The Cambridge Hospital
Affiliated with
Harvard Medical School

February 2, 1983

Mr. Robert W. Healy, City Manager
City of Cambridge
City Hall
Cambridge, MA 02139

Dear Mr. Healy:

I am writing in response to Councillor Francis Duehay's Council Order (Number 9) requesting a study be conducted to assess the impact that the recently enacted hospital reimbursement legislation, Chapter 372, will have upon the health and hospital operations in Cambridge. I will summarize in this letter the results of a study recently concluded, in conjunction with the preparation of the FY1984 budget, by Ernst and Whinney and my Fiscal staff.

Chapter 372,which was signed into law by Governor Edward King on August 10, 1982, incorporates an agreement in principle reached between the Massachusetts Hospital Association, Massachusetts Business Roundtable, Blue Cross, Life Insurance Association of Massachusetts, and state government for reform of the acute care hospital financing system. The Medicare program will also participate in this arrangement as a result of an experimental three(3) year waiver. The intent of this legislation was to develop a new hospital financing system aimed at controlling the rise in hospital costs. Under the previous system, hospitals had no incentives to control costs or monitor volume because reimbursement was based on a retrospective actual cost finding methodology. The core of the Chapter 372 system is the Blue Cross Maximum Allowable Cost (MAC) contract, under which reimburseable costs are determined on a prospective formula basis.

Under Chapter 372, all hospitals will have to live within budgets determined in advance by taking Fiscal Year 1981 costs as a base and rolling it forward by an inflation factor each year, adjusting for certain "costs beyond control" of the institution as well as changes in the volume of services to be rendered. This prospectively determined budget is the hospital's MAC. A hospital will be reimbursed at the MAC level whether it underspends or exceeds this level, and although the MAC level will be the basis of payment for all payers, the actual amount each third party payer will reimburse the hospital will be determined by a complicated network of discounts and productivity factors. The net effect of this legislation is to restrain hospital industry growth by several percent over a three year period.

The impact that this legislation will have upon The Cambridge Hospital will be similar to that upon all acute hospitals in Massachusetts. In general, the amount of incremental net revenue that will be generated each year for the next three years will be constrained by the ratcheting down effect of this legislation. Increases in the hospital and ambulatory budget will have to be correspondingly compressed to be reimbursed by third party payers.

If costs in excess of the maximum allowable cost level are budgeted, they will not be reimbursed and will have to be funded by additional tax support from the city.

The Cambridge Hospital, through Representative Saundra Graham's legislative efforts, is entitled to additional Medicaid reimbursement for the provision of free care. This will soften the impact of Chapter 372 for the hospital. However, there still is no provision in this legislation to adequately reimburse hospitals incurring a high volume of bad debts, i.e. municipal hospitals.

Specifically, the impact study indicates that projected net revenues for Fiscal Year 1984 are sufficient to cover a seven percent increase in expenses over Fiscal Year 1983. Of this $1.8 million increase, approximately $1.4 million dollars is required to fund projected salary increases awarded in Fiscal Year 1983. This remaining $400,000 will be used to fund all non-salary increases attributed to inflation, etc., as well as additional staffing monies needed for the Emergency Room, interpreters services, and the proposed expansion of obstetrical services in conjunction with Massachusetts General Hospital. Although we have been able to develop a very tight budget within this framework with much aid from the Health Policy Board and Medical Staff, we will rely upon the city to fund any salary increments awarded during Fiscal Year 1984. The only reduction in services proposed is the closure of one Neighborhood Health Center and transfer of these patients to other system sites.

Currently, action is being taken to develop the data base that will be needed to prepare for extremely difficult FY1985 and 1986 budget cycles. Historically, the hospital and ambulatory budgets have increased between twelve and fifteen percent annually. It is currently anticipated that the seven percent increase allowed for FY1984 will be further reduced in FY1985 and 1986. To provide similar service delivery during those years without significant monies in tax support will be impossible. For this reason the following avenues are being pursued:

1) Chapter 372 Incentives. The new reimbursement methodgy incorporates a number of complex incentives. Strategies involving increases and decreases in the volume of services, inpatient and outpatient shifts in volume, expense management, and changes in service delivery are being evaluated.

2) Planning. I have recently appointed a multi-disciplinary planning committee to serve as a critical force in identifying and addressing the problems that Chapter 372 will present for the residents of this community.

3) Three-year Operating Expense Budget. The fiscal staff has commenced work on developing projected expense budgets for the three year life of the current reimbursement arrangement. This will create the data base to test the "what if?" iterations that will be required as adjustments to the status quo are indicated.

4) Profit and Loss Analysis. Upon the completion of Step 3., an analysis of costs and revenues associated with each service the hospital provides will be undertaken. As part of an assessment of the services we currently provide, it is important that we are able to quantify the impact each has upon the bottom line.

In summary, the enactment of Chapter 372 will place great pressure on the services currently being rendered in Cambridge. In Fiscal Year 1984, the proposed budget is predicated upon closing one Neighborhood Health Center, funding of FY1984 pay raises by the city, as well as across the board belt tightening in every department. In the long run, steps have been initiated to identify and react to the impact that this legislation will undoubtedly have upon both the quality and quantity of health care in this city.

Very truly yours,

Melvin H. Chalfen MD

Melvin H. Chalfen, M.D.,
Commissioner of Health & Hospitals

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cc: Alfred P. Vellucci

CITY OF CAMBRIDGE

CAMBRIDGE, MASSACHUSETTS 02139
Tel. 498-9011

EXECUTIVE DEPARTMENT
ROBERT W. HEALY
City Manager

February 28, 1983

To the Honorable, the City Council:

With respect to Awaiting Report Item No. 8 relative to the impact of Chapter 372 of the Mass. General Laws on health and hospital operations, enclosed please find copy of a report from Melvin H. Chalfen, M. D., Commissioner of Health & Hospitals.

Very truly yours,

Robert W. Healy
City Manager

RWH/mbf
Enc.

Agenda Item Number Two S-87

Re: response to Awaiting Report Item No. 8 regarding the impact of Chapter 372 of the Mass. General Laws on health & hospital operations.

In City Council,

February 28, 1983

2/28/83
Placed on File