Deloitte & Touche

Alberta Health & Wellness

Lakeland Regional Health Authority
Revenue Assumptions Review

October 4, 2002

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Executive Summary

Lakeland Regional Health Authority (Lakeland) submitted a three year Business Plan to the Minister of Health & Wellness (Minister) on April 30, 2002 and a subsequent revised three year business plan on July 31, 2002, both of which were rejected by the Minister due to these Business Plans projecting significant financial deficits. On August 19, 2002 in a letter to Lakeland, the Minister expressed disappointment that the Board was not meeting the Province's accountability requirements for a balanced budget.

In the same August 19, 2002 letter to Lakeland, the Minister acknowledged that Lakeland previously communicated that their problem "…results from an unfair application of the funding formula since regionalization." Alberta Health & Wellness fulfilled Lakeland's request for a third party review of the application of the funding formula by appointing Deloitte & Touche to review the funding formula as it relates to Lakeland. The results of this review are in a separate report entitled; "Population Formula Review, October 4, 2002".

In the August 19, 2002 letter to Lakeland the Minister also stated he would ask Deloitte & Touche to consider the validity of revenue assumptions in the revised July 31, 2002 Business Plan. Alberta Health & Wellness engaged Deloitte & Touche in August 2002 to perform a review to consider the validity of revenue assumptions in the revised July 31, 2002 Business Plan submitted by Lakeland to Alberta Health & Wellness with particular attention on the potential savings accrued from service repatriation.

Deloitte & Touche conducted the review of Lakeland's revenue assumptions using a collaborative and consultative approach. Interviews with Lakeland's Chief Executive Officer and Chief Financial Officer were used to review Lakeland's assumptions for major revenue elements in the July 31, 2002 Business Plan. Deloitte & Touche met with Lakeland's Chief of Medical Staff and key physicians to discuss clinical repatriation, a major component of Lakeland's revenue assumptions. Lakeland's revenue assumptions were also compared to those of other similar Regional Health Authorities (RHA's) to assist in the assessment of revenue assumptions.

The assessment revealed that Lakeland's revenue assumptions, in their July 31, 2002 Business Plan, are overstated. Lakeland's projections for increasing clinical repatriation in order to generate significant revenue are unsubstantiated. Lakeland's projections for generating revenue through donations also seem high. The projections for other sources of RHA generated revenue including fees and charges, and investments and other income seem reasonable.

In summary, Lakeland's potential saving accrued from service repatriation cannot be substantiated thus Lakeland's revenue assumptions to balance their budget in their July 31, 2002 Business Plan are not reasonable.

Introduction

Background

The Board of Directors for Lakeland Regional Health Authority (Lakeland) submitted a three-year Business Plan (2002/03 to 2004/05) to the Minister of Health & Wellness (Minister) on April 30, 2002. In this plan Lakeland projected a deficit of approximately $7.0 million for 2002/03, with further estimated deficits of $2.8 and $1.3 million in 2003/04 and 2004/05 respectively. On May 22, 2002 Lakeland submitted a letter providing further clarification to the Minister on fund inequities faced by the Region. In the letter, several references were made to concerns with certain aspects of the population based funding methodology. In June 2002, the Minister was not prepared to approve Lakeland's business plan and requested the Board submit a revised balanced budget to the end of the 2003/04 fiscal year. The Minister assigned an external consultant to assist Lakeland to balance their budget.

On July 31, 2002 a revised business plan for 2002/03 to 2004/05 was submitted to the Minister with plans for annualized reduction of $ 2.27 million but still with a projected deficit for 2002.03 of $7 million.

In a July 31, 2002 letter from Lakeland to the Minister the Board rejected the external consultant and management's recommendations to balance the budget.

On August 19, 2002 in a letter to Lakeland, the Minister expressed disappointment that the Board was not meeting the Province's accountability requirements for a balanced budget. In the same letter the Minister indicated that Lakeland is convinced their problem "…results from an unfair application of the funding formula since regionalization". Alberta Health & Wellness engaged Deloitte & Touche to conduct a review to address Lakeland's concerns about the application of the formula. The results of this review are in a separate document entitled "Population Formula Review October 4, 2002".

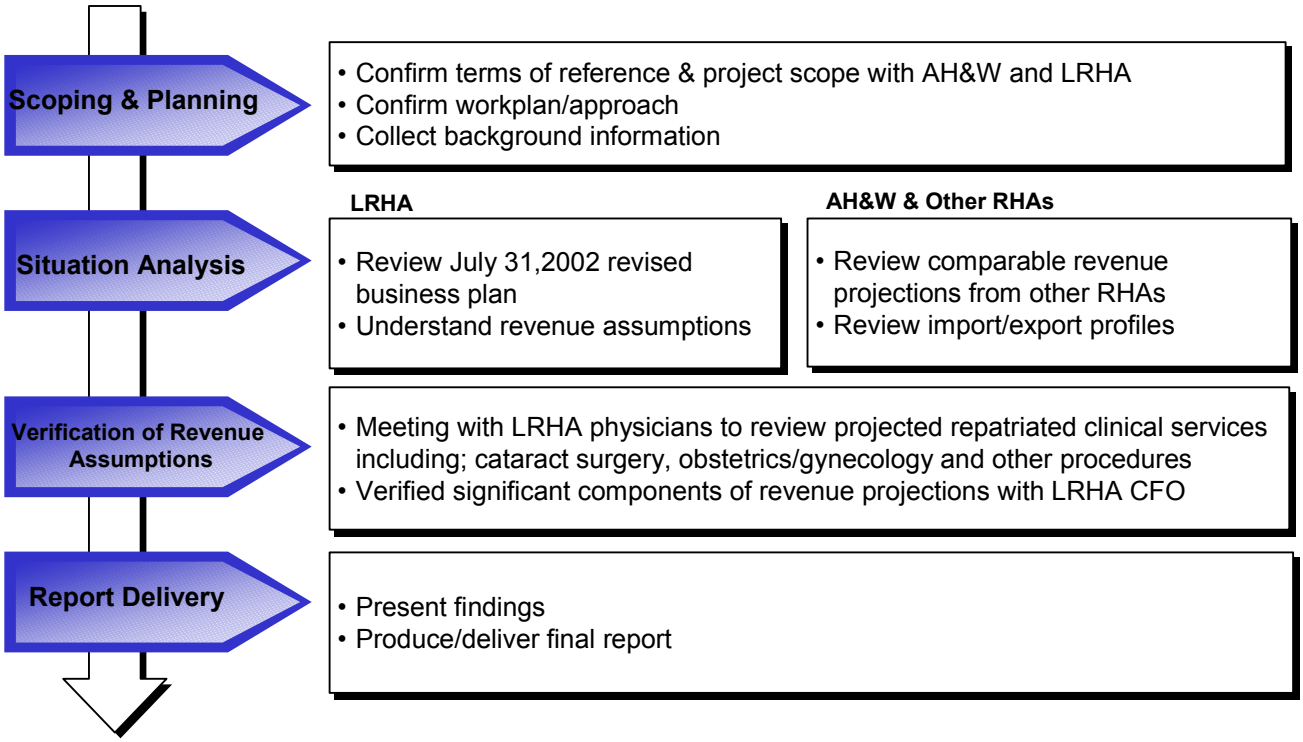
In the August 19, 2002 letter to Lakeland the Minister also stated he would ask Deloitte & Touche to consider the validity of revenue assumptions in the revised July 31, 2002 Business Plan.

Scope of the Review

Alberta Health & Wellness engaged Deloitte & Touche to assess the validity of assumptions specifically relating to revenue projections in the July 21,2002 three-year Business Plan submitted by Lakeland with particular emphasis on the potential savings accrued from service repatriation.

Methodology/ Approach

Our methodology involves a four-phased approach:



Discussion of Revenue Elements

Introduction

All Regional Health Authorities (RHAs) in Alberta follow a standard Business Planning process set by Alberta Health and Wellness. This includes the reporting of both revenue and expenditures. The significant elements that contribute to an RHA's revenue reported to Alberta Health and Wellness are:

Alberta Health & Wellness Contributions (Global Funding)

These contributions consist of four major components;

i. Population Funding
ii. Import / Export Adjustment
iii. Non Formula Funding
iv. Minimum Guarantee

One Time, Additional and Non-Base Funding is also included and consists of funding elements that Alberta Health & Wellness provide RHAs for start-up and/or continuation of programs.

Some funding elements are designated for capital and some are "flow through" funding for specific programs. These are monitored by Alberta Health & Wellness for their use and are not part of global funding.

Other Government Contributions

For Lakeland these components are:

v. APWSS Capital Upgrading
vi. Fair Value Rent for Non-Acute Facilities
vii. Fair Value Rent for Non-owned Facilities
viii. Student Health Initiative program
ix. Primary Health projects
x. Others

RHA Revenue Generated Revenue

Fees and Charges

These represent revenue-generating items for Acute Care, Continuing Care and Outpatient activities. Such items could include: private hospital room upgrades, televisions, hospital parking fees, etc. The rates associated with these charges are controlled by provincial and/or inter-provincial regulations. The revenue an RHA generates from acute care largely depends on the percentage of aged population in the RHA area as well as their proximity to major urban centres and centres of excellence.

Donations

Donations reflect the fundraising activities executed by individual facilities and any voluntary contributions from internal or external sources. These funds are typically chanelled back into health service delivery programs and / or capital initiatives.

Investment and Other revenue

This element is comprised of interest generated from investment holdings (i.e. GIC's) and other interest income realised from the average balances held in an RHA operating account. These investment holdings arise from monthly Alberta Health & Wellness contributions and other Government funding initiatives.

Repatriated Clinical Services

All RHAs offer a variety of clinical services that may be offered to residents in their own RHA facilities or in other Regions. When a resident receives a clinical service in another region this results in an exported service to that Region. Conversely, when a Region attempts to attract patients back by offering these clinical services in their Region this is called repatriating clinical services. Fundamentally funding follows the patient to the Region where the clinical service is provided.

Analysis

Deloitte & Touche was provided with Lakeland's Three Year Revised Business Plan, dated July 31, 2002. All revenue assumptions were reviewed and verified with Lakeland Management. There was communication with other Regional Health Authorities to compare and validate Lakeland's Revenue assumptions.

For clinical service repatriation, which impacts the import/export calculation under Global Funding, a Physician consultant met with Lakeland Physicians, who represented the areas of Surgery, Obstetrics, and General Practice, to verify proposed clinical service repatriation assumptions.

Deloitte & Touche did not review all revenue components. The following Table provides the list of Revenue Components not analyzed and our reason for not reviewing them.

Revenue Components	Reason
Alberta Health Contributions	
• System common opportunities	Defined Revenue from Y2K upgrade
• Non-district Nursing Home Capital Upgrade	"Flow through" amount designated by Alberta Health & Wellness
• Early Childhood Development	
• Telehealth	
• Children Health Initiative	
• Health Innovation Program	
• Meningitis and other vaccines	
• ICD 10	
• Aboriginal Liaison	
• Other Physician compensation	
• Rural on-call remuneration program	
• Specialist on call	
Other Government Contributions	
• APWSS Capital Upgrading	Estimated grants are for "capital only"
• Fair Value Rent for Non-Acute Facilities	"Flow through" amount designated by Alberta Health & Wellness
• Fair Value Rent for Non-owned Facilities	
• Student Health Initiative program	Funds from Education to offset expenditures for education
• Others	Not material
• Amortization of External Capital contributions	Not Applicable
• Net ancillary operations	Not material

The following Revenue Components were reviewed by assessing Lakeland's assumptions, analyzing those assumptions and then determining their reasonability:

Global Funding
- Population Based Funding
- Import/Export (also studied under repatriation services
- Non Formula
- Minimum Guarantees

RHA Generated Revenue
- Fees and charges
- Donations
- Investment and Other Income

Repatriated Clinical Services
- Obstetrics/Gynecology
- Cataract Surgery
- Other Procedures

Alberta Health & Wellness Contributions (Global Funding)

Lakeland Assumptions

All RHAs were directed by AH&W to project a 4% increase for global funding (population based funding, non-formula, import/export and minimum guarantee) for the years 2002/03 to 2005/06.

Analysis

Lakeland and all other RHAs reviewed in this study projected a 4% increase for population based funding, non-formula funding and minimum guarantee in their three year business plans.

For import/export projections, Lakeland increased their export adjustment by 4% from 2002/03 to 2005/06 and then reduced the adjustment by $1.5 million for the years 2003/04 and 2004/05 and by $3 million for the year 2005/06. The net affect was approximately $3 million reduction in the import/export adjustment to funding.

Deloitte & Touche Comments

Global funding revenue assumptions of 4% were directed by Alberta Health & Wellness and were adhered to by Lakeland.

RHA Generated Revenue

The three elements of focus within the RHA generated revenue category are Fees and Charges, Donations and Investment & Other Income.

1. Fees and Charges

Lakeland's Assumptions

Fees and Charges increases have ranged from 3.6% to 9.6 % from 1998/99 to 2001/02 respectively. Lakeland projected a conservative increase in Fees and Charges based on historical experience. From 2001/02 to 2002/03 a there was a projected 6.8% increase for all Fees and Charges with a projected a 5% straight-line increase from 2003/04 to 2005/06. The CFO states this is a conservative estimate in comparison to other RHA's based on a recent inter regional survey of revenue.

Deloitte & Touche Comments

Lakeland continuing care charges are controlled and regulated by provincial regulations and/or inter-provincial regulations

Acute care revenue largely depends on the level of aged population in Lakeland as well as proximity to major urban centres

Based on the relatively stable rates of the past years and consistent mix of continuing care beds and acute care beds in Lakeland and no future plans for changes in rates, or mix of approved beds, the projected amounts for Fees and Charges seem reasonable.

2. Donations

Lakeland Assumptions

Lakeland incorporated a regional Foundation in 2002 without a business plan or board of directors.

Lakeland projected an increase of $300,000 in donations in addition to the historical donation base of $550,000 from 2003/04 to 2005/06.

Deloitte & Touche Comments

Based on analysis and comparison to other RHAs, Lakeland's donations projections appear to be unrealistic due to:

- Establishment of new foundation without a business plan
- Lack of a significant historical base of funds
- Competition for limited fundraising dollars and;
- Comparable RHAs are projecting no increases and actual decreases in donations in their business plans 2002/03 to 2004/05

Although, Lakeland's projected donations, for 2002/03 to 2004/05 appear to be overstated they may however achieve their objectives by strong local community support.

3. Investment Income and Other Revenue

Lakeland Assumptions

Lakeland is projecting a decline of 10% from 2002/03 to 2005/06 in their Investment Income and other revenue.

Deloitte & Touche Comments

Based on Lakeland's present investments in GICs, money market securities, bonds and equities of approximately $4 million and on an estimated average balance of $5 million in Lakeland's operating account and a projected return of prime less 1/4 %, it is feasible that Lakeland will make its investment revenue targets through to 2005/06, assuming current interest rates remain steady.

Other revenue from program funding is a simple flow through of funding to match program expenditures.

Lakeland's revenue assumptions seem reasonable for the Investment Income and other Revenue.

Repatriated Clinical Services

Lakeland Assumptions

Lakeland believes that their continued efforts to repatriate clinical services will result in the number of export separations continuing to decrease and the number of imports to increase from 2002/03 to 2005/06 due to in part:

- Addition of obstetrical/gynecological specialists
- Introduction of additional cataract surgery and,
- Increase in general surgical procedures

The financial impact of these repatriated clinical services in the revised July 31, 2002 three-year Lakeland Business Plan are as follows:

- 2003/04: decrease exports, increase imports (inpatient $813, 829, ambulatory care $700,000)
- 2004/05: decrease exports, increase imports (inpatient $1,141,677, ambulatory care $400,000)
- 2005/06: decrease exports, increase imports (inpatient $2.3m, ambulatory care $700,000)

Deloitte & Touche Comments

Neither Lakeland medical staff nor management could provide estimated, detailed workload projections for the above estimated repatriated services from 2002/03 to 2005/06.

Lakeland Management could not provide implementation plans to support estimates for projected repatriated services from 2002/03 to 2005/06.

Meetings with Lakeland medical staff indicate a high commitment to repatriate projected services conditional upon the Region providing the necessary supporting infrastructure. There is strong evidence of cooperation between Lakeland physicians and Lakeland management to support repatriating services.

Repatriation of services and funding impact to Lakeland is always possible but to the extent projected or proposed in the Lakeland revised July 31, 2002 three-year Business Plan is unsubstantiated primarily to the lack of workload projections from Management and the Medical Staff.

It is unreasonable to believe that Lakeland can reach its repatriation targets for 2002/03 to 2005/06.

In summary, even if Lakeland's clinical repatriation assumptions were substantiated and achieved the Region would not receive a net revenue increase due to a reduction in the import/export adjustment because Minimum Guarantee funding (if still in place) to Lakeland would be reduced by a corresponding amount in the years 2002/03 to 2005/06.

Conclusion

Lakeland's revenue assumptions specifically related to donations and clinical services repatriation in the revised July 31, 2002 three-year Business plan are overstated and are not reasonable.

There are no clear plans to raise over $500, 000 in donations over the next three years. For clinical care repatriation for Obstetrics/Gynecology, Cataract Surgery and other procedures, Lakeland cannot substantiate relevant workload projections and link these to the import/export costs identified in the July 31, 2002 three-year Business Plan.