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BUREAU OF STATE AUDITS

Los Angeles County Department of Health Services:

Despite Securing Additional Funding and Implementing Some Cost-Cutting Measures, It Still Faces Significant Challenges to Addressing Its Growing Budget Deficit

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CALIFORNIA STATE AUDITOR

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September 11, 2003 2002-019

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 195, Statutes of 2001, the Bureau of State Audits presents its audit report concerning Los Angeles County Department of Health Services' (Health Services) financial capacity to render health care services to county residents.

This report concludes that despite implementing some cost-cutting measures and securing additional funding, Health Services still faces significant challenges to addressing its growing budget deficit. At the end of fiscal year 2001–02, Health Services projected a budget deficit of $709.4 million by fiscal year 2005–06. To alleviate this shortfall, Health Services developed a new strategic plan in June 2002. As a result of an initiative approved by voters in November 2002, and agreement with the State and federal government, Health Services is now pursuing a plan designed to result in annual net savings increasing to $357.5 million in fiscal year 2005–06. However, even though Health Services has successfully implemented many action items from its new strategic plan, preliminary injunctions and prolonged negotiations threaten the implementation of other proposals. Finally, even if Health Services successfully implements all of its strategic plan proposals, it would still face an estimated budget deficit of $345.4 million in fiscal year 2006–07. Without stable funding and cost-cutting flexibility, Health Services' future financial viability and capacity to provide health care services to the residents of Los Angeles County will continue to remain in question.

Respectfully submitted,

Elaine M. Howle

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State Auditor

Los Angeles County Department of Health Services:

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SUMMARY

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Our review of the Los Angeles County Department of Health Services (Health Services) to evaluate the current status of its latest strategic plan revealed that:

- ☑ *To alleviate a deficit projected to reach $709.4 million by fiscal year 2005–06, Health Services developed a new strategic plan in June 2002.*
- ☑ *Health Services subsequently secured the funding it needed to pursue a plan designed to result in annual net savings increasing to $357.5 million in fiscal year 2005–06.*
- ☑ *Although Health Services has implemented many proposals from its new strategic plan, some proposals that promise significant savings face major challenges.*
- ☑ *Even if Health Services successfully implements its proposals, it would still face a projected deficit of $345.4 million in fiscal year 2006–07.*

RESULTS IN BRIEF

At the end of fiscal year 2001–02, the Los Angeles County Department of Health Services (Health Services) estimated its budget deficit at $326.6 million for fiscal year 2003–04 and projected the shortfall would grow to $709.4 million by fiscal year 2005–06, if left unchecked. To alleviate the shortfall while maintaining an integrated and coordinated system of care for low-income and medically indigent residents, Health Services developed a new strategic plan, building on an earlier proposal to improve efficiency and identify new funding sources. Presented to the Los Angeles County Board of Supervisors (board) in June 2002, the new strategic plan outlines three scenarios for the county's health care system, each relying on different levels of funding and various reductions in program size and costs. The board instructed Health Services to begin implementing action items shared by Scenarios II and III, such as reducing services at High Desert Hospital and closing 11 health centers, pending the outcome of Health Services' efforts to secure additional funding.

Working with the county, the State, and federal officials, Health Services subsequently secured the funding it needs to proceed with Scenario III and avoid what Health Services predicts would be more painful cuts. A voter-approved initiative is expected to provide an estimated $146 million annually to support Health Services' emergency and trauma hospitals, and public health bioterrorism needs, starting in fiscal year 2003–04 and continuing indefinitely. Further, Health Services expects agreements with the State and the federal government to provide another $250 million over fiscal years 2002–03 through 2004–05.

Health Services projected that the full and timely implementation of the 21 proposals contained in Scenario III would result in annual net savings increasing to $357.5 million in fiscal year 2005–06. To date, Health Services has implemented or begun to implement 15 of the 21 proposals, including the avoidance of capital costs at High Desert Hospital, successfully reducing its system from six hospitals to five, closing 16 health centers, cutting public health and administrative expenditures,

and reforming its partnership program with private-sector health providers. By taking these actions, Health Services expects to save $38.2 million in fiscal year 2002–03.

However, other Scenario III proposals face challenges. For example, preliminary injunctions have so far prevented Health Services from closing the Rancho Los Amigos National Rehabilitation Center (Rancho Los Amigos) and reducing beds at the Los Angeles County–University of Southern California Medical Center (LAC/USC). Further, Health Services expects to implement two proposals—restructuring psychiatric services and contracting out certain administrative services—later than initially expected. These and other delays have prevented Health Services from saving the full $56.8 million targeted for fiscal year 2002–03 and may reduce future savings as well.

Finally, even if Health Services successfully implements all the Scenario III proposals, it would still face a budget deficit of $345.4 million in fiscal year 2006–07, growing to $767.8 million in fiscal year 2007–08. The deficit results primarily from the expiration of temporary state and federal funding agreements. For example, the extension of the 1115 Medicaid Demonstration Project, an agreement between the State and the federal Centers for Medicare and Medicaid Services that provides Health Services with $900 million over a five-year period, ends in fiscal year 2004–05. Moreover, Health Services predicts that delaying the closure of Rancho Los Amigos and the reduction of beds at LAC/USC until July 2004 will cause it to run a deficit of $69.5 million by fiscal year 2005–06, increasing to $840.5 million by fiscal year 2007–08. Without stable funding and cost-cutting flexibility, Health Services' future financial viability and capacity to provide health care services to the residents of Los Angeles County will continue to remain in question.

AGENCY COMMENT

Health Services generally agrees with the findings contained in our report. ■

INTRODUCTION

BACKGROUND

The Los Angeles County Department of Health Services (Health Services) is the health care provider for the county's low-income and medically indigent residents, serving approximately 800,000 patients. With a budget of approximately $3.3 billion for the county fiscal year ending June 30, 2003, Health Services' mission is to protect, maintain, and improve the health of communities. Serving as provider, contractor, and coordinator, as of July 1, 2003, Health Services operates five hospitals, one multiservice ambulatory care center, six comprehensive health centers, 17 health centers, and one residential rehabilitation center. Health Services also contracts with private sector health providers to operate approximately 100 clinics. In addition, Health Services provides public health services to county residents including AIDS prevention and treatment programs, restaurant inspections, and alcohol and drug treatment programs. Finally, its affiliation with area medical schools offers future health professionals training grounds to develop their skills.

Care Provided by Health Services' Facilities

Comprehensive health center—freestanding center that provides an array of outpatient services, including primary care, specialty care, and/or urgent walk-in services.

Health center—provides primary care and/or public health services.

Hospital—an institution that is built, staffed, and equipped for the diagnosis of disease; for the treatment, both medical and surgical, of the sick and the injured; and for their housing during this process.

Multiservice ambulatory care center—Provides specialty services, surgical and nonsurgical procedures, comprehensive diagnostic services, and a limited amount of urgent care. All services are provided on an outpatient basis.

Public-private partnership program—a collaborative effort between Health Services and private, community-based providers (partners) that are committed to providing quality health services in a culturally and linguistically appropriate environment to low-income and uninsured communities. The program is comprised of community clinics and private medical groups with which Health Services contracts to provide outpatient primary care and limited specialty care to Health Services' patients.

Residential rehabilitation center—provides supervised 24-hour live-in alcohol and drug programs within structured treatment recovery environments.

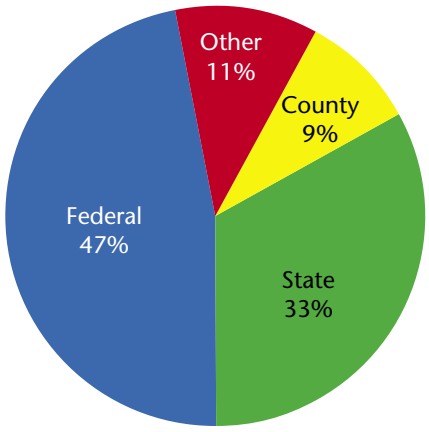
HEALTH SERVICES' SOURCES OF FUNDING

Health Services relies on multiple funding sources. One significant federal source has been the 1115 Medicaid Demonstration Project (1115 Waiver), an agreement between the State and the federal Centers for Medicare and Medicaid Services to provide Health Services with additional funding over a 10-year period beginning July 1, 1995. The 1115 Waiver initially was to expire June 30, 2000, but was extended through June 30, 2005, providing an additional $900 million in federal funding over five years and requiring Health Services to meet several objectives, such as providing a minimum number of outpatient visits each year. Another source of funding is California's Medicaid program,

Medi-Cal, which is a primary source of health care coverage for low-income individuals without medical insurance. Health Services also receives funding from Medicare, the federal program that provides health insurance to most people over 65 years old and to certain disabled persons, and the State has provided Health Services a portion of its revenues from sales taxes, vehicle license fees, and tobacco taxes since at least fiscal year 1991–92. In addition, Los Angeles County contributes proceeds from its general fund and the tobacco settlement, which among other things requires the tobacco industry each year for 10 years to pay $25 million to fund a charitable foundation that will support the study of programs to reduce teen smoking and substance abuse and the prevention of disease associated with tobacco use. Health Services receives a small amount of revenue from private health insurers and out-of-pocket payments made directly by patients as well. The Figure illustrates the proportion of Health Services' funding from these sources for fiscal year 2001–02.

FIGURE

Health Services' Sources of Funding
Fiscal Year 2001–02



Source: Health Services.

During fiscal year 2002–03, voters in Los Angeles County approved the Preservation of Trauma Centers and Emergency Medical Services; Bioterrorism Response Initiative (Measure B), that is estimated to provide Health Services $146 million in annual revenue beginning in fiscal year 2003–04. In addition, due to an agreement between the State and the federal government, Health Services expects to receive a total of

$250 million in revenue between fiscal years 2002–03 and 2004–05. We discuss these additional funding sources in greater detail in the body of the report and provide Health Services' estimates of its fiscal outlook through fiscal year 2007–08 in Appendix A.

WE PREVIOUSLY REVIEWED HEALTH SERVICES' PRELIMINARY PROPOSALS TO ADDRESS ITS BUDGET CRISIS

The Bureau of State Audits (bureau) previously evaluated the financial condition of Health Services, issuing a report in May 2002 titled *Los Angeles County Department of Health Services: Current Proposals Will Not Resolve Its Budget Crisis, and Without Significant Additional Revenue It May Be Forced to Limit Services*. In general, we concluded that Health Services faced a projected shortfall of at least $688 million by fiscal year 2005–06, threatening its ability to maintain then-current levels of health care services to low-income and medically indigent county residents. We presented Health Services' preliminary proposals to address its forecasted budget deficit and assessed its capacity to mitigate the projected shortfall. We concluded that the preliminary proposals, contained in Health Services' January 2002 strategic plan, needed further development. For example, the plan did not go far enough in providing implementation schedules, clearly defined milestones, and tools to track progress, and most of the proposals did not include estimates of cost savings. Essentially, Health Services intended the January 2002 strategic plan to provide recommendations regarding broad policy and organizational issues and to establish redesign parameters.

SCOPE AND METHODOLOGY

Chapter 195, Statutes of 2001, required the bureau to conduct two audits evaluating the financial capacity of Health Services to render necessary health care services to the residents of Los Angeles County. In particular, we were asked to do the following in each audit:

- List and describe each of the proposals put forward to reduce Health Services' expenditures or increase its revenues, including the current status of each.

- Review projections of budgetary shortfalls to determine whether the assumptions that underlie Health Services' baseline revenue and expenditure estimates for the period beginning in 2001 and ending in 2005 are reasonable, and adjust the projections as necessary.

- Devise an accounting tool adequate to track Health Services' budget deficit.

- List and explain how 1115 Waiver extension requirements and other existing or potential laws, regulations, or administrative rules affect Health Services' deficit.

- Evaluate Health Services' timeliness and effectiveness in addressing its deficit.

- Determine the extent to which Health Services' proposals to address its deficit are complete and likely to be effective.

Since the publication of our first report in May 2002, the California Department of Health Services (state DHS) hired a contractor to monitor Health Services' financial condition over the next several years. Because the scope of the contractor's work duplicates what we were asked to do, we met with the state DHS and its contractor to coordinate the audit effort. To avoid duplication of effort, as required by statute, we collectively agreed that the bureau would limit its work reported here to a high-level status update of Health Services' strategic plan and fiscal outlook since the release of our May 2002 report. We agreed that the bureau would not evaluate the reasonableness of projections contained in Health Services' fiscal outlook document or the cost-savings estimates in its current strategic plan because the state DHS contractor would perform those evaluations. Additionally, we did not audit any of Health Services' financial data contained in our report. The contractor for the state DHS is scheduled to release its first annual report in the fall of 2003.

To conduct our review, we examined documents and interviewed key staff to identify Health Services' projected fiscal outlook and the current status of those proposals contained in its latest strategic plan that were specifically designed to address its projected deficit. We present a glossary of terms in Appendix B. ■

AUDIT RESULTS

IN ITS STRATEGIC PLAN, THE LOS ANGELES COUNTY DEPARTMENT OF HEALTH SERVICES PROPOSES TO ADDRESS ITS DEFICIT BY REDESIGNING THE COUNTY HEALTH SYSTEM

On June 26, 2002, the Los Angeles County Department of Health Services (Health Services) presented a revised strategic plan that builds on the January 2002 strategic plan we assessed in our May 2002 report. Approved by the Los Angeles County Board of Supervisors (board), the new strategic plan consists of an overall strategy, proposals for redesigning the county's health care system, and three potential scenarios for reducing the size of Health Services' projected deficit. Overall, the June 2002 strategic plan seeks to achieve an integrated and coordinated system comprising a balanced program of medical services to care for low-income patients and those who are medically indigent—that is, county residents who need but cannot afford medical care.

Health Services Proposes to Redesign the County's Health Care System

As a cornerstone of its overall strategy, Health Services proposed to centralize specialized services at Los Angeles County—University of Southern California Medical Center (LAC/USC) and reduce the scope of services provided by its other hospitals. For example, when Health Services presented its new strategic plan, it intended either to close Rancho Los Amigos National Rehabilitation Center (Rancho Los Amigos) or transition it to alternate governance, possibly putting it under the control of an existing nonprofit hospital. Further, Health Services proposed converting High Desert Hospital (High Desert) to a multiservice ambulatory care center offering only outpatient services.

Health Services' strategic plan includes various other proposals for redesigning the county's health care system, such as consolidating and integrating clinical staff and administrative systems as well as redefining its relationship with area medical schools: the University of Southern California, the University of California at Los Angeles, and the Charles R. Drew University of Medicine and Science. In addition, Health Services proposes defining a benefits package for its clientele, creating an

integrated patient database, and instituting a performance management system for its managerial and clinical personnel. Health Services believes that, regardless of its fiscal outlook, it should implement these proposals because they are essential to the creation of an efficient and effective system of health care delivery. However, because many of these proposals did not focus specifically on addressing Health Services' projected deficit, we do not discuss them in more depth in this report.

Three Scenarios Depict How Health Services Can Reduce Its Budget Deficit

To present alternative ways it could address its impending budget shortfall, Health Services included three scenarios in its revised strategic plan for the board's consideration. Scenario I depicts the county health system should the board reject Health Services' plan for redesigning its health system and Health Services fail in its ongoing efforts to secure additional funding from federal, state, and local sources. Under Scenario I, a significantly reduced system with just three hospitals would focus on providing care only to the most seriously ill. Most other services would be eliminated. Although Health Services presented Scenario I as a possible alternative for its system redesign, it did not recommend it. Scenario II presents the system that would result if Health Services followed its plan for redesigning its health system but failed to obtain additional funding. Under Scenario II, a system with two hospitals, ambulatory care facilities, and health centers, although smaller, would provide a balanced range of services. Scenario III, an extension of Scenario II, reflects a system that would follow Health Services' proposed redesign and succeed in securing additional and more flexible use of revenues. The four-hospital system would allow Health Services to shift its focus from critical revenue needs to patient needs and best clinical practices. Table 1 outlines each scenario's anticipated effect on the county's health care system in fiscal year 2005–06.

Scenario III reflects a system that would follow Health Services' proposed redesign and succeed in securing additional and more flexible use of revenues.

In response to Health Services' presentation of its strategic plan and its three scenarios, the board instructed Health Services to begin implementing action items shared by Scenarios II and III, such as reducing services at High Desert and closing 11 health centers. Depending on the likelihood of additional revenue streams, Health Services would eventually focus on either Scenario II or Scenario III.

TABLE 1

System Design Changes in Scenarios Presented in the June 2002 Strategic Plan Effective Fiscal Year 2005–06

	Scenario I	Scenario II	Scenario III
Hospitals			
Los Angeles County—University of Southern California	Open (665 beds)	Open (600 beds)	Open (600 beds)
Martin Luther King Jr.—Charles R. Drew	Open (233 beds)	Open—no trauma services, 16 percent budget cut (205 beds)	Open—16 percent budget cut (205 beds)
Olive View—University of California, Los Angeles (UCLA)	Open (201 beds)	Reduced to multiservice ambulatory care center	Open (201 beds)
Harbor/UCLA	Closed	Reduced to multiservice ambulatory care center	Open (318 beds)
High Desert Hospital	Closed	Reduced to comprehensive health center	Reduced to multiservice ambulatory care center
Rancho Los Amigos National Rehabilitation Center	Closed	Alternate governance or closed	Alternate governance or closed
Health Centers			
Northeast Area			
El Monte & Hudson Comprehensive Health Centers (CHCs)	Closed	5 percent budget cut	5 percent budget cut
Roybal CHC	Closed	Closed	5 percent budget cut
Health Centers	Closed (5)	Closed (5)	Closed (4)
Coastal Area			
Long Beach CHC	Closed	5 percent budget cut	5 percent budget cut
Health Centers	Closed (3)	Closed (3)	Closed (1)
School Based Clinic	Closed	Closed	Open
Southwest Area			
Humphrey CHC	Closed	5 percent budget cut	5 percent budget cut
Health Centers	Closed (5)	Closed (5)	Closed (4)
San Fernando Valley Area			
Mid-Valley CHC	Closed	5 percent budget cut	5 percent budget cut
Health Centers	Closed (5)	Closed (5)	Closed (2)
School Based Clinics	Closed (3)	Closed (3)	Closed (2)
Antelope Valley Area			
Antelope Valley/Health Services Partnership Clinics	Closed (3)	Closed (3)	5 percent budget cut
Antelope Valley Rehabilitation Center	Closed	Open	Open
South Antelope Valley Health Center	Closed	Open	Open
Other Programs			
AIDS	Unchanged	Unchanged	Unchanged
Alcohol and Drug Services	Unchanged	Unchanged	Unchanged
Children's Medical Services	Unchanged	Unchanged	Unchanged
Health Services Administration	Proportionate reduction	Proportionate reduction	Proportionate reduction
Juvenile Court Health Services	5 percent budget cut	Unchanged	Unchanged
Public Private Partnerships	Closed	Closed	Reduced
Public Health	20 percent budget cut	11 percent budget cut	7 percent budget cut
Office of Managed Care Administrative Functions	Contracted out	Contracted out	Contracted out

Source: Health Services.

ITS SUCCESS IN SECURING ADDITIONAL REVENUE ENABLED HEALTH SERVICES TO PROCEED WITH SCENARIO III

Having completed or initiated a number of action items from Scenarios II and III, as discussed in the next section, Health Services returned to the board in October 2002 to present a status update of its attempts to secure additional funding. Due to a proposed countywide special tax on the November 5 ballot and the State's ongoing negotiations with the federal Centers for Medicare and Medicaid Services (CMS), both of which might result in new funding for Health Services, the board agreed to postpone consideration of additional Scenario II cuts, including service reductions at Los Angeles County Harbor–University of California Los Angeles Medical Center (Harbor/UCLA) and Los Angeles County Olive View–University of California Los Angeles Medical Center (Olive View/UCLA), pending resolution of the funding situation.

A voter-approved initiative is expected to provide an estimated $146 million annually to support Health Services' emergency and trauma hospitals, and public health bioterrorism needs starting in fiscal year 2003–04.

In November 2002, voters overwhelmingly approved the Preservation of Trauma Centers and Emergency Medical Services; Bioterrorism Response Initiative (Measure B), which is expected to provide an estimated $170 million annually from increased property taxes starting in fiscal year 2003–04 and continuing indefinitely. Of this amount, $140 million is designated to support Health Services' emergency and trauma hospitals and $6 million is dedicated to support its public health bioterrorism needs beginning in fiscal year 2003–04, with the bulk of the remaining balance going to noncounty trauma hospitals. Furthermore, in February 2003, the State reached an agreement with the CMS regarding the State's two-year Selective Provider Contracting Program (SPCP) waiver, which has historically provided federal funding to California hospitals that care for large numbers of low-income patients. As a result of this agreement, Health Services expects to receive $250 million in additional funding through county fiscal year 2004–05: $100 million in supplemental Medi-Cal inpatient payments, $100 million pledged by the State from its federal SPCP funding, and $50 million from the federal share of the orthopedic hospital outpatient settlement.[1] Health Services' success in securing future funding in late 2002 and early 2003 allowed it to address its fiscal deficit by proceeding with

[1] For more information on the orthopedic hospital outpatient settlement, see *Belshe v. Orthopaedic Hospital.*

Scenario III. The remainder of our report focuses on Health Services' efforts to implement Scenario III and various pending issues that could have an impact on its future financial viability.

HEALTH SERVICES HAS IMPLEMENTED SEVERAL ACTION ITEMS FROM ITS JUNE 2002 STRATEGIC PLAN

Health Services estimates it will save $38.2 million in fiscal year 2002–03 by implementing Scenario III proposals, $18.6 million short of its initial savings projections for that year.

While Health Services has implemented, or is in the process of implementing, many of the action items contained in its June 2002 strategic plan, it has not been able to implement them all as expected. Consequently, Health Services estimates it will save $38.2 million in fiscal year 2002–03 by implementing Scenario III items, $18.6 million short of its initial Scenario III savings projection for that year. Health Services plans to make up for the loss in projected savings through a general systemwide surplus in fiscal year 2002–03 of approximately $130 million. Table 2 on the following pages shows Health Services' Scenario III implementation plan and cost savings estimates from its June 2002 strategic plan as well as the status of each action item as of July 29, 2003. Each year's projected savings reflect the impact of proposed changes compared with the cost of service provided in fiscal year 2001–02. The following sections describe the completed or initiated items as well as the causes for any delays or failures to meet projected savings targets.

Increase Efficiencies at Martin Luther King, Jr./ Charles R. Drew Medical Center

Scenario III proposes that Martin Luther King, Jr./Charles R. Drew Medical Center (King/Drew) increase operational efficiency to incrementally reduce its budget by a total of 16 percent by fiscal year 2005–06. Health Services bases this proposal on various studies, including our May 2002 report, which ranked King/Drew near the bottom in terms of operating efficiency as measured by inpatient operating expense per patient day as well as employee days per patient day compared with other Health Services' hospitals. According to Health Services' projections, complete implementation of this proposal will lead to annual cost savings increasing to $61.9 million in fiscal year 2005–06.

TABLE 2

Scenario III Projected and Actual Savings

	Projected Savings						Actual Savings	
	Board Decision Date	Projected Implementation Date	Estimated Net Savings* (Dollars in Millions) 2002–03	2003–04	2004–05	2005–06	Actual Implementation as of July 29, 2003	2002/03 Savings
Hospitals								
Reduce LAC/USC by 100 acute beds	10/02	05/03	$ 2.0	$16.1	$29.8	$31.9	Uncertain due to preliminary injunction	†
LAC/USC efficiencies	10/02	07/05				20.1		—
King/Drew to phase in 16 percent efficiencies	06/02	05/03	2.8	20.9	46.2	61.9	07/03	†
Rancho Los Amigos alternate governance or closure	10/02	07/04			64.8	70.4	Uncertain due to preliminary injunction	—
Elimination of High Desert Hospital inpatient rehabilitation	03/02	03/02	‡	‡	‡	‡	03/02	‡
Convert High Desert Hospital to a multiservice ambulatory care center	06/02	05/03	1.4	9.8	11.1	12.5	07/03	†
High Desert Hospital capital cost avoidance	06/02	07/02	2.0	0.9				$ 0.0§
Restructure psychiatric services	10/02	10/02	0.2	20.2	25.3	29.2	Negotiations ongoing	0.3
Comprehensive Health Centers								
Implement consistent staffing model	10/02	05/03	3.7	23.3	24.0	24.6	07/03	†
Health Centers								
Northeast Area Close 4 health centers	06/02	10/02	6.3	8.9	9.3	9.7	10/02	6.3
Coastal Area Close 1 health center	06/02	10/02	1.0	1.4	1.4	1.5	10/02	1.0
Southwest Area Close 4 health centers	06/02	10/02	12.7	18.1	18.7	19.4	10/02	7.4
San Fernando Valley Area Close 2 health centers	06/02	10/02	3.2	4.5	4.7	4.8	10/02	3.2
Antelope Valley Area Antelope Valley/Health Services partnership 5 percent efficiencies	06/02	10/02	0.0	0.2	0.2	0.2	10/02	0.0

	Projected Savings						Actual Savings	
	Board Decision Date	Projected Implementation Date	Estimated Net Savings* (Dollars in Millions) 2002–03	2003–04	2004–05	2005–06	Actual Implementation as of July 29, 2003	2002/03 Savings
Other								
Close 5 health centers	03/02	03/02	‡	‡	‡	‡	03/02 through 09/02	‡
Reduce PPP visits	06/02	09/02	$12.5	$ 15.0	$ 15.0	$ 15.0	09/02	$12.5
Administrative reductions (Phase I)	03/02	03/02	‖	‖	‖	‖	03/02	‖
Administrative reductions (Phase II)	06/02	07/02	#	#	#	#	07/02	#
Administrative reductions (Phase III)	10/02	05/03	**	**	**	**	Delayed	**
Public health reductions	06/02	10/02	6.7	9.2	9.4	9.7	07/02 through 10/02	7.5
Contract out Office of Managed Care administration	06/02	05/03	2.3	8.0	8.0	8.0	Negotiations ongoing	†
Cost/revenue adjustments††	10/02	07/03		25.7	41.6	38.6		
Scenario III Totals‡‡			**$56.8**	**$182.2**	**$309.5**	**$357.5**		**$38.2**

Source: Health Services.

* From projected budgets compared with fiscal year 2001–02 service level for each year.

† The savings originally projected for fiscal year 2002–03, will be covered by surplus/savings from Health Services' fiscal year 2002–03 operations.

‡ Proposed and implemented under the January 2002 strategic plan. Therefore, these savings were already included in Health Services' June 2002 fiscal outlook.

§ According to the Chief Administrative Office for Los Angeles County, these savings do not impact Health Services' budget.

‖ Because this action item was proposed and implemented under the January 2002 Strategic Plan, projected savings are not reflected in Scenario III totals. However, Health Services estimates savings of $8 million annually, of which $5.9 million for fiscal year 2002–03 was initially included in its June 2002 fiscal outlook. Additionally, the entire $8 million annual savings was subsequently included in its fiscal year 2002–03 budget.

Since this action item was proposed and implemented under the January 2002 Strategic Plan, projected savings are not reflected in Scenario III totals. Additionally, Health Services did not include estimated annual savings of $5 million in its June 2002 fiscal outlook. However, Health Services' subsequent fiscal forecasts, and its fiscal year 2002–03 budget, reflect the $5 million annual savings.

** Reductions dependent on facility reductions that are uncertain due to preliminary injunction. Therefore, Health Services did not project savings for this proposal.

†† Cost/revenue adjustments refer to revenues generated by facilities to be closed, which can still be collected by Health Services and distributed across the system.

‡‡ Excludes onetime expenses such as costs associated with layoffs, facility closure costs, and facility transition costs. Health Services has not yet completely identified or quantified these costs but proposes that they could be partially paid for with tobacco settlement funds.

Key:

King/Drew:	Martin Luther King Jr./Charles R. Drew Medical Center
LAC/USC:	Los Angeles County/University of Southern California
PPP:	Public-private partnership
Rancho Los Amigos:	Rancho Los Amigos National Rehabilitation Center

For fiscal year 2003–04, King/Drew facility administration, in concert with the clinical leadership, identified several areas in which staffing exceeds the current clinical workload and where, according to Health Services, staffing cuts can occur without reducing the level of care patients receive. As a result, Health Services incorporated the first 5 percent of the total 16 percent efficiencies at King/Drew into its current budget, with an additional 5 percent to occur in fiscal year 2004–05 and the remaining 6 percent in fiscal year 2005–06. To assist in implementing these efficiencies, Health Services intends to hire a consultant on a contingency fee basis to work with King/Drew in areas that include the emergency department, operating room, and inventory management.

In June 2003, a physician practicing at King/Drew, and the Union of American Physicians and Dentists filed a complaint with the Los Angeles County Superior Court requesting a temporary restraining order precluding any layoffs or reductions in medical services at King/Drew or Health Services' six comprehensive health centers until the county complies with the Beilenson Act. The Beilenson Act requires the county to post notices and hold public hearings (Beilenson hearings) regarding any proposed reduction in medical services. The county did not hold public hearings regarding the proposed personnel reduction at King/Drew because Health Services did not intend for these personnel reductions to reduce medical services at the facility. The court issued a temporary restraining order which subsequently was converted into a preliminary injunction which prohibits any cuts that reduce the level of medical services for medically indigent patients at King/Drew and Health Services' six comprehensive health centers until the county posts notices and holds hearings as required by the Beilenson Act. However, Health Services maintains that its staffing reductions at King/Drew and its comprehensive health centers do not reduce the level of services it provides to the community, and as such, implemented a majority of the staffing reductions. Furthermore, Health Services expects to continue implementing its Scenario III proposal at King/Drew. (The effect of the preliminary injunction on proposed staff reductions at Health Services' comprehensive health centers is discussed in more depth later in the report.)

Health Services maintains that its staffing reductions at King/Drew do not reduce the level of services it provides to the community.

Eliminate Inpatient Rehabilitation Services at High Desert Hospital

Historically, Health Services provided a limited number of inpatient rehabilitation services at High Desert. At the time of the January 2002 strategic plan, High Desert averaged 2.2 acute

rehabilitation inpatients daily but maintained the legal capacity to serve six inpatients. In March 2002, the board voted to eliminate inpatient rehabilitation services at High Desert, and High Desert's inpatient rehabilitation services ceased that month. Although this item appears in the June 2002 strategic plan, it originated in Health Services' January 2002 strategic plan and was already approved and implemented before the adoption of the revised plan. Therefore, Health Services had already built the $500,000 annual savings related to this proposal into its June 2002 base fiscal outlook and did not project additional savings in its June 2002 strategic plan.

Convert High Desert to a Multiservice Ambulatory Care Center

The board approved Health Services' proposal to eliminate inpatient services at High Desert because Health Services operates four other health centers in the area, and an additional 468 beds are available in two nearby hospitals.

At the time Health Services proposed its June 2002 strategic plan, High Desert was a small hospital with 70 inpatient beds and no emergency room. Because Health Services operates four other health centers in the area, and an additional 468 beds are available in two nearby hospitals, the board approved Health Services' proposal to eliminate inpatient services at High Desert by converting it to a multiservice ambulatory care center.

However, the board also directed Health Services to explore ways to keep High Desert open as an inpatient facility. Among the options Health Services considered were leasing beds to the California Department of Corrections and to a private medical group. Health Services concluded that none of these options provided a feasible means of allowing Health Services to accomplish its mission in a cost-effective manner. For example, Health Services determined that the proposal to lease the facility to a private physicians' group would divert at least $6.7 million in resources to an acute care facility that would not improve access to health care services for the medically indigent. On June 3, 2003, the board rejected the proposal to enter into negotiations to lease High Desert to the private physicians' group. Additionally, on June 6, 2003, a United States District Court denied a motion for a preliminary injunction to halt the elimination of inpatient beds at High Desert. The plaintiffs have since dismissed this case. As of July 1, 2003, High Desert surrendered its hospital license.

Health Services estimated that this conversion would result in savings of $1.4 million in fiscal year 2002–03, with annual savings reaching $12.5 million in fiscal year 2005–06. However,

because the conversion did not occur in fiscal year 2002–03, Health Services did not meet the first-year savings target associated with this action item.

Avoid Capital Costs at High Desert

After converting High Desert to a multiservice ambulatory care center, Health Services determined that seismic upgrades required by Senate Bill 1953 (Chapter 740, Statutes of 1994) would no longer be required, resulting in a cost avoidance of $2 million in fiscal year 2002–03. However, the Chief Administrative Office for the county contends that these savings should not accrue to Health Services' budget, as capital costs generally are paid from the county's general fund. Table 2 beginning on page 12 shows that Health Services did not realize savings related to this action item in fiscal year 2002–03.

Implement a Consistent Staffing Model at the Comprehensive Health Centers

Although implementing the consistent staffing model required staff reductions, Health Services intended to accomplish the cuts without reducing medical services.

Because costs among its various comprehensive health centers varied considerably, Health Services developed a staffing model to standardize staffing levels across facilities. According to the director of Health Services' Office of Ambulatory Care (Ambulatory Care), the consistent staffing model requires a 5 percent budget reduction at all comprehensive health centers and an additional $10 million cut at the Humphrey Health Center in the Southwest Area designed to bring Humphrey's staffing level in line with that of the other comprehensive health centers. Although implementing the model required staff reductions, Health Services intended to accomplish the cuts without reducing medical services and therefore did not hold Beilenson hearings. As with the proposal regarding King/Drew, the proposed budget reductions at the comprehensive health centers underwent legal scrutiny, with Health Services contending that no service reductions of the type addressed by the Beilenson Act have or will occur. The Los Angeles County Superior Court issued a preliminary injunction restraining the County from implementing any reductions in the level of medical services at King/Drew or the six comprehensive health centers until the county posts notices and holds hearings as required by the Beilenson Act. As the county does not believe services will be reduced it has implemented a majority of the personnel actions.

Health Services projected that implementing the staffing model would save $3.7 million in fiscal year 2002–03 and that annual net savings would reach $24.6 million in fiscal year 2005–06. Although Health Services targeted May 2003 for staffing model implementation, according to the director of Ambulatory Care, it did not actually occur until July 2003, when 116 positions were eliminated. Therefore, Health Services did not achieve fiscal year 2002–03 savings as a result of this action. Despite the July personnel reductions, the director of Ambulatory Care anticipates Health Services will not meet its projected savings target of $23.3 million in fiscal year 2003–04, but estimates saving $16 million instead.

Close Some Health Centers

Between March 2002 and October 2002, Health Services closed 16 health centers saving more than $17.9 million in fiscal year 2002–03.

Between March 2002 and October 2002, Health Services closed 16 health centers. Following Beilenson hearings, the board approved five of the health center closures in March 2002, based on the consolidation proposal from the January 2002 strategic plan. Because the board approved the first five closures before adopting the revised June 2002 strategic plan, Health Services had already incorporated the estimated $400,000 in annual savings into its June 2002 base fiscal outlook.

In June 2002, the board approved Health Services' proposal to close an additional 11 health centers, pending Beilenson hearings, and reduce the budgets of three Antelope Valley/Health Services partnership clinics by 5 percent. Health Services estimated that the 11 closures and 5 percent budget reductions would generate savings of $23.2 million in fiscal year 2002–03, with annual savings increasing to $35.6 million in fiscal year 2005–06. Following Beilenson hearings in August 2002, the board approved the proposed closures. Health Services completed implementation in October 2002 by transferring current patients to other clinics, moving 340 displaced employees to critical unfilled positions elsewhere within the system, and making the 5 percent efficiency cuts at the Antelope Valley/Health Services partnership clinics.

The Northeast, Coastal, San Fernando Valley, and Antelope Valley areas achieved their projected savings for fiscal year 2002–03 of a combined $10.5 million. The Southwest Area achieved only $7.4 million of its $12.7 million targeted savings.

Reduce Public-Private Partnership Visits

The public-private partnership (PPP) program is a collaborative effort between Health Services and private, community-based health service providers (partners) to bring quality health care to low-income and uninsured communities. In fiscal year 2001–02, 128 clinics participated in the program. In the June 2002 strategic plan, Health Services recommended that PPP visits be scaled back to save $15 million annually. Health Services estimates that it saved $12.5 million in fiscal year 2002–03. Health Services also expects to meet or exceed its savings goal of $15 million in fiscal year 2003–04.

Reduce Administrative Costs

In its January 2002 strategic plan, Health Services proposed consolidating and streamlining the administrative functions of its offices of Health Services Administration, Public Health, and Managed Care, projecting savings of $8 million annually. The board approved Phase I administrative reductions in March 2002, which eliminated 94 positions. Because the board approved this proposal before adopting the June 2002 strategic plan, Health Services did not include these cost-savings amounts in its June 2002 projections. Rather, Health Services already reflected partial-year savings of $5.9 million for fiscal year 2002–03 in its June 2002 base fiscal outlook, and it subsequently included the full $8 million annual savings in its fiscal year 2002–03 budget and later forecasts.

Building on the January 2002 strategic plan, Health Services also recommended a $5 million annual reduction to Health Services Administration (Administration) to be achieved by further consolidating and streamlining administrative processes. Phase II reductions, implemented in July 2002, eliminated 64 positions. Unlike Phase I savings, Health Services' June 2002 base fiscal outlook did not reflect the $5 million annual savings; however, subsequent fiscal forecasts, and its fiscal year 2002–03 budget, do reflect these savings.

Also building on the January 2002 strategic plan, Phase III administrative reductions were designed to reflect the reduced administrative demands of a smaller health system. Specifically, reductions to Administration's centralized functions were intended to reflect reduced services in the facilities it supports. Phase III reductions were scheduled to take place in May 2003 to parallel the timing of other Scenario III reductions. However, because of various factors impeding Health Services' implementing Scenario III items that would reduce the size of

the health care system, Administration has not undergone a Phase III cut. Therefore, Health Services has not yet projected any savings related to this action item.

Cut Public Health Expenditures

The Phase I and II administrative reductions just described included a $1 million reduction to Public Health's budget for fiscal year 2002–03. In its June 2002 strategic plan, Health Services recommended an additional annual reduction of $8.9 million to Public Health's budget, starting in October 2002.

Public Health reductions occurred in such areas as sexually transmitted disease programs, tuberculosis programs, and immunization clinics.

Public Health comprises four budget areas: AIDS services, alcohol and drug services, children's medicine, and general public health. Because of federal and state requirements, Health Services lacks the flexibility to cut the budget for the first three areas. Therefore, Health Services focused its reductions in the area of general public health. Reductions occurred in such areas as sexually transmitted disease programs, tuberculosis programs, and immunization clinics. Budget cuts made by October 2002 eliminated 96.9 positions, with displaced workers moved to vacant positions. Health Services estimates $7.5 million in actual fiscal year 2002–03 savings related to this item. Health Services projects savings of $9.2 million in fiscal year 2003–04, reflecting the annual savings total of $8.9 million plus a cost-of-living increase.

HEALTH SERVICES FACES MAJOR CHALLENGES IN IMPLEMENTING SOME PROPOSALS THAT PROMISE SIGNIFICANT COST SAVINGS

Although Health Services has successfully implemented many action items from its June 2002 strategic plan, preliminary injunctions threaten the timely and complete implementation of three action items from the strategic plan, while prolonged negotiations hamper the implementation of another two. Health Services projects that fully implementing these five items on time would result in savings of $159.6 million in fiscal year 2005–06. However, because of various roadblocks, Health Services no longer anticipates being able to reach this goal.

Legal Injunctions Threaten the Implementation of Proposals Related to Two Hospitals

Medically indigent and low-income residents have contested the implementation of several proposals from Health Services' June 2002 strategic plan. The complaint filed by Harris against

the board (Harris case) challenges Health Services' planned reduction of LAC/USC by 100 beds, as well as the proposed closure of Rancho Los Amigos. The complaint filed by Rodde against Bonta (Rodde case) seeks to enjoin the county from closing Rancho Los Amigos. The resulting preliminary injunctions may affect Health Services' ability to implement three action items, potentially increasing its projected deficit.

Reduce LAC/USC by 100 Beds and Implement Efficiencies

Anticipating LAC/USC's transition to a new location with fewer beds (census) by fiscal year 2007–08, Health Services' June 2002 strategic plan calls for the reduction of the current LAC/USC census by 100 acute beds: 50 in each of fiscal years 2002–03 and 2003–04. Following this reduction, Scenario III requires LAC/USC to locate areas in which to cut expenses, reducing its cost-per-day average to a level closer to that of Harbor/UCLA and Olive View/UCLA hospitals, which would allow a 4.7 percent cost reduction from its operating subsidy. Health Services projects that, taken together, these actions would produce annual savings of $52 million in fiscal year 2005–06.

On June 3, 2003, a U.S. District Court issued a preliminary injunction in the Harris case, barring the county from reducing the number of beds at LAC/USC or closing Rancho Los Amigos.

On January 28, 2003, the county held a Beilenson hearing regarding the 100-bed reduction at LAC/USC and the closure of Rancho Los Amigos, with the board voting to proceed with implementation of both action items as outlined in the June 2002 strategic plan. In the Harris case, low-income and medically indigent county residents filed a complaint that sought to enjoin the county from reducing the level of service at LAC/USC and closing Rancho Los Amigos. On June 3, 2003, a U.S. District Court issued a preliminary injunction in the Harris case, barring the county from reducing the number of beds at LAC/USC, closing Rancho Los Amigos, or taking any steps to accomplish the reduction or closure.

The Harris preliminary injunction effectively suspends implementation of this proposal and may delay the related efficiency reductions. The county is appealing the preliminary injunction and anticipates a hearing by the United States Court of Appeals for the Ninth Circuit in the fall of 2003. As a result of the preliminary injunction, Health Services expects its deficit to increase (see Appendix A for details on Health Services' fiscal outlook). Moreover, the preliminary injunction freezes LAC/USC's census at the then-current level of 745 budgeted beds, potentially affecting the transition to the new LAC/USC, which will be licensed for 600 beds.

Transition to Alternate Governance or Close Rancho Los Amigos

Another legal action involves the proposed closure of Rancho Los Amigos. Health Services projected that immediately transitioning the administration and funding to alternate governance—that is, putting it under the control of another entity, such as an existing nonprofit hospital—or closure would cut $70.4 million from Health Services' budget in fiscal year 2005–06. To determine Rancho Los Amigos' viability under alternate governance, the board commissioned and examined a variety of studies. The conclusion of all the analyses was that, given the county's determination to affect change by the end of fiscal year 2002–03 and contribute no more than $14.7 million to the operation of Rancho Los Amigos in fiscal year 2004–05, Rancho Los Amigos would not be financially viable under alternate governance.

The January 28, 2003, Beilenson hearing regarding the proposed bed reduction at LAC/USC also addressed the future of Rancho Los Amigos. The board approved Rancho Los Amigos' closure, and Health Services proceeded with implementation. However, in March 2003, two complaints were filed, one in a U.S. District Court and the second in a Superior Court of California. The class action Rodde complaint, filed by disabled Medi-Cal beneficiaries, resulted in a preliminary injunction on May 6, 2003, barring the county from closing Rancho Los Amigos or terminating, reducing, or making any further reductions in any medical services that are covered by the Medi-Cal program until the county can assure the court that disabled people will continue to receive timely and comparable services from other Medi-Cal providers in the county and/or that disabled people will continue to have the same access to inpatient and outpatient services at other health care facilities within the county health care system that they experienced at Rancho Los Amigos.

As to the second complaint—the Harris complaint previously discussed—the court issued a preliminary injunction on June 3, 2003, barring the county from closing or reducing the level of medical services at Rancho Los Amigos or from taking any steps to accomplish these ends.

The Harris and Rodde preliminary injunctions prevent Health Services from closing Rancho Los Amigos, pending further court action. As it has with the Harris complaint, the county is appealing the Rodde complaint ruling and expects a hearing before the United States Court of Appeals for the Ninth Circuit

Health Services predicts that delaying the closure of Rancho Los Amigos and the reduction of 100 beds at LAC/USC until July 2004 could increase its deficit by as much as $72.7 million in fiscal year 2007–08.

in the fall of 2003. The County and the plaintiffs in the Harris and Rodde cases are also actively pursuing settlement discussions through this court's mediation program on the issues of the closure of Rancho Los Amigos and the reduction in beds at LAC/USC. Health Services predicts that delaying the closure of Rancho Los Amigos and the reduction of 100 beds at LAC/USC until July 2004 could increase its deficit by as much as $72.7 million in fiscal year 2007–08. We present Health Services' projections as of July 2003 in Appendix A.

Health Services May Not Achieve Savings Related to Proposals to Restructure Psychiatric Services and Contract Out Certain Administrative Functions

Ongoing negotiations hinder Health Services' ability to implement two Scenario III action items, potentially making future savings targets unattainable. In its January 2002 strategic plan, Health Services proposed what has become a Scenario III action item—pursuing unreimbursed costs for services it provides the county Department of Mental Health (DMH). The June 2002 strategic plan recommends that, beginning in 2003, Health Services restructure its psychiatric services to avoid incurring $20.2 million in costs for providing such services to DMH. The estimated net variable costs for which Health Services is not reimbursed by DMH is projected to rise to $29.2 million by fiscal year 2005–06. Health Services estimates that it saved $254,000 in fiscal year 2002–03 by transferring responsibility for outpatient psychiatric services provided at King/Drew to DMH, and a similar transfer of outpatient psychiatric services is planned from LAC/USC to DMH. However, because it has not yet reached an improved agreement with DMH, Health Services does not expect to achieve the full projected cost savings of $20.2 million related to this action item in fiscal year 2003–04. In fact, Health Services has revised its savings estimates in this area, projecting savings of $14.1 million in fiscal year 2003–04, $10.6 million in fiscal year 2004–05, and only $4 million in fiscal year 2005–06. Health Services included these revised savings estimates in its July 2003 fiscal forecast.

Health Services' June 2002 strategic plan also recommends contracting out certain administrative functions at its Office of Managed Care for a savings of $2.3 million in fiscal year 2002–03 and $8 million annually thereafter. Administrative areas targeted for outsourcing include network operations, medical administration, financial operations, member services,

information systems, marketing, and compliance. However, Health Services reported that, as of July 2003, negotiations with its contractor, L.A. Care, were still ongoing. Consequently, Health Services did not meet the fiscal year 2002–03 savings target related to this item, and its fiscal year 2003–04 target savings are also at risk, depending on the expediency with which Health Services finalizes a contract.

SEVERAL UNRESOLVED ISSUES COULD AFFECT HEALTH SERVICES' LONG-TERM FINANCIAL VIABILITY

Health Services did not factor any impact of the State's fiscal year 2003–04 budget into its July 2003 fiscal forecast because of the delay in the budget's passage.

Health Services is faced with a variety of uncertainties that could impact its future financial viability. Foremost among these are Health Services' continuous negotiations regarding additional funding as well as the requisite flexibility to allow Health Services to take complete advantage of already available funding streams. For example, Health Services did not factor any impact of the State's fiscal year 2003–04 budget into its July 2003 fiscal forecast because of the delay in the budget's passage. According to Health Services, the uncertainty of the State's economy makes forecasting for future years unreliable.

Although not an exhaustive list, the following sections describe significant issues that Health Services has identified as having the potential to either positively or negatively affect its financial viability.

Health Services Is Uncertain How Much It Will Receive in the Future Under the Emergency Services and Supplemental Payment Fund Program

As discussed earlier, California recently entered a two-year agreement with the CMS to extend the SPCP waiver to December 2004. The SPCP waiver specifies the amount of special payments Los Angeles County will receive under the Emergency Services and Supplemental Payment Fund (Emergency Services Fund) program during this period. The waiver also calculates the inpatient upper payment limit for non-state-owned hospitals in the county, such as Health Services' hospitals. The upper payment limit is a federal Medicaid limit on the amount of payments that Medicaid can pay a statewide group of hospitals for a given set of services. However, Health Services does not know how much it will receive from the Emergency Services Fund or what the upper payment limit will be when the SPCP waiver expires in December 2004. Therefore, for fiscal years beyond 2004–05,

Health Services is forecasting payments from the Emergency Services Fund at the level established before the SPCP waiver agreement. However, it is possible that payments received in future years could be less than the pre-waiver level, depending on the future upper payment limit.

Health Services Is Pursuing Stable Funding Under the Disproportionate Share Hospital Flexibility Proposal

In anticipation of various restructuring actions to address its budget deficit, Health Services developed the disproportionate share hospital (DSH) flexibility proposal to allow Los Angeles County to maintain its share of DSH funding at the fiscal year 2001–02 level. However, because recent legal actions have thus far prevented the elimination of 100 beds at LAC/USC and the closure of Rancho Los Amigos on the scheduled dates, the value of the DSH flexibility proposal is uncertain at this time. Further, the proposal has not gained CMS approval and requires state legislation to implement. Therefore, Health Services has not reflected any potential financial impact of this proposal in its July 2003 fiscal forecast shown in Appendix A.

Health Services Wants to Expand Health Coverage to the Uninsured Using Funds From the State's Children's Health Insurance Program

Los Angeles County and the Alameda County Medical Center, a public hospital authority, are considering an 1115 Medicaid Demonstration Project proposal to expand health coverage to the uninsured in those counties on a regional basis. Funded by California's unused Children's Health Insurance Program allocation, the expansion would provide coverage of certain vital health care services to uninsured adults (parents and childless adults). Any proposal must be submitted to the State and gain CMS approval. Health Services has not yet determined the potential financial benefit of this proposal.

Health Services Proposes to Use Tobacco Settlement Funds to Pay for Scenario III Transition Costs

The various restructuring activities planned under Scenario III involve transition expenses, including the cost of restructuring High Desert into a multiservice ambulatory care center. These transition costs, which are not included in the savings estimates shown in Table 2 or in the July 2003 fiscal forecast shown in Appendix A, are onetime expenses and include costs related

to laying off employees and closing facilities, among others. Health Services has not estimated the amount of these costs but proposes paying for them with tobacco settlement funds, which would require board approval.

The Pending Medicare Prescription Drugs and Modernization Act of 2003 Could Result in Additional Revenues for Health Services

Both the Senate and the House of Representatives put forward a Medicare Prescription Drug bill, and each contained a provision relating to the DSH program, with the House version being more favorable to Health Services. Based on the House proposal, Health Services estimates it could receive an additional $29 million to $30 million in DSH funds for fiscal year 2003–04, with a decrease of approximately $5 million per year in subsequent years because, according to Health Services, the proposal does not include a cost-of-living allowance. However, Health Services has not reflected the potential impact of the additional funding in its July 2003 fiscal forecast because the Medicare Prescription Drugs and Modernization Act of 2003 was still pending in the House-Senate Conference Committee as of July 24, 2003; therefore, Health Services does not know whether it will pass, if the proposed additional DSH funding will be included in the final version, and what the amount may be.

Resolution of Legal Challenges Could Affect Health Services' Fiscal Forecast

Health Services' July 2003 fiscal forecast is built on the assumptions that Rancho Los Amigos will be closed and LAC/USC will be reduced by 100 beds on July 1, 2004. However, because of ongoing litigation, Health Services cannot be certain if or when these reductions will occur. Accordingly, Health Services may have to adjust its fiscal forecast as circumstances dictate.

Health Services' Fiscal Forecast Assumes That Its Outpatient Clinics and Health Centers Will Receive Federally Qualified Health Center Status by Fiscal Year 2005–06

Under the current 1115 Waiver, Health Services receives reimbursement for Medi-Cal costs of its hospital outpatient clinics, comprehensive health centers, and health centers under the cost-based reimbursement clinic provision. The Federally Qualified Health Center (FQHC) program also reimburses on a cost basis for Medi-Cal patients. Therefore, in anticipation of

Although Health Services' applications for Federally Qualified Health Center status were recently denied, it intends to pursue an appeal or request for reconsideration.

the 1115 Waiver's expiration at the end of fiscal year 2004–05, Health Services submitted FQHC applications to the federal Health Resources and Services Administration to ensure the continued receipt of cost reimbursement for its outpatient clinics, comprehensive health centers, and health centers. If approved, FQHC status would allow Health Services to continue to receive $100 million annually. Although Health Services' FQHC applications were recently denied, it intends to work with its advocates in Washington, D.C., on a potential appeal or request for reconsideration. Health Services' July 2003 fiscal forecast, shown in Appendix A, assumes FQHC approval for relevant facilities beginning in fiscal year 2005–06.

Health Services Is Investigating Additional Long-Term Revenue and Cost Efficiency Strategies

As part of the planning process that led to the January 2002 strategic plan, Health Services established a work group to identify and investigate potential revenue and cost efficiency strategies. Subsequently, Health Services has pursued a number of strategies to enhance revenue generation and generate cost savings without reducing service levels or making general staff reductions. The most significant of these strategies to come to fruition was the passage of Measure B as discussed previously.

Health Services reports that it has also identified 31 other potential opportunities as of August 2003. For example, one proposal is to identify and recover any overpayments of sales tax due to complex regulations affecting health care products. Another proposal is intended to help ensure that Health Services receives maximum reimbursement from the State and federal government for capital projects. Health Services does not expect the net benefit of these other potential opportunities to exceed $40 million annually even in the best-case scenario.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: September 11, 2003

Staff: Ann K. Campbell, Audit Principal
Michael Tilden, CPA
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APPENDIX A

Fiscal Outlook of the Los Angeles County Department of Health Services

The Los Angeles County Department of Health Services (Health Services) periodically prepares a fiscal outlook document for the Los Angeles County Board of Supervisors (board) to provide updated projections regarding funding sources, cost-cutting activities, and future deficits or surpluses. Table A.1 on the following page contains Health Services' latest fiscal outlook, which it presented to the board in July 2003. The table highlights the annual deficits projected in Health Services' June 2002 strategic plan and the projected impact of savings from Scenario III reductions and newly negotiated revenues. For example, in fiscal year 2002–03, Health Services expects to receive $50 million from the federal share of the orthopedic hospital outpatient settlement; in fiscal year 2003–04, Health Services expects to begin receiving Measure B funding of $146 million annually. Finally, Table A.1 displays Health Services' adjusted projected surpluses or deficits for the next five years. For example, assuming it is able to close Rancho Los Amigos and eliminate 100 beds at Los Angeles County—University of Southern California Medical Center on July 1, 2004, Health Services projects a deficit of $840.5 million by fiscal year 2007–08.

TABLE A.1

Health Services' Fiscal Outlook, July 2003
(Dollars in Millions Based on Fiscal Year 2002–03 Supplemental Budget Resolution)

	Fiscal Years					
	2002–03	**2003–04**	**2004–05**	**2005–06**	**2006–07**	**2007–08**
Surplus/deficit projected as of June 26, 2002, strategic plan		($326.6)	($549.2)	($709.4)		
Scenario III reductions/use of fund balance	*	267.8	327.8	357.5		
Original fiscal stabilization revenue request to help fund Scenario III, extrapolated through fiscal year 2007–08	*	(58.8)	(221.4)	(351.9)	($387.3)	($423.7)
Forecast update†	$185.0‡	3.8	(122.2)	(6.3)§	(114.2)	(151.8)
Contribution to new LAC/USC equipment fund	(55.0)	—	—	—	—	—
Annual surplus/(deficit) without additional funding	**130.0**	**(55.0)**	**(343.6)**	**(358.2)**	**(501.5)**	**(575.5)**
Additional Funding						
Measure B	—	146.0	146.0	146.0	146.0	146.0
Acceleration of Rancho Los Amigos alternate governance or closure	—	58.6	—	—	—	—
Disproportionate Share Hospital funding redistribution resulting from Rancho Los Amigos closure and High Desert conversion, based on current law	—	—	6.7	6.7	6.9	7.1
State/federal transition agreement						
Selective Provider Contracting Program	80.0	70.0	50.0	?‖	?‖	?‖
Orthopedic outpatient lawsuit settlement—federal share	50.0	—	—	—	—	—
Subtotal, additional funds	**130.0**	**274.6**	**202.7**	**152.7**	**152.9**	**153.1**
Annual surplus/(deficit) with additional funding‖	**260.0**	**219.6**	**(140.9)**	**(205.5)**	**(348.6)**	**(422.4)**
Fund balance at start of fiscal year	121.0	130.0#	349.6	208.7	3.2	(345.4)
Cumulative year-end fund balance/(deficit)‖	**381.0**	**349.6**	**208.7**	**3.2**	**(345.4)**	**(767.8)**
Impact of deferment of Rancho Los Amigos closure (207 beds) until July 1, 2004	—	(58.6)	—	—	—	—
Impact to fund balance at start of fiscal year	—	—	(58.6)	(58.6)	(58.6)	(58.6)
Adjusted cumulative year-end fund balance/(deficit)‖	**381.0**	**291.0**	**150.1**	**(55.4)**	**(404.0)**	**(826.4)**
Impact of deferment of LAC/USC 100-bed reduction until July 1, 2004**	—	(16.1)	—	2.0	—	—
Impact to fund balance at start of fiscal year	—	—	(16.1)	(16.1)	(14.1)	(14.1)
Adjusted cumulative year-end fund balance/(deficit)‖	**381.0**	**274.9**	**134.0**	**(69.5)**	**(418.1)**	**(840.5)**

* The $56.8 million of projected savings for fiscal year 2002–03 Scenario III savings were already in the fiscal year 2002–03 budget base, and therefore do not appear on this schedule.

† Reflects reduced savings estimates for the Scenario III proposal to restructure psychiatric services.

‡ Already includes $50 million reserved for the new LAC/USC equipment fund.

§ Reflects release of $96.1 million trust fund originally reserved to mitigate audit finding by the Office of Inspector General.

‖ We describe other factors that Health Services believes may affect its future fiscal condition on pages 23 through 26 of our report.

Of the $381 million in the prior fiscal year's cumulative year-end fund balance, Health Services already includes $251 million in the fiscal year 2003–04 "Forecast Update" line to consistently show Health Services' fiscal outlook without the "Additional Funding" items.

** Defer to July 1, 2004, LAC/USC 100-bed reduction. Due to the delayed impact of Disproportionate Share Hospital funding, Health Services will receive $2 million in fiscal year 2005–06.

Key:

High Desert:	High Desert Hospital
LAC/USC:	Los Angeles County/University of Southern California Medical Center
Rancho Los Amigos:	Rancho Los Amigos National Rehabilitation Center

APPENDIX B

Glossary of Terms and Abbreviations

1115 Medicaid Demonstration Project (1115 Waiver)	Refers to Section 1115 of the federal Social Security Act, which allows the secretary of Health and Human Services to waive any provision of the Medicaid law for demonstration projects that test a program improvement or an innovation of interest to the federal government. For example, under an 1115 Waiver, a state can be exempt from compliance with the usual requirements or may receive federal matching funds for expenditures not ordinarily eligible under Medicaid.
Acute care	A pattern of health care in which the patient is treated for an acute episode of illness, for the sequel of an accident or other trauma, or during recovery from surgery. It may involve intensive care and is often necessary for only a short period of time.
California Medical Assistance Commission (CMAC)	A small, independent commission established in 1982 to negotiate contracts for specific services in the Medi-Cal program. The goal of the commission is to promote efficient and cost-effective Medi-Cal program expenditures through a system of negotiated contracts, fostering competition and maintaining access to quality health care for beneficiaries.
Comprehensive health center	A freestanding center operated by Health Services that provides a wide array of outpatient care, including primary care, specialty care, and/or urgent walk-in services.
Department of Health and Human Services	The federal department responsible for health-related programs and issues. Formerly the Department of Health, Education, and Welfare.
Disproportionate share hospital (DSH)	California (and other states) has special reimbursement programs aimed at making up the shortfall for hospitals when care is provided to a patient who has little or no funds to cover the cost of care or who is a Medi-Cal beneficiary. Under Senate Bill 855 (Chapter 279, Statutes of 1991), a hospital that provides a certain amount of uncompensated care is designated as a DSH and may qualify for additional funds. DSHs receive supplemental payments in addition to Medi-Cal payments for services rendered. To qualify, a hospital must have a Medi-Cal inpatient utilization rate at least one standard deviation above the statewide mean or a low-income utilization rate in excess of 25 percent. Funding is through intergovernmental transfers from public entities and matching federal financial participation fund payments; no state funds are involved.
Federally Qualified Health Center	A federal payment option that enables qualified providers in medically underserved areas to receive cost-based Medicare and Medicaid reimbursement and allows for the direct reimbursement of nurse practitioners, physician assistants, and certified nurse midwives. Many outpatient clinics and specialty outreach services are qualified under this provision.
Health center	A Health Services' facility that provides primary care and/or public health services.
Hospital	An institution that is built, staffed, and equipped for the diagnosis of disease; for the treatment, both medical and surgical, of the sick and the injured; and for their housing during this process.
Inpatient care	Care given a registered bed patient in a hospital, nursing home, or other medical or post-acute-care institution.
Multiservice ambulatory care center (MACC)	A center designed to provide specialty services, surgical and nonsurgical procedures, comprehensive diagnostic services, and a limited amount of urgent care. All MACC services are provided on an outpatient basis.
Measure B (Preservation of Trauma Centers and Emergency Medical Services; Bioterrorism Response Initiative)	On November 5, 2002, the voters of Los Angeles County approved Measure B, which assessed a special tax to support emergency, trauma, and bioterrorism activities in Los Angeles County. The tax is 3 cents per square foot per parcel and became effective in fiscal year 2003–04. Health Services and the chief administrative officer recommended that Health Services would receive approximately $140 million to provide trauma and/or emergency services and $6 million to support public health bioterrorism needs beginning in fiscal year 2003–04.
Medicaid	A federal entitlement program for the poor who are blind, aged, disabled, or members of families with dependent children. Each state has its own standards for qualification. Authorized by Title XIX of the Social Security Act, Medicaid does not cover all poor people but only those who meet specified eligibility criteria. Subject to broad federal guidelines, states determine the benefits covered, program eligibility, rates of payment for providers, and methods of administering the program. All states but Arizona have Medicaid programs.
Medi-Cal	California's version of the Medicaid program.

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Medically indigent	Medical indigency is the nexus of health need and inability to pay. Health insurance status and family income are two important factors driving medical indigency and can be considered risk factors.
Outpatient care	Care given a person who does not require hospitalization. Also called ambulatory care. Many surgeries and treatments are now provided on an outpatient basis, while previously they had been considered reason for inpatient hospitalization.
Primary care	Basic or general health care, traditionally provided by family practice, pediatrics, and internal medicine.
Public-private partnership program	A collaborative effort between Health Services and private, community-based providers (partners) that are committed to providing quality health services in a culturally and linguistically appropriate environment to low-income and uninsured communities. Comprises community clinics and private medical groups with which Health Services contracts to provide outpatient primary care and limited specialty care to Health Services' patients.
Residential rehabilitation center	Provides supervised 24-hour live-in alcohol and drug programs within structured treatment recovery environments.
Secondary care	Services provided by medical specialists, such as cardiologists, urologists, and dermatologists, who generally do not have first contact with patients.
Selective Provider Contracting Program (SPCP)	A state program that operates through a waiver under Section 1915(b) of the Social Security Act. Originally approved in 1982, the 1915(b) waiver allows CMAC to negotiate Medi-Cal rates with hospitals and to contract with a select number of hospitals. The waiver also covers the Senate Bill 1255 Supplemental Payment program. Every two years the State must reapply to renew the waiver.
Senate Bill 855, Chapter 279, Statutes of 1991	The law that created the inpatient DSH program. Hospitals qualify on an annual basis. Supplemental payment adjustments are made to qualified inpatient acute-care hospitals in addition to Medi-Cal payments for services rendered. To qualify, a hospital must have a Medi-Cal inpatient utilization rate of at least one standard deviation above the statewide mean or a low-income utilization rate in excess of 25 percent with at least a 1 percent Medi-Cal utilization rate. Payments are based on the hospital's peer group and low-income rate. Payments are funded by intergovernmental transfers from public entities and matching federal financial participation; no state funds are involved.
Senate Bill 1255, Chapter 996, Statutes of 1989	Welfare and Institutions Code, Section 14085.6. The law that created the Emergency Services and Supplemental Payment Fund. Supplemental payments are made to qualifying hospitals based on negotiations between the hospital and CMAC. Qualifying hospitals must be DSH-qualified, contracting under the SPCP to provide Medi-Cal services, and licensed to provide emergency services on site. Children's hospitals, however, can maintain emergency services in conjunction with other hospitals. Hospitals that provide emergency services must demonstrate a need for extra funding to cover the costs of these services. CMAC determines the award levels, and the California State Department of Health Services administers and distributes the funds. There is no ceiling on the individual payments. Funding is through intergovernmental transfers and matching federal financial participation.
Senate Bill 1953, Chapter 740, Statutes of 1994	This act is based on the Milestone 4 Report (prepared by the Hospital Safety Board and the Office of Statewide Health Planning and Development) from 1990 and is a long-term plan to bring existing hospitals up to the requirements of the 1973 Alquist Hospital Seismic Safety Act. The intent of the act is to ensure that hospitals can remain functional after an earthquake, maintain care of the patients already there at the time of the earthquake, and provide care to persons injured in the earthquake.
Tobacco settlement	The tobacco settlement, known as the master settlement agreement, among other things requires the tobacco industry each year for 10 years to pay $25 million to fund a charitable foundation that will support the study of programs to reduce teen smoking and substance abuse and the prevention of disease associated with tobacco use.
Upper payment limit	A federal Medicaid limit on the amount of payments that Medicaid can pay a statewide group of hospitals for a given set of services. The limit is expressed as a percentage of the estimated amount that would be paid for the same services under Medicare. A recent federal policy change reduced the upper payment limit from 150 percent to 100 percent.

Agency's comments provided as text only.

County of Los Angeles
Department of Health Services
313 N. Figueroa
Los Angeles, CA 90012

August 28, 2003

Elaine M. Howle
State Auditor
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Ms. Howle:

The Los Angeles County Department of Health Services appreciates the Bureau of State Audits' second audit required under Chapter 195, Statutes of 2001, titled *Los Angeles County Department of Health Services: Despite Securing Additional Funding and Implementing Some Cost-Cutting Measures, It Still Faces Significant Challenges to Addressing Its Growing Budget Deficit*. Additionally, the Department wishes to express its appreciation to the audit team for again approaching this audit in a thoughtful and professional manner.

The Department generally agrees with the draft report, and requests that the minor changes discussed and agreed to at the August 27, 2003 exit conference are included in your final audit report. As stated in the draft report, the Department continues to face significant hurdles in implementing the redesign plan adopted by our Board of Supervisors in June 2002. Many of those hurdles, including legal challenges, are out of the Department's control. Therefore, we have focused our efforts on implementation of the cost-savings objectives that can be implemented at this time. However, as your report indicates, our anticipated budget deficits continue to grow. Our strategy for long-term stability clearly involves continued partnership with the State and Federal governments and redesigning our system to be modern and efficient through the use of information technology, improved clinical practices and consolidated administrative functions.

Again, the Department appreciates your attention to the important public policy decisions facing the County's public health system.

Sincerely,

(Signed by: Thomas L. Garthwaite)

Thomas L. Garthwaite, M.D.
Director and Chief Medical Officer
Los Angeles County Department of Health Services

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COMMENT

California State Auditor's Comment on the Response From the Los Angeles County Department of Health Services

To provide clarity and perspective, we are commenting on the Los Angeles County Department of Health Services' (Health Services) response to our audit report. The number corresponds with the number we have placed in Health Services' response.

● Our report includes the minor changes agreed to at the exit conference.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press