KINGSTON GENERAL HOSPITAL

Management Discussion and Analysis (unaudited)
For the year ended March 31, 2016

The objective of the Management Discussion and Analysis is to help readers of the Financial Statements of Kingston General Hospital (KGH), better understand the financial position and operating activities for the fiscal year ended March 31, 2016. This analysis should be read in conjunction with the audited financial statements and the accompanying notes to the statements.

The management of KGH acknowledges that it is our responsibility to provide appropriate information systems, procedures and controls to ensure that the information in the financial statements and this report is complete and reliable. This is done under the oversight of the Board of Directors and the Finance and Audit Committee of the hospital.

Overview

Kingston General Hospital is southeastern Ontario's centre for tertiary complex-acute and specialty care, and home to the Cancer Centre of Southeastern Ontario. KGH serves almost 500,000 people through its Kingston facility and 24 regional affiliate and satellite sites. Together, approximately 4,000 staff, physicians and volunteers partner with patients and families to deliver upon our aim of *Outstanding Care, Always.*

We have made great strides to improve the financial health of our organization. Over the past seven years we have sustained balanced operating financial results while addressing inflationary cost pressures and the impact of Health System Funding Reform (HSFR). Capacity to invest in the ongoing replacement of patient care equipment, technology, and building infrastructure renewal has increased. Our working capital position is positive.

Prior to fiscal 2013, the Ministry of Health and Long-Term Care (Ministry) funded hospitals on the basis of how much they had received in the previous year. Commencing April 1, 2012, the Ministry began to reform the funding methodology (HSFR) so that some funding would be based on forecasted population growth, past usage of health services, the number of people cared for, and the services provided. Fiscal 2016 (the year ended March 31, 2016) was the fourth year operating under this new funding model.

For KGH, the application of the funding methodology in fiscal 2016 further reduced the hospital annual operational funding by approximately $5.0 million. This funding reduction came at the same time, for the fourth consecutive year, that hospitals did not receive funding to offset the cost of inflationary factors on hospital operating costs. By engaging everyone who works, learns and volunteers at KGH, the hospital was able to identify and implement solutions to these financial challenges while continuing to provide safe, high quality, patient and family-centred care.

For the year ended March 31, 2016, the hospital reported a surplus of revenue over expenses before building amortization of approximately $18 million. Approximately $5 million of this favourable fiscal result was due to the recognition of higher than planned funding for specific patient care activity volumes.

The remaining approximate $13 million resulted from amounts provisioned from the operating budget to provide for capital expenditure. The total surplus of revenue over expenditures for the year was approximately $16 million after the inclusion of building amortization expense.

Financial Analysis of the Hospital

The assets of the hospital exceeded its liabilities at the end of the most recent fiscal year by $62.7 million (net assets). The analysis below focuses on the change in net assets during fiscal 2016.

(000')	Unrestricted	Invested in Capital Assets	Total
Balance, beginning of year	21,659	25,010	46,669
Excess of revenue over expenses	23,727	(7,695)	16,032
Net change in investment in capital assets	(10,451)	10,451	-
Balance, end of year	34,935	27,766	62,701

Total net assets increased during the year primary due to the impact of the hospital's surplus position. The portion of net assets invested in capital assets increased from $25.0 million to $27.8 million this year. This increase corresponds to the increase in capital asset expenditures less the increase in amortization, repayment of long-term debt, and amounts funded by deferred contributions.

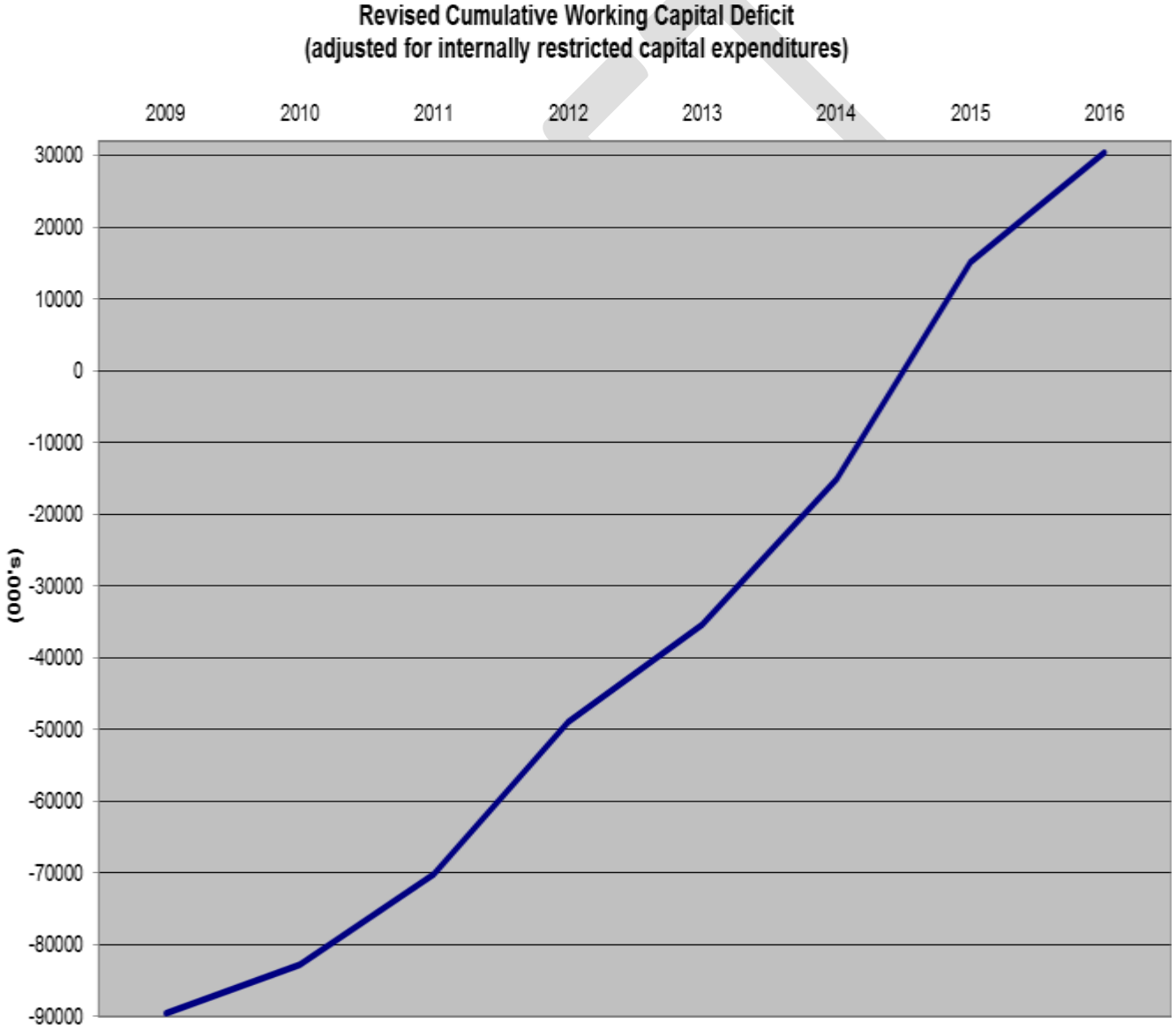
Working Capital

Working capital is a reflection of an organization's ability to meet its short-term financial obligations and is defined as an excess of current assets over current liabilities. As at March 31, 2016 the hospital's total working capital position was positive at approximately $62.0 million; an increase of $5.1 million from the previous year-end position. It is important to note that during the year the hospital utilized $5.3 million in cash (otherwise part of the working capital calculation) to purchase additional investment assets being held for a future replacement of health information systems technology. Current assets include cash of approximately $46.4 million that cannot be used for hospital operational activities. This amount includes $25.4 million for approved capital expenditures, $13.5 million provisioned for recoverable and deferred liabilities and $7.5 million designated for research projects facilitated through the Kingston General Hospital Research Institute.

The hospital did not make any draw upon its operating line of credit in fiscal 2016 ($30 million borrowing capacity).

The audited Consolidated Statement of Cash Flows reflects the changes in the cash components of working capital. Changes in non-cash working capital items are detailed in note 13 of the accompanying Notes to Consolidated Financial Statements.

As the hospital internally restricts cash for all approved capital expenditures not completed by the end of the fiscal year, and specific restricted operational liabilities, the revised working capital figures depicted below more accurately represent the working capital position. This revised depiction indicates an adjusted positive working capital position for the second year in a row. This calculation also includes amounts held as other investments ($13.1 million) in alignment with the Ministry calculation for adjusted working capital.



2009	($89.6M)	2011 ($70.2M)		2013 ($35.4M)	2015 $15.1M
2010	($82.7M)	2012 ($50.0M)		2014 ($15.1M)	2016 $30.6M

Long-term Debt

KGH has a conservative approach to taking on new long-term debt. In March 2012, the Board proactively approved the investment of $5.7 million of surplus cash to fund future long-term debt liabilities maturing in 2016/2017 relating to infrastructure investments made in 2006/2007 that did not have associated dedicated funding. In fiscal 2016, taking advantage of low borrowing rates, KGH refinanced $3.2 million of this maturing long-term debt in order to re-provision an equal amount to provide internal financing capacity for future business systems replacement anticipated from the Health Care Tomorrow - Hospital Services project (HCT).

Included in the total long-term debt outstanding of approximately $9.3 million at the end of the recent fiscal year, is the outstanding portion of debt incurred in 2012 ($7.8 million) to support an energy retro-fit project. The payments on this debt are supported by a contractual guarantee of reductions in energy costs over the 15 year amortization period of the loan. The energy savings are being achieved.

Investment in Capital Assets

In 2010 KGH developed a long-range capital plan which indicated a need to invest at least $20 million per year in order to provide for the ongoing replacement of existing patient care equipment, technology and facilities infrastructure. Supported by increased funding from the Ministry Health Infrastructure Renewal Fund (HIRF) and ongoing support from the KGH Auxiliary and donors to the University Hospitals Kingston Foundation, (refer to note 14 in the accompanying Notes to Consolidated Financial Statements) this level of funding for fiscal 2016 capital replacement capacity was exceeded (achieved capacity of $21.4 million). Cash to complete all capital expenditures approved to date has been internally restricted for this purpose.

During the fiscal year, the hospital accounted for the purchase of approximately $20.3 million of capital assets (approved in previous and current year). Expenditures occurred in the following categories:

Patient care and non-clinical equipment	$10.0 million
Information management systems	$ 1.8 million
Facilities infrastructure/renovations	$ 8.5 million

During the year, $13.3 million of capital expenditures were reported as funded through the use of deferred capital contributions.

Operating Revenues

Kingston General Hospital is funded by the Province of Ontario in accordance with funding policies established by the Ontario Ministry of Health and Long-Term Care, Cancer Care Ontario, and the South East Local Health Integration Network (SE-LHIN).

The hospital is required to annually execute the Hospital Services Accountability Agreement (H-SAA) with the SE-LHIN. This agreement sets out the rights and obligations of the two parties and sets standards, targets and performance expectations for the funding provided. If the hospital does not meet certain performance standards or obligations, the SE-LHIN has the right to adjust some funding streams received by the hospital.

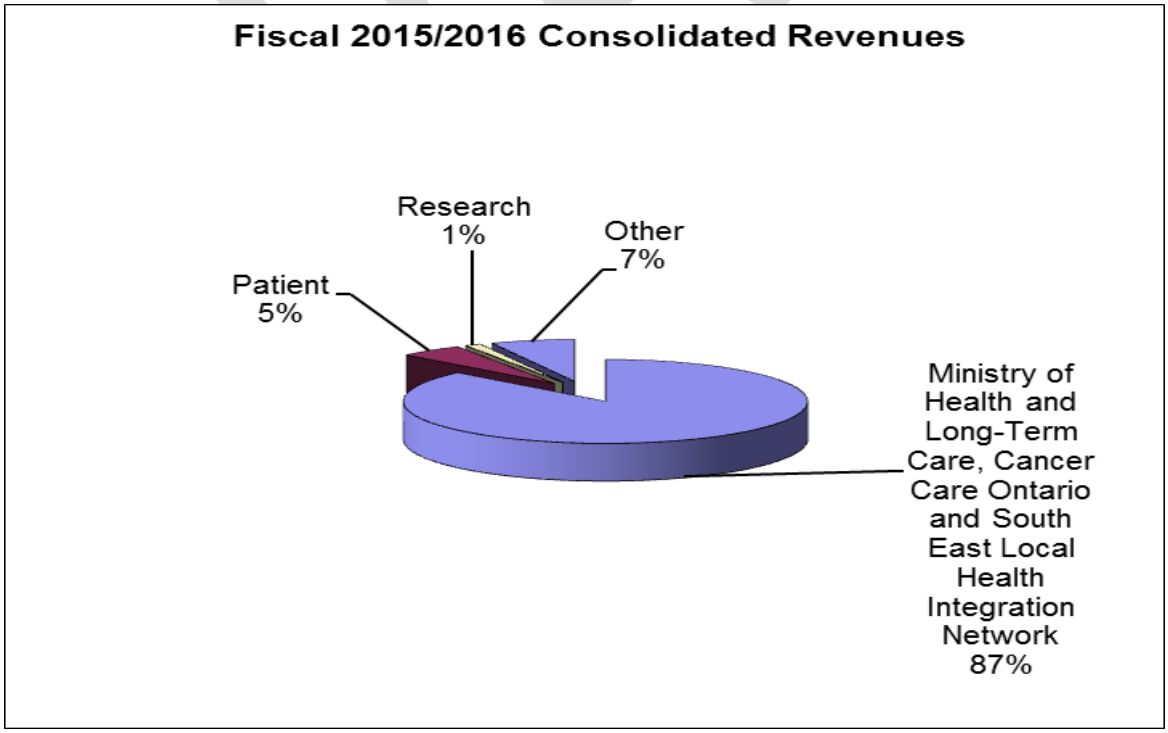
Given that all funding adjustments are not finalized until after the submission of year-end data, the amount of revenue recognized in these financial statements includes management's best estimates of amounts that may become payable.

At approximately $401 million, funding from provincial government sources is the hospital's most significant source of income, representing 87% of total operating revenue in fiscal 2016 (consistent with the previous year).

Approximately $24 million is classified as patient care revenue. This funding source includes revenue from diagnostic imaging billings, preferred accommodation charges, co-payment fees (for patients designated as alternate level of care (ALC), and revenue generated from the provision of services to patients not covered by OHIP (Ontario Health Insurance Plan).

The consolidated financial results of Kingston General Hospital include those of the Kingston General Hospital Research Institute, which is controlled by Kingston General Hospital. The approximate $5 million of research revenue includes support provided by the hospital for administrative infrastructure and the expenses for research activities performed under the oversight of this organization.

Other revenue generated to support the provision of patient care includes amounts derived from ancillary services such as parking and occupancy rental fees for third-party operated retail services (approximately $5 million) and investment income (approximately $1 million). One-time non-recurring miscellaneous revenues and recoveries for services provided to parties external to the hospital contributed approximately $19 million. Amortization of deferred capital grants contributes the balance of the other revenue category.



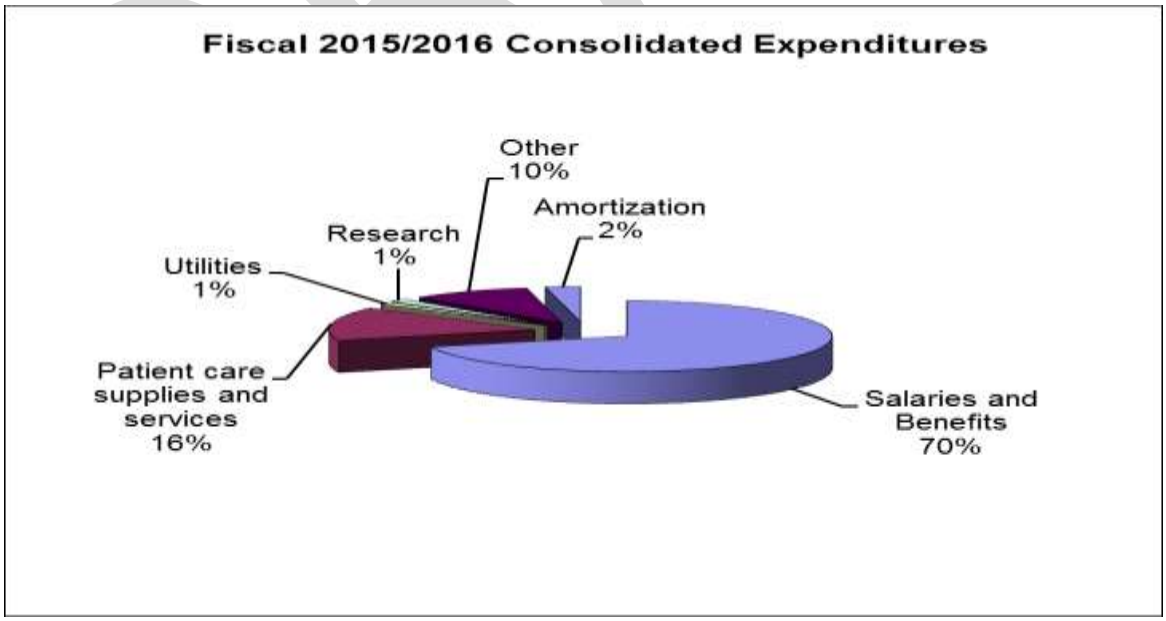
Revenues	$000's
Ministry of Health and Long-Term Care, Cancer Care Ontario, South East Local Health Integration Network	$ 401,036
Patient	23,580
Research	4,758
Other	31,939
Total revenues	$ 461,313

Operating Expenditures

A hospital is made up of much more than bricks, mortar and medical equipment. It takes people to deliver *Outstanding Care, Always* so it's no surprise that the single largest operating expense is for compensation related expenses. At approximately $310 million, salaries and benefits cost increased approximately $4 million or 1.26% over the previous fiscal year. This included accommodating inflationary salary increases for hospital employees and medical residents.

Patient care and supplies expense totaled approximately $68 million for fiscal 2016. This cost decreased by approximately $1 million over the prior year. Savings resulting from competitive procurement processes assisted in lowering this operating cost.

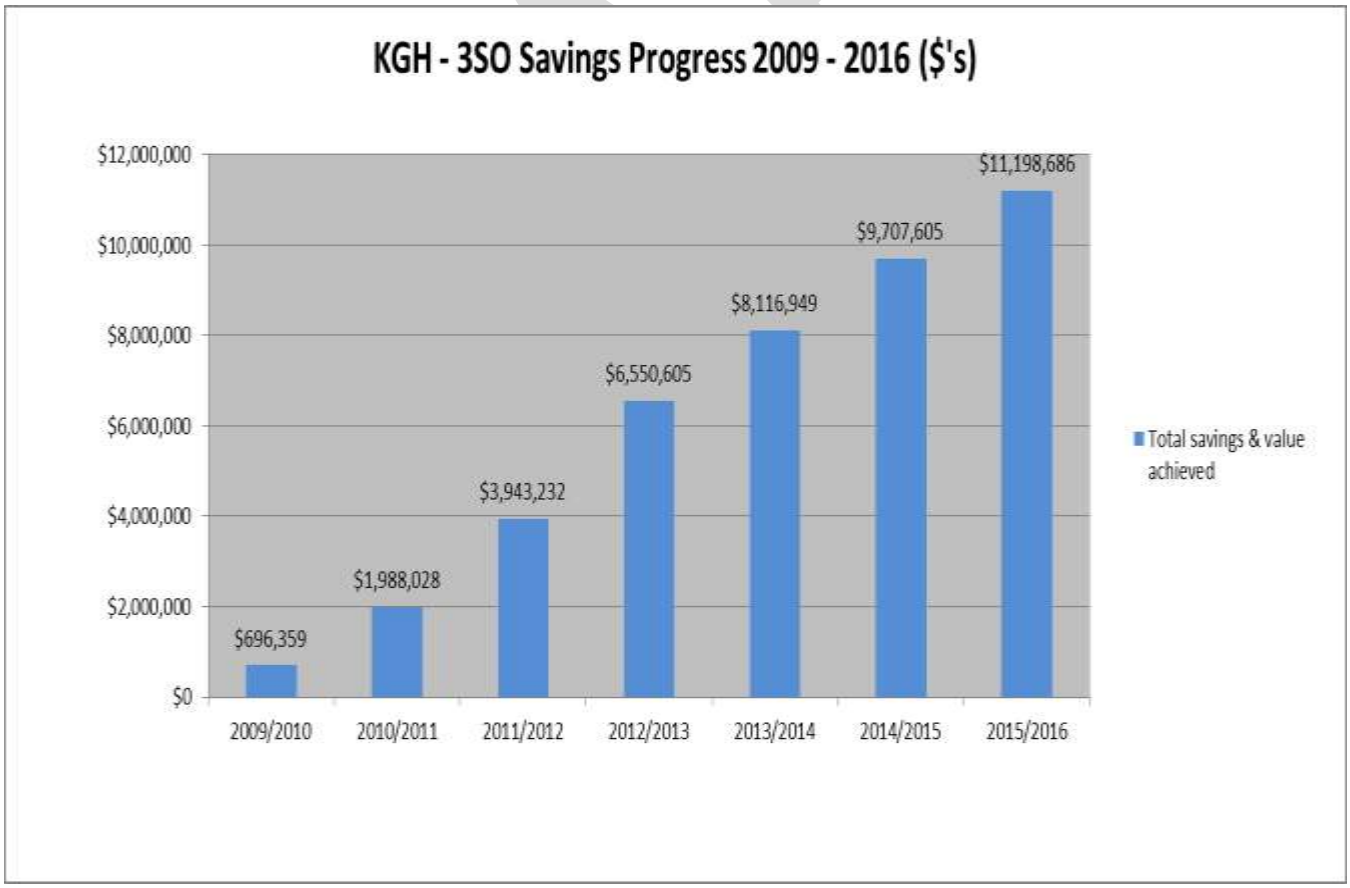
Administrative and support services expenses such as professional fees, general supplies, insurance and facilities related operating costs are included in the other expense category. Also reported in this category are $516 thousand of interest expense on long-term debt obligations and $352 thousand bad debts expense. The increased cost in this category, over the prior fiscal year, is attributable to higher expenses for minor capital purchases (individual cost less than $5,000) and expensed capital purchases for the Ventilator Equipment Pool managed by the hospital on behalf of the Ministry.



Expenditures:	$000's
Salaries and benefits	$ 310,137
Patient care and supplies	67,949
Utilities	4,579
Research	6,613
Other	41,795
Amortization	12,197
Total operating expenses	$ 443,270

Kingston General Hospital is a member of Shared Support Services of South Eastern Ontario (3SO) which was formed to undertake procurement services and provide the management oversight to inventory, and supply change processes for the seven hospitals within the South East Local Health Integration Network.

The following chart indicates the cumulative savings facilitated by 3SO in collaboration with KGH leadership since inception of this organization.



Human Resources

Turning our hospital into a positive, dynamic and healthy workplace is a top priority. During this past fiscal year we launched a Leading a Mentally Healthy Workplace Certificate program, supported attendance at the Rotman Advanced System Leadership program and rolled out our new frontline and emerging leaders training program known as LIFT. We continued to reinforce the importance of completing performance plans as a way of improving employee engagement, growth and development.

As at March 31, 2016 the hospital employed 3,669 individuals, slightly higher than the previous year (2015 – 3,653). The workforce total increases to 4,151 when including medical residents.

KGH has a high percentage of unionized staffing; 91.4% of staff as at March 31, 2016 was represented by union organizations (2015 – 91.2%). Staff employed fulltime was 60.1% (2015 – 59.8%).

Operational Efficiency

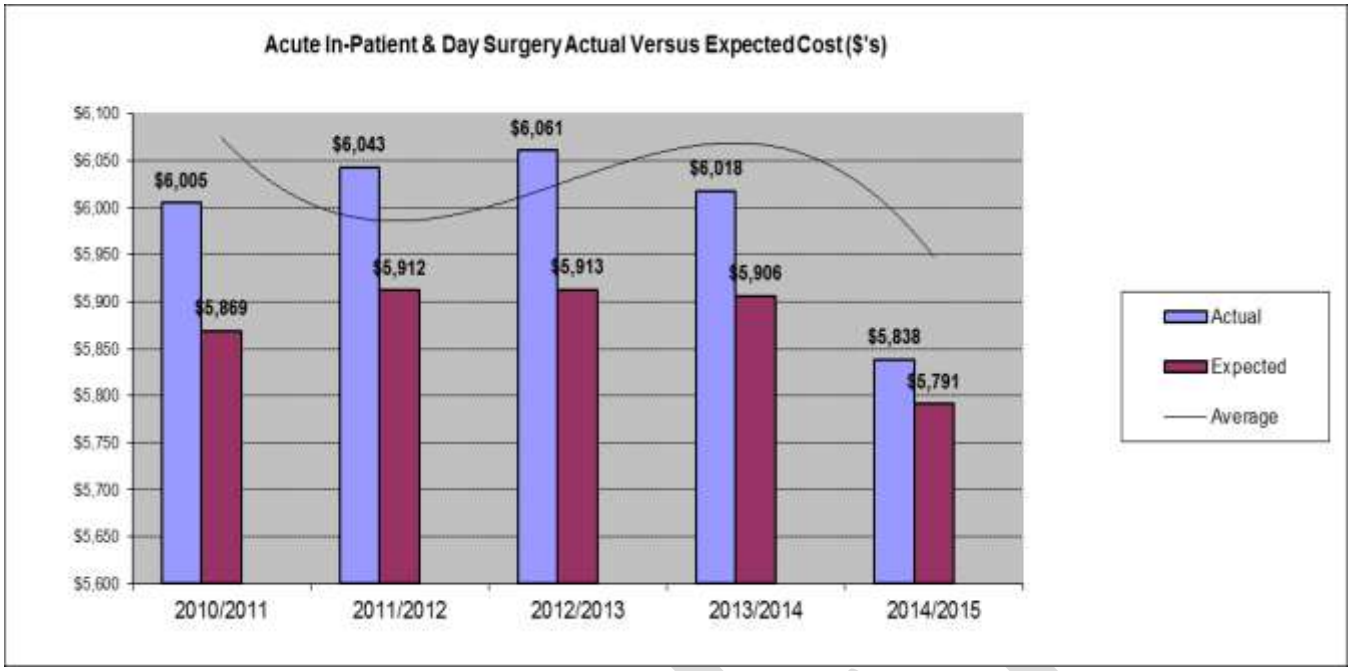
There are two financial performance indicators included in the fiscal 2016 H-SAA.

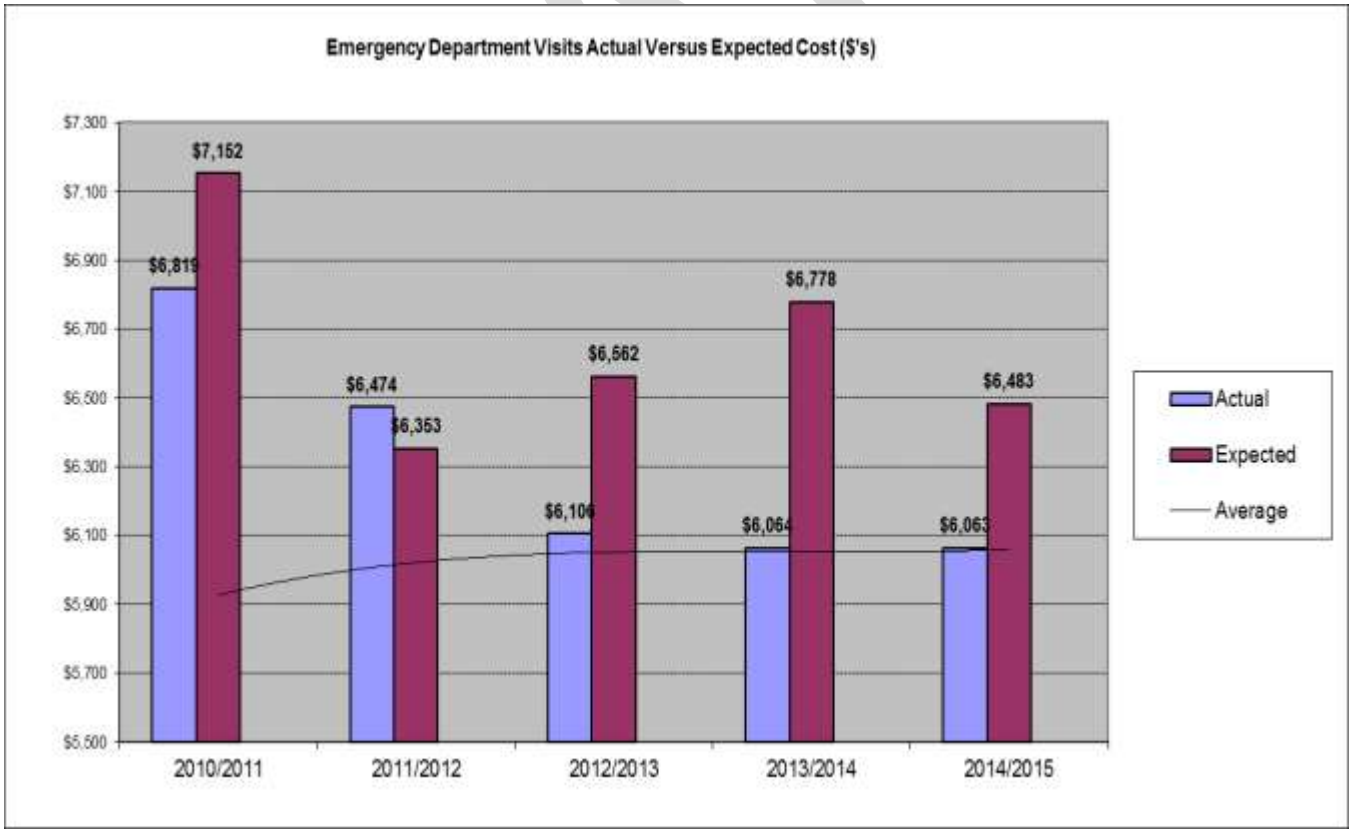
The current ratio is a measure of the organization's ability to meet its current liabilities utilizing its short-term assets (the sum of cash, accounts receivable, inventory, etc.) and is calculated by dividing the total of current assets by the total of current liabilities. A current ratio less than 1.0:1 could signal issues, such as an inability to meet commitments as they come due and/or ability to meet emerging operational pressures. The acceptable Ministry target for this ratio is between 0.8:1 and 2.0:1. The hospital met the current ratio target for fiscal 2016. The $62.0 million total working capital surplus as at March 31, 2016 translates to a current ratio of 1.93:1.

The second financial performance indicated in the fiscal 2016 H-SAA is the total margin percentage. The total margin measures total operating revenues in excess of total operating expenses and is calculated by dividing the operating surplus by total operating revenue. It is a measure of management's efficiency and the hospital's ability to live within available resources during a specific operating fiscal year. KGH's total margin at March 31, 2016 was 4.06%; slightly in excess of the high end of the Ministry target for this indicator of between 0% - 3%.

HSFR allocates a portion of hospital funding utilizing the Health Based Allocation Methodology (HBAM) which compares actual cost to expected cost. The following charts represent Kingston General Hospital's actual versus expected cost performance for the two categories of patient based activity funded in this manner, for the last five fiscal years for which complete data is available.

For all years represented, the hospital incurred actual costs for total in-patient and day surgery cases in excess of expected costs. The KGH actual cost per case decreased in 2015 from the previous year, narrowing the gap between actual and expected cost from -1.9% in fiscal 2014 to -0.8% (approximate $2.0 million gap). The fiscal 2015 HBAM performance results will be utilized to inform fiscal 2017 hospital funding. The hospital continues to focus efforts to bring its actual costs for this patient care population in-line with expected results.





The cost for an Emergency Department visit in fiscal 2015 remained consistent with the prior year level. The costs for an emergency department case in fiscal 2015 were 6.5% favourable to the expected cost per case.

The HBAM sets expected expenses at actual expense for the remaining patient care categories (i.e. inpatient mental health and all outpatient activity including dialysis and oncology).

Patient activity volumes

Quality Based Procedures (QBP's) funding is the second component of HSFR aligned to patient activity. For this element of the funding model, the Ministry stipulates the volumes and price of each specific procedure to be funded for a hospital.

The following highlights Quality Based Procedures volume over the last four years. No comparative information is provided for QBP's in the year they are introduced.

	2016	2015	2014	2013
Hip & knee replacement	**603**	**602**	**557**	**573**
Stroke care	**374**	**361**	**318**	**282**
Non-cardiac vascular disease	**101**	**107**	**89**	**77**
Congestive heart failure	**364**	**371**	**340**	**372**
Chronic obstructive pulmonary disease	**502**	**481**	**401**	**477**
GI endoscopy	**1,898**	**1,994**	**2,597**	**2,381**
Systemic therapy – treatment & supportive	**16,889**	**17,535**	**17,230**	**15,397**
Hip fracture	**256**	**246**		
Neonatal jaundice	**101**	**102**		
Pneumonia	**267**	**312**		
Tonsillectomy	**1**			
Knee arthroscopy	**24**			
Colorectal & prostate cancer surgery	**138**			

As with the prior years, patient activity in fiscal 2016 exceeded the total funded volumes of all non-elective QBP's (hip & knee replacement, knee arthroscopy, tonsillectomy and some cancer surgeries are categorized as elective).

As it relates to the QBP activity volumes above, the following are of note:

Stroke care: Increased cases can be attributable in part to changes aligned with best practice stroke care as well as a naturally occurring growth rate due to an aging population.

GI Endoscopy: The decrease in the current year is due to a change in the methodology criteria for reporting cases.

The volume variability across the years for the remaining QBP's is primarily based on patient population.

A key cost driver in the organization is the volume of patient activity provided. The following highlights changes in key activity levels over the last four years:

	2016	2015	2014	2013
Inpatient stays (includes births)	**22,818**	**22,525**	**22,309**	**21,108**
Births	**2,004**	**1,935**	**1,958**	**1,974**
Emergency Department visits	**58,834**	**56,643**	**53,954**	**53,479**
Cancer Centre visits	**90,562**	**84,363**	**77,847**	**72,862**
All other ambulatory visits	**118,514**	**109,303**	**105,225**	**150,332**
Operative cases	**8,989**	**9,126**	**9,118**	**8,995**
Acute average length of stay	**5.9**	**6.1**	**6.2**	**6.5**
Imaging Exams	**128,597**	**125,219**	**119,695**	**121,545**
Clinical laboratories tests	**2,765,648**	**2,706,691**	**2,674,530**	**2,537,123**

As it relates to the activity volumes above, the following are of note:

Inpatient stays: Occupancy was consistently high during the year and the acute length of stay improved. The number of cases remained relatively unchanged from the prior year due to the non-acute patients awaiting transfer to other care facilities.

Cancer Care Centre Visits: The increase is primarily radiation therapy clinic and treatment visits.

Emergency Department Visits: Emergency Department visits increased approximately 4% from the prior year level. The change in hours at Hotel Dieu Urgent Care centre continue to impact volumes after 7 pm with a 10% increase in lower acuity visit levels.

All other ambulatory visits: The increase over the prior year is aligned to the opening of the Mental Health Intensive Transitional Treatment clinic prior mid-year, as well as growth in chronic kidney disease hemodialysis visits.

Operative cases: Cancellation rates decreased as a result of planned Operating Room closures. High occupancy rates contributed to a drop in total cases

Acute average length of stay: The length of stay continues to trend lower; KGH is 0.2 of a day below its expected length of stay. There was a 9% increase in patients in the hospital awaiting access to non-acute care facilities.

Imaging exams: Ultrasound exams increased as a result of process improvements; continued increased activity for breast cancer screening.

Clinical laboratories tests: Increase in test volume related to overall increase in patient activity, as well as increased service within the region.

Outlook for 2016/17

In January of 2016 KGH submitted our annual Hospital Annual Planning Submission (HAPS) to the SE-LHIN aligned to our approved operating and capital budgets for fiscal 2017.

The balanced operating budget assumed that the Ministry would not be providing any additional funding to hospitals to offset rising costs due to inflation for next fiscal year. Approximately $11 million of new revenue generating and cost savings efficiencies were incorporated into the operating budget to address the anticipated unfunded inflationary factors, changes under HSFR for the current fiscal year and new investments required to continue to support the delivery of safe, and quality patient care. Unfortunately this amount only allowed us to target the initial level of capital investment capacity for the upcoming fiscal year at $19 million.

Subsequent to the HAPS submission, hospitals in Ontario received notification of an inflationary increase in funding for fiscal 2017. For KGH this inflationary increase totals approximately $1.9 million. The hospital will align this inflationary funding to increase the fiscal 2017 capacity for investment for the replacement of technology, patient care equipment, and building infrastructure at the level achieved in the prior year ($21 million).

Hospitals also received the results of the re-calculated HBAM component of the funding formula. This significant adjustment was undertaken by the Ministry to address issues in the methodology design and implementation, including issues identified by hospitals (KGH among them) since it was established four years ago. For KGH this total adjustment amounted to approximately $4 million, with 50% of this increased funding being provided in fiscal 2017. As the original fiscal 2017 HAPS submission had limited capacity for deviations from the budget plan, the hospital will be provisioning this additional funding and KGH's favourable performance on the total QBP funding component, to offset any higher than planned patient care activity and aligned operating cost pressures that may occur in the next fiscal year.

People from all over the hospital will also be busy this coming year providing input on the Health Care Tomorrow - Hospital Services project as it steps up its efforts to find new ways for hospitals in our region to come together to improve access to care and use the resources entrusted to us more efficiently.

Summary

Guided by our aim of achieving *Outstanding Care, Always* Kingston General Hospital is committed to focused and effective management of our fiscal resources. We will undertake to sustain our organization's strong financial health in the year ahead.

Financial Results Summary

$ millions	Fiscal 2016	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012
Operating Results					
Revenue	461.3	469.3	453.0	448.1	429.7
Expense	(443.3)	(438.7)	(423.8)	(426.8)	(407.0)
Deficiency of revenue over expenses - operations	18.0	30.6	29.2	21.3	22.7
Building Amortization					
Revenue	17.9	17.5	16.3	16.1	7.4
Expense	(19.9)	(19.4)	(18.8)	(18.5)	(9.7)
Deficiency of revenue over expenses - building amortization	(2.0)	(1.9)	(2.5)	(2.4)	(2.3)
Total surplus (deficit) position	16.0	28.7	26.7	18.9	20.4

J'Neene Coghlan, Chief Financial Officer

Jim Flett, Interim President and Chief Executive Officer