MT. ASCUTNEY HOSPITAL
AND HEALTH CENTER
A Dartmouth-Hitchcock Affiliate

July 1, 2015

Attn: Mr. Michael Davis, Director of Health System Finances
Green Mountain Care Board
89 Main Street, Third Floor, City Center
Montpelier, Vermont 05620

Re: Budget 2016 Narrative

Dear Mr. Davis,

This letter serves as the narrative required to accompany the electronic budget files which have been sent under separate cover.

Executive Summary: Overall, a modest operating margin has been established for the 2016 budget year. While we have made many changes and improvements over the last few years, we are still somewhat fragile due to our size and susceptibility to service mix changes beyond our control. Fiscal Year 2015 began with a difficult first quarter as documented in our previous bi-monthly submissions. This difficult start was largely due to two particular issues. Volume was down throughout the organization for much of the quarter. Additionally, we experienced an adverse change in our payer mix starting in the last quarter of FY14 and continuing into FY15. Infusion, Chemotherapy and Swing Bed services have experienced significant growth in Medicare and Medicaid volume while commercial payers have been diminishing. Expense management has been excellent for the entire year and volume has improved in a number of areas but the payer mix continues to be problematic. As a result, we expect a negative operating margin for FY15.

The FY16 Budget reflects volume levels similar to the FY15 budget with some key exceptions outlined later in this document. Next year's budget assumes solid and continued expense management. We also expect our recent negative payer mix trends to continue. While this is a smaller margin, we believe that this is a manageable margin that reflects the reality of the community services we provide as part of our mission, the healthcare environment we function in, the communities we serve, and our affiliation with Dartmouth-Hitchcock Health where we have purposefully moved away from low volume, but high margin services.

FY16 Budget Volumes: Inpatient volumes (Acute and Swing Bed) are expected to increase slightly to the levels that we are currently performing at. Inpatient Acute Rehabilitation is also expected to increase slightly with the completion of the Certificate of Need project in FY15.

Outpatient volumes will be a mixed bag of change compared to Budget 2015. Emergency Room volume will continue to trend down as it has for the last few years. Observation Bed services will remain flat. Outpatient Surgery will increase as we pull back Gastroenterology from other area hospitals. (New

Hampshire based) Radiology, Chemotherapy, Infusion Therapy and Rehabilitative Therapy will all remain flat. Laboratory is expected to be down slightly as it has operated in FY15.
Clinic volume is expected to increase slightly. Primary Care will be up slightly with an increased emphasis on productivity and Specialty Care will be essentially flat. We have eliminated Urology and Plastics but this change has been offset by increases in Physiatry and Gastroenterology.

FY16 Budget Gross Rate Increases: Acute Inpatient and Swing Bed pricing will increase 8.0% in FY 2016. Inpatient Rehabilitation routine services will increase by 7.0%. Outpatient service increases will range from 6.5 to 7.0% with Radiology and Laboratory will be increasing at the lower end. Physician services will increase 4%. Supplies and pharmaceuticals will have an increase of 0%. Overall, this results in an average gross increase of 5.7%.

FY16 Budget Deductions from Revenue: MAHHC has experienced a growing and ongoing shift in our payer mix as Medicare and Medicaid have grown in a few key departments. Chemotherapy, Infusion and Swing Bed services have changed significantly in their respective mix of payers. These are high cost/unit departments with long treatment plans/stays. Our contractual allowance percentage has grown by 2% of gross revenues over the last 12 months or so. This has adversely affected the bottom line. As a result, we have increased our estimates for the coming year to reflect these changes. Bad Debt and Charity Care will increase slightly based on the last 18 months experience. DSH funding has also been reduced by DVHA this year. We have seen a continued trend of well--insured patients migrating towards Dartmouth-Hitchcock, with Medicare and Medicaid remaining in the local community.

FY16 Budget Net Patient Revenue: Net patient revenue will be decreasing, budget to budget, by approximately 1%.

FY16 Budget Other Operating Revenue: Other operating revenue is expected to be down from projected and prior years despite additional 340B and Meaningful Use revenues. Reductions in cafeteria sales, providers "contracted" to other organizations, and reduced grant revenues are the main drivers of this change. The impact of no longer contracting these providers will be offset by increased revenues in these specialties as the specific providers are growing their panels and business.

FY16 Budget Total Net Revenue: Total Net Revenue will be decreasing, budget to budget, by 2.3%.

FY16 Budget Expense: Overall expense management has been strong over the last few years and MAHHC expects to continue this trend. FTE's will remain essentially flat after a number of reductions over the last year or so. Benefits have been running favorably. Our self-insured Health Insurance has done well and we have designed new plan improvements for 2016. We have made ground to reduce the liability of our pension and are currently 97% funded. Despite that, the defined benefits pension expense is up significantly over Budget 2015 due primarily to a falling discount rate. The FY 2016 budget reflects a significant change in our benefits as we position ourselves to avoid the "Cadillac Tax" coming in the next couple of years. Essentially, by bringing our plan in closer alignment with the Federal Government's expectations, we will move money to salaries from benefits to assist employees with making this transition and to address our lagging pay scales.

Purchased Labor and Purchased Services are going to be favorable this year and Supply Costs will increase slightly with overall volume. Some of this improvement reflects the movement from contracted to employed people, the reduction of consulting help, and no significant projects are expected in the near future. Utilities are going to be favorable this year as the hospital locked into better-than-market rates for heating fuel. Expansion of our leased space in Woodstock and increases in the Provider Tax over FY 2014, and a significant increase in ACO fees are the major drivers of the increases in Rent, Equipment, and Other Fees. Mt. Ascutney Hospital and a host of other Vermont Hospitals continue to negotiate and litigate the methodology the State of Vermont utilizes for the Provider Tax. This methodology unfairly burdens hospitals such as Mt. Ascutney which employ large portions of their medical staff.

Interest will increase with the addition of the loan for the C.O.N. project. Depreciation will improve due to the EMR being fully depreciated, our inability to fund significant capital investments on the heels of the $6m renovation project, and the avoidance of the Fair Market Value depreciation assessment associated with the Dartmouth-Hitchcock Health affiliation.

FY16 Budget Non-Operating Revenues: General contributions are not reflected in non-operating revenues again for this budget. As the capital campaign continues, related contributions are reflected in temporarily restricted net assets and released from restrictions as the purpose is met. Investment income is assumed at historical levels. The gain on interest rate swap is assuming the most current trend, with a smaller gain year over year. 2.5% realized returns are expected on investments for the period. Similar percent gains are expected for unrealized returns.
FY16 Budget Margins: The operating margin will come in at just above breakeven (0.1%) and total margin will be approximately 1%.

FY 16 Capital budget investments: We expect to finish most of the Certificate of Need project in FY15 and approximately $300,000, associated with the last phase, will be completed in FY16. The remainder of the $2.3m will be largely routine equipment replacement routine facility expenditures.

Please let us know if there are additional requests or concerns. Thank you.

Sincerely,

David C. Sanville
C.F.O./V.P. Finance

cc: GMCB Budget 2016 File