

**To:** The Honorable Kevin Mullin, Chair, Green Mountain Care Board

**From:** John Brumsted, CEO, University of Vermont Health Network  
Todd Keating, CFO, University of Vermont Health Network

**Date:** February 14, 2020

**Subject:** Fiscal Year 2019 Actual-to-Budget Narrative

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### **UVM Health Network Executive Summary**

As the UVM Health Network has reported in previous submissions to the Green Mountain Care Board, margin performance continues to be a main financial focus of our affiliate hospitals. Adequate operating margin allows the Network to enhance the care we provide to our patients, maintain our high credit ratings, and decrease our borrowing costs. On a consolidated basis, the Network's Vermont hospitals saw a 1.8% operating margin in FY 2019, which follows similar trends of decreasing operating margins year over year, for the past four years. For context, in order to meet our financial framework goal and the expectations of our rating agencies, we need to be working to a 3% Network margin in FY 2022. For our Network as a whole, our actual margin performance in FY 2019 was off budget by 1.2%, or \$25.5M. The compounding impact of not receiving medical inflation rate increases for commercial payers and imposing the full burden of the cost shift over the years is taking its toll on margin performance. For the first quarter of FY 2020, we have seen a further erosion of our margin, and actually posted a negative margin of \$10M for the Network as a whole. The causes for this decline are multi-factorial, and represent challenges we are facing as a whole, as well as challenges at the individual affiliate level, but to be clear, this is not sustainable.

Our Network is not immune from the challenges and pressures that are causing financial strain on hospitals and health care organizations locally and across the country. In addition to higher than expected workforce expenses, high pharmacy costs (including oncology and infusion expenses) challenged our expense growth as we provided the level of care necessary for the patients who walked through our doors. As utilization for these services rises, the cost of that care follows and compounds. Not only does this impact expenses, but because it is a pass through item to patients, in FY 2019 we estimate additional pharmaceutical utilization and higher than budgeted inflation rates resulted in increased net patient revenues between \$13M to \$19M. We will get into more detail on the impacts this has on both current and future budgets with the FY 2021 budget submission.

For FY 2019, Central Vermont Medical Center’s net patient revenue (NPR) was 1.60% below its approved budget. Porter Hospital’s NPR was within 0.51% of its approved budget. UVM Medical Center’s NPR was within 0.92% of its approved budget. Together, the UVM Health Network’s three Vermont hospitals received 0.56% more NPR than budgeted for FY 2019.

**Summary of Patient Revenue (NPR+FPP) Change from FY 2019 Budget to FY 2019 Actual**

Hospital	FY 2019 Actual	FY 2019 Budget	Difference		FY 2019 Budget With Accounting Change	Difference	
UVM Medical Center	\$ 1,285,234,193	\$ 1,273,460,046	\$ 11,774,146	0.92%	\$ 1,267,090,324	\$ 18,143,868	1.43%
Central Vermont Medical Center	208,006,996	\$ 211,387,021	\$ (3,380,025)	-1.60%	\$ 209,580,023	\$ (1,573,027)	-0.75%
Porter Hospital	84,961,115	\$ 84,530,515	\$ 430,600	0.51%	\$ 83,463,124	\$ 1,497,991	1.79%
<b>Total UVMHN - VT Hospitals</b>	<b>\$ 1,578,202,303</b>	<b>\$ 1,569,377,582</b>	<b>\$ 8,824,721</b>	<b>0.56%</b>	<b>\$ 1,560,133,471</b>	<b>\$ 18,068,832</b>	<b>1.16%</b>

In order to give an apples to apples comparison between the FY 2019 actuals and the FY 2019 budget, the budget table above needed to be adjusted for the following accounting changes: payment reform investments that had moved to deductions; and bad debt collection fees that had moved to expenses. This is similar to the adjustments that were made during the FY 2020 budget process.

Responding to these common challenges, our locally-led, non-profit Network is doing our part to preserve access to care, while also changing the way care is delivered to focus on wellness as much as illness and to control costs for all Vermonters. The important work by which the UVM Health Network continues to make progress on the overarching goals of the APM includes performance improvement metrics and the transition to high-value care, with an emphasis on care delivery optimization, population health management, and value-based contracting. The Network’s Vermont affiliates continue to participate in all three programs of OneCare Vermont under the APM – Medicare, Medicaid, and commercial.

In FY 2019, the UVM Health Network continued fulfill its role to improve patient care and the way that care is delivered. The Network is building the foundation of its population health management efforts by rolling out Epic across its Vermont hospitals, and the Network has completed the Miller Building on the UVM Medical Center campus. The UVM Health Network Medical Group is optimizing the way it delivers care across the Network, with the goal of providing high quality care as close to patients’ homes as possible. All of the Network’s six hospitals are integrating their core operations in order to realize the savings that a true health system can provide. This is our road ahead to long-term sustainability.

## Central Vermont Medical Center

### Operating Revenues

<b>NPR</b>	<b>Total</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 211,387,021	
Utilization	\$ 2,992,522	1.4%
Reimbursement/Payer Mix	\$ (3,482,597)	-1.6%
Bad Debt/Free Care	\$ (1,030,959)	-0.5%
Physician Acq/Trans	\$ -	0.0%
Pharmacy	\$ -	0.0%
Changes in Accounting	\$ (1,806,998)	-0.9%
Changes in DSH	\$ (51,993)	0.0%
Other (please label)		0.0%
Other (please label)		
FY 2019 Actual Results	\$ 208,006,996	-1.6%

### Total Patient Revenue: NPR + FPP + Health Reform Revenues

\$ Variance: (\$3.4M)

% Variance: (1.6%)

Bad Debt and Charity combined had an unfavorable budget variance of approximately \$1M. The remaining unfavorable variance was due to an unfavorable payer mix shift and an erosion of collection rates. Included in the technical accounting change is a change in where the ACO deductions were recorded.

The BlueCross BlueShield Vermont ACO was budgeted in the FPP line for \$9M, but throughout FY 2019 we received fee-for-service revenue. This is the primary reason the Net Patient Care Revenue has a positive variance of \$6.2M, and the Net Patient Care Revenue including Fixed Prospective Payments has a negative budget variance.

### Other Operating Revenue

\$ Variance: \$1.9M

% Variance: 13.7%

Other Revenue was favorable to budget primarily due to Other Contract Pharmacy 340B Revenue and a larger than budgeted endowment release of funds.

## Operating Expenses

<b>Expenses</b>	<b>Amount</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 221,962,950	
Salaries	\$ (2,869,607)	-1.3%
Fringe Benefits	\$ 1,602,551	0.7%
Physician	\$ 750,625	0.3%
Contract Staffing	\$ 2,350,305	1.1%
Supplies	\$ (274,442)	-0.1%
Drugs	\$ 4,749,785	2.1%
Facilities	\$ 190,565	0.1%
IT Related	\$ 49,187	0.0%
Depreciation	\$ (655,630)	-0.3%
Interest	\$ 65,362	0.0%
Health Care Provider Tax	\$ (949,232)	-0.4%
Purchased Services	\$ 1,509,393	0.7%
Other	\$ 919,654	0.4%
Changes in Accounting	\$ (985,478)	-0.4%
FY 2019 Actual Results	\$ 228,415,989	2.9%

Total Operating Expense from the FY 2019 budget to FY 2019 actual was unfavorable by \$6.5M, or 2.9%.

### Staff Salaries

\$ Variance: (\$2.9M)

% Variance: (1.3%)

Salaries Non-MD were favorable to budget, primarily due to shortages in nursing positions.

### Fringe Benefits

\$ Variance: (\$1.6M)

% Variance: (0.7%)

Fringe Benefits were unfavorable to budget due to a high volume of specialty pharmaceutical spend within our self-funded health insurance plan related to employees with cancer diagnoses.

### Physician Salaries

\$ Variance: (\$0.8M)

% Variance: (0.3%)

Physician Fees were over budget due to unbudgeted physician travelers in the Hospitalist and Neurology service areas of \$800K and \$680K, respectively.

### Contract Staffing

\$ Variance: (\$2.3M)

% Variance: (1.1%)

There were 18.2 traveler FTEs in FY 2019. More than half of the expense was to fill staffing vacancies at Woodridge, and the majority of the remaining expense was to cover staffing shortages and high census in the hospital inpatient acute care setting. In addition, there was one ED and one Surgical Tech traveler.

#### Health Care Provider Tax

\$ Variance: \$0.9M

% Variance: 7.7%

Health care provider tax was under budget due to less than budgeted Net Patient Service Revenue.

#### All Other Operating Expenses

\$ Variance: (\$6.2M)

% Variance: (10.7%)

The drug expense overage of \$4.7M, or 2.1%, was largely related to two items. The first which was a high utilization and higher cost of pharmaceuticals provided to the patients we served which are pass through billable items and a systems issue with how our Meditech EMR handled drug inventory. The first major driver of the drug expense overage in the FY 2019 budget was a result of increased utilization and acquisition costs of chemotherapy drugs. Most notably, the spend on the top five oncologic drugs utilized increased over 40% from FY 2018 to FY 2019. The second, we completed a physical inventory at the end of the year in FY 2018, and a large adjustment was made to the expense to reconcile the difference. Due to the timing of the budget process, the adjustment was not incorporated into the FY 2019 budgeted drug costs, causing the FY 2019 budget to understate estimated costs. In FY 2019 we initiated a systems improvement to correct this issue.

Purchased Services was over budget by \$1.5M mainly due to three factors: \$578K of collection agency fees over and above the budget adjustment accounting change; Anesthesia services which were over budget by \$400K; and the remaining \$500K was associated with an engagement with consultants to review and redesign the revenue cycle process.

#### Net Operating Margin

\$ Variance: (\$7.9M)

% Variance: (243.7%)

Expense variances of (\$6.4M) combined with revenue variances of (\$1.5M).

#### Non-Operating Revenue

\$ Variance: (\$8.4M)

% Variance: (198.1%)

Non-Operating Revenues were unfavorable to budget due to pension expense. CVMC's total pension liability on 9/30/19 was \$29.9M, and the funded status was at 80.6%. The major

contributor to this variance is the change in discount rate from 9/30/18 of 4.40% to 3.25% on 9/30/19, which was offset a little by stronger actual investment returns.

Total Margin

\$ Variance: (\$16.3M)

% Variance: (217.9%)

Negative operating margin variance combined with a negative non-operating revenue variance.

Summary

In FY 2018 CVMC posted an operating loss of \$7.9M, and in FY 2019 CVMC was able to reduce that loss to \$4.7M. CVMC continues to respond to the challenges of a changing Central Vermont payer landscape with a shift away from commercial payers to governmental and transition to the APM. Increasing salary and contracted workforce (traveler) expense is another challenge that is being addressed creatively through a variety of workforce development programs. Epic will improve the overall coordination of patient care delivery system throughout the UVM Health Network, and our revenue systems implementation costs and reduced productivity during the implementation and stabilization phases will have a financial impact in the short term.

CVMC remains committed to implementation of margin improvement initiatives and a break-even operating margin for FY 2020. We look forward to our continued collaboration with the Green Mountain Care Board, including our work with the Board on CVMC's performance improvement plan, which began at the onset of FY 2020.

## Porter Hospital

<b>NPR</b>	<b>Total</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 84,530,514	
Utilization	\$ (2,055,157)	-2.4%
Reimbursement/Payer Mix	\$ (1,161,644)	-1.4%
Bad Debt/Free Care	\$ (463,545)	-0.5%
Physician Acq/Trans	\$ 360,313	0.4%
Changes in Accounting	\$ (1,067,391)	-1.3%
Changes in DSH	\$ 61,334	0.1%
FY19 & FY18 Critical Access Medicare Settlement Rate	\$ 2,611,583	3.1%
2018 ACO Settlement	\$ 1,019,910	1.2%
Change in APM Model Reserve	\$ 1,125,199	1.3%
FY 2019 Actual Results	\$ 84,961,115	0.5%

### ***Summary of Patient Revenue (NPR+FPP) Change from FY2019 Budget to FY2019 Actual***

Hospital	FY2019 Actual	FY2019 Budget	Difference	FY2019 Budget With Accounting Change	Difference
	Porter Hospital	84,961,115	\$ 84,530,515	\$ 430,600 0.51%	\$ 83,463,124

### Total Patient Revenue: NPR + FPP + Health Reform Revenues

\$ Variance: \$430K

% Variance: 0.51%

Porter Hospital's Net Revenue as compared to the FY 2019 approved NPR was favorable by 0.51%. This increase was primarily driven by two components: favorable 2018 ACO performance for Medicare, and our cost report filings for FY 2018 and cost report assumptions for FY 2019. In the absence of these factors, Porter would have experienced a significantly unfavorable variance to budget.

### Other Operating Revenue

\$ Variance: \$1.4M

% Variance: 29.0%

Other Operating Revenue exceeded budgeted expectations. This was primarily driven by the increase in 340B revenue.

<b>Expenses</b>	<b>Amount</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 86,193,572	
Salaries	\$ (1,640,891)	-1.9%
Fringe Benefits	\$ 150,885	0.2%
Physician	\$ 992,957	1.2%
Contract Staffing	\$ 1,489,300	1.7%
Supplies	\$ (277,886)	-0.3%
Drugs	\$ 112,880	0.1%
Facilities	\$ 455,362	0.5%
IT Related	\$ (542,992)	-0.6%
Depreciation	\$ (156,493)	-0.2%
Interest	\$ 8,889	0.0%
Health Care Provider Tax	\$ 18,017	0.0%
Purchased Services	\$ 631,505	0.7%
Other	\$ 281,460	0.3%
Changes in Accounting	\$ (1,067,391)	-1.2%
FY 2019 Actual Results	\$ 86,649,174	0.5%

#### Salaries & Fringe Benefits

\$ Variance: \$992K

% Variance: 1.9%

Total expenses were reasonably aligned with budgeted expectations. The unfavorable salary expense variance of \$992K was primarily attributed to the salary and benefit component of the physician transfers in radiology and general surgery, which occurred in FY 2019. Continued reliance on temporary labor specifically in the areas of nursing, laboratory, radiology, and pharmacy technicians also contributed to the variance in salaries.

#### Depreciation

\$ Variance: (\$156K)

% Variance: 5.2%

Depreciation expense was favorable to budget by 5.2%, which was due to realized savings for equipment purchases that were negotiated under network pricing. Additionally, there were selected capital items that were deferred as a result of infrastructure constraints.

#### All Other Operating Expenses

\$ Variance: (\$407K)

% Variance: 1.6%

Although other expenses are reflecting a favorable result, primarily due to savings in insurance expense, when adjusting for the accounting change, other expenses are unfavorable to budget by \$660K. This is predominantly due to two factors: \$305K associated with the implementation of



the Workday payroll and HRIS system, and \$345K for a negotiated property lease settlement.

Net Operating Margin

\$ Variance: \$1.4M

% Variance: 1.5%

Operating margin performance was favorable to budgeted expectations. The positive performance from an operating perspective was mainly driven by favorable 2018 Medicare performance in the ACO, and FY 2018 and FY 2019 cost report settlements and assumptions. In the absence of these factors, Porter would have experienced a breakeven operating margin as compared to budget.

Non-Operating Revenue

\$ Variance: \$298K

% Variance: 74.7%

Non-operating revenue exceeded budgeted expectations due to favorable investment performance.

Total Margin

\$ Variance: \$1.7M

% Variance: 1.8%

Total margin exceeded budgeted expectations due to aforementioned factors.

## UVM Medical Center

### Total Patient Revenue: NPR + FPP + Health Reform Revenues

\$ Variance: \$11.8M

% Variance: 0.9%

While there was a favorable revenue variance of \$11.8M, it is important to understand the driving factors behind it and the real impact it had on the total expense base. The expense related to this addition revenue was much higher than \$11.8M, resulting in a margin deficit.

Actual collections rates were below budget estimates by approximately -1.0%, which resulted in an unfavorable variance to budget of approximately -\$30M in revenues. The primary causes of this were: the commercial rate request was reduced from 4.0% to 2.5% by the Green Mountain Care Board; there was a change in the outpatient Medicare payment rates; and lower than anticipated ACO revenues.

Although professional revenues were lower than budget, revenues from additional inpatient and outpatient volume helped fill the revenue void created by the unfavorable collection rate. However, there were additional expenses associated with this volume, which the hospital had to find other sources to fund.

Additional revenues related to increased utilization and base cost of pharmaceuticals provided to patients we served resulted in an additional \$10M to \$15M in revenues. These revenues were the result of a higher pharmaceutical expense base to treat patients.

### Other Operating Revenue

\$ Variance: \$45.4M

% Variance: 43.0%

The main driver was higher than budgeted 340B specialty and contract pharmacy volume.

Another large driver was the fact that for FY 2019, the UVM Health Network was required to adopt the new Revenue Recognition accounting pronouncement. Grant revenues are now reported in hospital operations, which accounts for \$8.6M of this variance. Because grant revenues equal grant expenses, they have a bottom line zero dollar impact.

### Staff Salaries

\$ Variance: (\$31.9M)

% Variance: (7.2%)

Below are the driving factors of this variance:

Additional FTEs primarily related to additional inpatient and outpatient volume/revenues drove a significant increase in the number of FTEs, which accounts for over \$16M of the variance.

Due to workforce challenges, there was an increased utilization of travelers and other premium pay factors, which resulted in an approximately \$6.4M variance.

Unbudgeted salary increases due to higher than expected wage inflation/low unemployment (tech and nurse union contract, \$13 hour minimum, LNA increase, other range and market adjustments) resulting in \$6.6M of variance.

Due to a reporting change for grant revenues and expenses, grant salaries are now reported as part of hospital operations. Because grant expenses are covered by grant revenues, they have a bottom line zero dollar impact. This expense was not budgeted, and the variance accounts for \$3.2M.

#### Physician Salaries

\$ Variance: \$4.4M

% Variance: 2.6%

Professional revenues were lower than budget, which had a direct impact on the Medical Group's financial performance. There is an adjustment portion of the physician's salary related to performance, which generated a lower salary base and accounts for this favorable variance.

#### Fringe Benefits

\$ Variance: \$0.8M

% Variance: 0.5%

Favorability in Workers Comp, Physician, and Non-Physician fringes, offset by higher claims experience in our self-funded plan.

#### All Other Operating Expenses

\$ Variance: (\$41.4M)

% Variance: (9.7%)

Higher medical surgical supplies of \$8.5M driven from high volume and revenues. Higher pharmacy expense of \$22.7M, driven by higher volumes/revenues and increased cost base. Higher purchased services of \$10M, offset by \$8.2M of favorable expense variance across other areas.

#### Net Operating Margin

\$ Variance: (\$7.8M)

% Variance: (20.0%)

Expense variances were larger than the revenue variances. The difference between our requested and budgeted 4.0% commercial rate increase and the 2.5% that was approved was \$6M. If the 4.0% had been approved, we would have covered more of the inflationary increases in our budget, and we would have come close to meeting our net operating margin target.

Non-Operating Revenue

\$ Variance: \$1.5M

% Variance: 4.4%

Higher than budgeted market performance on investments.

Total Margin

\$ Variance: (\$6.4M)

% Variance: (8.9%)

Large operating margin variance with a small market performance offset.

<b>NPR</b>	<b>Total</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 1,273,460,046	
Utilization	\$ 42,856,422	3.4%
Reimbursement/Payer Mix	\$ (23,519,628)	-1.8%
Bad Debt/Free Care	\$ (1,585,048)	-0.1%
Physician Acq/Trans	\$ -	0.0%
Pharmacy	\$ -	0.0%
Changes in Accounting	\$ (6,369,722)	-0.5%
Changes in DSH	\$ 392,122	0.0%
Other (please label)	\$ -	0.0%
Other (please label)		
FY 2019 Actual Results	\$ 1,285,234,193	0.9%

<b>Expenses</b>	<b>Amount</b>	<b>% over/under</b>
FY 2019 Approved Budget	\$ 1,339,909,057	
Salaries	\$ 11,539,704	0.9%
Fringe Benefits	\$ (1,788,124)	-0.1%
Physician	\$ (5,456,529)	-0.4%
Contract Staffing	\$ 18,007,324	1.3%
Supplies	\$ 8,099,627	0.6%
Drugs	\$ 22,758,522	1.7%
Facilities	\$ (2,036,608)	-0.2%
IT Related	\$ 1,242,540	0.1%
Depreciation	\$ (396,676)	0.0%
Interest	\$ (2,055,038)	-0.2%
Health Care Provider Tax	\$ (503,175)	0.0%
Purchased Services	\$ 11,537,238	0.9%
Other	\$ 1,863,812	0.1%
Grant Accounting Adjustment	\$ 8,590,689	0.6%
Changes in Accounting	\$ (6,369,722)	-0.5%
FY 2019 Actual Results	\$ 1,404,942,642	4.9%