

Salinas Valley Memorial Healthcare System

Increased Transparency and Stronger Controls Are Necessary as It Focuses on Improving Its Financial Situation

REPORT NUMBER 2011-113, ISSUED MARCH 2012

This report concludes that the Salinas Valley Memorial Healthcare System's (Health Care System) board of directors (board), when making decisions regarding executive compensation, violated the Ralph M. Brown Act, which requires legislative bodies of local public agencies to conduct their meetings in an open manner. In an environment characterized by a lack of an executive compensation policy and limited transparency, the Health Care System granted compensation for its executives at the upper end of the range for the health care industry. In addition, the former chief executive officer (CEO) received generous retirement and severance benefits totaling \$4.9 million between 2008 and 2011, most of which were paid to him before he retired.

Our review also noted weaknesses in controls in several areas. We identified 11 instances in which the Health Care System had business relationships between 2006 and 2010 with entities in which its executives or board members had economic interests. In the two relationships we reviewed, the former CEO may have violated conflict-of-interest laws in one instance, and the board may have violated conflict-of-interest laws in the other instance. Also, the Health Care System did not ensure that many of the individuals its conflict-of-interest code identified as needing to submit statements of economic interests did so. Further, it does not have a written policy and procedures to demonstrate that its community funding furthers its public purposes, thereby risking questions about whether this funding violates the constitutional prohibition against public agencies making gifts of public funds. Additionally, for contracts we reviewed for which it was not required by state law to use a competitive process, the Health Care System generally did not document how it selected contractors in a way that demonstrated that it obtained the best value when procuring goods and services.

Finally, we noted that the Health Care System has undertaken several initiatives to improve its financial situation, including reducing its staff by 341 positions between July 2010 and October 2011. Even though it reduced its staffing, there is no indication that this decrease affected patient quality of care, as reflected by complaints and similar measures.

In the report, the California State Auditor (state auditor) made the following recommendations to the Health Care System. The state auditor's determination regarding the current status of recommendations is based on the Health Care System's response to the state auditor as of September 2012.

Recommendation 1.1.a—See page 16 of the audit report for information on the related finding.

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should develop a formal policy that establishes a process for determining executive compensation, including retirement benefits, that clearly documents all executive compensation decisions.

Health Care System's Action: Fully implemented.

The board adopted an executive compensation policy in July 2012 that defines the Health Care System's process for establishing executive compensation and requires that compensation, including benefits, for the CEO shall be approved by the board in open sessions of board meetings. Similarly, this policy requires that the board approve salary scales and benefits for executives other than the CEO in open sessions. The policy also specifies that the CEO has the authority to set salaries for other executives and must report the salaries he or she sets to the board.

Recommendation 1.1.b—See pages 16—19 of the audit report for information on the related finding.

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should clearly indicate compensation matters on the agendas for its board meetings.

Health Care System's Action: Fully implemented.

The Health Care System's updated executive compensation policy requires that matters concerning compensation for the CEO or other executives must be specified in agendas and/or minutes for board meetings. In addition, review of the agendas for board meetings in May through August 2012 indicate that the Health Care System is following this policy.

Recommendation 1.1.c—See pages 16—19 of the audit report for information on the related finding.

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should discuss executive compensation matters only in open sessions of board meetings, except in the limited circumstances that allow for discussion in closed sessions.

Health Care System's Action: Fully implemented.

The Health Care System's executive compensation policy specifies that the CEO's compensation, including benefits, the CEO's employment agreement, and salary scales and benefits for executive positions other than the CEO shall be approved by the board in open session, and discussion of these compensation matters may occur in closed session only in the limited circumstances specified in law. The Health Care System's board agendas and minutes for May through August 2012 indicate the board is adhering to its executive compensation policy.

Recommendation 1.2—See pages 19 and 20 of the audit report for information on the related finding.

To ensure that the terms of its CEO's employment and compensation are clear, and to aid the board in its oversight role, the Health Care System should engage its next permanent CEO in a written employment contract.

Health Care System's Action: Fully implemented.

According to the Health Care System's executive compensation policy, its permanent CEO, when hired, will be engaged in an employment agreement. In addition, in its six-month response, the Health Care System indicated that it now requires employment contracts for all of its executives, including the CEO, and that it executed an employment contract with its chief operating officer. Moreover, Chapter 322, Statutes of 2012 (Assembly Bill 2180), requires that a written employment agreement entered into with a hospital administrator by a local health care district include all material terms and conditions regarding compensation and benefits agreed to by the district and the hospital administrator. In addition, the governor vetoed Assembly Bill 2115 of the 2011–12 Regular Legislative Session on September 13, 2012. This bill if enacted, would have required, rather than permitted, local health care districts to enter into written employment agreements not to exceed four years when hiring a hospital administrator or CEO.

Recommendation 1.3—See pages 27 and 28 of the audit report for information on the related finding.

To help reduce its operating costs and improve its overall financial situation, the Health Care System should continue to try to modify its employee benefits, such as paid time off, so they are aligned with industry practice.

Health Care System's Action: Pending.

In its six-month response, the Health Care System stated that in light of current union contracts, it is challenged with balancing nonunion benefits to union benefits to ensure it is able to retain qualified employees and candidates. Nonetheless, the Health Care System indicated that its executive leadership team and the board continue to evaluate opportunities to shift this variance between the Health Care System's employee benefits and industry practice.

Recommendation 2.1.a—See pages 32—37 of the audit report for information on the related finding.

To ensure that the Health Care System, its board members, medical staff, employees, and consultants are engaged only in appropriate business relationships with respect to their economic interests, the Health Care System should engage an independent investigator to review the Health Care System's business relationships with entities that we identified as being economic interests of its board members and executives to determine whether any of the relationships violate applicable legal prohibitions and take appropriate corrective action if they do.

Health Care System's Action: Partially implemented.

The Health Care System engaged a law firm to conduct an independent investigation of its relationships with business entities we identified in our report as economic interests of the Health Care System's board members and executives. According to a general summary of the law firm's findings, it found that seven of the nine relationships it examined did not violate any applicable legal prohibitions; for the other two relationships, one of them had ceased and in the other the affected employee or official no longer has a financial interest in the entity. Consequently, according to the law firm, no corrective action was required for any of the nine relationships. However, the law firm also indicated it detected some issues during its investigation and analysis that raised concerns regarding the manner in which the Health Care System identified and addressed potential conflicts of interest. As a result of these issues, the law firm indicated it is working with the Health Care System to implement systems to address these concerns in order to prevent similar issues in the future.

Recommendation 2.1.b—See pages 32—37 of the audit report for information on the related finding.

To ensure that the Health Care System, its board members, medical staff, employees, and consultants are engaged only in appropriate business relationships with respect to their economic interests, the Health Care System should implement the requirement in its recently updated conflict-of-interest policy that board members, medical staff, employees, and consultants disclose potential conflict-of-interest situations to their supervisors and the ethics and compliance officer, who shall review each situation and make a determination on the appropriate resolution.

Health Care System's Action: Fully implemented.

According to the Health Care System, 24 individuals who submitted statements of economic interests for 2011 identified financial interests in their statements. The revenue integrity and compliance director determined based on her review of the 24 statements that 11 of them required further discussion between the individuals and either the revenue integrity and compliance director or the individuals' supervisors. Following these discussions, according to the revenue integrity and compliance director, she determined no actual violations of conflict-of-interest laws occurred in 2011. In addition, all 24 individuals understood that moving forward they needed to be alert for potential conflicts of interest associated with their identified financial interests.

Recommendation 2.2—See pages 37 and 38 of the audit report for information on the related finding.

To ensure that it has an up-to-date, approved conflict-of-interest code, the Health Care System should develop a protocol to file an action through the superior court to adopt a code if, in the future, the board of supervisors does not approve a code within six months of one being submitted to it by the Health Care System and if follow-up efforts with the board of supervisors prove unsuccessful.

Health Care System's Action: Fully implemented.

The Health Care System amended its conflict-of-interest policy to specify that if the board of supervisors does not approve changes proposed by the Health Care System's conflict-of-interest code within six months of submission, then the Health Care System will seek legal counsel to consider potential superior court action to ensure action by the board of supervisors.

Recommendation 2.3.a—See pages 38—41 of the audit report for information on the related finding.

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to specify an individual as its filing officer, in accordance with guidelines of the Fair Political Practices Commission.

Health Care System's Action: Fully implemented.

The Health Care System's amended conflict-of-interest policy specifies that its ethics and compliance officer, now called its revenue integrity and compliance director, serves as the filing officer for all positions designated in its conflict-of-interest code as needing to file statements of economic interests (designated filers).

Recommendation 2.3.b—See pages 38—41 of the audit report for information on the related finding.

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to delineate the steps its filing officer should take to ensure that all Health Care System board members, medical staff, employees, and consultants who are required to file statements of economic interests do so.

Health Care System's Action: Fully implemented.

The Health Care System's amended conflict-of-interest policy delineates the steps that the revenue integrity and compliance director will take to ensure that designated filers submit their statements of economic interests, including sending reminders to all designated filers, following up when individuals do not submit their statements, and reporting noncompliance to the Health Care System's executive leadership.

Recommendation 2.3.c—See pages 38—41 of the audit report for information on the related finding.

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to specify penalties for failure to file.

Health Care System's Action: Fully implemented.

The Health Care System amended its conflict-of-interest policy to specify that individuals submitting their statements late are subject to progressive discipline and a fine of \$10 per day that the statements are late, up to a maximum fine of \$100. In addition, the policy states that designated filers whose statements are not received within 30 days of their due dates will be referred to the Fair Political Practices Commission for noncompliance enforcement proceedings.

Recommendation 2.4—See pages 40 and 41 of the audit report for information on the related finding.

To help ensure the accuracy and completeness of filed statements of economic interests, the Health Care System's filing officer should follow state regulations for reviewing submitted statements, including verifying the cover sheet for completeness for all submitted statements.

Health Care System's Action: Fully implemented.

The Health Care System's amended conflict-of-interest policy specifies that the revenue integrity and compliance director will review all submitted statements for overall completeness and general accuracy. In addition, in the Health Care System's six-month response, it indicated that in collecting and reviewing the statements for 2011, the revenue integrity and compliance director reviewed the cover sheets for all statements and ensured completion and submission of all appropriate schedules.

Recommendation 2.5—See pages 41—43 of the audit report for information on the related finding.

To ensure that it is not making gifts of public funds, the Health Care System should develop and implement a policy and written procedures to demonstrate how funds it provides to support entities and programs in the community further the Health Care System's public purposes.

Health Care System's Action: Fully implemented.

The Health Care System adopted a community funding policy to ensure that all Health Care System resources provided to any individual, organization, or entity are expended for the public purpose of its mission of improving health care. This policy includes procedures the Health Care System is to follow in evaluating and approving requests for community funding, and specifies that all Health Care System decisions related to community funding will be made pursuant to these procedures. The Health Care System also provided in its six-month response documentation that demonstrates it is following its new community funding policy and procedures.

Recommendation 2.6—See page 43 of the audit report for information on the related finding.

To help ensure that the Health Care System has the information it needs to comply with state regulations regarding public disclosure of the disposition of event tickets, the Health Care System should develop and implement a policy and written procedures for tracking its distribution of event tickets. The procedures should ensure that the Health Care System follows state requirements for making pertinent public disclosures.

Health Care System's Action: Partially implemented.

Included in the Health Care System's community funding policy is a policy regarding the disposition of event tickets. The policy specifies that when the Health Care System receives tickets or other benefits in response to providing community funding, the benefits shall be provided to the Salinas Valley Memorial Hospital Foundation (foundation). The policy also indicates that the foundation is responsible for maintaining all records related to the distribution of all tickets and benefits. However, it does not appear that the Health Care System's policy regarding ticket disposition is adequate to ensure it complies with applicable state reporting requirements because, among other things, the policy does not ensure that the Health Care System's provision of tickets to the foundation will be publicly disclosed.

Recommendation 2.7—See pages 45—47 of the audit report for information on the related finding.

To increase the transparency of its processes for awarding contracts that are not required by law to be selected using a competitive process, the Health Care System should require its employees to fully document the steps they take in selecting contractors and to describe how the selections result in the best value to the Health Care System.

Health Care System's Action: Partially implemented.

The board adopted a revised procurement management policy in June 2012 that directed the Health Care System's executive leadership group to adopt a procurement manual that incorporates, clarifies, and coordinates all Health Care System procurement policies. The Health Care System is in the process of drafting a procurement manual that will include guidance and requirements for Health Care System employees to follow when making all organizational procurements. The guidance and requirements in the procurement manual will address the steps Health Care System staff should follow to document and describe how their selections of contractors result in the best value. The procurement manual is currently being completed and reviewed by legal counsel, with anticipated completion by the end of 2012. According to the revenue integrity and compliance director, the Health Care System started providing training at the department director level on the new procurement policies and procedures since May 2012.