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January 31, 2019

Pat Jones, Director of Health Systems Finance
Green Mountain Care Board
89 Main Street
Montpelier, VT 05620

RE: Copley Hospital FY2018 Actual Financial Performance

Ms. Jones:

The following narrative highlights Copley Hospital's actual financial performance for the fiscal year ending September 30, 2018. The hospital's financial performance was not materially different from the projections reported to the GMCB in August 2018 during our proposed FY2019 budget hearing.

OVERVIEW

FY2018 was a challenging year for Copley financially with utilization lower than expected, a rate cut for the third year in a row, and continued cost pressures related to staffing challenges and medical inflation that outpaces the allowed growth in revenue. In response to these financial pressures, Copley implemented an expense mitigation plan in the summer of 2018 that allowed for additional cost control without compromising the delivery of high quality care. By the end of FY2018, expenses were within 0.6% of the budget and net patient revenue was $1.8 million (2.6%) under the GMCB approved budget of $66.2 million. Copley generated an operating loss of $2.2 million in FY2018. This marks the third year in a row Copley generated a loss from operations, deteriorating our cash to 64 days on hand by the end of the fiscal year.

NET PATIENT REVENUE

Net patient revenue was $1.8 million (2.6%) under the GMCB approved budget of $66.2 million, mostly due to lower than expected utilization from medical staff turnover. The following summarizes the components that make up this budget variance in net patient revenue, followed by further explanation.

NPR, Budget 2018	$68,024,531	
Utilization	(3,183,130)	-4.7%
Reimbursement	1,494,609	2.2%
Bad debt and charity care	(109,562)	-0.2%
DSH	0	0%
NPR, Actual 2018	$66,226,448	-2.6%

Utilization

Copley attributes the $3.2 million budget variance in net patient revenue to lower than expected utilization. Notably:

- Total surgical utilization was down 3.7% from budget, with Operating Room cases under budget by 6% and Procedure Room cases remaining on budget. OR utilization was under budget primarily due to the unexpected retirement of the area's only pediatric dental surgeon, a slower than expected ramp-up of an orthopedic surgeon hired as a replacement during FY2018, and the medical condition of an orthopedic surgeon that required a reduction in their surgical time.
- Inpatient admissions were under budget by 4.7%, including a 1.8% decrease in surgical admissions, and observation admissions were over budget by 7%. The average length of stay was 2.6 days, nearly 11% under budget ALOS of 2.9 days.
- Emergency room visits were down 4.4% from budget. This decrease may be partially attributable to health reform efforts that placed a social worker in our Emergency Department to provide enhanced screening and ongoing follow-up with patients to ensure that they have connected with a PCP and/or other resources in the community following discharge. This role has been instrumental in decreasing the percentage of Emergency Department visits of Super-Utilizers, who made up a small percentage of the ED patients, but accounted for a disproportionally high amount of health care utilization.
- Infusion Center visits, which are predominately oncology services, were over budget by 3%.
- In January 2018, Copley's sleep study program ended due to a shortage of providers to support the service. This program operated in collaboration with North Country Hospital, who could no longer provide Copley with a physician to support the program.

Reimbursement

Copley estimates that $1.5 million in net revenue is attributable to better than budgeted reimbursement rates. A major contributing factor to this increase is the cost-based reimbursement that the hospital receives from Medicare, which makes up 38% of Copley's revenue. As a Critical Access Hospital, Medicare reimburses us on the basis of allowable cost, not volume, to help reduce financial vulnerability that could put access to healthcare in rural communities at risk. As such, the negative impact on revenue of decreased utilization was partially offset by an increase in the average rate of reimbursement per day/charge for Medicare patients.

Bad debt and charity

As a percentage of gross revenue, bad debt and charity care increased to 2.3% over the budgeted rate of 2.1%, resulting in a drop of net patient revenue of $110 thousand.

RATES

As illustrated in table below, Copley has contributed significantly to bending the cost curve by reducing rates over 11% in the last three years. The state as a whole has increased rates by more than 8% during this time, making Copley one of the lowest cost hospitals in Vermont.

	Actual FY16	Actual FY17	Actual FY18	3-Yr Total	Estimated Impact on FY18 NPR
Proposed Rate Change	-3.0%	0.0%	0.0%	-3.0%	$(1,115,000)
GMCB Rate Adjustment	-1.0%	-3.7%	-3.4%	-8.1%	$(3,010,500)
Approved Rate Change	-4.0%	-3.7%	-3.4%	**-11.1%**	**$(4,125,500)**
State Average*	+4.4%	+1.7%	+2.1%	+8.2%	
* Source: GMCB Material for September 14, 2017 Final Decision					

Copley's 11% rate reduction is estimated to have given back $4.1 million in NPR to private and commercial payers in FY2018. Copley has been the largest contributor to the reduction of health care prices in the state over the last three years despite being a critical access hospital that accounts for less than 3% of the state's total NPR.

OPERATING EXPENSES

In response to declining utilization and continued cost pressures related to staffing and medical inflation, Copley implemented extra cost control measures in the summer of 2018, including additional requirements for the approval of purchases and overtime, and a freeze on hiring actions, education, travel, and capital expenditures. Any requests for exceptions to the freeze were reviewed by the senior leadership team and subject to the approval of the CEO, allowing for necessary cost control without compromising the delivery of high quality care.

By the end of FY2018, Copley Hospital incurred total expenses of $69.7 million, up $387 thousand (0.6%) from the approved budget of $69.3 million. The budget variance is comprised of an overage of $481 thousand in labor costs, overage of $908 thousand in supplies and drug costs, and savings of $1 million in all other expenses. The table below details the components that make up the expense budget variance, followed by further explanation.

Expenses, Budget FY2018	$69,296,653		
Salaries	(69,142)	-0.3%	**Labor Related $481,035, 1.2%**
Fringe benefits	(219,715)	-3.9%	
Contracted labor	1,014,763	85.7%	
Physicians	(244,871)	-2.4%	
Supplies	317,266	3.2%	**Supply Chain $907,966, 7.1%**
Drugs	590,700	22.6%	
Facilities	(64,855)	-1.8%	**Other Costs $(1,001,997), -6.3%**
Depreciation	(61,114)	-2.0%	
Interest	1,914	1.7%	
Health Care Provider Tax	(162,837)	-4.1%	
Other – Dues, Subs, Educ.	(135,677)	-20.1%	
Other – Insurance	(230,603)	-17.7%	
Other – Purchased Services	(348,825)	-9.6%	
Expenses, Actual FY2018	$69,683,657	0.6%	

Labor & Related Costs
We remain challenged by recruitment and retention of skilled staff and the need for contracted labor, which was $1 million over budget for FY2018. We continue to focus on improvements in this area. We have been working to grow our workforce from within, providing cross-training opportunities. We have developed relationships with 14 educational institutions to provide opportunities for onsite clinical rotations and with 8 graduate programs in nursing, medicine, and healthcare administration. We remain hopeful that our efforts will result in the eventual reduction of travelers. However, as a rural hospital that does not have a deep bench of staff to draw from when coverage needs arise, some travelers and locums will always be needed in order for us to manage unexpected family and medical leaves of absence and turnover.

Supply Chain
As a rural community hospital without economies of scale to leverage greater volume discounts, we have experienced significant cost pressure related to the supply chain. Supplies and drugs were over budget by $908 thousand, or 7.1%, in FY2018. In particular, we continue to face significant inflationary pressure related to drug costs, which is exacerbated by increased drug shortages. We achieved savings of over $170 thousand from participation in 340(b) drug pricing, but these savings only scratch the surface of inflation rates often in the double digits. At Copley, oncology drugs make up 46% of our total drug costs and were $334 thousand, or 29%, over budget in FY2018.

We are currently exploring joining the New England Alliance for Health (NEAH) to utilize the purchasing leverage of the combined membership to help contain supply chain costs. The member-based organization is led by Dartmouth-Hitchcock Health System, and promotes collaboration and resource planning among its members and regional partners. A number of Vermont's critical access hospitals are currently members, including North Country Hospital, Northeastern Vermont Regional Hospital, and Grace Cottage Hospital. We are in the early stages of discussions with NEAH and have yet to determine the amount of potential cost savings that this collaborative opportunity could provide for Copley.

Other Costs
Overall, Copley has been successful in containing the growth of other expenses, which are under budget by more than $1 million, or 6%. We continue to focus on opportunities to improve efficiency, strategically reduce costs, and further develop a culture of ownership that embeds cost management into the mindset of all of our staff.

OTHER & NON-OPERATING REVENUE
Other operating revenue was $1.2 million, under budget by $114 thousand due to decreases in visiting physician practice rental revenue, revenue from pharmacy support services provided to the Vermont State Psychiatric Hospital, and meaningful use funds.

Non-operating revenue was $570 thousand, over budget by nearly $200 thousand, comprised primarily of philanthropic support from our community.

OPERATING MARGIN

Copley generated an operating loss of $2.2 million in FY2018, marking the third year in a row Copley generated a loss from operations. With a deficit of revenue over expenses of $1.6 million, our cash position has deteriorated to 64 days on hand at the end of the fiscal year.

The extra cost control measures implemented in the summer of 2018 remain in place at Copley to-date and will continue until our cash position is improved. We are able to pay our employees and vendors timely and are not in violation of any loan covenants. However, with limited cash reserves, we are in a financially vulnerable position that makes it challenging to weather unexpected downturns, such as a provider's unexpected medical leave, and to invest in necessary capital and infrastructure improvements.

We remain committed to continuing our efforts to reduce the cost of care and to provide access to high quality care in our community. We will be closely monitoring our spending and utilization to determine if the measures we have put into place will be adequate to meet our FY2019 budget. Should it be necessary, we will reach out to you for further discussion on how we can work collaboratively with the GMCB to secure Copley's financial health as the hospital system evolves to value-based reimbursement.

Please feel free to call if you have any questions regarding Copley's actual FY2018 financial performance.

Sincerely,

Art Mathisen
Chief Executive Officer, Copley Hospital