ALAMEDA HEALTH SYSTEM: LOOMING INSOLVENCY OF A CRITICAL COUNTY SAFETY NET

EXECUTIVE SUMMARY

Alameda Health System (AHS) is an integrated public health care system established by Alameda County to meet the county's state-mandated health care obligations. As an independent hospital authority, AHS is operated by an Executive Leadership Team (AHS administration) which reports to a governing Board of Trustees (AHS trustees) appointed by the county Board of Supervisors (BOS).

AHS's June 30, 2019 audited financial statements show AHS having a negative net worth (i.e., what AHS owes is more than what AHS owns) of $300.6 million. AHS's internal budget documents report a "balanced" budget for the year ending June 30, 2020; yet, the same documents show AHS having a cash deficit of approximately $144 million. AHS's forecasts for the years ending June 30, 2021 and 2022 show continued annual cash deficits of $123 million and $82 million, respectively, with deficits for the years 2019 through 2022 totaling $453 million—prior to the additional expenses and lost revenue now projected as a result of the Coronavirus pandemic. AHS's negative net worth together with the substantial and continuing cash deficits raise the grand jury's concern as to the continued operation of AHS.

AHS and the county have shared a joint mission for nearly 25 years: to provide quality healthcare to the county's indigent population. However, since AHS's inception, the relationship between the parties has had a tension derived substantially from the parties' failure to balance AHS's responsibility for operational control of AHS with the county's health service mandate and its allegiance to other constituencies.

As one witness indicated, "it's not about the money. It's about the political will and competency to make tough decisions." These decisions cannot continue to be "kicked down the road." The future of a critical county safety net is at stake.

The AHS administration, AHS trustees and BOS share responsibility for the financial health of AHS. While the three parties have held joint meetings about AHS financial challenges, those meetings have not resulted in a viable plan to return AHS to financial health. The parties' goals are straightforward: the county must meet its statutory obligations to provide medical care to indigent county residents; AHS must operate the hospital system to provide that medical care as efficiently and transparently as possible. If resources

prove insufficient, AHS and the county need to identify and agree on the scope of services and on the least politically damaging way to provide them—by cutting back on services, increasing the county's financial support, or some combination of the two. Both parties then will need to present a uniform public face in support of that decision.

An improved relationship between the county and AHS is necessary to focus on defining a reasonable scope of the care to be offered by AHS, along with AHS reducing expenses and achieving revenue targets. As one witness indicated, "It's not about the money. It's about the political will and competency to make the tough decisions." Put another way, resolution will require the parties to make difficult decisions which appear to have been avoided or delayed to please special interests. These decisions cannot continue to be "kicked down the road." The future of a critical county safety net is at stake.

BACKGROUND

Historically, public hospitals are where the indigent, poor and uninsured seek health care. Alameda County has operated public hospitals for more than 100 years: Alameda County Infirmary (now Fairmont Hospital) in San Leandro accepted its first patient in 1864 and Oakland's Highland Hospital opened in 1927. In 1933, the obligation of all California counties to provide health care to indigent, poor and uninsured county residents (safety net health care) was codified in California Welfare and Institutions Code section 17000.

The county merged its two public hospitals and three clinics into Alameda County Medical Center in 1991. Shortly thereafter, the BOS sought a new governance structure for the medical center that would allow it to be more efficient and cost-effective in a shifting, competitive market; they settled on a public hospital authority model. In 1996, enabling legislation and associated revisions to California Health and Safety Code section 17000 permitted the county to establish an independent public hospital authority to manage, administer and control the Alameda County Medical Center and to meet the county's safety net health care obligations. The BOS formally handed legal control and governance of the medical center to the newly formed authority—now known as Alameda Health System—in July 1998. Currently, AHS operates five hospitals (Fairmont, Highland, Alameda, San Leandro and John George Psychiatric) and four wellness centers with over 800 beds and 1,000 physicians.

Relationship Between AHS and Alameda County

Although separate legal entities, Alameda County and AHS are inextricably linked. The formal relationship between them is controlled by the enabling laws and agreements that govern AHS's

creation.[1] AHS is operated by the AHS administration which reports to the AHS trustees. The BOS controls the AHS bylaws and appoints the AHS trustees.

The AHS bylaws give the trustees the "responsibility to manage, administer and control AHS including but not limited to all matters pertaining to quality of care…." The AHS trustees are obligated to fulfill specific duties and responsibilities related to budget, contracts, personnel, services, accountability, and reporting. Two budget-related responsibilities set out in the bylaws are noteworthy:

- Adopt a balanced budget by June 30 for the following fiscal year.
- Strive to maintain a balanced budget, making adjustments to offset unanticipated expenditures or unrealized revenues as needed.

History of Financial Interactions

All public health systems have issues with funding. In addition to county funding, these systems rely heavily on federal (e.g., Medicaid and Medicare) and state (e.g., Medi-Cal) funding programs, the rules of which are volatile. AHS's funding issues are further exacerbated by California having one of the lowest Medicaid reimbursement rates in the country, and by the high cost of labor in Alameda County.

AHS has an annual operating budget of approximately $1.1 billion. Alameda County provides approximately $200 million annually to AHS, including approximately $120 million from Measure A funds and $80 million in service contracts. In 2004, the county's voters passed Measure A, a ten-year half-a-percent increase in its sales tax, to provide annual funding for medical and mental health services to the county's indigent, low-income and uninsured residents. The measure was renewed in 2014 for another 15 years. AHS receives 75% of the generated funds; in FY2019 (July 2018– June 2019), AHS received approximately $123 million in Measure A funding. In addition, in FY2020, the county has approximately $81 million in service contracts with AHS: $43 million to provide health care services through AHS public hospitals and wellness centers, and $38 million to provide mental health services at John George Psychiatric Hospital.

Alameda County also has financed specific projects for AHS. For example, it issued and pays the interest on approximately $600 million in bonds for construction of the Highland Hospital Acute Care Tower. The county also is providing up to $70 million of designated capital funds over ten years to help support AHS's $240 million Epic Electronic Health Records project.

[1] *The enabling laws and agreements include Assembly Bill 2374 (1996); California Health and Safety Code section 101850; Alameda County Administrative Code Chapter 2.120; three agreements ("transfer documents") known as the master contract, the services agreement and the lease agreement; and the AHS Bylaws.*

Outstanding Debt with Alameda County Consolidated Treasury

In the early 2000's, AHS faced significant cash shortfalls and borrowed from the Alameda County Consolidated Treasury, accumulating a $200 million debt, referred to by the parties as the "Net Negative Balance" (NNB). In 2004, the BOS placed a $200 million limit on borrowing by AHS and established a repayment schedule. The debt repayment schedule called for a reduction of the $200 million limit to $70 million by June 30, 2016.

In 2013 and 2014, AHS again faced significant cash shortfalls, mostly due to inefficient billing and health records systems, as well as the cost of acquiring and operating financially struggling San Leandro and Alameda hospitals. In response, AHS and the county replaced the existing repayment agreement with the current Permanent Agreement in April 2016. The Permanent Agreement revised the 2016 debt limit from $70 million to $145 million and required that the debt limit be paid down by $5 million per year to $50 million in June 2034. The Permanent Agreement allows AHS, with county authorization, to exceed the annual debt limit by up to $50 million during the fiscal year if the annual debt limit is met by the end of the fiscal year.

Alameda Health System - Highland Hospital

The Permanent Agreement also specifies a series of financial planning and reporting requirements. Perhaps most importantly, AHS is expected to immediately notify the BOS, the AHS trustees, the county auditor-controller and the county administrator if it believes it cannot meet the Agreement's repayment schedule. In that circumstance, AHS's chief executive officer, the county administrator and the county auditor-controller are directed to develop a financial and operational "turnaround" plan detailing how AHS can avoid or mitigate the problem.

2015 Grand Jury Report on AHS

In June 2015, the Alameda County Grand Jury published a report titled "Alameda Health System Governance and Oversight." The report focused on AHS's 2014 fiscal crisis—the need for a cash infusion of approximately $220 million to maintain financial stability—and the governance and management issues that contributed to the crisis. That grand jury found that the fiscal crisis had been worsened because of ineffective oversight of AHS finances by the AHS trustees and the BOS. It also concluded the lack of transparent communication between AHS and the county

delayed the crafting of a comprehensive solution. AHS and the county both disagreed, in whole or in part, with the grand jury's findings but indicated they were implementing the jury's recommendations to address reporting and communication issues.

Déjà Vu All Over Again?

This year's grand jury was introduced to AHS during orientation sessions with several AHS executive managers as well as county elected officials and employees familiar with AHS. Statements made during the orientation sessions indicated AHS is experiencing issues strikingly similar to those reported by the grand jury in 2015. In particular, the grand jury was told AHS has a $100 million liability coming due and does not have the cash to pay it; AHS characterizes its budget as "balanced" when it is not; the relationship between the AHS trustees and the BOS is "problematic;" and, most incredibly, AHS's debt with the county could balloon to over $500 million by June 2022. The grand jury asked itself: Are these statements accurate? And, if so, given the balanced budget requirement in the AHS bylaws, the financial reporting and oversight responsibilities under the Permanent Agreement and the supposed implementation of the 2015 grand jury's recommendations, how could this situation have arisen – again?

Political pressure by some county supervisors has interfered with AHS operations and efforts to control costs.

INVESTIGATION

During the course of our investigation, the grand jury heard testimony from current and former AHS trustees and members of the AHS administration, current Alameda County supervisors and current and former staff in the county's Health Care Services Agency (HCSA) and Auditor-Controller Agency. The jury also reviewed numerous documents, correspondence, and other materials related to AHS finances, with a focus on FY2017 through FY2020, including:

- AHS governing documents.
- The 2016 Permanent Agreement on repayment of AHS's debt to the Alameda County Consolidated Treasury.
- AHS preliminary and final budgets for FY2017 through FY2020.
- Meeting minutes, notes, as well as associated documents and presentation materials for selected meetings of the BOS, BOS Health Committee, AHS trustees, and AHS Finance Committee. The grand jury reviewed audio and video recordings of some of these meetings.

- Correspondence among AHS administration, AHS trustees, BOS and county staff.
- Recent independent audits and consulting reports related to the financial status of AHS.
- The 2014–2015 Alameda County Grand Jury report on AHS.

Is AHS Facing Another Financial Crisis?

The grand jury first wanted to determine the correctness of the comments about AHS's financial situation: AHS presents its budget as "balanced" when it is not; AHS has a $100 million liability coming due but does not have the cash to pay; and AHS's debt balance with the county could balloon to over $500 million by June 2022.

Operating Budget and Efficiency

Although giving the AHS trustees the specific responsibility to adopt and maintain a balanced budget, AHS defines the term as a balanced *operating* budget—a balance of the revenue and expenses needed to operate AHS day to day. AHS's definition excludes changes in both revenue and expense reserves which would normally be included in calculating a balanced budget. The grand jury heard from AHS witnesses that these items are excluded because they are transactions beyond AHS's control. County witnesses disagreed and testified that AHS's use of a balanced operating budget does not adequately represent the actual financial position of AHS, which contributes to the tensions between the parties, particularly between county staff and AHS.

County witnesses testified that AHS's use of a balanced operating budget does not adequately represent the actual financial position of AHS, which contributes to the tensions between the parties, particularly between county staff and AHS.

AHS's operating revenue comes from patient services and supplemental federal, state and county payments, including Measure A funding. Almost 80% of AHS's operating expenses are employee wages and benefits, and physician contract services. The other 20% of operating expenses include pharmaceuticals, medical and other supplies, equipment leases and the like.

To measure its operating budget performance, AHS focuses on EBIDA (Earnings Before Interest, Depreciation and Amortization) and the EBIDA Margin (EBIDA ÷ Total Operating Revenue). The EBIDA Margin is a measure of short-term operational efficiency or profitability—the higher the margin, the more profitable AHS's operations. Witness testimony maintained that a realistic EBIDA Margin for a public hospital system like AHS is in the 6% to 8% range, that even 3% might be considered "healthy."

For each of the three most recently completed fiscal years, FY2017 through FY2019, the AHS trustees approved a balanced operating budget with a positive EBIDA Margin (see Table 1). The end-of-year actuals indicate that AHS was more profitable than expected in FY2017 and FY2019 but less profitable in FY2018.

Table 1: Revenue and Expense Statement for FY2017–19

	(dollars in millions)								
	FY2017			FY2018			FY2019		
	Actual	Budget	Variance	Actual	Budget	Variance	Actual	Budget	Variance
Net Revenue	$ 971,991	$ 925,256	5.1%	$1,008,197	$1,020,624	-1.2%	$1,062,607	$1,058,365	0.4%
Operating Expenses	$ 919,584	$ 878,096	4.7%	$ 992,672	$ 991,173	0.2%	$1,011,134	$1,026,444	-1.5%
EBIDA	$ 52,407	$ 47,160	11.1%	$ 15,525	$ 29,451	-47.3%	$ 51,473	$ 31,921	61.3%
EBIDA Margin	5.4%	5.1%		1.5%	2.9%		4.8%	3.0%	

While annual operating performance is informative, the grand jury found that it belies the challenges and the internal tensions that the AHS trustees and administration face while trying to generate revenue and control expenses month to month. For example, by February 2018, a six-month trend of below-budget operating performance led the AHS Finance Committee to request that the AHS administration provide more detailed monthly financial reports, and implement a financial action plan to achieve a balanced budget in FY2018. Without the trustees' diligent financial oversight and the administration's successful "Back to Budget" plan, AHS's financial results for FY2018 might have been much worse. Similarly, by Fall 2018, AHS expected to receive significantly less supplemental revenue than budgeted. Again, AHS had to closely monitor and aggressively reduce operating expenses by $15 million to achieve a balanced operating budget for FY2019.

The grand jury considered evidence that the following internal issues contributed to AHS's financial challenges and tensions over the past few years:

- Late or erroneous patient billings and delayed or late collection efforts resulted in lost revenue. Mismanaged billings and collections were attributed to AHS's inefficient and ineffective reporting systems. The implementation of the Epic system should greatly relieve these concerns.

- Service claims declined by Alameda County and/or the state of California were not analyzed by AHS for appeal, potentially resulting in lost revenue. This issue also was attributed to AHS's poor, inefficient and ineffective reporting systems. Implementation of the Epic system should greatly relieve these concerns.

- AHS's contractual rates with the county HCSA for provision of behavioral health services were never adjusted to reflect current and expected costs of delivering such services. In addition, AHS has not drawn down the full value of the contract in the past seven years. These practices resulted in lost revenue to AHS that is now being remedied by the county.

- Labor costs, which account for over three-quarters of AHS's operating expenses, are high and an increasing percentage of total operating expense (see Table 2). AHS must negotiate separate contracts with 18 different labor unions, which is time consuming, expensive and limits its negotiating flexibility.

Table 2: AHS Labor Costs

	(dollars in millions)		
	ACTUAL		BUDGET
	2018	2019	2020
Contracted Physician Services	$ 89,177	$ 92,419	$ 88,692
Other Labor	$ 685,855	$ 702,110	$ 734,267
Total Labor Expense	$ 775,032	$ 794,529	$ 822,959
Total Operating Expenses	$1,009,196	$1,021,832	$1,053,610
Contracted Physician Services	8.8%	9.0%	8.4%
Other Labor	68.0%	68.7%	69.7%
Total Labor Expense	76.8%	77.8%	78.1%

The grand jury also considered evidence that the following issues, which directly or indirectly involved the county, also contributed to AHS's financial challenges and tensions over the past few years:

- Alameda and San Leandro Hospitals were incorporated into AHS. Each hospital was labeled a "loss leader" generating higher expenses than revenue.

- Political pressure by some county supervisors has interfered with AHS operations and efforts to control costs. The grand jury heard evidence of a county supervisor appearing at a hearing concerning a contentious AHS labor negotiation dressed in the uniform of

the involved labor union. Another example occurred after AHS voted to defer approximately $20 million in seismic work at Alameda Hospital, the result of which would have been to reduce services. The grand jury heard testimony that a county supervisor's public opposition was a significant factor in AHS reversing its decision and incurring that cost.

- AHS assumed the highest-cost (Class A) office space previously leased by the county in San Leandro. The grand jury was told that a lease for comparable lower-cost (Class B) space may have saved AHS $3 million in rent.

- The county reclaims its non-federal share of Medi-Cal supplemental reimbursements to AHS, asserting that share is funded by AHS's Measure A funds. The resulting loss of revenue significantly widens the gap between Medi-Cal coverage and AHS's actual cost of care.

- Excessive overstay in AHS facilities of otherwise dischargeable patients with no placement options (e.g., homeless) resulted in an estimated unbudgeted cost of $28 million to AHS in FY2019. The grand jury learned that the county has committed to work with AHS on this issue and to increase the availability of respite beds and other placement options.

- AHS has filed a lawsuit against the county and Alameda County Employees' Retirement Association (ACERA) regarding current pension liabilities along with those dating back to the formation of AHS. A member of the BOS Health Committee is also on the ACERA board. These factors add to the tensions between AHS and county. The grand jury did not investigate this issue because of the pending litigation.

The harbinger of significant AHS operating losses materialized by early 2019. In February 2019, AHS's interim chief financial officer reported to the Finance Committee:

> *The additional cost [of Epic training and support] as well as [an estimated $33 million decline in] supplemental revenues will put a significant strain on finances in the coming year. As you can see, without changes going forward, the EBIDA Margin is quickly shrinking. This gives a glimpse into the challenges that AHS will face when preparing the 2020 budget.*

In fact, throughout the spring of 2019, AHS's "quickly shrinking" EBIDA Margin was forecast to turn negative for the first half of 2020—AHS operations would start losing money within six months unless significant expense reduction measures were instituted.

After an arduous and extended FY2020 budgeting process, the AHS trustees approved a balanced FY2020 operating budget in September 2019. However, AHS forecasts for FY2021 and FY2022 reflected significant operating losses of more than $50 million per year (see Table 3). Worse yet, the forecasted operating losses will be further aggravated by the Coronavirus pandemic, which is projected as a weekly loss of $2–$3 million.

Table 3: Revenue and Expense Projections for FY2020–22

	(dollars in millions)		
	BUDGET FY2020	FORECAST FY2021	FORECAST FY2022
Net Revenue	$ 1,082,445	$ 1,009,489	$ 1,029,678
Operating Expenses	$ 1,041,773	$ 1,063,156	$ 1,094,565
EBIDA	$ 40,672	$ (53,667)	$ (64,887)
EBIDA Margin	3.8%	-5.3%	-6.3%

Cash Needs and Growing Debt

Simply put, AHS's annual operating expenses are just a portion of its overall financial obligations. Additional cash is needed for liabilities AHS committed to in prior years. Many of AHS's prior-year liabilities have been carried on its books for years, awaiting the completion of government audits and formal requests for payment. AHS now expects those significant liabilities to come due over the next few years but has no way to pay them.

Under the 2016 Permanent Agreement, if AHS has an outstanding debt with the county, all AHS cash receipts are deposited daily into the Alameda County Consolidated Treasury. AHS draws on the treasury to pay its bills up to the debt limit set by the Permanent Agreement. The debt limit was $130 million as of June 30, 2019 and decreases by $5 million per year through June 30, 2034.

In March 2019, AHS was informed that California intended to request reimbursement of $99.6 million by December 2020, for the state's 2008–2015 overpayments to AHS on Medi-Cal Waiver claims. The AHS Finance Committee noted, in April 2019, that "[w]hile we have reserved for these issues from a financial statement perspective, we do not have cash put aside for this issue." This highlights a continuing dilemma and disagreement between AHS and the county: the difference between financial statement reserves and actual cash reserves. The grand jury heard from county witnesses that AHS has the ability, and was advised by the county, to set aside cash reserves to pay prior-year liabilities. In contrast, AHS witnesses testified that, while AHS

can reserve for liabilities in their financial statements, it does not have an ability to set aside cash reserves because all cash is taken by the county and applied against AHS's outstanding debt to the county. The reality is, regardless of who is correct, there is no cash reserved to pay for this liability.

AHS's FY2019 year-end financial report lists prior-year liabilities totaling $200 million, including the $99.6 million to California. These liabilities were not included in the FY2019 debt-balance calculation because AHS had not received a formal request for repayment. Instead, following usual practice, the liabilities were just moved forward to the FY2020 forecast.

Many of AHS's prior-year liabilities have been carried on its books for years, awaiting the completion of government audits and formal requests for payment. AHS now expects those significant liabilities to come due over the next few years but has no way to pay them.

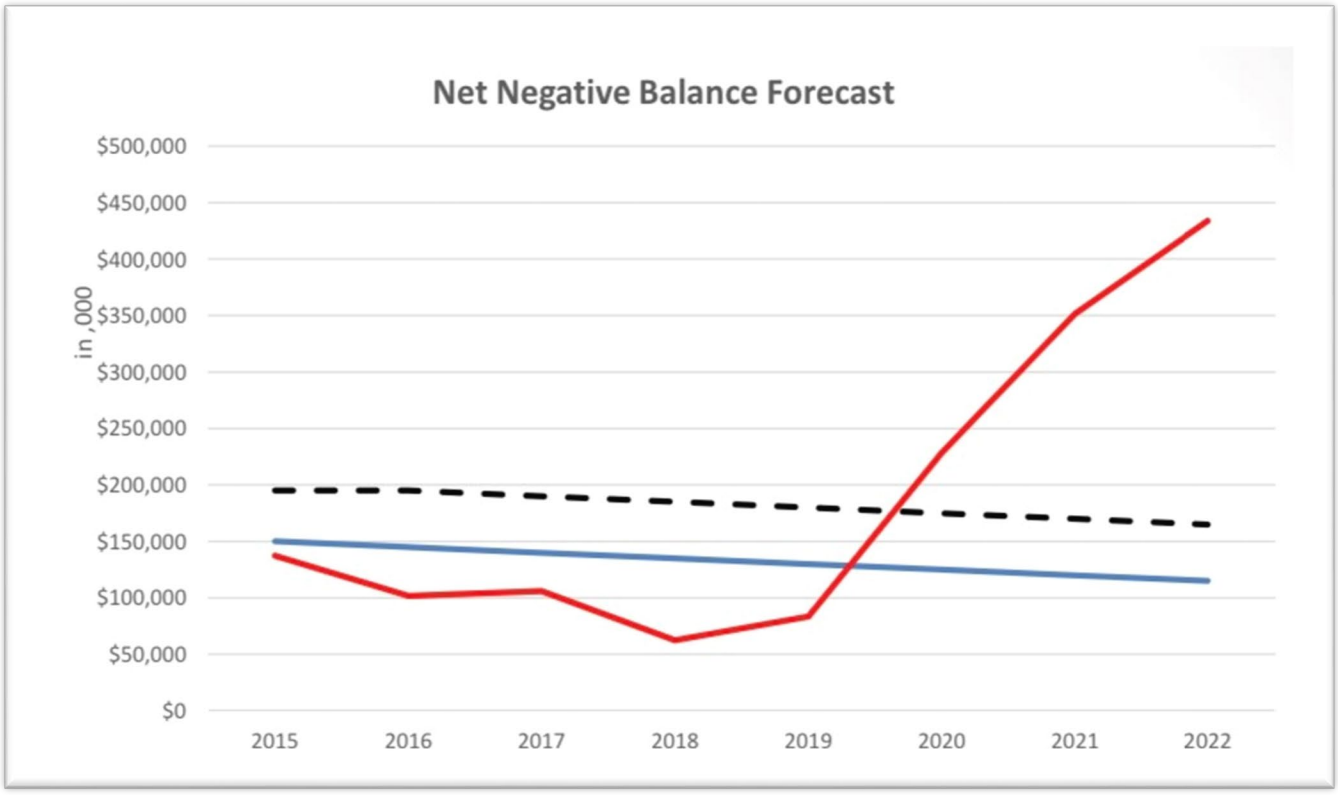
As of early 2020, AHS expects the prior liabilities to come due over the next few years. The combined cash deficits from FY2019 through FY2022 are forecast to total almost $453 million (see Table 4).

Table 4: AHS Cash Forecast for FY2019–22

(dollars in millions)

	ACTUAL		BUDGET	FORECAST		2019 through 2022
	2018	2019	2020	2021	2022	
Cash From (To) Operations	$ 15,525	$ 51,472	$ 40,671	$ (53,667)	$ (64,887)	
Other Cash	$ 64,884	$ (153,207)	$ (185,691)	$ (69,827)	$ (17,467)	
Total Cash Surplus (Deficit)	$ 80,409	$ (101,735)	$ (145,020)	$ (123,494)	$ (82,354)	$ (452,603)
Line of Credit At June 30	$ (62,483)	$ (83,622)	$ (228,399)	$ (351,647)	$ (433,753)	

The cash required to cover anticipated operating losses and pay prior-year liabilities is projected, in the worst case, to plummet AHS into a severe cash deficit and violate the debt limit (i.e., Net Negative Balance) set forth in the Permanent Agreement (see following Chart [Source: AHS]).



— NNB Limit - - Intra Year Limit — NNB Forecast

AHS Reporting Obligations

Under the Permanent Agreement, AHS is required to report on the financial status of its operations to the BOS Health Committee at the committee's regularly scheduled monthly meeting. However, AHS makes quarterly, not monthly, reports to the BOS Health Committee.

AHS is supposed to work with the county HCSA, the County Administrator's Office, and the county Auditor-Controller Agency to provide relevant financial and operational information in its regular reports to the BOS Health Committee, including AHS's ability to meet its debt limit with the county. The grand jury learned that AHS does not engage county staff to ensure the information in its reports is relevant to the county. The grand jury was told the BOS Health Committee and county staff typically receive AHS reports the day of a committee meeting, leaving little time to review the report prior to presentation and discussion. Witnesses also told the grand jury that the numbers presented in AHS financial reports were "volatile" and "inconsistent."

The relevance and timeliness of AHS's financial reporting became a contentious issue in Spring 2019.

AHS and Alameda County Responses to the 2019–2020 Fiscal Crisis

AHS began the FY2020 budgeting process in early 2019 facing projected operating losses and needing to repay significant prior-year liabilities. The grand jury was particularly interested in how AHS and the county responded, given that the relationship between the AHS trustees and the BOS had been described as "problematic."

AHS Budgeting for FY2020

The initial draft FY2020 operating budget, in March 2019, projected a loss of $88.3 million and an EBIDA Margin of -7.1%. The AHS trustees, required by the bylaws to adopt a balanced budget, advised the AHS administration to target a marginally profitable EBIDA Margin in the range of 1.47% to 2.8%. To achieve that target, between $86.2 and $99.6 million in savings had to be found. AHS worked to identify potential revenue sources and expense reduction options that could achieve the FY2020 EBIDA target. Options considered, among others, included staff wage freezes, furloughs, benefits restructure, elimination of discretionary expenses (such as travel), requesting [county] resources to support difficult patient placement, and service reductions/eliminations of lower margin programs such as primary care at Alameda Hospital, women's health services, and neonatal intensive care (NICU).

By June 2019, the projected budget gap was down to $25–$30 million. The AHS administration proposed to further reduce the gap by cutting the previously identified lower-margin services. The AHS trustees and the county objected to the elimination of these services and agreed to a two-month delay in the submission of a balanced budget that would avoid such service cuts. A balanced operating budget ultimately was accomplished through an unexpected windfall from several state and county programs totaling approximately $60 million. The final FY2020 operating budget was approved by the AHS trustees on September 26, 2019. It projected annual operating income of $28.8 million and an EBIDA Margin of 3.8%. Both operating revenue and expenses were budgeted to be higher than in any previous year.

Alameda Health System

Communications and Posturing

Throughout the FY2020 budgeting process in the spring and summer of 2019, AHS and the county publicly praised each other and emphasized the need to work together to solve AHS's financial crisis. But an underlying tension was evident in both sides readily pointing out shortcomings of the other and, in doing so, were often prone to old biases and posturing.

Once the magnitude of its financial crisis became apparent, AHS recognized the need to communicate the situation to its funders and stakeholders, including the county. On March 11, 2019, at a regularly scheduled update to the BOS Health Committee, AHS reported that current and future supplemental funding uncertainty, pension costs, debt, and lack of cash reserves were significant concerns. As required by the Permanent Agreement, on March 15, 2019, AHS advised the BOS Health Committee and the county administrator that AHS expected to settle the $99.6 million Medi-Cal waiver claim against it in FY2020, which would likely exceed AHS's available cash and violate the debt limit with the county.

Notwithstanding these unsettling prospects, the grand jury was told only one substantive meeting took place between the parties over the next six weeks. That meeting occurred on April 3, 2019, when AHS met with the chair of the BOS Health Committee and delivered the message:

> *We [AHS] fully expect that we will not be able to remain in compliance with our Permanent Agreement with the County next year. We foresee the need to partner with the County to share details of the efforts we are taking to close the gap and asking for your help in whatever you may be able to offer, including a temporary suspension of the Permanent Agreement or broader renegotiation.*

On May 22, 2019, AHS again met with the BOS Health Committee, county administrator, county auditor-controller, and the county HCSA Director to confer on the reasons for AHS's expected noncompliance with the Permanent Agreement in FY2020.

Two weeks later, on June 4, 2019, the BOS summarized their concerns about the depth and scale of the structural financial problems in a letter to the AHS trustees:

> *While AHS informed the County of challenges related to balancing its FY 2019–20 budget and need to repay prior year Medicaid Waiver overpayments…it was only after additional questioning that AHS disclosed a major structural deterioration in financial performance that is not limited to the FY 2019–20 budget….AHS projects its forecasted [debt with the county] to be over $572 million in FY 2021–22….[which] would result in AHS being out of compliance with the Permanent Agreement by over $457 million at the end of FY 2021–22.*
>
> > *After the County's request for additional data, AHS disclosed a long-range forecast…that shows AHS's operating cash flow declining from a $46 million surplus in FY 2018–19 to a $169 million deficit in FY 2021–22….This forecast is radically different than the last long-range forecast shared with the County…in January 2018 when [AHS] was seeking approval for a financing plan related to the Epic Electronic Health Records [project]….*

> *Unfortunately, AHS did not fully disclose its structural financial challenges and forecasts during its regularly scheduled updates to the County's Health Committee. Given the lack of transparency and timely information from AHS regarding the scope of its structural financial problems, as well as widely differing financial forecasts…the County had no alternative but to retain [on May 21, 2019] independent consultants…to evaluate AHS's fiscal condition and validate the information provided by AHS to the County.*

In the next regularly scheduled quarterly update to the BOS Health Committee, on June 10, 2019, AHS again advised that the forecast $99.6 million recoupment from prior-year Medi-Cal waivers threatened AHS's ability to meet the $125 million debt limit in FY2020. Also, that AHS's options to eliminate the remaining $25–$30 million FY2020 budget gap were to discontinue lower-margin programs including psychiatric emergency services, women's services, and well-baby and NICU services.

Later that same day, the AHS chief executive officer sent an email to all AHS employees staking out AHS's position vis-a-vis the county:

> *These changes [i.e., declining supplemental revenue] pose a greater threat to Alameda Health System as they are exacerbated by other financial burdens we already bear with Alameda County including repayment of structural debt that has existed since our inception, pension costs, and no general fund support from the county that is normally available to other comprehensive public health systems like AHS….*
>
> > *Despite our aggressive efforts to reduce expenses by nearly $15M in FY19…operating expenses will further outpace revenue growth in the foreseeable future unless there are significant changes in Medi-Cal rates and the financial structural relationship between Alameda Health System and the County of Alameda [emphasis added]….*
> >
> > *…without additional local support our Board is faced with only the tough choices to honor AHS's obligations to the County to produce a balanced budget, which includes continuing to meet AHS's debt payment to the County, through a combination of cutting wages and/or benefits, reducing or even eliminating vital community services, and even closing facilities….The Board will be considering these service eliminations for the FY20 budget to take effect as of January 2020 if we are unable to secure additional financial support from our funding partners.*

Two days later, on June 12, 2019, AHS went public with its position and published a trustee-authored editorial in the local press. The editorial echoed much of the AHS chief executive officer's email to AHS employees:

> *[The county's] support has always been necessary for AHS to survive, but it has become increasingly insufficient as other reimbursement programs decline or grow at a pace that hasn't kept up with the inflationary growth in expenses…. In other counties, public health systems receive substantial county general funds to help cover these costs. Alameda Health System does not….*
>
> > *The AHS Board welcomes the opportunity to partner with the county to find creative solutions to shore up the fiscal foundation for AHS. Options could include debt forgiveness, state and federal advocacy to increase funding for AHS, and strategic investments in services that address social factors such as adequate housing and nutrition that disproportionately impact a number of our patients…*
> >
> > *Now, more than ever, it is imperative that we look to our county partners to help to identify additional funding that will help Alameda Health System continue fulfilling this mission next year and for the years to come.*

The county reacted quickly with responses reflecting its long-standing claims about AHS's lack of transparency, inaccurate financial reporting, and blame-shifting. On June 13, 2019, a county supervisor and the HCSA director each had statements read to the AHS Finance Committee. The supervisor's statement said, in part:

> *…at this critical time, instead of working together, the [AHS] administration's foremost purpose seems to be to shift the blame [and] create dissension between its employees and its board with the county. I also question the administration's lack of transparency and the unwillingness to acknowledge its own past errors and ongoing operational issues which have cost the system millions of dollars. In fact, while the CEO was advocating [at the] June 10 Health Committee for cooperation, he was sending the memo…to everyone but the county and blaming [the county] for the current crisis.*

Similarly, the HCSA director's statement said, in part:

> *[W]e are concerned about recent communications to the employees and physicians at AHS and the broader community through this week's media efforts to cast blame on the county…these challenges require partnership, not provocation…I am disappointed and deeply concerned by the budget proposal before you today….*
>
> > *Last year, [the AHS Chief Executive Officer] and I initiated regular meetings between AHS and HCSA executive teams to align on key initiatives and problem-solve on issues that arise. AHS financial issues have not been the topic of these conversations…none of the other proposals before you have been the topic of our joint conversations….We've held comprehensive conversations about these*

> *initiatives [to reduce unnecessarily long hospital stays] and [are surprised] to hear that we are being held out as the problem….*
>
> *HCSA has engaged [an outside "HCSA consultant"] to assess the situation at AHS. We believe we can find ways to improve financial performance and are investing in this health check to reach a diagnosis that will keep our valuable public health system in service to our community.*

A day later, on June 14, at a BOS town hall meeting, two county supervisors publicly condemned AHS's lack of transparency and timely information and implied that AHS executive salaries were excessive.

On June 27, 2019, the county auditor-controller wrote AHS saying, in part:

> *As AHS is aware, the County has contracted with [the HCSA consultant] to conduct an independent assessment of AHS due to the serious concerns the County has regarding the accuracy of the financial information provided by AHS, and the reported structural financial crisis that AHS predicts will continue to worsen over the upcoming fiscal years…. My office is retaining the services of [an outside "Auditor-Controller consultant"]…to provide a separate review…of AHS's overall fiscal condition.*

Finally, also on June 27, the BOS wrote to the AHS trustees, saying "As you know the County has engaged [the HCSA consultant] to help us assess the financial situation at AHS. … We feel strongly that the Board of Trustees should retain its own outside health care consultant and that this consultant should report directly to the Board of Trustees."

Themes Defining the Relationship

As exemplified by the communications detailed above and expanded by witness testimony before the grand jury, AHS and the county consistently reiterate long-standing differences of perspective on their relationship and sources of AHS's financial problems.

AHS themes include:

- AHS's outstanding debts arose long ago and were not incurred by current AHS management;
- Alameda County has an obligation to support AHS financially through good times and bad, like most other counties do for their public hospitals;
- Unlike other counties, Alameda County does not provide general fund support to AHS;

- The long-standing debtor-creditor financial structure for county support does not work: AHS desires to renegotiate the terms of the Permanent Agreement; and

- The political agenda of some county supervisors has interfered with AHS's ability to efficiently manage its operations.

The county's themes include:

- A strong distrust of the accuracy, transparency and timeliness of AHS's financial information resulting in the retention of multiple outside consultants "to figure out what is going on";

- A belief that AHS administration is not always up to par, is resistant to change and engages in sloppy business practices;

- An unwillingness by certain county supervisors to consider AHS's proposals to reduce operational costs if that reduction is opposed by those supervisors' constituencies; and

- A conviction that AHS's share of Measure A funds is equivalent to general fund support of AHS and should be used to address specific AHS cash deficits and supplemental revenue needs.

One theme on which AHS and the county seem to agree, perhaps for different reasons, emerged through witness testimony: the governance structure of AHS is problematic and needs to be revisited and strengthened in order for the parties to better understand and respect each other's governance and operational roles.

Evidence considered raised the question for the grand jury: Can AHS ever fully repay its debt to the county? Even with transparent and efficient management, an average annual EBIDA Margin of 3% to 5% does not appear sufficient to pay off AHS's outstanding debt and buffer against any future financial crises.

What's Happened Since the FY2020 Budget Was Approved in September 2019?

The HCSA consultant report on AHS's financial situation was released in October 2019 and focused on John George Psychiatric Hospital. The report stated that AHS's initial and revised estimates of FY2019 operating losses at John George Psychiatric Hospital ($42.1 million and $31.2 million, respectively) significantly overstated the likely shortfall at the hospital. The consultant estimated the loss to be approximately $12 million. AHS disagreed with the consultant's estimate and the assumptions on which it was founded.

The Auditor-Controller consultant report on AHS's overall financial condition, originally due in January 2020, was not

yet available to the grand jury in April 2020. The county claims that AHS has not provided all data requested by the consultant. AHS agrees, saying they have provided substantial and pertinent information; that is, the data the consultant needs, not necessarily all it wants. The grand jury understands that no effort has been made by the county or its consultant to resolve this issue.

Prompted by the BOS, the AHS trustees hired their own outside consultant to assess AHS's financial situation (Phase I) and evaluate and make recommendations regarding governance structure (Phase II). A draft Phase I final report was under review but not available to the grand jury at the time of this report.

In December 2019, the county HCSA with approval of the BOS proactively provided AHS $23 million for adjusted AHS contractual rates for FY2014 through FY2018 and is negotiating a similar rate-adjustment payment of $18 million to AHS for FY2019 and FY2020.

AHS and the county agree: the governance structure of AHS is problematic and needs to be revisited and strengthened in order for the parties to better understand and respect each other's governance and operational roles.

In March 2020, organized labor contacted the BOS complaining about AHS's negotiating practices and requesting that the BOS reexamine the governance and management of AHS. The grand jury was told that the BOS Health Committee intends to take up the request once the Coronavirus pandemic subsides.

In April 2020, the county and AHS each created a task force to assess Coronavirus-related concerns raised by labor unions and AHS health workers. Miscommunication and antagonism prevented cooperation between the task forces.

Finally, the grand jury learned that AHS is again facing an all-too-familiar financial situation as it initiates FY2021 budget planning: needing to close a significant projected budget gap and expecting over $100 million in liabilities to come due without the cash to pay them. Déjà vu all over again.

The good news is that both AHS and the county say they are still negotiating a path forward for a sustainable future for AHS. On the other hand, the grand jury heard testimony that all such negotiations are informal, taking place between random members of the BOS and AHS trustees as well as members of the county and AHS staffs, and that no formal meetings between the parties have been scheduled.

CONCLUSION

AHS and Alameda County have a complicated relationship that reflects the inherent complexities of operating a public health care system. In its investigation, the grand jury did not delve into and report on every detail of this relationship. Rather, we focused on broader patterns of interaction that reflect long-standing sources of tension in the relationship.

AHS faced a financial crisis heading into FY2020, with a projected lack of operational profitability and no cash to pay for substantial liabilities from previous years. The AHS trustees and administration addressed the budget shortfall head-on and seemed to be back on track. Diligent financial oversight by the AHS trustees and budget management by the AHS administration needs to continue. Better transparency and efficiency of operations must also occur. Nevertheless, AHS and the county have not yet determined how to resolve the current cash and debt crisis. Long-standing issues of distrust and posturing around those issues continue to slow the effort to do so.

Evidence considered raised the question for the grand jury: Can AHS ever fully repay its debt to the county? Even with transparent and efficient management, an average annual EBIDA Margin of 3% to 5% does not appear sufficient to pay off AHS's outstanding debt and buffer against any future financial crises. Alameda County and AHS must collaboratively resolve how to pay for AHS's long-term debts with the county.

The county must meet its statutory obligation to provide medical care to indigent county residents. AHS must operate the hospital system to provide that medical care as efficiently and transparently as possible. If resources prove insufficient, AHS and the county need to identify and agree on the scope of services to be provided. If that scope is determined to be less than currently offered, AHS and the county need to agree on the least damaging way to provide health services—by cutting back on services, increasing the county's financial support, or some combination of the two. Both parties then will need to present a uniform public face in support of that decision.

As one witness aptly stated, "It's not about the money. It's about the political will and competency to make the tough decisions." An improved relationship between the county and AHS is necessary to focus on defining a reasonable scope of the care to be offered by AHS, along with AHS reducing expenses and achieving revenue targets. Put another way, resolution will require the parties to make difficult decisions which appear to have been avoided or delayed to please special interests. These decisions cannot continue to be "kicked down the road." The future of a critical county safety net is at stake.

ADDENDUM

This time of COVID-19 pandemic is creating unprecedented demands on the finances, services and operations of both Alameda County and AHS. Nevertheless, the pandemic should not be an excuse to "kick the can down the road." Alameda County and AHS should make a concerted effort to address the long-standing matters presented in this report. The pandemic takes highest priority, but the review and implementation of these findings and recommendations also must be of high priority. Otherwise, history most assuredly will repeat itself.

FINDINGS

Finding 20-7:
The friction between AHS's responsibility for operational control and Alameda County's health service mandate and allegiance to other constituencies continues to frustrate both parties, exacerbate their mutual distrust, and interfere with their ability to communicate and implement long-lasting solutions to AHS's financial crises.

Finding 20-8:
AHS's narrow focus on a balanced operating budget and EBIDA does not adequately represent the actual financial position of AHS.

Finding 20-9:
Even with transparent and efficient management, an average annual EBIDA Margin of 3% to 5% is not sufficient for AHS to pay off its outstanding debt and buffer against any future financial crises.

Finding 20-10:
AHS and Alameda County do not agree on whether AHS can establish a cash reserve to pay prior-year liabilities. The lack of a cash reserve exacerbates the long-term financial stability of AHS and its ability to comply with the Permanent Agreement, leading to further distrust between AHS and Alameda County.

Finding 20-11:
AHS does not provide its financial reports to county supervisors and staff sufficiently in advance of regularly scheduled meetings between the parties to allow county supervisors and staff time to familiarize themselves with those reports prior to being presented by AHS.

Finding 20-12:
AHS and Alameda County acknowledge the need for flexibility in the use of Measure A funds to take advantage of matching-fund opportunities. However, they often disagree on how AHS should specifically allocate Measure A funds to support its operations. This disagreement magnifies and exacerbates the distrust between AHS and Alameda County.

Finding 20-13:
Political pressure from some Alameda County supervisors has interfered with AHS operations and efforts to control costs.

Finding 20-14:
Negotiating separate contracts with 18 different labor unions is both time consuming and expensive for AHS and limits AHS's negotiating flexibility. AHS's negotiations with labor have been further compromised by public support of negotiating labor unions from some county supervisors.

Finding 20-15:
AHS and Alameda County agree that the governance structure of AHS is problematic and needs to be revisited and strengthened in order for the parties to better understand and respect each other's governance and operational roles.

RECOMMENDATIONS

Recommendation 20-6:
If resources prove insufficient to adopt and maintain a balanced AHS budget, AHS and the county must identify and agree on the scope of services and on the least politically damaging way to provide them—by cutting back on services, increasing the county's financial support, or some combination of the two. Both parties then must present a uniform public face in support of that decision.

Recommendation 20-7:
Beginning with its FY2021 budget and continuing with its presentation of financial results, AHS must include all revenue and expense accounts in accordance with pronouncements of the Governmental Accounting Standards Board (GASB). The budget and presentation of financial results must not exclude accounts, believed by AHS, to be outside its control.

Recommendation 20-8:
AHS must, by September 30, 2020 and in consultation with Alameda County supervisors and staff, develop and regularly report a cash flow statement of sufficient scope and detail to provide an early warning system as to the approach of another cash crisis.

Recommendation 20-9:
Alameda County and AHS must collaboratively resolve how to pay for AHS's long-term debts with the county.

Recommendation 20-10:
AHS and Alameda County must develop a procedure whereby AHS has the ability to set aside cash to pay prior-year liabilities.

Recommendation 20-11:
AHS must provide financial reports to county supervisors and staff at least one calendar week prior to any regularly scheduled meeting at which those reports are to be presented.

Recommendation 20-12:
AHS and Alameda County must agree on how AHS allocates its share of Measure A funds as part of its budget.

Recommendation 20-13:
Individual members of the Board of Supervisors must not interfere in the day-to-day operations and management of AHS including labor negotiations and structure of service delivery.

REQUEST FOR RESPONSES

Pursuant to California Penal Code sections 933 and 933.05, the grand jury requests each entity or individual named below to respond to the enumerated Findings and Recommendations within specific statutory guidelines, no later than 90 days from the public release date of this report.

Responses to Findings shall be either:
- Agree
- Disagree Wholly, with an explanation
- Disagree Partially, with an explanation

Responses to Recommendations shall be one the following:
- Has been implemented, with a brief summary of the implementation actions
- Will be implemented, with an implementation schedule
- Requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a completion date that is not more than 6 months after the issuance of this report
- Will not be implemented because it is not warranted or is not reasonable, with an explanation

RESPONSES REQUIRED

Alameda Health System Board of Trustees	Findings 20-7 through 20-15 Recommendations 20-6 through 20-12
Alameda County Board of Supervisors	Findings 20-7 through 20-15 Recommendations 20-6, 8, 9, 10, 12 and 13