

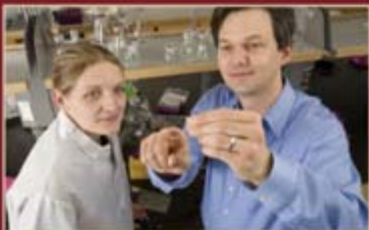


University of Wisconsin
Hospital and Clinics

Capital and Operating Budget Fiscal Year 2011

Executive Summary and Highlights
Authority Board
May 5, 2010

OPEN SESSION



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Introduction

FY11 Budget

FY 2011 Budget – Introduction/Overview

Budget Process

The economics of the health care industry are challenging. Assumptions around decreasing and uncertain governmental reimbursement, the economy and the impact on charity care and bad debt and access to the credit markets were areas of much discussion. Our investment portfolios suffered during the past 1-2 years, there has been a shift from more medical and less surgical business and the assessment of Reform on UWHC is in process.

Health Care Reform will have significant impact on our industry. We are in the process of understanding, assessing and developing our strategy for how UWHC will look in the future. Reform will impact our partners in the Medical Foundation, the School of Medicine and Public Health as well as employers/employees and health plans.

Volume/Activity

During the first 9 months of FY 2010 inpatient admissions were 0.3% above plan and 2.2% above last year and the average length of stay was 1.9% above budget. Through review of service line business plans, discussions with medical staff leadership and service line directors, historical trends, population growth and other factors, admissions are projected to grow in FY 2011 by 2.3% over the FY 2010 projections and 3.4% over the FY 2009 actual. Outpatient visits are projected to grow by 3.5% over the FY 2010 forecast and 3.9% over the FY 2009 actual.

Introduction Cont'd

FY11 Budget

Price /Reimbursement

The recommended price increase for FY 2011 is 7.5% and will be effective July 1, 2010. This price increase will generate a 4% increase in net revenue/reimbursement. Most of this will provide the means to cover the inflation on our costs for FY 2011.

Medicare payments for FY 2011 will be flat from FY 2010. The net impact of the State's Hospital Assessment (Medicaid program) will be a 4% decrease to UWHC for next fiscal year. The impact beyond FY 2011 is unknown. The Managed Care, HMO/PPO plans are projected to increase between 5% and 7.5%. As we've seen over the past couple of years the government and self-pay will become a larger percentage of our business, while HMO/PPO and Indemnity will become less. The impact of this continued shift from higher to lesser paying payors is a negative \$8.5m next year.

Charity Care/Bed Debts

Historically we have experienced an increase in both our charity care and bad debts. This was largely due to the economic downturn. With the growth in the Medicaid program we have seen stabilization during FY 2010 of charity and bad debts. The total provision will rise slightly to approximately \$87m next year.

Introduction Cont'd

FY11 Budget

Graduate Medical Education and Affiliation Agreement

UWHC provides financial support for over 500 residents. For FY 2011 the estimated total cost of the graduate medical education program is projected at \$35.7m.

UWHC financially supports members of the faculty to provide administrative leadership to hospital operations through the Affiliation Agreement. This support amounts to \$17.4m in FY 2011. In addition UWHC supports faculty retention and recruitment engaged in clinical care. This is often necessary due to the low government reimbursement rates, low local HMO rates and start up efforts for new programs. This financial support is approximately \$24.4m for FY 2011. The remaining \$15.7m supports hospital based services, bringing the total affiliation support to \$57.5m in FY 2011.

Human Resources

The deployment and retention of personnel continues to be one of the most significant challenges for UWHC. Our employees (over 7,000 people) provide the patient care, technical and administrative support necessary in the provision of health care to the people we serve. We strive to provide a work environment that people want to come to work in as well as stay. UWHC has 4 labor contracts that are in negotiation or will be negotiated impacting the FY 2011 budget. Our goal is to balance an appropriate wage and benefit package with the need to provide cost effective patient care.

Introduction Cont'd

FY11 Budget

Epic/HealthLink

During FY 2010 UWHC completed the 4 year Epic implementation journey. In this last phase we implemented OpTime for Peri-Operative Services, ADT/Resolute billing and the completion of electronic health record (EHR) applications in all ambulatory clinics. Overall it was a successful installation. The final cost is estimated at \$52m. This is a fully integrated patient management system which intertwines the clinical components of an EHR for clinical documentation, medication management, computerized provider order entry, health information management and business applications such as registration, appointment scheduling and billing.

We will continue to provide operational resources towards the optimization of this system throughout FY 2011.

Margins

Our approved long range financial plan (LRFP: 2011-2015) called for operating margins of 5% in order to meet the capital investment and build up our cash reserves. Our industry is very capital intense and UWHC will require greater investment as our facilities and equipment age and need replacement. The 5% margins are also needed to meet the rating agency's financial ratios in order to maintain our A+ bond rating and keep our cost of capital/interest low.

Capital/Cash Flow

The LRFP provided for an increase in our routine capital investments over the next 5 years in response to our aging facilities. The 5% margins over the next 5 year period will allow UWHC to not only meet our capital requirements, but also to build up our cash reserves. In recent discussions with rating agencies it was noted that our days cash on hand should be increased to meet the agency goal. We anticipate going to the bond market in the next 2-3 years and our goal is to be strong financially.

Introduction Cont'd

FY11 Budget

Conclusion

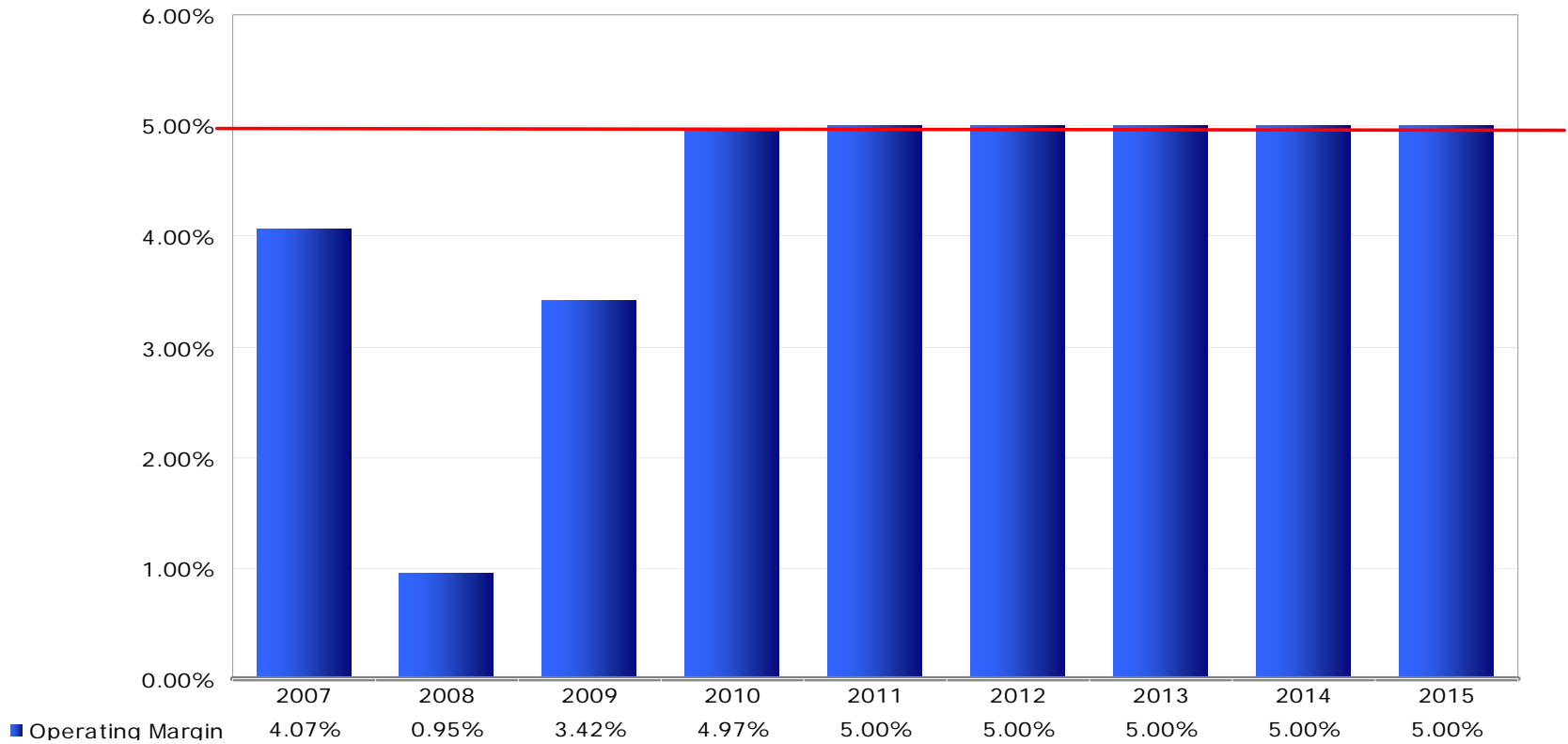
UWHC will have its challenges – health care reform, economy, EPIC/HealthLink optimization, declining reimbursement, cost structure pressure and funding of graduate medical education. We also have opportunities – our partners UWMF and SOMPH, strong service lines, expand the name recognition and partnering within the region.

Our desire and goal is to provide the best patient care experience in a cost effective manner with good clinical outcomes. The financial goal is to provide the necessary funds to meet these needs through a strong and financially healthy UWHC.

Long Range Financial Plan Profitability/Operating Margin

FY11 Budget

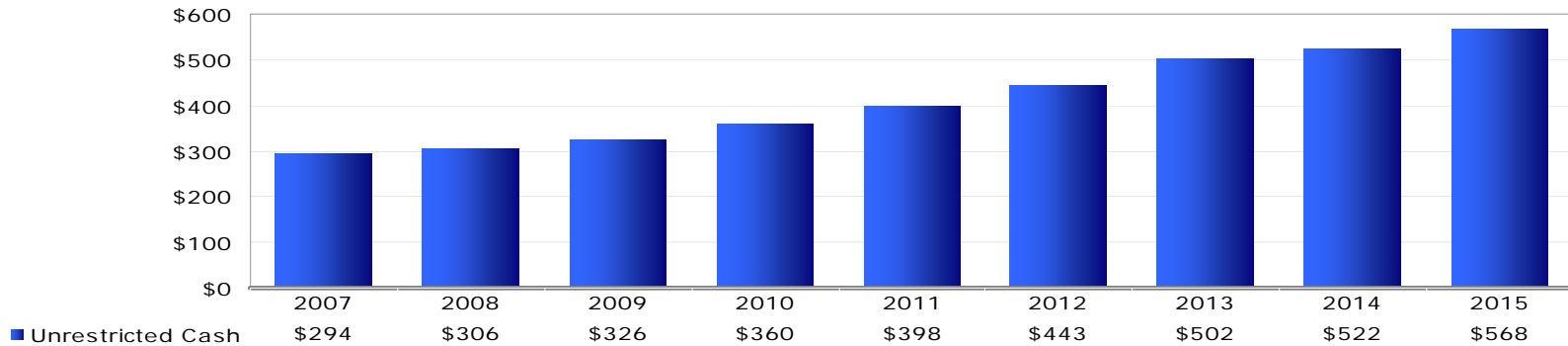
Profitability / Operating Margin



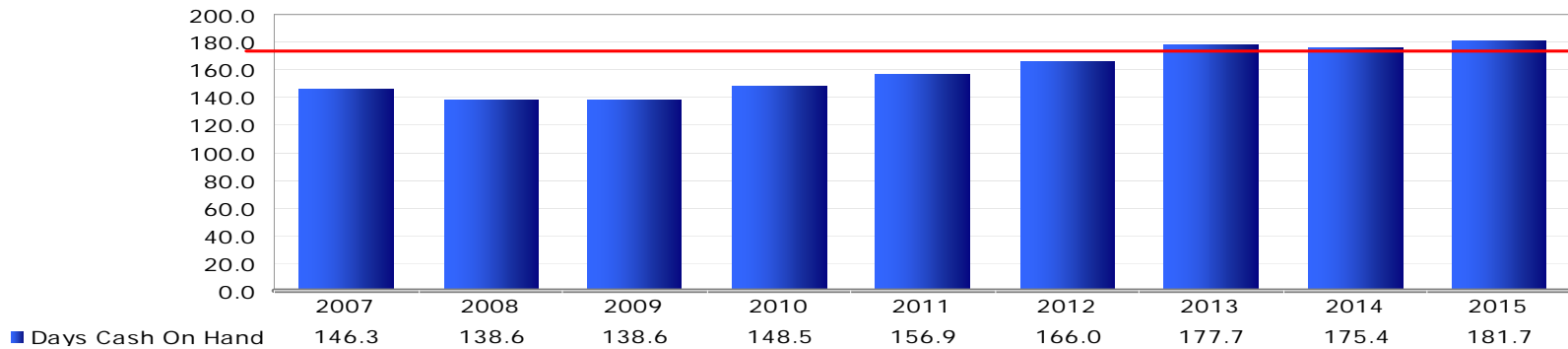
Long Range Financial Plan Unrestricted Cash & Days Cash on Hand

FY11 Budget

Unrestricted Cash



Days Cash On Hand



Summary Profit and Loss Statement

FY11 Budget

(000's omitted)	FY 09 Actual	FY 10 Projection	FY 11 Budget	Dollar Variance	% Change
Gross Patient Revenues	\$ 1,782,726	\$ 1,987,800	\$ 2,171,100	\$ 183,300	9.2%
Less Provision for Bad Debt & Charity Allowances	63,446	85,900	86,900	1,000	1.2%
	<u>799,448</u>	<u>930,500</u>	<u>1,074,000</u>	<u>143,500</u>	15.4%
Net Patient Revenues	919,832	971,400	1,010,200	38,800	4.0%
Other Revenues	<u>15,679</u>	<u>16,700</u>	<u>17,300</u>	<u>600</u>	3.6%
Total Revenue	<u>935,511</u>	<u>988,100</u>	<u>1,027,500</u>	<u>39,400</u>	4.0%
Salaries and Agency Cost	357,018	366,400	379,800	13,400	3.7%
Benefits	141,644	148,100	156,400	8,300	5.6%
Supplies, Drugs and Other Expenses	350,679	367,200	383,500	16,300	4.4%
Interest	10,011	8,100	8,200	100	1.2%
Depreciation	<u>44,209</u>	<u>49,000</u>	<u>48,200</u>	<u>(800)</u>	-1.6%
Total Expenses	<u>903,561</u>	<u>938,800</u>	<u>976,100</u>	<u>37,300</u>	4.0%
Operating Income	<u>31,950</u>	<u>49,300</u>	<u>51,400</u>	<u>2,100</u>	4.3%
Total Non-operating Revenue	<u>4,751</u>	<u>11,800</u>	<u>8,000</u>	<u>(3,800)</u>	-32.2%
Excess of Revenue over Expenses	<u>\$ 36,701</u>	<u>\$ 61,100</u>	<u>\$ 59,400</u>	<u>\$ (1,700)</u>	-2.8%
EBITDA	\$ 90,921	\$ 118,200	\$ 115,800	\$ (2,400)	-2.0%

Summary of Non-Operating Revenue

FY11 Budget

<u>(000's omitted)</u>	<u>FY09 Actual</u>	<u>FY 10 Projection</u>	<u>FY 11 Budget</u>	<u>Dollar Variance</u>	<u>% Change</u>
Investment Income & Other	\$ 10,910	\$ 7,340	\$ 7,480	\$ 140	1.9%
Fair Value Gain (Loss) on Investments	(12,685)	6,500	0	(6,500)	-100.0%
Fair Value Gain (Loss) on Swap Agreements	0	(6,500)	0	6,500	100.0%
UWHC interest in Joint Venture results:					
Wisconsin Therapies/Chartwell	497	710	500	(210)	-29.6%
Wisconsin Dialysis	(49)	(70)	50	120	> 100%
Unity/UHC	4,865	3,080	600	(2,480)	-80.5%
UHC eICU	(977)	(960)	(1,000)	(40)	-4.2%
Madison Surgery Center	2,025	1,640	1,610	(30)	-1.8%
Sleep Equipment of WI	(15)	0	0	0	0.0%
Madison United Healthcare Linen	167	50	50	0	0.0%
Madison Environmental Resourcing	13	10	10	0	0.0%
Generations	0	0	(1,000)	(1,000)	-100.0%
Watertown Memorial Pediatric unit	0	0	(300)	(300)	-100.0%
Total Non-Operating Income	<u>\$ 4,751</u>	<u>\$ 11,800</u>	<u>\$ 8,000</u>	<u>\$ (3,800)</u>	<u>-32.2%</u>

Balance Sheet

FY11 Budget

<u>(000's omitted)</u>	<u>FY 09 Actual</u>	<u>FY 10 Estimate</u>	<u>FY 11 Budget</u>
<u>Cash & Investments</u>			
Unrestricted	\$ 326,351	\$ 387,200	\$ 426,300
Restricted by Trustee & Donors	9,602	10,300	10,000
Accounts Receivable	115,612	119,800	132,600
Property, Plant and Equipment, Net	410,395	417,600	420,400
Other Assets	68,412	66,200	68,100
Total Assets	<u><u>\$ 930,372</u></u>	<u><u>\$ 1,001,100</u></u>	<u><u>\$ 1,057,400</u></u>
Current Liabilities	\$ 96,046	\$ 112,400	\$ 117,200
Long-term Debt	249,834	242,800	235,400
Pension Related & Other Liabilities	70,833	78,300	79,300
Net Assets			
Unrestricted	505,124	559,000	616,900
Restricted	8,535	8,500	8,600
Total Liabilities and Net Assets	<u><u>\$ 930,372</u></u>	<u><u>\$ 1,001,000</u></u>	<u><u>\$ 1,057,400</u></u>

Capital Budget/Cash Flow

FY11 Budget

The Capital Budget for FY2011 consists of projects to be funded by operating cash. Capital spending is budgeted at moderate levels with the intent to build cash reserves.

(000's Omitted)

Sources of Funds

Net Income	\$59,400
Add: Depreciation	48,200
Deduct: Principal Payments on Debt and Pension Liability	9,400
Working Capital and Other Changes	5,900
Total Sources	\$92,300

Proposed Uses of Funds

Facilities Remodeling, Renovation & Expansion	
Construction >\$250,000 (see Appendix 2)	16,960
Infrastructure > \$250,000	4,500
Construction & Infrastructure < \$250,000	2,450
Facilities Contingency	1,000
Subtotal	\$24,910
Equipment	
Equipment >\$250,000 (See Appendix 2)	\$15,790
Equipment <\$250,000	8,000
Equipment Contingency	2,000
Subtotal	\$25,790
Total Facilities and Equipment	\$50,700
Capital Contribution - Faculty Office Building Buy-out existing space	\$2,500
Total Uses	\$53,200
Additions to Cash Reserves	\$39,100

Financial Ratios

FY11 Budget

The projected operating results for Fiscal Year 2011 reflect the goal of improving margins and cash reserve position in order to continue favorable bond ratings and comparability to "A" rated industry standards.

	UWHCA			Comparisons "A" Rated Hospital Averages (Based on 2008 audited financial statements)		
	FY 09 Actual	FY 10 Projection	FY 11 Budget	S&P	Fitch	Moody's
	Operating Margin	3.4%	5.0%	5.0%	2.5%	2.7%
Total Margin	5.1%	6.1%	5.7%	4.2%	3.9%	4.6%
Days Cash on Hand	136	152	161	175	171	157
Days in Accounts Receivable	42	45	48	49	48	49
Long-term Debt to Capitalization	0.33	0.30	0.28	0.34	0.40	0.38
Cash to Debt	130.6%	159.5%	181.1%	130.8%	113.4%	113.9%
Maximum Debt Service Coverage	5.6	6.7	7.2	3.7	3.1	4.3

Analysis of Patient Activity Changes

FY11 Budget

	FY 2009 <u>Actual</u>	FY 2010 <u>Projected</u>	FY 2011 <u>Budget</u>	FY10 Proj. to FY11 <u>% Change</u>	FY09 Actual to FY11 <u>% Change</u>
Admissions	25,450	25,731	26,314	2.3%	3.4%
Inpatient Days	136,774	138,417	141,775	2.4%	3.7%
Average Daily Census	375	379	388	2.4%	3.7%
Case Mix Index	1.85	1.89	1.92	1.6%	3.8%
Clinic Visits ⁽²⁾	563,486	565,948	587,450	3.8%	4.3%
Emergency Visits	42,858	41,064 ⁽¹⁾	40,703	-0.9%	-5.0%
Surgical Cases	24,961	25,361	25,787	1.7%	3.3%

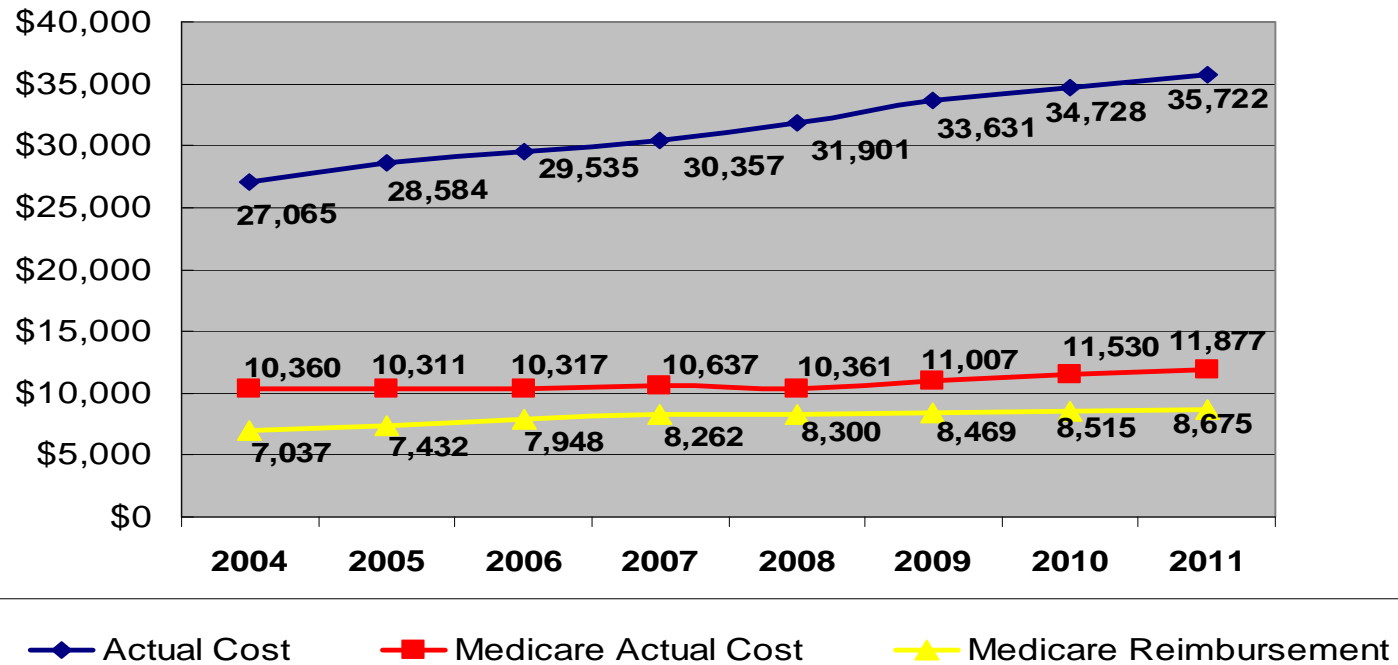
(1) Change in direct admit count as of 10/09

(2) Excluding flu shots

Medicare: Direct Graduate Medical Education

FY11 Budget

Direct Graduate Medical Education cost continues to be reimbursed on a rate per resident. The Balanced Budget Reform Act (BBRA) and modified by the Benefits Improvement and Protection Act of 2000 (BIPA) has changed the reimbursement rate from a hospital specific rate-per-resident to 85% of the locally adjusted national rate-per-resident. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA) did not change the reimbursement methodology related to Direct Medical Education. Due to the current Medicare formula which includes a 1980 base rate computation, UWHC continues to be reimbursed at less than Medicare's fair share of Direct GME costs. In addition, the difference of \$27 million between the Medicare payments of \$8.7 million and total costs of \$35.7 million need to be built into other payor rates, which they are often reluctant to recognize.

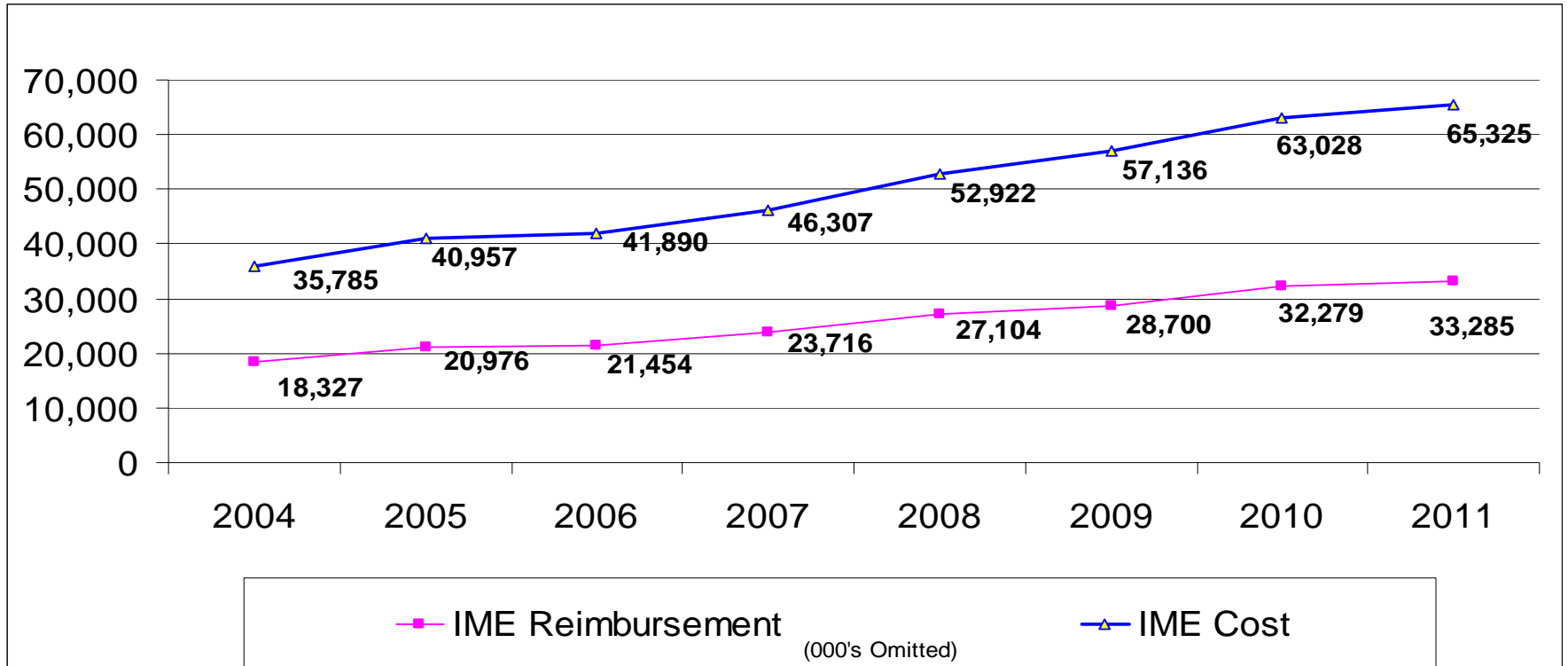


(000's Omitted)

Medicare: Indirect Medical Education - Reimbursement

FY11 Budget

Indirect Medical Education (IME) continues to be reimbursed by Medicare on a ratio of interns and residents to the number of available beds. The hospital is currently limited in its reimbursement to its FY1996 IME resident cap of 288 with minor adjustment for the new ED residency program. In FY11 our estimated UW funded resident FTEs will be 375 at an estimated cost of \$65.3 million (over the \$35.7 Direct Cost from previous page). Medicare reimbursement for IME in FY2011 is estimated at \$33.2 million. IME reimbursement is often targeted for reduction at the Federal level.



Wisconsin Medicaid Hospital Assessment

FY11 Budget

On February 19, 2009, Governor Doyle signed 2009 Act 2 into law. This bill established the tax assessment on Wisconsin's acute care hospitals. Due to the assessment, there are several components that will affect the hospitals. First, the hospitals will be required to pay an assessment fee equal to a % of their gross patient revenue reported on the Wisconsin Hospital Association survey. Second, the hospitals will be receiving additional reimbursement from the State, due to the additional income generated by the assessment from the federal government. The increases will affect both the fee-for-service and the HMO payments. The following is a breakdown of the additional revenue and expense projected by UW related to the assessment: The decrease is primarily due to the effect of the shift in hospital assessment payment increase from rate based to access based. In FY09 the increase in the hospital assessment came in the form of higher base rates. In FY's 10 and 11, it will come in the form of a per discharge or visit add-on payment, not reflecting acuity.

	Fiscal Year		Total 2-yr projection
	2010	2011	
Projected Increase in Medicaid Payments due to Assessment**	\$ 23,862,168	\$ 24,875,350	\$ 48,737,518
Hospital Assessment	\$ 24,388,143	\$ 26,826,957	\$ 51,215,100
Net Estimated Hospital Medicaid Increase	<u>\$ (525,975)</u>	<u>\$ (1,951,607)</u>	<u>\$ (2,477,582)</u>

** Includes estimated fee-for-service access payments, HMO access payments and other supplemental payment increases.

Comparison of Charity Care & Bad Debt Expense

FY11 Budget

	Million Dollars	Change	%
2008 Actual	\$ 58.6	\$ 14.2	32%
2009 Actual	\$ 63.4	\$ 4.8	8%
2010 Projection	\$ 85.9	\$ 22.5	35%
2011 Budget	\$ 86.9	\$ 1.0	2%

Work Force Changes

FY11 Budget

The majority of the FTE increases in FY11 are volume related. Our goal is to continue to improve our overall operating efficiency.

	<u>FY09 to FY10</u>	<u>FY10 to FY11</u>
Total FTEs	6,254.55	6,280.00
Volume Related	8.86	52.50
AFCH OR	4.25	4.25
Health Link	2.75	(2.30)
H1N1	5.29	(5.29)
Compliance, Coding & Regulatory Initiatives	5.70	12.65
Other	(1.40)	14.69
Total FTEs*	<u>6,280.00</u>	<u>6,356.50</u>

**Gross FTE count includes 356.46 FTE to be reimbursed from the School of Medicine and Public Health, UW Medical Foundation, House Staff rotations, and other outside funding sources.*

Commitment to Education

FY11 Budget

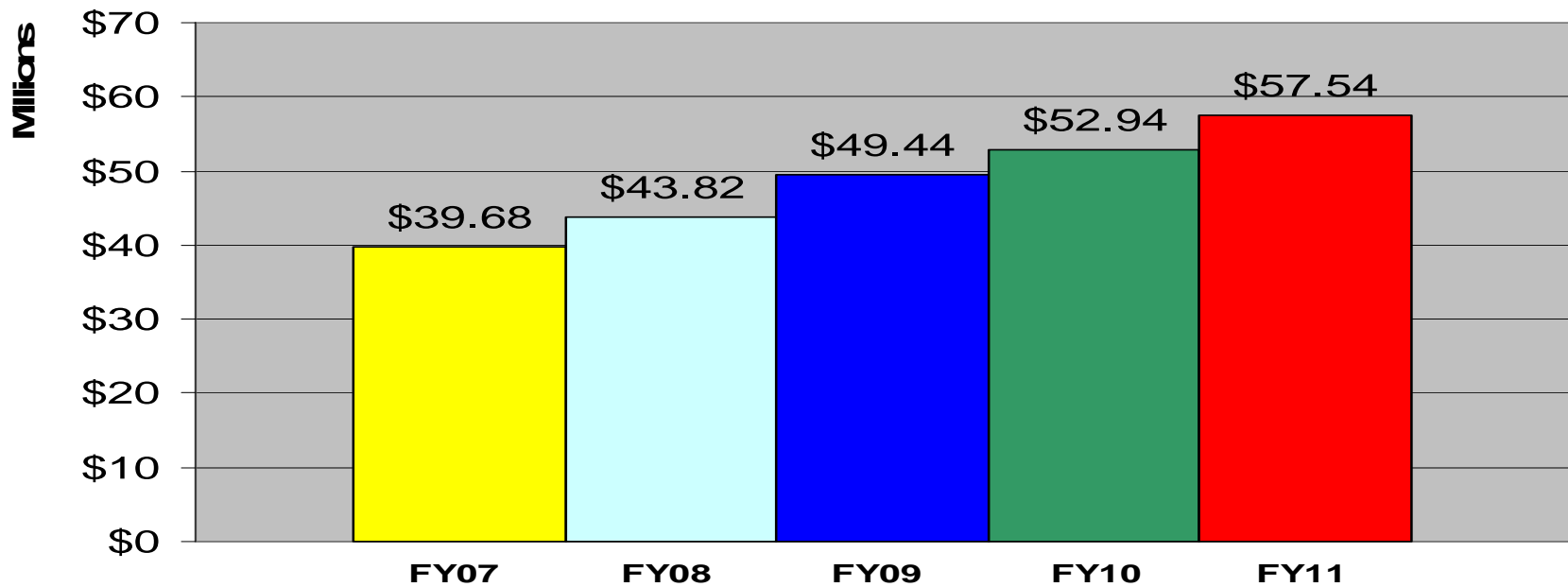
	<u>FY 2009 Actual</u>	<u>FY 2010 Projected</u>	<u>FY 2011 Budget</u>
Intern and Resident Salary, Benefit and Support Cost	\$ 22,290,630	\$ 22,897,380	\$ 24,291,188
Paramedical Education Program Salaries, Benefits and Other Costs			
Pharmacy	847,766	778,076	838,613
EMS	818,649	911,502	1,067,403
Dietary	174,078	175,078	190,505
Radiology Tech	414,587	460,785	504,629
Ultrasound Tech	379,406	423,928	410,646
Radiotherapy	73,669	51,618	55,122
School of Nursing Faculty Support	25,000	25,000	25,000
Total Operating Contributions	<u>\$ 25,023,785</u>	<u>\$ 25,723,367</u>	<u>\$ 27,383,106</u>

Note: The cost associated with Residents in the first line of this table represents salaries, fringe benefits and support payments. They do not include related hospital overhead costs which are included in the total cost of \$35.7 million as shown on the graph of Medicare Direct Graduate Medical Education. The above costs also do not include other indirect costs created by presence of medical education activities in the clinical areas of the hospital. UWHC has committed capital contributions to the School of Nursing Building project totaling \$3.1 million which will be payable as the project commences in agreed upon installments.

Affiliation Agreement

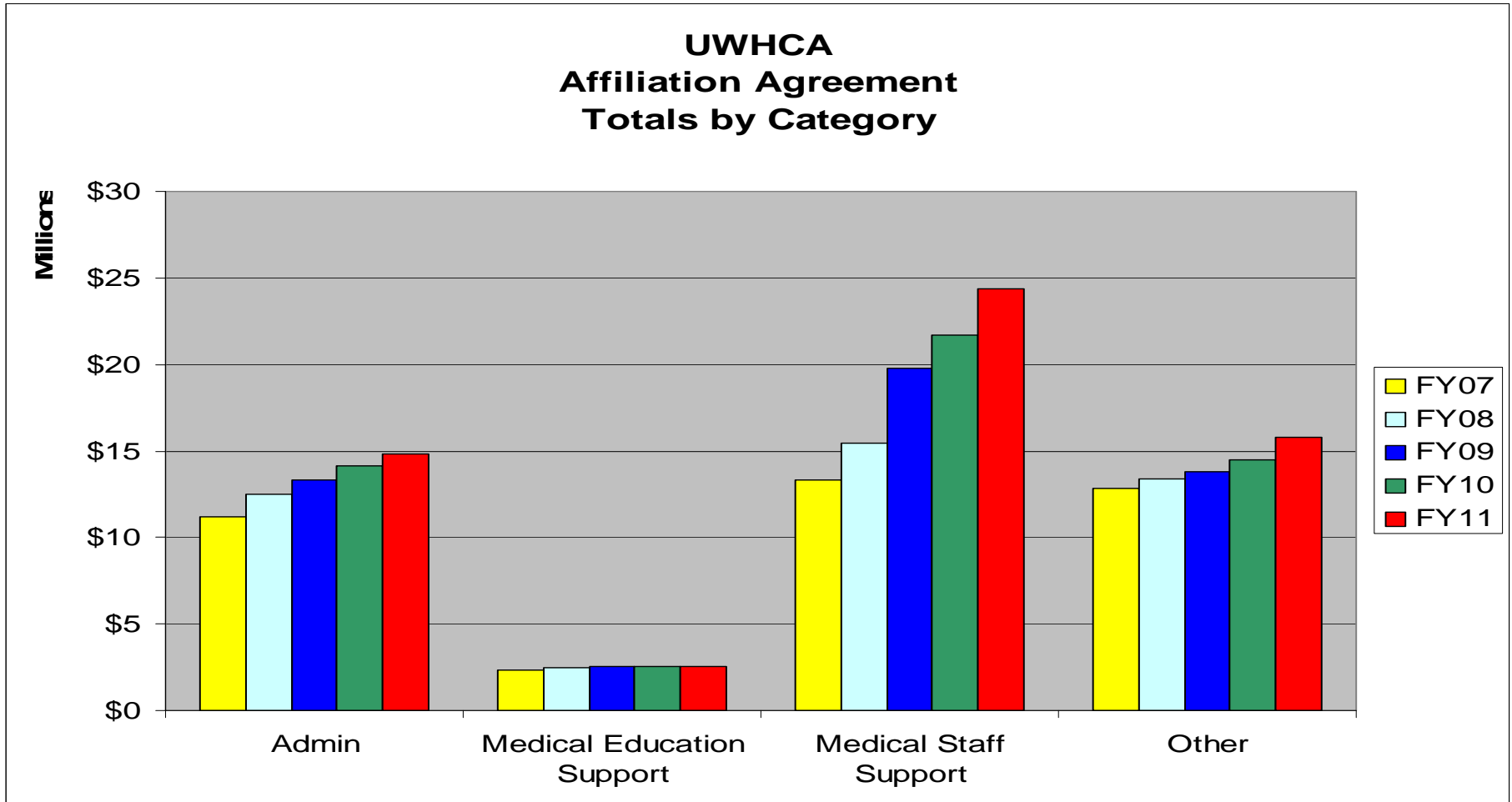
FY11 Budget

UWHCA Affiliation Agreement Annual Totals



Affiliation Agreement

FY11 Budget



Cost Structure Changes

FY11 Budget

Standard Inflation (3%)	\$	28.6	M
FTE Additions (approx 76.5)		4.6	
Affiliation agreement		4.5	
Strategic Plan Implementation		1.0	
Repairs & Maintenance		1.4	
Expense decrease due to cost saving and other initiatives		(2.8)	
Total Expense Increase	\$	<u>37.3</u>	<u>M</u>

Analysis of Comparison of Operating Cost per Adjusted Discharge

FY11 Budget

From a historical perspective, UWHC's operating cost (excluding bad debt expense) per adjusted discharge.

	<u>Operating Cost per Adjusted Discharge</u>	<u>% Change from Previous Year</u>	<u>Case Mix Index (CMI)</u>	<u>Operating Cost per Adjusted Discharge / CMI</u>	<u>% Change from Previous Year</u>
2007	\$ 18,083	5.52%	1.84	9,828	4.95%
2008	\$ 18,647	3.12%	1.80	10,359	5.41%
2009	\$ 19,469	4.41%	1.85	10,524	1.59%
2010 Projected	\$ 19,707	1.22%	1.89	10,427	-0.92%
2011 Budget	\$ 20,001	1.49%	1.92	10,417	-0.09%
5 Yr Annual Increase					2.19%

Income from Operations Changes from FY2010 to FY2011

FY11 Budget

FY 2010 Operating Income - projected		\$49.3 M
a. Volumes	\$ 10.6 M	
b. Price/Reimbursement @ 7.5%	38.3 M	
c. Payor Mix Change	(8.5) M	
d. Bad Debt/Charity	(1.0) M	
e. Inflation	(28.6) M	
f. Cost Changes	<u>(8.7) M</u>	
		\$ 2.1 M
FY 2011 Operating Income - budget		<u><u>\$ 51.4 M</u></u>

Investment Balances & Returns

FY11 Budget

UWHC Investment Allocation Strategy is reviewed with the UWHC Finance committee. Based upon the historical operating results, the decline in investment earning rates and previously approved strategies, the asset allocation mix is expected to be modified by holding the equity and Intermediate Bond portfolios to less than 50% of the total investment portfolio from an initial plan of increasing these to 66% of the total. FY 2011 assumptions are conservative, given low Treasury rates; unrealized market value gains/losses on the Intermediate Term Bond Fund and the Endowment Fund are not projected in the 2011 budget.

<u>Account</u>	<u>Est June 2011 Balances</u>	<u>Investment Allocation</u>	<u>Estimated FY 2011 Investment Return</u>	<u>March 2010 YTD Investment Return</u>	<u>March 2010 YTD Benchmark</u>
Operating Account and Commercial Paper					
US BANK	\$ 21,315	5.0%	0.50%	0.12%	0.00% (A)
Capital Replacement Fund					
UW Foundation Expendables Fund	\$ 213,150	50.0%	1.00%	0.24%	0.24% (B)
Intermediate Term Bond Fund					
Robert W. Baird Investments	\$ 106,575	25.0%	4.50% **	5.25%	5.08% (C)
Equity Securities					
UW Foundation Endowment Fund	\$ 85,260	20.0%	5.00% **	12.96%	27.21% (D)
Total Unrestricted Cash	<u>\$ 426,300</u>	<u>100.0%</u>			

(A) Average Financial and Non-Financial Commercial Paper, less fees
 (B) Average One-month LIBOR
 (C) Barclay's Intermediate Gov/Credit Index
 (D) Average S & P 500 Index
 **Excludes market value gains/losses

Recommendation

FY11 Budget

The Finance Committee of the University of Wisconsin Hospital and Clinics Authority recommends to the Board of UWHCA:

- Approval of the FY2011 Capital Budget in the amount of \$50.7 million to be funded from operations.
- Approval of a 7.5% price increase effective July 1, 2010.
- Approval of the FY2011 Operating Budget including the achievement of an Operating Margin of 5.0%.