Kingston General Hospital

Outstanding care, always™

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Management Discussion and Analysis

(unaudited)

For the year ended March 31, 2017

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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, 2017. The 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 (KGH) is a community of people dedicated to transforming the patient and family experience through innovative and collaborative approaches to care, knowledge and leadership.

As southeastern Ontario's leading centre for complex-acute and specialty care, and home to the Cancer Centre of Southeastern Ontario, KGH serves, through its Kingston facility and 24 regional affiliate and satellite sites, almost 500,000 people who live in a 20,000 square kilometre predominantly rural area, as well as some communities on James Bay in Ontario's north.

In the Greater Kingston area, we are the third-largest employer and we have over 820 volunteers who contribute their energy and skills to caring for others.

KGH has sustained balanced operating financial results over the past eight fiscal years. During this time we have been able to offset unfunded inflationary cost pressures and work within the financial resources provided us. During this time we have steadily increased our capacity to invest in the ongoing replacement of patient care equipment, technology, and building infrastructure. Our working capital position is positive.

Before 2012, the amount of annual funding each hospital received from the Ministry of Health and Long-Term Care (Ministry) was mainly based on historical spending and inflation. Under this system, each hospital was given a lump-sum payment.

In 2012, the Ministry began implementing its Health System Funding Reform (HSFR), a model intended to allocate health-care dollars equitably, promote best clinical practices, and keep spending growth to sustainable levels. The reform introduced two key funding components:

- The health-based allocation model (HBAM) estimates health-care expenses based on demographics and actual use of health services, taking into account the types and complexity of patient care that hospitals provide. Under this model, the Ministry is to adjust funding to hospitals based on patient demand and population growth.
- The quality-based procedures (QBPs) component funds hospitals for the types and number of patients they treat. The Ministry established specific procedures for hospitals to follow, based on best practices and efficiency measures, in treating their patients, and determined the amount each hospital would receive under this component. The Ministry's goal in setting QBPs is to standardize care and minimize variations, and to ensure that hospitals provide care according to best practices.

For KGH, the application of the funding methodology in fiscal 2017 provided the hospital with increased funding of approximately $5.0 million. This funding increase came at the same time that the hospital was challenged with increased levels of patient care activity throughout the fiscal year. The hospital was able to apply this unplanned funding to increase the resources necessary to continue to provide safe, high quality, patient- and family-centred care.

The total surplus of revenue over expenditures for the year ended March 31, 2017 was approximately $13.6 million after the inclusion of building amortization expense.

The hospital reported a surplus of revenue over expenses before building amortization of approximately $15.5 million. The majority of this surplus was provisioned in the operating budget to provide for capital expenditure replacement.

Financial Analysis of the Hospital

The assets of the hospital exceeded its liabilities at the end of the most recent fiscal year by $76.3 million (net assets). The analysis below focuses on the change in net assets during fiscal 2017.

($000's)	Unrestricted	Invested in Capital Assets	Total
Balance, beginning of year	34,935	27,766	62,701
Excess of revenue over expenses	21,806	(8,252)	13,554
Net change in investment in capital assets	(2,939)	2,939	-
Balance, end of year	53,802	22,453	76,255

Total net assets increased during the year primarily due to the impact of the hospital's surplus position. The net change in investment in capital assets corresponds to the increase in capital asset expenditures less the increase in amortization, repayment of long-term debt, and items funded by deferred contributions. It reflects the hospital's strategic decision to invest operating funds for the ongoing replacement of patient care equipment, technology and building infrastructure upgrades.

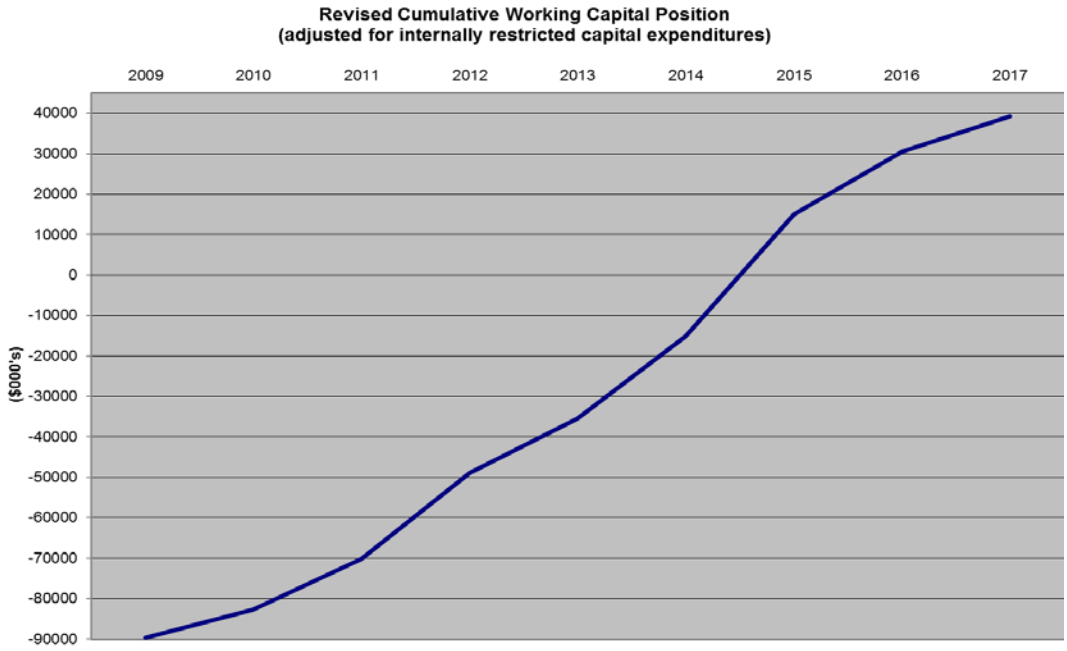
Working Capital

Working capital is defined as an excess of current assets over current liabilities. It is one measure of an organization's ability to meet its short-term financial obligations. As at March 31, 2017 the hospital's total working capital position was positive at approximately $80.6 million; an increase of $18.6 million from the previous year-end position. A portion of the total current assets is provisioned for approved capital expenditures; $34.1 million. An additional amount of $12.3 million is provisioned for specific operational liabilities and $6.9 million is held designated for research projects facilitated through the Kingston General Hospital Research Institute.

The hospital did not draw upon its operating line of credit in fiscal 2017($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.

The hospital recalculates, removing the amount of funds provisioned for capital investment from current assets as noted above, and including amounts held as other investments to more accurately represent its working capital position. For three consecutive years, this revised working capital position is positive.



2009	($89.6M)	2011 ($70.2M)	2013 ($35.4M)	2015 $15.1M	2017 $39.2M
2010	($82.7M)	2012 ($50.0M)	2014 ($15.1M)	2016 $30.6M	

Long-term Debt

Included in the total long-term debt outstanding of approximately $7.6 million as at March 31, 2017 is $5.3 million representing the outstanding portion of debt incurred in 2012 ($7.8 million) to support an energy retrofit 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 planned energy savings are being achieved.

The remaining portion of the long-term debt is aligned to refinancing undertaken in fiscal 2016. This provided $3.2 million which was invested and provisioned to provide funding capacity for future upgrades to the hospital's key business information technology systems.

Investment in Capital Assets

Since 2010 the hospital has steadily increased the amount invested annually to provide for the ongoing replacement of patient care equipment, technology and facilities infrastructure. Funding for this capital expenditure is provisioned within the annual operating budget and provided by 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). The hospital achieved a capacity for capital expenditure in fiscal 2017 of approximately $24.0 million. Cash to complete all capital expenditures approved as at March 31, 2017, but not completed, 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	$ 9.0 million
Information management systems	$ .5 million
Facilities infrastructure/renovations	$ 10.8 million

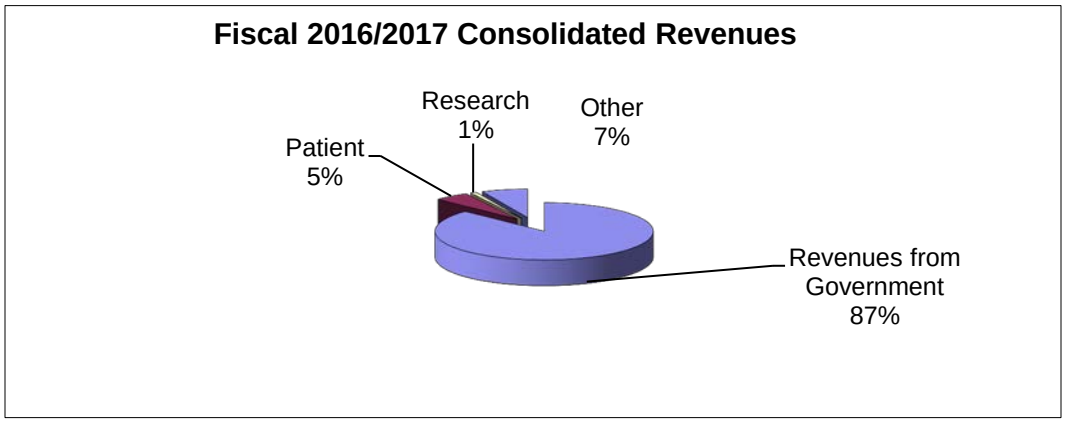
During the year, $19.1 million of the above capital expenditures were reported as funded through the use of deferred capital contributions (donations or grants).

Operating Revenues

The Ministry directly, and indirectly, through the Local Health Integration Networks and Cancer Care Ontario, provides the majority of funding to hospitals.

Hospitals need to generate the remaining funding needed to support operations from other revenue sources such as semi-private and private accommodation charges, parking fees, food services and other retail outlets.

KGH annually executes the Hospital Services Accountability Agreement (H-SAA) with the South East Local Health Integration Network (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. The amount of revenue recognized in these financial statements includes management's best estimates of amounts that may become payable given that all funding adjustments are not finalized until after the submission of year-end data.



Revenues (in thousands of dollars)

Ministry of Health and Long-Term Care, Cancer Care Ontario, South East Local Health Integration Network	$ 412,956
Patient	24,554
Research	4,370
Other	32,279
Total revenues	$ 474,159

Provincial government funding provided approximately $413.0 million or 87 per cent (consistent with the previous year level) of total operating revenue in fiscal 2017.

Included in the category of patient care revenue above (approximately $24.6 million) is funding provided by the Ontario Health Insurance Plan (OHIP) to the hospital for 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 account for the remainder of revenue in this category.

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 $4.4 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 $4.5 million) and investment income (approximately $1.2 million). One-time non-recurring miscellaneous revenues and recoveries for services provided to parties external to the

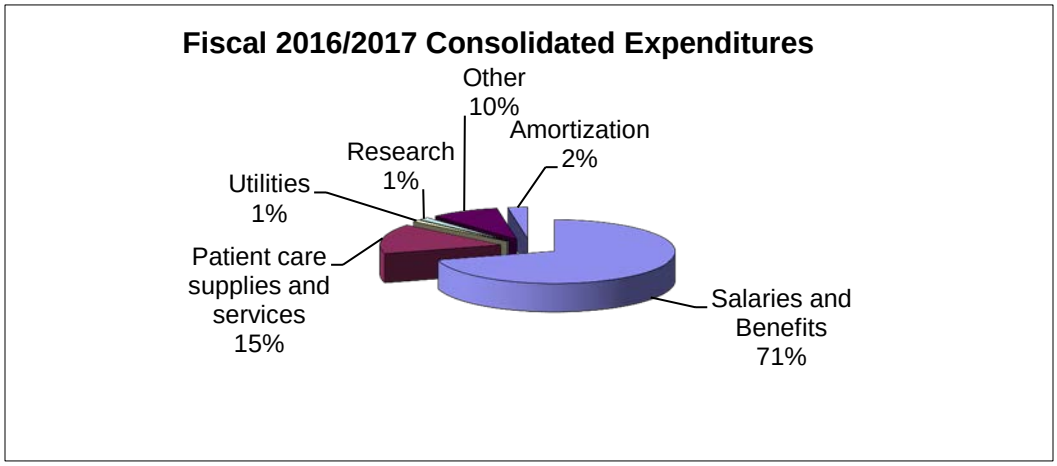
hospital contributed approximately $20.8 million. Amortization of deferred capital grants contributes the balance of the other revenue category.

Operating Expenditures

At KGH we empower our people to transform the patient experience through a relentless focus on quality, safety and service. Payment to staff for compensation related expenses accounted for 71 per cent of operating expenditures in fiscal 2017. At approximately $323.4 million, this expense increased approximately 4.3 per cent over the previous fiscal year. This included accommodating inflationary increases for salary and benefits costs for hospital employees and medical residents, and additional staffing resources required to offset higher levels of patient care activity than in the previous fiscal year.

Patient care and supplies expense totaled approximately $70.3 million for fiscal 2017. This cost was also impacted by patient care activity levels increasing by approximately $2.4 million over the prior year. Savings resulting from competitive procurement processes and ongoing continuous improvement initiatives assisted in lowering this operating cost.

The other expense category includes administrative and support services expenses such as professional fees, general supplies, insurance and facilities related operating costs. Also reported in this category are $319 thousand of interest expense on long-term debt obligations and bad debts expense of $308 thousand. Operating efficiencies in this category resulted in a total expense increase of only 0.5 per cent over the previous year.



Expenditures (in thousands of dollars)

Salaries and benefits	$ 323,380
Patient care and supplies	70,345
Utilities	4,577
Research	6,231
Other	42,012
Amortization	12,164
Total operating expenses	$ 458,709

Human Resources

At Kingston General Hospital we are all dedicated to serving the needs of our community and the more than 500,000 residents of southeastern Ontario. Our aim is to provide *Outstanding Care, Always* to every patient and to help us deliver we strive to enable high staff performance.

As at March 31, 2017 the hospital employed 3,770 individuals, slightly higher than the previous year (2016 – 3,669). The workforce total increases to 4,249 when including medical residents.

Union organizations represented 91.6 per cent of individuals (2016 – 91.4 per cent). Staff employed fulltime represented 59.5 per cent of the workforce (2016 – 60.1 per cent).

Of course, employees aren't the only one's helping our patients and their families. Here at KGH, we also rely on our physicians, Patient Experience Advisors, and the hundreds of people who volunteer their time and talents.

Operational Efficiency

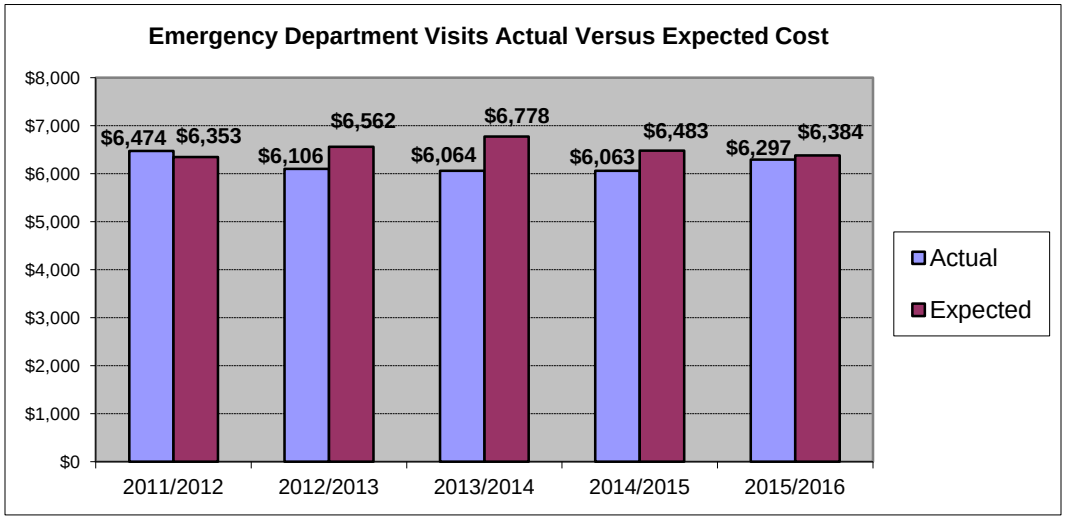
The fiscal 2017 H-SAA includes two financial performance indicators.

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 2017. The $80.6 million total working capital surplus as at March 31, 2017 translates to a current ratio of 2.12:1.

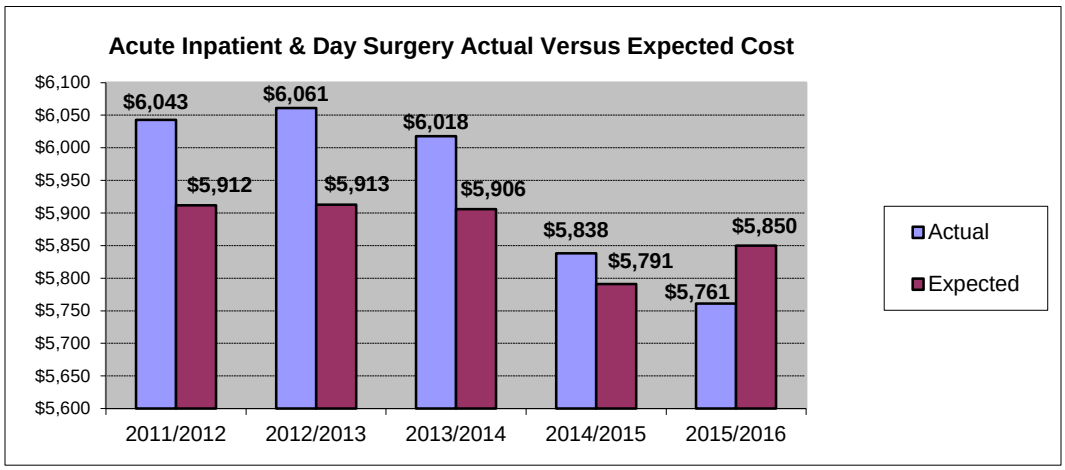
The second financial performance indicator included in the fiscal 2017 H-SAA is the total margin percentage. The total margin measures total operating revenues in excess of total operating expenses and is calculated by dividing the operating surplus by total operating revenue. It is a measure of management's efficiency and the hospital's ability to live within available resources during a specific operating fiscal year. KGH's total margin at March 31, 2017 was 3.36 per cent; slightly in excess of the high end of the Ministry target for this indicator of between zero per cent – three per cent.

The following chart represents the hospital actual versus expected cost performance under the HBAM for Emergency Department activity for the last five fiscal years for which complete data is available.

Activity in the Emergency Department is costed from the initial registration of the patient through to discharge or the point in time that a decision is made to admit as an inpatient. The actual cost has remained within the funding allocation for the last four years.



The second category of patient activity funded under the HBAM is inpatient and day surgery activity. The results for fiscal 2016 represent KGH working within the expected cost per case in this funding category for the first time since the introduction of Health System Funding Reform. The fiscal 2016 HBAM performance results will be utilized to inform fiscal 2018 hospital funding. The hospital continues to focus efforts to sustain the actual costs for this patient care population in-line with expected funding.



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 (QBPs) funding is the second component of HSFR aligned to patient activity. For this element of the funding model, the Ministry stipulates the volume and price of each specific procedure to be funded for a hospital. The following highlights QBPs volume over the last five years. No comparative information is provided for QBPs in the year that they are introduced.

	2017	2016	2015	2014	2013
Hip & knee replacement	607	603	602	557	573
Stroke care	379	376	361	318	282
Non-cardiac vascular disease	109	101	107	89	77
Congestive heart failure	410	364	371	340	372
Chronic obstructive pulmonary disease	540	502	481	401	477
GI endoscopy	2,212	1,898	1,994	2,597	2,381
Systemic therapy – treatment & supportive	17,482	16,976	17,535	17,230	15,397
Hip fracture	259	256	246		
Neonatal jaundice	115	101	102		
Pneumonia	246	267	312		
Tonsillectomy	0	0	0		
Knee arthroscopy	26	24			
Colorectal & prostate cancer surgery	163	130			
Thyroid surgery	19	26			
Breast surgery	93	89			

The actual patient activity for QBPs has exceeded the total funded volume for all QBP procedures in all years since the implementation of this new funding methodology.

As it relates to the QBP activity volumes for fiscal 2017 noted above, the following is of note:

GI endoscopy: Increased cases can be attributable in part to the introduction during the year of a new procedure.

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

A key cost driver for the organization is the volume of patient activity provided. The following table highlights the changes in key activity levels over the last five year period:

	2017	2016	2015	2014	2013
Inpatient days	168,141	160,485	158,699	155,094	155,663
Births	1,914	2,004	1,935	1,958	1,974
Emergency Department visits	60,051	58,834	56,643	53,954	53,479
Cancer Centre visits	93,755	90,085	84,363	77,847	72,862
All other ambulatory visits	115,340	116,889	109,303	105,225	150,332
Operative cases	9,052	8,989	9,126	9,118	8,995
Acute average length of stay	6.1	5.9	6.1	6.2	6.5
Imaging Exams	135,834	128,597	125,219	119,695	121,545
Clinical laboratories tests	2,876,327	2,765,648	2,706,691	2,674,530	2,537,123

As it relates to the fiscal 2017 activity volumes above, the following are of note:

Inpatient days: Occupancy was consistently high during the year. The overall total inpatient days increased approximately five per cent over the previous year. Total acute care activity increased four per cent (6,047 inpatient days) and adult mental health activity increased 14 per cent from the prior year (1,609 inpatient days).

Cancer Care Centre visits: The approximate four per cent increase is primarily in radiation and systemic therapy and surgical clinic visits.

Emergency Department visits: Emergency Department visits increased approximately two per cent from the prior year, and are primarily attributable to an increase in lower acuity level visits.

All other ambulatory visits: The decrease over the prior year reflects growth in chronic kidney disease patients transitioning to home-based hemodialysis visits.

Acute average length of stay: Although the average length of stay increased from the prior year's performance, KGH is 0.13 of a day below its expected length of stay. Many initiatives were actioned to reduce the number of patients in the hospital awaiting access to non-acute care facilities (19 per cent overall reduction).

Imaging exams: CT study volumes increased aligned to oncology related activity and a targeted effort to reduce wait lists.

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

Looking Forward

April 1, 2017 marked an exciting time in the history of Kingston General Hospital. After more than 175 years as a standalone facility, the hospital was integrated with the Religious Hospitallers of Saint Joseph of the Hotel Dieu of Kingston (operating as Hotel Dieu Hospital) to form the new Kingston Health Sciences Centre. KGH brings its strong financial foundation to the new legal entity.

In January of 2017 KGH submitted our annual Hospital Annual Planning Submission (HAPS) to the SE-LHIN with a balanced operating budget and a capital budget providing an initial capital investment capacity of $20 million. This budget will be added to a similarly balanced operating budget submitted by Hotel Dieu Hospital.

Opportunities exist to find cost efficiencies in combining the operations of the two hospitals while continuing to operate on both of its main site locations. These savings will be utilized to offset one-time costs related to the integration activities in fiscal 2017/18 and to provide resources to address additional investment in clinical resources and/or capital expenditure.

Summary

Guided by our aim of achieving *Outstanding Care, Always* Kingston General Hospital managed an extremely challenging level of patient care activity and corresponding operating pressures in fiscal 2017. On behalf of senior leadership, we would like to thank everyone for their commitment and dedication to the organization. Your continued support under the new Kingston Health Sciences Centre will support the next chapter in the evolution of health care in our community.

Financial Results Summary

in millions of dollars	Fiscal 2017	Fiscal 2016	Fiscal 2015	Fiscal 2014	Fiscal 2013
Operating Results					
Revenue	474.2	461.3	469.3	453.0	448.1
Expense	(458.7)	(443.3)	(438.7)	(423.8)	(426.8)
Excess of revenue over expenses - operations	15.5	18.0	30.6	29.2	21.3
Building Amortization					
Revenue	18.3	17.9	17.5	16.3	16.1
Expense	(20.2)	(19.9)	(19.4)	(18.8)	(18.5)
Deficiency of revenue over expenses - building amortization	(1.9)	(2.0)	(1.9)	(2.5)	(2.4)
Total surplus position	13.6	16.0	28.7	26.7	18.9