

M001
Chronic Disease Services
Department of Health and Mental Hygiene

Operating Budget Data

(\$ in Thousands)

	<u>FY 04</u> <u>Actual</u>	<u>FY 05</u> <u>Working</u>	<u>FY 06</u> <u>Allowance</u>	<u>FY 05-06</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
General Fund	\$32,463	\$34,767	\$35,431	\$664	1.9%
Special Fund	5,191	5,401	5,146	-255	-4.7%
Reimbursable Fund	<u>1,260</u>	<u>1,156</u>	<u>577</u>	<u>-580</u>	<u>-50.1%</u>
Total Funds	\$38,914	\$41,324	\$41,154	-\$170	-0.4%
Contingent & Back of Bill Reductions			-191	-191	
Adjusted Total	\$38,914	\$41,324	\$40,963	-\$361	-0.9%

- A smaller patient census at Deer's Head Center's renal dialysis unit reduces pharmaceutical and medical supply costs by \$0.8 million in fiscal 2006. An additional \$0.2 million reduction results from the purchase of equipment in fiscal 2005 to produce efficiencies in providing dialysis treatments.

Personnel Data

	<u>FY 04</u> <u>Actual</u>	<u>FY 05</u> <u>Working</u>	<u>FY 06</u> <u>Allowance</u>	<u>FY 05-06</u> <u>Change</u>
Regular Positions	584.30	575.80	572.80	-3.00
Contractual FTEs	<u>20.69</u>	<u>17.50</u>	<u>23.58</u>	<u>6.08</u>
Total Personnel	604.99	593.30	596.38	3.08

Vacancy Data: Regular Positions

Turnover, Excluding New Positions	28.87	5.04%
Positions Vacant as of 12/31/04	42.00	7.29%

- Three food service positions will be abolished in fiscal 2006 as part of a Department of Health and Mental Hygiene initiative to reduce costs in this area.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Plans to Increase Hospital Census Stymied: Previous plans to significantly increase hospital patient census at Western Maryland Center and Deer’s Head Center were not implemented due to fiscal constraints.

Private Dialysis Provider Reduces Demand for Services at Deer’s Head Center: A private provider of dialysis services opened in Salisbury in 2004. As a result, a 40% reduction in dialysis patients at Deer’s Head Center is expected between fiscal 2004 and 2006.

Issues

Hospital and Dialysis Units May Recover Additional Funds: Changes in billing procedures and recent rate increases for dialysis services have the potential to increase the amount the centers recover in coming fiscal years.

Recommended Actions

	<u>Funds</u>
1. Increase turnover expectancy from 5.04 to 5.54%.	\$ 145,650
2. Reduce funds for the addition of contractual food service workers.	36,167
3. Reduce funds for the addition of contractual office personnel.	12,169
4. Reduce funds for renal dialysis services.	93,425
Total Reductions	\$ 287,411

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Department of Health and Mental Hygiene

Operating Budget Analysis

Program Description

The State's two chronic hospital centers, Western Maryland Center and Deer's Head Center, provide specialized services for those in need of complex medical management, comprehensive rehabilitation, long-term care, or dialysis. Specifically, both centers provide:

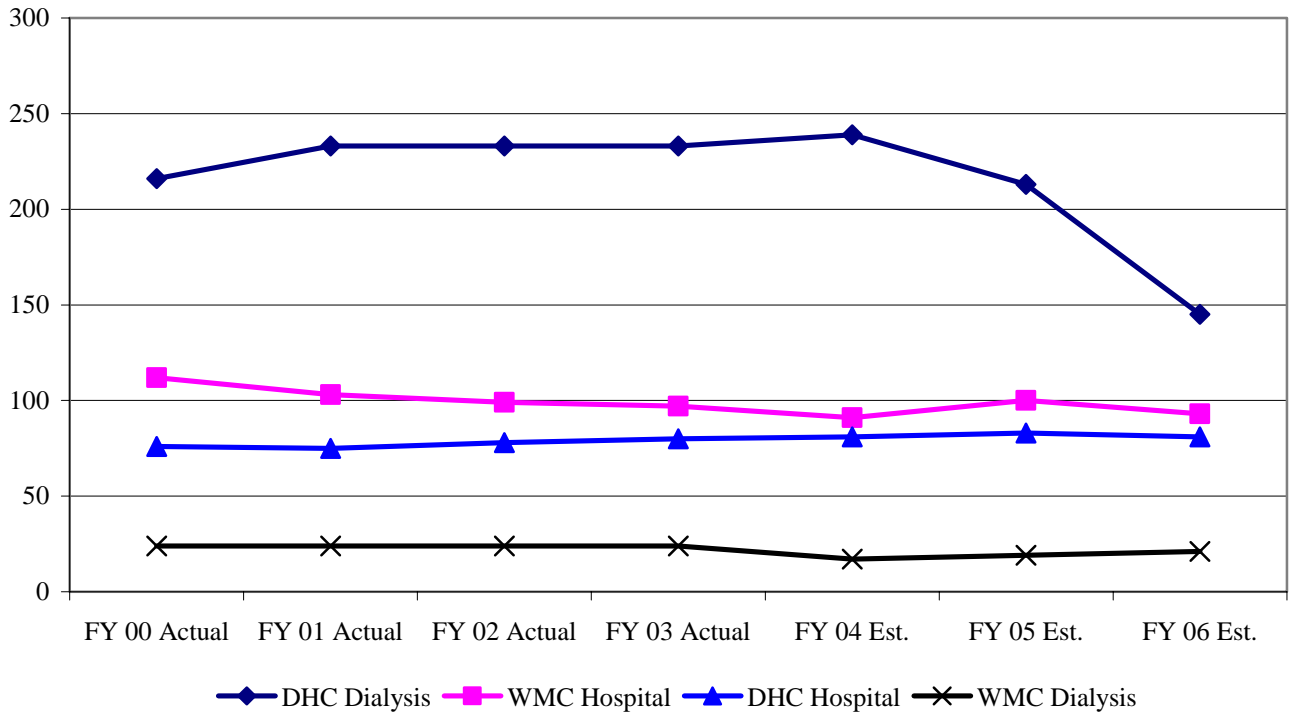
- chronic care and treatment to patients requiring rehabilitation at a level greater than that available at a nursing home;
- long-term nursing home care for patients no longer in need of hospital-level care but unable to function in traditional nursing homes; and
- inpatient and outpatient renal dialysis services.

Performance Analysis: Managing for Results

Fluctuations in the average daily census at Western Maryland Hospital Center and Deer's Head Hospital Center, detailed in **Exhibit 1**, reflect recent fiscal constraints. The combination of cost containment and rising pharmaceutical costs at each of the centers has necessitated maintaining vacancies to reduce expenditures. Although positions were added in fiscal 2002, hiring for these positions was contingent on verification that the centers did not expect to incur a deficit in non-dialysis services; mid-year fiscal 2002 estimates, inclusive of cost containment, indicated small deficits in non-dialysis expenses. Although the positions were made available in fiscal 2003 under the same conditions, many positions were lost in an effort to contain the size of the State workforce, mitigating plans to significantly increase the census.

Despite personnel reductions, the hospital centers have been able in recent years to incrementally increase patient census by producing cost efficiencies. Western Maryland Center is increasing the average daily census in fiscal 2005 by reducing per diem costs in the hospital and comprehensive care units; however, the estimated average daily census in fiscal 2006 remains nearly 20 patients below fiscal 1999 levels. At Deer's Head Center, the census has increased steadily since 1999, to an average of 81 patients in fiscal 2006. Deer's Head Center has been able to increase census, in part, by treating more patients in its chronic hospital unit and fewer in the more-costly comprehensive care unit.

Exhibit 1
Census at the State’s Chronic Hospital Centers
Fiscal 2000 – 2006



Source: Maryland Operating Budget Fiscal Year 2006

The source of the largest changes in patient census is in the centers’ renal dialysis units. The census at Deer’s Head Center is expected to decrease 40% from fiscal 2004 levels, from an average of 239 patients to an average of 145 patients in fiscal 2006. The reduction is the result of competition from a private dialysis provider, which began operating in Salisbury in 2004. Many of the center’s more ambulatory patients discontinued services at Deer’s Head Center, which leaves a population that is both smaller and more medically complex. At Western Maryland Center, the census has increased from a low of 17 dialysis patients in fiscal 2004 to an estimated 21 patients in fiscal 2006. The increase has allowed the center to achieve greater economies of scale in providing these services, reducing the average cost of treatment.

Governor's Proposed Budget

The fiscal 2006 allowance for Western Maryland Center and Deer's Head Center is \$41 million, \$0.4 million less than the fiscal 2005 working appropriation. Personnel savings result from position abolitions and anticipated reductions in health insurance expenses. Operating savings result from reductions in census at Deer's Head Center's renal dialysis unit. Changes to the centers' budgets are detailed in Exhibits 2 and 3.

Exhibit 2
Budget Trends in Chronic Disease Services Funding
Fiscal 2004 – 2006
(\$ in Millions)

	<u>FY 04</u> <u>Actual</u>	<u>FY 05</u> <u>Working</u> <u>Appropriation</u>	<u>FY 06</u> <u>Allowance</u>	<u>Difference</u> <u>FY 05-06</u>	<u>Percent</u> <u>Change</u>
Western Maryland Center					
Hospital	\$18.3	\$18.9	\$19.1	\$0.2	1%
Renal Dialysis	0.7	0.8	0.8	0.0	-1%
Total	\$19.0	\$19.7	\$19.9	\$0.2	1%
Reimbursement for Hospital Expenses	6.9	4.7	4.4	-0.4	-8%
Reimbursement for Dialysis Expenses	0.6	0.7	0.7	0.0	0%
Deer's Head Center					
Hospital	\$15.2	\$16.1	\$16.0	-\$0.1	-1%
Renal Dialysis	4.6	5.5	5.0	-0.5	-9%
Total	\$19.9	\$21.6	\$21.0	-\$0.6	-3%
Reimbursement for Hospital Expenses	6.2	4.2	4.6	0.4	9%
Reimbursement for Dialysis Expenses	4.4	4.5	4.1	-0.5	-10%

Note: Numbers may not sum to total due to rounding.

Source: Maryland Operating Budget Fiscal Year 2006

Exhibit 3
Governor's Proposed Budget
Chronic Disease Services
(\$ in Thousands)

How Much It Grows:	General Fund	Special Fund	Reimbursable Fund	Total
2005 Working Appropriation	\$34,767	\$5,401	\$1,156	\$41,324
2006 Governor's Allowance	35,431	5,146	577	41,154
Contingent & Back of Bill Reductions	<u>-166</u>	<u>-24</u>	<u>0</u>	<u>-191</u>
Adjusted Allowance	\$35,265	\$5,122	\$577	\$40,963
Amount Change	\$498	-\$279	-\$580	-\$361
Percent Change	1.4%	-5.2%	-50.1%	-0.9%

Where It Goes:

Personnel Expenses

Increments and other compensation	\$514
Workers' compensation premium assessment	458
Contributions to employee retirement system	207
Overtime earnings.....	54
Position reclassifications	32
Accrued leave payout	-76
Abolition of three food service worker positions	-117
Salary reduction to reflect fiscal 2005 position abolitions	-185
Food service savings yet to be identified.....	-327
Employee and retiree health insurance	-510
Other fringe benefit adjustments	-4

Other Changes

Medical care costs, including hospitalization and pharmacy services.....	229
Anticipated increase in utility costs.....	145
Outpatient care, based on fiscal 2004 actual expenditures	81
Addition of contractual personnel at Deer's Head Center.....	69
Energy efficiency plan repayment and maintenance costs	68
Food expenses at Western Maryland Center	56
Replacement of 275-pound capacity washing machine at Deer's Head Center.....	51
Laboratory services, based on fiscal 2004 actual expenditures	46

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Where It Goes:

Replacement building equipment	-55
Completed replacement of manual crank beds	-58
Medical equipment to allow greater efficiency in mixing dialysis solutions	-76
Savings from use of disposable dialysis filters	-81
Consolidation of units at Western Maryland Center	-99
Pharmaceutical and medical supply costs for Deer's Head Center's renal dialysis unit, based on reductions in census	-772
Other adjustments	-11
Total	-\$361

Note: Numbers may not sum to total due to rounding.

Personnel Expenses

The inclusion of increments in the Governor’s proposed budget increases personnel expenditures by \$0.5 million in fiscal 2006. Workers’ compensation charges, which are increasing across departmental units, add another \$0.5 million to the allowance. Contributions to the employee retirement system increase \$0.2 million, offset by a \$75,872 reduction in accrued leave payouts. Employee and retiree health insurance costs are expected to decline \$0.5 million as a result of a departmental effort to align health insurance costs with actual expenditures.

Position changes generate significant cost savings in the centers’ budgets. A total of 8.5 positions were abolished in fiscal 2005, with savings only partially credited in the current fiscal year. The fiscal 2006 allowance is reduced \$0.2 million to fully realize position reductions. Three food service positions will be abolished in fiscal 2006 as part of a department initiative to reduce costs in this area, producing additional cost savings of \$0.1 million. The department is in the process of identifying additional savings in food services, which will reduce the budget by an additional \$0.3 million. These reductions are partially offset by increases in overtime and position reclassifications in fiscal 2006.

Operating Expenses

The cost of medical care, including hospitalization and pharmacy services, is expected to increase \$0.2 million at Deer’s Head Center, based on medical inflation and anticipated growth in the center’s chronic hospital unit census. Cost increases for outpatient care at Deer’s Head Center and laboratory services at Western Maryland Center are anticipated based on fiscal 2004 actual expenditures.

Changes in Deer’s Head Center’s renal dialysis unit reduce expenses by a total of \$1.0 million in fiscal 2006. The majority of cost savings, \$0.8 million, result from the reduction in census at the facility. A private dialysis provider has entered the market in Salisbury, reducing the number of Deer’s Head Center patients by nearly 100 over the past two years. Additional savings are the net result of fiscal 2005 purchases to produce efficiencies in providing dialysis treatments.

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Equipment expenses decrease in fiscal 2006, as several pieces of equipment were purchased in the last fiscal year. The cost of equipment for the grounds of Deer's Head Center decreases \$55,400. The center will also complete replacement of manual crank beds in fiscal 2005, reducing medical equipment costs by \$58,256. These savings are offset by the scheduled replacement of a 275-pound capacity washer at the facility.

Utility costs are expected to increase by \$0.1 million between the centers, based on increases in both cost and usage. At Deer's Head Center, costs related to 2003 energy efficiency upgrades increase \$0.1 million as a result of increases in loan repayments and maintenance costs.

Other miscellaneous changes include the addition of contractual food service and housekeeping personnel at Deer's Head Center and an increase in food costs at Western Maryland Center. These costs are offset by a \$0.1 million reduction at Western Maryland Center owing to the consolidation of administrative units.

Impact of Cost Containment

The fiscal 2006 allowance reflects the elimination of \$190,660, the appropriation for matching employee deferred compensation contributions up to \$600, contingent upon enactment of a provision in budget reconciliation legislation.

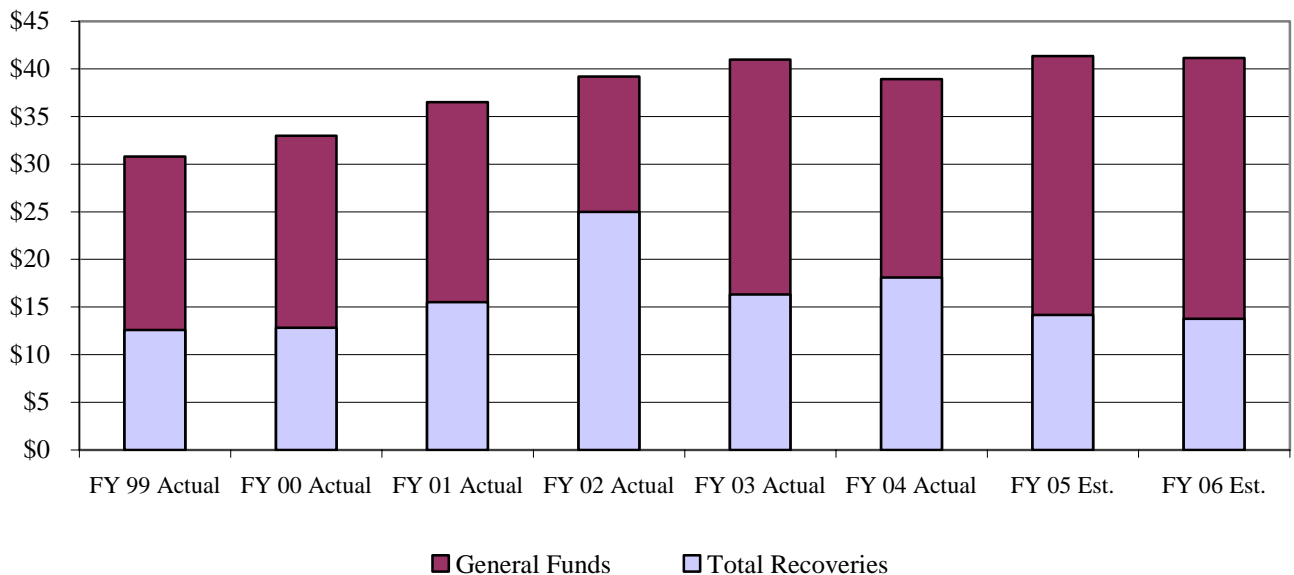
Issues

1. Hospital and Dialysis Units May Recover Additional Funds

Each of the chronic hospitals, Western Maryland Center and Deer’s Head Center, provide inpatient hospital and comprehensive care services as well as inpatient and outpatient renal dialysis services. These centers are limited in the amount of funds they can recover for the cost of treatment, as State law limits the amount billed to the actual cost of service. This prevents shifting of costs among payors but depresses the amount of recoveries. Recoveries are also limited by low rates of reimbursement from Medicare and Medicaid, the source of coverage for a majority of the centers’ patients.

Exhibit 4 shows recoveries relative to the growth in the centers’ budgets since fiscal 1999. Between the centers’ hospital and dialysis units, the centers have recovered approximately 40% of the cost of care each year. These recoveries represent both hospital recoveries deposited into the general fund and dialysis recoveries recognized as special funds in the centers’ budgets. Factors influencing the amount of recoveries are discussed below.

Exhibit 4
Sources of Centers’ Funding
Fiscal 1999 – 2006
(\$ in Millions)



Source: Maryland Operating Budget

Hospital Recoveries

The hospital centers provide services to those in need of services, regardless of insurance coverage or ability to pay. Any recoveries from Medicaid, Medicare, or other third-party payors are not recognized in the hospital centers' budgets; these proceeds are deposited directly into the general fund. In fiscal 2006 the hospital centers are expected to recover \$9 million from these sources, approximately 25% of the cost of treatment.

According to State law, the chronic hospitals must seek cost-based reimbursement; that is, the hospitals may not charge more than the cost of treatment for services provided. This policy, and reimbursement limits established by Medicaid and Medicare, limits the percentage of the cost of treatment the centers can recover.

The department bills the federal government throughout the year based on estimated costs of providing treatment, filing a report at the end of the year based on actual costs. The department has realized additional revenue through the year-end cost settlement process, at which time adjustments are made by the federal government based on level of care provided and patient casemix. Although the cost settlement process has yielded additional revenue in recent years, the potential also exists for negative adjustments.

The chronic hospitals anticipate recovering approximately 25% of the cost of treatment in fiscal 2005 and 2006, equivalent to \$9 million. These estimates assume no cost settlements at the end of the year, a process which added \$1.6 million to the amount recovered in fiscal 2004. At the end of fiscal 2004, the centers recovered a total of 40% of the cost of care.

The department, with assistance from Harmony Healthcare International, has identified areas in which the chronic hospitals may be able to increase the level of reimbursement from the federal government. A review of billing procedures revealed that the chronic hospitals were understating the medical acuity of many nursing home patients, reducing the amount of reimbursement available. Correcting this oversight has the potential to increase revenue by up to \$1 million each year. Previous assistance from Maximus helped the centers to recover \$14 million in previous years' cost settlements in 2002; this accounts for the abnormally high rate of recovery in fiscal 2002.

Dialysis Collections

The renal dialysis units at Western Maryland Center and Deer's Head Center were entirely supported by collections from patients and third-party payors until fiscal 2000. Inflation in medical costs began to exceed the amount of reimbursement from these payors beginning in fiscal 2001, requiring a certain amount of general funds to resolve the difference. General fund support for renal dialysis services totaled \$1.2 million in fiscal 2001, 20% of the total cost of treatment. Since that time, the centers have been able to reduce the amount of general funds required by identifying efficiencies in providing treatment, such as revising staffing patterns and reducing medical supply costs.

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Losses experienced by the two facilities have been primarily the result of low Medicare reimbursement rates. Medicare, which covers the majority of dialysis patients at the centers, had not increased rates since 2001, contributing to the losses experienced by the centers. The Centers for Medicare and Medicaid Services (CMS) recently approved a rate increase effective January 1, 2005, that raises the reimbursement for treatment services by 10%, resulting in an anticipated increase of \$0.2 million per year in payments from Medicare. CMS is also in the process of reviewing the payment rate for certain dialysis drugs, which has the potential to further increase the amount of special fund recoveries.

The amount of funds recovered by the renal dialysis units is influenced by many of the same factors that influence hospital recoveries, including medical coverage and patient casemix. **Exhibit 5** shows the fluctuations in revenues and expenditures since fiscal 2003. In addition to reimbursement rates, each of the centers' budgets have been influenced by patient census. The census at Deer's Head Center is expected to decrease 40% between fiscal 2004 and 2006, the result of competition from a private dialysis provider. With a lower census, the center is expecting to recover a smaller percentage of the cost of care; conversely, increases in census at Western Maryland Center contribute to greater efficiencies. The center expects less need for general funds in fiscal 2005 and 2006.

Exhibit 5
Renal Dialysis Costs and Revenues
Fiscal 2003 – 2006

	<u>FY 03 Actual</u>	<u>FY 04 Actual</u>	<u>FY 05 Est.</u>	<u>FY 06 Est.</u>
Western Maryland Center				
Special funds	\$715,945	\$575,829	\$681,423	\$683,241
General funds	44,348	158,919	122,966	114,474
Total	\$760,293	\$734,748	\$804,389	\$797,715
Percentage recovered	94%	78%	85%	86%
Deer's Head Center				
Special funds	\$4,821,290	\$4,421,656	\$4,535,608	\$4,074,338
General funds	799,246	219,674	961,760	943,065
Total	\$5,620,536	\$4,641,330	\$5,497,368	\$5,017,403
Percentage recovered	86%	95%	83%	81%

Source: Maryland Operating Budget; Department of Legislative Services

Recommended Actions

	<u>Amount Reduction</u>	
1. Increase turnover expectancy to 5.54%. Fiscal 2006 turnover expectancy is budgeted at 5.04%, below the current 7.29% vacancy rate. This action will require the centers to maintain three additional vacancies in fiscal 2006.	\$ 145,650	GF
2. Reduce funds for the addition of contractual food service personnel at Deer’s Head Center. The addition of these two positions is inconsistent with the Department of Health and Mental Hygiene’s efforts to reduce costs in this area.	36,167	GF
3. Reduce funds for the addition of contractual office personnel at Deer’s Head Center. This position replaces an abolished full-time equivalent staff position, negating efforts to contain the size of the State workforce.	12,169	GF
4. Reduce general funds for renal dialysis services at Deer’s Head Center. This action reduces by 10% the amount of general funds to reflect continued reductions in patient census in fiscal 2006.	93,425	GF
Total General Fund Reductions	\$ 287,411	

Current and Prior Year Budgets

Current and Prior Year Budgets Chronic Disease Services (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2004					
Legislative Appropriation	\$33,678	\$5,717	\$0	\$1,250	\$40,646
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	-1,069	10	0	17	-1,042
Cost Containment	-146	0	0	0	-146
Reversions and Cancellations	0	-536	0	-8	-544
Actual Expenditures	\$32,463	\$5,191	\$0	\$1,260	\$38,914
Fiscal 2005					
Legislative Appropriation	\$34,287	\$5,401	\$0	\$1,156	\$40,844
Budget Amendments	480	0	0	0	480
Working Appropriation	\$34,767	\$5,401	\$0	\$1,156	\$41,324

Note: Numbers may not sum to total due to rounding.

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Fiscal 2004

The general fund appropriation decreased \$1.1 million to realign health insurance, telecommunications, and other expenditures among departmental units. The majority of cost savings – \$1.0 million – was realized at Deer’s Head Center. Cost containment further reduced the general fund appropriation by \$0.1 million.

Special funds were cancelled at Deer’s Head Center because the appropriation for renal dialysis exceeded collections.

Fiscal 2005

The general fund appropriation was increased by \$0.2 million at each of the facilities to recognize the fiscal 2005 cost-of-living adjustment. Additional funds were used to realign general funds among departmental units in order to accurately reflect position cap reductions.

Audit Findings

Audit Period for Last Audit:	July 1, 2000 – August 17, 2003
Issue Date:	December 2003
Number of Findings:	3
Number of Repeat Findings:	1
% of Repeat Findings:	33%
Rating: (if applicable)	N/A

Finding 1: Adjustments to time reports were not adequately reviewed by supervisory personnel, and certain payroll duties were not adequately separated.

Finding 2: Proper internal controls were not established over materials and supplies.

Finding 3: **Certain recorded collections were not verified to deposit.**

*Bold denotes item repeated in full or part from preceding audit report.

**Object/Fund Difference Report
DHMH – Chronic Disease Services**

<u>Object/Fund</u>	<u>FY04 Actual</u>	<u>FY05 Working Appropriation</u>	<u>FY06 Allowance</u>	<u>FY05 - FY06 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	584.30	575.80	572.80	-3.00	-0.5%
02 Contractual	20.69	17.50	23.58	6.08	34.7%
Total Positions	604.99	593.30	596.38	3.08	0.5%
Objects					
01 Salaries and Wages	\$ 27,647,158	\$ 29,251,849	\$ 29,488,036	\$ 236,187	0.8%
02 Technical & Spec Fees	940,462	779,683	848,199	68,516	8.8%
03 Communication	124,882	123,777	131,429	7,652	6.2%
04 Travel	18,326	17,757	15,875	-1,882	-10.6%
06 Fuel & Utilities	815,826	905,400	1,095,415	190,015	21.0%
07 Motor Vehicles	42,030	45,531	62,127	16,596	36.4%
08 Contractual Services	3,030,223	2,970,465	2,871,189	-99,276	-3.3%
09 Supplies & Materials	5,746,668	6,667,608	6,220,379	-447,229	-6.7%
10 Equip - Replacement	299,553	353,729	266,104	-87,625	-24.8%
11 Equip - Additional	153,687	99,608	36,549	-63,059	-63.3%
12 Grants, Subsidies, and Contributions	9,307	14,289	15,073	784	5.5%
13 Fixed Charges	79,942	94,237	103,608	9,371	9.9%
14 Land & Structures	5,607	0	0	0	0.0%
Total Objects	\$ 38,913,671	\$ 41,323,933	\$ 41,153,983	-\$ 169,950	-0.4%
Funds					
01 General Fund	\$ 32,463,366	\$ 34,767,111	\$ 35,431,344	\$ 664,233	1.9%
03 Special Fund	5,190,541	5,400,597	5,145,926	-254,671	-4.7%
09 Reimbursable Fund	1,259,764	1,156,225	576,713	-579,512	-50.1%
Total Funds	\$ 38,913,671	\$ 41,323,933	\$ 41,153,983	-\$ 169,950	-0.4%

Note: The fiscal 2005 appropriation does not include deficiencies, and the fiscal 2006 allowance does not reflect contingent reductions.

Fiscal Summary
DHMH – Chronic Disease Services

<u>Program/Unit</u>	<u>FY04 Actual</u>	<u>FY05 Wrk Approp</u>	<u>FY06 Allowance</u>	<u>Change</u>	<u>FY05 - FY06 % Change</u>
Western Maryland Center	\$ 19,037,933	\$ 19,731,763	\$ 20,046,780	\$ 315,017	1.6%
Deer's Head Center	19,875,738	21,592,170	21,107,203	-484,967	-2.2%
Total Expenditures	\$ 38,913,671	\$ 41,323,933	\$ 41,153,983	-\$ 169,950	-0.4%
General Fund	\$ 32,463,366	\$ 34,767,111	\$ 35,431,344	\$ 664,233	1.9%
Special Fund	5,190,541	5,400,597	5,145,926	-254,671	-4.7%
Total Appropriations	\$ 37,653,907	\$ 40,167,708	\$ 40,577,270	\$ 409,562	1.0%
Reimbursable Fund	\$ 1,259,764	\$ 1,156,225	\$ 576,713	-\$ 579,512	-50.1%
Total Funds	\$ 38,913,671	\$ 41,323,933	\$ 41,153,983	-\$ 169,950	-0.4%

Note: The fiscal 2005 appropriation does not include deficiencies, and the fiscal 2006 allowance does not reflect contingent reductions.