NORTHWESTERN MEDICAL CENTER
NARRATIVE ON ACTUAL FISCAL YEAR 2016 RESULTS

NMC's net patient revenue for FY2016 exceeded budget by $4.2 million, of which, approximately $2.3 million was associated with the acquisition of a pediatrics practice. The remaining $1.9 million variance came from growth of outpatient physician practices and clinics offset by hospital based net patient revenue that finished the year approximately ($400,000) below budget. We experienced a favorable variance in both Bad Debt and Free Care write-offs but this was offset by higher than expected contractual allowance write-offs on hospital based revenue.

As we have stated in previous discussions with the Green Mountain Care Board, even though the net patient revenue cap treats all net patient revenue as though it is the same, it is important to recognize that it is not. Growth in net patient revenue associated with primary prevention and wellness is highly favorable to the statewide pursuit increasing access, improving wellness and reducing costs while revenue associated with traditional hospital services such as inpatient care, emergency department visits and surgeries is an indication that we are falling short of that goal. We are proud to present our actual 2016 results showing that hospital revenue fell short of budget while our outpatient physician practices and clinics continue to grow.

- Mousetrap Pediatrics has been an established practice in our community for many years and was acquired by Northwestern Medical Center (NMC) effective January 1, 2016 and is now Northwestern Pediatrics. We believe that the net patient revenue associated with Northwestern Pediatrics meets the criteria required to be considered an acceptable physician transfer and therefore exempt from the net patient revenue cap in FY2016.
- NMC continues to focus on the growth of outpatient physician practices and clinics as part of broader statewide goals of improving access to the right care in the right setting in the patient's community and increased access and utilization of primary prevention services. Of the remaining $1.9 million dollar variance, $570,000 is from Primary Care and Addiction Medicine which are the key components of primary prevention in our community. Another $350,000 came from Dermatology and Urology which are services that have a history of long wait times for our patients as they attempt to be seen by providers in Chittenden County. We are pleased to be able to offer these services to our patients locally with much improved access. The remainder of the variance is from the Orthopedic practice which is heavily tied to our addiction medicine and pain management service line. The orthopedic practice includes a dedicated interventional pain physician and a sizable portion of the patients seen throughout the practice are referred from the addiction medicine clinic for help dealing with chronic pain which is integral to the goals of increasing prevention and wellness.
- Charity and bad debt write-offs (combined) as a percentage of gross revenues was under budget by 1.3 percentage points. This area has been particularly challenging to budget for given the significant shifts in insurance coverage that have taken place as a result of the Affordable Care Act within the past two years. There were many unknowns regarding the impact of these shifts in coverages and the increasing levels of patient financial responsibility that come along with high deductible plans at the time that the 2016 budget was prepared so a conservative approach was taken in preparing the budget. A 1.4% variance from budget resulted in additional net revenues of $2.3 million. At the time that the 2017 budget was prepared, we had more experience under the current law and felt more confident in budgeting a lower write-off rate for both Bad Debts and Free Care. The

budget for FY2017 is 2.3% of gross patient revenue which is in line with the actual results in FY2016.

- Hospital based outpatient Medicare contractual allowances were over budget by $2.4 million in FY2016. Outpatient contractual allowances are highly subject to shifts in the mix of outpatient services received and because of the high volumes associated with this payer class, a small variance in the write-off percentage can result in a large change in the dollars collected. We implemented an overall 8% price decrease but prices were not decreased evenly across all services which makes modeling contractual allowances for payers that are not on a percent of charge contract more difficult. It is likely that the model used did not fully capture the effects of the targeted approach taken in implementing the price decrease. This variance more than offsets the favorable variance that we saw in Free Care and Bad Debt, leaving hospital collection rates very close to budget.

In total, operating expenses ended the year $4.5 million or 4.6% over budget.

- The acquisition of Northwestern Pediatrics as an unbudgeted physician transfer added $2.1 million dollars of expenses in FY2016.
- Salaries and Wages – part of this variance was related to the acquisition of Northwestern Pediatrics. The majority of the variance in this line was driven by patient care areas such as the Emergency Room and the Inpatient Units. Emergency Department visits exceeded budget by 11.6% and additional staffing (both nursing and physician) was needed to treat these patients. We continue to see a decrease in the acute average length of stay but acute admissions exceeded budget by 12.8% and Swing Bed days were more than twice the amount budgeted resulting in total patient days excluding Nursery being over budget by 5.7%. We continue to deal with a nursing turnover rate that is higher than we would like which results in additional training and orientation time.
  A variety of other smaller variances also contributed, including additional IT staffing required to support the setup of Northwestern Pediatrics as well as a significant upgrade to our EHR that has been occurring over the last twelve to eighteen months.
- Depreciation exceeded budget by $640,000 or 16% which was related to the timing of the purchase or completion of some large assets compared with the assumptions used during the budgeting process.
- Capital expenditures, excluding the Master Facility Plan CONs, came in under budget in FY2016 with total expenses of $5.6 million compared with a budget of $6.2 million. The Master Facility Plan CON projects remain on budget and progress reporting will continue to be done for these.

Other Operating Income exceeded budget by 45% due to the reclassification of certain reference lab revenue and by grant income that was over budget.

- Based on a recommendation from our independent auditing firm, we reclassified revenue associated with reference lab testing for other organizations to other operating revenue. As stated in our FY2017 budget narrative, we believe this reclassification will make NMC consistent with other healthcare organizations in Vermont.
- The major components of grant income that NMC earns are related to the cost of administering the Blue Print Grant and funding the Community Health Team. This income is variable and matches expenses so the variance has no impact on the net operating income of NMC.

Non-operating revenue was over budget for the year due to positive returns on our investments. Due to the unpredictable nature of the stock market, no income is budgeted related to these returns.