

**COPLEY HOSPITAL, INC.
FY 2016 PROPOSED BUDGET
NARRATIVE**

A. SUMMARY

Copley Hospital proposes a rate reduction of 3% for FY2016, reducing gross patient revenue by \$3.2 million and net patient revenue by \$1.4 million. This rate decrease was deemed necessary after taking into consideration the impact of favorable utilization and reimbursement experience of FY2014 and FYTD2015.

Proposed net patient revenue is within the 3.0% limit set by the Green Mountain Care Board, plus a requested exception for health reform investments of 0.1% related to participation in the OneCare Vermont ACO. Major factors influencing the proposed 3.1% increase in net revenue include increased utilization, more favorable collection and reimbursement rates than assumed in the FY2015 budget, and a 3% rate reduction.

B. HEALTH REFORM INVESTMENTS

Copley Hospital's FY2016 budget submission includes a request for an allowance of \$82,000 within net patient revenue for estimated participation fees in the Accountable Care Organization, OneCare Vermont. In addition to participation in the OneCare Vermont ACO, Copley is actively involved in the following health reform initiatives for which an allowance in net patient revenue is not being requested:

- Community Health Accountable Care LLC (CHAC) participation with the FQHCs
- Shared Decision Making program
- VT Program for Quality in Health Care (VPQHC) initiative to reduce readmissions
- Blueprint for Health Program

Copley Hospital's FY2015 budget included an allowance in its net patient revenue for credible health reform investments related to the participation in the OneCare Vermont ACO. Copley has not received any information from OneCare Vermont related to the return on investment at this time.

C. NET PATIENT REVENUE

Copley Hospital is budgeting net patient revenue of \$61,469,771 in FY2016, up \$1,869,287 or 3.1% from the approved FY2015 budget of \$59,600,484. The proposed increase in net patient revenue exceeds the GMCB allowed 3.0% increase by \$82,000, or 0.1%, to fund costs associated with the health reform investment discussed in Section B above. Following is a summary of the composition of the proposed change in net patient revenue:

| | | |
|----------------------|--------------|-------|
| NPR, Budget 2015 | \$59,600,484 | |
| Utilization | 890,328 | 1.5% |
| Bad debt and charity | 1,137,860 | 1.9% |
| Reimbursement rates | 1,484,943 | 2.5% |
| DSH | -197,688 | -0.4% |
| Rate Decrease of 3% | -1,446,156 | -2.4% |
| NPR, Budget 2016 | \$61,469,771 | 3.1% |

The factors influencing the proposed net patient revenue budget are described further below, including the impact of current projections, cost pressures, and various revenue assumptions.

a. Projected Net Patient Revenue FY2015

Current projections for FY2015 indicate that net patient revenue may be \$62.7 million for the year, 5.2% over the approved FY2015 budget due to the following factors:

- increased utilization
- increased cost of chargeable supplies and drugs, priced based on an industry standard algorithm
- favorable bad debt and charity care
- better than budgeted average payment rates

This significant net patient revenue overage is being addressed in the proposed budget for FY2016, which includes a 3% rate reduction. The proposed rate reduction reduces gross patient revenue by \$3.2 million and net patient revenue by \$1.4 million, ensuring that budgeted net patient revenue remains within the limits set forth by the GMCB for annual net patient revenue growth.

b. Expenditures and Cost Saving Initiatives

Copley Hospital is budgeting total expenses of \$61,638,926 in FY2016, up \$2,111,791, or 3.5% from the approved FY2015 budget of \$59,527,135. Significant factors contributing to Copley's budgeted expenses include cost savings related to health and dental insurance and increases in budgeted contracted labor, chargeable supplies, and drugs.

c. Revenue Assumptions

Utilization

FY2016 proposed utilization is based on the three-year average utilization of services from FY2013 thru projected FY2015, adjusted to account for the anticipated revitalization of the general surgery program and the return of an orthopedic surgeon that has been away for a year.

Inpatient admissions are budgeted to increase 3.3% from the approved FY2015 budget, while inpatient days are budgeted to decrease 5.9% due to the lower average length of stay of 2.6 days. Outpatient visits are budgeted to increase 5.3% from the approved FY2015 budget, reflecting volume variations in the various ancillary service lines. Physician office visits are budgeted to be 1.3% more than the approved FY2015 visits.

Overall, utilization changes account for \$1.4 million in additional gross patient revenue, estimated to yield \$890 thousand in net patient revenue, excluding the impact on bad debt and charity care discussed below.

Bad Debt & Charity

Total bad debt and charity care write-offs as a percentage of gross revenue have been budgeted at 3.2%, based on Copley's current experience. This represents a significant decrease from 4.2% budgeted in FY2015, resulting in an increase in budgeted net patient revenue of \$1.1

million. Copley is taking a risk in assuming that the current experience reflects the future trend to be expected in bad debt and charity care.

Reimbursement Rates

Copley Hospital's FY2016 proposed budget includes a reimbursement rate, before DSH, of 57.3%, representing an increase over the approved FY2015 budgeted rate of 54.5%. The budget-to-budget impact on net patient revenue of changes in assumed reimbursement rates is approximately \$1.5 million. Following is a summary of the reimbursement assumptions for each of the major payer sources and the impact on the proposed FY2016 net patient revenue.

Medicare

Medicare net revenue is budgeted at \$15,913,468, or 46.9% of Medicare gross revenue. Medicare reimbursement was estimated using a CAH-specific reimbursement model based on projected allowable Medicare costs and calculated in accordance with legislated payment rules currently in effect. This estimate includes the impact of recent cost report adjustments related to the disallowance of a portion of the VT provider tax.

Copley estimates that the budget-to-budget change in net patient revenue due to Medicare reimbursement assumptions is a decrease of approximately \$900 thousand.

Medicaid

Overall Medicaid net patient revenue (excluding DSH) is budgeted at \$6,191,218, or 32.6% of Medicaid gross revenue. Medicaid reimbursement is proposed based on current year-to-date payment trends, reflecting a \$780 thousand decrease in budgeted net patient revenue. As instructed by the GMCB, no payment rate increase was incorporated into the proposed budget, nor any changes related to the Governor's plan around the cost shift or other health reform payment incentives.

Commercial/Other

Net patient revenue from commercial and other payer sources is budgeted at \$38,866,210 or 72.7% of gross revenue for commercial and other payers. Copley experienced significantly more favorable average reimbursement rates than previously budgeted during FY2014 and FY2015. The reimbursement rates proposed in the FY2016 budget are based on current actual reimbursement rates from commercial and other sources. The overall budget-to-budget increase in net patient revenue related to commercial/other reimbursement rate assumptions is approximately \$3.2 million.

These payors primarily reimburse hospital services based on a percentage of charge, thus reimbursement from these sources will decrease as we implement the 3% rate decrease, estimated to decrease net patient revenue by \$1.4 million. Professional fees are reimbursed based on fixed fee schedules. The Hospital assumes no changes in these fixed reimbursement rates in proposing net patient revenue for FY2016.

Disproportionate Share (DSH)

Copley Hospital’s FY2016 proposed budget includes a decrease of \$198 thousand in disproportionate share payments, in accordance with the State’s Notice of Disproportionate Share Payments for FFY2016 dated May 2015.

D. RATE REQUEST

Copley Hospital’s FY2016 budget request includes an overall rate decrease of 3%, reducing gross patient revenue by \$3.2 million and net patient revenue by \$1.4 million. A rate decrease was deemed necessary after taking into consideration the impact of the favorable utilization and reimbursement experience in FY2014 and expected to continue in FY2015. The rate reduction will not be applied across-the-board to all services, but will be applied to the markup for chargeable supplies and drugs.

E. ADDRESSING NPR BUDGET OVERAGE FY2014

Copley Hospital generated net patient revenue of \$59,947,666 in FY2014, up \$2,152,041, or 3.7% from the FY2014 budget of \$57,795,625. Major factors contributing to this overage, as described further in the narrative previously filed for FY2014, were a significant payor mix shift, less bad debt and charity care than budgeted, and more favorable reimbursement rates than budgeted.

As a hospital can experience fluctuation in net patient revenue from year to year, we believe that the results of one year should not be reviewed in isolation. Following is a table of Copley’s net patient revenue budget variances for the last three years, demonstrating that Copley’s cumulative net patient revenue for the three years ending in FY2014 is on budget.

| NPR | FY2012 | FY2013 | FY2014 | Cumulative |
|------------|------------|------------|------------|-------------|
| Actual | 51,398,678 | 53,862,405 | 59,947,666 | 165,208,749 |
| Budget | 51,073,832 | 56,335,433 | 57,795,625 | 165,204,890 |
| Variance | 324,846 | -2,473,028 | 2,152,041 | 3,859 |
| % Variance | 0.6% | -4.4% | 3.7% | 0.0% |

Although we were cumulatively on budget by the end of FY2014, these favorable trends have continued into FY2015. Copley projects a significant net patient revenue budget variance FY2015, discussed further in section C(a) above. With these recent net patient revenue budget overages in mind, we have proposed that the FY2016 budget address the overages in the following manner:

- Implementing a 3% rate reduction to decrease gross patient revenue by \$3.2 million and net patient revenue by \$1.4 million, and
- Decreasing the Operating Margin to 2.2% rather than the 3% we historically target, a \$500 thousand impact on retained earnings.

F. CAPITAL BUDGET

Capital spending for FY2016, excluding potential Certificate of Need (CON) requests, is budgeted at \$3,802,035 and will be funded through operations. No major items over \$500,000 individually are included in the non-CON capital budget for FY2016.

Copley has submitted a CON request for the replacement of our surgical suite. The total capital project is estimated to be \$12.5 million and will be funded through a combination of philanthropic support, debt financing, and working capital. Should our CON request be approved, we anticipate that the project would begin in FY2016 and be completed in FY2017. As this CON is not yet approved, the submitted FY2016 budget does not include any operating impact of this CON proposal.

G. ALL OUTPATIENT VISITS

Copley defines the statistic "outpatient visits" as each unique visit by a patient that is not admitted as an inpatient. This includes, but is not limited to, visits related to the following: outpatient surgery, diagnostic imaging, laboratory, physical therapy, respiratory care, the emergency department, and physician clinics.

H. COMMUNITY HEALTH NEEDS ASSESSMENT

Copley Hospital is currently conducting its Community Health Needs Assessment (CHNA). Our report will be made available to the public by September 30, 2015. We plan to share the report internally with staff and externally with our Board of Directors, Unified Community Collaborative and our Extended Blueprint for Health team along with key social service agencies and community leaders. Copies of it will be available online and in hard copy by request. Copley Hospital will develop an implementation strategy that will be brought to our Board of Directors for adoption by February 15, 2016.

I. TECHNICAL DISCLOSURES

In filing projected FY2015 and proposed FY2016 budget, we have made several reclassifications in order to properly align the reporting of all items across the categories of revenue, expense, FTEs and statistics.

- i) Revenue – The revenue centers previously allocated to the clinic department were reclassified to other ancillary and physician practices departments.
- ii) Expenses – The expense centers previously allocated to the clinic and uncategorized physician practice departments were reclassified to the other ancillary and physician practices departments.
- iii) FTEs – The expense centers previously allocated to outpatient routine department were reclassified to the ancillary and physician practices departments.
- iv) Statistics – The visits allocated to the clinic department have been reclassified to the physician practices department.

The other ancillary department represents the Hospital's outpatient clinic, where infusions and other ambulatory procedures are performed (also referred to internally as the Ambulatory Care Unit). These were previously in the "clinic" line, but it was determined that they should be moved since that line is categorized under physician services.

