Lakeshore Regional Entity

Financial Audit Presentation
June 18, 2020

Roslund Prestage & Company
CERTIFIED PUBLIC ACCOUNTANTS

525 WEST WARWICK DRIVE, SUITE A, ALMA, MICHIGAN 48801

Roslund Prestage & Company
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report

To the Members of the Board
Lakeshore Regional Entity
Norton Shores, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of Lakeshore Regional Entity (the Entity), as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the Entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, each major fund, and the aggregate remaining fund information of the Entity, as of September 30, 2019, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

The accompanying financial statements have been prepared assuming that Lakeshore Regional Entity will continue as a going concern. As discussed in Note 18 to the financial statements, Lakeshore Regional Entity has a deficit net position of $(24,884,178) and has incurred substantial annual deficits in the last two fiscal years which raises substantial doubt about its ability to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Lakeshore Regional Entity
Statement of Net Position
September 30, 2019

		Mental Health Operating		Medicaid Risk Reserve		Total Proprietary Funds
Current assets						
Cash and cash equivalents	$	14,057,568	$	-	$	14,057,568
Accounts receivable		1,138,680		-		1,138,680
Due from affiliates		28,605,210		-		28,605,210
Due from MDHHS		8,910,068		-		8,910,068
Prepaid expenses		20,224		-		20,224
Total current assets		52,731,749		-		52,731,749
Noncurrent assets						
Capital assets - depreciable, net		35,700		-		35,700
Total assets		52,767,449		-		52,767,449
		FY2018 Total assets				64,011,078
Liabilities						
Accounts payable		3,124,499		-		3,124,499
Accrued payroll and benefits		41,068		-		41,068
Due to affiliate		62,000,848		-		62,000,848
Due to MDHHS		3,807,977		-		3,807,977
Unearned revenue		8,500,970		-		8,500,970
Compensated absences		176,266		-		176,266
Total liabilities		77,651,627		-		77,651,627
		FY2018 Total liabilities				73,320,802
Net position						
Net investment in capital assets		35,700		-		35,700
Unrestricted		(24,919,878)		-		(24,919,878)
Total net position	$	(24,884,178)	$	-	$	(24,884,178)
		FY2018 Total net position				(9,309,724)

Lakeshore Regional Entity
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended September 30, 2019

	Mental Health Operating	Medicaid Risk Reserve	Total Proprietary Funds
Operating revenues			
State funding			
Medicaid	$ 258,434,362	$ -	$ 258,434,362
Healthy Michigan	27,746,354	-	27,746,354
Incentive payments	3,010,495	-	3,010,495
Medicaid risk corridor - MDHHS	1,866,277	-	1,866,277
PA2 revenues	1,878,717	-	1,878,717
Substance use - State portion	1,889,875	-	1,889,875
Total State funding	294,826,081	-	294,826,081
Federal funding			
Substance use - Community grant	5,244,987	-	5,244,987
Substance use - Prevention	1,629,182	-	1,629,182
Substance use - Opiod Target Response	883,419	-	883,419
Substance use - State Opioid Response Grant	673,512		673,512
Substance use - Partnership for Success II	445,987	-	445,987
MI Youth Treatment Improvement & Enhancement	21,547	-	21,547
Block grants	180,119	-	180,119
Total Federal funding	9,078,753	-	9,078,753
Contributions - Local match drawdown	2,556,372	-	2,556,372
Total operating revenues	306,461,206	-	306,461,206
	FY2018 Operating revenues		291,309,018
Operating expenses			
Funding for affiliate partners			
Autism Training	11,496	-	11,496
Medicaid	252,010,635	-	252,010,635
Healthy MI	33,166,468	-	33,166,468
SUD Block Grant	8,055,223	-	8,055,223
PA2 Liquor Tax	855,981	-	855,981
Total funding for affiliate partners	294,099,803	-	294,099,803
Other contractual obligations			
Contracted services - Prevention	3,697,855	-	3,697,855
Hospital Rate Adjuster	9,193,492	-	9,193,492
Local match expense	2,556,372	-	2,556,372
IPA assessment	3,650,157	-	3,650,157
Total other contractual obligations	19,097,876	-	19,097,876
Administrative expenses			
Board per diem	20,300	-	20,300
Capital outlay - under $5,000	10,441	-	10,441
Depreciation expense	43,658	-	43,658
Dues and memberships	7,508	-	7,508
Insurance	20,112	-	20,112
Legal and accounting	230,461	-	230,461
Meeting expense	14,780	-	14,780
Professional contracts	7,523,109	-	7,523,109
Rent	45,730	-	45,730
Salaries and fringes	1,723,651	-	1,723,651
Supplies	16,232	-	16,232
Travel and training	56,838	-	56,838

Lakeshore Regional Entity
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended September 30, 2019

	Mental Health Operating	Medicaid Risk Reserve	Total Proprietary Funds
Administrative expenses (continued)			
Utilities	$ 39,444	$ -	$ 39,444
All other costs	20,814	-	20,814
Total administrative expense	9,773,077	-	9,773,077
Total operating expenses	322,970,757	-	322,970,757
	FY2018 Operating expenses		304,183,612
Operating income (loss)	(16,509,551)	-	(16,509,551)
Non-operating revenues (expenses)			
Investment income	21,065	-	21,065
Total non-operating revenues (expenses)	21,065	-	21,065
Change in net position	(16,488,486)	-	(16,488,486)
	FY2018 Change in net position		(9,357,138)
Net position, beginning of year	(9,309,724)	-	(9,309,724)
Prior period adjustment	914,032	-	914,032
Net position, end of year	$ (24,884,178)	$ -	$ (24,884,178)

NOTE 4 - DUE FROM AFFILIATES

Due from affiliates as of September 30th consists of the following:

Description	Amount
Allegan County Community Mental Health	3,100,786
HealthWest	4,919,868
Network180	14,330,600
Ottawa Community Mental Health	4,222,236
West Michigan Community Mental Health Systems	2,031,720
Total	28,605,210

NOTE 5 - DUE FROM MDHHS

Due from MDHHS as of September 30th consists of the following:

Description	Amount
Performance Bonus Incentive	1,910,636
FY18 MDHHS Risk Portion	1,360,996
FY19 MDHHS Risk Portion	1,866,277
Retro payments	1,576,118
Block grant	314,777
HRA	1,881,264
Total	8,910,068

NOTE 6 - CAPITAL ASSETS

A summary of changes in capital assets is as follows:

Description	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets being depreciated				
Leasehold Improvement	9,500	-	-	9,500
Computers and software	159,525	-	-	159,525
Vehicles	31,485	-	-	31,485
Total capital assets being depreciated	200,510	-	-	200,510
Accumulated depreciation				
Leasehold Improvement	(9,500)	-	-	(9,500)
Computers and software	(80,167)	(43,658)	-	(123,825)
Vehicles	(31,485)	-	-	(31,485)
Total accumulated depreciation	(121,152)	-	-	(164,810)
Net capital assets being depreciated	79,358	(43,658)	-	35,700
Net capital assets	79,358	(43,658)	-	35,700

NOTE 14 - RISK MANAGEMENT

MMRMA

The Entity is exposed to various risks of loss related to theft of, damage to, and destruction of assets; errors and omissions; injuries; and natural disasters. The Entity participated in the public entity risk pool – Michigan Municipal Risk Management Authority (MMRMA) for auto and general liability, property and crime and vehicle physical damage coverage.

MMRMA, a separate legal entity, is a self-insured association organized under the laws of the State of Michigan to provide self-insurance protection against loss and risk management services to various Michigan governmental entities.

As a member of this pool, the Entity is responsible for paying all losses, including damages, loss adjustment expenses and defense costs, for each occurrence that falls within the member's self-insured retention. If a covered loss exceeds the Entity's limits, all further payments for such loss are the sole obligation of the Entity. If for any reason MMRMA's resources available to pay losses are depleted, the payment of all unpaid losses of the Entity is the sole obligation of the Entity. Settled claims have not exceeded the amount of coverage in any of the past three years.

The Entity's coverage limits are $10,000,000 for liability, $1,500,000 for vehicle physical damage, and approximately $1,051,421 for buildings and personal property.

Medicaid Risk Reserve

The Entity covers the costs up to 105% of the annual Medicaid and Healthy Michigan contract. The Entity and MDHHS equally share the costs between 105% to 110% of the contract amounts. Costs in excess of 110% of the contract are covered entirely by MDHHS.

The Entity has established a Medicaid Risk Reserve Fund, in accordance with Michigan Department of Health and Human Services guidelines, to assist in managing any potential operating shortfalls (as noted above) under the terms of its contract with the MDHHS.

NOTE 15 – CONTINGENT LIABILITIES

Under the terms of various federal and state grants and regulatory requirements, the Entity is subject to periodic audits of its agreements, as well as a cost settlement process under the full management contract with the State. Such audits could lead to questioned costs and/or requests for reimbursement to the grantor or regulatory agencies. Cost settlement adjustments, if any, as a result of compliance audits are recorded in the year that the settlement is finalized. The amount of expenses which may be disallowed, if any, cannot be determined at this time, although the Entity expects such amounts, if any, to be immaterial.

NOTE 16 – ECONOMIC DEPENDENCE

The Entity receives over 90% of its revenues from the State of Michigan directly from MDHHS.

NOTE 17 – PRIOR PERIOD ADJUSTMENT

The prior period adjustment in these financial statements consists of the following items:

Description	Amount
Additional revenues received from MDHHS for prior fiscal years	370,207
Reduction in use tax payable	543,825
Total	914,032

NOTE 18 – GOING CONCERN

As of the financial statement date, the Entity has a deficit net position of $(24,884,178) in its Mental Health Operating Fund. The Entity liquidated the remaining funds in its Medicaid Risk Reserve (ISF) during FY18 and did not have any remaining reserves in the ISF fund to offset the FY19 Operating Fund deficit.

As of the date of the opinion, there is evidence to show that the Entity will be unable to continue to meet its obligations as they become due within 12 months from the financial statement date. The Entity has incurred substantial annual deficits in the last two fiscal years which raises substantial doubt about its ability to continue as a going concern. Furthermore, future projections available as of the date of the opinion show this deficit continuing to increase.

Mitigating factors that could play a role in the Entity's ability to continue as a going concern include 1) a favorable settlement to the contract dispute with MDHHS (see note 19) and 2) changes to the revenue allocation methodology as detailed in the following paragraph

For fiscal year 2020, the revenue allocation model for PIHPs is expected to be altered based on feedback from the PIHPs and CMHSPs. The proposed changes in the methodology could have a positive impact to the Entity's financial status going forward.

NOTE 19 – SUBSEQUENT EVENTS

In July 2019, MDHHS sent a formal notice to the Entity that MDHHS would be cancelling the Specialty Prepaid Inpatient Health Plan contract with the Entity effective September 30, 2019. In its formal notice, MDHHS stated that the Entity is in material default related to not having a viable risk management strategy in accordance with MDHHS standards. The Entity sent a response to MDHHS which disputed the cancellation of its PIHP contract, demanding for a retraction of the notice, and meeting with key stakeholders. MDHHS respond to the Entity which stated that MDHHS will not be retracting the notice of cancellation.

A hearing date with the Administrative Law Judge (ALJ) was scheduled for October 17, 2019 (subsequent to year end). However, MDHHS reached out to the Entity in September of 2019 with the intent of working out a settlement agreement that would address their concerns moving forward and allow continuation of the contract with the Entity. A deferral of the hearing with the ALJ was requested and received.

The first meeting occurred on September 23, 2019 with representatives from MDHHS, the Entity and its Board, and CMHSP Participants. Progress was made on terms of an agreement however several issues, including Board governance and past financial deficits, remain under negotiation with MDHHS going into fiscal year 2020. As of March 2020, these negotiation meetings were deferred due to the urgency of the COVID-19 pandemic. The hearing remains on deferral with updates to the ALJ every two months.

MDHHS is continuing to fund the Entity into fiscal year 2020 with month-to-month contracts. No additional settlement negotiation meetings are scheduled as of the date of the opinion. Management expects that these meetings will be rescheduled once the urgency of the COVID-19 pandemic has subsided.

NOTE 20 – DEFICIT NET POSITION

As of the financial statement date, the Entity is in a deficit net position. As outlined in Numbered Letter 2016-1 issued by the Department of Treasury, this deficit does not pass the 4 Step test for proprietary funds to determine if a deficit elimination plan is required. Therefore, the Entity is required to file a deficit elimination plan with the State.

NOTE 21 - UPCOMING ACCOUNTING PRONOUNCEMENTS

GASB Statement No. 84, Fiduciary Activities, was issued by the GASB in January 2017 and will be effective for the Entity's 2019-2020 fiscal year. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. This Statement establishes criteria for identifying fiduciary activities for all state and local governments. The focus on the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a