SPECIAL STUDY SESSION
March 20, 2002

The Board of Supervisors of Maricopa County, Arizona convened at 12:00 P.M., March 20, 2002, in the Board of Supervisors' Conference Room, Tenth Floor, 301 W. Jefferson, Phoenix, Arizona, with the following members present: Don Stapley, Chairman; Fulton Brock, Vice Chairman; Andy Kunasek, Max W. Wilson, Mary Rose Wilcox, Fran McCarroll, Clerk of the Board; and Shirley Million, Administrative Coordinator. Also present: David Smith, County Administrative Officer; and Paul Golab, Deputy County Attorney. This meeting was called for discussion purposes only and no issue will be voted on.

PRESENTATION: BUDGET UPDATES AND FORECASTS – MIHS

Item: Maricopa Integrated Health Systems presentation of budget updates and forecasts. (ADM 2100)

Chairman Stapley said that this study session is for discussion purposes only and no vote will be taken on any issues. He asked David Smith to give an overview of what the expectation is for this meeting.

David Smith said that relevant persons in the County who had input into this matter were in attendance with teams making presentations from the County's Financial Management and Internal Audit departments, who have been looking at the cash situation and other financial issues in the system. Also in attendance were corporate representatives from Quorum-Cambio (Quorum) and representatives from Deloitte Consulting who have done a detailed study of the financial status of the hospital in the past fiscal year and projections for the next fiscal year. He indicated that this discussion will focus on the third item of the Supervisors' List of Strategic Priorities, which is "A Healthy Community and Solvent Health Care System" – two issues that are of equal concern. He explained, "We're trying to make the best strategic and tactical decisions about our health care system when healthcare is becoming an increasingly volatile industry. We need to identify how much risk we can absorb, how much volatility in terms of the financial situation of the system that we can handle, and how much responsibility we continue to have in the community to provide our fair share of quality health care - and all of the options thereto." He said it was necessary for the Board to hear the best, most cogent information, not filtered through staff, and then to take action as deemed necessary.

Mark Hillard distributed handouts and showed slides during his presentation, which began with the positive trends the Health Plan Membership had taken since 1999. He foresaw an aggressive projection in membership for 2002 due in part to Proposition 204 and the Senior Select membership gains in the last two months.

He next touched on the population that MIHS serves, the largest being AHCCCS (Arizona Health Care Cost Containment System) patients which he sees as increasing in number in the future. He mentioned the steady flow of inpatients, which bucks the declining trend nationally, while outpatient services are increasing nationally. MIHS is experiencing increases in both areas which he attributed in part to the following: The hospital contains one of the largest trauma services in Maricopa County resulting in an escalating emergency room caseload. Also increasing are pediatric services and births, which have almost reached capacity and have overflowed onto a second floor. Questions were asked as to how many of the birth mothers are non-citizens (undocumented women for which federal emergency services monies are received) and the answer was 60-80%. Mr. Hillard felt they would easily meet their projections in every category as they were conservatively formulated and some had already been reached.

Net income discussions followed and Mr. Hillard explained that in 1997 and the late 1990s the County had to subsidize the health system from the general fund by approximately $20-30 million per fiscal year. He reported that the loss of 80% of the ALTCS (Arizona Long Term Care System) business, and resulting competitive increase in payouts to providers had a huge impact last year. In 2000-2001 the profit was $25 million and in 2001, it was down to $15 million illustrating the adverse effect that the loss of the ALTCS income had on the budget.

He said that in the projected net income figures for the FY 2002 budget, the projected net income discrepancies in the Deloitte and MIHS figures total $9,903,000, the largest of these is $8,207,000 for the Delivery System category that deals directly with patients (page 1 of his handout).

He next discussed the rapidly escalating Senior Select enrollments using amounts and numbers which he termed ultra-conservative. Mr. Hillard explained his view of the differences in the MIHS and Deloitte projected numbers in all categories and in particular Senior Select which was the greatest with a $1,675,000 differential in net income. Also in Senior Select expenses, there were differences amounting to $542,000 in Physician Costs and $2,833,000 in Other Medical. He addressed the latter saying, "Other Medical expenses is a conglomeration of many line-items of which the largest is pharmaceuticals which hits everybody's pocketbooks."

Still addressing the 2002 FY budget, Mr. Hillard spoke to the $8,207,000 difference in the Delivery System projection and said that the explanation for this is on page 4 of his handout, with the largest difference of $2,904,000 listed for net revenue. He said that because hospitals get what patients pay rather than what they are billed, their net to gross conversion is set at 47%. Salaries were the next largest item with a $2,266,000 difference which he attributed to his use of an anticipated $4 million increase in employee salaries and which Deloitte did not include. These two items comprise more than half of the differences, the others being made up of other operating expenses ($1,277,000), provision in bad debt ($1,391,000) and non-operating expenses ($1,293,000).

In moving to the projected 2003 budget, page 5 of the Net Income MIHS handout shows that the projected FY 2003 budget difference between the MIHS figures and the Deloitte report totals $21,974,833. The largest single item is, again, the Delivery System total of $13,707,000. Other total differences are Senior Select ($6,295,000); MHP ($1,509,000); Health Select (527,000) and MLTCP (+$63,167), totaling $8,267,833 and, adding this to the $13,707,000, gives the total of $21,974,833. He breaks the projected Delivery System Budget FY 2003 down as follows (page 9): Management Initiatives, $7,546,000 (from page 8); Rate Variance Salary, wages, benefits and contract labor, $1,960,000 and Rate Variance Supplies, $3,966,000, which totals $13,472,000 (page 9).

Note: The aggregate total in considering Management Initiatives, which contained amounts not in the Deloitte rectification, showed projected totals as follows (page 8 of the handout).

Gross Patient Revenue	$49,594,000.
Net Patient Revenue	$29,269,000
New Revenue	$29,578,000
Total Expenses	$22,032,000
Gross Margin	$7,546,000
Net Income	$7,546,000

Mr. Hillard said there were some big problems to overcome but expressed the hope that accentuating the positive and eliminating the negative aspects of the system could control expected losses until the economy turned around.

Ross Tate and Eve Murillo, Internal Audit, presented their audit report. Mr. Tate said their report is not related to information that has been given by Mr. Hillard but relates to an additional issue that was identified last Fall and which highlighted many trends similar to those that led up to the near-bankruptcy conditions in the mid-1990s.

Mr. Tate presented graphs illustrating trends in the cash on hand in the Treasurer's Office, "Total Health System Combined Cash" and the "Medical Center (only) Cash." The former went from a low of approximately $14 million in December 1996 to a high of $90 million in December of 1999 and a decline to approximately $29 million in December 2001. The Medical Center went from approximately minus $68 million in December 1996 to a minus $21 million in March 1998 and then declined steadily to the present total of approximately a minus $158 million, with an adjusted balance of approximately $105 million following two injections of ALTCS money ($34M in November 2000 and $15M in November 2001). Those were the last deposits made from the ALTCS program.

Supervisor Brock said, "The acid test of the hospital and its performance is in cash, and this auditor's report shows two things: 1. The County has infused cash into the system the past two Novembers - and these aren't even cumulative, these are just annual; 2. If this were a business we'd show negative earnings of $3 million a week instead of $1-2 million a month in write-offs, that's $3 million a week times 50 weeks or $150 million bucks and the trend has been in an increasingly negative down-turn since the Spring of 1998. We need to watch what's going on with the cash." He made the point that while there is growth in some areas, as shown by Mr. Hillard's report, "if we're losing money on every deal then we need to look carefully at that."

Supervisor Kunasek asked Mr. Tate about the ALTCS transfers in November of 2000 and 2001, wanting to know if he characterized them as bills that were owed or bailouts.

Mr. Tate replied that the ALTCS program has been the moneymaker in the Health Care System and the hospital has not been. He said that those transfers were, "just infusions from within the system and not transfers from outside of the system."

David Smith asked for comments on the system's cash picture from all those in the room who have a responsibility to the County in this. He said that the general fund backs up all of this with taxpayer dollars and "it's incongruous to have a system that may be turning the corner, bottoming out and showing improvement, and then have the cash continue to diminish. That's a problem to me, because in the end we have to protect the general fund. We need to know how much of a threat to the general fund this cash position represents."

Tom Manos said there are only a few reasons why cash flow would significantly drop, that the hospital business isn't as profitable as it used to be, and he noted that there was a dollar-for-dollar drop in cash for the drop in profitability. But he said that the bigger issue would be the growth in accounts receivable and the third reason was an increase in capital spending. As to when this could impact the general fund, Mr. Manos said there are set-asides required for the health plan. Currently, the hospital is desperately close to those set-asides. He said that if the threshold is broken the County would probably have to step in with necessary cash.

Mr. Sines said, "The system has spent $82 million in four years on capital projects, which is a lot of money to put back into a hospital system. It was done because the infrastructure, particularly in the hospital itself, is very run down." Accounts receivable has grown by $23 million. He said, "Basically, you should not be pouring a lot more money into that hospital building because it is so old and the structure is so poor that your money wouldn't be spent wisely. The hospital is in such a state of disrepair and so old that a decision will have to be made in 4-6 years to replace it or close it because there won't be enough cash to rebuild it." He indicated that the healthcare plan is subsidizing the hospital and the hospital will never produce a positive bottom line without it.

During discussion, it was conceded that the County must reduce its risk. The healthcare business under the best of conditions is a very risky one, particularly in today's market. There are a number of proprietary hospitals in the Valley that are having problems and hospital care is becoming more and more dominated by large systems. A district that would truly insulate the County is needed, but the one that is currently being talked about would not truly insulate the County's general fund from risk.

Leo Kessler, from Deloitte Consulting, said, "You have no cash balance build-up that the normal hospitals have, which is cash on hand to run on for 145 days. By comparison, there is a significant difference to where you are at $20M, and that alone shows how risky this situation really is." He added, "If the hospital was shut down tomorrow there is a tail to be paid out that would last over a longer period than you have cash to cover." He stated that a plan of action is needed to bring cash back in for the 2003 budget.

At the end of Audit's report, Chairman Stapley asked Mr. Tate to inform the Board monthly on the cash position of the hospital and health care system so the Supervisors will be continually aware of that status.

Leo Kessler began Deloitte's report by explaining that at the end of November 2001, Sandi Wilson had asked them to give a conservative estimate of where the County will be at the end of this year (2002) with regards to the cash balance and operations at the hospital. He asked that everyone understand that they were not asked, "to create the most likely or worst case scenario but for a conservative estimate of where the finances will be." He said that this directive would help explain the variance between Deloitte's numbers and those given by Mark Hillard, and he assured the Board that both sets of numbers were guaranteed to be wrong at year's end.

He indicated that their plan was prepared from information given to them by MIHS, although they did not have some of the latest numbers to include in their projection. He said they have had limited experience and exposure with MIHS management, which was the intention so that neither their anticipations nor the intervention of management could color Deloitte's interpretation. He said that Deloitte intends to maintain the position, "We were here, we did the work, but we offer no opinion."

Mr. Kessler called attention to page 4 of the Deloitte handout on the overall profitability by month for the past two years. He said that the trend line shows where the system is headed but that monthly peaks and valleys don't always tell you the trend, as illustrated by the March 2001 low point reached when the hospital wrote off an accumulated $17 million as bad debt. The chart on page 5 shows how the trends are being driven by the functional deterioration of the hospital and the FHC's, (Family Health Centers) who are considered as part of Maricopa County's healthcare delivery system. The delivery system is the problem area and the primary cause of the health system's financial crises. He said that the Health Plan line is also moving down slightly while the CHC (Comprehensive Healthcare Centers) are managing to hold the line as the primary-payer side of the equation.

He said that if the hospital's threatened decertification by the Center for Medicare and Medicaid Services should be realized it would no longer be eligible to bill the government for these categories of service and that would cause a major upheaval because these areas generate a significant portion of the hospital's revenue. However, the Deloitte report did not take this unconfirmed aspect into consideration.

Mr. Kessler explained the "high level summary of assumptions" for various portions of the health care system including the health plans and other portions of the handout, and answered questions.

He stated that the two most important issues impacting the health plan performance are the continued decrease in ALTCS enrollment and the increase in patient base per thousand of Senior Select.

Mr. Kessler explained that for the past 18 years he has spent 100 percent of his time doing projections for integrated health systems similar to this one, as well as HMOs individually and a lot of stand-alone hospitals. Additionally, he has done a lot of consulting work around capital projects and strategic planning dealing with start-up facilities and turn-around conditions. He wanted the Board to understand that he has a serious background in these kinds of issues.

Supervisor Brock asked Mr. Kessler about cash projections for the future and he said that the estimated net cash projection of amounts due to the County by year-end 2002 is $11M, the estimated year end 2007 deficit is $397M, but he added, "that is way out there." He estimated the cash balance at year-end 2003 at $5M.

Supervisor Brock asked, "When do we run out of cash?"

Mr. Kessler said, "I would say, in the projected year, in 2003 when you're at $5M of cash."

Discussion ensued on the reserve fund which is $20M but it was explained that this amount would not cover the healthcare system at the current rate of expenditure for even one month.

MEETING WAS RECESSED TO THE EXECUTIVE SESSION

There being no further business to come before the Board at this time, the meeting was recessed.

Don Stapley, Chairman of the Board

ATTEST:

Fran McCarroll, Clerk of the Board