	C-99

Analysis
Page

001-001 by \$229,000. Recommend deletion of funding for judges' training program through the DSS because funding should be provided through the Trial Court Funding Program.

Supplemental Security Income/ State Supplementary Program

- | | |
|--|-------|
| 38. Proposal Assumes no Payment of SSP Administration Fees. The assumption that Congress will enact legislation to eliminate the fee charged to California creates a \$43 million General Fund risk if federal action does not occur. | C-100 |
| 39. General Fund Savings From Proposed Federal Reimbursement of Refugee Costs Are Overstated. The budget overstates the General Fund savings that could be realized from this proposal by \$5.8 million. | C-100 |
| 40. Budget Should Reflect Savings From "Deeming" Sponsor's Income. Reduce Item 5180-111-001 by \$8 Million. Recommend reducing the proposed appropriation for SSI/SSP grants in order to account for a statutory provision that increases the length of time a sponsor's income is considered in determining grants for immigrants, for a General Fund savings of \$8 million in 1994-95. | C-101 |
| 41. Restricting Eligibility of Substance Abusers Would Result in a Shift of Costs. The budget proposal to restrict the eligibility of persons receiving SSI/SSP benefits because of drug and alcohol disabilities (a) overstates General Fund savings by \$1 million, due to a technical error, and (b) would result in a shift of costs to state and local governments for health and social services provided to those who lose benefits and are not rehabilitated. | C-101 |
| 42. State Should Pursue Federal Medicaid Funds for Personal Care for SSI/SSP Recipients. Recommend that (a) the Legislature direct the DSS to seek approval to claim federal Medicaid funds for personal care services provided to | C-103 |

**Analysis
Page**

SSI/SSP recipients receiving nonmedical out-of-home care and (b) the department develop an estimate of the net savings and report to the subcommittees during hearings on the budget. This could result in General Fund savings in the range of \$20 million annually.

43. **Department Is Seeking Federal Funds to Establish Fraud Pilot Projects.** Recommend that the department report to the subcommittees, during the budget hearings, on (a) the status of the application for federal funds to support the SSI/SSP fraud pilot projects that are proposed to be supported by state funds and (b) any state and federal statutory changes necessary to implement the pilot projects. C-104

County Administration of Welfare Programs

44. **COLAs for County Administration Not Consistent With Budget's Policy in Other Programs. Reduce Item 5180-141-001 by \$14,500,000.** Recommend that the amount proposed for a cost-of-living adjustment (COLA) for county administration of welfare programs be deleted, for a General Fund savings of \$14.5 million, because funding COLAs for this program is inconsistent with the budget's overall policy toward COLAs for local assistance programs. C-106
45. **Department Should Modify Approach in Conducting Proposed Fraud Studies.** Recommend that before undertaking two proposed studies of fraud in child-only AFDC cases, the DSS modify its approach to address the methodological shortcomings in the department's study of fraud in Orange County. C-109
46. **County Share of Fraud Program Costs Should Be Commensurate With Share of Benefits. Reduce Item 5180-141-001 by \$14,443,000.** Recommend legislation to adjust the state and county shares of the nonfederal costs of the AFDC fraud programs to correspond to the state and county shares of the costs of AFDC grants. This would allocate the costs of the fraud programs in a manner that is commensurate with the distribution of program benefits to the state and counties, and would result in a General Fund C-110
-

- | | Analysis
Page |
|--|--------------------------|
| <p>savings of \$14.4 million in 1994-95. Further recommend that funds for the two components of the AFDC fraud programs—early and continuing fraud—be combined into a single allocation so that counties can allocate the funds between the two components in the most cost-effective manner.</p> | |
| <p>47. Department Should Reassess its Approach Toward Interim Statewide Automated Welfare System (SAWS). Withhold recommendation on the proposed 14-county interim SAWS project (\$11.6 million in 1993-94 and \$15 million in 1994-95 from the General Fund) and recommend that the DSS and the Department of Finance report, during the budget hearings, on the concerns raised in this analysis.</p> | C-113 |
| <p>48. State's Share of SAWS Development and Implementation Cost Is Too High. Reduce Item 5180-001-001 by \$6,024,000. Recommend enactment of legislation to increase the county share of the nonfederal costs of the SAWS project to correspond to the county's share of the benefits. This would allocate the costs of development and implementation in a manner that is commensurate with the distribution of program benefits, for a General Fund savings of \$6 million in 1994-95 and over \$125 million from the General Fund over the 12-year life of the project.</p> | C-116 |
| <p>49. Statewide Implementation of SAWS Should Provide for Competition. Recommend that the DSS report, during budget hearings, on how its RFP to implement the statewide SAWS project will maximize the state's opportunities to achieve an expeditious and cost-effective implementation.</p> | C-117 |
| <p>50. State Should Not Pay for Relatively High County Overhead Costs. Reduce Item 5180-151-001 by \$8,950,000. Recommend capping the amount of state funding for administrative overhead in the Child Welfare Services (CWS), IHSS, AFDC, and Food Stamps Programs because the state should not pay for relatively high county overhead costs. This would result in General Fund savings of approximately \$9 million in the CWS Program in 1994-95</p> | C-118 |

and an undetermined amount in the AFDC, IHSS, and Food Stamps County Administration Program.

Child Welfare Services

51. **Counties Should Share Cost of Program Continued Beyond Pilot Stage. Reduce Item 5180-151-001 by \$555,000.** Recommend that counties assume a share of cost for continuing "Options for Recovery" project beyond the pilot stage in the same manner as other CWS programs. C-121
52. **Ongoing CWS Activity Should Be Budgeted as Other CWS Programs. Reduce Item 5180-151-001 by \$1,349,000.** Recommend that counties pay a share of cost for proposed continuation of specialized care augmentation in the CWS Program, for a General Fund savings of \$1.3 million in 1994-95. C-121
53. **Positions Should Remain on Limited-Term Rather Than Permanent Basis.** Recommend that 5.5 positions established to develop a Level-of-Care Assessment instrument be continued on a limited-term (two-year), rather than permanent, basis because the workload does not justify continuation on a permanent basis. C-123
54. **Budget Does Not Reflect Savings Anticipated From an Increase in Federal Funds. Reduce Item 5180-001-001 by \$6,100,000 and Item 5180-151-001 by \$1,600,000.** Recommend a reduction in General Fund support for the child welfare services case management system, in order to reflect an increase in available federal funds. C-124

Adoptions Programs

55. **Budget Does Not Assume Savings From Independent Adoptions Fee Increase. Reduce Item 5180-151-001 by \$600,000.** Recommend a General Fund reduction of \$600,000 to reflect the availability of increased fee revenues for the Independent Adoptions Program. C-126