SOUTHWESTERN VERMONT MEDICAL CENTER
Significant Revenue and Expense Variances
Fiscal Year ended September 30, 2016

Purpose

This document is prepared to address the significant net patient service revenues variance drivers in FY 2016 and were appropriate identify the specific direct expenses associated with the revenue variances.

Operations overview

In FY 2016 Southwestern Vermont Medical Center (hereafter "SVMC" or "Hospital") exceeded the budgeted gain from operations was $916,182 higher than budget or a .46% operating margin variance.

Table #1 is the comparative summary FY 2016 financial results vs. FY 2016 budget.

Table #1 – Summary Financial Results

	FY 2016 Budget	***FY 2016 Actual***	***Variance***
Net patient service revenues	$144,025,568	$151,922,754	$7,897,186
Other operating revenues	2,022,823	2,730,803	707,980
Total operating revenues	*146,048,391*	*154,653,557*	*8,605,166*
Operating expenses	*141,665,763*	*149,354,747*	*7,688,984*
Operating gain	*4,382,628*	*5,298,810*	*916,182*
Non-operating activities-net	600,000	618,918	18,918
Excess revenues over expenses	***$4,982,628***	***$5,917,728***	***$935,110***
Operating margin	***2.96%***	***3.42%***	***.46%***

The actual operating margin was better than budget by .46%. This positive increase was generated by higher than budgeted net patient service revenues less the corresponding operating expenses to provide those services as well as realization of non-direct patient care revenues.

The overall increase in patient service revenues was $7,897,186 or 5.5% over the budget. Operating expenses increased in almost direct portion of the revenue increase. The expenses increased at a rate of 5.4%. The areas of increase expenses were in direct relationship to the revenues especially in the cost of drugs sold and in the primary care and preventive medicine areas.

Net Patient Service Revenues

In FY 2016 net patient service revenues of $151,922,754 was $7,897,186 greater than budget or 5.5%. The variance to budget was mainly driven by increased volumes in the outpatient setting. Inpatient and observation services were under budget and prior years. The outpatient services increase was primarily due to higher than anticipated volumes in oncology service volumes and drugs in the Cancer Center, physician practices – primary care, endoscopy, laboratory, MRI and others. Orthopedic services overall were significantly under budget both in the inpatient service and outpatient surgery service. Additionally, bad debt and charity care amounts were under budget. The table #2 below provides a summary of the ***significant*** net patient service revenue variances.

*Table #2 – **Significant** net patient revenue variances from budget*

Drugs sold – Cancer Center	$5,471,000
Inpatient and observation	(3,229,000)
Surgical volume (orthopedics)	(1,338,000)
Physician practice primary care and preventive services	2,312,000
Laboratory	887,000
MRI	691,000
All other outpatient services	2,128,000
Subtotal	*6,922.000*
Bad debt expense and charity care improvements	975,000
Net patient service revenue variance	***$7,897,000***

Drugs sold – Cancer Center

As in FY 2015 the revenues and costs generated from pharmaceuticals have significantly exceeded SVMC's budget. The nearly $5.5 million in excess net revenues is over 3.8% of the Hospital's total operating revenue budget. The cost of pharmaceuticals of nearly $12 million represents 8.5% of the Hospital's total operating budget. In FY 2016, the Hospital's drug costs were nearly $12 million up from the previous year of $8.9 million, actual.

In the FY 2016 the cost of drug sold costs were reduced when developing the budget in mid FY 2015. As of July 2015 SVMC became eligible for the 340b discount drug pricing program. Management estimated a $1.4 million savings related to the 340B discount drug program in the FY 2016 budget process which SVMC qualified for the first full year. The actual savings was just over a million dollars due to changes in the program related to a federal court ruling.

The Cancer Center is the service line which the Hospital has seen a significant growth in revenues and the cost of the pharmaceuticals. Table #3 below shows the actual growth since 2013 in volumes, charges and net patient revenues.

Table #3 – Cancer Center – Patients with Pharmaceutical

	Unique Patients	Patient Visits with Pharm	Gross Charges	NPSR	NPSR Per Visit	% Change
FY 2013	401	3,136	$18,090,933	$9,308,046	$2,968	--
FY 2014	353	2,884	$19,559,730	$9,158,066	$3,175	6.97%
FY 2015	371	3,371	$24,029,948	$10,977,778	$3,256	2.55%
FY 2016	402	3,727	$32,244,705	$14,294,163	$3,835	17.79%

Over the four years the Cancer Center has seen its patient volumes decline then increase back to 2013 levels. The average patient visits where pharmaceuticals are received have increased from 7.82 times to 9.27 times or 18% increase. The increase is due to updated protocols and updated types of therapies. The costs of the pharmaceuticals have increased significantly, even with the 340B pricing available to the Hospital. The *actual to actual* increase is over $3.3 million, however the actual to budget increase was approximately $5.4. The difference is caused by several factors but other significant factors are the timing and historical trends utilized in the budget process and the total revenue cap methodology utilized in the budget process.

Inpatient Utilization

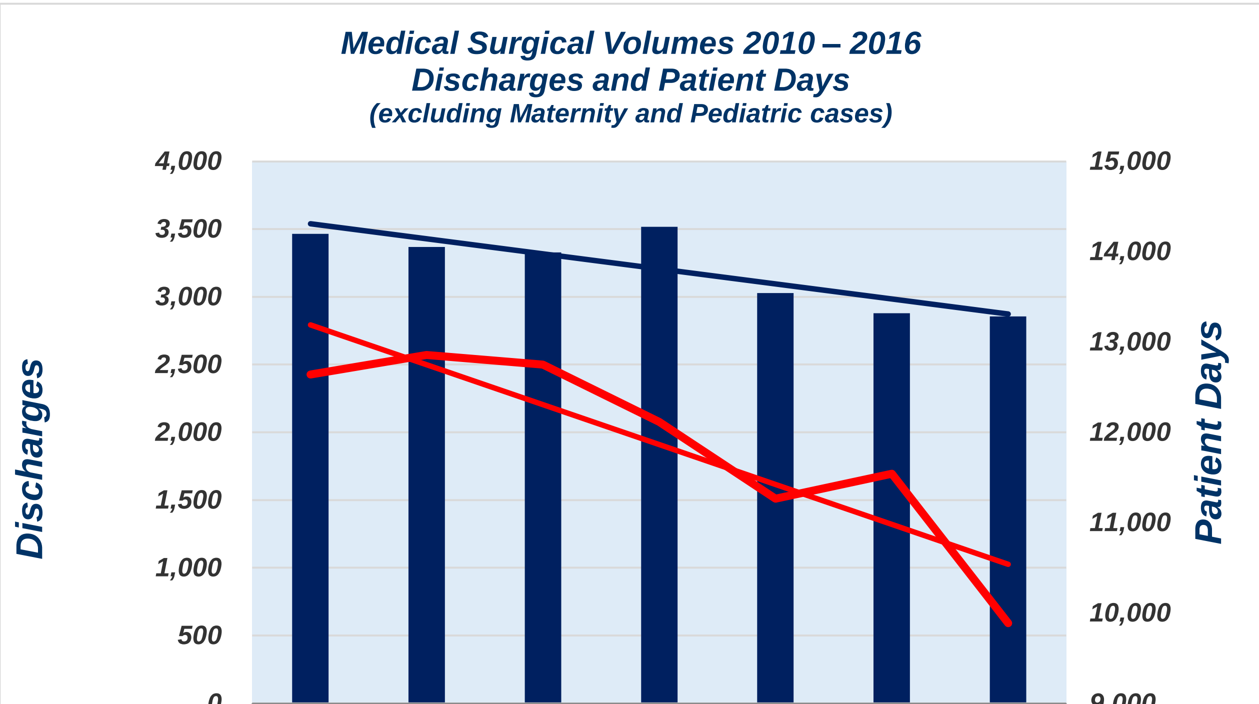
The Hospital continues to improve its primary care network in our service area. The expanded primary care, the positive effects of the "VT Blueprint", and the transitional care nurses and care teams are having an effect on costly inpatient care services in our region. The table below shows the reduction in the inpatient and observation utilization.

Table #4 – Total Inpatient and Observation days/volumes

	Twelve months ended September 30, 2016			
	Actual FY 2016	Budget FY 2016	Variance	Prior year FY 2015
Inpatient Acute Patient Days	11,141	12,159	(1,018)	12,827
Observation patients	978	1,179	(201)	1,023

Additionally, the graph below shows the actual Medical Surgical volumes from 2010 to present.

Graph #1 – Inpatient Medical Surgical Volumes 2010 to 2016



	2010	2011	2012	2013	2014	2015	2016
Discharges	3,465	3,367	3,329	3,518	3,029	2,880	2,856
Patient Days	12,639	12,856	12,751	12,116	11,265	11,542	9,886

The costly Medical Surgical inpatient utilization has been trending down since 2010. Discharges are down over 17% and patient days are down nearly 22%, in an area of the state that is aging. As mentioned above the expanded primary care, the positive effects of the "VT Blueprint", and the transitional care nurses and care teams are having an effect on costly inpatient care services in our region. Additionally, readmission rates have declined. Another contributing factor, less than 5%, has been the migration of orthopedic services leaving the Bennington market due to the inability of the Hospital to recruit new Orthopedists. Effective January 2017 SVMC has retained three additional Orthopedists in Bennington and nearby Massachusetts. It is anticipated this will increase some inpatient volumes but rebuild the outpatient services that have left the market. Also, out of state volumes from MA will increase.

Outpatient surgical volumes

In FY 2016 the continued deterioration of the orthopedic services effected the outpatient surgery volumes greater than anticipated in the budget. The outpatient loss of $1.3 million was greater then anticipated. With the new orthopedic surgeons in Bennington in FY 2017 and especially in 2018 volumes that were leaving the service area should be retained.

Primary Care and Preventive Services

This area of the Hospital revenues increased by over $2.3 million. The Hospital continues to improve its primary care network. Over the past years SVMC has opened Express Care a walk-in physician office with no appointments, opened a new primary care center that is one mile north of the Massachusetts boarder, increased providers in Bennington and in the Northshire the northern most area in our service area. The primary care visit and revenues exceeded all by over $1.4 million.

One area of preventive services where SVMC has seen significant growth is the area of colonoscopies. For nearly three years the Hospital has been recruiting to replace a gastroenterologist that left the region and an additional gastroenterologist to replace a soon to be retiring physician. In FY 2016 both recruitments were completed. Additionally, the Hospital identified a significant back log in preventive diagnostic colonoscopies of greater then 500. In FY 2016 the majority of the back log was eliminated. That elimination increased revenues by over $900,000.

Overall, the operating expenses in the physician fees and salaries category was over $1.7 million. Much of this variance was related to the above two areas. Please note there are non-physician costs also related to this increase in volumes in the offices and to perform the procedures, as well.

Laboratory

The Laboratory outpatient revenues in FY 2016 were over budget by $887,000. The direct operating costs were over budget by $777,000. A significant portion of the increase is related to the increase in the "tick test" which is a costly test that SVMC discussed in FY 2015. The trend has leveled off and SVMC was able to reduce the per test charge, which reduces cost SVMC charges Vermonters through working with the medical community, the vendor and lab personal.

The table below demonstrates the significant increase in volumes and revenues. It also demonstrates the change in the Hospitals charging for this test.

Table #5 – Outpatient "Tick" Test

Outpatient "Tick Test"

	Tick Testing - - Non Lyme	Gross Charges	NPSR	NPSR Per Visit	% Change
FY 2013	175	$48,141	$14,259	$81	--
FY 2014	622	$94,808	$52,596	$85	4.94%
FY 2015	2,582	$650,254	$324,213	$126	48.50%
FY 2016	5,730	$912,486	$445,128	$78	-38.35%

As demonstrated by the table the cost to the average patient is now less however the overall volume of the tests and revenues generated are up. The above is an _actual to actual_ comparison.

MRI Services

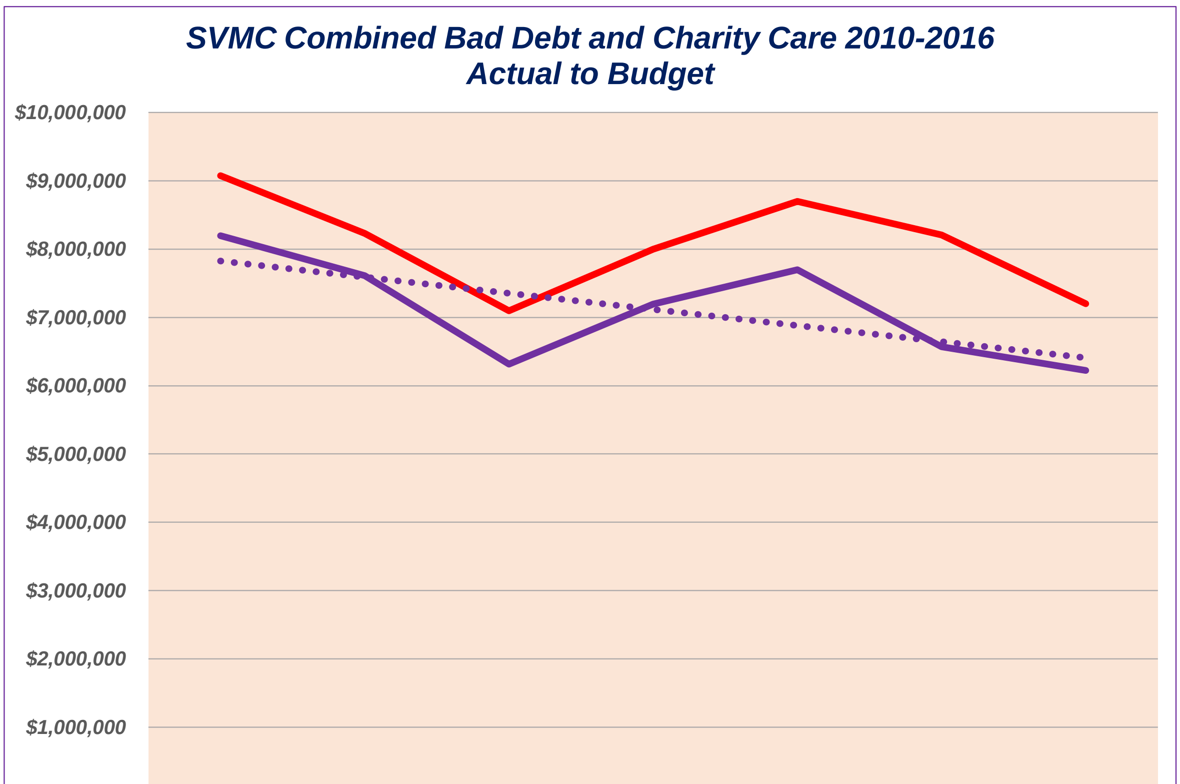
In late FY 2015, the Hospital recruited a neurologist. The Hospital has been recruiting for a neurologist for many years. Neurologist utilize MRI's to diagnosis neurological patient problems. The increase was driven by the new MD in the community which management did not anticipate increased volumes as incurred. The revenues generated exceeded budget by $691,000.

Bad Debt and Charity Care

In FY 2016, management continued on our goal to reduce the bad debt expense at the Hospital. In addition, our goal is to provide affordable care to patients and families that do not have the means to pay for their care. At the beginning of of FY 2016 the Hospital expanded its Charity Care policy. This revision in the policy expanded eligibility as long as the patient and their family cooperated with the charity counselors and provided the required information.

In FY 2016, Bad Debt and Charity Care was approximately $975,000 favorable to budget. New policies as previously mentioned as well as additional technology capabilities and human resources have contributed to our short term success. The graph below provides the combined bad debt and charity care amounts in total from 2010.

Graph #2 – Combined Bad Debt and Charity Care



	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Actual	$8,199,184	$7,610,196	$6,316,722	$7,192,667	$7,700,723	$6,572,936	$6,225,052
Budget	$9,076,037	$8,231,938	$7,100,000	$8,000,000	$8,700,000	$8,210,000	$7,200,000

As the graph demonstrates the trend line is showing a decrease when health care/hospital costs continue to increase. Additionally, the prices the Hospital charges have increased 3 to 7% a year since 2010.

Both internal policy and procedures have assisted in the improvements as well as external factors. Medicaid expansion and the Accountable Care Act where the exchanges have provide opportunity for individuals and families to obtain coverage has assisted in the downward trend. There are other factors as well.

Other Revenue Changes

There are *many* other revenue areas with both positive variances and negative variances. Above are the significant drivers. A significant driver in the overall financial performance of the Hospital in FY 2016 was the increase in Medicare and Medicaid revenues. Medicare and Medicaid revenues increased accounted for over 75% of the $7,897,186 increase. Commercial insurance revenues increased over budget by 1.7%.

The tables below show the gross charge and net revenues by payer.

Table # 6 – Payer schedule – Gross Patient Service Revenues/Charges

Payer	***Actual***	***Budget***	***Variance***	***%Var***	***FY16 %Total***
Medicare	*$155,332,115*	*$145,929,973*	*$9,402,142*	*6.44%*	*49.2%*
Medicaid	*58,628,506*	*55,107,567*	*3,520,939*	*6.39%*	*18.6%*
Commercial/Other	*101,449,416*	*99,160,565*	*2,288,851*	*2.31%*	*32.2%*
Total Gross Charges	***$315,410,037***	***$300,198,105***	***$15,211,932***	***5.07%***	***100.0%***

The above table show the gross patient charges by major payer classification. Approximately two thirds of the patient charges are Medicare and Medicaid.

Table #7 below shows the Payer schedule – Net Patient Service Revenues. Above charges for Medicare and Medicaid represent two thirds of the Hospitals charges the net collectible revenues for Medicare and Medicaid combined is only slightly over 50% of the Hospitals revenues.

Table #7 – Payer schedule – Net Patient Service Revenues

Payer	Actual	Budget	Variance	%Var	FY16 %Total
Medicare	$57,581,550	$51,697,659	$5,883,891	11.4%	37.9%
Medicaid	21,623,808	20,797,604	826,204	4.0%	14.2%
Commercial/Other	72,717,396	71,530,305	1,187,091	1.7%	47.9%
Total Gross Charges	**$151,922,754**	**$144,025,568**	**$7,897,186**	**5.5%**	**100.0%**

The above table shows that a significant portion of the Hospitals revenue increase was in the governmental payers which pay less than the Commercial payers. This explains why SVMC's operating margin was not greater than it was due to increases in in the lower paying financial class since and significant direct costs to provide the service.

Summary

The net patient service revenues were 5.5% over budget. Operating expenses were 5.4% over budget. A significant portion of the revenue overage was dollar for dollar offset in operating expenses due to the increase in governmental payer mix. The cost of drug sold is the most significant example to SVMC. The current budget approval process will continue to create these types of variances each and every year as we are seeing in FY 2017.

Further detail information is available upon request and management urges the GMCB and staff of the GMCB to communicate their additional needs. Additional information can be requested from Stephen D. Majetich, CFO at 802-447-5011 or stephen.majetich@svhealthcare.org and James Roy, Controller at 802-447-5040 or james.roy@svhealthcare.org.