

IMPROVING STATE APPROPRIATION CONTROL
OVER THE RESIDENT COUNTY HOSPITALIZATION PROGRAM

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AT ISSUE

Michigan counties provide hospitalization coverage for indigents under a state mandate. The state actually pays the hospital bills for participating counties and requires those counties to pay back a share of the costs; however, appropriation controls in the executive branch do not effectively enforce the payback requirement.

Wayne County systematically has failed to repay amounts owed the state. At the end of fiscal 1983, the executive branch of state government in effect wrote-off \$89.5 million in delinquent county receivables, without legislative participation, by allocating money from the unobligated general-fund balance to create an “allowance for loss.” By the end of 1986 Wayne County owed another \$60 million to the state; negotiations for a settlement are now underway. Even if the current debt is settled, the problem of inadequate appropriation control will remain.

Settling unpaid county obligations that have built over several years can threaten the state’s fiscal balance. The necessity for this can be prevented by creating a single appropriation account to control indigent hospitalization spending and by restricting expenditures from county payback revenue to the amount actually received, which would make administrative practice conform to existing appropriation instructions. If lawmakers do not choose to enforce those instructions, they should change them to conform to actual practice — and appropriate state funds for the program to begin with, rather than years after the fact. It would be prudent also to insure that no future decision to accept a loss of substantial receivables from the state’s books is made without legislative participation.

This paper describes the steps that could bring adequate fiscal control.

Background: Mandated County Hospitalization services for the Indigent

The Social Welfare Act, as amended in 1957, requires counties to provide for hospitalization of indigent residents. Since 1979 the state has obligated itself to participate financially in these resident county hospitalization (hereinafter, “RCH”) programs; since 1982 it has reimbursed hospitals directly for indigent care at Medicaid daily rates and required “county payback” to the state for all but \$100 of those rates. Any county except Wayne may elect to forego state participation and pay hospitals directly.

Legislative Instructions for Financing Resident County Hospitalization

Three sets of legislative instructions govern the fiscal basis for RCH programs for the indigent:

1. Legislation creating the program (MCL 400.66a-i, MSA 16.466(l)-(9)) calls for state payments to hospitals for treatment of indigents followed by partial county reimbursement to the state.

2. Annual appropriations for the program specify the amounts that are appropriated from the general funds of the state (“general fund/general purpose”) and from “county payback,” as well as for the program in total. For example, the fiscal 1984-85 appropriations (1984 PA 246) were specified as shown in the left side of the following table. The two columns on the right break out these appropriations into their components. The “general assistance medical,” or outpatient, portion of the program is funded by the state, with a small amount of federal money, under state eligibility standards. The general assistance medical-hospitalization” (i.e., RCH) account is funded by state general funds and county payback. Thus, even though the appropriation pattern mixes the financing of two separate medical programs, each of the two is completely specified not only in terms of the total authorization but also of the sources from which the authorized funds are to come.

Appropriations As Contained in 1984 PA 246	<u>Appropriation Components</u>	
	GA Medical (outpatient)	GA Medical Hospitalization
GENERAL ASSISTANCE MEDICAL		
General assistance medical	\$28,380,000	
General assistance medical		
-hospitalization	62,483,100	\$62,483,100
GROSS APPROPRIATION	\$90,863,100	\$62,483,100
Appropriated from:		
Federal revenues:		
Total federal	151,100	
Special revenue funds:		
Local funds—county payback	41,406,100	41,406,100
State general fund/general purpose	\$49,305,900	\$21,077,000

3. The Legislature has directed that whenever appropriations are made from restricted revenues such as county payback, expenditures from the restricted revenue “shall not exceed the amount appropriated ... or the amount paid in, together with the balances carried forward from the previous fiscal year, whichever is the lesser” (MCL 18.1453, MSA 3.516(453)). The intended effect of such a provision would appear to be that restricted revenues are appropriated only upon receipt, since the only way to insure that expenditures remain within the limit of amounts “paid in” is to restrict spending authority to amounts on hand at any given time. Thus, of the \$62,483,100 appropriated to the RCH account for 1985, only the \$21,077,000 in general-purpose funds were appropriated without strings attached. The law says that spending from the other \$41,406,100 was to be limited to the amount of county payback actually received. The Michigan Constitution requires the executive branch of state government to follow such legislative instructions: “No money shall be paid out of the state treasury except in pursuance of appropriations made by law.” (Article 9, Section 17)

Problems With Appropriation Controls in the Executive Branch

Appropriation controls established for the RCH program are deficient in two respects, each of which has a straightforward remedy.

Problem No. 1: Non-Restrictive Appropriation Accounts. First, appropriation accounts for the RCH program are not specified so that legislative restrictions on the spending of county payback revenues affect the total amount that can be expended in the program. The following table shows the detail of the applicable appropriation accounts as they were presented in state financial statements at the end of fiscal 1985.

	<u>Account Status at Year-End, FY 85</u>	
	110 43 3365	110 43 3393
	GA Medical-Hosp	County Payback
Current Appropriation	\$ 62,483,100.00	\$(41,406,100.00)
Balance from Prior Yr	.00	.00
Restricted Revenues	.00	38,216,885.32
Advances	.00	.00
Transfers	(8,119,214.68)	3,189,214.68
Total Authorizations	\$54,363,885.32	.00
Expended	\$49,867,136.60	.00
Encumbered Balance Fwd	.00	.00
Unencumbered Balance Fwd	.00	.00
Lapsed	4,496,748.72	.00
Overexpended/-obligated	.00	.00

Note that the total amount appropriated by the Legislature, including both general-purpose funds and restricted county payback, is placed in one account (110 43 3365), while the county payback requirement, or debit, is placed in another (110 43 3393). This means that the total authorization, rather than just the general-purpose portion, is treated as if it were eligible for spending without restriction, and the county payback requirement is treated as a separate issue, the satisfaction of which is divorced from spending authority in the RCH account. All the money can be spent as if it were derived from general-purpose revenue, which it is not. This two-account structure is insufficiently limiting as a basis for fiscal control.

Remedy No. 1: A Single Account to Control the Program. The practical way to establish centralized fiscal control over the RCH program is to create a single account that controls both the availability of county payback revenue for spending and the actual expenditure of money in the hospitalization program. This would insure that spending authority is limited by the general fund/ general purpose appropriation and the availability of county payback.

The following table shows how such an account might be set up at the beginning of the fiscal year: the required county payback would be recorded as a restricted-revenue debit against the current appropriation total, thereby reducing the initial spending authorization to the general-purpose amount. In the example, only \$21 million of the \$62 million appropriated would be available immediately. As revenues were received from county payback, the restricted-revenue debit would be reduced — thereby increasing total authorizations by the same amount and allowing increased spending from the account. In the example: after one month, \$4 million in county payback has been received, reducing the restricted revenue debit and increasing the spending authority by that amount, and \$5 million has been expended, leaving \$20 million in unused spending authority. The table also shows how such an account would have looked at year-end, using actual data from 1985.

Because county payback revenues were \$3 million below the appropriated level and almost \$5 million was transferred from the account, actual spending authority for the year was only \$54 million; expenditures were \$4 million below that.

**Operation of a Hypothetical Unified
Resident County Hospitalization Account**

	Initial Set-Up	After one Month	Year-End Results
Current Appropriation	\$ 62,483,100-00	\$ 62,483,100-00	\$ 62,483,100-00
Balance from Prior Year	.00	.00	.00
Restricted Revenues	(41,406,100.00)	(37,406,100.00)	(3,189,214.68)
Advances	.00	.00	.00
Transfers	.00	.00	(4,930,000.00)
Total Authorizations	\$ 21,077,000.00	\$ 25,077,000.00	\$ 54,363,885.32
Expended	\$.00	\$ 5,000,000.00	\$ 49,867,136.60
Encumbered Balance Fwd	.00	.00	.00
Unencumbered Balance Fwd	.00	20,077,000.00	.00
Lapsed	.00	.00	4,496,748.72
Overexpended/-obligated	\$.00	.00	.00

Creating in this manner a single appropriation account for RCH would establish a basis for fiscal control over expenditures in the program.

Problem No. 2: Premature Recognition of Payback Revenues. The second problem with appropriation controls for the resident county hospitalization program is that county payback revenues are recognized as available in state appropriation accounts before they are received. The legislative rule, noted earlier, is that such revenues should be made available for spending only upon receipt.

The reason for applying such a rule to appropriation controls for this program is clear: to maintain overall fiscal balance in the general fund/general purpose accounts. Experience over a multi-year period shows that county payback revenues are uncertain of receipt and therefore should be recognized as available on a conservative basis. Premature recognition of county payback runs the risk that spending intended to be financed with county payback will instead be financed de facto with general-purpose money, leaving the state at year-end with mere receivables to offset actual outlays. over the long run, such receivables, if uncollectable, would have to be written off the books and formally covered with general-purpose funds. Appropriating county payback only upon receipt avoids these risks and aids in keeping general-purpose obligations within estimated general-purpose resources.

Revenues are recognized by the State of Michigan on the “modified accrual” basis, which requires that they be both “measurable” and “available” before being added to the state’s accounts. County payback for RCH becomes measurable as an expected source of revenue when the state incurs an obligation to pay for the hospitalization of indigents on behalf of a county. According to the 1986 Comprehensive Annual Financial Report of the state, county payback becomes “available” at the same time:

“Revenue which the State earns by incurring obligations (such as matching federal grants) are (sic) generally recognized in the same period that the related obligations are recognized. Such accrued revenue is considered available even if it is not received within 60 days....”
(page 16)

This means that the \$38,216,885.32 carried in 1985 appropriation accounts as county payback revenue does not represent \$38,216,885.32 received, but rather \$38,216,885.32 billed. Figures from the Department of Social Services indicate that the state actually received only \$28,174,945.85 in fiscal 1985 from the counties involved. The difference at year-end (\$10,041,939.47) represents billed but unpaid amounts that became a receivable from local units of government on the state’s general fund balance sheet. In closing the state’s books at the end of fiscal 1983, executive-branch officials provided in effect for the write-off of \$89.5 million in receivables from Wayne County as uncollectable, by allocating that amount from the general funds of the state to create an “allowance for loss.” This result can be avoided by limiting recognition of county payback revenue to money actually received. The history of the last several years suggests that this is a prudent standard of availability for recognizing county payback revenue.

Remedy No. 2: Restricting the Recognition of Payback Revenue. Both program history and legislative instructions call for a conservative method of recognizing county payback revenues and making them available for spending. Such a limitation on county payback availability could be implemented together with the integration of RCH appropriation accounts, as discussed above, to insure its effectiveness. This would mean establishing the following rules:

1. If appropriations are made in a budget act from county payback revenues, the amount of such county payback revenues recognized as revenue in state accounts would be limited to the amount that is both measurable and available by the following standards:

a. Such county payback revenues would be considered measurable only when a service has been rendered and the state makes a specific claim for reimbursement from the unit of government involved in the payback arrangement.

b. Such county payback revenues would be considered available only when money claimed by the state is actually received from the unit of government.

2. A single appropriation account would be created to control spending in the resident county hospitalization program. The amount carried as the current legislative appropriation” in the account would be the total appropriation amount including estimated county payback revenue to be received. The county payback requirement would be carried as a debit or deduction in “restricted revenue additions,” thereby reducing the “total authorizations” in that appropriation account by the amount of the required payback. As county payback revenues were recognized in state revenue accounts by becoming both measurable and available, they would be applied against the debit as a restricted revenue addition to the resident county hospitalization appropriation account, thereby increasing the total authorization for spending in that appropriation account.

An Alternative Solution: Eliminate County Payback as a Source of Finance

The remedies described above assume that the Legislature wishes to make administrative practice conform to its appropriation instructions — i.e., that it wishes to make the county payback requirement a restrictive control over RCH spending. An alternative resolution of the issue would be to change appropriation instructions to conform to actual practice. This could be done by appropriating the entire RCH amount from general fund/general purpose revenues. In 1985, for example, the entire \$62,483,100 appropriation might have been taken from general fund/general purpose revenues, rather than just \$21,077,000. The county payback requirement could be made an unrestricted source of revenue, decoupling the collection of such funds from appropriation instructions. If the money collected were less than estimated, the shortfall could be dealt with administratively. Because the entire program amount would be appropriated from general-purpose revenues to begin with, there would be no risk that the failure to collect payback revenues would affect the state's balance sheet, as long as revenue estimates were accurate.

Insuring Legislative Participation in Any Decision to Accept a Major Loss on Accounts Receivable

If steps are not taken either to insure that the RCH program expends only its general fund/general purpose appropriation plus any county payback received, or to end the expectation in appropriation accounts that RCH spending will be financed partly from county payback, then the state will continue to assume the risk of having to create “allowances for loss” of accumulated county payback receivables — which can affect the year-end balance of the general fund. In view of the significance of this risk, the Legislature may wish to insure that it has a role in any future decision as to whether the collection of such receivables is to be enforced or they are to be written off as uncollectable. The last time this choice was faced, the executive branch made the decision unilaterally.

At the end of fiscal 1983 the amount and age of receivables from Wayne County were substantial enough that the state's accountants decided those receivables could no longer be carried as current assets: the likelihood of their receipt within the immediate future was too remote. A law enacted in 1927 allows state revenue administrators “to bring suits, to settle and compromise” past due accounts owed the state, provided that the Administrative Board must approve any discount greater than fifteen percent in settling accounts over \$100 (MCL 14.131 et seq., MSA 3.231 et seq.). The state in 1983 sued Wayne County for the outstanding receivables, and the parties reached agreement on a settlement for \$89.5 million in accounts owed the state. Under the agreement up to \$45.65 million could be forgiven, and the rest would have to be repaid over a period of years. The Administrative Board approved this settlement. In closing the state's accounts for fiscal 1983, officials of the Department of Management and Budget then established an \$89.5 million allowance for loss on receivables from local governments, which effectively allocated \$89.5 million from unobligated general fund balance to cover the receivables.

It can be argued that such unilateral action is at odds with the basic separation of powers by which Michigan state government operates. Under the Constitution, the Legislature has sole power to appropriate money, and no money may be paid out of the treasury except in pursuance of legislative appropriations.

The surest way to prevent such situations from developing again is to establish effective control over the recognition and spending of county payback revenue, as described earlier. However, if the Legislature wishes to protect the separation of financial powers granted by the Constitution, it would be prudent also to insure that no future decision to accept a loss of substantial receivables from the state's books is made without legislative participation. The alternative is to cede a crucial aspect of the "power of the purse" to the executive.