Response to Recent Criticism of Our Hospital

Today's anxiety arising from the coronavirus pandemic reinforces the vital importance of keeping a financially healthy, 4-star safe Sonoma Valley Hospital (SVH) in our community. We need SVH to serve on the frontlines of the current crisis, just as we need it to deal with countless daily medical emergencies (9,000 per year) that occur in the lives of Valley residents.

In February, a private ad in the *Index Tribune* questioned why our Hospital's Board has not taken action regarding the last seven year's $31.4 million of "Operating Losses." In fact, the ad used "operating margin," a useful number for planning and analysis but not a good measure of financial results; nor is it a good measure one should think of as "Operating Losses". The Hospital's $9.5 million of "Earnings Before Depreciation and Amortization" over those same seven years is a much more credible indicator of SVH financial performance and cash flows.

The misleading ad also failed to consider the realities of operating a small rural District Hospital in Sonoma and its counterpart hospitals in California and around the country that are failing. Among significant facts the ad did not consider or discuss:

- Government Accounting standards require District hospitals to expense deprecation on assets purchased not by the Hospital, but by philanthropy and General Obligation Bonds. This is "book depreciation" on assets it did not buy and is unlikely to ever have to pay to replace. It is roughly $2.3 million a year of depreciation deducted from "operating margin" but it has nothing to do with SVH cash flow or sustainability. Over the seven years that same "book" depreciation accounted for more than half of the negative operating margin.
- SVH and other hospitals have almost no control over the prices they can charge for services provided to Medicare and Medi-Cal patients which constitute 61 percent of SVH net revenues. Those prices are set by State and Federal agencies. Moreover, hospitals cannot refuse to serve those patients. Together, over the last three years, Medicare and Medi-Cal losses have averaged $8.5 million of annually.
- Moreover, the regulatory regime for hospitals sets specific requirements for equipment, staffing levels, and staff qualifications that limit opportunities for cost cutting.
- In addition, indigent community members must be admitted and treated often with little in the way of reimbursement. In addition, patients of limited means may have insurance and must be admitted, but they often cannot or will not cover their co-payments because they either have not yet covered their annual deductible amounts or cannot or will not make their co-payments for the services provided to them. These shortfalls are not reimbursed by the insurers
- Further, Kaiser's market presence in the North Bay means more than half the Sonoma Valley market is unavailable for SVH to serve other than in its Emergency Department.

The idea that Operating Margin losses (Revenues minus out of pocket cost) at SVH are the result of poor management or marketing is wrong. No other industry operates with such demands and constraints. Better marketing and management might help improve the numbers, but are inadequate to explain the challenges in managing SV Hospital (and the hundreds of other small hospitals in California and around the County, many of which have been forced to close decimating their local communities.)

Most of Sonoma Valley Hospital's "Direct Margin" losses arise from serving Medicare and Medi-Cal patients, the inability to serve the half or more of the Sonoma Valley market that are members of Kaiser, plus the misleading depreciation of assets not purchase by SVH.

In recent years all of the above, plus losses from the very popular Obstetrics, In-Home Care, and Skilled Nursing lines of business (roughly $-1 million per year) made hospital cash management very difficult. In doing our work we found that in 2016, and 2019, SVH had to borrow against parcel taxes (2016) and IGT receivables (2019) to pay its vendors and keep the doors open.

Another management challenge involves dealing with the vagaries in the amounts and timing of Federal and State reimbursements. They greatly complicate profitability and cash flows. These Intergovernmental transfers (IGT) involve large sums of money in retroactive accounting adjustments that significantly affect revenues and profits. Note as well the hospitals, including SVH, that pursue such reimbursements must make significant up front "Matching Fee" payments to those who do the analysis and negotiate with Federal Agencies to receive higher reimbursement for losses incurred serving Medi-Cal patients a year or two earlier. When agreements are finally reached for Government reimbursements to reduce the losses, the timing of those reimbursements are uncertain. Meanwhile the Hospital had to absorb the losses that adversely impacted cash flows. Fortunately, a 2019 bridge loan helped the Hospital obtain the cash needed when IGT payments were delayed.

Finally, the recent (2018/19) closing of Obstetrics, Home Care and Skilled Nursing, combined with savings from the UCSF relationship, generous local philanthropy, achieving a four-star Medicare rating for safety, attendant success in generating significant IGT reimbursements, plus parcel taxes are what kept the Hospital afloat through all of its challenges. Moreover, early results for 2020 appear to show much improved results and cash flows generally consistent with the budget. The SVH management and Board of Directors have kept the doors open and put in place programs that are yielding much improved financial results. All of this required a competent hard-working CEO and Board plus some first-rate marketing to generate the needed community support and results.

Attached to this report – or available on our Web site at Key Performance Indicators is a spread sheet showing the Key Performance Indicators we believe are credible measures of our Hospital's financial health and performance.

Sonoma Valley Hospital

Key Performance Indicators

Year	"Hospital Operating Loss" (Operating Margin) per 2/7/20 I-T Ad (A)	Net Income / (Loss) prior to Restricted Contributions	Net Income/(Loss) w Restricted Contributions & GO Bond Activity (C)	EBDA - Not including Restricted Contributions	Net Fund Balance (Equity) at Year End (B)	Total Contributions
2013	$ (4,593,000)	$ (2,014,449)	$ 1,958,737	$ 118,256	$ 10,857,528	$ 3,858,727
2014	$ (4,080,000)	$ (1,397,736)	$ 2,980,280	$ 942,140	$ 13,618,231	$ 3,757,072
2015	$ (4,896,000)	$ (2,073,062)	$ 658,472	$ 1,435,335	$ 14,279,101	$ 1,171,395
2016	$ (3,548,000)	$ (1,060,894)	$ 1,399,720	$ 2,400,303	$ 15,681,823	$ 1,022,384
2017	$ (4,887,000)	$ (2,398,468)	$ 462,363	$ 987,457	$ 16,140,667	$ 974,392
2018	$ (6,399,000)	$ (3,374,304)	$ (299,836)	$ 49,898	$ 15,840,832	$ 1,227,291
2019	$ (2,998,000)	$ 198,477	$ 4,234,934	$ 3,590,712	$ 20,127,639	$ 1,994,059
TOTALS	**$ (31,401,000)**	**$(12,120,436)**	**$ 11,394,670**	**$ 9,524,101**		**$ 14,005,320**

Operating Margin, although not a valid measure of financial performance, is an important metric because it reflects the significant losses from service to Medicare patients that must be made up by other income sources. Earnings Before Depreciation and Amortization (EBDA), which includes GO bond receipts less bond interest expense is the best, although conservative, measure of financial performance in that GO bond receipts are assured for many years to come. The hospital's financial position includes another significant contributor to the hospital's finanial strength that should not be overlooked; restricted contributions ($9,524,101 for the seven years ended 6/30/19).

(A) - Should be $(7,499,000) and total should be $(34,307,000)

(B) - In July 2019, Net Fund Balance increased approximately $2,000,000 to over $22,000,000 from the gain on the sale of land. Net Fund Balance (Equity) increased $9,270,111 or 85% from 6/30/13 to 6/30/19.

(C) - Total contrbituions for the seven years ended 7/31/19 exceeded $24.3 million. As of 1/3120, total contributions and pledges for the new Outpatient Diagnostic Center exceeded $19.5 million.