Limited Scope Management Audit

October 6, 2014

GFHN

Prepared by the County of Santa Clara
Board of Supervisors'
Management Audit Division

Gardner
Family Health
Network

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October 6, 2014

Jeffrey V. Smith, County Executive
County of Santa Clara
East Wing, 11th Floor
70 West Hedding Street
San Jose, CA 95110

Dear Mr. Smith:

At the request of your office, we have completed a Limited Scope Management Audit of the Gardner Family Health Network (Gardner). We would like to express our appreciation to the management of the Gardner companies for their assistance with this audit.

The Gardner network consists to two affiliated companies, one of which provides primary care services and the other of which provides mental health services.

The purpose of the audit was to examine the business operations and financial status of the Gardner companies in light of the companies' request for $4.3 million in subsidies, advances and a line of credit from the County. These requests are 1) a $220,000 ongoing subsidy for the Downtown Clinic for primary care, 2) a $2.1 million one-time advance on expected mental health settlement payments for mental health care, and 3) a $2 million line of credit for primary care clinics.

We have not expressed an opinion as to whether the County should provide the funding requested by Gardner. Rather, we have provided observations and recommendations intended to 1) protect the County's financial interests in the event that the County elects to provide some or all of the requested funds, and 2) to improve the financial stability of the companies. As such, we have made recommendations about conditions that we believe the County

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should place on any allocations of funds it may elect to provide.

Key points raised by this audit include:

- Both Gardner companies face financial threats. These threats include that although their cash positions have improved since January, and both companies expect modest surpluses by the end of FY 2014-15, they both have historical and ongoing cash-flow problems. These problems are exacerbated by Gardner's renovation expenses and operating costs for a clinic in the County of San Mateo, as further described below.

- Gardner's full Board of Directors has provided limited oversight of financial and policy matters to both companies. If the County provides additional funding, we recommend that such provision be tied to a variety of improvements to the Gardner Board itself and to its policies and practices.

- Both companies are self-funded for employee health insurance. Self-funding provides both benefits and draw-backs for cash flow. We recommend that Gardner staff obtain comparative information for commercial health insurance and compare the costs and risks to its present self-funded plan, and provide this analysis to the Gardner Board of Directors.

- In March, 2014, Gardner began operating a clinic in the City of Atherton in San Mateo County. The company's adopted FY 2014-15 budget shows operating losses for this clinic. These losses are budgeted to be partially backfilled by net operating surpluses from clinics in the County of Santa Clara, and those clinics receive General Fund support from the County of Santa Clara. In our opinion, at least some of these monies are improperly budgeted for use in the Atherton clinic, and, in the absence of additional funding beyond what is currently budgeted, will be used to subsidize the Atherton operations. Gardner officials have characterized the adopted clinic budget as the "worst case scenario," and have stated that Gardner expects to break even at the Atherton clinic. We have also raised concerns about the potential for this clinic to affect Gardner's funding such that there may not be sufficient funds in future years for Gardner to operate its County of Santa Clara clinics. For example, $1 million of the current Atherton subsidy from a third-party is not contractually obligated to continue beyond the current fiscal year. We recommend that County of Santa Clara funds be managed and accounted for separately from Atherton clinic funds.

Again, we greatly appreciate the assistance that Gardner management provided to us during this audit. If you have any questions, please feel free to contact me.

Respectfully submitted,

Roger Mialocq

Roger Mialocq
Board of Supervisors Management Audit Manager

cc:
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Executive Summary

This *Limited Scope Management Audit of the Gardner Family Health Network* was requested by the Office of the County Executive of the County of Santa Clara in the summer of 2014, following a request from officials with Gardner Family Health Network for increased financial assistance from the County.

The objective of the audit was to assess the extent of risk to the County as a result of its potential expansion of financial involvement with the Gardner companies, and assess the viability of the Gardner enterprise assuming continuation of current practices. The scope of the audit was limited to review of the GFCC and GFHN financial and business policies, procedures and practices.

Gardner Family Health Network (Gardner Network) is comprised of two affiliated non-profit public benefit corporations: Gardner Family Health Network, Inc. (GFHN) and Gardner Family Care Corporation (GFCC). GFHN is the parent corporation dedicated to providing primary care including medical and dental services to underserved populations. GFCC is dedicated to social and behavioral services including substance abuse programs, Women, Infant and Children (WIC) support services, and outpatient mental health services to underserved communities. The two companies share the same Board of Directors, and the same executive management, but are otherwise separate companies with distinct revenues, requirements, and functions.

GFHN

Financial Status

GFHN closed out FY 2013-14, according to its unaudited financial statements, with net income of just over $68,000, and had less than $400,000 in cash assets. Throughout the year, there were five months in which there were net operating losses. It ended the year with $1.2 million in accounts payable, although this had improved considerably by August, and most of its accounts receivable were more than 30 days overdue. Its cash flow problems are exacerbated by the loss of a $1 million line of credit from its bank in June 2013. Its financial condition was better by the end of August, but it remains extremely vulnerable, in large part due to debts and operating losses associated with its clinic in the City of Atherton. Its FY 2014-15 adopted budget anticipates a year-end surplus of $1.4 million.

Operations

GFHN operates seven clinics, six of which are in the County of Santa Clara and one of which is in Atherton, in the County of San Mateo. With the exception of two of the County of Santa Clara clinics – one in Gilroy and the other on Alum Rock Avenue in San Jose – all of the GFHN primary care clinics are expected to have operating losses in FY 2014-15. This includes anticipated losses of nearly $800,000 at the Atherton clinic. This loss is backfilled by $2.3 million of County General Fund monies paid to GFHN to partially cover the costs of operating the County of Santa Clara clinics. We expect the Atherton clinic losses to increase in future years, as the clinic's primary funder – Lucile Packard – is scheduled to withdraw existing annual support in the amount of $1 million. Gardner management has explained that they are actively working to mitigate this loss by working with Packard to potentially extend

grant funding along with identifying alternative funding sources, possibly from the Health Plan of San Mateo.

Oversight and Governance

GFHN is a federal health center, with oversight and partial funding provided by the U.S. Health Resources and Services Administration (HRSA). At the commencement of this audit, HRSA had mandated GFHN develop and implement a Financial Recovery Plan, which is imposed on grantee organizations whose stability and viability are threatened.

Although the company had oversight over the last year by a subset of its Board of Directors, the full Board has often failed to participate in monthly meetings required by federal law and the bylaws of the company. According to Gardner administration, in compliance to HRSA's recommendation to improve Board oversight, the Board has recently taken action to enforce its bylaws and improve Board member activity, including the removal of one Board member.

The Board also has failed to adopt appropriate policies governing important aspects of operations, such as billing and collections. In our opinion, the lack of appropriate policies has historically affected the organization's financial condition; however, with the appointment of a new Chief Financial Officer at the onset of calendar year 2014, there have been improvements to the organization's financial and business practices. However, in the absence of adopted policies, these improved business practices are not enforceable by the Board and there is no guarantee they will continue.

Employee Health Insurance

The company is self-insured for employee health care and it has had insufficient funds from which to pay claims, resulting in isolated instances where some employees have had their medical accounts turned over to collections. Due to the unpredictability of claims, the lack of an insurance plan increases the potential for cash shortages. The Chief Operating Officer reports that they periodically evaluate health care premiums to determine whether a transition to a third party health care insurer may prove to be more economical. We requested but did not receive documentation of insurance quotes or comparative analyses.

Financial Requests

Due to the company's financial and cash flow problems, it has requested $2.2 million in assistance from the County. Approximately $2 million has been requested in the form of a "working capital advance" or a fixed term loan. The company has proposed using its St. James clinic in San Jose as collateral for these funds. We note that this clinic is a major source of revenue and a key patient care site for GFHN, and could not readily be converted to cash to repay the County without considering whether the revenue from the facility could be replaced, and where its patients would go for care.

In addition, the company has requested $220,000 in ongoing funds to cover its operating losses – which are anticipated to be $220,000 in FY 2014-15 – for the Downtown San Jose clinic. These requests are in addition to the provision of $2.3 million of County funds for the purpose of providing primary care at the clinics in the County of Santa Clara and in addition to reduction of rent for the Downtown clinic to $12 per year.

Recommendations

We recommend that if the County provides additional funding for GFHN, that it do so only on the condition that the GFHN Board of Directors improves the make-up of its Board, – requests and receives -a comparison of the relative costs of commercial health insurance plans compared to its self-insurance plan for the current year through at least 2018, adopts and implements improved financial policies, and ensures that County funds are maintained separately from funds used to support its clinic in Atherton. We note that this last condition would require GFHN to develop a new FY 2014-15 budget and new sources of funding for the Atherton clinic, which currently is partially funded by "surpluses" from operation of clinics in the County of Santa Clara These surpluses are partially funded with County of Santa Clara General Fund dollars.

GFCC

Financial Status

GFCC closed out FY 2013-14, according to its unaudited financial statements, with net income of $118,356. It also had unreserved operating cash of $1,337,089, in addition to cash reserves of close to $700,000 for health claims and a Board reserve. Further, it retains a $500,000 line of credit with its bank. However, its adopted FY 2014-15 budget anticipates a year-end surplus of just $10,450, and the mental health program frequently experienced cash flow problems in FY 2013-14, according to its unaudited financial statements.

Operations

GFCC operates two stand-alone clinics in the County of Santa Clara in addition to the services it provides at GFHN clinics. The County provides one of these clinics to GFCC without charge. Its services are funded primarily through County contracts for State-funded mental health services.

Oversight and Governance

GFCC is not a federal health center, and is not overseen by HRSA. Its oversight consists of that provided by the County relative to its contracts, and that provided by its Board of Directors, which is the same as the Board for GFHN.

Employee Health Insurance

GFCC is self-insured for employee health care and it has had insufficient funds from which to pay claims. Due to the unpredictability of claims, the lack of an insurance plan increases the potential for cash shortages.

Financial Requests

Mental health funds are paid to GFCC for contract services by the County with State funds at an interim rate. A settlement is made later, once the level of service, actual cost of service units, payor mix and processing of third-party payor billings have occurred. GFCC has requested an "advance" on expected future settlements for claims whose processing is backlogged at both the County and State levels. It expects the value of these settlements to be $2.6 million. However, in some years, under the final settlement, the County owes GFCC and in some years GFCC owes the County. Since the request was made, a portion of

estimated $2.6 million of claims were settled and payment authorized by the Board of Supervisors. That payment was about 33 percent of the estimated amount due.

Recommendation

We recommend that if the County provides an advance on anticipated mental health claim settlements, that it do so at a rate of not more than 33 percent of the remaining amount claimed, and that it consider waiting until additional claims can be settled by a new analyst who is being hired to carry out this task.

INTRODUCTION

This *Limited Scope Management Audit of the Gardner Family Health Network* was requested by the Office of the County Executive of the County of Santa Clara in the summer of 2014, following a request from officials with Gardner Family Health Network for increased financial assistance from the County.

The Gardner Family Health Network (GFHN) is a long-time County contractor that provides a variety of services to low-income County residents. GFHN provides services through two affiliated 501(c) (3) corporations: the Gardner Family Health Network, Inc. (GFHN), and the Gardner Family Care Corporation (GFCC).

Objectives and Scope

The objective of the audit was to assess the extent of risk to the County as a result of its potential expansion of financial involvement with the Gardner companies, and assess the viability of the Gardner enterprise assuming continuation of current practices. The scope of the audit was limited to review of the GFCC and GFHN financial and business policies, procedures and practices.

Methodology

We conducted this audit in accordance with generally accepted government auditing standards set forth in the 2011 revision of the "Yellow Book" of the U.S. Government Accountability Office. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. In accordance with these requirements, we performed the following management audit procedures:

Audit Planning—The task plan for this management audit was developed after reviewing the most recent financial audit for GFHN, as well as materials related to the financial of the request, including the federally approved financial recovery plan.

Entrance Conference—An entrance conference was held on July 29, 2014 with Gardner executives to introduce the management audit team, describe the management audit program and scope of review, and respond to questions. An initial request for documents information was also provided at the entrance conference.

Pre-Audit Survey—A preliminary review of documentation and interviews with the Chief Financial Officer and the Controller of each corporation and the Chair of the Board of Directors' Finance Committee were conducted.

Field Work—Field work activities included additional interviews with Gardner Network fiscal staff, interviews with staff at the federal Health Resources and Services Administration (HRSA), and County Mental Health fiscal staff. We reviewed both corporations' organizational charts

and payroll data. We reviewed agendas and minutes of all GFHN Board meetings for the year preceding the audit, and proposed budgets for both corporations. We reviewed all available financial policies and procedures, account balances and bank statements for all accounts, worker's compensation costs for the last three years, reports to HRSA, Short-Doyle cost report information provided by the County, audited financial statements for both corporations for the prior three fiscal years, Form 990 (federal income tax) statements from 2009 to 2011, state registration records, resumes of executive leaders, agreements, leases, and deeds as available, and current and aged accounts payable and receivable. We reviewed daily cash reports, worker's compensation claims for the last three years, and reports showing claims and liabilities for employee health insurance benefits.

Draft Report—On September 25, 2014, a draft report was prepared and provided to Gardner officials to describe the study progress and provide general information on our preliminary findings and conclusions.

Exit Conference—An exit conference was held on September 30 with Gardner officials to collect additional information pertinent to our report, to obtain their views on the report findings, conclusions and recommendations, and to make corrections and clarifications as appropriate. Following the exit conference, a revised draft was provided to officials on October 2, 2014 for their use in preparing a formal written response.

Final Report—A final report was prepared following the exit conferences. A response was obtained from Gardner officials and is attached.

OVERVIEW

Nature and Mission of the Organization

Gardner Family Health Network (Gardner Network) is comprised of two affiliated non-profit public benefit corporations: Gardner Family Health Network, Inc. (GFHN) and Gardner Family Care Corporation (GFCC). Collectively, they have about 478 full-time-equivalent (FTE) staff, with 283 staff at GFHN and an estimated 195 at GFCC. In 2013, according to data from its federal funder, GFHN served 41,110 patients. In 2011, according to its federal tax return, GFCC served about 18,265 patients.

The mission of the Gardner Network is to improve the physical and mental health status of the communities it serves, especially the disenfranchised, disadvantaged and most vulnerable members. Gardner Network seeks to provide high quality, comprehensive health care, including prevention and education, early intervention, and treatment and advocacy services which are affordable, respectful, and culturally, linguistically and age appropriate.

Two Separate Corporations

GFHN is the parent corporation dedicated to providing primary care including medical and dental services to underserved populations.

GFCC is dedicated to social and behavioral services including substance abuse programs, Women, Infant and Children (WIC) support services, and outpatient mental health services to underserved communities.

These two entities were formed in 1997 in response to the financial difficulties of the previous incarnation of GFHN, the Family Health Center (later, the Family Health Foundation), which suffered material financial losses. Rather than close the Foundation or merge the two entities, it was determined that the two agencies could recover a greater reimbursement rate and amount from the federal government if the two organizations were to affiliate. Further, as affiliates, under the same Board of Directors, the two companies would be able to share resources, including by reducing executive management such that the two companies share one Chief Executive Officer, one Chief Operating Officer, one Chief Financial Officer, one Chief Information Officer and one Human Resources Director. All other staff are unique to each corporation.

We were unable to determine the reasons for the financial decline experienced by the Family Health Foundation in 1996. Therefore, we have been unable to determine whether the factors negatively impacting the Family Health Foundation's finances during the 1990's are still applicable today.

Executive Management

A brief synopsis of Executive roles for the two corporations is provided below. A review and analysis of GFHN's and GFCC's governance and oversight is provided in Sections C of Parts I and II of this report.

Board of Directors

The two companies share one Board of Directors. While the same Board oversees both organizations, the Board reportedly holds separate meetings for each corporation.

Chief Executive Officer, Chief Operating Officer, and Human Resources Director

The two companies share a single Chief Executive Officer and Chief Operating Officer. Both Officers, according to their employment agreements, spend approximately 60 percent of their time overseeing GFHN and 40 percent over GFCC. The Human Resources Director also currently splits her time 60 percent over GFHN and 40 percent over GFCC.

Chief Financial Officer

The Chief Financial Officer dedicates approximately 90 percent his time overseeing GFHN and spends only 10 percent with GFCC.

Chief Information Officer

The Chief Information Officer currently splits his time 50/50 between GFHN and GFCC.

Because each corporation is distinct, with different functions, requirements, revenue sources, financial conditions and financial requests of the County, we have divided this report into two parts, one for each corporation. Part I addresses GFHN and Part II addresses GFCC.

PART I: GARDNER FAMILY HEALTH NETWORK INC. (GFHN)

I. A. Summary of Operations and Finances - GFHN

As shown in Table 1 below, GFHN ended FY 2013-14 with a very small net income and minimal cash.

Table 1

Gardner Family Health Network
Extract of Unaudited Financial Statements as of June 30, 2014

FY 2013-14 Actuals	Total
Revenue	$33,692,595
Expenditures	$33,624,182
Net Income	**$68,413**
Cash Assets	$396,091

The adopted GFHN budget for FY 2014-15[1] provides $35 million worth of services at seven Bay Area clinics. Most of the anticipated GFHN revenue comes from Medi-Cal and other payments for services, with about $11 million coming from contracts and grants. Its largest expense is payroll and benefits, representing $25 million, or 72 percent of costs. Staffing and operations are further described below.

GFHN Clinics in the County of Santa Clara

Six of GFHN's clinics are in the County of Santa Clara. Based on its adopted FY 2014-15 budget, these clinics operate as described below. Clinics with budgeted operating losses are shown in red, while clinics with operating surpluses are shown in black.

Alviso

The Alviso Health Center is on Gold Street in Alviso. Its five staff will provide about 3,000 patient visits this fiscal year for family and pediatric primary health services Monday through Friday from 8:00 a.m. to 5:30 p.m., at a projected operating loss of $116,000. Its annual revenues are about $475,000.

[1] The budget was furnished to us as a proposed budget on September 12, and management reports that it was adopted without changes by the Board of Directors on September 30.

Gardner Downtown Health Center

The Gardner Downtown Health Center is on East Santa Clara Street in San Jose. This property is owned by the County and leased to GFHN for $12 per year[2] through August 31, 2016. (A new downtown clinic is under construction.) Its five staff will provide 4,200 patient visits this fiscal year for family and pediatric medical services, at an operating loss $221,000 by June 30, 2015. As part of the request for assistance that triggered this audit, GFHN has requested that the County provide $220,000 in ongoing funding to enable the clinic to "break even." The County had approved a contract for up to $550,000 for this clinic's start-up operations beginning in April 2012. In addition, the Board of Supervisors approved an additional $220,000 on a one-time basis in June 2014 to cover the clinic's FY 2013-14 losses.[3] The clinic's annual revenues are about $591,000.

Gardner Health Center

The Gardner Health Center is on East Virginia Street in San Jose. Its 34 staff will provide services for 26,700 patient visits this fiscal year for family and pediatric medicine, women's health services, and nutrition and education services. The adopted FY 2014-15 budget for this clinic anticipates an operating loss of $97,000 by June 30, 2015. Its annual revenues in the adopted budget are $4.8 million. This clinic facility is owned by the other Gardner corporation, *GFCC*, but mortgaged.

St. James Health Center

The Saint James Health Center is on East Julian Street in San Jose. Its 49 staff will provide 32,500 patient visits this fiscal year, including family and pediatric medicine, women's health services, nutritional services and education, integrated behavioral health services, and dental, optometry and pharmacy services Monday through Friday from 8:30 a.m. to 5:30 p.m. Operating losses are expected to amount to $36,600 at this clinic in FY 2014-15. GFHN reportedly owns this facility. Clinic revenues are budgeted at $7.5 million, making up more than 20 percent of GFHN's total revenues, and almost 26 percent of the revenue stream for all clinics in the County of Santa Clara. GFHN has proposed to use this facility as collateral for the requested financial assistance from the County. As noted later in this report, the fact that this site is GFHN's second-largest revenue generating facility and that it provides so many patient visits, calls into question the practicality of the ability to sell the property to recover funding in the event that GFHN became unable pay its County debts.

Combined, the Downtown, Alviso, Gardner and St. James clinics are collectively projected to incur operating losses of about $470,000 in FY 2014-15.

[2] Until July 1, 2013, GFHN paid the General Fund rent of $268,800 per year for use of the facility. However, the County reduced the rate in response to GFHN's financial problems.
[3] See Part II of this audit for more on this payment.

CompreCare Health Center

The CompreCare Health Center is on Alum Rock Avenue in San Jose. Its 52 staff will provide 44,000 patient visits this fiscal year for family and pediatric services, women's health services, nutritional services and education, dental, optometry and pharmacy services Monday through Saturday from 8:00 a.m. to 5:30 p.m. This clinic anticipates an operating surplus of $1.1 million by June 30, 2015. Its annual revenues are about $8.6 million.

Gardner South County Health Center

Gardner South County Health Center is on Monterey Street in Gilroy and is owned by GFHN. This clinic's 36 staff will provide 33,000 patient visits this fiscal year for family and pediatric medical services, women's health services, nutritional services and education, integrated behavioral health, dental, optometry and pharmacy, Monday through Saturday from 8:00 a.m. to 5:00 p.m. The expected surplus at this center in FY 2014-15 is $1.6 million.

Net County Clinic Surplus

In summary, the Downtown, Alviso, Gardner and St. James clinics are collectively spending $470,000 more than they take in this year, but this loss is offset by $2.7 million in expected surplus generated by the Gilroy and CompreCare clinics. Combined, the County of Santa Clara clinics are expected to net $2.3 million of surplus by June 30, 2015. However, the FY 2014-15 budget allocates $762,000 of this surplus to a clinic in the County of San Mateo, as described below.

Gardner-Packard Children's Health Center

Funding for County of Santa Clara clinics includes patient revenues and federal funds, and also a $1.5 million General Fund primary care contract from the County of Santa Clara for the provision of 77,211 patient visits at specific clinics in the County of Santa Clara.

Section 4.6 of the contract states: "Contractor will not use County funds for general costs that do not support or otherwise directly relate to the scope of contracted services."

In addition, the clinic revenues include a budgeted $804,000 of County "Measure A" General Funds. The "Measure A" funds are pursuant to a 2012 voter-approved 1/8th cent sales tax.[4] The GFHN budgeted Measure A funds are provided via a FY 2014-15 County contract with the "Community Health Partnership" (CHP), a consortium of community clinics that includes GFHN. According to the contract, CHP will provide $767,927 of 2012 Measure A funds to GFHN this fiscal year.[5] Most of this contract money is specified for provision of "91,711

[4] The ballot language stated that the 2012 sales-tax Measure A funds "will be used for County purposes including local priorities such as …. health coverage for low-income children…." Note that this funding is distinct from a 2008 Measure A bond issue which provided, among other things, $50 million for a new downtown clinic, which GFHN will operate, as it won the bid in 2010.

[5] The reason for the $36,073 difference between the budgeted amount and the contract amount is undetermined.

primary care visits" by GFHN. The contract with Community Health Partnership does not specify where those visits must be provided.

We note that the Co-Chair of the CHP's 10-member Board of Directors, which is responsible for determining CHP "program priorities," is GFHN's Chief Executive Officer.

To recap, County of Santa Clara General Fund monies are provided directly to GFHN to cover some of the costs to operate GFHN clinics in the County of Santa Clara. In addition, County of Santa Clara General Fund dollars are provided to a third party, which in turn provides a portion of those dollars to GFHN[6]. The third-party funding priorities are established in part by the GFHN leadership in the role of third-party Board Co-Chair. The total amount of General Fund dollars contracted for payment to GFHN in FY 2014-15 is $2.3 million, and of this, $762,000 is budgeted by GFHN to cover the operating losses in Atherton. As described later in this section, about 28 percent of the patients at the out-of-county clinic reside in the County of Santa Clara.

County Funding

The GFHN budget allocates all of the County of Santa Clara General Fund dollars, from both contracts, to the County of Santa Clara clinics. However, because there is an expected "surplus" from the operation of the County of Santa Clara clinics, some of the funds provided by the County General Fund are planned in the GFHN FY 2014-15 budget to cover losses at a clinic in San Mateo County. That clinic is not included in the list of clinics that the County of Santa Clara is providing $1.5 million to support. In our opinion, use and budgeting of the funds in this manner is inconsistent with the terms of the contract between the County of Santa Clara and GFHN. This opinion is disputed by GFHN.

While we believe that the general intent of voters who approved the 2012 Measure A sales tax was that those monies be used within the County of Santa Clara, the actual language of the ballot measure was broad and vague. Determination of the legality of the out-of-county use of those funds is beyond the scope of this audit.

The clinic in San Mateo County is the Gardner-Packard Children's Health Center on El Camino Real in Atherton. GFHN began providing services there in March 2014. That clinic's 18.5 staff will provide pediatric services and nutritional and education services for 13,500 patient visits this fiscal year, operating Monday through Friday from 8:00 a.m. to 5:00 p.m. Its anticipated operating losses in FY 2014-15 are $762,000. Even though the adopted budget *does not* allocate County funds specifically to this site, as shown in Attachment 1, net income from the County clinics will offset the losses at the Atherton clinic this fiscal year, unless additional resources are identified by Gardner officials. GFHN's adopted FY 2014-15 clinic operations budget is summarized in Attachment 1. It projects a $2.3 million surplus in the County of Santa Clara and a loss of more than $762,000 at the GFHN San Mateo clinic, for net clinic income of $1.5 million.

[6] The FY 2014-15 contract by the Santa Clara Valley Medical Center awards $3.35 million to CHP. CHP's allocation of $767,927 dollars to GFHN represents almost 23 percent of the total County funds awarded to CHP, which serves both San Mateo and Santa Clara counties.

As a condition of additional County financial assistance to GFHN, the County should prohibit use of surplus funds to directly or indirectly subsidize the clinic in San Mateo County. For example, the surplus derived from clinics subsidized by the County General Fund should be held in in reserve for future operation of those clinics, rather than fund operations at the Atherton site. *Note that if this condition were instituted, it would mean that the adopted FY 2014-15 GFHN budget would not be compatible with receipt of additional funds.* GFHN's Chief Operating Officer explained in an email that the FY 2014-15 budget as adopted on September 30, 2014, is conservative in that it does not reflect ongoing efforts with Packard.

"Because we had not finalized the reconciliation of Gardner Packard with LPCH at the time of the development of the GFHN budget (which includes addressing the past and ensuring we break even during this new fiscal year) we opted to be conservative and show 'worst case' scenario," he said.

The history of this clinic is as follows. Lucile Packard Children's Hospital at Stanford (Packard) operated a Primary Care Clinic in Palo Alto, at which it trained physicians in residence. On November 20, 2012, the clinic partnered with GFHN to become the Gardner & Packard Children's Health Center (Center). Under the December 2011 Clinic Operations Transfer Agreement, GFHN provides its own staff to the center, and Packard provides resident physicians, at a cost to GFHN of $56 per visit.[7] According to the notes to the most recent audited financial statements, "In effect, the pediatric residency program has been turned over to GFHN." The arrangement required that the clinic be relocated from the Palo Alto site to either a site in the County of San Mateo or a site in the County of Santa Clara. The relocation occurred in early 2014.

A room in the new Gardner & Packard Children's Health Center.

Packard provided substantial financial support to GFHN for the new clinic. For example, GFHN entered into a lease agreement through December 2027[8] effective January 1, 2013 of about 10,000 square feet of prime medically zoned office space, which GFHN extensively remodeled. Packard is the lease guarantor.

GFHN management reports that the remodeling cost about $5 million, and according to the most recent audited financial statements, the building owner provided a $2 million credit for these tenant improvements. According to Exhibit 7.4 of the Clinic Operations Transfer Agreement, the cost of tenant improvements was "not expected to exceed $1.5 million." The FY 2012-13 financial statements show that Packard loaned GFHN $3.2 million without interest for the

[7] As of October 2, 2014, Packard had not demanded payment and had not been paid for these services.
[8] Future extensions are permissible under the lease agreement.

remodeling work, and management reports that Packard has not required payments on that loan thus far. Repayment is due to be made at a rate of 10 percent per year for 10 years, with an undetermined start date, per the financial statements.

Accounts payable records indicate that as of the commencement of this audit, GFHN was at least three months behind on some payments to contractors for the remodeling work. At the exit conference on September 30, GFHN's Chief Financial Officer reported that all payments due to contractors for the remodeling project had been paid. We note, however, that GFHN paid most of the cost of renovations with funds borrowed from Packard.

In addition, Packard has agreed to a $2 million subsidy over two years to support the transition, and also contributes $425,000 annually as a grant to the clinic for five years. FY 2014-15 is the second of the two years, and therefore, $1 million is budgeted from Packard to the Atherton clinic operations. Packard also provided short-term operating advances of $400,000 for the clinic until the new Medi-Cal rate could be established and billed. These short-term advances will be repaid by retroactive billing of Medi-Cal-eligible visits back to March 17, according to the GFHN Chief Financial Officer.

Clinic Operations Began in 2014

GFHN began serving patients at the new Atherton site on March 17, 2014, with a grand opening following on June 3. Based on GFHN's accounts payable records and the most recent audited financial statements, the monthly base rent plus expense payments required under the rental agreement is about $81,000 per month[9]. Based on our review of accounts payable records, this is GFHN's largest, non-payroll current monthly expense. Between July, 1 2014 and December 31, 2027, according to the most recent audited financial statements, the minimum rent payable by GFHN on average is $97,120 per month for the Atherton site.

The rent is expensive because of the nature and location of the property. The building is described by the investment company[10] that owns it as follows: "Atherton is one of the most affluent communities in the country, and Atherton Square is the only office project in the town of Atherton. It truly boasts a 'one of a kind' location!" The site is further described as having a "strong appeal to doctors and dentists due to the location, building quality, small suite sizes, ease of access, and identity in Atherton along El Camino Real. Clinics in the building include Stanford Hospital's Clinics, Plastic Surgery, Endoscopy, Urology, Allergy, Physical Therapy, Vascular Laser Treatment, Cosmetic Laser Treatment, MRI Testing, and Dental Practices."

Location Considerations

At the exit conference, Gardner officials stated that they had explored two or three other sites as possible locations for the clinic, and that there were few medically zoned options near Stanford facilities. Further, they said, the site improved patient access relative to the former Palo Alto site

[9] GFHN paid rent for about a year while the renovations were under way. The GFHN Chief Operating Officer stated at the exit conference that this expense had not been factored into the plans.
[10] Diamond Investment Properties.

because it is served by a bus line on El Camino Real. In addition, the site is on the Redwood City border, and this was an important consideration since many patients reside in that area.

GFHN was to receive revenues, primarily Medi-Cal payments, which it would use to pay its own staff and to pay $56 per visit to Packard for its physicians. Gardner management reports that Packard has thus far –not demanded the $56-per-visit payment for its resident physicians.

The federal Health Resources and Service Administration (HRSA) must approve changes in service locations of federal health centers, including the Gardner & Packard Center. HRSA raised "concerns about the nature of the relationship and agreements" between GFHN and Packard.

In response, in April 2014, the president of Packard sent a letter to HRSA's administrator. He described Packard's financial support for the project, and the longstanding relationship between Packard and GFHN, and requested retroactive approval of the relocation. Without the approval, GFHN would not qualify to apply for Medi-Cal reimbursement. According to the letter, delay in the approval could cost GFHN as much as $180,000 per month. HRSA approved the move, paving the way for GFHN to seek approval for a Medi-Cal reimbursement rate for each patient visit at the site.

Medi-Cal Reimbursement Rates

The Medi-Cal reimbursement rate per visit at the Palo Alto site had been $227, according to the GFHN Chief Fiscal Officer. The rate GFHN reportedly requested for the Atherton site was about $350, which would yield an estimated net reimbursement to GFHN of $280 per patient visit. (The State typically approves only 80 percent of the projected cost during the first full year of opearions.) However, a new interim rate[11] approved September 12 by the California Department of Healthcare Services is $261.79, less than the $280 rate that GFHN had expected. According to the GFHN Chief Financial Officer, this rate is applicable to about 85 percent of the total visits, with remaining visits receiving a lower rate. The weighted average of these rates is projected to be about $237 per visit, according to the Chief Financial Officer. Due to the lower rate, we believe the project will continue to affect the company's cash flow and operating losses. As shown in Attachment 1 of this report, the overhead cost alone for the Packard site is almost $90 per visit. As previously discussed, GFHN owes Packard $56 per visit for its physicians. Thus, at $237 per visit, after deducting $90 for overhead and $56 for doctors, there is only $91 left to pay GFHN's clinical staff and other operating costs. We note that the FY 2014-15 budget reflects a projected loss of $762,000 for the current year at that site, even though the budget reportedly factored in a rate higher than the $261.79 that was approved, and it includes $1.4 million in assistance from Packard, $1 million of which expires in June.

The State has authorized GFHN to submit Medi-Cal claims for each visit retroactive to March 17. According to the GFHN Chief Financial Officer, monies received from the retroactive – Medi-Cal payments will be used to pay $400,000 of operating advances that were provided by Packard while the clinic was operating for about six months without being able to bill Medi-Cal.

[11] A permanent reimbursement rate will be set following review of actual costs at the end of FY 2014-15.

In June 2014, the GFHN Treasurer informed the other GFHN Directors that GFHN barely made its May payrolls, and had very little cash.[12] Board minutes from that meeting reflect that she told fellow Directors: "The contributor of the cash drain was the impact of the Packard Project," and she told them that GFHN would likely end the fiscal year with $5.5 million in debt as a result of the project.[13]

Additional Funding Sought

At the exit conference, Gardner officials stated that they are actively working to find additional funding for the clinic in Atherton. In addition, they stated that they can end the arrangement at any time if it fails to break even. They provided a May 23, 2012 amendment to the Clinic Operations Transfer Agreement between GFHN and Packard. That amendment added new language to the contract specifically to allow GFHN to terminate the agreement in the event that "…GFHN reasonably determines that it will be unable to break even in its operation of the Clinic." However, it is unclear in the amendment whether that termination provision is applicable generally, or whether it was only applicable through July 1, 2012. Depending on how the amendment is interpreted, the legal ability of GFHN to terminate the agreement due to operating losses may or may not have expired on July 1, 2012. GFHN's Chief Operating Officer said that the agreement permits GFHN to terminate the agreement at any time. However, as a practical matter, GFHN would presumably still owe Packard at least $5.8 million at the point of termination of the agreement, and Packard presumably would demand re-payment of funds provided to GFHN for the construction and operations of the clinic if GFHN ceased to operate the clinic. At the exit conference, Gardner officials emphasized that if they cannot operate it at cost, they will not continue it.

We note that the Gardner & Packard site is not located in the County of Santa Clara, and its federally approved service area, shown on the following page, does not include any Santa Clara areas. (Please see Part I Subpart C for more on the service area requirement.)

[12] As previously shown, cash as of June 30, 2014 was less than $400,000, per the unaudited financial statements.
[13] The FY 2013-14 unaudited financial statements show liabilities to Packard totaling $5.8 million. This amount represents the majority of GFHN's total liabilities.

The County of San Mateo
Federally Designated Medically Underserved Area
Served by the Gardner & Packard Site

Source: California Office of Statewide Health Planning and Development, Medical Service Study Area 176b, service area for Gardner & Packard Clinic per U.S. HRSA Shortage Areas by Address.[14]

At the exit conference, Gardner officials stated that the Atherton clinic is serving residents of the County of Santa Clara. They provided a count of "managed care eligible patients by plan" as of August 2014 for that clinic. According to this count, 1,186 patients fall under the Valley Health Plan (VHP) (28 percent of total patients) while 3,112 patients (72 percent of total patients) fall under the San Mateo Health Plan. At our request, GFHN provided a list of addresses for the VHP patients. With the exception of six addresses that are not in the County of Santa Clara, all of the VHP patients are listed as residing within the County of Santa Clara. That is, 1,180 of the patients served at the Atherton clinic reside in the County of Santa Clara.

Under the terms of the FY 2014-15 primary care agreement with the County of Santa Clara, the $1.5 million payment is expressly reserved for clinics within the County of Santa Clara; other clinics outside the County boundary, whether or not they serve County residents, are not covered by the agreement. In our opinion, use of these funds for this purpose is inconsistent with scope of the contract.

As previously mentioned, the County also provides a General Fund subsidy of $767,927 to GFHN that is funded with "Measure A" sales tax monies. This money makes up a portion of the surplus County clinic funds that are budgeted by GFHN to cover losses at the Atherton clinic.

[14] See *http://datawarehouse.hrsa.gov/GeoAdvisor/ShortageDesignationAdvisor.aspx, and http://gis.oshpd.ca.gov/atlas/places/mssa/176b.*

Restrictions on use of the money in the ballot measure for that sales tax were general – "County purposes" and "local" priorities – rather than specific. Determination of whether it is permissible to use Measure A funds to provide care to County of Santa Clara and non-County residents at an out-of-county clinic is beyond the scope of this audit.

Because the Packard operations subsidy ends in FY 2014-15, it appears plausible that the Atherton clinic could have an operating loss of ($1.7 million) or more by the end of FY 2015-16.[15]. We note that GFHN would not be able to make its payroll without Packard's assistance. Unless some or all of it is debts are forgiven, GFHN will have to eventually pay off the long-term loans it owes to Packard, which totaled $3.4 million as of June 30, 2014, according to GFHN's unaudited financial statements. This is in addition to short-term liabilities to Packard of $2.4 million, per the unaudited FY 2013-14 financial statements. At the exit conference, Gardner officials stated that although the $1 million subsidy for the current year does not *contractually* continue into FY 2015-16, they anticipate continuation of this subsidy. As previously described, they are also seeking other sources of funds for the clinic for the current and future years.

Since losses at the Atherton clinic are currently backfilled by net income from the County of Santa Clara clinics, if the Atherton clinic's losses increased to $1.7 million or more per year, it would jeopardize the ability of GFHN to provide services in the County of Santa Clara without additional resources.

Other Services

In addition to the seven clinics described above, GFHN has about 21 staff to provide other services, including homeless services, medical services for Job Corps participants, dental and social services for the First Five children's program, and behavioral services in the County of Santa Clara. These services together are expected to net an operating loss of $73,810. The total company-wide budgeted net income is $1.43 million by the end of June. This includes the County of Santa Clara surplus of $2.3 million, the Atherton clinic loss of $762,000, and the services losses of $73,800.

I.B. Financial Condition - GFHN

GFHN administration recently relieved its long-term third party auditor this past fiscal year and – the firm of Moss Adams LLP to audit their FY 2013-14 financial statements. During the course of this audit, GFHN officials provided unaudited financial statements for GFHN. These unaudited statements contain no contextual narrative and minimal footnotes, and no background regarding changes in financial condition from the prior fiscal year. This financial information has not been audited or tested by the Management Audit Division, such testing being outside the scope of this project.

[15] That is, ($1 million) + ($762,000) = ($1.7 million.)

As of June 30, 2014, the unaudited financial statements for GFHN indicate that the corporation has marginally recovered operating costs. The unaudited income statement reveals that GFHN ended the fiscal year with a net income of $68,413, as shown in Table 2 below.

Table 2

Gardner Family Health Network
Extract of Unaudited Income Statement as of June 30, 2014

Revenues	**Total**
Patient Fees	$22,829,932
Grant - Dept. of Health & Human Services	5,580,343
Grant - County of Santa Clara	2,614,759
Other Grants	1,461,064
Other Revenue	1,206,499
Total Revenue	**$33,692,595**
Expenses	
Salaries	18,263,820
Fringe Benefits	5,777,188
Purchased: Dental & Optometry	325,913
Other	922,313
Salaries & Benefits	$25,289,235
Supplies & Minor Equipment	2,605,355
Lucile Packard Children's Hospital	1,476,277
Lease, Rental, Utilities	1,325,979
Depreciation/Amortization	1,209,583
Other Expenses	1,717,753
Services and Supplies	$8,334,947
Total Expenses	**$33,624,182**
Net Income	**$68,413**

While the GFHN income statement indicates the organization recovered its operating cost through the year, the net income is equivalent to only 0.2 percent of total annual expenditures or less than one day's worth of total operating costs. GFHN's balance statement, summarized in Table 3 on the following page, also illustrates the lack of cash in reserves compared to the outstanding liabilities.

Table 3

Gardner Family Health Network
Extract of Unaudited Balance Statement as of June 30, 2014

Assets	Total
Cash	$396,091
A/R - Patient Fees	3,299,164
A/R - Grants	952,079
A/R - Other	28,153
Other Assets	446,900
Total Current Assets	$5,122,388
Fixed Assets	$9,355,846
Total Assets	**$14,478,234**
Liabilities	
Accounts Payable	$1,207,110
Health Insurance Benefits	481,140
Loans/Notes Payable	833
Accrued Payroll & Fringe Benefits	483,940
Accrued Vacation & Sick Leave	1,040,970
Accrued Packard	2,406,730
Other Accrued Liabilities	-11,325
Total Current Liabilities	$5,609,397
Packard Line of Credit	3,400,000
Deferred revenues	267,028
Long Term Liabilities	708,057
Total Other/Long Term Liabilities	$4,375,085
Total Liabilities	**$9,984,482**
Total Net Assets	**$4,493,752**

According to the unaudited balance statement, as of June 30, 2014, GFHN had approximately $4.5 million in net assets; however, when evaluating just current assets, the company accrued $5.6 million in current liabilities against $5.1 million in current assets. This approximately $500,000 shortfall indicates that the company, as of the end of the fiscal year, would be unable to pay back its short-term obligations if these debts came due.

Inadequate Cash Reserves

As recorded in the unaudited balance statement, at the end of FY 2013-14, GFHN retained $396,091 in cash. This cash amounts to approximately one percent worth of FY 2013-14's total annual operating expenditures, or four days' worth of working capital. Nonprofit industry

standards recommend building and maintaining a reserve fund equivalent of three to six months' worth of operating expenses[16], which echoes the Government Finance Officers Association's recommended practice to retain no less than two months' worth of operating expenditures in reserves for government agencies.[17]

Dating back to FY 2010-11, GFHN's audited financial statements display low year-end balances of unrestricted cash, as depicted in the table below. While there is only four days' worth of funding recorded at the end of this past fiscal year, the organization's cash position is the best it has been in four years, and is much better than its balance of $13,611 in FY 2011-12, as shown in Table 4.

Table 4

Gardner Family Health Network
Year-End Cash Balances, FY 2010-11 through FY 2013-14

Fiscal Year	Unrestricted Cash	Percent Change from Prior Year
2013-14	$396,091	320%
2012-13	$94,356	593%
2011-12	$13,611	-94%
2010-11	$232,577	-

The organization's inability to build up adequate cash reserves is evident in an evaluation of GFHN's monthly income throughout this past fiscal year. GFHN may have concluded the fiscal year marginally recovering operating costs; however, for five months out of the fiscal year, as shown in Table 5 on the following page, GFHN had operating losses. Due to the insufficient inflow of cash every month, the organization did not have the financial flexibility to retain a larger cash reserve. The cash-flow problem is also apparent by the historical lending from one corporation to another, which, according to GFHN administration, has been reconciled and cleared from their accounting ledger with the release of the FY 2013-14 unaudited financial statements.

[16] Nonprofits Assistance Fund. Nonprofit Operating Reserves and Policy Examples. https://nonprofitsassistancefund.org/sites/default/files/publications/operating_reserves_and_policy_example.pdf
[17] Government Finance Officers Association. Replenishing General Fund Balance. http://www.gfoa.org/replenishing-general-fund-balance

Table 5

Gardner Family Health Network
Income Summary by Month for Fiscal Year 2013-14

Month	Revenue	Expenditures	Net Income
July	$2,597,383	$2,730,918	**-$133,535**
August	2,577,202	2,836,182	**-258,980**
September	3,128,345	3,154,640	**-26,295**
October	2,882,992	3,133,006	**-250,014**
November	2,564,591	2,522,606	**41,985**
December	2,524,543	2,811,239	**-286,696**
January	2,851,275	2,806,480	**44,796**
February	2,811,813	2,532,272	**279,540**
March	2,986,288	2,835,413	**150,875**
April	2,981,973	2,696,325	**285,648**
May	2,914,184	2,910,060	**4,124**
June	2,872,005	2,655,040	**216,965**
Total	**$33,692,595**	**$33,624,182**	**$68,413**

Accounts Payable

At end of Fiscal Year 2013-14, the GFHN unaudited balance statement shows $1.2 million in accounts payable; however, a more recent evaluation of Aged Payable reports show that the organization has reduced payables to about $450,000, as shown in the table below.

Table 6

Gardner Family Health Network
Comparison Aged Payables Reports through August 2014

Length of Payments Due	8/1/2014	8/18/2014	Percent Change
Current	$139,552	-$1,116	-101%
1-30 Days	$210,811	$253,869	20%
31-60 Days	$214,237	$163,544	-24%
61-90 Days	$23,257	$5,050	-78%
Over 90 Days	$85,025	$31,313	-63%
Total	**$672,882**	**$452,660**	**-33%**

During the course of this audit, GFHN administration provided Aged Payables reports for the beginning and middle of the month of August. Within that time, the organization dropped its total accounts payable outstanding by 33 percent, including decreasing the total value of outstanding claims 61-90 days past due by 78 percent and 63 percent for claims over 90 days

due. In comparison to the total outstanding $1.2 million in accounts payable accrued by the end of Fiscal Year 2013-14, GFHN has reduced its total accounts payable debt by 63 percent to only $452,660. As of August 18, 2014, 56 percent of the total value of accounts payable were within 30 days past due, and 92 percent were within 60 days past due.

Accounts Receivable

In August of 2010, GFHN exchanged its HealthPro medical billing system for NextGen, an advanced Electronic Health Records System. According to GFHN officials, with the implementation of this system the organization failed to follow up on a large volume of accounts receivable initially filed in HealthPro. During the organization's annual audit for FY 2012-13, the audit report identified $7.4 million in accounts receivable that were uncollectible and needed to be written off from the corporation's assets. In a more detailed breakdown, $3.6 million was uncollectible from prior fiscal years an additional $4.8 million was from that fiscal year.

As shown in Table 7 on the following page, over the past five years, the largest year-end accounts receivable balance occurred in Fiscal Year 2012-13. At the end of FY 2012-13:

- 13 percent of the total accounts receivable value was less than 30 days past due;
- 22 percent of the total accounts receivable value was less than 60 days past due;
- 26 percent of the total accounts receivable value less than 90 days past due;
- 29 percent of the total accounts receivable value less than 120 days past due; and,
- Ultimately, 35 percent of the total accounts receivable value was more than180 days past due.

At the end of that same year, 65 percent of the total accounts receivable value was over 181 days past due, indicating that billings had not been appropriately followed up to ensure timely payment by patients and/or third party payers.

As of August 31, 2014, GFHN had improved its billing efforts with:

- 25 percent of the total accounts receivable value less than 30 days past due;
- 37 percent of total accounts receivable less than 60 days past due; and
- 55 percent of total accounts receivable less than 120 days past due.

While the organization ended the month with 45 percent of total accounts receivable more than 120 days past due, maintaining and collecting past due accounts within four months reflects the organization's greater financial recovery efforts.

Table 7

Gardner Family Health Network
Year-End Accounts Receivable Balances

	Balance of Accounts Receivable by Period of Days Past Due							
End of Fiscal Year	**0-30**	**31-60**	**61-90**	**91-120**	**121-150**	**151-180**	**181+**	**Balance**
FY 2009-10	$1,353,112	$621,941	$181,198	$134,819	$1,771,103	-	-	$4,062,173
FY 2010-11	17,708	1,074,055	906,346	600,067	446,607	591,569	2,943,927	6,580,279
FY 2011-12	154,884	827,017	421,891	279,789	368,940	328,809	3,200,342	5,581,672
FY 2012-13	963,365	605,632	301,621	200,313	252,446	226,355	4,706,749	7,256,481
FY 2013-14	1,006,535	562,190	326,903	200,372	158,436	234,055	657,993	3,146,484
As of 8/31/14	759,675	369,313	279,330	265,880	276,994	207,129	907,184	3,065,505

I.C. Oversight and Governance - GFHN

Federal Requirements

The Gardner Family Health Network, Inc. is a federal health center, under federal Public Health Service Act Section 330. Compliance with the act is enforced by the U.S. Health Resources and Services Administration (HRSA), which provides grants to GFHN to fulfill the requirements of the Act. According to HRSA's "Health Center Program Requirements," health centers are "entities that serve designated medically underserved populations/areas or special medically underserved populations comprised of migrant and seasonal farmworkers, the homeless or residents of public housing."

Medically Underserved Areas/Populations are areas or populations designated by HRSA as having: too few primary care providers, high infant mortality, high poverty and/or high elderly population. GFHN must comply with the requirements of the Act to retain its federal grant funding.

When HRSA's Bureau of Primary Health Care (BPHC) determines that one of its grantees "has serious financial problems that threaten both its stability and viability,[18]" it will require the grantee to develop and follow a Financial Recovery Plan as a condition of continued federal funding.

GFHN at the commencement of this audit was subject to a federally approved Financial Recovery Plan. Such a plan "serves as a short-to-intermediate-term plan to guide financially-troubled organizations toward financial stability and can be used as a guide for development of long term plans needed for complete financial recovery. It is designed to provide the organization's staff, the Board of Directors and the BPHC with measurable, timeframed [*sic*] objectives which permit monitoring of progress."[19]

[18] HRSA Bureau of Primary Health Care (BPHC) Policy Information Notice 2002-18.
[19] Ibid.

State Requirements

As GFHN is a nonprofit, it must register with the California Secretary of State, and California charities must also register and file annual financial reports with the State Attorney General's Registry of Charitable Trusts. [20]

The Board of Directors has responsibilities and rights under California law. For example, Corporations Code Section 5231 (a) states "A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner that director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." To the extent that Directors carry out duties consistent with this and other relevant sections of the code, Section 5231 (c) relieves them of liability for actions or omissions relative to their corporate duties.

In addition, to maintain its tax-exempt status, GFHN is required to comply with the applicable federal Internal Revenue Service code provisions and the applicable sections of law and regulations of the California Franchise Tax Board. For example, GFHN must file Form 990 tax returns, and is prohibited from engaging in political activity.

Board of Directors' Composition and Responsibilities

Composition and Powers of the Board

Per the GFHN bylaws, there must be at least nine Directors, but not more than 19 Directors. Federal law requires GFHN to have at least nine Directors, but not more than 25.[21] At least 51 percent of the Directors must be "Consumer Directors" per the bylaws, defined as:

- Users of the services
- Residing in the service area
- Representative of the social-economic, age, sexual, linguistic and racial population served by the corporations

Remaining Directors must be "Professional Directors," defined as:

- Persons who are residents of or employed in the County of Santa Clara
- A professional from any field the Board deems necessary, including clinical health providers, business management, labor unions, clergy, social workers, educators, attorneys, administrators or others.

[20] GFHN's registration with the Secretary of State at the commencement of this audit was active. However, the Attorney General's Office registration of GFHN was listed as "delinquent" as of September 8, 2014. According to the Attorney General's Office, "This may mean they have not submitted the required annual renewal report (RRF-1) or have not submitted copies of IRS Form 990s as required."

[21] Section 330(k)(3)(H) of the PHS Act and 42 CFR Part 51c.304.

The Board's powers include:

- Approve grant applications and budgets
- Select, evaluate and, if necessary, dismiss the CEO
- Select the services and service hours provided
- Measure and evaluate the organization's programmatic and financial goals and develop plans for the long-range viability of the organization by engaging in strategic planning, ongoing review of the organization's mission and bylaws, evaluating patient satisfaction, and monitoring organizational assets and performance
- Establish general policies

The makeup of the Board and the responsibilities identified in the bylaws mirror the requirements of Section 330 of the Public Health Services Act. However, HRSA has authority to waive the requirement that a majority of the Board must be GFHN patients. Although GFHN's customers come from a variety of backgrounds, including backgrounds that would make them suitable as Board members, the fact that the Board members must be selected from a pool of about 41,000 people (GFHN's patient volume), significantly limits the pool of persons from which to identify individuals with the skills, availability and willingness to oversee a large, complex operation without compensation.

Basis for Removal

Reasons for which Directors can remove other Directors include, among others:

- Four unexcused absences from monthly Board meetings within a twelve-month period

Compensation

Although there is no compensation for Board members, if a Consumer Director's annual income is below the federal poverty level, they may be reimbursed for wages lost as a result of participation in corporation business.

Meetings and Quorum Requirements

The bylaws require monthly meetings of the Directors, and a simple majority participating in order to take actions.

2014 Committees

A document labeled "Board Committees 2014" shows six three-person standing committees, as follows: Executive, Finance, Governance/Personnel, Program/Planning, Fund Development, and Continuous Quality Improvement. Each committee has three alternate members. An additional document titled "Board of Directors Committees and Membership August 2014" indicates that membership on the committees was expanded, and a standing Audit Committee was formed. For example, the August 2014 Finance Committee roster includes four members, one alternate, the Chief Financial Officer and the Chief Operating Officer. The original 2014 roster included three

members and two alternates, and did not include administration officials. The Finance Committee is tasked with overseeing preparation of monthly financial reports, reviewing the financial condition quarterly and reporting findings to the Board, advising the Board on preparation and administration of the operating budget, insuring the accounting functions are performed properly, exploring methods to finance operations and making recommendations to the Board.

Engagement of the Board of Directors

We reviewed the agendas and minutes furnished by Gardner management of the GFHN Board's meetings for the 12 months prior to the commencement of this audit, covering the period from July 2013 to June 2014. Over that period, the number of directors on the Board ranged from 14 to 17, according to the meeting minutes. Shortly before the period under review, GFHN had paid off a $1 million line of credit and a $1.75 million mortgage on its Jackson Avenue property, which was sold during FY 2013-14 to cover these costs.

The agenda for the July 2013 meeting included belated adoption of the FY 2013-14 budget. Despite the urgency of the financial situation following the loss of credit in June of 2013, and the fact that the fiscal year was underway with no budget in place, the meeting was adjourned due to lack of a quorum. Ten Directors did not participate. The following month, with five Directors participating by telephone, the Board adopted the budget.

Several Directors routinely do not participate in the Board meetings. Over the 12-month period we reviewed:

- At each Board meeting, an average of 41 percent of the Directors did not participate
- One director missed all of the meetings, and a second director missed nearly all meetings
- As summarized on the following page, eight directors missed five or more meetings

Table 8

FY 2013-14
Eight Directors Missed Five or More Meetings

	Directors	Meetings Missed
	A	12
	B	10
	C	7
	D, E, F	6
	G,H	5
Total	**8**	**40**

Note: Includes one canceled meeting. Excludes meetings at which absences were not recorded.
Source: Board of Directors' Meeting Minutes

At eight of 12 meetings, more "Professional Directors" were absent than "Consumer Directors." Of the total number of absent Directors over the period, 45 percent were "Consumer Directors" and 55 percent were "Professional Directors."

Meeting records do not indicate whether any of these absences were excused. Even if each Director had two excused absences, six of them – about 40 percent of Directors – still would have been eligible for removal from the Board per the attendance requirement of the bylaws.

Further, Board meetings were often brief. For example, according to the Board's minutes, the total time spent on all topics, including fiscal and policy matters, by the Board from late July to the beginning of December of 2013 was 40 minutes. This does not include an "email meeting" of unknown duration.

Operating Losses

According to its unaudited financial records, during this July-to-December period GFHN posted losses amounting to $627,000, equal to almost five percent of its total revenue over that time.

The Board met for nearly five hours in December, and all but three Board members attended. But soon after – with the exception of two meetings that occurred in March following the release of the financial audit in which significant issues were raised – most meetings were again of short duration with several Directors absent.

It should be noted that the more engaged members of the Board have driven financial improvements in the last six to 12 months. Steps taken include reconciling transfers and loans of monies between GFHN and the other corporation (GFCC) and planning to hire a new financial auditor. The Chief Executive Officer hired an experienced Chief Financial Officer (CFO) in

January 2014, who is monitoring cash every day and has furnished the Board with much more detailed financial information. In concert with the Finance Committee, the CFO is driving budget and accounting improvements for GFHN. Despite the early deficits, GFHN's finances improved in the latter part of FY 2013-14, finishing the year with a small operating surplus. Records provided by GFHN management show that as of July 2014, average monthly patient fee collections had increased 17 percent compared to 2012 receipts, even though the dollar amount billed had increased just four percent. As of May 2014, there were new draft policies regarding billing and collections.

Effects of Abridged Involvement of the Full Board

The responsibility to establish policies and to ensure the operational and financial viability of the companies rests with the Board of Directors. The following effects are the result of the abridged involvement of the full Board of Directors:

- Failure to adopt the operating budget of GFHN prior to the start of the fiscal year, which has occurred in both FY 2013-14 and FY 2014-15. In addition, our review of the Board's minutes for FY 2013-14 showed no evidence of amendments to that year's budget, despite changes in the organization's financial condition.

- As of the commencement of this audit, the Board had not adopted essential financial and operational policies. Federal law governing health centers such as GFHN requires "systems in place to maximize collections and reimbursement for its costs in providing health services, including written billing, credit and collection policies and procedures."[22] Based on information provided by management, there appear to be few policies adopted by GFHN. We received draft policies for GFHN dated May 2014 for credit and collection, patient refunds, patient charges and billing. The only financial policy that appeared to be in force as of the commencement of this audit is for write-off of uncollectable accounts, dated December 2013. Because uncollectable accounts had not been tracked and were not written off in a timely manner, the Board was unaware that $12.0 million of GFHN assets ($4.1 million in prior revenue adjustments, $3.1 million in current year revenue losses for Fiscal Year 2012-13, and $4.8 million in accounts receivable adjustments) would never materialize. According to the GFHN Chief Financial Officer, such a policy would not have made a difference because collections on these accounts had simply failed to occur.

- In addition, federal law requires GFHN to maintain "accounting and internal control systems appropriate to the size and complexity of the organization reflecting Generally Accepted Accounting Principles (GAAP) and separates functions appropriate to organizational size to safeguard assets and maintain financial stability." Further, GFHN must have an annual financial audit performed in accordance with Federal audit requirements, including submission of a corrective action plan addressing all findings, questioned costs, reportable conditions, and material weaknesses cited in the Audit

22 Section 330(k)(3)(F) and (G) of the Public Health Service Act.

Report.[23] The most recent financial audit identified numerous financial and control problems. Recent prior audits did not find such problems.

At the commencement of this audit:

- GFHN did not have adequate accounting policies, such as policies governing recording of billed revenues. This resulted in 100 percent of billed amounts being recorded as revenues, even though GFHN only collects 92 to 94 percent of billed revenues, according to records provided by the current Chief Financial Officer. This error overstated revenues by approximately $2 million per year for at least four years, and constituted $8 million of the previously mentioned $12 million write off of assets in FY 2012-13.

- The company did not have policies governing budget development and adoption. As previously noted, the GFHN budgets for the current and past fiscal years have not been adopted timely.

- The company did not have policies governing loans between itself and the affiliated company. At present, according to GFHN's Treasurer, its Chief Financial Officer, and Board minutes, with the exception of some rental property, the two corporations have reconciled and extinguished their obligations to each other. As of the commencement of this audit, however, there remain no policies governing whether and under what circumstances the Board may approve financial transactions between the two entities.

- The company did not have a policy regarding cash reserves. As a result, GFHN lacked the cash to pay employee self-insured health insurance claims timely, according to Board minutes, resulting in some employees' claims being sent to collections. At the exit conference, GFHN's Chief Operating Officer and Chief Financial Officer stated that such problems had been resolved. However, the Chief Operating Officer explained that the company has retained its self-insured plan is because GFHN would have to make premium payments to an insurer within 30 days, and if they couldn't do so the insurance would lapse. He stated that having a self-insured plan gives the organization more flexibility with respect to the timing of the funding of the self-insurance premium equivalent. At the exit conference, GFHN officials stated that a policy requiring cash reserves would not have made a difference in their ability to weather their fiscal crisis, which was due to a variety of factors that made their expenses exceed their revenues. However, such crises are the reason why organizations should maintain cash reserves. Enforcing a cash reserve policy would have required GFHN to reduce expenses or increase revenues in an earlier period in order to have generated savings. While such reserves likely would not have been enough to address the entirety of the fiscal crisis, it would have mitigated it. Further, because expenditure of reserves would have required approval of the GFHN Board of Directors, it would have been a concrete indicator to Directors that income was less than expenses and that one or the other or both would have to change quickly.

23 Section 330(k)(3)(D), Section 330(q) of the PHS Act and 45 CFR Parts 74.14, 74.21 and 74.26.

- The company did not have policies governing criteria for undertaking capital projects, preparing capital project budgets or managing capital projects. For example, at the same time that GFHN was unable to pay employee benefits and other obligations, its capital project expenses and debts were increasing rapidly. GFHN's Chief Executive Officer stated at the exit conference that they have not needed such policies due to the fact that they rarely undertake capital projects, and that when they do, they are grant funded. The Chief Financial Officer said that in the future, they would conduct more evaluation of proposed projects.

- The company did not have policies governing internal controls, such as cash handling and separation of duties. Internal control weaknesses were identified in the financial audit released in March 2014.

- The company did not have policies regarding removal of Board members for lack of participation in Board business. As noted previously, a substantial minority of Directors frequently do not participate in Board meetings. As the minutes for most meetings during FY 2013-14 include the names of topics but little or no record of the discussion, based on these records alone it would have been difficult for members of the Board who attend infrequently to be fully aware of matters requiring their attention. As previously described, Directors have a legal duty to exercise "such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." Because the bylaws specify that Directors may be removed for four unexcused absences from the required monthly Board meetings, we infer that numerous absences are inconsistent with the bylaws and therefore the Directors' duty of care. Each absent Director represents a missed opportunity to bring another perspective to solving known problems and another line of inquiry into potential problems.

- Due to the vagueness of meeting minutes, the level of involvement of the full Board in the development and review of the Financial Recovery Plan required by HRSA[24] is unclear. However, based on the length of Board meetings, the absence of a record of discussion of the plan in the minutes, and the fact that the initial Financial Recovery Plan was rejected by HRSA and resulted in threats of the loss of federal grant funds, it appears that the Board could have played a larger role in development of the initial plan submitted in early 2014. (A revised plan addressing the "shortcomings" of the first plan was submitted in May 2014 and accepted by HRSA.) In it, GFHN attributed the downturn in finances to a handful of factors, including lower overall patient volumes and cash collection, a higher volume and magnitude of workers compensation claims, and debt payments. HRSA initiated an audit of GFHN; however, no draft report was prepared. A final report may or may not become available, according to HRSA officials.

[24] According to the HRSA Bureau of Primary Health Care (BPHC) Policy Information Notice 2002-18, Financial Recovery Plans are required of grantees "when it is determined that an organization supported with a Federal grant award by the BPHC has serious financial problems that threaten both its stability and viability."

I.D. Health Insurance - GFHN

As of May 2007, GFHN terminated its employee health insurance programs with Kaiser Permanente in favor of establishing and operating a self-insurance program for employee health benefits. At the time, Gardner officials determined that operating a self-insurance fund would be more economical than paying for the significant increases in health insurance premiums.

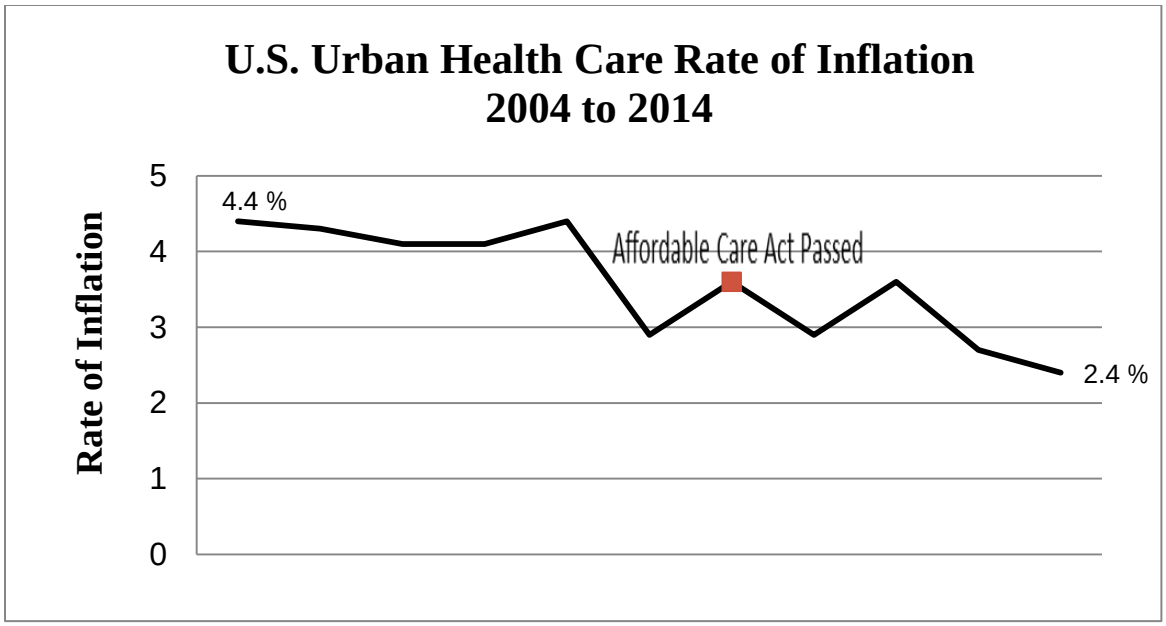
The company self-insures for employee medical costs up to $150,000 per year per covered beneficiary, or up to $4.6 million per year in aggregate for all covered personnel, according to the notes from the FY 2012-13 audited financial statements. If claims exceed these amounts, GFHN has "stop loss" insurance to cover excess claims.

Employers who self-fund for insurance are exempt from a variety of regulations and costs that are required of commercial plans. Between January and May of 2014, Kaiser Family Foundation surveyed 2,052 of employers who provide insurance benefits to their employees. Of those surveyed, of employers who provide health coverage, 81 percent of those with 200 or more workers are either partially or fully self- insured. This percentage has increased over the last decade. According to the survey of firms with 200 or more employees, the average premium of self-funded plans for family coverage in 2014 was $17,229, versus $17,423 for commercial plans.[25]

The Chief Operating Officer stated at the exit conference that he believes the premium cost for health insurance under a commercial plan exceeds the self-insurance cost. He said that the company periodically contacts various insurance companies to determine whether it would be less expensive to purchase insurance than the cost of self-insurance. He said that they have always determined that commercial rates are more expensive. We requested but did not receive documentation of insurance quotes or analyses prepared by GFHN of these comparative costs. The Chief Operating Officer indicated that he is not opposed to a commercial plan, if a commercial plan is less expensive than the self-insurance costs.

However, we note that the rate of growth in health costs, and the rate of growth in the cost of health insurance plans, has dropped markedly in recent years, as shown below.

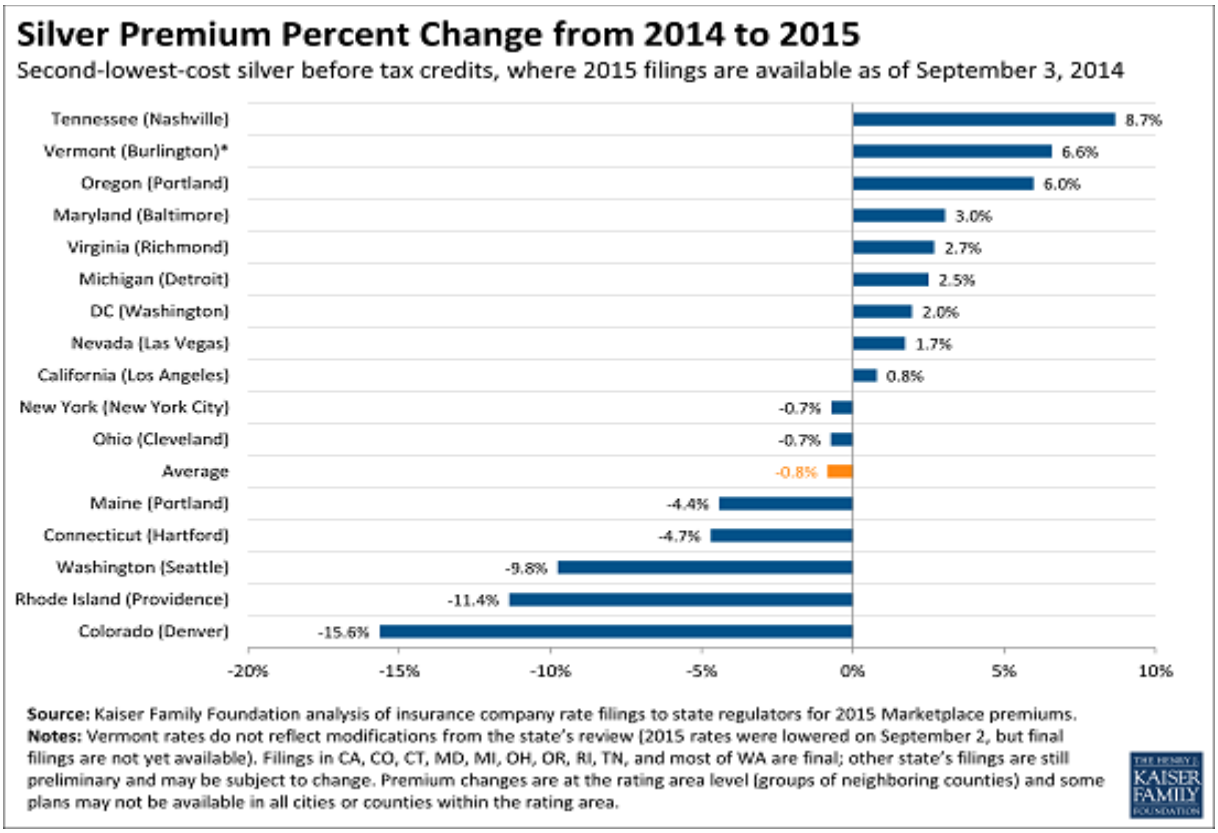
[25] The full report is available at: http://kff.org/health-costs/report/2014-employer-health-benefits-survey/.



Source: U.S. Bureau of Labor Statistics, All Urban Consumers, Consumer Price Index for Health Care for the first half of each calendar year from 2004 through 2014.

In terms of insurance costs, in the past, costs sometimes increased by double-digit percentages from one year to the next. However, such rapid growth is not occurring now. For example, the weighted average cost increase from 2014 to 2015 for plans under the Affordable Care Act (ACA) "Covered California" insurance market is projected to be 4.2 percent, according to Covered California. Covered California includes the Valley Health Plan and nine other insurers.

An analysis of premium cost increases between 2014 and 2015 prepared by the Kaiser Family Foundation based on analysis of ACA "Silver" plans in cities around the country shows an average *decrease* in premium costs. That analysis included premiums in the City of Los Angeles, which are estimated to increase by less than one percent, as shown below.



Provisions of the ACA are continuing to be implemented, and therefore the long-term effect of the law on premium increases is uncertain. But based on these initial data, we believe that continued evaluation of the relative cost of a health insurance plan vs. self-insurance for GFHN is warranted.

The Chief Operating Officer's second basis for supporting retention of the self-insurance plan is that it would give GFHN more flexibility with respect to the timing of medical costs payments. Being self-insured allows GFHN to delay payments to employees' medical providers when cash is tight. Management reports that its goal is to maintain medical claims to 30 to 60 days outstanding, and that is has achieved this goal in the last six months. If a commercial plan were adopted, it most likely would require premium payments within 30 days, thereby reducing payment flexibility.

GFHN manages its self-insurance program through a contract with Benefit and Risk Management Services (BRMS) which is responsible for plan oversight and administration. While BRMS processes and adjudicates all medical, dental, and vision claims, GFHN also retains Innovative Cost Management Services (ICMS) as a financial consultant responsible for a variety of analytics for the plan including actuarial services. According to the financial assessment by ICMS, GFHN has encountered difficulty in maintaining a fund balance adequate to cover all liabilities in recent years.

Accounting for health claims includes not just accounts payable (current liabilities), but also claims that are not yet known, but may be anticipated. Incurred But Not Reported (IBNR)

liability is an estimate of claims that might be outstanding as determined by an actuary. Under the Self Insured Health Plan, doctors have up to one year to submit claims to BRMS for processing, allowing for the possibility of employee health claims to trail in later in the year.

According to unaudited financial statements for Fiscal Year 2013-14, GFHN's outstanding health liabilities have decreased by 47 percent while IBNR has decreased by seven percent. This improvement in GFHN's conditions is shown in Table 9 below.

Table 9

Self-Insurance Liability and IBNR* Balance
Year-End Fiscal Years 2012-13 and 2013-14

Annual Balance	Health Liabilities	IBNR*
GFHN as of 6/13	$907,333	$761,448
GFHN as of 6/14	$481,140	$708,057
Balance Change	-47%	-7%

*Estimated amounts that have been incurred but not reported.

In addition to ensuring that a commercial plan would be less expensive, prior to a change in health plans, GFHN would have to have an adequate reserve to pay out IBNR claims. Unaudited financial statements provided by GFHN did not include detail on the fund balances of their self-insurance funds, although the organization did provide a balance statement as of August 31, 2014 detailing a balance $15,959 in its self-insurance funds.

As noted in Part II D of this report, this issue also affects the Gardner Family Care Corporation *(GFCC)*. Together, according to the FY 2013-14 unaudited financial statements, the two organizations must retain approximately $1.1 million for IBNR claims prior to a health plan change. During our exit conference, however, Gardner officials explained that IBNR is calculated once a year by their self-insurance consultant and that the number can vary greatly through the year. IBNR is calculated by multiplying the average pay out per day by the average amount of days between the incurred date of claim to the date of pay. Using metrics provided by the Chief Financial Officer, as of the end of August, the average amount of days in between when a claim is incurred and when it is paid dropped from 55.6 days as of June 30, 2014, to 21 days as of the end of August. The IBNR amount would subsequently be reduced for GFHN from $708,455 to $267,582, assuming that the average amount paid out per day has not significantly changed. We have not tested the claims payment rate and we do not know if it is faster than the rate upon which the current IBNR calculation is based. Therefore we express no opinion as to whether the IBNR value is exaggerated or accurate.

Despite the improvements shown in Table 9, and the possibility of a much lower IBNR due to the improvement of days in between an incurred claim and its payment, in our opinion, the practice of self-insuring for employee medical costs increases GFHN's cash flow vulnerability. As previously indicated, each employee can incur up to $150,000 in medical expenses for which GFHN is liable. If in one month just two of its employees were to have major health problems or

be injured in car accidents or have a baby requiring intensive care, monthly medical claims expenses could double. At the exit conference, the Chief Operating Officer stated that changing to a commercial insurance plan would increase the cash-flow vulnerability rather than decrease it, due to the fact that GFHN would have to make timely payments to the insurer. As a self-insurer, GFHN has the ability to delay payments to employees' medical providers when cash is limited.

GFHN officials have noted that the self-insurance plan is likely to be subject to an excise tax (commonly known as the "Cadillac Tax") imposed on high-cost health plans by the Affordable Care Act[26]. This tax will go into effect in 2018, and is applicable to self-insured and commercial plans. For self-insured plans, the tax is imposed on the self-insuring employer, which in this case means GFHN will be responsible for any such taxes that may be assessed. We cannot accurately estimate an annual tax liability for GFHN because the federal regulations that will provide detailed calculation methods have not been promulgated. However, the tax rate on "excess" benefits will be 40 percent, which will be applicable to costs in excess of $10,200 per individual per year. As previously noted, GFHN insures for up to $150,000 per year per individual. In our opinion, this is another threat to the company's future cash flow.

In addition, as noted in Part II D of this report, GFCC has increased its liabilities over the same time period, and as previously described, its liabilities combine with those of GFHN to make it more difficult for GFHN to switch to a health insurance plan.

We recommend that whether the County provides GFHN with additional funding or not, that Gardner continue to explore health insurance options. The County may be able to assist with this, such as by enabling GFHN to piggyback on a County plan or facilitating the transition to the Valley Health Plan.

I.E. Financial Requests - GFHN

The GFHN administration has submitted requests to the County Executive's Office for approximately $2.2 million in financial assistance from the County of Santa Clara to aid in covering operating costs, as follows.

1. GFHN is requesting $220,000 in annual, ongoing payments to cover operating losses of the Downtown Health Center; and,

2. GFHN is requesting that the County serve as loan guarantor for a line of credit that would be secured by the St. James clinic property; or, for the County to provide a direct "working capital advance" of up to $2 million, or a fixed term loan, which could be secured by receivables or liens against the property.

At the exit conference, the Gardner Chief Executive Officer stated that any funds provided to the Gardner companies by the County would be repaid.

[26] Title 26 of the Internal Revenue Service code, Section 49801.

Gardner Downtown Health Center

The first request is for ongoing, annual support of $220,000 to alleviate operating losses in that amount at the Gardner Downtown Health Center. In the Provider Agreement signed April 1, 2012 between the County of Santa Clara and GFHN to operate the Downtown Health Center, the County contracted to provide up to $550,000 to support GFHN's operations.

The transmittal to the County Board of Supervisors dated April 10, 2012, stated:

"The Administration recommends that the $550,000 be allocated from the Appropriation for Contingencies and therefore requires a 4/5 vote of the Board of Supervisors. Initially, it was our hope that Gardner would be able to qualify for Federal Grant funding to offset the cost of operating this facility but those grants are no longer available due to reductions in available Federal funding. This allocation is for the first full year of services and the Administration will work closely with Gardner and monitor their performance. It is possible that an additional subsidy may be required in the second year of the contract and that will be addressed after evaluating the actual experience of clinic operations over the next 9 to 12 months." The temporary nature of the subsidy is consistent with a September 8, 2010 transmittal to the Board of Supervisors, which stated "Although the County never planned to allocate county resources for this service [operation of the downtown clinic], we have recently become aware that Gardner believes it will need a subsidy of $625,000 in the first year and a subsidy of $360,000 in the second year to provide health care services at this site."

An amendment to the provider agreement extended the expiration date to December 31, 2015, but did not provide additional funding.

In correspondence between GFHN administration and the County Executive, GFHN administration explained that they assumed the County's financial support was ongoing and not just for the initial start-up. At the exit conference, Gardner officials reiterated that they never intended to operate the clinic without an ongoing County subsidy and that it would not have made sense from a business standpoint for them to engage in the operations without an ongoing subsidy. In a May 6, 2014 letter to the County of Santa Clara Board of Supervisors, Gardner indicated that it might cease to operate the clinic without a subsidy. Although that letter suggests that the funding is needed only through FY 2015-16, we believe that Gardner officials intend and expect the subsidy to continue annually.

In June 2014, the County Board of Supervisors approved an additional $220,000 specifically on a one-time basis to cover the clinic's FY 2013-14 losses. These funds were remitted by the County Behavioral Health Department as a partial payment of the draft reconciliation amount of backlogged "Short-Doyle" reimbursements for fiscal years 2010-11 and 2011-12 owed to the *other corporation* – Gardner Family Care Corporation *(GFCC)* – for *mental health services*. It is unclear where these monies were actually deposited by Gardner, and if GFHN must pay back this money to GFCC. As of the commencement of this audit, the County owes GFCC $43,797 for the remaining balance from the reconciliation of those two years. Past years remain unreconciled, as discussed in Part II of this report.

The Downtown clinic is one of four County of Santa Clara clinics with operating losses, as shown in Attachment 1 of this report. Clinic operating losses were previously discussed in Part I.A of this report. In addition to this request, GFHN paid the County $269,000 per year for rent until July 2013 when the rent was reduced to $12 per year to ease GFHN's financial difficulties.

Working Capital Advance, Line of Credit, or Loan

As previously indicated, in late FY 2012-13, GFHN lost its $1 million line of credit and a $1.75 million mortgage from its bank. The debts were subsequently paid from the proceeds of the sale of its Jackson Avenue property. In correspondence with the County, GFHN administrators noted the cash flow difficulties previously described, which they attributed in part to a lower volume of patients being served and a transition to an Electronic Health Records System that backlogged and invalidated aging accounts receivable.

Gardner has asked the County to serve as a guarantor for a line of credit from a third party financial institution or to directly provide a fixed-term loan or working capital advance of $2 million. The GFHN administration has suggested that all options may be secured by payer receivables and/or liens against GFHN properties.

In the GFHN's Financial Recovery Plan approved by HRSA, GFHN detailed a 12-month plan to improve yearly cash position from $1.7 million to $2.2 million. GFHN's stated plans for improving cash flow include efforts to improve provider productivity, improve cash collections, "right-size" the workforce, and contain costs. The working capital advice, line of credit or loan was requested to provide access to cash when needed while GFHN is implementing these processes to improve its financial condition.

As previously discussed, the financial statements portray the corporation ending the last fiscal year with revenues marginally over its operating costs, and analysis of revenues and expenditures by month shows that cash shortages occur through the year and are common. The cash-flow problem is also apparent by the historical lending from one corporation to another, which, according to GFHN administration, has been reconciled and cleared from their accounting ledger with the release of the FY 2013-14 unaudited financial statements. GFHN officials have suggested use of the building that houses the St. James Clinic as collateral. This clinic generates significant revenue and facilitates thousands of patient visits per year. The practical ability to sell the property to pay off debts tied to it should be a factor in deciding whether to use that facility as collateral for any funding the County may provide.

I.F. Recommendations - GFHN

1) GFHN has proposed that it receive a line of credit or working capital from the County, with the County interest secured by collateral, such as a building. If the County uses a clinic as collateral, and GFHN is unable to re-pay the funds in the future, it may not be practical to sell the property due to the effect on patients and on GFHN's revenues. Therefore, we recommend that if the County provides such funding, it do so under conditions that are 1) designed to improve the long-term stability of the organization, and 2) designed to protect the County's financial interests. Recommended conditions include:

a) That the GFHN Board of Directors direct staff to obtain health insurance plan quotes and prepare an analysis of the relative costs of converting from self-insurance to commercial insurance from the current year through at least 2018.

b) That the GFHN Board of Directors enacts appropriate financial and operational policies, as previously described in this section, and as may be deemed necessary by County Administration, to safeguard the County's assets. For example, the County may wish to require submission of monthly financial reports to County officials, and copies of financial audits, so long as County discretionary funds are in the care of GFHN.

c) That the GFHN Board of Directors enacts a policy requiring removal of Directors who fail to participate in four or more Board meetings in a twelve-month period, except for certain narrowly defined circumstances that constitute excused absences, and that it promptly remove and replace Directors who currently meet that criteria, and that it advertise widely for replacements. The GFHN Board may wish to seek a waiver to the requirement that most of its Directors be customers, at least until GFHN has appropriate cash reserves, in order to be able to recruit Board members from the widest range of the public as possible. According to the Chief Executive Officer at the exit conference, the federal audit by HRSA in May raised this issue as well. He said that one Director has been removed in response. As previously indicated, waiving this requirement would vastly increase the size of the pool from which to draw Board members, which should increase the number of persons who are available, willing and able to serve.

d) That the GFHN Board provide regular evidence to the County that a) GFHN is compliant with the federally approved Financial Recovery Plan and any other federal conditions that may be imposed by its federal grantor, and b) that the Board is engaged in overseeing and questioning compliance with the plan and any other federally imposed conditions.

2) GFHN has proposed that it receive ongoing annual payments of $220,000, sufficient to cover its operating losses at the Downtown clinic. This is one of five clinics at which expenses exceed revenues, and per the GFHN adopted FY 2014-15 budget, its losses are currently funded by surplus net income from the South County and CompreCare clinics. GFHN's adopted FY 2014-15 budget already includes a County payment of $1.5 million for primary care services, and a County-funded contract with a third party for about $767,927, both of which are General Fund monies. GFHN already allocates these monies to costs exclusively for the County clinics. But due to the operating losses at the Atherton clinic, $762,412 of County clinic net income would be consumed by San Mateo County clinic losses in the current fiscal year, and it is likely these losses will grow as existing private support for the Atherton clinic is planned to be reduced in future years. We recommend that if the County provides the $220,000 to GFHN, that as a condition of this additional County support, GFHN be prohibited from using any monies generated directly or indirectly from the County or from clinics in the County of Santa Clara for GFHN operations outside the County of Santa Clara. Further, we recommend that financial operations within the County of Santa Clara be accounted for in a separate account, with any surpluses remaining in that separate account to be spent exclusively on clinics serving the County of Santa Clara population. *We note that*

this is inconsistent with the GFHN adopted FY 2014-15 budget. This would require GFHN to identify an alternate source of funding for the operating losses in Atherton.

PART II: GARDNER FAMILY CARE CORPORATION (GFCC)

II.A. Summary of Operations and Finances - GFCC

The Gardner Family Care Corporation (GFCC) is the affiliate of GFHN. It provides social and behavioral services including substance abuse programs, Women, Infant and Children (WIC) support services, and outpatient mental health services, exclusively in the County of Santa Clara. (WIC is a federally funded nutrition program.) According to the most recent federal tax return[27] available, GFCC provides outpatient counseling to 3,600 clients, drug-related programs to 2,665 clients, and parental and child health services to 12,000 clients per year. In addition to services provided at GFHN clinics, GFCC operates two stand-alone clinics in the County of Santa Clara, as follows:

- Centro de Bienestar, on East Virginia Street in San Jose. This clinic provides behavioral health, counseling and WIC services from 8:00 a.m. to 5:30 p.m. This facility is owned by GFCC, but is mortgaged.

- Proyecto Primavera, on Tully Road in San Jose is a clinic facility provided by the County without charge to GFCC. Counseling services are provided at this clinic Monday through Friday from 8:00 a.m. to 5:00 p.m.

The primary source of GFCC funding is contracts with the County Mental Health Department, which are budgeted at $15.6 million in the adopted FY 2014-15 budget. This represents 78 percent of its $20.1 million budget. The other large source of revenue for the company is $2.3 million of WIC funds. The adopted FY 2014-15 budget anticipates a year-end operating surplus of just $10,450. Its largest expense is salaries and benefits, representing 85 percent of costs, or $17.1 million.

GFCC's services are funded primarily through California Short-Doyle Act payments for mental health services. Under its contract with the County, GFCC receives monthly payments by the County, primarily based on total units of service claimed and interim payment rates per unit of service. Determination of the amount *actually earned* occurs after Medi-Cal billing/payment has occurred and GFCC's actual cost reports have been submitted and combined into the County cost report submission to the State six months after the fiscal year is over. The State performs an initial reconciliation eighteen months or more after the fiscal year is over and a final settlement at some point after that. Both the State and the County have backlogged reconciliations for several years.

[27] 2011 Form 990, page 2.

II.B. Financial Condition - GFCC

As shown in Table 10 below, GFCC was in better condition than *GFHN* as of the close of FY 2013-14. Unlike *GFHN*, which lost its bank line of credit in 2013, GFCC remains credit-worthy, with a $500,000 line of credit with its bank.

GFCC provided unaudited statements for FY 2013-14. These statements contain no contextual narrative and minimal footnotes, and no background regarding changes in financial condition from the prior fiscal year. This financial information has not been audited or tested by the Management Audit Division, such testing being outside the scope of this project.
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Table 10

Gardner Family Care Corporation
Extract of Unaudited Financial Statements as of June 30, 2014

FY 2013-14 Actuals	Total
Revenue	$18,741,606
Expenditures	$18,623,250
Net Income	**$118,356**
Operating Cash Assets	$1,337,089

As of June 30, 2014, the unaudited financial statements for GFCC indicate that the corporation recovered its operating costs this past fiscal year. In addition to the operating cash assets, it also had cash reserves of $316,450, and an additional $372,942 in cash set aside for health insurance claims.

Detail of the net income is shown in Table 11 on the following page.

Table 11

Gardner Family Care Corporation
Extract of Unaudited Income Statement as of June 30, 2014

Revenues	FY 2013-14
Contracts & Grants:	**$17,023,607**
Mental Health	14,252,125
Women, Infant, and Children	2,088,245
Blossoms Perinatal	127,026
Outpatient Substance Abuse	556,211
Patient Fees:	**1,079,896**
Drinking Driver	828,351
Drug Diversion	200,049
Outpatient Substance Abuse	51,496
Miscellaneous:	**638,103**
Other Revenue	638,103
Total Revenue	**$18,741,606**
Expenses	
Salaries & Benefits:	**$15,063,182**
Salaries & Wages	11,142,633
Employee benefits	3,092,451
Payroll Taxes	828,098
Services & Supplies:	**$3,560,068**
Professional fees	846,455
Equipment/Maintenance	523,107
Depreciation	456,868
Building Maintenance	268,516
Interest-building	261,594
Travel	242,878
Family Assistance	152,701
Program and other supplies	136,881
Other	671,068
Total Expenses	**$18,623,250**
Net Income	**$118,356**

According to GFCC's unaudited income statement for FY 2013-14, the organization recovered its operating cost through the year with a net income equivalent to only 0.6 percent of total annual expenditures or approximately two days' worth of total operating costs. While GFCC's net income is equal to less than one percent of annual operating costs, the organization's balance statement for the end of Fiscal Year 2013-14 displays a healthier overall financial condition, as shown in Table 12.

Table 12

Gardner Family Care Corporation
Extract of Unaudited Balance Statement as of June 30, 2014

Assets	Total
Cash - Operations	$1,337,089
Cash - Board Reserve	316,456
Cash - Self Insurance	372,942
Total Cash	$2,026,487
A/R - Grants	3,212,187
A/R - Other	4,883
Due from Affiliate - GFHN	21,765
Total Receivables	$3,238,835
Other Current Assets	$228,669
Total Current Assets	$5,493,991
Long-term Grants Receivable	$1,287,557
Fixed Assets	$6,289,225
Total Assets	**$13,070,773**
Liabilities	
Self-Insurance	$1,780,803
Accrued Vacation & Sick Leave	603,907
Accrued Payroll & Fringe Benefits	542,974
Accounts Payable	514,391
Mortgage Payable	227,229
Accounts Payable - Health Insurance Claims	63,359
Due to County	6,050
Other Liabilities	10,494
Total Current Liabilities	$3,749,207
Health Insurance IBNR	381,307
Mortgage Payable - Long Term Portion	5,967,467
Total Other/Long Term Liabilities	$6,348,774
Total Liabilities	**$10,097,981**
Total Net Assets	**$2,972,792**

As of June 30, 2014, GFCC's unaudited balance statement recorded almost $3.0 million in net assets, an indication of the corporation's relative financial stability, in comparison to its affiliated corporation. Similarly, when current assets are compared to current liabilities, GFCC's assets exceed liabilities by $1.7 million, also indicating the organization's ability to pay off short-term debts.

As recorded in the unaudited balance statement, GFCC retained $1.3 million in operating cash, an amount equivalent to 26 days' worth of working capital, or about seven percent of total operating expenses. Although 26 days' worth of reserves falls below the recommended industry standard of three months, GFCC's current assets are sufficient to cover current liabilities.

Mental Health Program

As discussed more thoroughly in Part II, Subpart E of this report, GFCC's financial assistance request is related to its mental health program. In addition to our assessment of the organization's overall fiscal health, an analysis of GFCC's mental health program indicates that while the organization may be financially stable overall, the mental health program has struggled to maintain a positive cash flow. An overview of the mental health program's finances is provided below in Table 13.

Table 13

Gardner Family Care Corporation
Mental Health Program Extract of Unaudited Income Statement as of June 30, 2014

Fiscal Year 2013-14	Revenues	Expenditures	Net Income
July	$1,119,255	$1,118,620	$635
August	$1,127,796	$1,132,728	-$4,932
September	$1,180,559	$1,190,589	-$10,030
October	$1,153,447	$1,204,224	-$50,777
November	$1,063,225	$1,089,088	-$25,863
December	$1,121,732	$1,131,484	-$9,752
January	$1,118,881	$1,124,031	-$5,150
February	$1,188,213	$1,152,690	$35,523
March	$1,107,865	$1,097,609	$10,256
April	$1,203,454	$1,201,461	$1,993
May	$1,262,266	$1,199,948	$62,318
June	$1,712,091	$1,700,649	$11,442
Total	**$14,358,784**	**$14,343,121**	**$15,663**

As detailed in Table 13, half of the months in Fiscal Year 2013-14 ended with marginal operating deficits while the other half marginally recovered their operating costs. Overall, the mental health program ended the year with a net income of $15,663 indicating that the program has struggled to continually recover its operating costs throughout the year.

II.C. Oversight and Governance - GFCC

GFCC has significantly less oversight than its parent corporation. As noted in the Overview section of this report, the Chief Financial Officer is expected to allocate just 10 percent of his

time to this corporation. The Board minutes for GFCC are substantially similar to those for GFHN, meaning that they have limited substantive information. The bylaws of the two companies are very similar, with the primary difference being that the GFCC bylaws limit the number of Directors on the Board to 15 (as opposed to 19 for *GFHN*.) We did not receive any policies for GFCC, and it does not appear that the existing or draft policies of *GFHN* are in use by GFCC fiscal staff.

Federal Requirements

Unlike its parent corporation, GFCC has no federal grants and is not a federal health center. As such, it does not have reporting or compliance requirements overseen by HRSA. It does not have federally designated service areas.

State Requirements

In addition to having to meet the same state and federal requirements for non-profit, tax-exempt corporations, GFCC had an active registration with the Secretary of State at the commencement of this audit. However, unlike *GFHN*, it is exempt from filing and reporting requirements to the State Attorney General's Office under Health and Safety Code section 1250, according to exemption documents on file with the Attorney General's Office.

Most of its funding is restricted to use for mental health services, as described later in this report.

II.D. Health Insurance – GFCC

In conjunction with its affiliated corporation, GFCC in May 2007 terminated its employee health insurance programs with Kaiser Permanente in favor of establishing and operating a self-insurance program for employee health benefits. At the time of this divestment, with insurance premiums increasing by large amounts every year, Gardner administration –believed that operating a self-insurance fund would be more economical than paying for the significant increases in health insurance premiums. However, as noted in Section I.D, such increases are not occurring in the market currently.

The Chief Operating Officer stated at the exit conference that the company has retained its self-insurance plan two reasons. First, he stated that the rates obtained from commercial insurance carriers for a comparable health insurance plan have not been lower than the premium equivalent under GFCC's self-insurance plan for the last two years, and that actual costs have been even lower than the premium equivalent.

He said that the company periodically contacts various insurance companies to determine whether it would be less expensive than the costs of self-insurance. He said that they have always determined that commercial rates are more expensive. We requested but did not receive documentation of insurance quotes or analyses prepared by GFCC of these comparative costs.

The Chief Operating Officer's second reason for supporting retention of the self-insurance plan is that it would require GFCC to make payments to the insurer within 30 days to maintain

coverage. Being self-insured allows GFCC to delay payments to employees' medical providers when cash is tight. However, he indicated that for the last six months, outstanding payments are within 30 to 60 days.

GFCC manages its self-insurance program through a contract with Benefit and Risk Management Services (BRMS) who is responsible for plan oversight and administration. While BRMS processes and adjudicates all medical, dental, and vision claims, the organizations also retain Innovative Cost Management Services (ICMS) as a financial consultant responsible for a variety of analytics on the plan including actuarial services. According to the financial assessment by ICMS, GFCC – like its affiliate – encountered difficulty in maintaining a fund balance adequate to cover all liabilities in recent years. Unlike *GFHN*, GFCC's liabilities increased between FY 2012-13 and FY 2013-14 as shown in Table 14 below.

Table 14

Self-Insurance Liability and IBNR* Balance
Year-End FY 2012-13 and 2013-14

Annual Balance	Health Liabilities	IBNR*
GFCC as of 6/13	$1,633,386	$356,329
GFCC as of 6/14	$1,780,803	$381,307
Balance Change	9%	7%

*Estimated amounts that have been incurred but not reported.

Accounting for health claims includes not just accounts payable (current liabilities), but also claims that are not yet known, but may be anticipated. Incurred But Not Reported (IBNR) liability is an estimate of claims that might be outstanding as determined by an actuary. Under the Self Insured Health Plan, doctors have up to one year to submit claims to BRMS for processing, allowing for the possibility of employee health claims to trail in later in the year.

GFCC officials report that in recent years, the amount of health insurance claims and the magnitude of these claims have escalated, contributing to the organization's accrual of liability. - If GFHN were to identify a commercial plan that was economically feasible, both *GFHN* and GFCC would need an adequate reserve to pay out IBNR claims. Unaudited financial statements provided by GFCC detailed a balance of $372,942 in their self-insurance fund. Together, the two organizations must retain approximately $1.1 million for IBNR claims prior to a health plan change as of the end of FY 2013-14. The combined total of health reserves for both companies as of the end of FY 2013-14 was undetermined as of the drafting of this report as this information was not included in the GFHN unaudited financial statements. Although we could not total the sum of self-insurance funds between the two organizations for the end of the fiscal year, GFHN and GFCC provided updated statements as of August 31, 2014, detailing a balance of $15,959 for GFHN and $225,516 for GFCC for a sum of $241,475 in self-insurance funds between the two organizations.

It is important to note, as discussed in Part I.D of this report, that IBNR is calculated only once every year by the self-insurance consultant. It is not an actuarial figure based on analysis of acuity, age or other analytical factors. The figure is calculated by multiplying average daily payouts by the average number of days it takes to pay claims. Therefore, as claims are paid faster, the IBNR is lower. The Chief Financial Officer stated that the number of days to pay claims has dropped significantly, meaning that once an updated calculation is performed to reflect improved speed of payment, the IBNR amount will be about half of that reflected on the financial statements. We have not tested the claims payment rate and we do not know if it is faster than the rate upon which the current IBNR calculation is based. Therefore we express no opinion as to whether the IBNR value is exaggerated or accurate.

We recommend that whether the County provides GFCC with additional funding or not, that Gardner continue to explore health insurance options. The County may be able to assist with this, such as by enabling GFCC to piggyback on a County plan or facilitating transition to the Valley Health Plan.

II.E. Financial Request - GFCC

As described in Part II, Section A, GFCC's services are funded primarily through California Short-Doyle Act payments for mental health services. Under its contract with the County, GFCC receives monthly payments by the County, primarily based on total units of service claimed and interim payment rates per unit of service. Determination of the amount actually earned occurs after Medi-Cal billing/payment has occurred and GFCC's actual cost reports have been submitted and combined into the County cost report submission to the State six months after the fiscal year is over. GFCC's request for funding is related to the anticipated future "settlement" amounts, as follows:

1) GFCC is requesting an advance of approximately $2.1 million, which is equivalent to what its officials assert is 80 percent of anticipated Mental Health cost settlements from the State and County of $2.6 million for the fiscal years FY 2006-07 through FY 2011-12.

Expected vs. actual settlement payments can and do vary considerably, due to variation in the level of service provided, the actual cost per unit of service, the payor mix and the proper processing of third-party payor billings. This is illustrated by the fact that two of the years that were included in the $2.6 million estimated amount due have subsequently been reconciled and paid on a draft basis. These two years are FY 2010-11 and FY 2011-12.[28] For these two years, the amount that GFCC estimated was owed by the County was $765,808. This amount is included in the $2.6 million figure.

For FY 2010-11, GFCC expected a settlement payment from the County of $257,821. However, the reconciliation resulted in GFCC owing the County $89,850. For FY 2011-12, GFCC estimated that the County owed it $507,987. The County owed GFCC only $353,647 per the

[28] The transmittal to the Board of Supervisors stated that the cost settlement encompassed amounts due for Fiscal Years 2007-2012. Based on information provided by the Mental Health Department, the settlement in fact covered only the two years noted.

draft settlement. The combination of the two years: ($89,850) + $353,647 = $263,797, not the $765,808 that GFCC estimated was due. That is, for two years of the claims for which reconciliations have been completed, only 33 percent of the amount claimed was payable. Given that the known payable amount was 33 percent of what was claimed, and that GFCC has requested payment of 80 percent of claims, we believe there is significant risk to the County by advancing these monies at the rate requested. It is theoretically possible that GFCC owes the County money, rather than the other way around, for the remaining unreconciled years of FY 2006-07 through FY 2009-10.

After deducting the $765,808 that has been settled, GFCC's unreconciled claims are about $1.9 million. Assuming that 100 percent of this claim was in fact due, an 80 percent advance would equal about $1.5 million. However, due to the fact that in some years GFCC owes the County money as a result of the reconciliation, providing this advance without collateral would create a significant risk to the General Fund, particularly if GFCC is found to have a net liability to the County for the outstanding claims. GFCC officials have suggested use of the St. James Health Center as collateral for this advance. As previously mentioned, this poses problems in itself in that the facility is a significant source of revenue and cannot realistically be sold without greatly impacting the viability of the *GFHN* enterprise and the lives of many primary care patients. The FY 2014-15 County budget added a new staff person specifically to reconcile cost reports for GFCC and other contractors. The Behavioral Health Department was in the process of hiring someone for this position as of August.

Use of Settlement Funds Authorized in June

As described above, the combination of the two draft settlement amounts is: ($89,850) + $353,647 = $263,797. Of this amount, $220,000 of *mental health* settlement funds, owed to *GFCC* pursuant to its provision of mental health treatment and paid by the County Behavioral Health Department, were approved by the Board of Supervisors for payment in June 2014. (The balance of $43,797 was still due as of the commencement of this audit.)

The $220,000 amount equates to the annual operating loss at *GFHN*'s *primary care* Downtown clinic and was approved by the Board of Supervisors specifically to backfill the operating loss for the provision of primary care at that clinic.

It was not clear which company actually received the funds, or whether GFHN must reimburse the $220,000 to GFCC.

II.F. Recommendation - GFCC

GFCC has requested an "advance" of 80 percent of estimated backlogged mental health payment settlements. The most recent settlements equated to 33 percent of the amount that GFCC estimated was due from the County. In some years, GFCC owes reimbursements to the County once the settlement is completed. The County Mental Health Department is adding a new employee to work on these backlogs for both GFCC and other contractors.

1) If the County provides an advance, we recommend that it reduce the percentage of the estimated amount advanced to not more than 33 percent of the unreconciled amount, and that it consider waiting until the County has hired its new analyst and attempted to settle as much of the GFCC backlog as possible.

GFHN Clinics FY 2014-15 Operating Budget (Adopted September 30, 2014)[1]

	Santa Clara Clinics							San Mateo Clinic	Total All Clinics
	Downtown	Alviso	CompreCare	Gardner	St James	Gilroy	Santa Clara Co. Clinic Total	Gardner Packard	
Anticipated Annual Patient Visits	*4,220*	*2,988*	*43,895*	*26,714*	*32,502*	*32,899*	*143,218*	*13,500*	***143,218***
Proposed Full-Time-Equivalent Staff	*5.2*	*5.2*	*52.2*	*33.9*	*48.7*	*36.2*	*182* [2]	*18.5*	***182***
Total Revenues	**590,511**	**474,674**	**8,610,979**	**4,826,244**	**7,464,091**	**6,868,267**	**28,834,766** [4]	**4,412,928** [3]	**28,834,766**
All Expenses Except Overhead	(623,547)	(453,711)	(5,749,322)	(3,784,474)	(5,765,518)	(4,045,737)	(20,422,309)	(3,978,080) [5]	(20,422,309)
Overhead Expenses	(187,665)	(136,551)	(1,730,340)	(1,138,991)	(1,735,215)	(1,217,622)	(6,146,384)	(1,197,260)	(6,146,384)
Total Expenses	**(811,212)**	**(590,262)**	**(7,479,662)**	**(4,923,465)**	**(7,500,733)**	**(5,263,359)**	**(26,568,693)**	**(5,175,340)**	**(26,568,693)**
Total Clinic Operating Surplus/(Loss)	**$ (220,701)**	**$ (115,588)**	**$ 1,131,317**	**$ (97,221)**	**$ (36,642)**	**$ 1,604,908**	**$ 2,266,073**	**$ (762,412)**	**$ 1,503,661**
Analysis:									
Revenue Per Visit	$ 140	$ 159	$ 196	$ 181	$ 230	$ 209	$ 201	$ 327	$ 201
Total Cost Per Visit	$ (192)	$ (198)	$ (170)	$ (184)	$ (231)	$ (160)	$ (186)	$ (383)	$ (186)
Overhead Cost Per Visit	$ (44)	$ (46)	$ (39)	$ (43)	$ (53)	$ (37)	$ (43)	$ (89)	$ (43)
Annual Visits per Staff Person	804	574	840	787	667	908	789	730	789
Surplus/(Loss) Per Visit	**$ (52)**	**$ (39)**	**$ 26**	**$ (4)**	**$ (1)**	**$ 49**	**$ 16**	**$ (56)**	**$ 10**

[1] Figures shown are from the proposed budget for GFHN clinics, inclusive of clinic overhead costs and revenues allocated to clinics. GFHN has other operations, such as homeless services, that are not shown here. Total net income for all services in the proposed budget is $1,429,854.

[2] Includes five new staff for Santa Clara clinics.

[3] Includes temporary $1 million operating subsidy and annual $425,000 grant by Packard.

[4] Includes County Primary Care Grant of $1.5 million, Measure A funds of $804,000 and Santa Clara Family Health Plan receipts of $250,000.

[5] Includes expenses payable to Packard of $756,000.

Attachment 1

GARDNER
FAMILY HEALTH NETWORK, INC.

ALVISO HEALTH CENTER - GARDNER PACKARD CHILDREN'S HEALTH CENTER - COMPRECARE HEALTH CENTER - GARDNER DOWNTOWN HEALTH CENTER
GARDNER SOUTH COUNTY HEALTH CENTER - ST. JAMES HEALTH CENTER - GARDNER HEALTH CENTER - HEALTHCARE FOR THE HOMELESS

Ms. Cheryl Solov
Contract Senior Manager
Management Audit Division
SANTA CLARA COUNTY BOARD of SUPERVISORS
County Government Center, East Wing, 10th Floor
70 West Hedding Street
San Jose, CA 95110

Dear Ms. Solov:

We are in receipt of your final management audit report in connection with your recent review of our two affiliated corporations: *Gardner Family Healthcare Network* (GFHN) and *Gardner Family Care Corporation* (GFCC).

On behalf of my entire senior management team, our board of directors, and myself, I want to extend a sincere thank you and an appreciation for your hard work and diligence in conducting your operational review and in preparing your assessments and list of recommendations.

While a detailed response to each and every one of your findings and recommendations would be beyond what could reasonably fit within the confines of this letter, we are happy to present some of our thoughts.

- First, on the GFCC side, we are happy to accept your recommendation of a County advance of no more than 33% against the un-reconciled outstanding A/R balance due to GFCC from the County of roughly $2.5MM. By our calculations, this advance would approximate $750K. We ask only that we proceed quickly with this matter, as waiting for the County to hire a new analyst would cause unwarranted and needless delay. A limit of 33% should provide the County the needed "cushion" to preclude any dramatic adjustments of either direction when these accounts are finally reconciled.

- Second, the GFHN & GFCC Board is already addressing and remedying much of the board-related recommendations which you have made to ensure that the Board is abiding by Gardner's By laws; especially removing inactive Board members. To be clear, much of these matters were already being discussed and addressed by board governance as a result of recommendations stemming from both last year's financial (A133) audits and HRSA recommendations. It is important to note, that Gardner must

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have a user (patient) majority board in order to maintain our federal 330 grant which provides many benefits to the corporations such as Federally Qualified Health Center "FQHC" reimbursement (enhanced medi-cal reimbursement), Federal Torts Claim Act mal practice insurance coverage and grant funding for the uninsured. Furthermore, if you evaluate more closely the qualifications of the "users" you will see that several patients are professionals to include an Attorney, Financial Analyst, Cisco Corporate Affairs Manager, Psychiatric Social Worker with a Doctorate in Education and a Masters in Social Work and an Independent IT Consultant.

- Third, much of your recommendations re: financial policies governing financial review, scrutiny of projects, etc... are already underway. Indeed, although clearly-written and more comprehensive financial policies have not yet been formally presented to the board for their express approval and adoption (targeted for 4th Qtr 2014 implementation), much of our improved financial condition stems precisely from a more focused and diligent application of sound financial review and business practices. We have made significant improvement in our financial reporting and accounting including but not limited to booking our patient net revs and A/R on a net realizable basis, our A/P is current, and our reported healthcare expenses are only out by 4 weeks as a general rule.

- Fourth, regarding healthcare expenses, we are -- as a standard business practice -- at this moment conducting an exhaustive review of the current self-insurance program. The Affordable Care Act provides greater impetus as there is a need to evaluate the impact of a potential "Cadillac tax" on our budget and employees and the possible alternatives that might be available. This is a complicated matter, not easily remedied. Indeed, we are meeting with our employees and bargaining units to re-evaluate our current benefits package, and more appropriate strategies in light of healthcare reform and competitive nature of the business in which we operate. By our calculations, a significant change in this segment of our business will take at least a year to implement. Gardner is not opposed to commercial insurance if it is lower than the self insured premium equivalent. It is important to note that:
  a. A self insurance plan gives the organization more flexibility with respect to the timing of the funding of the self insurance premium equivalent.
  b. In 2010, prior to ICMS being appointed the role of Gardner's Consultant, ICMS completed a full RFP process to examine GHS's options for fully insured quotes. Every major carrier responded with a Decline to Quote (DTQ) based on industry with the exception of Kaiser Permanente. Kaiser's proposal offered rates which were uncompetitive at the time of proposal.
  c. Cash will be needed to cover the Incurred but not reported (IBNR) claims if Gardner opted out of the self insurance plan. While Gardner believes that the IBNR is lower due to improved payment of claims, it is estimated that $500,000 to a million in cash will need to be available for the IBNR.

- Fifth, we continue to focus diligently on a review of our Gardner-Packard joint venture. It is true that this project has been faced with significant obstacles and delays including but not limited to higher startup and operating costs than anticipated, delays in obtaining our "New" PPS rate, etc... It is also true that we and our partners at Packard remain committed to expending every reasonable effort at ensuring project success. Divestment is an option that we are prepared to explore. To this end, however, I am requesting flexibility with regard to the Gardner Packard Children's Health Center (GPCHC) until Gardner and Lucile Packard Children's Hospital (LPCH) have, "at least", an opportunity to reconcile our accounts. LPCH has always committed to maintaining the GPCHC at a break even or better status or at a minimum "no harm" status. It is in both of our "best interest" to do so. LPCH is a partner with the County in providing services in low-income communities and is a contractor with Valley Health Plan to do so. Gardner believes that GPCHC will be made "whole" through the reconciliation process in which case will support the 1186 Valley Health Plan enrollees and others without funding from Santa Clara County.

- Finally, we are requesting a fixed-term loan of up to $2MM or a working capital loan of same amount. At a minimum, we need up to $700K (one period's payroll expense) to help us manage the cash drain during three (3) payroll period months including this month -- Oct 2014. While have greatly improved our cash position over the last 10 months, we may still find ourselves in rare instances where the cash-in is insufficient for that month's expenses. To this end, if necessary, Gardner has four sites that could be used as collateral and has a long history of maintaining its commitments.

Once again, in the last 13 months Gardner has made significant strides to improve its operational oversight and financial condition. Productivity and patient mix has improved, expenses have been reduced, Billing is improving, the allowance for uncollectable accounts has been increase to a realistic level and the Gardner board is taking action to comply with our By-laws. While the operational and financial condition has improved, the County's financial assistance will ensure that we will be able to continue with the success to date. I thank you, Mr. Roger Mialocq and Mr. Adrian Gonzales for all of your hard work and look forward to accepting your proposals and the financial assistance which we have requested.

Sincerely,

Reymundo Espinoza - MPH
Chief Executive Officer

Cc: Roger Mialocq, Adrian Gonzales, Joe Demont, Efrain Coria