Copley Hospital, Inc.
FY20 Proposed Budget Narrative
to the Green Mountain Care Board (GMCB)
July 1, 2019

1. *Executive Summary*

In FY19, unexpected medical staff vacancies and an unfavorable shift in payer mix have challenged our ability to meet budgeted utilization and net patient revenue (NPR). The medical leave of a prominent orthopedic surgeon, attributable to over $5 million in NPR annually, has been one of the most significant challenges of the year. We adjusted the surgical block schedule, provided more cross-training among the orthopedic surgeons, and bolstered the orthopedic practice staffing to help address access to orthopedic services and improve operational efficiency during this absence. The immense team effort required to make these changes has helped to offset much, but not all, of the absent surgeon's lost revenue. In addition, Copley has experienced an increase in the mix of services provided to Medicare beneficiaries, which are reimbursed at a significantly lower rate than commercial payers. As a result, NPR is projected to be nearly $1.9 million, or 2.6%, lower than the approved FY19 budget.

In addition to a shortage in NPR, Copley contends with significant expense pressure related to unfavorable health insurance claims and the cost of supplies and drugs. In response to these financial pressures, we implemented extra cost control measures, including a limitation on hiring actions, education, travel, and capital investments, while we continued to explore more strategic and sustainable cost savings opportunities. Copley recently joined the New England Alliance for Health (NEAH), which will allow us to utilize the purchasing leverage of 18 facilities throughout Vermont and New Hampshire to help reduce the cost of employee benefits, supplies, and drugs. We anticipate beginning to realize cost savings in FY20, conservatively estimated to total over $230 thousand. As a result of our aggressive management of expenses, operating expenses are projected to be below budget by $554 thousand, or 0.8%, for FY19.

Copley projects an operating loss of $1.2 million in FY19, marking the fourth year without income generated from operations, depleting our cash position. We project Days Cash on Hand of 67 days by the end of the year. With limited cash on hand, we have deferred investment in improvements to our infrastructure and equipment, including a much needed fully-integrated health information system and upgrade of our MRI, keeping our capital spending contained below our annual depreciation. This is not sustainable in the long-term. It is imperative that Copley achieve a reasonable operating margin over the next several years to allow for investment in these necessary improvements to our infrastructure and equipment and build our cash reserves to secure our financial sustainability.

Our FY20 proposed budget reflects our continued commitment to cost containment and aims to improve Copley's financial position so that we can secure access to high quality healthcare in our community, be better positioned to take on risk with the ACO, and invest in necessary capital and infrastructure improvements. In our efforts to meet these objectives, the FY20 proposed expenses include $1.2 million in cost savings goals, containing our budgeted growth in expenses to 1.8% in FY20. During the last three years, Copley has been strongly dedicated to cost reduction efforts and has asked the GMCB to allow us time to implement necessary changes thoughtfully and strategically, thereby ensuring a sustainable future for Copley. We are proud to report that the FY20 proposed budget reflects a three-year average annual growth in expenses of only 2.8%.

Copley's efforts to reduce the rate of expense growth have been significant, but they have not been enough to the bridge the gap caused by unfavorable trends in NPR. In order to attain a 3.5% growth in NPR and yield a moderate operating margin of 1.4%, Copley proposes a 9.8% increase in average gross charges. While we understand that this change in average gross charges is high for one year, Copley has contributed significantly to bending the cost curve by reducing average gross charges by 6.6% since 2015, bringing our five-year cumulative increase to only 3.2% by FY20. The state as a whole has increased rates by nearly 11% since 2015, making Copley one of the lowest cost hospitals in Vermont and the largest contributor to the reduction of healthcare prices in the state over the last four years.

Copley is sincerely interested in participating in OneCare's 2020 Risk-Based ACO Program for our Medicaid population. Our most important objective is to have a strong financial footing as Copley considers entering into risk payment reform. We believe Copley has demonstrated its commitment to implementing operational efficiencies and strategic expense reductions in an effort to improve its financial position, but challenges still remain. With limited cash reserves, we are in a financially vulnerable position that makes it challenging to weather unexpected downturns, take on risk in payment reform, and invest in necessary capital and infrastructure improvements. Copley is in a position where it requires a 9.8% increase in average gross charges to achieve a positive operating margin for the first time since FY15. We respectfully ask that the GMCB work with us to achieve financial stability so that Copley can make a seamless transition to a new healthcare payment model and ensure Copley is properly positioned to deliver high quality healthcare in our community for many years into the future.

2. *Payment and Delivery Reform*

A. Copley has signed a letter of intent to participate in OneCare's 2020 Risk-Based ACO Program for our Medicaid population. OneCare will supply us with a Participation Agreement this summer, along with a financial model to help support further decision making. A commitment to participate or not will be made in August. Should we opt to participate in this risk-based program, Copley can provide further information at that time to the GMCB regarding estimated Fixed Prospective Payments, our maximum upside and downside risk, and our plans for managing this new financial risk while maintaining access to high quality care and appropriate levels of utilization.

D. Copley offers a self-insured health plan for its employees that is managed and administered by MVP Health Plan, Inc. Under the terms of its agreement with the United Nurses and Allied Professionals Local 5109, Copley must continue to offer the medical insurance plans currently in effect for the duration of the agreement which ends in May 2021.

E. Whether as part of an ACO or in a fee-for-service environment, we at Copley are committed to delivering the highest possible quality of care and the most efficient care appropriate. As an integral partner of the Unified Community Collaborative/Accountable Communities for Health Team (UCC/ACH), Copley continues to work in collaboration with community partners to address shared population health goals; specifically through increased screening opportunities, education and improvements in referral and coordination of care processes. Since Copley Hospital does not own any primary care practices, we work collaboratively with community providers (including our local Federally Qualified Health Center), social service agencies, town officials and business leaders to address what can be done to impact the above quality measures. Collaboration with other community organizations has allowed for more efficient use of community resources, decreased duplication of services and has contributed to improvements in access and availability of needed services to ensure that all patients receive the right care, at the right time, by the right provider. Copley supports the mission and vision of all of our community partners and recognizes the importance of our primary care partners in moving the needle on many of the All Payer Model quality measures and other population health initiatives. Please refer to Copley's Non-Financial Reporting submitted on April 30, 2019 for more specific information on Copley's population health and quality improvement initiatives.

3. *Reconciliation of FY19 Budget Performance*

Below is a summary income statement showing a reconciliation between the FY19 approved budget and full-year projection for FY19, followed by budget variance explanations.

	BUD19	PROJ19	Variance	% Var
Net patient revenue	$70,201,316	$68,344,899	($1,856,417)	-2.6%
Other operating revenue	1,188,760	994,300	(194,460)	-16.4%
Total operating revenue	$71,390,076	$69,339,199	($2,050,877)	-2.9%
Operating expenses	71,157,535	70,603,548	(553,987)	-0.8%
Operating surplus	$232,541	($1,264,349)	($1,496,890)	-643.7%
Non-operating revenue	376,900	403,288	26,388	7.0%
Excess of revenue over expense	$609,441	($861,061)	($1,470,502)	-241.3%

NPR is projected to be below budget by $1.9 million (2.6%) as a result of an unfavorable payer mix shift (from Commercial to Medicare) and lower than expected utilization due to the medical leave of an orthopedic surgeon, retirement of our pediatric dental surgeon, and slower than expected ramp up of surgeons hired in 2018. We have reorganized the surgical block schedule, provided for more cross-training among the orthopedic surgeons, and bolstered the orthopedic practice staffing to improve operational efficiency and help address access to surgical services during our orthopedic surgeon's medical leave. The immense team effort required to make these changes has helped to offset much, but not all, of the absent surgeons' lost revenue.

Other operating income is projected to be $194 thousand below budget as a result of not renewing the pharmacy support agreement with the Vermont State Psychiatric Hospital, offset partially by increases in contracted rehab services in local schools and business and increased revenue from orthopedic research grants.

Expenses are projected to be below budget by $554 thousand (-0.8%) as a result of implementing extra cost control measures, 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. Some examples of cost savings we have realized as a result of these efforts include: reducing the cost of contracted labor, not filling the Hospitalist Nurse Practitioner position, replacing our Anesthesiologist position with CRNA's, among other things. Offsetting some of these savings, we are experiencing high health insurance claims cost and continue to contend with high medical inflation on implants and drugs.

As a result of these challenges in meeting our budgeted utilization, Copley projects an operating loss of $1.2 million in FY19, marking the fourth year without income generated from operations. After consideration of non-operating revenue, comprised primarily of philanthropic support, the FY19 projected shortfall of revenue over expense is $860 thousand, depleting our cash position. We project Days Cash on Hand of 67 days by the end of the year. It is imperative that Copley achieve a reasonable operating margin over the next several years to rebuild our cash reserves.

4. *Budget-to-budget growth*

A. Net patient revenues:

i. NPR Change:

Copley Hospital proposes net patient revenue of $72.6 million in FY20, reflecting a 3.5% increase from the approved FY19 budget and a 6.3% increase over current FY19 projections. Copley's request to allow the maximum NPR growth of 3.5% is driven by the need to generate a positive operating margin after four years without income from operations. Copley's ultimate goal is to generate a 3% operating margin annually. The proposed NPR growth of 3.5%, combined with keeping proposed expense growth to only 1.8%, gets us nearly half way to that goal, with a 1.4% operation margin.

ii. Significant changes from FY19 Budget:

There were no physician transfers, certificates of need, re-basing, or any other changes made to the FY19 budget as approved by the GMCB in the budget order dated September 28, 2018.

Described further in section 3 above, FY19 NPR is projected to be below budget by $1.9 million as a result of an unfavorable payer mix shift and lower than expected utilization. These more recent trends in payer mix, utilization, and medical staff changes were reflected in the FY20 proposed budget, most notably:

- Surgical Services – Total operating room cases are proposed to decrease by 140 cases, or 6%, as a result of the retirement of our pediatric dental surgeon, slower than expected ramp up of surgeons hired in 2018, and medical leave of an orthopedic surgeon for the first half of FY20. Our proposed utilization assumes that this orthopedic surgeon will return on a non-surgical basis initially.
- Inpatient Services – Inpatient operating room cases are proposed to decrease by 63 cases, or 8%, due to medical staff changes and the recent trend of more orthopedic procedures being performed on an outpatient basis. Acute inpatient admissions are proposed to decrease 4.4%, while acute inpatient days are proposed to decrease by 11.5% due to a reduction in the actual average length of stay from 2.6 days to 2.4 days.
- Sleep study – 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. Copley is actively recruiting medical staff to reopen this service line in late summer or fall of 2019. Copley's FY20 proposed NPR includes $716 thousand related to re-opening our Sleep Lab.

iii. Cost savings initiatives:

In May 2019, Copley joined the New England Alliance for Health (NEAH), which will allow us to utilize the purchasing leverage of the combined membership of 18 facilities throughout Vermont and New Hampshire to help reduce the cost of employee benefits, supplies, and drugs by over $230 thousand in FY20. Copley is excited about the opportunities that membership in NEAH will provide that go well beyond group purchasing power. NEAH promotes collaboration, coordination of care, and population-based resource planning among its members and regional partners and provides services that will help to ensure quality of patient care and ultimately improve the health of the communities we serve.

In addition to cost savings from membership in NEAH, Copley commits to another $932 thousand in strategic cost savings in its proposed FY20 expenses. Refer to section 4.B.iii below for further details.

Copley has contributed significantly to bending the cost curve by keeping its five-year cumulative increase to only 3.2% by FY20. The state as a whole has increased rates by nearly 11% since 2015, making Copley one of the lowest cost hospitals in Vermont and the largest contributor to the reduction of healthcare prices in the state over the last four years.

iv. **NPR Assumptions by Payer:**

a. **Medicare:** Medicare reimbursement estimates are based on a CAH-specific reimbursement model based on the trend in estimated inpatient costs per day and the ratio of costs to charges for outpatient and ancillary services. The estimates are calculated in accordance with legislated payment rules currently in effect. There are no significant prior year settlement adjustments impacting proposed Medicare net patient revenue.

b. **Medicaid:** Medicaid reimbursement is proposed based on current payment trends.

c. **Commercial/Selfpay/Other:** These payers primarily reimburse hospital services based on a percentage of charge. Since Copley is requesting a 9.8% increase in average gross charges, reimbursement from these sources is budgeted to increase in the FY20 proposed budget. Professional fees are reimbursed based on fixed fee schedules. Copley has assumed no changes in these fixed reimbursement rates in preparing its proposed FY20 budget. As a result, the effective commercial rate increase is proposed to be 8.5%.

v. **NPR Bridges:**

Please refer to Appendix VI, Table 1.

B. Expenses:

i. **Expense Change:**

Copley Hospital proposes total expenses of $72.5 million in FY20 which is up $1.3 million, or 1.8% from the approved FY19 budget and up $1.9 million, or 2.6% from the projected FY19 expenses. During the last three years, Copley has been strongly dedicated to cost reduction efforts and has asked the GMCB to allow us time to implement necessary changes thoughtfully and strategically, thereby ensuring a sustainable future for Copley. We are proud to report that the FY20 proposed budget reflects a three-year average annual growth in expenses of only 2.8%.

ii. **Significant changes from FY19 Budget:**

There were no physician transfers, certificates of need, or any other changes made to the FY19 budget as approved by the GMCB in the budget order dated September 28, 2018.

Described further in section 3 above, FY19 expenses are projected to be under budget by $554 thousand (-0.8%) as a result of implementing extra cost control measures, offset by cost pressure related to health insurance claims and medical inflation on implants and drugs. These more recent cost trends and cost savings identified from our aggressive management of expenses, which are described further in section 4.B.iii below, have been reflected in the FY20 proposed expenses.

iii. **Cost savings initiatives:**

Copley’s proposed FY19 expenses includes $1.2 million in strategic cost savings for FY20, equivalent to a 3.1% rate change, most notably:

- Workforce - $564 thousand savings, reducing support staff by 3 FTEs and providers by 1.2 FTEs. This includes savings from the reduction of travelers by 1.5 FTEs, workforce efficiencies in revenue cycle functions, elimination of the Hospitalist Nurse Practitioner position, and replacing our Anesthesiologist with CRNAs.

- Supply chain - $389 thousand savings from improvements in management of inventory, changes in lab equipment that utilizes less disposable supplies, and reduction in supply and drug costs as a result of group purchasing leverage from membership in NEAH.
- Other costs - $209 thousand savings in recruitment, education, and benefits administration as a result of membership in NEAH.

iv. **Expense Bridges:**
Please refer to Appendix VI, Table 2.

5. *Bad Debt*

A. Please refer to the table in Appendix VII for the amount of bad debt carried by the hospital at the close of FY17 and FY18.

B. Bad debt accounts with balances greater than $10 are placed with either a collection agency or an attorney for collection, depending on the circumstances surrounding the status of the accounts'. Copley's primary bad debt collection agency is Action Collection Agency of Boston (ACA).

C. The President of ACA, who is the former President of the American Collectors Association, was an active participant in the Medical Debt Collection Task Force for the Patient Friendly Billing Project for HFMA Region 1. ACA strives to meet these guidelines in keeping their collections letters clear and not confusing for our patients, while safeguarding all patient information as required under HIPAA and the FDCPA, which regulates consumer collections. ACA asserts that their verbal communication with patients is also professional and compassionate, as they recognize that healthcare is a unique type of consumer debt and must be treated as such.

6. *Operating Margin and Total Margin*

After four years without generating income from operations, Copley needs to achieve a reasonable operating margin for the next several years in order to rebuild cash reserves necessary to weather unexpected downturns, take on risk in payment reform, and invest in necessary capital and infrastructure improvements. Ideally, Copley would generate at least a 3% operating margin annually. Copley's proposed budget contains expense growth to only 1.8%, which gets us nearly half way to our goal, with a 1.4% operating margin and a Total Margin of 1.8%.

7. *Charge Request*

A. Change in Average Gross Charges:

After taking into consideration trends in utilization and cost savings efforts, our current financial position requires that we request a 9.8% increase in average gross charges in order to attain a 3.5% growth in NPR, yield a moderate operating margin of 1.4%, and prevent further deterioration of our cash. As illustrated in the table below, this brings our 5-year cumulative increase to only 3.2%.

	Actual FY16	Actual FY17	Actual FY18	Actual FY19	Budget FY20	5-Yr Total
Change in Charges	-4.0%	-3.7%	-3.4%	4.5%	9.8%	**3.2%**

While we understand that this change in average gross charges is high for one year, Copley has contributed significantly to bending the cost curve by reducing average gross charges by 6.6% since 2015. The state as a whole has increased rates by nearly 11% during this time, making Copley one of the lowest cost hospitals in Vermont. As a small hospital that makes up less than 3% of the State's total NPR, Copley has been the largest contributor to the reduction of health care prices in the State over the last four years.

B. Commercial "ask":
The FY20 proposed change in average gross charges of will be applied equally to all payers and service lines. Copley has assumed no changes in fixed commercial reimbursement rates for professional fees in preparing its proposed FY20 budget, resulting in an effective commercial rate increase of 8.5%.

C. Charge Schedule:
Please refer to Appendix VIII.

D. Cost Shift:
Without meaningful payment reform that adequately finances the shortfall in government reimbursement, hospitals will continue to be forced to shift the unreimbursed costs of serving public program beneficiaries and uninsured patients to private sector payers. We must do this in order to remain financially viable under the existing reimbursement system and continue to preserve high quality access to vital healthcare services for all of our patients.

8. *FY 2018 variances*
Copley received a letter regarding our FY18 financial performance due to a 2.6% shortfall in NPR. Copley addressed the issues and requirements outlined in the letter in a presentation to the GMCB during the public hearing held on April 12, 2019. For more details, please refer to the presentation materials and transcripts of that hearing. Copley received an enforcement letter from the GMCB, dated May 1, 2019, in which the Board communicated its decision not to rebase Copley's budget or take other enforcement action at that time.

9. *Capital budget investments*
Capital spending for FY20 is proposed to be $3 million with no projects subject to Certificate of Need review or individual capital expenditures proposed over $500 thousand. We have developed a master facility plan to identify facility, technology, and equipment needs in the coming years, including the more immediate need for a fully-integrated health information system and upgrade of our MRI. We face difficult decisions in prioritizing our needs with limited cash and need to generate an operating margin in order to fund these improvements to provide a safe and comfortable patient environment, high quality care, and seamless coordination of care amongst providers.

15. *Technical concerns*
Copley Hospital has no technical concerns or reporting issues at this time.