CALIFORNIA DEPARTMENT OF
Mental Health
1600 9th Street, Sacramento, CA 95814
(916) 654-2309

December 12, 2007

DMH INFORMATION NOTICE NO.: 07-25

TO: LOCAL MENTAL HEALTH DIRECTORS
LOCAL MENTAL HEALTH PROGRAM CHIEFS
LOCAL MENTAL HEALTH ADMINISTRATORS
COUNTY ADMINISTRATIVE OFFICERS
CHAIRPERSONS, LOCAL MENTAL HEALTH BOARDS

SUBJECT: MENTAL HEALTH SERVICES ACT FISCAL POLICY CHANGES

REFERENCE: IMPLEMENTATION OF THE MHSA, WELFARE AND INSTITUTIONS CODE (WIC) SECTION 5847(a)(7), SECTION 5847(d), SECTION 5892 AND CALIFORNIA CODE OF REGULATIONS SECTION 3520.

The purpose of this Department of Mental Health (DMH) Information Notice is to inform the Counties[1] that receive funding under the Mental Health Services Act (MHSA) regarding DMH's intent to clarify fiscal policies related to MHSA. DMH is currently developing regulations regarding many of these policies and wants to provide initial guidance to counties as they continue to implement MHSA components and programs. Specific fiscal policies addressed by this Information Notice include:

- MHSA Agreement
- Payments to Counties
- Component Allocations
- Local Prudent Reserve
- Unexpended Funds
- Funds Remaining in Planning Estimates
- Interest
- Local Program Sustainability
- Fiscal Year (FY) 2005-06 Community Services and Supports (CSS) One-Time Funding
- Cash Management

[1] "County" means the County Mental Health Department, two or more County Mental Health Departments acting jointly, and/or city-operated programs receiving funds per WIC Section 5701.5.

**MHSA Agreement**

DMH initially developed the county MHSA contract to serve as the official document defining the terms and conditions of participation in the MHSA. This contract required signed amendments in order to make any funding changes, such as increasing funding for a component or implementing a new component.

DMH is in the process of replacing the MHSA contract with the MHSA Agreement. Key differences under the MHSA Agreement include:

- Unilateral modification by DMH based on a Plan update submitted by a county
- County discretion to delegate the approval authority for the MHSA Agreement to the local mental health director or other designee
- Provision to allow assignment of funding from the county to DMH for State-administered programs such as the MHSA Housing Program

These provisions should reduce the processing time required to increase or add components as well as provide each county with the flexibility to participate in State-administered programs. The MHSA Agreement will also provide fiscal information so that a county can determine maximum available funds, approved funding and funds distributed to the county by each component.

The controlling document related to performance under the MHSA Agreement is each county's Three Year Program and Expenditure Plan, including subsequent Plan updates. Each county will be required to submit a Plan update in order to modify their Three Year Program and Expenditure Plan when incorporating a new component or new services, or requesting funds for expansion of already approved services. DMH will use approved Plan updates to unilaterally modify the MHSA Agreement. A county may submit a Plan update at any time; however, each county will be required to submit at least one annual Plan update for each fiscal year. Refer to page 2, Section II of DMH Information Notice No.: 07-21 (October 18, 2007) for information on the process to update the County's Three Year Program and Expenditure Plan.

**Payments to Counties**

In order to provide expedited cash flow to counties, DMH previously provided quarterly distributions of initial approved CSS Plan amounts to counties 30 days prior to the start of the quarter. DMH, in consultation with the California Mental Health Directors' Association (CMHDA), has decided to revise this approach and move to a cash-based system which ensures that sufficient MHSA funds are available to support the total funding level by component for the subsequent fiscal year. This means that revenues will accumulate for 12 months in the State Mental Health Services (MHS) Fund prior to distribution in the subsequent State fiscal year but will allow substantial cash payments to each county at the beginning of each fiscal year.

Under the new fiscal policy, each county will receive 75 percent of its approved annual Plan amount upon Plan approval (and execution of a MHSA Agreement) or at the start of the fiscal year, whichever is later. The remaining 25 percent will be distributed upon submission of required reports which include the semi-annual Local MHS Fund Cash Flow Statement and the Annual MHSA Revenue and Expenditure Report. It is envisioned that a county that submits the above reports when due will be able to access the remaining 25 percent of their approved amount by March 1st of the fiscal year. Planning funds for each component will be distributed in total upon approval by DMH (and execution of an MHSA Agreement) and are not subject to the 25 percent withholding amount. DMH will withhold all future MHSA distributions from any county that does not submit the required reports (i.e., no future fiscal year distributions will be made until a county submits the required reports).

DMH will implement this policy with the new MHSA Agreements. Thus, each county will receive the undistributed balance of 75 percent of its FY 2007-08 approved Plan amount upon approval of the Plan and execution of an MHSA Agreement (50 percent of the FY 2007-08 approved Plan amounts have already been distributed to most counties). The remaining 25 percent will be distributed upon submission of the September 30, 2007 Local MHS Fund Cash Flow Statement and the FY 2006-07 Annual MHSA Revenue and Expenditure Report (due December 31, 2007). DMH will unilaterally modify the MHSA Agreements based on approved Plan updates as requested by each county. Each county will then either receive 75 percent of the additional approved amount or 100 percent of the additional approved amount depending on when the MHSA Agreement is modified. Thus, if the MHSA Agreement is modified prior to submission of the two required reports, 75 percent of the additional approved amount will be distributed, and if the MHSA Agreement is modified after submission of the required two reports, 100 percent of the additional approved amount will be distributed.

**Component Allocations**

Welfare and Institutions Code (WIC) Section 5892 dictates the portion of MHSA funds dedicated to each of the different components, including Workforce, Education and Training (WET), and Capital Facilities and Technological Needs, through FY 2007-08. Thus, FY 2007-08 will be the last year in which MHSA funding is dedicated specifically for the WET and Capital Facilities and Technological Needs components consistent with WIC Section 5892. Funds dedicated to WET and Capital Facilities and Technological Needs will be distributed by DMH in subsequent fiscal years as funds are made available to counties through Planning Estimates.

**Local Prudent Reserve**

WIC Section 5847(a)(7) requires each county to establish and maintain a prudent reserve for CSS to ensure that, in years in which revenues for the MHS Fund are below recent averages, the county will be able to continue to serve the same number of children, adults and seniors that it had been serving in the previous fiscal year. DMH, in consultation with the Mental Health Services Oversight and Accountability Commission (MHSOAC) and the CMHDA, has determined that a level of 50 percent of the most recent annual approved CSS funding level should be set aside as the required prudent reserve amount. Each county should maintain the 50 percent prudent reserve at the local level and fully fund the prudent reserve by July 1, 2010, unless the county would have to reduce MHSA services below those funded in FY 2007-08 (including services funded with the FY 2007-08 CSS augmentation and CSS administration) in order to reach the 50 percent prudent reserve. Each county is required to submit a Plan update in order to dedicate specific funding to the prudent reserve. A county that cannot attain the 50 percent prudent reserve requirement by July 1, 2010, because services would have to be reduced should dedicate future increases in CSS Planning Estimates to the local prudent reserve until the 50 percent level is met prior to increasing service levels beyond those funded in FY 2007-08 through expanded existing programs or new programs.

Unexpended CSS funds or funds remaining in a county's CSS Planning Estimate (i.e., unapproved funds) may be used for the prudent reserve. A county must request funds up to the Planning Estimate amount for the prudent reserve through the Plan update process. DMH will review and approve such requests (provided the requested amount does not exceed 50 percent of the most recent annual approved CSS funding). The amount will be incorporated into the MHSA Agreement and distributed to each county.

After July 1, 2010, a county proposing either new or expanded CSS services through a Plan update should incorporate and request the required 50 percent prudent reserve when estimating the funding necessary for new or expanded services. This will ensure that the 50 percent required reserve is maintained. Counties do not need to incorporate a 50 percent prudent reserve for proposed non-recurring expenditures or for proposed non-CSS expenditures (i.e., WET, Capital Facilities and Technological Needs, and Prevention and Early Intervention).

MHSA funds dedicated to a local prudent reserve can only be accessed in accordance with WIC Sections 5847(a)(7) and 5847(f). A county will be able to access these funds only with DMH approval. For audit purposes, each county should be able to clearly identify funds in their local MHS fund dedicated to the local prudent reserve. Interest earned on funds dedicated to the local prudent reserve is to be used for services consistent with a county's approved Plan and/or the local prudent reserve.

**Unexpended Funds**

WIC Section 5892(g) requires that MHSA funds allocated to a county be spent in accordance with an approved Plan or Plan update. Further, WIC Section 5847(d) requires each county to prepare an annual Plan update that indicates the utilization of unspent funds allocated in the previous year and proposed expenditures of such funds for the same purpose. Also, each county has three years (ten years for Capital Facilities and Technological Needs and WET) to obtain DMH approval and spend funds for approved services or dedicate funds for the local prudent reserve pursuant to the reversion process dictated by WIC Section 5892(h).

Each county has the ability to use unexpended funds (i.e., funds approved and distributed for CSS services or one-time activities that were not spent during the time period anticipated by the county) for services consistent with their approved Plan pursuant to WIC Section 5847(d). Services funded pursuant to an approved Plan are accounted for on a first-in, first-out (FIFO) basis (i.e., the first dollar distributed to the county is the first dollar spent on services irrespective of the fiscal year). Each county also has the ability to fund its local prudent reserve with unexpended funds. A county needs to submit a Plan update requesting that these funds be used for the local prudent reserve. Funds approved for the prudent reserve will be identified in the MHSA Agreement as dedicated to the local prudent reserve.

Each county will need to identify the use of unexpended funds through the annual Plan update process. Unexpended funds will be considered available to fund services in the current and subsequent year (provided the funds are not subject to the reversion process dictated by WIC 5892(h)). DMH is in the process of developing the requirements for the CSS FY 2008-09 annual Plan update.

**Funds Remaining in Planning Estimates**

Pursuant to the reversion process dictated by WIC Section 5892(h), each county has three years (ten years for Capital Facilities and Technological Needs and WET) to obtain DMH approval and spend funds for approved services or for the local prudent reserve. A county may choose not to request and/or receive State approval to use all funds reserved for the county through a Planning Estimate in the year in which the funding becomes available. A county may subsequently submit a request (through a Plan update) to use funds remaining in prior year Planning Estimates as long as the county can demonstrate sustainability (as discussed below) of the program and the funds have not reverted (as dictated by WIC 5892(h)). A county may also submit a request (through a Plan update) to dedicate funds remaining in Planning Estimates to the local prudent reserve. A county may submit a Plan update at any time but is required to submit at least one annual Plan update each fiscal year.

**Interest**

WIC Section 5892(f) requires that each county place funds received from the State MHS Fund into a local MHS fund, that the balance of the local MHS fund be invested consistent with other county funds, and that the interest earned on such investments be transferred to the State MHS Fund. Rather than having each county remit interest earned on the local MHS fund balance to the State MHS Fund, DMH will treat interest similar to unexpended funds (discussed previously) in that each county can use the interest to fund services consistent with their approved Plan or fund their local prudent reserve.

Each county will identify interest earned on the local MHS fund balance through the Annual MHSA Revenue and Expenditure Report. Interest will be combined with MHSA distributions from DMH to compute total available funding. Net expenditures (determined on a modified accrual basis) will be subtracted from available funding to determine unexpended funds. Each county will then need to identify the use of unexpended funds through the annual Plan update process. Unexpended funds will be considered available to fund services in the current and subsequent year (provided the funds are not subject to the reversion process dictated by WIC 5892(h)). DMH is in the process of developing the requirements for the CSS FY 2008-09 annual Plan update.

**Local Program Sustainability**

A county may submit a Plan or Plan update that proposes to use all funds reserved through the Planning Estimate regardless of when the Plan is approved. In doing so, a county must submit a Plan or Plan update in accordance with the applicable requirements and fully justify the use of all funds. The Plan approval process will include a review of the reasonableness of any such proposals and the ability to sustain the program when the request is for funding in excess of the Planning Estimate (i.e., when a county requests funds from a prior year's Planning Estimate). Factors to be considered will include, but may not be limited to: interest earned on the local MHS fund balance; current and projected costs, including anticipated cost of living increases; caseload growth; anticipated increases in other revenues; whether the expenditure is non-recurring; and/or the impact of other structural reforms such as reduced reliance on higher levels of care.

**FY 2005-06 CSS One-Time Funding**

Pursuant to the reversion process dictated by WIC Section 5892(h), all FY 2005-06 approved CSS funds must be spent prior to June 30, 2008 (i.e., the end of the three-year period). Thus, funds approved as FY 2005-06 one-time expenditures must be spent on approved one-time expenditures, services and/or the local prudent reserve prior to June 30, 2008. After June 30, 2008, a county will no longer be able to request FY 2005-06 CSS funds for one-time expenditures supported through other components (i.e., Capital Facilities and Technological Needs and/or WET). A county can request to fund Capital Facilities and

Technological Needs, WET and the local prudent reserve through funding dedicated to these components or through CSS (subject to the 20 percent limit on such funding pursuant to WIC Section 5892(b)).

FY 2005-06 CSS one-time funds may be used on approved Plan services even if the funding was approved for a one-time expenditure. Thus, a county that has spent their entire FY 2005-06 Planning Estimate on approved services, one-time expenditures, and/or the local prudent reserve by June 30, 2008, would not have any FY 2005-06 CSS funds subject to reversion on June 30, 2008.

**Cash Management**

DMH previously provided quarterly distributions of the initial approved CSS Plan amounts to counties 30 days prior to the start of the quarter. California Code of Regulations Title 9 Section 3520 requires each county to submit Local MHS Fund Cash Flow Statements every six months. DMH initially intended to manage the amount of quarterly distributions to each county through the Cash Flow Statement whereby a county with an unreserved cash balance of 35 percent or more would have subsequent distributions reduced. The 35 percent threshold was established to allow for the quarterly advance payment (25 percent) plus an operating reserve (10 percent).

DMH will no longer be providing quarterly distributions 30 days prior to the start of the quarter but will provide 75 percent upon Plan approval (and execution of an MHSA Agreement) or at the start of the fiscal year, whichever is later, and 25 percent upon submission of specific required reports (as discussed previously under “Payments to Counties”). As a result, DMH is no longer managing the unreserved cash balance of each county and the Local MHS Fund Cash Flow Statement will no longer be used in the calculation of county distributions. Rather, the Local MHS Fund Cash Flow Statement will be used to proactively identify potential program issues (e.g., a county not implementing their Plan as proposed or a county incurring expenditures beyond a sustainable level of funding).

DMH will allow for local flexibility in that each county will be permitted to maintain an operating reserve equal to 10 percent of the most recent annual approved amount for CSS services. The operating reserve will be identified as a use for unexpended funds as part of the Plan update process.

DMH intends to draft regulations, where necessary, to implement these fiscal policies.  The proposed regulations will be available for comment prior to becoming effective.  If you have any questions, please contact your County Liaison identified from the link on the following internet site:  http://www.dmh.ca.gov/Provider_Info/default.asp.

Sincerely,

Original signed by:

STEPHEN W. MAYBERG, Ph.D.
Director