Pennsylvania Intergovernmental Cooperation Authority

Staff Report
on
State Funding
of the
Philadelphia Department of Human Services

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STATE FUNDING OF THE PHILADELPHIA DEPARTMENT OF HUMAN SERVICES

Executive Summary

Problems relating to the Department of Human Services (DHS) are among the most significant obstacles to the financial stability of the City of Philadelphia (City). PICA Staff in previous reports has commented on a number of problems relating to the progress of reforms in DHS management and service delivery, and risks relating to DHS revenues due to problems with the Commonwealth of Pennsylvania (State) children and youth funding process and the potential impact of Federal welfare reform.

This report focuses on the problems relating to the State children and youth funding process. The report includes a review of the laws and regulations which form the basis of the current process, and highlights significant problems relating to the process. These problems relate to the substance of the process, as well as general lack of clarity in the process and the manner in which it has been implemented. The results of these problems are significant for the City and may include: less predictability of funding levels; increasing need to provide funding from the local tax base; disparities in local tax burdens between Philadelphia and other counties; and less effective management of the children and youth system. The problems highlighted in the report are summarized below.

The State bases its children and youth funding to Philadelphia on hypothetical cost figures which may be below actual cost because the inflation adjustment used by the state is too low, resulting in lower State funding to the City

State funding provided to DHS is based on a county-requested and State-certified "needs based budget" which is supposed to represent a realistic projection of county spending for the children and youth program. The process of estimating the needs based budget, however, is based on an assumed inflation rate for the cost of contracted services which is at or below the general level of inflation. Because the actual costs of services may increase more rapidly than the general level of inflation, over the long term this may result in needs-based budget amounts falling further and further below actual county costs, which would result in a smaller and smaller share of actual county costs receiving State funding.

State regulations limit the costs that the State will reimburse, in some cases having an unfair effect on Philadelphia

State Department of Public Welfare (DPW) regulations impose some unreasonable restrictions on reimbursable costs which in some cases may have an adverse effect on particular counties. There are statewide caps on reimbursable salary levels which do not take into account differences in the cost of living across the State. There are limitations on the level of "indirect" administrative costs (costs incurred outside the children and youth department) which results in reimbursements based on organizational structure and not actual costs. Mental Health/Mental Retardation (MH/MR) costs are totally excluded from reimbursement, despite the fact that these are actual costs that counties must incur, and, in some cases, there are no alternative funding streams which can be accessed to support these costs.

The State funding process is unclear and as a result the City cannot demonstrate that it is

being underfunded or predict the likely level of future funding

The needs-based budget process rules, and the actual basis for DHS-requested and DPW-certified needs-based budgets are not clearly presented by either the City or the State in published documents. The general lack of clarity is a major source of the conflict that has existed since the inception of the needs-based budget process between DHS and DPW. The lack of clarity prevents the need-based budget process from promoting better management of the children and youth system and predictability of children and youth funding levels to the City.

The current process may discourage counties from restructuring programs to improve service or save money

There may be disincentives under the current need-based budget process for counties to restructure services to promote lower costs and improved service, since such restructurings require proposing "initiatives" under the current process. Due to the lack of clarity of the rules for calculating the impact of initiatives on the need-based budget, counties may be reluctant to propose initiatives because of their unpredictable effect on the overall certified budget and State funding levels. The needs-based budget process should be clarified or simplified to remove any disincentives to restructure services to reduce costs and improve services.

Although State funding is based on estimates of spending and Federal revenues, no additional State dollars are provided if actual revenues or expenditures are different from estimates

Pennsylvania's current children and youth funding process does not base State funding on actual Federal revenues or actual county spending. State funding cannot exceed the level contained in the certified needs-based budget which is based on projected Federal revenues and county spending. Even if actual Federal revenues are lower than projected or actual county spending is higher than projected, State funding cannot increase, which could mean that State dollars could fund a lower percentage of actual costs than the percentages stipulated by the State in Act 30.

Taxpayers in counties with high needs for children and youth services and little ability to pay for such services, such as Philadelphia, pay more to support the children and youth program than taxpayers in other counties, and the funding system does not address this inequity

Pennsylvania's current children and youth funding process does not attempt to adjust State funding levels to counties in relation to the level of need for children and youth services and financial capacity of individual counties so that the burden on local taxpayers across the State is equalized. This contributes to disparities in tax burdens on households and businesses across that State and deters economic development in counties across the State with high needs for services and low financial capacity, such as Philadelphia.

Federal welfare reform could result in a loss of revenue to Philadelphia, but the actual impact will depend on procedures developed by the State to allocate Federal "block grant" funds to counties

Federal welfare reform may result in Federal funding programs such as Title IV-A and Title IV-E being converted from open-ended "entitlements" to "block grants." This would require that a system be developed for allocating Federal block grant funding to counties. The City could be negatively impacted by such a change, since the current Federal funding may be weighted to locations with high levels of low-income populations due to eligibility standards. Despite the risk welfare reform poses to the City, with respect to the children and youth program, at least, welfare reform could benefit the City if the State uses welfare reform as an opportunity to reevaluate its overall children and youth funding system and improve the overall rationality, fairness and clarity of the system.

Introduction

Problems related to the funding and operations of its Department of Human Services are among the most substantial obstacles to the City of Philadelphia's achieving long-term financial stability. The Department faces long-term problems relating to expenditure growth driven by adverse social and economic trends. Continued management improvements and efforts to improve services and reduce costs are essential to controlling the growth of expenditures. With regard to DHS revenues, the potential impact of Federal welfare reform is a significant risk factor. Another significant problem relating to departmental revenue is the "needs-based budget" process for allocating State funding to Philadelphia, which has problems of substance and is also in many respects unclear and unpredictable.

This report focuses on issues relating to "needs-based budget" process of allocating State funding to DHS. The first section of the report contains a review of the history leading up to the establishment of the needs-based budget process in Act 30 of 1991, and a review of the provisions of Act 30 and DPW rules and regulations implementing the process. This is followed by a review of the major problems of the needs-based budget process from the perspective of PICA Staff. The conclusions are based on a review of State statutes and regulations and information provided by Philadelphia DHS and State DPW officials. Some of the issues raised in this report have been raised previously by the City in its Five-Year Financial Plans and elsewhere. The problems relating to the State's children and youth funding process are serious problems for the City, and resolving them is essential to the City's ability to maintain a stable financial outlook over the long term.

DHS and DPW officials, and members of the private child welfare advocacy community, received and commented on a draft copy of the report. DHS officials and members of the private advocacy community were in general agreement with the report; they provided a few specific comments which were incorporated into the final edition. In a letter to PICA Staff, the DPW Deputy Secretary for Children, Youth and Families expressed her concerns with regard to interpretations of budget figures contained in the report and conclusions drawn in the report about the needs-based budget process. PICA Staff has made changes to the report to respond to certain of DPW's concerns. PICA Staff however does not accept as valid some of the positions expressed by DPW in its letter. In these cases, a statement of DPW's position is presented in the final report edition, along with a PICA comment with respect to DPW's position. The full text of the letter from the Deputy Secretary to PICA Staff is provided in Appendix A.

This report does not directly address issues of reforms in DHS management and operations. Nonetheless, controlling the growth in DHS expenditures is critical to maintaining the City's financial stability, and this cannot occur without continued efforts to improve DHS services, reduce costs and strengthen management. Management reform is also essential to achieving progress in improving the needs-based budget funding process, since management reform and reasonable expenditure growth would seem to be critical to maintaining the confidence of State officials responsible for DHS funding.

The report also does not address in detail the potential impact of Federal welfare reform. Although the kinds of changes likely to occur as a result of welfare reform pose significant risks to the City, welfare reform could be a positive event if the State views it as an opportunity to reevaluate the overall State process of children and youth funding and as a result takes steps to remedy some of the problems in the current process and make appropriate changes in response to welfare reform.

Children and Youth Funding Process Background

This section provides some of the recent history of child welfare funding in Pennsylvania, and the State statutes and regulations that form the basis of the child welfare funding process. In addition, the impact of this process on Philadelphia and Pennsylvania budget trends over the past five years is reviewed.

From 1985 to 1990, the State budget repeatedly did not include sufficient appropriations to meet the State's financial obligations under Act 148 of 1976 with respect to county services for abused and neglected children and juvenile justice programs (referred to, in Pennsylvania, as "children and youth" services). Under Act 148, the State was required to fund a certain percentage of county costs for children and youth services, with the percentage varying depending on the type of service. In the years when the State could not meet its Act 148 obligations, available State funds were distributed to counties based on a formula which used statistical measures of poverty and other factors, but which may have had little relation to actual county spending for children and youth programs. The gap between the State's Act 148 funding obligations and the amount of funding it actually provided was referred to as "overmatch" since the gap was made up with county funding above the amount required under Act 148, which meant that in effect counties were being required to match State contributions at a rate higher than required under Act 148.

The Settlement Agreement

Because of the significant and growing amount of the overmatch that counties were providing, the City of Philadelphia, Allegheny County and the Pennsylvania State Association of County Commissioners, jointly, sued the State in an effort to resolve the overmatch problem. In June of 1990, an out-of-court settlement was reached.

Under the settlement agreement, the State agreed, beginning with FY92, to institute a "needs-based budget" process. Under this process, counties were to submit to the Department of Public Welfare, prior to the beginning of each fiscal year, "in a form acceptable to DPW, their annual client and budget estimates and a description of proposed changes to their approved three-year plan." The agreement said that "DPW shall meet with counties, as necessary, to review their annual plans and, on the basis of that review, shall determine the counties' projected reimbursable costs under any relevant statute...and shall request, at a minimum, the aggregate amount of the counties' projected costs as deemed to be reimbursable by DPW as a result of that review." The agreement also provided that "DPW shall not be restrained in the preparation of its needs-based budget by any budget targets which may be imposed by the Governor's Office or the Budget Secretary," and that "DPW's needs-based budget shall be supplied to the General Assembly by the Governor's Office."

Act 30 of 1991

The settlement agreement led to the passage on August 5, 1991 of Act 30 of 1991. The Act instituted an annual "needs-based budgeting" process for funding county children and youth services. Under this process, counties were to submit to DPW a "needs-based budget in a form prescribed by the department containing their annual client and budget estimates and a description of proposed changes in their annual plan." On the basis of discussions between counties and DPW and DPW review, DPW "shall make its determination of each of the counties total costs and reimbursable costs and the amount allowed each of the counties" under statutory reimbursement percentages. The total amounts allowed to all counties in the State as determined by DPW "shall be the aggregate child welfare needs-based budget." This budget, "along with supporting documentation shall be submitted to the Governor by November 15, 1991 and November 1 each year thereafter." The Act also provides that "contemporaneously with the submission of the General Fund budget, the Governor shall submit the aggregate child welfare needs-based budget...along with supporting documentation to the..(General Assembly)." Act 30 also provides that DPW "shall promulgate guidelines for reviewing and determining county-submitted needs-based budgets," and that "the department determination shall consider whether the county's budget is reasonable in relation to past costs, projected cost increases, number of children in the county and the number of children served, service level trends and projections of other sources of revenue."

Act 30 mandated a method for allocating State funds in the event that annual appropriations were insufficient to fully fund the needs-based budgets of all counties. The Act provides that reimbursement for child welfare services "shall not exceed the funds appropriated each fiscal year." In the event that the State appropriation for county child welfare programs is not sufficient to fully fund the statutory State share of the needs-based budgets, "each county shall be provided a proportionate share allocation of the appropriation calculated by multiplying the sum of the amounts appropriated for reimbursement...by a fraction, the numerator of which is the amount determined for that county's child welfare needs-based budget and the denominator is the aggregate child welfare needs-based budget." However, in this case, the Act provides that, although reimbursement for child welfare services cannot exceed the funds appropriated each fiscal year (FY), "a county shall be allowed reimbursement beyond its proportionate share allocation for that fiscal year for expenditures made in accordance with an approved plan and needs-based budget, but not above that amount determined to be its needs-based budget." This provision appears to mean that even if funds are not immediately available to fully fund the State's required share of a county's needs-based budget, that county will still be eligible to receive reimbursement for the unreimbursed amount should funds become available in the future.

The Act also increased the statutory State share of county child welfare costs for various service categories. The increases were to be phased in gradually, with the first increase scheduled to take effect in FY92, and the last in FY94.

Finally, Act 30 provided that the State would not be required to fully fund its statutory share of the aggregate needs-based budget in FY92, FY93 and FY94. The State was required to appropriate 82 percent of its statutory share in FY92, 90 percent in FY93, and 95 percent in FY94. In FY95 and future years, the State would be required to fund 100 percent of its statutory share of the aggregate needs-based budget.

The Regulations

As Act 30 required, the DPW regulations were amended to comply with Act 30. The amendments to Chapter 3140 of Title 55 of the Pennsylvania Code were published on June 27, 1992 in the Pennsylvania Bulletin. References to "the regulations" below are to these amended regulations.

The regulations required counties to submit to DPW for approval a "needs-based plan and budget estimate" to serve as a basis for county children and youth programs. The needs-based plans are required to contain the forms and information specified in a bulletin published annually by DPW, and to be consistent with State objectives for delivery of children and youth services. If DPW determines that a county's needs-based plan "is not consistent with State children and youth service objectives, the county will be given the opportunity to include initiatives in the plan that are directed at solving problems preventing the achievement of State objectives. Refusal of a county to develop initiatives consistent with State objectives may result in disapproval of the needs-based plan and budget estimate or a portion of the needs-based plan and budget estimate."

The regulations provide that DPW's determination of the appropriate level of State reimbursement "will consider whether the county's needs-based plan and budget estimate is reasonable in relation" to thirteen "criteria." Some of these criteria relate to staff-to-caseload ratios, staff-to-supervisor ratios, funding of new and vacant staff positions, salary and benefit levels, initiative funding, and Federal revenue estimation. Other criteria require that annual cost increases for "currently provided" purchased services be limited to inflation, and that annual increases in administrative costs be limited to 3 percent.

<u>Implementation of the Regulations Through DPW "Bulletins"</u>

The needs-based budget process as implemented has involved several steps. By July or August, counties submit an "Annual Plan" document containing the county's requested needs-based budget for the fiscal year to begin the following July, with supporting narrative and tables following a form mandated each year by DPW. The Annual Plan is reviewed by DPW and a recommended needs-based budget amount for each county and the State as a whole is provided to the Governor prior to the presentation of the Governor's budget to the General Assembly. The General Assembly receives the DPW needs-based budget at the same time the Governor's budget is presented to the General Assembly. After General Assembly action on the Governor's budget, DPW notifies counties of their "certified" needs-based budget, generally prior to the beginning of the fiscal year. Based on the DPW-certified needs-based budget, counties are to submit to DPW, prior to July 15, an "Implementation Plan" which represents the county's actual spending plan for the fiscal year. The Implementation Plan may differ from the certified budget, except that the level of State Act 148 funding cannot exceed the level in the certified budget. The Implementation Plan is usually contained in the same document as the Annual Plan for the following fiscal year. Implementation Plans must be approved by DPW.

The required form of the Implementation Plan and Annual Plan documents has been indicated each year in separate DPW "bulletins". The discussion below relates to the key elements of the most recently issued bulletin, issued on May 8, 1995, which included forms and instructions to be followed by counties in preparing the FY96 Implementation Plan and the FY97 Annual Plan.

Under Bulletin guidelines, the FY97 needs-based budget request that is submitted to DPW is the sum of four components: "Carry Forward"; "Increased Services"; "New FY 1996-97 Initiatives/Special Grant Pick-Ups"; and "Annualization of FY 1995-96 Approved Initiatives and Special Grant Pick-Ups." The discussion below summarizes the procedures for calculation of these four components as described in the Bulletin.

Carry Forward

The carry forward component of the needs-based budget is supposed to represent the cost of providing the same quantity of services as was provided the previous year, in the same manner.

The forms that counties must include in their Annual Plans separate the requested needs-based budget into six "object of expenditure" categories: staff costs (salary and benefits), miscellaneous personnel costs ("memberships, staff training and development and purchased personnel services"), subsidies (for families with adopted children), operating costs (space rental costs, office supplies), purchased services, and fixed assets. The method of calculating carry forward amounts is different for each object of expenditure.

Carry forward staff costs are the projected cost of maintaining the FY96-certified level of positions throughout FY97 including the positions certified in FY96 for increased services and initiatives, less the additional cost of annualizing the cost of personnel associated with FY96-approved initiatives.

Carry forward purchased services costs are calculated by applying a "cost of living adjustment" (COLA) to the Implementation Plan amounts for the prior year. For the FY97 Annual Plan calculation, the COLA for purchased services is 2 percent. The application of this COLA is based on one of the criteria of "reasonableness" included in the regulations.

The Bulletin suggests that a certain COLA should also be applied to the Implementation Plan amounts for miscellaneous personnel, subsidies, and operating costs when calculating carry forward amounts for these objects of expenditures. According to a DPW official, for the FY97 Annual Plan calculation, counties were instructed to use a 2 percent COLA for these categories. However, the official indicated that other figures would be considered acceptable if adequately justified by the counties.

Fixed asset costs for the FY97 Annual Plan, according to the Bulletin, "are estimated based on need without regard to the FY 1995-96 certified level but must be listed and justified in (the carry forward) section as well in increased services as appropriate."

For objects of expenditure other than staff, when the Implementation Plan budget is different from the State-certified amount, adjustments must be made to the Implementation Plan prior to applying any COLA to calculate the carry forward amount. Where the Implementation Plan for a major service category is higher or lower than certified levels, amounts must be subtracted or added to certain objects of expenditures within that major service category to produce a modified Implementation Plan where the total for each major service category is consistent with the certified level. (The "major service categories" represent different program types and include: in-home and intake services, community-based placement, institutional placement, and administration.) Then, any appropriate COLA is applied to the modified Implementation Plan to produce the carry forward amount.

Criterion of reasonableness number 11 in the regulations provides for a separate COLA for administrative cost, and indicates that this COLA cannot exceed 3 percent. This COLA is applied to the calculation of carry forward costs for the administration major service category. According to the Bulletin, in calculating the FY97 needs-based budget request, counties are to use 2 percent as the administrative cost COLA.

Increased Services

The increased services component of the needs-based budget is designed to represent the cost impact of two factors: (1) any quantitative (not qualitative) changes (increases or decreases) in service level between the previous year certified level and the current year; and (2) changes in the staff-to-caseload ratio from the prior year certified level to the current year.

Increased/decreased services for purchased services costs are based on a projection of increases or decreases in the number of units of purchased service, and should assume the same cost per unit of purchased service as was used to calculate the carry forward (the prior year cost per unit, increased by the COLA amount). Increased or decreased staff costs should be calculated in two parts: (1) a change in staff costs due to the projected change in caseload and purchased service levels, which should be related to the projected change in purchased service costs in order to maintain a constant ratio of staff-to-caseload; and (2) a change in staff costs due to a change in staff-to-caseload ratios. Change in costs for other objects of expenditure due to increased or decreased services should be reasonable in relation to the projected changes in purchased service and staff costs.

New FY97 Initiatives/Special Grant Pick-Ups

Any qualitative changes in services or new services must be proposed by counties as "initiatives" or "special grant pick-ups." The Bulletin defines initiatives as requests "to provide a new or different service or a current service in a different manner at a different rate." Special grant pick-ups are for funding of a service previously funded by a separate grant.

The new initiatives/special grant pick-ups component of the needs-based budget represents a request to receive funding for the projected cost of initiatives and special grant pick-ups that are expected to be first implemented some time during the needs-based budget year. Under the regulations, initiative funding is limited to 6 months during the first year, but may receive up to 10 months funding in the first year if DPW determines that the initiative will result in cost savings in the first year. Funding for special grant pick-ups is limited to the portion of the fiscal year following the date at which grant funding will expire.

Annualization of FY96 Approved Initiatives and Special Grant Pick-Ups

This component of the needs-based budget includes the additional costs to fully fund, for a twelve month period, initiatives or special grant pick-ups that were implemented for only part of the fiscal year in the prior year. According to the Bulletin, "carry forward (for the FY1996-97 needs based budget) includes that portion of initiatives and special grant pick-ups that were approved in FY 1995-96. For example, if an initiative was funded for ten months in FY 1995-96, the ten-month amount plus the COLA rate are included in the carry forward...The costs associated with the remaining months to annualize FY 1995-96 initiatives and grant pick-ups are shown in the Annualization of FY 1995-96 Initiatives/Grants section."

Impact of Needs-Based Budgeting on Philadelphia's Budget

A review of DHS expenditure and revenue trends since FY91 indicates that Act 30 and the needs-based budgeting process have increased the percentage of net DHS expenditures (total DHS expenditures less Federal revenues) receiving State funding. This result would be expected due to the provisions of Act 30 that increase gradually, over the period FY92 to FY94, the statutory share of net county expenditures required to receive State funding, and that require the State to gradually, over the period FY92 to FY95, increase to 100 percent the proportion of its statutory share that it funds.

The budgetary figures referred to below relate to Philadelphia General Fund financial results as reported in the City's annual financial reports. These figures do not present a complete picture of the financial aspects of the children and youth program since they include only City expenditures and exclude State expenditures relating to the children and youth program. The excluded State expenditures are for placement of juveniles in State-operated institutions (Youth Development Centers and Youth Forestry Camps) and for contracts with private providers of placement services for juveniles (known as the "Castille beds" contracts). The county share of these direct State expenditures are deducted from State grants to the counties. Thus, State revenues reported in the Philadelphia General Fund equal the State share of the direct county costs for the children and youth program, less the city share of the direct State costs. Accordingly, the total State financial contribution to the total children and youth program equals the total direct State costs in addition to the amount included in the City budget as State grant revenue. Further, the amounts of Federal reimbursements shown in the Philadelphia budget include only reimbursements received for county costs, not for State costs.

As a result of these operational aspects of the children and youth program, the expenditure and revenue amounts included in the City of Philadelphia General Fund budget for children and youth do not present the full picture of the relative Federal, State and City contributions to the children and youth program. A fuller budgetary picture is presented in the Annual Plan document submitted each year by DHS to DPW. Even this document, however, does not represent the full magnitude of the program since some special grant funds as well as significant costs within the court system related to the children and youth program are not included in the Annual Plan's needs-based budget.

Combined State Act 148 and Federal Title IV-B revenue to the City's General Fund was $62.8 million in FY91, the last year prior to needs-based budgeting, and increased to $108.7 million in FY95, an average annual increase of 14.7 percent during this period. Act 148/Federal Title IV-B revenue was 46.3 percent of net DHS spending (total DHS expenditures less Federal revenues other than Title IV-B) in FY91, and increased gradually to 65.2 percent in FY95. From a "bottom line" perspective, Act 30 and needs-based budgeting appear to have been successful.[1] However, there are a number of problems with the needs-based budget process, which will be detailed below, relating to the manner in which reimbursable costs are calculated and the lack of clarity in the process. These problems may not immediately impact the financial results of the program, but they may over the long term inappropriately reduce the share of total costs funded by the State, weaken management and program efficiency, and cause large disparities in local tax burdens among counties. It is notable that even after the increase in the percentage of total costs receiving State funding from FY91 to FY95, the amount of local tax funding provided by Philadelphia to the children and youth program was $56.0 million in FY95 (DHS unreimbursed obligations), not including indirect costs such as employee benefits and space rental, and not including court-related costs.

Another factor affecting DHS's financial results in recent years has been the substantial increase in Federal revenues to DHS, which increased from $49.8 million in FY91 to $116.0 million in FY95. This is due to substantial increases in Title IV-E revenue, due to improved procedures for gaining reimbursement for all eligible expenses, and the implementation of a new Federal revenue source, Title IV-A, beginning in FY95. As a result, Federal revenue has increased from 27.4 percent of total DHS expenditures in FY91 to 41.6 percent in FY95. The combination of the increase in Federal and State revenue has resulted in a decrease in the share of DHS costs funded by local taxpayers in Philadelphia. The percentage of DHS costs that was funded locally decreased from 37.9 percent in FY91 to 19.4 percent in FY95.

It is difficult to determine whether Act 30 and need-based budgeting had any impact on DHS expenditure growth. Total DHS obligations increased 14.2 percent in FY91 and 18.6 percent in FY92. Since FY92, expenditure growth has diminished somewhat, to 12.7 percent in FY93, 7.2 percent in FY94, and 7.4 percent in FY95. While the current growth rate is lower than in the early 1990s, it is still well above inflation.

State Budget Trends

In terms of the State General Fund, total State and Federal funding for the county child welfare program has increased from $427.7 million in FY92 to a budgeted $672.2 million in FY96, for an average annual increase of 12.0 percent over the past four years. During this period, total State funding increased from $253.9 million to $264.7 million, an average annual increase of 1.1 percent, while total Federal funding increased from $173.8 million to $407.5 million, an average annual increase of 23.7 percent. The rapid increase in Federal funding during this period was due to the implementation of a new funding source, Title IV-A Emergency Assistance, beginning in FY95, and a relatively rapid increase in Federal Title IV-E funding. From FY92 to FY96, Title IV-E funding increased from $145.0 million to $211.2 million, an average annual increase of 9.9 percent, well above the rate of increase in State funding.

As a result of the relatively rapid increase in Federal funding and the relatively slow

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1 These figures do not take into account the impact of diversion of some medical and mental health costs to Medicaid funding beginning in FY94.

increase in State funding for children and youth programs from FY92 to FY96, State funding declined from 59.4 percent of total children and youth funding in FY92 to 39.4 percent in FY96. A source of concern is that Federal welfare reform will result in a substantial reduction in the rate of growth, or an absolute reduction, in Federal funding to Pennsylvania for children and youth. Such reductions may result in the need for additional State funding for the State to meet its needs-based budget funding obligations. Additional county contributions are likely to be required as well.

Major Problems with the Children and Youth Funding Process

In the view of PICA Staff, there are a number of significant problems relating to the needs-based budget funding process for children and youth services. The discussion below includes descriptions of the problems from the perspective of PICA Staff. In certain instances the description of the problem is followed by a section entitled "DPW Response and PICA Staff Comments," which summarizes certain concerns raised by DPW after reviewing a draft copy of this report, and PICA comments on the DPW response.

The issues described are likely to be especially significant for Philadelphia, due to the City's high level of expenditures for the program, and low capacity to provide funding for the program from the local tax base. The problems, however, are likely to affect all counties in the State since they relate to the basic process for determining allocations of State funding to children and youth programs statewide.

COLA for Purchased Services--*The limit on the annual increase in the State-certified cost per unit of purchased services appears inappropriate, contrary to the needs-based budgeting concept, and could have a significant adverse impact on counties*

The regulations provide that "(t)he Department will make its determination of the county's total costs and reimbursable costs and the amount of State reimbursement allowed the county in accordance with section 704.1 (a) of the Public Welfare Code...this chapter and Chapter 3170 (relating to allowable costs and procedures for county children and youth). The Department's determination will consider whether the county's needs-based plan and budget estimate is reasonable in relation to the following criteria..." A list of 13 "criteria" of reasonableness follows. The seventh of these provides that "(t)he annual percentage increase in budgeted expenditures in the county's needs-based plan and budget estimate over the Departmentally determined, previous year, needs-based budget amounts for currently provided purchased services for...major service categories may not be more than the projected consumer price index for wage earners developed for the Department for the plan year."

This "criterion of reasonableness" number 7 has been interpreted to require a fixed annual cap on the increase in the certified cost per unit of purchased services, which cannot exceed the consumer price index for wage earners (CPI-W). In some years, DPW has set the this cap, called a "cost of living adjustment" (COLA), at the CPI-W, and in other years it has set the COLA below the CPI-W. The COLA is applied to certified prior year purchased services costs to calculate the carry forward amount in the following year's needs-based budget.

Actual Costs Could Be Higher than Certified Costs

Basing allowable year-to-year increases in the cost per unit of purchased services on the CPI-W, which represents the general level of inflation, could result in a situation where DPW-certified purchased service costs are substantially below the actual cost structure faced by county or private service providers in the event of an inflation rate for child welfare services substantially higher than the overall CPI-W. The City notes in its FY96-FY2000 Five-Year Financial Plan that, because of this regulation, the gap between DPW certified costs and DHS actual costs will compound over time, if actual children and youth service costs increase more rapidly than the general inflation level. According to the City, a needs based budget in year x is already below actual costs because it is based on arbitrarily low growth rates applied in the prior year. The needs-based budget for year x+1 is calculated by applying artificially low growth rates to year x's already artificially low needs-based budget. Future year calculations are made in the same manner. As a result, there will be an increasing gap between actual DHS costs and the State certified needs-based budget as time progresses.

In actuality, DPW certifications have not in fact become increasingly lower than DHS actual spending. While the reason for this is not entirely clear due to the overall ambiguity in the needs-based budget process, part of the reason may be that large increases in diversion funding (medical-related costs diverted to Medicaid funding) in recent years reduced actual per diem cost increases below levels they would otherwise have reached. This factor may have compensated for the needs-based budget rules to keep the deviation between actuals and certified needs-based budget levels from increasing over time. When maximum diversion has been achieved, this factor will be no longer present, and one would expect the gap between needs-based budget levels and actuals to begin to increase over time, if there are no changes in the needs-based budget process.

The cap on the increase in the cost per unit of purchased services is particularly problematic to the extent that these costs include a substantial amount of medical-related costs, since medical costs historically have increased more rapidly than overall inflation. Although a substantial amount of medical-related costs have been diverted to Medicaid funding, a significant level of medical costs, such as pediatric nursing costs, are still included within the purchased services funded under Act 148.

There may also be a need from time to time to adjust purchased service rates to reflect changes in cost structures, not necessarily across the board but for individual service categories. The current needs-based budget process does not allow this flexibility. Changes in purchased service rates can be achieved through initiative funding, but only if purchased services are proposed to be provided "in a different manner."

DPW Response and PICA Staff Comments

DPW Response: "You correctly state that increases in per diems could exceed the inflation factor for any year in question. What your analysis fails to include is the fact that they may increase at a rate less than that of inflation. Our experience with the Castille vendors has been that their per diems have consistently risen at or below the COLA since the contracts were initiated. Furthermore, actual costs can and have been lower than projected costs and the projected COLA can and has been higher than the actual rate of inflation. These phenomena are part of fluctuations of the marketplace."

PICA Staff Comment: The report clearly indicates that the COLA rule to date has not resulted in an increasing gap between certified and actual cost, possibly due to the impact of diversion of costs to Medicaid funding. The concern raised by the report is that actual costs could over time increase more rapidly than the limit allowed by the COLA, and that this is more likely to occur to the extent that purchased services costs include costs for medical services which historically have grown more rapidly than inflation.

Use of COLAs Below the CPI-W

The manner in which "criterion" 7 has been implemented is likely to make its impact even more of a problem. The "criterion" has been interpreted to mean that the allowable COLA that DPW requires counties to use may equal the CPI-W but cannot exceed the CPI-W, and may be lower than the CPI-W if DPW chooses. The purchased services COLA for the FY97 Annual Plans is 2.0 percent, lower than the CPI-W. The ability of DPW under the regulations to require the use of purchased services COLAs that are below the CPI makes it even more likely that the application of "criterion" 7 will result in increasing divergence over time between State-certified needs-based budget costs and actual costs incurred by counties.

Internal Inconsistency Within the Regulations

"Criterion" 7 appears to flatly contradict "criterion" 6, which indicates that "(s)ervice levels and service costs, excluding county staff costs, for purchased services projected for cost centers and major service categories in the county's needs-based plan and budget estimate shall be: (i) reasonable when compared with current and prior years trends in the number of children in the county and the number of children served and with service level, per diem and cost trends reported to the Department's program and fiscal reporting systems, (ii) reasonable when compared with service level, per diem and cost trends shown by other comparable counties, and (iii) adequately justified in the county's needs-based plan and budget estimate."

If prior year trends in per diem costs have exceeded the CPI-W, then the application of criteria 6 and 7 will clearly lead to different results. One "criterion" seems to limit per diem cost increases to no more than the CPI-W, and the other "criterion" seems to indicate that per diem cost increases should be consistent with prior year trends, and trends in other counties. This internal inconsistency of the regulations is a major source of concern.

DPW Response and PICA Staff Comments

DPW Response: "Each criteria the department uses to review needs-based plans do not stand alone. The department has developed a review process to take into account all of the criteria in its review, not just the COLA or service and per diem trends. You should also understand that criteria "6" is applied to service increases, which are service levels that exceed the service levels in the carry forward budget. While the COLA (criteria "7") applies to the unit cost for these services, it is criteria "6" which is the regulatory base used to review and determine the additional levels we certify. Criteria "7" is applied specifically to the carry forward (previously determined) budget amounts."

PICA Comment: Criterion 6 clearly states that service costs shall be "reasonable when compared with...per diem...trends reported to (DPW)." This portion of criterion 6 clearly relates to per diem costs and therefore has specific implications for the manner in which the carry forward portion of the needs-based budget is calculated. This portion of criterion 6 also clearly contradicts criterion 7.

Consistency With Act 30

In the opinion of PICA Staff, the use of a COLA for purchased services, based on "criterion" 7 of the regulations, is contrary to the spirit of the needs-based budgeting concept contained in Act 30, since it seems designed to promote State cost-containment and disregards the actual expenditure needs of counties. "Criterion" 6 in the regulations seems closer to the spirit of the needs-based budget process that was intended to be established under Act 30. The language in "criterion" 6 is closer to language in Act 30, which states that DPW's determination of a county's total costs and reimbursable costs included in a needs-based budget "shall consider whether the county's budget is reasonable in relation to past costs, projected cost increases, number of children in the county and the number of children served, service level trends and projections of other sources of revenue." Act 30 contains no suggestion that any fixed caps on cost increases should be used in determining needs-based budgets, but rather in emphasizing "past costs" and "service level trends" as the basis for needs-based budget amounts strongly suggests that fixed caps should not be used in determining the reasonableness of needs-based budgets.

DPW Response and PICA Staff Comments

DPW Response: "The needs-based plan regulations were promulgated pursuant to Act 30 and the Regulation Review Act. Counties were part of the drafting and redrafting of the regulations."

PICA Staff Comment: Despite the merits of the process of developing the regulations that DPW claims, PICA Staff believes that there are problems with the regulations which are the outcome of that process.

DPW Response: "While there is not specific mention of CPIW or COLA in Act 30, there is also no prohibition. The legislation directed the Department to develop and promulgate needs-based planning regulations for county child welfare services. In developing the regulations, the Department, as a prudent progam and fiscal administrator, set broad boundaries for development and review of needs-based budgets. The boundaries established in the regulations are consistent with the intent of the General Assembly to provide counties with the resources to fulfill its mandates while not sacrificing fiscal integrity and accountability."

PICA Staff Comment: The report clearly states that the COLA for purchased services is opposed to the spirit, and not necessarily the letter, of Act 30. Fiscal integrity and accountability involves the formulation of realistic budgets that can be used as a basis for sound management, and this goal is complementary to and not inconsistent with reducing costs. PICA Staff believes that the purchased services COLA is not the most effective means to achieve fiscal integrity and accountability.

Restrictions on "Allowable" Costs--*Certain limitations on costs that the State will reimburse appear inappropriate, and some have an adverse impact on Philadelphia*

Another problem relating to the content of the needs-based budget process is that there are certain restrictions on "allowable" costs, or costs that are considered reimbursable by the State, and these restrictions appear irrational or unfair. These restrictions, which are based on State regulations, relate to administrative costs, salary and benefit costs, and mental health/mental retardation costs.

Total non-allowable certified costs included within DHS's FY95 estimated actual needs-based budget are $4.1 million, or 1.2 percent of the total estimated actual expenditures of $347.2 million. These costs include $100,000 in salary costs, $140,000 in costs for psychiatric evaluations, $1.3 million in costs for Mental Retardation placements, and $2.5 million in indirect administrative overhead costs. These amounts are funded entirely through county funds. If they were considered reimbursable under Act 148, they would be funded through a combination of State and county funds.

While the amount of certified non-allowable costs is only a small portion of the overall needs-based budget, the fact that these costs are not reimbursable is an important issue. For instance, there appears to be no rational basis to completely exclude all MH/MR costs from reimbursement since in some cases there are no alternative sources of funding for these costs. In the case of salary costs and indirect administrative costs, there may be a legitimate reason for limits on reimbursability, but the manner in which costs are limited appears irrational or unfair.

Further, these unallowable costs may increase significantly in the future depending on changes in State policy regarding allowable salary levels or changes in the Medicaid program, such as a movement to managed care that could affect the level of Medicaid funding available for mental health services.

Statewide Caps on Salary and Benefit Levels

Criterion of reasonableness number 5 provides that staff salary and benefit levels shall not exceed allowable levels as provided in Chapter 3170 of DPW regulations. The City has indicated, in the FY96-FY2000 Plan, its concern that this provision imposes “arbitrary uniform statewide limits on salary and staff costs despite variations in personnel cost by areas of the state.” This penalizes certain counties, such as Philadelphia, where the cost of living is higher.

The idea of a State cap on allowable salary levels by personnel category does not seem unreasonable. In the view of PICA Staff, however, it appears that the salary cap should be adjusted for differences in cost of living in different areas of the State, if there are documented and significant differences in the cost of living among counties within the State.

DPW also imposes a uniform Statewide cap on fringe benefit costs of 36.28 percent of salary costs, as indicated in the Bulletin. DHS calculates its actual fringe benefit costs at 37.52 percent of salary costs. DHS’s excess costs are included in the needs based budget as non-reimbursable, and are 100 percent funded by the City. It seems appropriate that DPW should have a uniform statewide fringe benefit percentage cap that does not vary by county, if the cap represents a reasonable expectation regarding overall fringe benefit costs. In the opinion of PICA Staff, there appears nothing unreasonable about the State’s 36.28 percent standard (although the State’s own cost has recently been reported to be 41 percent).

Although non-reimbursement of personal services costs remains an important potential problem under State regulations, it has not become a significant practical issue to date. DHS has indicated that the actual amount of salaries that the State classifies as unreimbursable is small. In the FY96 implementation plan, only $101,280 out of $48.4 million in total staff costs are classified as unallowable. However, DHS indicates that State certification of salary levels could be more of a problem in the future, due to the possible reclassification of certain DHS positions according to the State classification.

DPW Response and PICA Staff Comments

DPW Response: “The upper limit of the Department’s financial participation is and always has been the maximum salary for a similar State position. The limit on benefit percentages is calculated each year by the Department’s Bureau of Financial Operations and published in a Children, Youth and Families Bulletin. The rate is based on the benefit rate paid to Commonwealth employees. In Philadelphia’s case, their last two needs-based plans contained no unallowable salaries or benefit costs. You should also note that the State employs may persons in the Philadelphia metropolitan area. The State salary structure is competitive and reasonable as evidenced by our continuing ability to hire and employ qualified candidates.”

PICA Staff Comment: DPW is correct to note that in the FY94 and FY95 DHS needs-based budgets there were no unreimbursable salary or benefit costs. However, the FY96 DHS needs-based budget includes $101,280 in unreimbursable salary costs.

PICA Staff Comment: On the face of it, there are serious questions about whether a salary structure that is completely uniform on a statewide basis can attract the appropriate level of personnel Statewide, given the fact that there are significant differences in the cost of living across the State. As the basis for the DPW assertion that the State salary structure is competitive, DPW mentions only its “continuing ability to hire and employ qualified candidates.” This simple response, without support from in-depth studies of State compensation issues, is not sufficient to dispel concerns about possible problems of salary competitiveness on a Statewide basis. Also, the uniform Statewide salary structure may have different effects for the work force of county governments as compared to the State government work force.

Administrative Cost Caps

DPW does not count as reimbursable certain indirect administrative costs that exceed two percent of the total Act 148 certified amount. This administrative cost cap policy is not contained in Act 30 or the regulations, but was based on a DPW bulletin. The policy relates only to certain indirect administrative costs, or those costs not incurred by the official children and youth agency in each county. While space rental costs, which are not listed under the Department of Human Services, are not covered by the cap, the cap does include costs such as the cost of negotiating space rental leases in the Department of Public Property, the cost of processing checks in the Department of Finance, and administrative costs in the Managing Director’s Office. DHS officials have indicated that comparable costs in other counties are not indirect and thus do not fall under the 2 percent cap. As a result, Philadelphia’s organizational structure contributes to higher unreimbursable costs than would be the case if its structure were more similar to that of other counties. According to DHS officials, $2.5 million in City costs are considered non-reimbursable as a result of this administrative cost cap. Because the City’s net administrative expenses are reimbursed by the State at a 60 percent rate, this cost cap may result in a reduction in State revenue to the City of approximately $1.5 million annually.

One effect of the administrative cost cap, which appears inappropriate, is that if the State Act 148 allocation decreases because of increased Federal revenue, the amount of reimbursable indirect administrative costs will also decrease, even while overall program costs are increasing. It also seems inappropriate that the organizational structure of a county should affect the degree to which administrative costs are or are not reimbursed, particularly if there is no reason to prefer one organizational structure over another. If the goal is to insure that administration costs are not excessive, it would seem more appropriate to cap all administrative costs, regardless of whether direct or indirect, and to cap them in relation to total children and youth program expenditures, not in relation to State Act 148 funding of the program, which does not vary in direct proportion to total spending.

Another rule relating to administrative costs is found in “criterion of reasonableness” number 11 in the regulations, which indicates that costs for the administration major service category cannot increase more than 3 percent over the amount in the previous year’s certified needs-based budget. This rule also seems inappropriate. For various reasons, total children and youth program expenditures may increase significantly more or less rapidly than 3 percent over the prior year. It would be more appropriate to cap allowable administrative costs as a percentage of total allowable program expenditures. Assuming that total allowable non-administrative costs were an adequate reflection of county needs, a cap on all direct and indirect administrative costs as a percent of total program costs would reflect needs while insuring that county spending on administration is not excessive.

DPW Response and PICA Staff Comments

DPW Response: "This draft report is clearly inaccurate in its description and understanding of indirect costs. There is a cap of two (2) percent of a county's State allocation for indirect administrative costs. There is no cap on federal revenue for these indirect costs. As there is not indirect cap on federal revenues, the county's share of revenue for indirect costs will increase as federal revenues increase; whereas you state administrative reimbursement will decrease."

PICA Staff Comment: PICA Staff continues to believe that there is a potential at least for total State and Federal reimbursement for indirect administrative costs to decrease due to an increase in Federal revenue. Whether this has actually occurred or will occur will depend on the exact extent to which Federal funding through IV-E or IV-A includes reimbursement for indirect administrative costs. The same possibility exists with respect to increases in Medicaid diversion funding.

DPW Response: "The intent of the limitation on the Department's participation (in funding for administration costs) is to prevent the child welfare program from paying excessive amounts toward administrative costs the county would have regardless of whether of not there was a child welfare program."

PICA Staff Comment: This may be a worthwhile goal, but it clearly cannot be achieved through the current rule limiting indirect administration costs. Any rule limiting administration cost to a certain percentage of overall expenditures or revenues from a particular source cannot insure that all costs that are unrelated to the child welfare program are not reimbursed.

DPW Response: "The Department encourages counties to, as much as possible, convert indirect costs to direct administrative costs using a cost allocation plan. This would reduce the level of indirect costs subject to the cap. Philadelphia has chosen not to make this conversion and therefore receives less reimbursement than it could."

PICA Staff Comment: A DHS official indicated that DHS was only recently informed of the possibility of reducing the level of indirect costs subject to the cap by "converting" indirect costs to direct costs. PICA Staff hopes that some progress will be made with respect to this issue in the near future, and will continue to monitor progress in this area.

DPW Response and PICA Staff Comments

DPW Response: "The three (3) percent cap on increased administrative costs... is part of the review process for the same reason that the COLA for purchased services is part of the process--to establish consistent parameters for review of a county's request. These requirements were published and adopted pursuant to the regulatory process."

PICA Staff Comment: The three percent administrative cost cap, like the COLA rule, cannot be justified simply because it will "establish consistent parameters for review of a county's request," or because it represents the outcome of a certain regulatory process.

Non-Allowability of MH/MR Costs

Section 3140.21 (c) of the regulations indicates that "mental health or mental retardation treatment services" will not be considered reimbursable costs. This is a significant problem since these costs are necessary and some cannot receive funding from other sources. In FY96, DHS expected to incur an estimated $1.3 million in non-reimbursable MR costs. Fortunately, the impact of the exclusion of MH/MR costs from reimbursability has been reduced because DPW has approved the diversion of approximately $10 million in annual funding for MH services provided in Residential Treatment Facilities (RTFs) to Medicaid (MA) funding. However, DHS officials indicate that MR costs are unlikely to be diverted to MA funding. Also, if the MA program is restructured in a manner that reduces diversion of MH services, such as may occur under a managed care Medicaid program structure, local taxpayers in Philadelphia would be required to fund all of the costs of any MH services not covered by MA.

As the City noted in its FY96-FY2000 Five-Year Financial Plan, there is an additional problem related to MH/MR funding. For some children in DHS's caseload, psychiatric evaluations are necessary to determine an appropriate longer term placement. The cost of these evaluations is payable by Medicaid. However, some providers are not willing to provide immediate service for children if reimbursed at Medicaid rates. If the City pays larger "full rates" for evaluations, these children can receive immediate service, but then the entire rate charge is not eligible for MA reimbursement, or for reimbursement under Act 148 funding. The City is often forced to choose between paying the larger rates which are not reimbursed, or maintaining children in emergency shelter for a considerable length of time until providers are able to provide evaluations at the MA rate. The total cost of psychiatric evaluations estimated to be non reimbursable in FY96 is $140,000. There appears to be no rational basis for DPW to exclude these costs from reimbursement, since these are necessary costs that DHS must incur in order to provide services efficiently.

DPW Response and PICA Staff Comments

DPW Response: "Section 3140.21 (c) of the regulations identify MH and MR treatment costs as nonreimbursable. This section of the regulations prohibits the use of Act 148 funds to pay for services to children until all other sources of funds have been exhausted. The Department's position on payment for these costs has and continues to be that if a child is otherwise eligible for child welfare services, the Department may participate in the cost of otherwise non-reimbursable services as long as the county submits documentation that funds are not available from the MH/MR program and describes the county's efforts to obtain funding from the MH/MR agency for the services. Philadelphia has chosen not to request reimbursement and provide the necessary documentation in order to receive reimbursement for their costs."

PICA Staff Comment: A DHS official indicates that DHS to date has not been informed of this DPW position with regard to the reimbursability of MH/MR costs. PICA Staff hopes that DPW will clarify its exact position on this issue to DHS in the near future and progress will occur toward achieving reimbursement under Act 148 for MH/MR services which cannot receive funding from other revenue sources.

Calculating the Impact of "Initiatives"--*The current needs-based budget process does not appear to account for the impact of one-year start-up costs for initiatives or the possible need to phase out funding for a previously-approved initiative after a certain period*

Because initiative funding is limited to only partial funding in the first fiscal year (ranging between 6 and 10 months), and because initiatives often have one-year start-up costs, adjustments need to be made to the carry forward calculation to insure that only recurring annual costs are made part of the ongoing carry forward base. Under the current system for calculating needs-based budgets as described in the Bulletin, there are specific provisions to take into account some of the budgetary impacts of new initiatives and annualization of prior year initiatives. However, there is no explicit provision in the Bulletin instructions that requires counties to eliminate one-year start-up costs for initiatives from the base used to calculate carry forward costs. Presumably this adjustment is being taken into account by the State and counties in their calculations, but it is a source of concern that the need for this adjustment is not mentioned in the instructions.

Also, no specific component of the needs-based budget calculation is designed to incorporate the impact of a DPW decision to discontinue funding of a previously funded initiative or special grant pick-up. Some initiatives are clearly of a stand-alone nature, for demonstration projects or other services that may be expanded in the future or discontinued entirely. Funding for some of these initiatives may need to be discontinued in the future. Examples of such initiatives funded in the FY96 budget year for DHS include: providing incentives to providers to establish more services at in-state facilities; and providing supervision, truancy and delinquency prevention services to 25th Police District youth. Perhaps provisions to allow discontinuation of funding for certain initiatives has not yet been incorporated into the needs-based budget process because DPW to date has not discontinued funding for any county initiative. The system will eventually have to incorporate provisions that will allow for phasing out funding of certain initiatives.

DPW Response and PICA Staff Comments

DPW Response: "During the year, staff monitor implementation of the initiative and identify problems. When problems occur and the initiative is discontinued and/or all funds are not spent, an adjustment is made in a future allocation level or payment to the county to recover the funds."

PICA Staff Comment: The problem remains that the exact manner in which this adjustment is made is not clearly described in the needs-based budget forms and instructions so that counties can make proper adjustments when submitting needs-based budget requests or understand the basis for DPW-certified budget amounts.

DPW Response: "Grant monitoring provides staff with an analysis of the progress of the grant and make recommendations for pick-up or discontinuance. The recommendation also identifies the amount to be incorporated with the budget."

PICA Staff Comment: The concern remains that the exact method of calculating the budgetary impact of discontinuing funding for a grant pick-up is not described in the needs-based budget forms and instructions.

Lack of Clarity--*There is a lack of clarity in the needs-based budget rules and how they are interpreted by DPW when making needs-based budget certifications and by DHS when it makes its needs-based budget request. This lack of clarity is a serious impediment to the ability of the needs-based budget process to promote better management of the Philadelphia children and youth system and predictability of children and youth funding levels to the City*

The problems with the substance of the needs-based budget process described above are significant. Another, perhaps even more serious, problem with the process has been the general level of obscurity in the manner in which it is implemented. There appears to be a lack of clarity in the manner in which the needs-based budget rules are implemented and needs-based budget amounts calculated, based on a review of the rules in the DPW Bulletin, documents provided to DHS containing the DPW-certified budget figures and the Annual Plan document containing DHS's requested FY97 budget.

The DPW Bulletin contains rules to be followed by counties in preparing the requested FY97 needs-based budget, along with forms that county Annual Plans must contain and instructions for filling out those forms. These rules and instructions in many instances are not very clear. The documents provided by DPW to DHS which contain the certified needs-based budget figures are not very detailed and generally do not indicate the basis for the DPW certification decision. DHS has indicated to PICA Staff that DPW officials have often either been unable to justify certain calculations that underlie DPW-certified amounts, or have simply been unclear about the basis for certified amounts.

The FY97 DHS Annual Plan submitted to DPW is unclear about the basis for calculations that underlie the needs-based budget request. For example, the Annual Plan does not clearly present the calculation of carry forward amounts based on particular COLAs, assumptions regarding cost per unit of service used to calculate increased services costs, the basis of calculations of staff to caseload ratios, and the relationship between cost figures presented by object of expenditure and figures presented by cost center. Neither the DHS Annual Plan document nor the documents that contain the DPW-certified needs-based budget provided to DHS make clear such basic budget elements as the number of staff positions, the salary level for each position, projected caseload, the projected number of units of purchased service by category, the cost for each unit of service, and other miscellaneous overhead costs.

The general obscurity of the needs-based budget rules, DHS requested needs-based budget amounts and DPW certified needs-based budget amounts, is probably the major reason why the needs-based budget process has remained a source of conflict between the City and State since its inception. An indication of the extent of the disagreement over the needs-based budget process is the fact that DHS appealed the DPW-certified needs-based budget it received in FY92, the first year of the needs-based budget process, and again appealed the DPW certified needs-based budget in FY93 and FY95. The needs-based budget process could be a vehicle for better management of the child welfare system and greater ability of counties to forecast funding levels. This cannot occur when the basic assumptions which form the basis of DHS-requested and State-certified needs-based budgets are never clarified.

The lack of clarity in the DHS Annual Plan is at least partially due to the DPW rules which dictate the organization of the document and the forms it must include. Currently, officials from several counties are working to propose improvements to the format of the Annual Plan, including required forms and their instructions. These efforts will be extremely worthwhile if they result in Annual Plan documents that more clearly show the basis of the needs-based budget figures. DPW will also need to provide better information to counties regarding the basis of its certified needs-based budget decisions.

In part the lack of clarity in the current needs-based budget process is due to its complexity, and its complexity is due to the regulations. For instance, the cap in the annual increase in the cost per unit of purchased services contained in the regulations appears to have resulted in the need for separate calculations of four components of the needs-based budget, carry forward, increased services, annualization of initiatives and new initiatives. Also, provisions in the regulations concerning annualization of costs and the funding of vacant positions add to the complexity of the process. One way to increase the clarity of the needs-based budget process would be to repeal the regulations that complicate the process, and replace the current needs-based budget process with a much simpler process. Under a simplified process, needs-based budget requests and certifications would be based only on key parameters such as: a number of staff positions, a salary level for each position, a projected number of units of purchased service by category, a cost for each unit of service, and other miscellaneous overhead costs. Under such a process, there would be no fixed rules on how these parameters could change from year to year. This option should be considered. Still, there is no reason why DPW and DHS cannot, when requesting or certifying needs-based budget amounts, clearly specify the manner in which the current procedures are implemented, despite the complexity of the current procedures.

DPW Response and PICA Staff Comments

DPW Response: "The bulletin has been provided in draft form to each county prior to publication since the beginning of the needs-based process. Very few, if any, comments are received from counties."

PICA Staff Comment: It may be true that very few comments have been made by counties to DPW. Nonetheless, the report mentions the fact that county financial officials are working toward making a joint recommendation to DPW on how the improve the needs-based budget forms and instructions so as to clarify the overall process, which suggests that county officials are dissatisfied with the current structure of the needs-based budget process.

DPW Response: "We have attempted to be as concise and as precise as we could with a very complex process. Regional staff has meetings with counties subsequent to issuing the allocation. These meetings are used to provide counties with the basis used to develop its needs-based recommendation. We have and will continue to provide counties with our method for calculating federal revenues when so asked."

PICA Staff Comment: DHS officials have indicated that meetings with DPW have not served to adequately clarify for DHS the basis of its DPW-certified needs-based budget.

Possible Disincentives for Efficient Management--*The current needs-based budget process may act as a disincentive for counties to restructure service delivery systems in pursuit of better services at lower cost*

The current needs-based budget process does not appear to be structured in a manner to promote incentives for counties to operate more efficiently. There may be an incentive under the current needs-based budget process to retain existing service structures and rates, and avoid major restructuring to promote efficiencies, because the process rewards maintenance of current service structures and discourages innovation. A major reason this could occur is that any proposals for significant service restructuring must be proposed as initiatives. Making such proposals may be risky, because of the lack of clarity in the overall needs-based budget process, which reduces the certainty of what the impact of such proposals would be on the various components of the needs based budget, and potential conflicts that may arise between the State and counties over these impacts. As a result, counties may have little incentive to propose the kinds of restructuring that could result in improved services and cost savings for county and State government over the long term.

PICA Staff believes that improvements in DHS service delivery can occur and have occurred under the current needs-based budget system. However, the current needs-based budget system does not provide an incentive for these improvements to occur. Rather, it appears that such improvements have occurred despite the current needs-based budget process and not because of it.

This is another reason why the problems with the overall clarity of the needs-based budget system should be addressed. Improvements in the clarity of the rules under the current needs-based budget system would reduce the potential for conflict over what should be the impact of major service restructurings on the needs-based budget. This would reduce the disincentive likely to exist within the current system to propose and implement major restructuring of the children and youth service system that could improve services or reduce costs.

State Funding is Not Based on Actual Costs--*The current children and youth funding process does not allow State funding levels to change in the event of a variance between budgeted and actual expenditures and revenues*

Section 3140.45 of the regulations provides that total payments to a county for a certain fiscal year under Act 148 cannot exceed the total State allocation to that county for that fiscal year in the certified needs-based budget. As a result, if "net" county expenditures (county expenditures minus Federal or other revenues) exceed the level in the certified needs-based budget (either due to actual Federal revenues being below the certified needs-based budget level or actual expenditures being above the certified level), the additional cost must be funded entirely with county dollars. In such a case, the actual percentage of net costs funded with county dollars would be higher than the Act 30 percentage used in determining the original needs-based budget.

In recent years, DHS has been particularly concerned about whether additional State funding would be available to counties in the event of shortfalls from needs-based budget certified levels for Federal Title IV-A revenue. This has been a critical issue because Title IV-A is a new revenue source and there are major uncertainties about the actual level of revenue that will be received from this source. This is an example of the kind of problem that exists under the current system because the system does not base State funding on actual county revenues and expenditures.

The lack of any provision to adjust State funding in the event of increases in net county expenditures from certified needs-based budget levels could be a serious problem in the current children and youth funding process. At the next time that major systemic changes in the children and youth funding system are being considered, the Governor and General Assembly should evaluate the costs and benefits of changing the system to one that would reimburse counties for a certain percentage of actual net costs.

DPW Response and PICA Staff Comments

<u>DPW Response</u>: "Your report expresses concerns about the negative impact on counties <u>if</u> federal funds were less than projected to calculate the State and county share. Your report does not describe what has <u>actually</u> happened in prior years, which is that counties, particularly Philadelphia, have been allowed to use higher than projected federal funds to offset State and

county costs. Counties were also allowed to use State funds available from excess federal revenues to pay for additional allowable Act 148 costs."

PICA Staff Comment: The problem cited in the report involves what may occur under the current needs-based budget process rules, not what has actually occurred. Although shortfalls from the needs-based budget estimate of federal funding may not have occurred to date, they still may occur in the future, and the rules of the current needs-based budget process do not adequately address this possibility.

No Equalization Provisions--*The current children and youth funding process does not include provisions to equalize the burden on local taxpayers of supporting the children and youth program*

The children and youth funding system created by Act 30 does not include provisions that would equalize across the State the burden on taxpayers in different counties needed to support the child welfare program. Such provisions might include adjustments to the State and local percentage share of net costs, based on need for child welfare services or financial capacity in different counties. Federal funding formulas for Medicaid and welfare programs and Pennsylvania funding for education programs incorporate provisions that adjust for differences among jurisdictions with respect to financial capacity and need. Act 30 contains no such provisions. The State and local percentage share of net costs for particular children and youth service categories is the same for all counties.

The DHS Annual Plan contains an extensive discussion of the extent to which the county of Philadelphia is different from most if not all other counties in Pennsylvania with respect to its need for children and youth services. In addition, a number of studies have indicated that the tax burden for the average Philadelphia household or business is substantially higher than that in many surrounding jurisdictions. At least some of the disparity in tax burden between Philadelphia and surrounding counties is due to the fact that the current State child welfare funding process does not include provisions to adjust for differences in need and financial capacity among counties.

The impact of the lack of local tax "equalization" provisions in the Act 30 funding formulas on the economic health of high financial need/low financial capacity counties in the State, Philadelphia in particular, is an important long-term issue that should be evaluated by the Governor and General Assembly when systematic changes in the children and youth funding system are next considered.

Impact of Welfare Reform--*Federal welfare reform may require significant changes in the children and youth funding system and provide an opportunity to improve some of the deficiencies of the current system*

In recent years, county children and youth programs in Pennsylvania have received large increases in Federal funding as a result of the implementation of the Title IV-A funding source and better systems to insure that maximum Federal reimbursement is received for costs eligible for Title IV-E reimbursement. This has enabled overall county program expenditures to increase rapidly while State funding has increased at a much slower rate. Some Federal welfare reform proposals currently pending would place a cap on Federal Title IV-A funding. This would mean that the level of Federal funding for child welfare programs to Pennsylvania would be unlikely to increase as rapidly in the future as in the recent past. In fact, depending on the "base year" used in the final Federal legislation, the amount of dollars available to Pennsylvania may actually decline. If a reduction in Federal funding (or the growth in Federal funding) were to occur, this would create a need for greater discipline for child welfare programs and the child welfare funding system and will make it more essential that the problems with the system discussed in this report be resolved.

Welfare reform may also result in conversion of funding programs from open ended "entitlements," where funding is essentially a reimbursement for certain types of expenditures which increases as expenditures increase, to "block grants" that are capped at a particular level and cannot increase beyond that level. If a movement to "block grants" were to occur, this would require that the State develop a system for allocating capped Federal grants to counties. The nature of that system could have significant effects on the distribution of financial burdens for the children and youth system among counties. This could have a significant impact on the City, particularly since currently Federal funding may be targeted to counties with high numbers of low-income residents as a result of eligibility standards. The overall needs-based budget process may have to be amended to accommodate any new State procedures for allocating Federal funding.

PICA Staff believes that welfare reform should be approached by the State as an opportunity to reevaluate its overall child welfare funding system and produce a rational and comprehensive approach to funding the children and youth program in Pennsylvania. At the very least, fair procedures for allocating Federal block grant funding may need to be developed, additional State funding may need to be provided to compensate for reductions in Federal funding that may occur, and the needs-based budget process may need to be changed to accommodate the new procedures for allocating Federal funding. If any of these actions are needed but do not occur, the result could be reduced services, higher local tax burdens or greater financial uncertainty for counties. The impact for a county like Philadelphia, with high needs for children and youth services and little ability to increase local funding level for the program, could be especially damaging. Such a scenario could result in a serious setback to the City's overall financial recovery that has occurred over the past four years.

Glossary

Title IV-E--Federal program under the Social Security Act providing funding for a fixed percentage of allowable State or local costs for placement services, adoption assistance, training and administration. Costs reimbursable under Title IV-E are limited to costs incurred for children meeting income-eligibility requirements. Non-placement services and services provided by for-profit agencies are not reimbursable.

Title IV-A--Federal "Emergency Assistance" program under the Social Security Act providing funding of 50 percent of costs of children in emergency situations. Almost all children in the DHS caseload have a family emergency which qualifies them for this assistance.

Title IV-B--Federal funding program under the Social Security Act providing funding for child welfare services. This is not open-ended entitlement funding received as reimbursement for particular expenditures, but is a closed-ended grant that can be used more flexibly. Title IV-B funds are counted as State funds for purposes of meeting the Act 30 reimbursement percentages of county child welfare costs.

Act 30--Amendment to Act 148 which instituted the needs-based budgeting process and changed State reimbursement percentages for county children and youth costs.

Act 148--State law that sets forth the manner in which the State is obligated to fund county children and youth programs, including reimbursement percentages.

Diversion--The process of receiving funding for medical services for children in the DHS caseload through Medicaid rather than through State Act 148 or Federal funding streams. Generally, medical costs incurred by DHS's contracted service providers are reimbursed directly by the State through Medicaid, while non-medical costs are reimbursed by the City, which in turn receives its funding from State, Federal and local sources.

Appendix A

Department of Public Welfare
Letter to PICA Staff --
Comments on Initial Draft
of this Report