



GEORGIA ALLIANCE OF COMMUNITY HOSPITALS

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Memorandum

To: Members of the 2010 Special Council on Tax Reform and Fairness for Georgians

Via: Email to Lindsey Napier (lindsey.Napier@house.ga.gov)

cc: Alliance Members

From: Julie Ellen Windom, Vice President
Georgia Alliance of Community Hospitals

Date: November 30, 2010

RE: Reports Assessing (1) Financial Needs and Inadequate Reserves of Georgia Not-For-Profit (NFP) Hospitals (Cleverley Report); (2) Cost of Uncompensated Community Benefits in Excess of the Estimated Value of NFP Hospitals' State Tax Exemptions (Pershing Yoakley Report); and (3) Presumptive Charity Care (Medlytix Report)

The Georgia Alliance of Community Hospitals (Alliance) is an association of public and private community not-for-profit (NFP) hospitals located throughout the state, including urban, suburban, and rural hospitals, large and small. Alliance hospitals and health systems are major providers of uncompensated medically indigent care and community outreach services to Georgians. These essential NFP health care institutions provide a "safety net" for all in need of care; operate the busiest emergency departments in the state; and provide both statewide and community-oriented physician training programs whose importance grows with growing doctor shortages throughout the state. NFP hospitals are governed by local Boards of Trustees who volunteer their time and talents to the service of their local communities. In many communities, NFP hospitals are the largest employers, and their presence and viability are essential in maintaining and attracting new business and industry.

Questions sometimes arise as to whether NFP hospitals maintain reserves in excess of that needed to meet their financial commitments and provide the facilities and services needed to provide quality health care for the communities and regions they serve. Some also ask whether NFP hospitals provide uncompensated benefits to their communities on a scale that justifies the tax exemptions historically afforded to them by law.

Attached for your information are two comprehensive reports prepared by recognized experts in the fields of health care finance and hospital community benefits, who have studied and answered those questions:

1. *Financial Assessment of Not-for-Profit Hospitals: Georgia Alliance of Community Hospitals*, prepared by Cleverley & Associates (Nov. 17, 2010); and
2. *Comparative Analysis of Uncompensated Community Benefits Provided by NFP Hospitals with the Estimated Value of Georgia Tax Exemptions*, prepared by Pershing Yoakley & Associates (Nov. 30, 2010);

Also, attached is a third report on *Presumptive Charity Care*, prepared by Medlytix LLC (Nov. 2010), which is referenced in the above Pershing Yoakley report in support of certain findings in that report concerning the uncompensated cost of medically indigent care.

The Cleverley & Associates report, authored by one of the nation's longtime leading experts in health care finance, William Cleverley, Ph.D., finds that (a) Alliance NFP hospitals do not have excess reserves; to the contrary, they have an aggregate **deficiency** of at least **\$2.3 billion** in cash and reserves to meet their established replacement needs; (b) profitability of Alliance NFP hospitals is very low relative to other industry sectors including publicly held, investor-owned healthcare companies that own for-profit hospitals, ambulatory surgery and imaging centers, and other provider facilities; (c) the current levels of profit/equity at Alliance hospitals are not sufficient to maintain sustainable growth; (d) Alliance NFP hospitals reinvest substantially more in their local community hospitals than do Georgia for-profit hospitals and U.S. hospitals, on average; and (e) Alliance NFP hospitals' charges are reasonable compared to national norms, and substantially lower than Georgia for-profit hospitals'. These findings demonstrate clearly that Alliance NFP hospitals do **not** maintain reserves in excess of their needs.

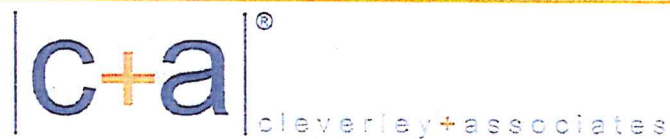
The Pershing Yoakley report, prepared by one of the Southeast's leading health care financial consulting and accounting firms, is based upon a comprehensive study of the cost of uncompensated community benefits that have been identified, quantified, and reported by Alliance NFP hospitals compared to the estimated value of state tax exemptions (*i.e.*, property, sales, income, and net worth) available under Georgia law to NFP hospitals. The cost of uncompensated community benefits included in the Pershing Yoakley study is very conservative in that it does not include the cost of benefits that were not identified by certain hospitals whose community benefit reports were not available for the study.

The Pershing Yoakley study finds that the estimated value of these NFP hospitals' state tax exemptions is far exceeded by the uncompensated cost of identified community benefits they provide. In their fiscal year 2009, the cost of uncompensated community benefits identified by the Alliance NFP hospitals was approximately \$1.2 billion, and that exceeded the estimated value of their state tax exemptions by about \$862 million. **In other words, the Alliance NFP hospitals provide, on average, four dollars (\$4) of uncompensated community benefits (at cost) to their local communities for every dollar (\$1) of their total estimated state tax exemptions.**

On behalf of the Georgia Alliance of Community Hospitals, I thank you for the opportunity to present these reports, and for your consideration.

Financial Assessment of Not-For-Profit Hospitals: Georgia Alliance of Community Hospitals

November 17, 2010



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- 1. Adequacy of cash reserves**
- 2. Reasonableness of profits**
- 3. Reinvestment in Local
Community Facilities**
- 4. Charge Comparisons**

- **Most recent audits of Georgia Alliance Systems (35 Healthcare Systems)**
- **Public-use file data for Alliance not-for-profit hospitals and all US acute-care hospitals**
 - ✓ **2009 Medicare cost reports**
 - ✓ **2009 Medpar**
 - ✓ **2009 HOPPS**

Cash & Reserve Adequacy

- **Working capital needs**
- **Capital replacement**
- **Contingencies**
- **Supplementation of operating earnings**

- 30 Days cash on hand (DCOH)
- $DCOH = \frac{\text{Cash \& reserves}}{\text{Avg daily cash exp}}$
- Alliance not-for-profit hospitals' avg daily cash exp = \$35.9 million
- 30 DCOH = \$1.08 billion

- **NFP sources of funding are**
 - ✓ **Cash reserves**
 - ✓ **Debt**

- **Capital needs**
 - ✓ **Allowance for depreciation**
 - ✓ **Adjustments for inflation / technological improvement**

- \$500,000 – 5-year life asset
- Inflation/technological improvement at 6% / year

| <i>Year</i> | <i>Historical Cost</i> | <i>Depreciation Expense</i> | <i>Accumulated Depreciation</i> | <i>Net Cost</i> | <i>Replacement Need (@ 6%)</i> |
|-------------|------------------------|-----------------------------|---------------------------------|-----------------|--------------------------------|
| 1 | \$500,000 | \$100,000 | \$100,000 | \$400,000 | \$106,000 |
| 2 | 500,000 | 100,000 | 200,000 | 300,000 | 224,720 |
| 3 | 500,000 | 100,000 | 300,000 | 200,000 | 357,305 |
| 4 | 500,000 | 100,000 | 400,000 | 100,000 | 504,991 |
| 5 | 500,000 | 100,000 | 500,000 | 0 | \$669,113 |

- **Accumulated depreciation = \$7.5 billion**
- **Average age of plant and equipment = 9.8 years**
- **Replacement needs at 6% = \$13.2 billion***

*** Replacement needs @ 4% = \$11.0 billion**

Alliance Not-for-Profit Hospitals' Cash & Reserve Adequacy (billions)

Cash & reserves available

| | |
|-----------------------------------|---------------|
| Cash & short-term investment | \$1.93 |
| Unrestricted long-term investment | 3.45 |
| Total available | \$5.38 |

Cash & reserve needs

| | |
|--------------------------------|---------------|
| Working capital | \$1.08 |
| Capital replacement (50% debt) | 6.60 |
| Contingencies | ? |
| Operating earnings supplement | ? |
| Total need | \$7.68 |

| | |
|-----------------------------|-----------------|
| Surplus (deficiency) | (\$2.30) |
|-----------------------------|-----------------|

Reasonableness of Profits

| | <i>Return on Equity %</i> | <i>Return on Assets</i> |
|-----------------------------------|---------------------------------------|---------------------------------|
| Alliance not-for-profit hospitals | 5.7 | 2.8 |
| S&P 500* | 19.0 | 8.2 |
| Major drugs* | 20.9 | 10.4 |
| Healthcare facilities*† | 19.0 | 6.9 |
| Insurance (accident & health)* | 17.5 | 5.2 |

* Data are from Reuters ProVestor Plus Company

Reports as of 10/13/10 for trailing twelve months (ttm) on after tax basis

† Includes 160 publicly traded companies in the hospital, long term care, outpatient surgery and other provider sectors.

| | | Income Statement | | |
|---|------------------------------------|---|--|--|
| | | <u>Year 1</u> | <u>Year 5</u> | |
| <div style="display: inline-block; vertical-align: middle; border-left: 1px solid black; border-right: 1px solid black; padding: 0 10px;"> <div style="border-top: 1px solid black; border-bottom: 1px solid black; width: 100%;"></div> <div style="border-top: 1px solid black; border-bottom: 1px solid black; width: 100%;"></div> <div style="border-top: 1px solid black; border-bottom: 1px solid black; width: 100%;"></div> <div style="border-top: 1px solid black; border-bottom: 1px solid black; width: 100%;"></div> </div> | Revenues | \$1,000 | \$2,000 | |
| | Balance Sheet Assets | | Growth <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;"> <u>\$1,000</u> </div> <div style="text-align: center;"> <u>\$2,000</u> </div> </div> | |
| | Assets | | | |
| | Balance Sheet Debt + Equity | | Debt Policy <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;">\$500</div> <div style="text-align: center;">\$1,000</div> </div> | |
| Debt | | | | |
| Profitability Goal | | <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;">\$500</div> <div style="text-align: center;">\$1,000</div> </div> | | |
| Equity | | | | |
| Total Debt + Equity | | <u>\$1,000</u> | <u>\$2,000</u> | |

Alliance Not-for-Profit Hospitals' Growth not Sustainable (millions)

| | <i>2008</i> | <i>2009</i> | <i>Change</i> | <i>%</i> |
|--------------------|-------------|-------------|---------------|----------|
| Revenue | \$13,100 | \$14,308 | \$1,208 | 9.2 |
| Assets | 15,865 | 16,529 | 664 | 4.2 |
| Liabilities | 7,949 | 8,558 | 609 | 7.7 |
| Equity | 7,916 | 7,971 | 55 | 0.7 |

- Growth rates are not sustainable (0.7% < 4.2%)
- More profit/equity growth is required
- Debt increased from 50.1% to 51.8%

Reinvestment in Local Communities

- Investment in plant and equipment
 - ✓ Growth in net fixed assets (2 year)
 - ✓ Revenue to net fixed assets

| | <i>Alliance not-for- Profit Hospitals ≥ 100 Beds</i> | <i>Georgia Hospitals ≥ 100 Beds</i> | <i>US Hospitals ≥ 100 Beds</i> | <i>Georgia for-Profit Hospitals ≥ 100 Beds</i> |
|--|--|---|--|--|
| 2-Year growth in net fixed assets % | 10.6 | 0.4 | 4.4 | -5.3 |
| Revenue to net fixed assets | 2.1 | 2.2 | 2.5 | 2.6 |

Charge Comparisons

➤ Reasonable charges

- ✓ Medicare charge per case (CMI & WI adj)
- ✓ Medicare charge per visit (RW & WI adj)

| | <i>Alliance not-for- Profit Hospitals ≥ 100 Beds</i> | <i>Georgia Hospitals ≥ 100 Beds</i> | <i>US Hospitals ≥ 100 Beds</i> | <i>Georgia for-Profit Hospitals ≥ 100 Beds</i> |
|---|--|---|--|--|
| Medicare charge per discharge (CMI & WI adj) | \$20,421 | \$20,591 | \$21,977 | \$26,127 |
| Medicare charge per visit (RW & WI adj) | \$331 | \$342 | \$333 | \$457 |

- Alliance cash positions are below required replacement needs and will force greater reliance on debt, raising the cost of service delivery. Alliance hospitals conservatively have an aggregate deficiency of at least \$2.3 billion in cash and reserves to meet their established needs. They do not have excess reserves.
- Profitability at Alliance hospitals is very low relative to other industry sectors. This implies Alliance hospitals are transferring value to their communities.
- Current profit/equity at Alliance Hospitals growth is not sufficient to maintain sustainable growth. Higher levels of debt financing will be required to maintain present growth which will raise the cost of service delivery.
- Alliance not-for-profit hospitals are reinvesting in their local community hospitals and maintaining reasonable charges.

| <i>System</i> | <i>Included Facilities</i> |
|---|---|
| Archbold Medical Center, Inc. | John D. Archbold Memorial Hospital Brooks County Hospital Early Memorial Hospital and Nursing Homes Grady General Hospital Mitchell County Hospital and Nursing Homes |
| Athens Regional Health Services, Inc. | Athens Regional Medical Center |
| Hospital Authority of Wayne County | Wayne Memorial Hospital |
| Central Georgia Health System, Inc. | Medical Center of Central Georgia |
| Hospital Authority of Clinch County | Clinch Memorial Hospital |
| Columbus Regional HealthCare System, Inc. | The Medical Center Doctors Hospital |
| DeKalb Regional Health System, Inc. | DeKalb Medical at North Decatur DeKalb Medical at Hillandale DeKalb Medical at Downtown Decatur |
| Emory Healthcare | Emory University Hospital Emory University Hospital Midtown |

(cont'd)

| <i>System</i> | <i>Included Facilities</i> |
|---|---|
| Floyd Healthcare Management, Inc. | Floyd Medical Center |
| Gwinnett Hospital System, Inc. | Gwinnett Medical Center Gwinnett/Duluth Medical Center |
| Hamilton Health Care System, Inc. | Hamilton Medical Center Murray Medical Center |
| Hospital Authority of Bainbridge Decatur County | Memorial Hospital |
| Hospital Authority of Colquitt County | Colquitt Regional Medical Center |
| Henry Medical Center, Inc. | Henry Medical Center |
| Hospital Authority of Houston County | Houston Medical Center Perry Hospital |
| Hospital Authority of Putnam County | Putnam General Hospital |
| Hospital Authority of Valdosta and Lowndes County | South Georgia Medical Center |
| Lanier Health Services, Inc. | Louis Smith Memorial Hospital |

(cont'd)

| <i>System</i> | <i>Included Facilities</i> |
|---|---|
| MCG Health, Inc. | MCG Health |
| Meadows Healthcare Alliance | Meadows Regional Medical Center |
| Northeast Georgia Health System, Inc. | Northeast Georgia Medical Center |
| | Northside Hospital |
| Northside Hospital, Inc. | Northside – Hospital Forsyth |
| | Northside Hospital – Cherokee |
| | Phoebe Putney Memorial Hospital |
| Phoebe Putney Health System, Inc. | Phoebe Worth Medical Center |
| | Phoebe Sumter Medical Center |
| | Piedmont Hospital |
| | Piedmont Fayette Hospital |
| Piedmont Healthcare, Inc. | Piedmont Newnan Hospital |
| | Piedmont Mountainside |
| Satilla Health Services, Inc. | Satilla Regional Medical Center |
| Glynn-Brunswick Memorial Hospital Authority | Southeast Georgia Health System - Brunswick |
| | Southeast Georgia Health System - Camden |

(cont'd)

| <i>System</i> | <i>Included Facilities</i> |
|--|--|
| Southern Regional Hospital System, Inc. | Southern Regional Medical Center |
| St. Joseph's/Candler Health System, Inc. | Candler Hospital St. Joseph's Hospital |
| St. Mary's Health Care System, Inc. | St. Mary's Hospital |
| Hospital Authority of Stephens County | Stephens County Hospital |
| Tanner Medical Center, Inc. | Tanner Medical Center-Carrollton Tanner Medical Center-Villa Rica Tanner Medical Center-Higgins General Hospital |
| Grady Memorial Hospital Corporation | Grady Memorial Hospital |
| Tift County Hospital Authority | Tift Regional Medical Center |
| University Health Services, Inc. | University Hospital WellStar Cobb Hospital |
| WellStar Health System, Inc. | WellStar Douglas Hospital WellStar Kennestone Hospital (and Windy Hill) WellStar Paulding Hospital |
| West Georgia Health Services, Inc. | West Georgia Medical Center |

| Provider | Hospital Name | City |
|----------|------------------------------------|---------------|
| 110001 | Hamilton Medical Center | Dalton |
| 110003 | Satilla Regional Medical Center | Waycross |
| 110005 | Northside Hospital Forsyth | Cumming |
| 110006 | St. Marys Hospital | Athens |
| 110007 | Phoebe Putney Memorial Hospital | Albany |
| 110010 | Emory University Hospital | Atlanta |
| 110011 | Tanner Medical Center- Carrollton | Carrollton |
| 110016 | West Georgia Medical Center | Lagrange |
| 110024 | Candler Hospital | Savannah |
| 110025 | Southeast Georgia Health System | Brunswick |
| 110028 | University Hospital | Augusta |
| 110029 | Northeast Georgia Medical Center | Gainesville |
| 110034 | Medical College of GA | Augusta |
| 110035 | Wellstar Kennestone Hospital | Marietta |
| 110038 | John D. Archbold Memorial Hospital | Thomasville |
| 110043 | St. Joseph's Hospital | Savannah |
| 110054 | Floyd Medical Center | Rome |
| 110064 | The Medical Center | Columbus |
| 110069 | Houston Medical Center | Warner Robins |
| 110074 | Athens Regional Medical Center | Athens |

| Provider | Hospital Name | City |
|----------|-----------------------------------|---------------|
| 110076 | Dekalb Medical at North Decatur | Decatur |
| 110078 | Emory University Hospital Midtown | Atlanta |
| 110079 | Grady Memorial Hospital | Atlanta |
| 110083 | Piedmont Hospital | Atlanta |
| 110087 | Gwinnett Medical Center | Lawrenceville |
| 110095 | Tift Regional Medical Center | Tifton |
| 110107 | Medical Center of Central Georgia | Macon |
| 110122 | South Georgia Medical Center | Valdosta |
| 110124 | Wayne Memorial Hospital | Jesup |
| 110143 | Wellstar Cobb Hospital | Austell |
| 110161 | Northside Hospital | Atlanta |
| 110165 | Southern Regional Medical Center | Riverdale |
| 110184 | Wellstar Douglas Hospital | Douglasville |
| 110186 | Doctors Hospital | Columbus |
| 110191 | Henry Medical Center | Stockbridge |
| 110215 | Piedmont Fayette Hospital | Fayetteville |
| 110226 | Dekalb Medical at Hillandale | Lithonia |
| 110229 | Piedmont Newnan Hospital | Newnan |



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William O. Cleverley, Ph.D., has been the President of Cleverley & Associates since its formation in January 2000. Prior to forming Cleverley & Associates, Dr. Cleverley was the President and Founder of CHIPS (Center for Healthcare Industry Performance Studies). CHIPS developed the first national proprietary healthcare data base of the nation's hospital industry. Dr. Cleverley is also Professor Emeritus at The Ohio State University where he has taught courses in healthcare finance since 1973.

Dr. Cleverley is the author of over 40 books dealing with the application and use of financial management principles and data in healthcare organizations. In addition, he has authored over 200 articles on healthcare financial issues in a wide variety of both academic and professional journals.

Cleverley & Associates is a firm specializing in providing benchmarking and consulting services to hospitals in the financial, operating, and clinical areas. The firm emphasizes data interpretation and business solution identification that will enable hospital clients to improve their financial performance.

Since 2004, Cleverley & Associates has included the Community Value Index® in its annual **State of the Hospital Industry** publication. The CVI assesses the level of community benefits provided by U.S. hospitals.