

INTERNAL SERVICE FUND TECHNICAL REQUIREMENT

Purpose

The establishment of an Internal Service Fund (ISF) is one method for securing funds as part of the overall strategy for covering risk exposure under the MDCH/CMHSP Managed Mental Health Supports and Services Contract (MDCH/CMHSP Contract). The ISF should be kept at a minimum to assure that the overall level of CMHSP funds are directed toward consumer services. General provisions and restrictions for establishing an ISF are outlined below:

General Provisions

- A. CMHSPs may establish an ISF for risk corridor financing in accordance with shared risk provisions contained in the MDCH/CMHSP Contract with the Michigan Department of Community Health.
- B. An ISF may be established for the purpose of securing funds necessary to meet expected risk corridor financing requirements under the MDCH/CMHSP Contract.
- C. When establishing an ISF, the CMHSP may apply any method it considers appropriate to determine the amounts to be charged to the various funds covered by the ISF provided that:
 - 1. The total amount charged to the various funds does not exceed the amount of the estimated liability determined pursuant to Governmental Accounting Standards Board (GASB) Statement No.10, *General Principles of Liability Recognition*, or such other authoritative guidance as issued by the American Institute of Certified Public Accountants (AICPA); and
 - 2. The estimated liability is computed based on an actuarial method or historical cost information as provided under Office of Management and Budget (OMB) Circular A-87, Attachment B, paragraph 25(d), which is attached to this document, and accordingly, made a part of this Technical Requirement. Under this method, additional charges may be made to various funds that represent a reasonable provision for expected future catastrophic losses.
- D. Non-compliance with the provisions of GASB Statement No. 10 and OMB Circular A-87 relative to any applicable matter herein will cause the ISF charges to be unallowable for purposes of the MDCH/CMHSP Contract.
- E. The CMHSP shall not commingle the ISF with funds of other departments, agencies, governmental funds or entities. The ISF shall not be used to finance any activities or costs other than ISF eligible expenses.

- F. All programs exposed to the risk corridor shall be charged their proper share of the ISF charges to the extent that those programs are covered for the risk of financial loss. Such charges must be allocated to the various programs/cost categories based on the relative proportion of the total contractual obligation, actual historical cost experience, or reasonable historical cost assumptions. If actual historical cost experiences or reasonable historical cost assumptions are used, they must cover, at a minimum, the most recent two years in which the books are closed.
- G. A set of self-balancing accounts shall be maintained for the ISF in compliance with generally accepted accounting principles (GAAP).
- H. The CMHSP shall restrict the use of the ISF to the defined purpose.
- I. The amount of funds paid to the ISF shall be determined in compliance with reserve requirements as defined by GAAP and applicable federal and state financing provisions contained in the MDCH/CMHSP Contract.
- J. To establish an adequate funding level to cover risk corridor requirements, the CMHSP may make payments up to the lesser of: (1) the total potential liability relative to the risk corridor and the overall risk management strategy of the CMHSP's operating budget; or (2) the risk reserve requirements determined under paragraph C above and the applicable financing provisions contained in the MDCH/CMHSP Contract.
- K. The CMHSP shall establish a policy and procedure for increasing payments to the ISF in the event that it becomes inadequate to cover future losses and related expenses.
- L. Payments to the ISF shall be based on either actuarial principles, actual historical cost experiences, or reasonable historical cost assumptions, pursuant to the provisions of OMB Circular A-87, Attachment B, paragraph 25(d)(3). If actual historical cost experiences or reasonable historical cost assumptions are utilized, they must cover, at a minimum, the most recent two years in which the books have been closed.
- M. Payments and funding levels of the ISF shall be analyzed and updated at least biannually pursuant to the provisions of OMB Circular A-87, Attachment B, paragraph 25(d)(3).
- N. If the ISF becomes over-funded, it shall be reduced within one fiscal year through the abatement of current charges or, if such abatements are inadequate to reduce the ISF to the appropriate level, it shall be reduced through refunds in accordance with OMB Circular A-87, Attachment B, paragraph 25(d)(5).
- O. Upon dissolution of the ISF, any funds remaining in the ISF after all of its claims and related liabilities have been liquidated shall be refunded pursuant to OMB Circular A-87, Attachment B, paragraph 25(d)(5).

General Restrictions

Use of funds held in the ISF shall be restricted to the following:

- A. The CMHSP shall restrict the use of the ISF to the defined purpose. The defined purpose of the ISF is to secure funds necessary to meet expected future risk corridor requirements established in accordance with the MDCH/CMHSP Contract between the CMHSP and the Michigan Department of Community Health. All expenses, for the purpose intended to be financed from the ISF, shall be made from the ISF. No expenses from this fund will be matchable--only the payments to the ISF will be matchable. No other expenses may be paid from the ISF.
- B. Payment of the CMHSP's risk corridor obligation.
- C. The CMHSP may invest ISF funds in accordance with statutes regarding investments (e.g., *Mental Health Code* 330.1205, Sec. 205(g)). The earnings from the investment of ISF funds shall be used to fund the risk reserve requirements of the ISF in accordance with OMB Circular A-87, Attachment B, paragraph 25(d)(2).
- D. The ISF may not loan or advance funds to any departments, agencies, governmental funds, or other entities in accordance with OMB Circular A-87, Attachment B 25(d)(5).
- E. Funds paid to the ISF shall not be used to meet federal cost sharing or used to match federal or state funds pursuant to OMB Circular A-87, Attachment A, paragraph C(1).
- F. State funds paid to the ISF shall retain its character as state funds in accordance with the Mental Health Code and shall not be used as local funds.

General Accounting Standards

The ISF shall be established and accounted for in compliance with the following standards:

- A. Generally accepted accounting principles (GAAP).
- B. GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, or other current standards.
- C. Financial Accounting Standards Board (FASB) Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, or other current standards.
- D. FASB Statement No.5, *Accounting for Contingencies*, or other current standards.
- E. OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, or other current standards.
- F. Other financing provisions contained in the MDCH/CMHSP Contract.
- G. The financial requirements set forth in the HCFA Federal 1915(b) waiver.

OMB Circular A-87, Attachment B, Paragraph 25(d)

“Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:

1. The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit’s settlement rate for those liabilities and its investment rate of return.
2. Earnings or investment income on reserves must be credited to those reserves.
3. Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.
4. Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.
5. Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer.”