



Office of the City Auditor

**Report to the City Council
City of San José**

**CITY'S FUNDING FOR THE
CHILDREN'S HEALTH
INITIATIVE: THE CITY HAS
HELPED FUND HEALTH CARE
COVERAGE FOR ABOUT 2,000
SAN JOSÉ CHILDREN
ANNUALLY**

**Report 14-01
February 2014**



Office of the City Auditor
Sharon W. Erickson, City Auditor

February 13, 2014

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

City's Funding for the Children's Health Initiative: The City Has Helped Fund Health Care Coverage for About 2,000 San Jose Children Annually

Since 2001, the City of San José (City) has provided \$2.1 million annually to the Santa Clara Family Health Plan (Health Plan) to fund health care coverage for San José children through its Healthy Kids program. The Healthy Kids program was created as part of the Children's Health Initiative, which was launched by Santa Clara County in 2000 to provide health coverage for uninsured children in the County whose families earned less than 300 percent of the federal poverty level or whose immigration status precluded them from enrolling in the state's Medi-Cal or Healthy Families programs.

The Health Plan is a licensed health maintenance organization (HMO) that provides health care coverage to eligible Santa Clara County residents through Healthy Kids and other programs. It also contracts with the California Department of Health Care Services to receive funding to provide health care services to Medi-Cal recipients. It is important to note that as an HMO, the Health Plan's main expenditures are for medical payments to doctors and other health care providers.

The objectives of our audit were to determine how City funding had been spent by the Health Plan and to determine how many children were covered using City funds. This audit was conducted in response to the Mayor's June, 2013 Budget Message, which asked that the City verify that none of the City funds spent on the Health Plan had supported an organization engaged in political outreach or in support of organizations engaged in any activities other than providing health insurance to children.

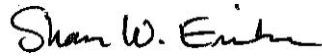
In FY 2012-13, more than 70 percent of all children covered by Healthy Kids (4,200 children out of 5,800 total) were San José residents. Under the FY 2012-13 grant agreement with the Health Plan, the City's funding provided health care coverage for 2,035 San Jose children. The City's funding covered 97 percent of the costs of these 2,035 children.

The Health Plan has had a long relationship with the Santa Clara Family Health Foundation, a nonprofit organization which fundraises for the Children's Health Initiative and other projects. Based on our review, it does not appear that the Health Plan transferred funds to the Foundation to support activities outside the scope of the City's grant agreement in FYs 2011-12 and 2012-13. Nonetheless, we recommend the City clarify its next contract with the Health Plan and improve monitoring of expenditures.

We would like to thank the Santa Clara Family Health Plan; the City's Department of Parks, Recreation and Neighborhood Services; and the City Attorney's Office for their time and insight during the audit process.

This report includes one recommendation. We will present this report at the February 20, 2014 meeting of the Public Safety, Finance, and Strategic Support Committee. The Administration has reviewed this report and its response is shown on the yellow pages.

Respectfully submitted,



Sharon W. Erickson
City Auditor

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Introduction

In accordance with the City Auditor’s Fiscal Year (FY) 2013-14 Work Plan, we have completed an audit of the City’s funding to the Santa Clara Family Health Plan for the Children’s Health Initiative. We conducted this performance audit in accordance with generally accepted government auditing standards. 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. We limited our work to those areas specified in the “Audit Objective, Scope, and Methodology” section of this report.

The Office of the City Auditor thanks the Santa Clara Family Health Plan; the City’s Department of Parks, Recreation and Neighborhood Services; and the City Attorney’s Office for their time and insight during the audit process.

Background

Since 2001, the City of San José (City) has provided \$2.1 million annually to the Santa Clara Family Health Plan (Health Plan) to fund health care coverage for San José children through its Healthy Kids program as part of Santa Clara County’s Children’s Health Initiative. The County Board of Supervisors created the Children’s Health Initiative in 2000 to provide comprehensive health coverage for uninsured children in the County whose families earn less than 300 percent of the federal poverty level¹ or whose immigration status precludes them from enrolling in the state’s Medi-Cal or Healthy Families programs.

Beginning in FY 2013-14, the City started a three-year phase-out of funding to the Health Plan. Funding for FY 2013-14 is \$1.1 million. Funding for FY 2014-15 and FY 2015-16 is scheduled to be \$550,000 and \$275,000, respectively. The City is decreasing its funding because the County will be directing a portion of revenues from a voter-approved sales tax increase passed in November, 2012 to the program (Measure A).

History of the Santa Clara Family Health Plan

In 1995, the Santa Clara County Board of Supervisors established the Santa Clara County Health Authority (Health Authority) for the purpose of developing a community-based health plan—the Santa Clara Family Health Plan—to provide

¹ The current federal poverty level for a family of four is \$23,550 or \$1,963/month.

health care services to Medi-Cal Managed Care recipients. The Health Authority contracts with the California Department of Health Care Services (DHCS) to receive funding to provide such services.

In 1996, the Health Authority became a licensed health maintenance organization (HMO) and in 1997 the Health Plan began operations. It is important to note that as an HMO, its main expenditures are for medical payments to doctors and other health care providers.

In 2000, the Health Plan formed the Santa Clara Family Health Foundation (Foundation), a nonprofit public benefit corporation, to raise funds and conduct outreach to promote health care services for children. In 2001, the Health Plan launched the Healthy Kids program to provide coverage under the Children’s Health Initiative.

In addition to Medi-Cal and Healthy Kids participants, the Health Plan also provides coverage to County residents through a Healthy Workers program and an arrangement with the DHCS to provide services for patients being transferred from Agnews Developmental Center to community facilities.

In FY 2012-13, the average monthly enrollment in all of the Health Plan’s programs was about 144,000—90 percent of whom were Medi-Cal recipients. About 5,800 were enrolled in the Healthy Kids program. Exhibit I shows the Health Plan’s revenues and expenses for FYs 2010-11 through 2012-13.

Exhibit I: Santa Clara Family Health Plan Revenues and Expenses, FYs 2010-11 Through 2012-13 (\$thousands)

	2010-11	2011-12	2012-13
Revenues:			
Medi-Cal funding and other programs’ revenues	\$202,881	\$238,420	\$288,368
Healthy Kids	<u>9,121</u>	<u>7,935</u>	<u>6,938</u>
Total	212,002	246,355	295,306
Medical expenses:			
Medical expenses for Medi-Cal and other enrollees	(176,990)	(222,044)	(262,657)
Medical expenses for Healthy Kids enrollees	<u>(7,031)</u>	<u>(6,377)</u>	<u>(5,406)</u>
Total	(184,021)	(228,421)	(268,063)
Revenues less medical expenses	27,981	17,934	27,243
Administrative expenses*	(17,152)	(18,030)	(19,222)
Non-operating income (expenses)	162	(11,789)	322
Net profit (loss)	\$ 10,991	\$ (11,885)	\$ 8,343

Source: Santa Clara Family Health Plan Annual Financial Statements and Santa Clara Family Health Plan

* Administrative expenses include salaries and benefits, services and supplies, and facility costs.

Audit Objective, Scope, and Methodology

The objectives of our audit were to determine how City funding had been spent by the Health Plan and to determine how many children have been covered using City funds. This audit was conducted in response to the Mayor's June, 2013 Budget Message, which asked that the City verify that none of the City funds spent on the Health Plan since 2001 had supported an organization engaged in political outreach or in support of organizations engaged in any activities other than providing health insurance to children. Prior to this, two Councilmembers had expressed concerns that City funding for the Children's Health Initiative had been used by the Foundation for political campaign activities in 2012.

To achieve our audit objectives, we:

- Interviewed City staff to understand the purpose of the grant agreements and City staff's role in monitoring the Health Plan to ensure compliance with the agreements
- Reviewed current and past grant agreements to understand what costs and activities were allowable under the agreements
- Interviewed Health Plan staff to understand their operational and fiscal controls to ensure enrollees in the Healthy Kids program were eligible and Healthy Kids costs were appropriately allocated, and their current and past relationship with Foundation
- Reviewed audited financial statements, quarterly performance reports submitted by the Health Plan to the City, and other documents provided by the Health Plan to understand their organization and its past financial and operational performance
- Examined Health Plan accounting records to determine the purpose of transactions between the Health Plan and the Foundation for FYs 2011-12 and 2012-13
- Verified eligibility of a random sample of families with children enrolled in the Healthy Kids program by reviewing submitted documentation related to income, residency, and age.

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Finding I **The City Funded About 2,000 of the 4,200 San José Children Covered by the Healthy Kids Program in FY 2012-13**

Summary

In FY 2012-13, more than 70 percent of all children covered by the Health Plan’s Healthy Kids program (4,200 children out of 5,800 total) were San José residents. Under the FY 2012-13 grant agreement with the Health Plan, the City’s funding provided health care coverage for 2,035 San José children. The City’s funding covered 97 percent of the costs of these 2,035 children. Based on our review, it does not appear that Health Plan transferred funds to the Santa Clara Family Health Foundation to support activities outside the scope of the City’s grant agreement in FYs 2011-12 and 2012-13. Nonetheless, we recommend the City clarify its next contract with the Health Plan and improve monitoring of expenditures.

About 72 Percent of Healthy Kids Enrollees Since FY 2006-07 Have Been San José Children

In FY 2012-13, the Health Plan covered about 5,800 children per month in Santa Clara County under the Healthy Kids program, of whom 4,216 were San José children. Exhibit 2 shows the average monthly enrollment in the Healthy Kids program from FY 2006-07 through FY 2012-13. The percent of enrollees who were San José residents has remained steady at about 72 percent.

Exhibit 2: Average Monthly Enrollment in Santa Clara Family Health Plan’s Healthy Kids Program, FY 2006-07 Through FY 2012-13

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
All Santa Clara County Healthy Kids participants	13,110	11,353	9,532	8,672	7,287	6,498	5,759
San José participants	9,460	8,217	6,905	6,241	5,235	4,715	4,216
San José participants as a % of total enrollment	72.2%	72.4%	72.4%	72.0%	71.8%	72.6%	73.2%

Source: Santa Clara Family Health Plan

As can be seen in Exhibit 2, average monthly enrollment in FY 2012-13 is less than half of what it was in FY 2006-07. According to the Health Plan, the declining enrollment in Healthy Kids has been due to a number of factors, including a rise in the number of children qualifying for a different program (e.g.,

Medi-Cal), a decline in the number of undocumented children in the County, low birth rates, and the County’s fairly high health insurance coverage rate for children.

The Health Plan Has Controls in Place to Ensure Eligibility of Healthy Kids Applicants

Families enroll in the Healthy Kids program with the help of Certified Application Assistants. These assistants are California state-certified and trained in enrolling individuals in Medi-Cal and the Healthy Kids program. During the enrollment process, the Certified Application Assistant gathers documentation to verify a prospective applicant’s eligibility and enters the data into enrollment software. Examples of some of the types of documentation gathered include:

- Paycheck stubs, employer statements, income tax returns, copies of public benefits award letters or bank statements showing direct deposit to verify income eligibility
- Recent rent, mortgage, or utility receipts or a current valid California Driver’s License or Identification Card to verify residency
- A birth certificate to verify age

The enrollment software makes a preliminary assessment of eligibility, which is then reviewed by a Health Plan staff member to confirm whether individuals qualify for the Healthy Kids program. They also search their database to ensure the applicant is not already covered by another program. Each year, the Health Plan requires enrollees to submit updated documentation to ensure continued eligibility and repeats the review process.

The City’s FY 2012-13 Grant Funding Paid for 34 Percent of Healthy Kids Overall Program Costs

Exhibit 3 shows the Health Plan’s total Healthy Kids revenues, medical expenses, and allocated administrative costs from FY 2006-07 through FY 2012-13. The Health Plan allocates its administrative costs based on the relative number of enrollees in each of its programs (e.g., Medi-Cal, Healthy Kids, etc.) Similar to the drop in enrollment shown previously, Healthy Kids revenues and related medical expenses have dropped significantly since FY 2006-07.

Exhibit 3: Healthy Kids Revenues and Expenses, FY 2006-07 Through FY 2012-13 (\$millions)

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Revenue	\$14.3	\$12.0	\$11.0	\$11.1	\$9.1	\$7.9	\$6.9
Medical expenses	(12.8)	(10.9)	(9.1)	(8.4)	(7.0)	(6.4)	(5.4)
Administrative costs	(2.9)	(2.7)	(2.0)	(1.3)	(1.0)	(0.8)	(0.8)
Net income/(loss)	(\$1.4)	(\$1.7)	(\$0-)	\$1.4	\$1.1	\$0.7	\$0.8

Source: Santa Clara Family Health Plan

Note: Columns may not foot because of rounding.

In FY 2012-13 the City’s \$2.1 million grant covered 34 percent of Healthy Kids overall costs (including administrative costs). By comparison, in FY 2006-07, the City’s grant funding covered just 13 percent of Healthy Kids costs.

The federal Affordable Care Act includes an 80/20 rule that generally requires insurance companies to spend at least 80 percent of the money they take in on premiums for health care and quality improvement activities instead of administrative, overhead, and marketing costs. Since FY 2006-07, the percentage of the Health Plan’s revenues spent on medical expenses has averaged 82 percent for the Healthy Kids program and 89 percent across all programs – well within the requirements of the Affordable Care Act.

The City’s FY 2012-13 Grant Funding Covered 97 Percent of the Costs for Over 2,000 San José Children

Exhibit 4 shows Healthy Kids revenues and expenses per covered child from FY 2006-07 through FY 2012-13. Over that time, the Health Plan has spent, on average, about \$80 per child per month on medical expenses and \$14 per child per month on administrative costs. Revenues per child have ranged between \$88 and \$107 per child per month (averaging \$98).

Exhibit 4: Healthy Kids Revenues and Expenses per Covered Child per Month, FY 2006-07 Through FY 2012-13

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Avg
Revenue per child per month	\$91	\$88	\$96	\$107	\$104	\$102	\$100	\$98
Costs per child per month:								
Medical expenses	\$81	\$80	\$79	\$81	\$80	\$82	\$78	\$80
Administrative costs	\$19	\$20	\$17	\$12	\$11	\$11	\$11	\$14
Total	\$100	\$100	\$97	\$93	\$91	\$93	\$89	\$95

Source: Auditor analysis of data provided by the Santa Clara Family Health Plan

Note: Columns may not foot because of rounding.

Under the City’s FY 2012-13 agreement with the Health Plan, the City’s funding was to go toward health care coverage for 2,035 San José children. This figure was derived by dividing the total grant by an estimate of the yearly cost to provide health care services for an individual child, calculated to be \$86 per month.² The actual cost, as can be seen in Exhibit 4, was \$89 per child per month. As such, the City’s funding covered 97 percent of the cost of these 2,035 San José children.

² This is calculated as follows: \$2.1 million / \$86 per child / 12 months = 2,035.

There Have Been Many Financial Transactions Between the Health Plan and the Santa Clara Family Health Foundation Over the Years

In June 2000, the Health Plan formed the Santa Clara Family Health Foundation, which is a nonprofit public benefit corporation dedicated to the support of medically related community service programs. The Foundation fundraises for the Children's Health Initiative, the Healthy Kids program, Healthy Workers, and other projects designated as priorities of the Health Plan. Although the Health Plan formed the Foundation, it does not have financial accountability for the Foundation and the Foundation's bylaws require that no more than 49 percent of its board of directors may be management or directors of the Health Plan.

Prior to July 2013 (when the relationship was terminated), the Health Plan and the Foundation had a very close relationship. From 2000 through 2006, the Health Plan contributed \$1,000,000 annually to the Foundation. In addition, prior to FY 2013-14 the two organizations were located at the same facility and shared some administrative costs.³ The Foundation, in its role as a fundraiser, was also the recipient of grants from other cities in Santa Clara County for the Healthy Kids program. These grant funds were remitted to the Health Plan once they were received by the Foundation.⁴ The City appears to be unique among cities in the County in that it paid the Health Plan directly, rather than providing funding to the Healthy Kids program through the Foundation. Santa Clara County also directly pays the Health Plan.

Audit staff reviewed all of the payments made to the Foundation by the Health Plan for FYs 2011-12 and 2012-13, and during that time it does not appear that the Health Plan transferred funds to the Foundation to support activities outside the scope of the City's grant agreement. Following is the complete list of payments the Health Plan made to the Foundation in FYs 2011-12 and 2012-13:

- Nearly \$12,000 in payments representing contributions withheld from Health Plan staff pay as part of a charitable giving program.
- Monthly pass-through payments in FY 2011-12 from a grant received by the Health Plan from First 5 Santa Clara County for both Health Plan and Foundation activities. This arrangement was not in place FY 2012-13 and has been discontinued.
- A \$50,000 repayment to the Foundation related to a Healthy Workers program grant from a different grantor. The Foundation had originally advanced this payment to the Health Plan; however, the original grantor rescinded its commitment to the Foundation.

³ In FY 2012-13, shared administrative costs included the cost of two staff members, one of whom was a health educator and the other an analyst working on a market research project.

⁴ The Health Plan's FY 2012-13 audited financial statements included a receivable of \$319,279 from the Foundation for shared administrative costs and grant funding due from the Foundation.

- A \$6,000 payment to sponsor a Healthy Kids 10th Anniversary event.

The City Should Update its Next Contract with the Health Plan and Improve its Monitoring of Expenditures

In reviewing current and past grant agreements, we believe the City should clarify two areas of ambiguity in the grant agreement with the Health Plan.

1. The current grant agreement specifies that the City's funding is to go toward "health coverage units," calculated to be \$86 per member per month. According to the Health Plan, the \$86 figure is an estimate of the premium cost needed to cover each child, including both medical expenses and administrative costs (as noted previously, the actual cost in FY 2012-13 was \$89). The grant agreement is unclear as to what constitutes a "health coverage unit," or premium, and whether it includes administrative costs. Modifying the agreement would clarify what costs the City is funding.
2. The current agreement allows for San José residents *between the ages of birth and 18*. In practice the Health Plan enrolls children between the ages of birth and 19 (i.e., through the month a child turns 19) in Healthy Kids. The City should clarify the age limit to cover children under the age of 19.

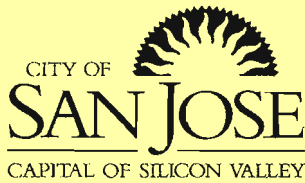
The City Should Improve its Monitoring of the Health Plan's Performance Under the Contract

The City Grants Manual provides guidance and policies to City staff on grant applications, administration, and close-out. In its section on monitoring procedures, the manual requires both program and fiscal desk reviews and site visits for grants greater than \$25,000 to ensure that grant funds are being used appropriately.

The Department of Parks, Recreation and Neighborhood Services (PRNS) is responsible for monitoring the Health Plan's performance and financial activity under the grant agreement. Each quarter, the Health Plan provides performance reports detailing activity to date on the Healthy Kids program and progress toward goals specified in the agreement. However, PRNS has not verified reported activity or conducted fiscal or performance site visits for this agreement in recent years.

Recommendation #1: We recommend that the Department of Parks, Recreation and Neighborhood Services should:

- a) **Work with the City Attorney's Office to clarify the language in the next grant agreement with the Health Plan regarding (i) what expenses are deemed appropriate under the agreement and (ii) the appropriate ages of children for which the City's funding should be used.**
- b) **Conduct performance and fiscal site visits, document reviews, or other appropriate monitoring activities.**



Memorandum

TO: SHARON WINSLOW ERICKSON
CITY AUDITOR

FROM: Julie Edmonds-Mares

SUBJECT: SEE BELOW

DATE: February 6, 2014

Approved

Date

2/6/14

SUBJECT: ADMINISTRATION'S RESPONSE TO CITY'S FUNDING FOR THE CHILDREN'S HEALTH INITIATIVE: THE CITY HAS HELPED FUND HEALTH CARE COVERAGE FOR ABOUT 2,000 CHILDREN IN SAN JOSE ANNUALLY"

The Administration has reviewed the final draft report of the Audit of *City's Funding for the Children's Health Initiative: The City Has Helped Fund Health Care Coverage For About 2,000 Children In San Jose Annually*" and agrees with the findings and recommendations made by the City Auditor's Office in the report. The Administration values the City Auditor's examination of the Santa Clara County Family Health Plan (Health Plan) and is pleased to see that the Health Plan has spent funds appropriately.

The Administration also acknowledges the need for additional administrative efforts that will clarify contractual obligations and ensure closer monitoring of expenditures.

RECOMMENDATIONS AND RESPONSE

Recommendation #1: We recommend that the Department of Parks, Recreation and Neighborhood Services should:

- a) Work with the City Attorney's Office to clarify the language in the next grant agreement with the Health Plan regarding (i) what expenses are deemed appropriate under the agreement and (ii) the appropriate ages of children for which the City's funding should be used.
- b) Conduct performance and fiscal site visits, document reviews, or other appropriate monitoring activities.

SHARON WINSLOW ERICKSON, CITY AUDITOR

Subject: Children's Health Initiative: The City Has Helped Fund Health Care Coverage For About 2,000 Children In San Jose Annually

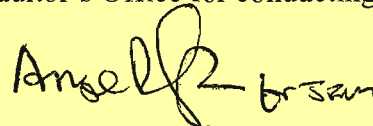
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Administrative Response: The Administration agrees with this recommendation. In future agreements, the Department of Parks, Recreation and Neighborhood Services (PRNS) will collaborate with City Attorney's Office and the Health Plan to clarify and detail the costs the City is funding and accurately reflect the age limit for which the funds should be used.

PRNS will apply its grants monitoring procedures as provided in the City's Grants Manual and practiced with other grant programs in the department. PRNS staff will conduct at least one mandatory site visit per year which will include the review of a random sampling of children enrolled to test for eligibility. During the site visit, PRNS will also conduct a financial review to verify the percentage of funds going to administration. PRNS has not had the capacity to perform site visits for this particular organization given recent staffing eliminations in the contracts and grants unit. However, PRNS will reprioritize internal workloads to ensure that these site visits occur accordingly. PRNS staff has met with City Auditor's Office staff for guidance on the pertinent supporting documentation to be reviewed during the future site visits.

CONCLUSION

Proactive actions will be taken to thoroughly address the above recommendation during this FY 2013-2014. The City Manager's Office and the Department of Parks, Recreation and Neighborhood Services would like to thank the City Auditor's Office for conducting this audit.



JULIE EDMONDS-MARES
Director, Parks, Recreation and
Neighborhood Services