

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medicine Board Annual Financial Report

This report is for information only.

Attachment

UW Medicine Board Financial Report to the UW Board of Regents, November,
2010



UW MEDICINE BOARD
ANNUAL FINANCIAL REPORT TO THE UW BOARD OF REGENTS

NOVEMBER, 2010

ATTACHMENT



EXECUTIVE SUMMARY

UW Medicine financial performance overall in FY 2010 was positive compared to budget. Total revenue for UW Medicine was \$ 2.9 billion in FY 2010, representing a 16% increase compared to FY 2009. The clinical programs recorded continued growth and positive financial performance. Research grant awards for UW Medicine increased by 17% over FY 2009. Support from the state of Washington, however, was reduced as a result of the general reduction to the University and the reductions in financial support for health care programs. The impact of the reduced funding for health care programs began with the passage of the 2009-11 state biennial budget and increased in 2010 due to further cuts included in the state supplemental budget. The impact of these reductions was \$84 million for the UW Medicine Health System for FY10 and FY11 combined. There are, however, several key initiatives and supplemental payment programs underway that are designed to reduce this impact substantially. The School of Medicine (SOM) state funds were reduced by 9.5%, and SOM budgets were also impacted by the reduction in endowment payouts.

Key financial highlights for FY 2010 include:

- The consolidated balance sheet for UW Medicine's healthcare programs remains stable. Cash increased, but remains below the Moody's "A" rated level. Debt ratios, however, remain exceptionally strong due to the relatively low level of debt at the medical centers. Net income from operations for the UW Medicine Health System (excluding revenue in the School of Medicine) was \$135.7 million (6.7%), including post-closing adjustments.
- Northwest Hospital & Medical Center (NWH) joined UW Medicine, effective January 1, 2010. The affiliation, which was a non-cash transaction, added over \$100 million of net assets (historic book value) to the University of Washington. NWH converted from a December 31 fiscal year end to a June 30 fiscal year end as of July 1, 2010. Operating results for the six month period ending June 30, 2010 reflected the region-wide softening of demand. We are working on a number of process improvement plans and program initiatives focused on cardiac and cancer services

aimed at enhancing volumes and improving the financial results at NWH. The SCCA plans to break ground on the Proton Beam facility at the NWH campus in FY 2011. We have also identified and implemented a number of measures intended to reduce expenses on the NWH campus, such as bringing the NWH facilities and physicians into the UW risk management program and arranging for NWH to participate in UW Medicine's group purchasing arrangements through the University Healthcare Consortium.

- FY 2010 proved to be another challenging year for health care with the continued economic downturn, resulting in softening demand for elective services and a rise in the uninsured population. This was reflected most directly at Harborview Medical Center. Harborview recorded a loss of \$10.4 million in FY 2010. While volumes increased from FY09 with the new capacity opening in FY10, they were less than budget. The operating loss was as a result of lower than budgeted volumes, particularly in the most intensive services, coupled with an increase in the numbers of uninsured and underinsured patients. This change came at a time when Harborview had just completed two major building projects that added capacity and expenses. Harborview also provided a record amount of charity care to our community. The amount exceeded \$187M. The hospital rapidly implemented their process improvement plans to mitigate levels of projected loss and maintained high quality care for patients from all walks of life.
- UW Medical Center (UWMC) had very strong financial results due to a stable commercial payer mix and solid patient volume in the types of clinical programs that have positive contribution margins, e.g., cancer care, cardiology, solid organ and stem cell transplantation. The operating margin was \$69.2 million (8.5%), and the total income was \$73.2 million.
- University of Washington Physicians (UWP) FY 2010 revenues were \$232.9 million, an increase of \$42.8 million over FY 2009. Cash per unit of output (relative value units or RVU's) increased and the Professional Services Supplemental Payment (PSSP) program added \$12.2 million of revenue from the Medicaid program in FY 2010. UWP reserves increased, primarily reflecting the recovery of the financial markets. Children's University Medical Group (CUMG) revenues were up by \$6 million over FY 2009.
- Northwest Hospital & Medical Center recorded a loss of \$6 million (4.4%) for the six months ending June 30, 2010. The loss is attributable to lower than anticipated volumes, including the impact of the transition of the radiation oncology service from the Swedish Tumor Institute to UW Medicine.
- Seattle Cancer Care Alliance (SCCA) had a very strong year financially, with total net income of \$23.8 million. The majority of the positive financial performance is attributable to the outpatient program. UW Medical Center recognizes SCCA financial results using the equity method, recording one-third of the total net income as "non-operating revenue."

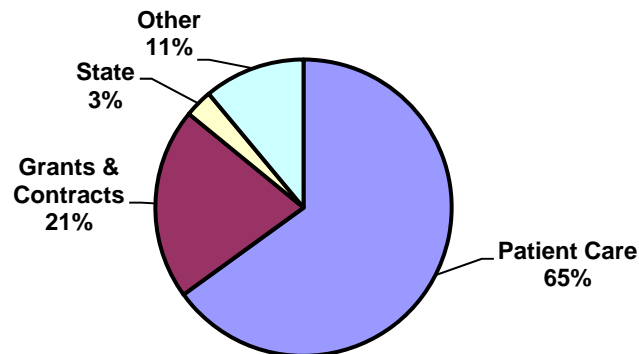
- The UW Physicians Neighborhood Clinics (UWPN) required \$7.5 million of operating support in FY 2010, \$600,000 in excess of expectations. The variance from budget was a function of approved new project costs for secondary care expansion, clinic improvements that were not in the original budget, and slight deterioration in the commercial payer mix.
- Airlift Northwest (ALNW) continued its positive turnaround begun in FY 2009. ALNW recorded income of \$2.1 million in FY 2010. The positive performance was accomplished through control of operating expenses, elimination of consulting expenses, and improved contract terms and pricing.
- UW Medicine research grant awards grew by \$96 million (17%) for UW-based research in FY 2010 compared to FY 2009. Grant awards from the National Institutes of Health (NIH) to UW Medicine faculty based at UW facilities increased from \$365 million in FY 2009 to \$471 million in FY 2010, an increase of 29%. The majority of the increase was due to NIH funding under the American Recovery and Reinvestment Act (ARRA).
- Total private support for UW Medicine for FY 2010 was \$137.2 million, comprising nearly half (48% of the University's private support for the year). Private grants decreased in FY 2010 to \$101.9 million from \$124 million in FY 2009, but gifts increased to \$35.3 million in FY 2010 compared to \$32.2 million in FY 2009. The decrease in private grants reflects, in part, the impact of the economic recession on funding from private foundations.
- Approximately \$556 million of total revenues were transferred between various UW Medicine entities and affiliates to support teaching, research, and patient care activities. In FY 2010, the major components included: \$234 million from the physician practice plans (UWP and CUMG) to support School of Medicine faculty salaries, clinical department operations, and central SOM expenditures; \$142 million from UWMC, HMC, and the Seattle Children's Hospital, to SOM clinical departments to provide faculty salary and program support; \$41 million from the medical centers to the SOM clinical departments to support graduate medical education; \$26 million in purchases of SOM developmental lab services by UWMC and HMC; \$25 million from the medical centers, practice plans, and SOM to support the central administrative and service functions of UW Medicine; \$6 million in UWMC and HMC purchases of services from the Consolidated Laundry; and \$5 million in research facilities support from SOM to HMC. There was \$69 million in purchases of supplies and services between UWMC, Fred Hutchinson, and the Seattle Cancer Care Alliance related to the operation of inpatient and outpatient oncology services at the SCCA and UWMC.

KEY STATISTICS & RESULTS

UW Medicine revenues were \$2.9 billion in FY 2010. This represents an increase of approximately 16% compared to FY 2009. The following charts summarize the sources of financial support for UW Medicine. Over the last five years, total UW Medicine

revenue has increased at an average rate of 8% per year. These increases have occurred in the setting of a competitive local health care market, significant reductions in state-funded programs and a very competitive process for peer reviewed research grant funding.

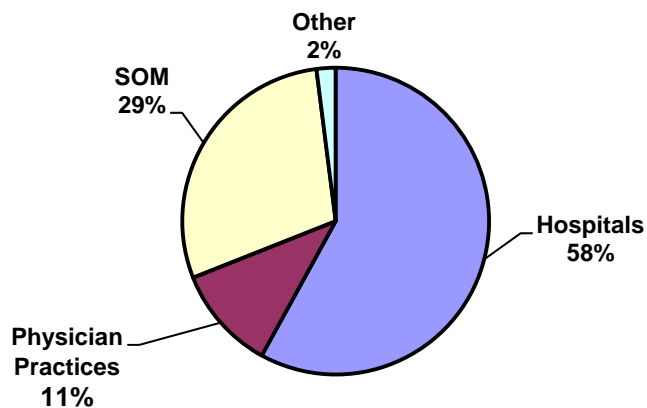
Fiscal Year 2010 – Revenue by source



Total Revenue: \$2.9 billion

(Other includes support from Wyoming, Alaska, Montana, and Idaho, revenue from endowments and gifts, and cost centers.)

Fiscal Year 2010 – Revenue by entity



Total Revenue: \$ 2.9 billion

(Other includes Airlift Northwest and the Consolidated Laundry.)

UW Medicine financial support comes predominantly from patient care revenues (65%) and research grants and contracts (21%). The following sections highlight the performance in each of these areas.

PATIENT CARE

The following table summarizes operating revenue received by the UW Medicine healthcare system in FY 2009 and FY 2010. This table does not include research grants and other funds received by the School of Medicine and does not include revenue from the Seattle Cancer Care Alliance outpatient services.

UW Medicine Health System	Operating Revenue (in millions)	
	2009	2010
Harborview Medical Center	\$667.8	\$703.3
UW Medical Center	752.5	811.5
Northwest Hospital & Medical Center	N/A	133.4*
UW Physicians	174.8	199.8
UW Physicians Network	21.9	23.6
Children's University Medical Group	90.4	110.2
Airlift Northwest	34.8	36.6
Total	\$1,742.2	\$2,018.4

*Includes the six months from January through June 2010.

Net income from UW Medicine clinical operations for FY 2010, after adjusting for revenues counted in more than one entity (e.g., UWP billings for physicians working in UWPN), was \$135.7 million or 6.7% of operating revenue. UWMC generated \$73.2 million of net income, Harborview lost \$10.4 million, and Northwest Hospital had a loss of \$6 million for the six months ended June 30, 2010. Airlift NW generated \$2.1 million of net income. The UW Neighborhood Clinics required \$7.2 million in support from UWMC and Harborview to offset expenses. UWPN losses for primary care are consistent with experiences at other comparable practices in academic medical centers and private settings. The secondary and tertiary care generated by UWPN results in significant revenue at UW Medicine hospitals. The net income generated by UWP, \$69.7 million, and CUMG, \$16.7 million, is distributed to the School of Medicine departments, Dean's office, and Seattle Children's Hospital (for a portion of CUMG revenue) to support operations.

The following tables provide benchmark comparisons for the medical centers.

Ratio/Indicator	Moody's "A"	UW Medical Center	Harborview Medical Center
Operating margin	3.0%	8.5%	(1.5)%
Debt to capitalization	38.9%	18.9%	1.0%
Days cash on hand	169.5	129.4	79.6
Days in A/R (net)	45.6	45.0	61.0

These comparisons reflect five important points:

- Operating margins at Harborview are affected by the high and increasing percentage of uninsured and under-insured patients served as well as the costs of putting the new Maleng and Ninth and Jefferson buildings into full operation;
- Harborview provided over \$187 million of charity care in FY 2010 as measured by foregone charges – an increase of \$32 million over FY 2009;
- The Harborview debt to capitalization number reflects the capital support provided by King County through voter-approved general obligation bonds;
- Days cash on hand showed increases, but remains somewhat below benchmark at both medical centers, again reflecting the high percentage of uninsured and under-insured patients and conservative use of debt; and
- Days in accounts receivable were reduced as we prepared for the successful conversion of the UW Medicine hospital billing system that occurred on August 1, 2010.

5-YEAR PERFORMANCE COMPARISON

The patient care activity of the UW Medicine Health System remains strong and stable, with the exception of UWPB where physician turnover and strategic closure of one clinic in FY 08 resulted in volume declines. Growth has been limited by very high occupancy levels at both medical centers. The following tables summarize the clinical activity for the owned and managed components of UW Medicine and the SCCA.

Harborview Medical Center

Statistic	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Admissions & short stays	22,439	21,147	21,764	20,463	20,984
Patient Days	129,831	133,345	136,662	136,687	135,124
Outpatient visits	223,916	218,229	230,315	224,769	246,420
Emergency visits	81,073	76,491	68,987	65,515	62,174
Average Length of Stay	6.9 days	7.2 days	7.4 days	7.0 days	6.9 days

UW Medical Center

Statistic	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Admissions	18,120	18,866	18,993	19,322	19,260
Patient Days	114,542	115,659	115,270	113,468	114,362
Outpatient visits	333,099	327,297	324,812	333,675	323,393
Emergency Visits	32,838	27,868	29,038	27,046	25,602
Average Length of Stay	6.3 days	6.1 days	6.1 days	5.9 days	5.9 days

UW Physicians Network

Statistic	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Clinic Visits	227,929	218,561	201,645	188,148	193,280
New Patients	15,784	14,867	11,768	10,264	11,567

Seattle Cancer Care Alliance

Statistic	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Clinic Visits	44,084	43,230	48,928	54,851	60,046
Admissions	455	428	573	607	560

Inpatient admissions for the SCCA 20 bed unit at UWMC are included in the UWMC admissions total.

RESEARCH PROGRAMS

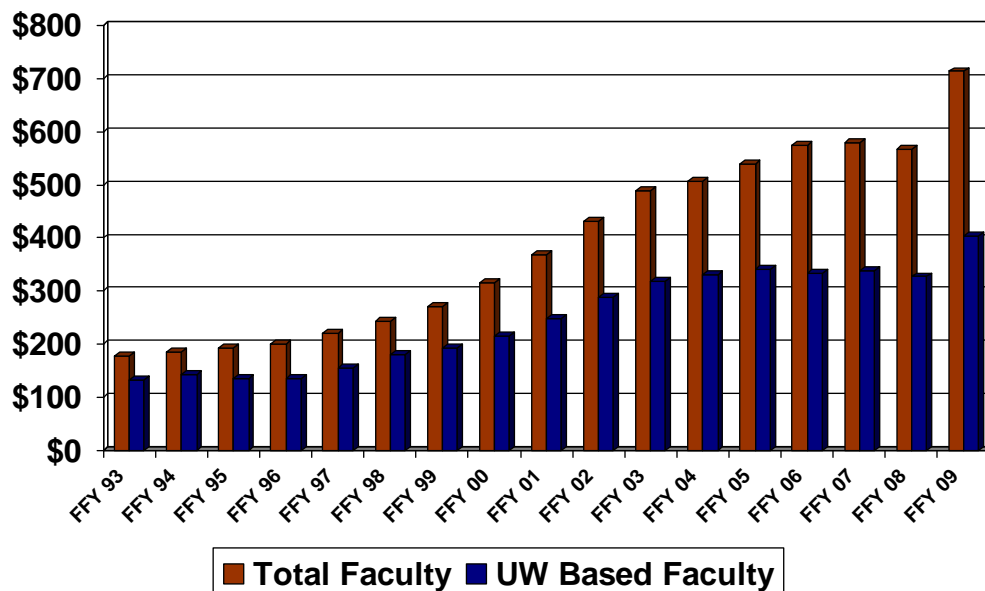
UW Medicine research continues to grow. UW School of Medicine grant and contract awards through the University of Washington totaled \$662 million in FY10. This was a \$94 million (17%) increase over FY 2009. The following table summarizes the UW-based SOM research awards over the past four years.

(\$ in millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	Average annual change
Federal	\$354.4	\$375.5	\$371.1	\$364.6	\$471.1	7%
Non-federal	\$110.1	\$118.1	\$146.2	\$203.0	\$190.8	15%
Total	\$464.5	\$493.7	\$517.3	\$567.5	\$661.9	9%

NIH awards represent the largest single source of awards received by UW Medicine faculty. The following chart tracks the growth of NIH awards to UW Medicine faculty over the past 14 federal fiscal years ending in federal fiscal year 2009. (NIH funding is on a federal fiscal year basis and comparative information is not available until several months after the close of the fiscal year on September 30.)

NIH Grant Awards to UW Medicine
(\$ in millions)



Note: Average annual growth rate: 9% for Total Faculty; 7.2% for UW-based faculty.

There were, in federal fiscal year 2009, 1,112 separate NIH awards to 732 UW-based SOM Principal Investigators. There are an estimated 868 regular and research faculty working on NIH research grants made to UW-based SOM faculty. In addition to NIH awards managed by the University of Washington, School of Medicine faculty receive NIH awards that are managed by affiliated institutions (e.g., Fred Hutchinson Cancer Research Center and Seattle Children's Hospital). Total NIH awards to UW Medicine faculty in federal fiscal year 2009 were \$713.2 million, an increase of \$147.1 million (26%) over federal fiscal year 2008. A significant component of the NIH growth is attributable to grants funded through the American Recovery and Reinvestment Act (ARRA).

UW Medicine faculty were second in the country among all medical schools, and first among public medical schools, in NIH research funding based on FY 2009 awards. The growth in NIH funding to UW School of Medicine faculty over the past seven years has exceeded the comparable growth of our peer institutions with the exception of the University of Michigan.

-----\$ in millions-----				
Institution	2002 NIH Awards	2009 NIH Awards	% change	
Michigan	\$ 255.7	\$ 443.4	73.4%	
Univ. of Washington	\$ 431.5	\$ 713.2	65.3%	
Univ. of Pennsylvania	\$ 431.4	\$ 641.6	48.7%	
Harvard	\$ 957.8	\$ 1,413.1	47.5%	
Yale	\$ 253.6	\$ 353.9	39.6%	
UCLA	\$ 340.5	\$ 468.7	37.6%	
UCSF	\$ 368.7	\$ 471.2	27.8%	
Johns Hopkins	\$ 372.6	\$ 444.7	19.4%	
Washington Univ.	\$ 320.4	\$ 348.0	8.6%	
Baylor	\$ 382.8	\$ 221.4	-42.1%	

UW Medicine's comparative success recently in NIH funding is due to a number of factors, including the interdisciplinary breadth of our research programs, the addition of new laboratory space at South Lake Union, and the increased emphasis on 21st century science such as genomics, proteomics, regenerative medicine, and global health research.

LOOKING FORWARD – FY 2011

Several key external and internal factors will influence UW Medicine's financial performance in FY 2011. The external factors include the pace of recovery from the economic recession and the impact of state budget reductions on health care funding for governmental programs, and federal health reform legislation. The internal factors include our success in implementing rapid and system wide process improvements to mitigate the impact of the state health care program budget reductions, the conversion to the new hospital billing system, and executing on our strategic priorities. The following paragraphs highlight several of the key activities that will mark FY 2011.

Strategic planning. UW Medicine's strategic planning work continues, and numerous activities are in the implementation phase. We have identified a number of immediate or "just do it" steps that we are taking to improve performance, implement new programs, and consolidate specific existing programs to reduce costs and increase efficiency. We also continue to develop business plans and implement our priorities around the larger strategic initiatives. The UW Medicine Board will continue to monitor performance over the coming year.

Patients First. Patients First is based on the strategic goal of improving service to every patient, every time. This system-wide initiative provides frontline staff, managers, physicians, and leaders with the tools and tactics to achieve our strategic outcomes. Patients First is based on measurable improvement methods designed by the Studer Group, a nationally recognized organization that supports the development of key aspects of what a patient would consider as excellence in service. The framework is crafted around four system-wide pillars: A focus on serving the patient and family; providing the safest care; becoming the employer of choice; and practicing fiscal responsibility.

Northwest Hospital & Medical Center. We are working on a series of 24 specific initiatives, evenly divided between infrastructure support and clinical program development. Making significant progress in these areas will be key to the future of clinical programs at NWH, reducing cost, and furthering integration within the UW Medicine Health System. The UW Medicine annual financial report next year will reflect the first full year of integration of NWH within UW Medicine.

South Lake Union Phase III. The University exercised its option on Phase III in FY 2010. The development of new research space at South Lake Union is a key step in ensuring the continued growth of UW Medicine's research programs. The focus in FY 2011 will be on Phase 3.1. The first milestone for the year was reached when the Master Use Permit was obtained in October 2010. Additional milestones for the year include obtaining permanent bond financing in November 2010, and breaking ground on demolition in July 2011, with a goal of starting construction in September 2012. Phase 3.1 will be completed in 2013.

Federal Health Reform. The passage of the health reform act will introduce significant changes into the health care financing and delivery system over the next ten years. The major changes in coverage will take effect beginning in 2014, and there may be significant changes in the law between now and 2014. However, there are several key preparatory steps that UW Medicine must perform that are not contingent on the specifics of the law. These steps include reducing our cost structure, enhancing our IT platform to support clinical, administrative and decision-making, and strengthening our financial systems and contracting and payer relations functions.