STATE OF CALIFORNIA-HEALTH AND WELFARE AGENCY PETE WILSON, Governor

DEPARTMENT OF ALCOHOL AND DRUG PROGRAMS

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ADP # 97-26

TO: County Alcohol and Drug Administrators

SUBJECT: Clarification of ADP #96-64

The purpose of this letter is to answer questions that have arisen regarding application of the requirements and restrictions identified in ADP #96-64. As you recall, the purpose of ADP #96-64 was to address the issue of profit on federal grants, including the Substance Abuse Prevention and Treatment (SAPT) Block Grant. To summarize the letter, profit is not allowable on state funds or any federal grants which pass through ADP. This letter will utilize a question/answer format to address the various issues.

Question No. 1:

May a county-operated program be reimbursed in excess of its actual costs using federal and state funds?

Answer:

The Department is not aware of any vehicle whereby federal funds could be used to pay a profit to another public entity. A county-operated program may not be reimbursed in excess of actual costs.

To reiterate ADP #96-64, the Health and Safety Code, Sections 11818(b) and 11987.5(a), state:

> "The cost of services specified in the county alcohol (drug) program contract with the department shall be based upon reimbursement of actual cost as determined with standard accounting practices."

The Section goes on to deal with how a county may reimburse their private providers.

The Health and Safety Code, Section 11758.27, requires the reporting of any unexpended federal funds to be reappropriated to the next fiscal year by a date specified in the contract. The contract between the Department and the counties

establishes the date of such notice as April 1 and further requires an accounting of all expenditures on a year-end cost report. Those unspent federal funds not identified by April 1 for rollover must be returned to the state.

Regarding state funds, Health and Safety Code, Section 11758.12(h), requires counties to identify "unspent" state general funds by a date specified in the contract. The contract requires that these funds be spent on identifiable drug and alcohol service priorities in the following fiscal year. While such funds are not required to be returned to the state if so identified and budgeted in the next fiscal year, they do not represent profit or payment in excess of costs of county-operated programs.

There appear to be no options for counties to be reimbursed in excess of actual costs with federal or state funds.

Question No. 2:

Does the Negotiated Net Amount (NNA) contract between the county and state require the reporting of the county's costs to provide or purchase services or the service provider's cost to deliver the services?

Answer:

It is the county's costs of providing or purchasing services that must be reported to the State. However, statutes and regulations define those costs in terms of what the county may pay a provider.

The rules regarding profit are contained in federal and state statute and regulations, as indicated in ADP #96-64. These laws and regulations require payment of actual costs. The contract between the counties and the State cannot supersede or conflict with these statutes. Accordingly, the current contract contains the following provision under Control Requirements: "Performance under Part I is subject to all applicable federal and state laws, regulations, and standards."

The county's cost report is basically a summary of all of the providers' cost reports, except as limited by provider contract maximums. When such maximums are less than a provider's costs, the county's cost report reflects a lower cost than the provider's cost report.

Question No. 3

Would ADP #94-64 require all county purchase of service contracts be cost contracts versus negotiated rate unit of service contracts?

Answer:

Since all contracts involving federal and/or state funds would have to be settled to actual costs at year-end, **this is the ultimate effect**. This does not preclude the county from using a "provisional" negotiated rate as a mechanism for funding providers, with the understanding that adjustment to actual cost or contract maximum will take place at year-end. The advantage of using such a mechanism is for the county to be able to assess the quantity of services being provided during the contract.

Question No. 4

Can a county designate county-other funds as the source for paying a profit?

Answer:

While federal and state laws and regulations do not specifically address how county overmatch may be used, there is a restriction on a practical level. As discussed in ADP #96-64, the only mechanism that could potentially result in profit has been the “negotiated rate”. The profit would simply be the difference between the total payments at that rate and the total net costs of the program. Realistically, **there is no way to identify that profit as attributable to any particular funding source**. This is why Health and Safety Code Sections 11817.8(c) and 11991.6(d) contain the proration provisions for audit findings. Therefore, unless the entire program was funded with county-other funds, the amount attributable to such funds would be only the pro-rata share of total funding. In conclusion, if a county wishes to allow a provider to retain the county’s pro-rata share of the overall profit, there would be no violation of federal or state requirements.

Question No. 5

If multi-modality providers have excess revenue in one modality and a loss in the other for a total net loss, is this acceptable?

Answer:

It is possible that, under certain circumstances, excess revenues under one modality could be used to offset losses in another. For example, if a single contract with multiple modality budgets and a single federal/state funding mix are utilized, and the contract language allows for sufficient movement of costs between budgets, it may be appropriate to move excess costs from one budget to another where a profit has been realized. Drug Medi-Cal (D/MC) funding is not appropriately mixed with separate modalities or other funding, as settlement requirements for D/MC are more stringent.

However, where separate contracts are utilized for each modality, attempts to settle such contracts in combination could create potential compliance problems and audit findings. Examples of issues that could arise are as follow:

! The first concern is the issue of whether each contract is funded via the identical funding mix. In order for all contracts of a provider to share in profits and/or losses, the preferable situation would be for all contracts to have the same funding mix. For example, if two contracts involve two different federal funding sources, and one contract shows a profit while the other shows a loss, allowing them to offset creates an illegal subsidizing of one federal grant with another. Another example would be where one contract is a D/MC contract, for which total costs exceed the maximum allowance (rate cap) limit. The Department has made it clear that other federal and state funds may not be used to subsidize D/MC costs in excess of these maximum rates.

! Second, there is the issue of contract maximums. The combining of costs and payments for all contracts with a provider may result in overriding those maximums. For example, unfunded costs above a contract maximum might be used to offset profit on another contract, thus eliminating the effect of the contract maximum. Technically, at least the contract with costs above the contract limit should be amended at that point, which might be impractical, in light of a county's contracting processes. Failure to do so, if audited, would result in an audit finding.

Question No. 6:

May a provider be allowed to retain payments in excess of costs under a contractual agreement that such funds would be "put back into the program"?

Answer:

Such allowance would be contrary to the laws and regulations addressed in this letter and in ADP #96-64. Even if it were allowable, there would be no way of ensuring that funds were ultimately used in the best interests of the program and the clients it serves.

I hope this clarifies these issues. If not, please call me at (916) 322-4834 or FAX me your concerns in writing to (916) 323-5873.

Sincerely,

GARY BELLAMY, Manager
Audit Services Branch

cc: Wagerman Associates, Inc.