MT. ASCUTNEY HOSPITAL
AND HEALTH CENTER

A Dartmouth-Hitchcock Affiliate

July 1, 2016

Attn: Mr. Michael Davis, Director of Health System Finances
Green Mountain Care Board
89 Main Street, Third Floor, City Center
Montpelier, Vermont 05620

Re: Budget 2017 Narrative

Dear Mr. Davis,

This letter serves as the narrative required to accompany the electronic budget files which have been sent under separate cover.

Executive Summary:

2017 will be a year of transition for the hospital, characterized by continuing integration into Dartmouth-Hitchcock Health (DH-H). There are significant challenges of decreasing volumes, decreasing reimbursement, uncertain environmental changes, and leadership transitions. The organization is adapting to DH-H regional planning, service allocations, and expectations of clinical and financial effectiveness and efficiency. Clinical, administrative, and technological integration are paramount to the success of the affiliation.

Volumes:

Most volumes are expected to be flat or close to it. We expect little growth in any of the Inpatient units and flat projections for most ancillaries. Most concerning is the reduced volume anticipated for surgery and surgical providers. Physician departures in 2016 and 2017 are expected to have a negative effect on both surgical volume and the related payor mix. Primary Care will have similar volumes but with a higher percentage of mid-level providers performing the services than previously.

Rate Increases:

Gross prices are increasing by 4.9%. Inpatient Room and Board for Acute Inpatient, Swing Inpatient, and Acute Rehabilitation are all increasing by 6%. Additionally, all Inpatient Ancillaries are increasing by 6% with the exception of the rehabilitative therapies which are increasing by 5%. All Outpatient charges and ancillaries are increasing by 6% as well, again excepting the rehabilitative therapies which are increasing by 5%. Physician charges are increasing by 4%.

Deductions from Revenue:

For the last two fiscal years, Medicaid and Medicare have increased as a percentage of total revenue. Medicaid is entirely fixed rates and a cut by the State of Vermont for Inpatient and Outpatient reimbursement is a material loss. Coupled with the elimination of Provider-Based reimbursement we are looking at an overall reimbursement percentage of around 22% of charges. While Medicare is cost based reimbursement, it still does not cover actual cost after sequestration and expense offsets. As a result, contractual allowances continue to climb as a percent of gross revenue. On the positive side, we expect more DSH revenue in the year, and less bad debt.

Net Patient Revenue:

The net result of a degrading payor mix, Medicaid cuts, and flat volumes is a net decrease in patient revenues of approximately .7%.

Other Operating Revenue:

Other operating revenue is up approximately $277,000 due mainly to increased CHT funding and 340b revenues.

Expenses:
Salaries and Benefits:
All salaries and benefits are about $590,000 or 1.8% lower than the 2016 budget.

Overall FTEs are down about 8 from prior budget but in line with 2015 and current actual levels. As part of our continuing integration, some key clinical positions are now contracted services from Dartmouth-Hitchcock. The related expenses are reflected as purchased services instead of salaries.

Recruitment and retention has been an ongoing issue for MAHHC. The 2017 budget reflects a few note-worthy changes and initiatives:

- 3% average merit increase has been scheduled for July 2016 for our non-M.D. staff. This will continue to move us towards market commensurate wages for our staff throughout the organization. While this has a minimal impact on 2016 (in effect for one quarter), it has a material effect for FY2017. This annualized to a $500,000 plus increase to salaries in the next year.
- 2% average market increase is scheduled in January 2017 to assist in offsetting the benefits increases and to continue to address our market deficiency in wages. This will also be geared towards staff.
- 2.5% average increase is scheduled for January 2017 for our MD's. This comes to approximately $80,000 in increased salaries for the nine months remaining in FY17. Contracts will also be changing a bit to reflect a higher base and lower incentives/bonuses since the latter appears to have little or no effect on provider performance.
- 3% average merit increase has been scheduled for July 2017 for our non-M.D. staff. This will continue to move us towards market commensurate wages for our staff throughout the organization. This has a minimal impact on 2017 (in effect for one quarter). This will amount to around $150,000 in increased cost for FY17.

Benefits are another area where integration is a work in progress. Our aggressive wage package, as budgeted, will help put us in a place to better move to the DH benefit platform in the future. Most other benefits stayed the same or had nominal inflationary increases. Some savings were also achieved through partnering with DH for Stop Loss coverage.

Depreciation and Interest:

- Depreciation is increasing due to capital purchases scheduled for 2017 and the ongoing increase from the Fair Market Valuation performed at the time of the affiliation.
- Interest is expected to decrease by approximately $150,000 as we refinance our debt upon entering DHOG effective 7/1/2016.

Other Expenses:

- Supplies and Contracted Services are increasing with 2-3% inflation factors, adjusted by volume.
- Telehealth as added to this category for FY17 at an annual cost of $55,000.
- Contracted Labor is expected to increase, mostly offset by a reduction of FTE's, as a number of employees are now contracted from Dartmouth-Hitchcock.
- Insurance (Liability) will be going down 10% from current premium rates as we move into the DH Captive insurance Program. We will also be avoiding the expected double digit increase associated with staying in the NEAH Program. Altogether, this was an improvement of about $72,000 from what we would have normally budgeted.

Operating Margin:

Our Operating Margin will be a 2.4% loss or approximately $1.24 million. A "System Allocation" payment in the same amount will be made as a net asset transfer to MAHHC from DH. This payment will occur below the line and so our Total Margin will improve. While this leaves an unfavorable Operating Margin on the books, functionally, cash, most ratios, ability to invest in infrastructure, etc. will look like we had an operating margin of $0.00.

Non-Operating Revenues:

Investment income assumptions are fairly conservative as the organization moves its assets to into Dartmouth-Hitchcock investment plan. Non-operating also revenues include 1.2 million in net asset transfers from Dartmouth Hitchcock as discussed above.

Capital budget investments:
In the coming year we expect no CONs to be filed, as most of the planned purchases are for replacement equipment and plant maintenance. The CON that is active currently will be completed in late FY16 or early FY17.

Please let us know if there are additional requests or concerns. Thank you.

Sincerely,

David C. Sanville
C.F.O./V.P. Finance