

**REPORT TO HONOURABLE COLIN HANSEN
MINISTER OF HEALTH SERVICES**

**REVIEW OF MATTERS PERTAINING TO
ST. MARY'S HOSPITAL AND THE FRASER HEALTH AUTHORITY**

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**REVIEW OF MATTERS PERTAINING TO ST. MARY'S HOSPITAL
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Introduction

For several years, operational funding has been provided on an annual basis to St. Mary's Hospital, New Westminster, BC by the government-constituted regional health authority, pursuant to an affiliation agreement between the two parties. In July 2002, the Fraser Health Authority (Authority) issued a notice of termination of its affiliation agreement with St. Mary's Hospital (St. Mary's). The two parties subsequently have sought to reach a new agreement that would see the Authority purchase from St. Mary's certain specified health services, resulting in much reduced annual funding being received by St. Mary's from the Authority. In April 2003 an agreement in principle was reached between the parties, and negotiations are continuing towards securing a new service/funding agreement.

St. Mary's has recently developed an operational business plan taking into account its redesigned health service provider role. The plan is intended to facilitate a transition from a largely government-funded institution to one providing services to a much greater extent to public and private organizations other than the regional health authority. At the Authority's request St. Mary's has recently provided to the Authority a copy of its business plan.

I have been requested to undertake a review and to report on the following matters:

- the viability of St. Mary's current business plan, including the development of revenue generating programs and services from other sources to support the sustainability of the hospital in its ongoing role to provide services to the Fraser Health Authority;
- the capacity of St. Mary's to implement the business plan successfully and in the time frame required by the Agreement in Principle between St. Mary's and the Fraser Health Authority;
- the feasibility of the concept of the "purchaser-provider" Agreement in Principle between St. Mary's and the Fraser Health Authority.

In conducting my review, I have received all of the information and explanations I have required. As requested, my report takes into account the assessment of St. Mary's business plan by the Fraser Health Authority.

Background

Master Agreement

In 1995 a Master Agreement was signed between the then Minister of Health and Minister Responsible for Seniors and the Denominational Health Care Facilities Association. The Association is comprised of groups/societies (owners) that, as part of their respective religious missions, carry out and deliver health care services in various parts of British Columbia. The Sisters of Charity of Providence in British Columbia, owners of Saint Mary's Hospital, are listed in the Master Agreement as Association members.

The Master Agreement was, and is, for the purpose of setting forth the operational relationship between the Minister and the owners. In summary, the agreement states that:

- ownership and title to the owners' facilities belong to the respective owners;
- owners shall manage the fiscal, human and physical resources under their control so as to meet the terms of specific agreements entered into by the owners with health authorities or teaching facilities, and so as to meet provincial health care standards and national accreditation standard;
- owners shall participate in any reasonable initiative to coordinate, rationalize, plan and deliver health care services to the people within the region and/or community, and do so in collaboration with other pertinent health bodies.

The Master Agreement sets out the provisions that should be included in those agreements entered into between the individual owners and various health authorities.

Other provisions of the Master Agreement relate to consultation, dispute resolution, termination and, on request by one of the parties, independent panel review in circumstances such as when notice to terminate a specific agreement is given by a health authority to an owner.

Affiliation Agreement and Its Termination

Pursuant to the Master Agreement, the Sisters of Charity of Providence in British Columbia signed in 1997 an Affiliation Agreement with the Simon Fraser Health Region. This agreement incorporated various provisions of the Master Agreement, including those relating to the independent panel. Other pertinent sections included:

- a requirement for the health region to consult with St. Mary's on decisions significantly impacting the hospital as an organization, providing as much notice as is reasonably possible;
- a section regarding annual funding from the health region and the provision by St. Mary's Hospital to the health region of an annual budget;

- provision for termination of the agreement by either party on not less than 365 days written notice to the other party.

The annual funding provided to St. Mary's by the Fraser Health Authority (successor to the Simon Fraser Health Region) in 2002/03 totaled \$29.4 million, excluding capital funding.

By letter dated July 10, 2002, the Authority issued a notice of termination of the Affiliation Agreement with St. Mary's. The serving of the notice was intended to assist in facilitating the Authority's Fraser North Health Services Reconfiguration Program by generating more than \$17 million of savings on an annual basis which, along with several other initiatives, would enable the Authority to address the financial imperatives mandated by the Ministry of Health Services. A further intention was to facilitate a reorganization of hospital services in Fraser North to achieve maximum value from available health dollars.

Upon receiving this notice, St. Mary's requested that an independent panel review the reasonableness of the decision by the Authority to terminate the agreement.

Independent Review Panel - Ministry Assessment

Pursuant to the request by St. Mary's, an independent review panel was appointed and proceeded to conduct hearings. The report of the panel, dated December 23, 2002, concluded that the reasonableness of the notice of termination was dependent on determining whether or not an alternative proposal/plan developed by St. Mary's was consistent with government policy, and as cost efficient as closure while substantially maintaining existing levels of health care services. The panel recommended that Ministry of Health Services staff undertake a full comparative assessment of the St. Mary's plan and then report to the Minister on their findings.

The St. Mary's proposal/plan was delivered to the Ministry of Health Services on January 3, 2003 for assessment by ministry staff. After detailed review, the staff concluded that, for reasons set out in their report, they were unable to validate St. Mary's proposal as being either consistent with government policy or as cost effective as closure while substantially maintaining service levels. As a result, the ministry staff recommended to the Minister that the notice of termination be deemed reasonable and be allowed to operate according to the terms of the Affiliation Agreement.

Draft Agreement in Principle

Officials of both the Authority and St. Mary's agreed that the conclusion of the ministry staff assessment did not preclude further discussion and negotiation towards a revised role for St. Mary's. However, as it was imperative for the Authority to reduce its expenditures to meet its budgetary exigencies, that role should necessarily take into account a future reduction in annual funding from the Authority.

As a result of discussions held in early 2003, the Authority presented to St. Mary's in late February 2003 a draft document, "Agreement in Principle: St. Mary's Hospital and Fraser Health Authority".

The draft agreement set out in point form the basis for a three year agreement that would reflect a new collaborative relationship between the Authority and St. Mary's. It proposed that the Authority, in consultation with St. Mary's, appoint up to 25% of the hospital's Board members and that its funding of services at the hospital be on the basis of "a purchaser-provider relationship where services, volumes, quality and standards are specified. Costs are all in, including all direct, indirect and overhead."

The draft agreement specified the core service areas the Fraser Health Authority would contract with St. Mary's to provide commencing April 1, 2004. These were in four major areas and together were costed/priced at \$10.85 million per annum. The Authority considered that the contracted services would build on the core strengths of St. Mary's and, at the same time, would be consistent with the clinical priorities of the Authority.

The draft agreement also provided a transitional funding schedule that proposed, in accordance with the level of service to be purchased by the Authority, that quarterly funding from the Authority be reduced over five quarters commencing with the second quarter of fiscal 2003/04. By the second quarter of fiscal 2004/05, quarterly funding by the Authority would be based on \$10.85 million of annual funding for purchased services. The transition period of 15 months was longer than anticipated in the Authority's clinical redesign plan.

In responding to the draft agreement in principle, St. Mary's stated that it had undertaken a thorough review, and that with two exceptions, it was in general agreement with the proposed core service areas, funding and transition plan. The two exceptions related to the omission of palliative care and inpatient surgery from the funded core service areas. St. Mary's considered that it was fundamental to its ongoing viability that these programs be continued, albeit in a modified form, at an annual cost to the Authority of \$3.15 million, thus adjusting the Authority's proposed annual funding for purchased services to \$14 million.

Approved Agreement in Principle

Following St. Mary's response, the draft agreement in principle was further discussed by the parties. Wordings were added relating to service costs and standards and the Authority's support for St. Mary's private sector initiatives. As well, a hospice program at an annual cost of \$1 million was added to the core service areas to be funded by the Authority, bringing the annual funding for purchased services to \$11.85 million. Quarterly transition funding over the five quarters commencing with the second quarter of fiscal 2003/04 were adjusted, and funding for the second quarter of 2004/05 was based on \$11.85 million of annual funding.

By letter dated April 9, 2003, St. Mary's advised the Authority that the hospital Board had unanimously passed a motion to instruct hospital staff to accept the Authority's offer of a three year agreement, 15 month transition, including hospice, for a total of \$11.85 million at the end of transition. The instructions were, as well, to actively pursue private sector and other initiatives that were supportive of the direction chosen by the Board. The Board considered this to be the least disruptive option open to it, as it was confident that alternative revenues could

be secured within a reasonable timeframe from third party payers. This agreement, and the consequent new role for St. Mary's, was announced April 15, 2003 in a joint press release.

Towards a New Operational Model

Over the period from April 15, 2003 to date, negotiations for a new agreement between the Authority and St. Mary's, consistent with the Agreement in Principle, have been ongoing. Issues such as types of services, service volumes, and extent of costs to be funded have yet to be resolved. At the same time the Authority, commencing July 2003, began its reduction of quarterly funding in accordance with the approved Agreement in Principle.

By letter sent in late August to both the Authority and St. Mary's, the Minister of Health Services confirmed his ministry's support for the new working relationship between the two parties. The Minister noted that the new working relationship was consistent with the analysis earlier conducted by ministry staff which, in the Minister's words, "concluded that the termination notice served by FHA to Saint Mary's Hospital was valid." He also emphasized that in order for the Authority to meet financial targets established by the ministry, it was crucial that there be no delays in the introduction by St. Mary's of redesign initiatives.

In responding to the Minister, St. Mary's advised that it was continuing to pursue its transition to the new model and was pursuing the completion of a new agreement with the Authority. At the same time, it stated that it continued to take the position that the termination notice served by the Authority to St. Mary's was invalid, and was proceeding in this endeavour while reserving all of its legal rights.

On September 8, 2003, the Authority wrote to St. Mary's expressing concern with matters brought to its attention regarding the viability of St. Mary's business plan, and requested a copy of the plan. The Authority undertook to provide St. Mary's with its comments regarding the plan's risk assessments, cash and credit flow and service volume and staffing assumptions, and the overall viability of the plan.

St. Mary's Business Plan and Its Underlying Premise

St. Mary's accepts, in principle, the proposed change in its role in providing health services. However, in implementing this change, it believes it must necessarily pursue a strategic direction that sees it maintain the delivery of a broad range of health services while seeking new revenue sources.

Following this premise, a draft business plan dated September 12, 2003 was provided by St. Mary's to the Authority on September 15, 2003. The plan outlined the hospital's redevelopment strategy and its business development opportunities. The plan called for base funding from the Authority to be at \$23.5 million rather than at \$11.85 million in order to enable St. Mary's to retain services marketable to third parties and to sustain its infrastructure; as the third party revenue came to fruition, the Authority funding would be reduced correspondingly until the long-term base funding level of \$11.85 million was reached.

It is the hospital's contention that any further expenditure cuts, over and above the \$6 million already made, would necessarily be to the operating rooms, surgery beds and activation beds. It is argued that eliminating these and other services would mean that they then could not be marketed to third party payers and, as well, increased pressure would be added to regional waiting lists.

On September 19, 2003, in response to a request from the Authority for more information concerning the hospital's business plan based on certain risk assessment criteria, St. Mary's provided the Authority with a supplementary document entitled, "Business Case - Risk Assessment Criteria". This document stated that, under current transitional funding arrangements, St. Mary's would face cash depletion by January 2004 and a cash flow shortfall of \$2.9 million by March 31, 2004. The hospital affirmed its position, put forward in a draft agreement submitted to the Authority in June, 2003, that funding should remain at the 2002/03 level (i.e. \$29.4 million) until a new agreement is signed, and that reductions associated with the agreement should become effective from the date of the agreement. This would address the immediate cash flow shortfall. The hospital also reconfirmed that it was seeking a base funding level of \$23.5 million until such time as new revenues were realized.

Also on September 19, 2003, St. Mary's wrote to Premier Gordon Campbell stating that, while negotiations for a new agreement with the Authority were continuing, the hospital was not able to survive on the funding proposed by the Authority and faced an immediate cash flow crisis, this occurring in the midst of "efforts to reshape the hospital according to its proposed new role and at a time when new business initiatives are coming to fruition."

Viability of St. Mary's Business Plan

Discussion

The business plan, and related business case, prepared by St. Mary's are, in the main, conceptual documents that focus on business development opportunities, and the extent to which those opportunities are likely to be realized over time. As St. Mary's is requesting the Authority to cover the full extent of its fixed costs, the plan documents make no attempt to demonstrate how the hospital would seek to reduce expenses to take into account any reduction in funding from the Authority below the \$23.5 million level during the period that the hospital was pursuing alternate revenue sources.

St. Mary's believes that during its transition phase it is essential that its current infrastructure be supported in order to be able to attract new health service purchasers. Having such infrastructure in place means St. Mary's will have excess capacity that will give it an advantage over other acute care facilities in pursuing third party payers. To accomplish this, the hospital requires the continued support of the Authority and the Ministry of Health Services.

St. Mary's advises that it has reduced expenditures by \$6 million (20%), and its business plan reflects the view that no further expenditure reductions are possible without compromising its operational infrastructure. Expenditures at the \$23.5 million level will enable

St. Mary's to have sufficient volumes to attract anaesthetists and physicians, and maintain diagnostics.

In summary, the plan documents request that the Authority:

- maintain funding at the 2002/03 level (\$29.4 million) until such time as a new service agreement between St. Mary's and the Authority is finalized and signed (assumed in the plan documents to be November 1, 2003);
- once the agreement is signed, provide a base funding level of \$23.5 million, which would gradually be reduced to \$11.85 million as alternate revenues are realized by St. Mary's;
- provide funding for specific capital projects and any future catastrophic requirements, these being over and above capital investment funded through business arrangements with third parties.

The business plan documents include only very fundamental financial information. A cash flow summary is provided in an appendix, based on the transition funding schedule from the Authority adjusted to commence November 1, 2003 (rather than July 1, 2003 as currently determined) and a base funding level of \$23.5 million. Based on funding determined by the existing Agreement in Principle, and depending on the extent to which new revenues are secured, the summary reflects cash flow deficiencies for 2004/05 ranging from \$6.8 million to \$13.4 million, with additional deficiencies extending into 2005/06.

Two other, related appendices to the business case set out potential quarterly revenues from identified business development opportunities. These appendices reflect revenues at 50% and 100% respectively of estimated revenue potential, ranging from \$50,000 in the 2003/04 third quarter to \$5.6 million in the 2005/06 fourth quarter. It must be emphasized that these revenue projections are broad estimates, and are subject to the successful completion by St. Mary's of current and future negotiations with several potential new third party payers.

As mentioned above, the plan documents do not provide information relating to the hospital's operational expenditures. There is no breakdown of current administrative and program costs, and how those costs might need to be reconfigured taking into account future service provision to new third party payers. Consequently, it is not possible to determine, from information provided, the efficacy of the \$23.5 million in base funding requested by St. Mary's to maintain its infrastructure. However, it appears the hospital is intending to maintain current administrative and program cost levels into the foreseeable future.

Conclusion

In April 2003, the St. Mary's Hospital Board formally and publicly accepted the Fraser Health Authority's offer of a three-year agreement for the purchase of health services, including hospice, for an amount of \$11.85 million in annual funding at the end of transition. As noted above, the hospital's current business plan does not reflect this agreement. St. Mary's

has now determined that it requires substantially more annual funding from the Authority than agreed to while it pursues new revenue sources.

The business plan, as developed, would see the Authority continue to fund St. Mary's for an uncertain period into the future at levels substantially higher than those negotiated. Consequently, an expectation gap has been created between what the hospital now sees as its funding requirements during its redevelopment period and what the Authority is prepared to pay for in respect of specified health services as reflected in the Agreement in Principle between the parties.

At the same time, the budgetary exigencies of the Authority have not abated. It is therefor necessary for the Authority to actively pursue and complete, with the service providers within its jurisdiction, the service purchasing initiatives that were begun in the spring of 2002.

It is my view that the viability of the current business plan provided by St. Mary's Hospital to the Fraser Health Authority is based on a premise that does not reflect the announced agreement in principle between the two parties, does not take into account the restricted extent of the Authority's financial resources, and does not provide reasonable surety that the hospital will be successful in meeting its proposed business development revenue targets in a timely manner.

Capacity of St. Mary's to Implement its Business Plan

Discussion

The St. Mary's business plan has been developed on a basis that would see the hospital continue to receive funding from the Fraser Health Authority at a level that would enable the hospital to maintain its current level of operation; funding from the Authority would decrease below \$23.5 million as new revenues were achieved from third party payers.

The business plan is presented on the basis that it would be detrimental to the redevelopment of St. Mary's to reduce expenditures during the proposed 15 month funding transition period or thereafter when new revenues from third party payers are not yet sufficient to fully offset the proposed decrease in funding from the Authority. St. Mary's takes the position that further cuts in operational expenditures, resulting in reduced infrastructure, would seriously affect its ability to attract new third party payers.

Given that some 15 months have passed since the issuance of the notice of termination, progress has been slow in attracting and contracting with new third party payers. However, St. Mary's has now formalized redevelopment program under the direction of a project manager assigned to the program. The project manager is supported by senior hospital staff, with meetings held on a frequent basis, objectives identified, responsibilities assigned and progress monitored and reported. Accordingly, there appears to be considerable time and energy currently being devoted to the project. However, it is unclear, given the known results to date and the hospital's weak working capital position, whether project resources, human and

financial, are of the kind and sufficiency that will result in the timely development of substantial new business for the hospital.

St. Mary's believes it is essential to the success of its business plan that it and the Authority enter into a more collaborative relationship, so that they not be in direct competition regarding the provision of health services to third party payers. This would increase the likelihood of success for the St. Mary's business plan.

As mentioned above, the business plan sets out alternative projections of business development revenues, however the accuracy of those projections is, at this stage, difficult to assess.

Conclusion

As presented, the St. Mary's Hospital business plan is premised on a basis that does not reflect the circumstances relating to agreed funding to be received from the Fraser Health Authority in current and future fiscal periods. Also, the achievement of projections of future revenues from third part payers remains, at this time, highly uncertain.

Accordingly, it is my view that St. Mary's Hospital does not appear to have the capacity to implement, in a timely manner, a business plan that serves the needs and meets the declared financial objectives of the Fraser Health Authority.

Feasibility of the Concept of the Purchaser-Provider Agreement in Principle

The Agreement in Principle between St. Mary's and the Authority provides for the funding of health services on the basis of a purchaser-provider relationship. The purchaser (Authority) undertakes to purchase certain specified services on an annual basis at a cost agreed to with the provider (St. Mary's). Service volumes, quality and standards are specified in the service agreement between the parties.

This type of relationship has the advantage of providing more direct linkage between service requirements and service provision than does the establishment of a broad-based funding envelope. It requires the purchaser to be very specific as to its service requirements and expectations, and the provider to be accurate and competitive in establishing its pricing of individual services on a full cost recovery basis. It encourages efficiencies on the part of both the purchaser and the provider.

A difficulty arises when the service (under moves from providing broad-based service funding to the purchasing of a smaller base of services. The service provider is faced with having to either downsize or secure alternate sources of revenue to replace the reduction in funding, and do so over a relatively short time period. This is, as described above, the conundrum facing St. Mary's.

It is my view that the purchaser-provider concept, forming the basis of the Agreement in Principle between St. Mary's Hospital and the Fraser Health Authority, is both feasible and valid, and should continue to be adopted by the parties to our health system.

Closing Observations

In determining next steps, the Fraser Health Authority must be clear as to the objectives it wishes to achieve from its ongoing relationship with St. Mary's Hospital. There may be operational objectives that in the long term are mutually advantageous and achievable but which, in the short to medium term, are affected by the need to consider financial realities.

In this regard, the desire to achieve a timely reduction in purchased services and consequent reduction in funding costs, while at the same time wishing to ensure that marketable health service capacity is maximized in the region, is a key issue that must be resolved in as rational and cost-effective a manner as possible in order that the public is provided with the best in affordable health care services now and in the future.

George L. Morfitt, FCA
Victoria, BC

October 10, 2003