

VII. STANDING COMMITTEE

B. Finance, Audit and Facilities Committee

UW Medicine Board Financial Update

See attached information.

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

OCTOBER 19, 2006

OVERVIEW AND EXECUTIVE SUMMARY

UW Medicine financial results in FY 2006 remain stable. The clinical programs recorded continued growth and positive financial performance. Research funding was stable, however, the flat growth in the NIH budget has stalled the consistent growth that had been experienced in the past decade. State support improved as a result of the FY 2006 supplemental budget that provided operating support for the South Lake Union Phase 2, the Foege building, and for the new Department of Global Health .

Key financial highlights for FY 2006 include:

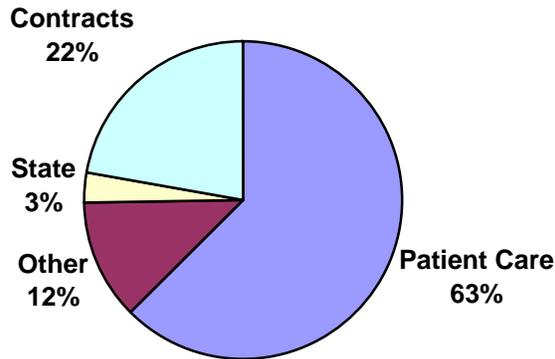
- The balance sheet for UW Medicine's clinical programs remains stable with a ratio of current assets to current liabilities of 1.8 to 1 and very low debt. Cash remains the weak spot on the balance sheet, although there was some improvement over the prior year.
- The clinical programs outperformed budget by a wide margin due to strong volumes, improved reimbursement, improved payer mix, and tight expense control. Operating margins were 3.1% at UW Medical Center and 2.2% at Harborview
- The fund balance for the School of Medicine declined, reflecting construction payments for the Foege Building. The impact related to flattening of the NIH budget at the national level was offset somewhat by the addition of research space at South Lake Union and improved indirect cost rates.
- UW Medicine development recorded its second-best year ever, raising \$109 million in support. This included a 45% increase in alumni giving, a 35% increase in average gift amount in the annual donor fund, and 100% participation from UW Medicine leadership.

The consolidated financial report for UW Medicine is included as an appendix to this report.

KEY STATISTICS & RESULTS

UW Medicine revenues were approximately \$2.08 billion in FY 2005. This represents an increase of approximately 6 % compared to FY 2004. The following charts summarize the sources of financial support for UW Medicine.

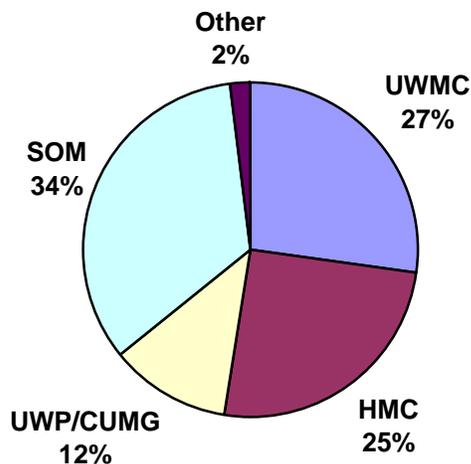
Fiscal Year 2006 – Revenue by source



Total Revenue: \$2.08 billion

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

Fiscal Year 2006– Revenue by entity



Total Revenue: \$2.08 billion

(Other includes Airlift Northwest and the Consolidated Laundry.)

UW Medicine financial support comes predominantly from patient services revenues (63%) and research grants and contracts (22%). The following sections highlight the performance in each of these areas.

PATIENT CARE

The following table summarizes net clinical revenue from patient services provided by UW Medicine medical centers, faculty physicians, and Airlift Northwest in FY 2006. This table does not include research grants and other funds received by the School of Medicine.

UW Medicine Clinical Organization	Net Patient Revenue
Harborview Medical Center	\$ 497,858,000
UW Medical Center	\$ 548,418,000
UW Physicians	\$ 173,957,000
UW Physicians Network	\$ 22,702,000
Children's University Medical Group	\$ 40,844,000
SCCA (outpatient clinic only)*	\$ 135,300,000
Airlift Northwest	\$ 28,200,000
Total	\$1,447,279,000

*Inpatient revenues for the SCCA 20 bed unit are included in the UWMC total.

Net income from operations was \$25.3 million (un-audited), or 2% of operating revenue. The net income included \$11.7 million at Harborview and \$13.6 million at UW Medical Center.

5-YEAR PERFORMANCE COMPARISON

The patient care activity of UW Medicine remains very strong. The following tables summarize the clinical activity for the owned and managed components of UW Medicine.

Harborview Medical Center

Statistic	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Admissions	16,758	17,314	19,087	18,375	18,777
Short Stay Patients	3,876	4,938	4,249	4,598	3,662
Patient Days	124,449	125,408	131,355	125,189	129,831
Outpatient visits	200,809	207,833	221,413	221,159	223,916
Emergency visits	85,809	88,081	87,634	79,112	81,073
Average Length of Stay	7.3 days	7.4 days	6.9 days	6.8 days	6.9 days

UW Medical Center

Statistic	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Admissions	16,517	16,966	17,919	18,086	18,120
Patient Days	111,612	111,688	118,209	118,455	114,542
Outpatient visits	331,303	333,784	350,062	352,927	333,099
Emergency Visits	34,873	33,892	35,462	35,547	32,838
Average Length of Stay	6.8 days	6.6 days	6.6 days	6.5 days	6.3 days

UW Physicians Network

Statistic	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Clinic Visits	220,400	225,167	232,458	237,732	227,929
New Patients	21,610	17,970	18,377	16,925	15,784

Seattle Cancer Care Alliance

Statistic	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Clinic Visits	30,885	35,130	38,149	38,774	44,084
Admissions	352	365	372	444	

*Clinic visits reflect only five months of operations in FY 2001. Inpatient admissions are for the SCCA 20 bed unit at UWMC and are included in the UWMC admissions total.

RESEARCH PROGRAMS

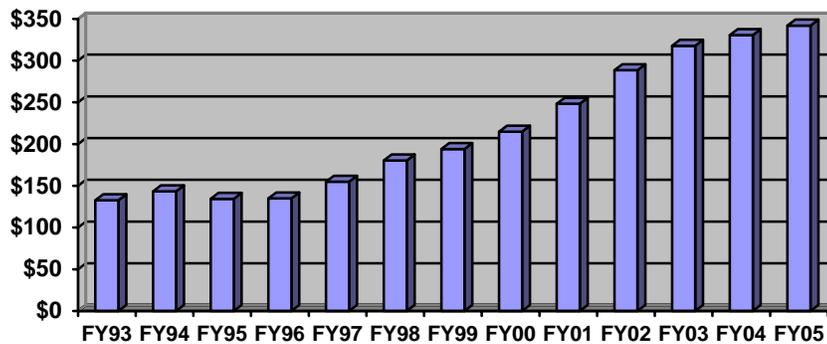
UW Medicine research continues to grow. UW School of Medicine awards through the University of Washington totaled \$460.4 million in FY 04, an increase of 6.5% over FY 03, and 48% of the total grant awards to the UW. Total awards to UW Medicine faculty in FY04 were greater than \$700 million.

NIH awards represent almost three-fourths of the total awards received by UW Medicine faculty. The following chart tracks the growth of NIH awards (managed by the UW) to UW Medicine faculty over the past 12 federal fiscal years (year ending September 30).

NIH Awards to UW School of Medicine managed at UW

Average annual rate of increase: 8.2%

\$ in millions



There were, in federal fiscal year 2004, 1,082 separate NIH awards to 704 Principal Investigators. There are an estimated 1,073 regular and research faculty working on NIH research grants. In addition to NIH awards managed by the UW, School of Medicine faculty receive NIH awards that are managed by affiliated institutions (e.g., FHCRC, Children's). Total NIH awards to UW Medicine faculty in federal fiscal year 2005 were \$538.8 million. UW Medicine faculty were second in the country among all medical schools, and first among public institutions, in NIH research funding based on FY 2005 awards.

LOOKING FORWARD – FY 2007

There are several major program and fiscal policy issues at the federal and state level that will have an impact on UW Medicine's financial affairs. These include the prospect of little or no growth in the NIH budget for extramural research, federal limitations on Medicaid funding in support of the medically indigent and on Medicare reimbursement for physicians services, and Washington state revisions to the basic hospital reimbursement system and the specific program used to pay for hospital services at UW Medical Center and Harborview Medical Center.

August 28, 2006

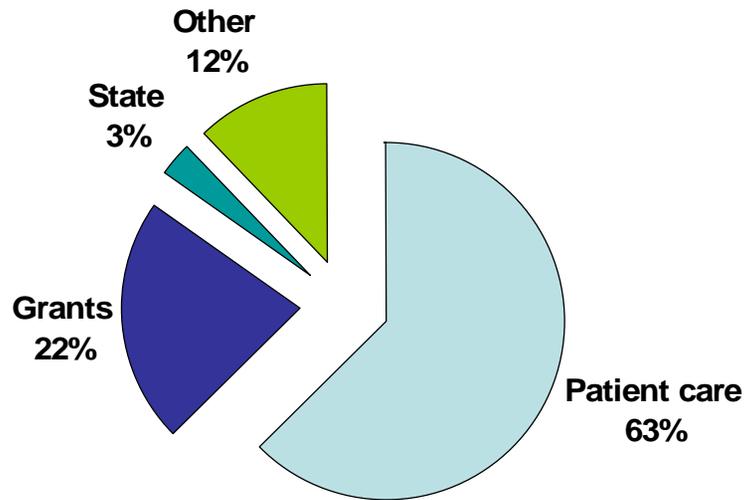
UW Medicine

Fiscal Year Ended June 30, 2006
Unaudited

UW Medicine Revenue FY 2006

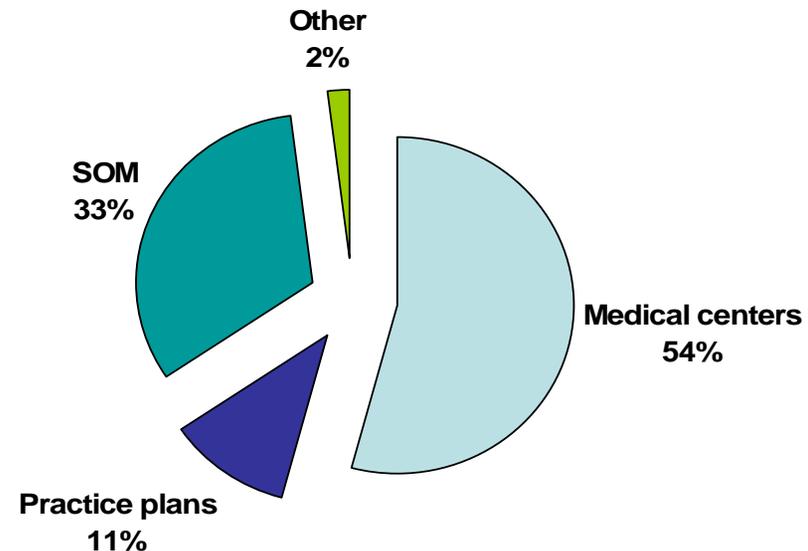
Total revenue: \$2.1 billion

By activity



Other includes WAMI contracts, revenue from endowments, gifts, and cost centers

By organizational units



Other includes Air Lift Northwest & the Consolidated Laundry

Highlights

- Balance sheet remains stable with a strong ratio of current assets to current liabilities (1.8:1) and very low debt. Cash remains the weak spot in the balance sheet, although there has been improvement since last year.
- UW Medicine outperformed budget by a wide margin due to strong volumes, improved reimbursement, improved payer mix, and tight expense control. Operating margins were 3.1% at UWMC and 2.2% at Harborview.
- The School of Medicine had a reduction in fund balance attributable to the construction payments for the Foege building. The concern related to flattening of NIH funding at the national level has been offset somewhat by the addition of research space at South Lake Union and improved indirect cost rates.
- Primary concerns going into FY07 are:
 - Lack of growth in NIH funding
 - Changes in Medicaid payments to hospitals affecting both the per case rate and the add on payments for the medically indigent
 - Continued downward pressure on Medicare physician payments

UW Medicine

Listing of Entities

Medical Centers/Practice Plans/Other

- University of Washington Medical Center
- Harborview Medical Center
- University of Washington Physicians
- Children's University Medical Group
- UW Physicians Network
- Airlift Northwest
- Consolidated Laundry

University of Washington School of Medicine

UW Medicine
Medical Centers/Practice Plans
(excludes School of Medicine)

Consolidated Balance Sheet
Comparison June 30, 2005 and June 30, 2006
(in 000's)

<u>Assets:</u>	<u>6/30/05</u>	<u>06/30/06</u>
Cash and Investments	\$ 318,603	\$ 341,891
Other Current Assets	256,663	262,007
Property Plant and Equipment	556,233	598,130
Other Assets	245,250	241,350
Total Unrestricted Fund Assets	\$ 1,376,749	\$ 1,443,378
<u>Liabilities and Fund Balance:</u>		
Current Liabilities	\$ 304,005	\$ 336,994
Other Liabilities	633	1,023
Long Term Debt (Net of Current Portion)	134,056	122,837
Fund Balance	938,055	982,524
Total Unrestricted Fund Liabilities & Fund Balances	\$ 1,376,749	\$ 1,443,378

➤ **Cash & Investments increase \$23 million**

- UWMC increase \$21 million due to net income and higher payables
- UWP increase \$10 million due to favorable patient account collections
- ALNW decrease \$8 million due to second helicopter purchase and debt repayment

➤ **Current Assets increase \$5 million**

- HMC increase \$6 million due from other funds

➤ **Plant and Equipment increase \$101 million**

- HMC increase \$61 million due to construction in progress and equipment
- UWMC increase \$38 million due to construction in progress and equipment

➤ **Current Liabilities increase \$33 million**

- HMC increase \$13 million due to contractual agencies, credit balances and accrued payroll
- UWMC increase \$10 million due to vendor and other payables
- UWP increase \$10 million due to departments and CMF

➤ **Long term debt decrease \$11 million**

- UWMC decrease \$6 million due to bond principal and capital lease payments
- ALNW decrease \$4 million due to debt payments

➤ **Fund Balance increase \$44 million**

- HMC increase \$23 million due to net income and restricted fund increase
- UWMC increase \$22 million due to net income

UW Medicine
Medical Centers/Practice Plans
(excludes School of Medicine)

Consolidated Statement of Revenues and Expenses
For the Year to Date Ended June 30, 2006
(In 000's)

	<u>Actual YTD</u>	<u>Budget YTD</u>
<u>Revenue:</u>		
Patient Service Revenue	\$ 1,301,423	\$ 1,250,702
State Appropriation	15,910	15,770
Other Revenue	81,782	77,268
Total Revenues	<u>1,399,115</u>	<u>1,343,740</u>
<u>Expenses:</u>		
Salaries, Wages and Benefits	791,531	768,191
Supplies and Other Expenses	468,860	457,118
Depreciation	65,098	69,020
Interest, Insurance and Taxes	6,281	6,873
Total Expenses	<u>1,331,771</u>	<u>1,301,202</u>
Income before CMF Assessment & Departmental Distributions	67,344	42,538
CMF Assessments & Departmental Distributions	<u>(42,045)</u>	<u>(39,301)</u>
Net Operating Income	25,299	3,237
Nonoperating Gains (Losses)	<u>14,285</u>	<u>7,705</u>
Revenues and Gains In Excess of Expense and Losses	<u>\$ 39,584</u>	<u>\$ 10,942</u>

■ Income from Operations was \$25,299 actual vs. \$3,237 budget

	Actual	Budget
HMC	11,699	3,811
UWMC	18,065	9,695
UWPN	(4,313)	(4,830)
All Other	(2,304)	(4,093)

- HMC – due to volume, lower than anticipated deductions from revenue
- UWMC -due to volume, lower than anticipated deductions from revenue
- UWPN – due to favorable reimbursement per visit
- All Others- ALNW board approved a revised budget in January 2006

■ CUMG and UWP income is distributed to departments and CMF

	<u>Actual</u>	<u>Budget</u>
CUMG	10,982	10,258
UWP	31,063	29,043

■ Non-Operating Gain \$14,285 actual vs. \$7,705 budget

- HMC \$2,351 favorable variance due to investment income
- UWMC \$4,943 favorable variance due to favorable SCCA performance

Net Income	\$ 39,584
Add back depreciation	65,098
Increase in current assets	(5,344)
Increase in current liabilities	32,990
Capital Expenditures	(106,996)
Decrease in other assets	3,900
Decrease in Long Term Debt	(11,219)
Increase in other liabilities	389
Transfers and other changes to fund balance	<u>4,885</u>
Net Change in Cash and Investments	<u><u>\$ 23,288</u></u>

	UWMC	HMC	UWP	CUMG	UWPN	All Other	Totals/ Averages
Operating Income (In 000's)	\$ 18,065	\$ 11,699	-	-	\$ (4,313)	\$ (2,304)	\$23,147 ¹
Total Income (In 000's)	\$ 24,706	\$ 15,400	-	-	\$ (313)	\$ (1,721)	\$ 38,072 ¹
Net Working Capital (In 000's)	\$ 131,200	\$ 117,047	\$ (1,685)	\$ (18)	\$ 4,672	\$ 15,686	\$ 266,903
<u>PERCENTAGES</u>							
Operating Margin %	3.1%	2.2%			(40.4%)	(6.7%)	1.6%
Total Margin %	4.2%	2.9%	-	-	(2.9%)	(5.0%)	2.7%
Debt / Equity	0.31	0.02	-	-	-	0.18	0.12
Days Cash	85	67	N/A	N/A	69	134	N/A
Days A/R (gross)	80	91	49	49	35	65	N/A

¹ Before eliminations

Medical Centers' benchmark comparison

Ratio/Indicator	Moody's "A" benchmark	UW Medical Center	Harborview Medical Center
Operating margin	2.6%	3.1%	2.2%
Excess margin	5.2%	4.2%	2.9%
Debt to capitalization	37.7%	25.3%	2.5%
Days cash on hand	166.0	84.8	66.5
Cash to debt	118.6%	104.7%	831.8%
Days in A/R (net)	51.4	57.6	63.2

Note: Comparisons of net patient revenue, debt service coverage, and debt to cash flow are only computed on an annual basis.

UWP benchmark* comparisons

Ratio/indicator	Comparison Group	UWP
Gross Charges (\$M)	396.8	404.5
Net Collection Rate	90.2%	92.3%
Days in AR	52.6	49.1
AR>180 days	8.5%	8.0%
Denial Rate	10.2%	12.0%
% of Net Collections within 60 days	62.0%	79%
Commercial payer %	46.0%	45.2%

* Benchmark group is 15 similarly sized practice plans.

State funds: State appropriated funds allocated to the School of Medicine by the University.

Off-campus facilities ICR/RCR funds: Indirect cost recovery of off-campus facilities costs (ICR) and research cost recovery (RCR). These funds are assigned to the School of Medicine by UW Central Accounting, and then allocated to School of Medicine departments (including the Dean's Office). These funds may be carried forward from year to year. The ending balance of RCR funds represents funds available to departments but unspent at year end.

Endowment income is earnings on endowments available for spending (i.e. not re-invested in the endowment). Gifts are funds received from donors. Endowment income and gifts are used to fund School of Medicine operations, subject to any donor restrictions.

Self-sustaining programs provide goods or services to other entities, either within or outside of the UW. The responsible department establishes the rates for goods and services. The rates are adjusted annually to account for over-under recoveries in the previous period. Balances at year end are primarily operating reserves and excess recoveries that will be resolved during the subsequent year rate calculation. Self-sustaining programs include resident training, WWAMI, Comparative Medicine and other department programs.

Clearing/other: Clearing accounts are mainly used for transfers of funds from the practice plans to the SOM departments (e.g., fund transfers for physician salaries). The funds are credited first to the clearing account, and then an entry is processed to distribute the funds to the departments. Any balance in clearing accounts relates to timing. Agency accounts represent funds received and expended on an activity approved by the University, but the University does not provide the funds (e.g., when a faculty member is editor of a publication and incurs expenditures and reimbursement related to that activity).

Research and training funds are funds held on account in the UW accounting system (Dean's Office as well as department accounts). The source of funds is practice plan or affiliated entity transfers to the School of Medicine. The transfers are made for expense reimbursement, or to fund School of Medicine operations.

Grant and contract revenue is recognized only to the extent of current period expenditures. Grant revenues are typically expended by the end of the grant period (not necessarily the University's fiscal period). Grant revenues are credited in a method that may not match the actual spending pattern on the grant.

Endowments are the principal balance (at cost) of endowments held in the UW Central Endowment Fund (CEF), including contributions and re-invested earnings.

	FY05 <u>6/30/05</u>	FY06 <u>6/30/06</u>
Revenues	784,664	847,171
Expenditures	774,320	850,670
Revenues in excess of expenditures	10,344	(3,499)
Beginning fund balance	387,278	397,622
Ending fund balance	397,622	394,123
Unexpended grant and contract revenue	<u>413,902</u>	<u>378,273</u>

	FY05 <u>6/30/05</u>	FY06 <u>6/30/06</u>
State funds (Note 1)	54,450	55,044
Off Campus Facilities ICR/RCR (Note 2)	31,600	47,577
Endowment Income & Gifts:		
Restricted (Note 3)	27,380	24,755
Unrestricted	6,172	7,311
Self-Sustaining	94,256	97,322
Clearing & Other	45,469	50,831
Research & Training (Note 4)	67,114	67,763
Grants & Contracts (Note 5)	437,519	462,309
Endowment Principal (at cost)	20,704	34,259
Total Revenue	<u>784,664</u>	<u>847,171</u>

Notes:

Note 1: State appropriation revenue is assigned at the beginning of each biennium. Spending may vary from the 1st to the 2nd year of the biennium, but total spending must not exceed the biennial appropriation. In general, state appropriations are spent to zero by end of biennium. University policy allows some carry-forward of unspent balances from biennium to biennium on a limited basis. Revenues are recognized to the extent of expenditures for each reporting period, therefore the fund balance will be \$0 at the end of the reporting period. The change in spending of state funds from FY05 to FY06 is within the normal range of spending fluctuation from year to year.

Note 2: FY06 off-campus facilities ICR/RCR increased from FY05 to FY06 due to increase in RCR from UW Central and ICR earned on research at additional locations (mainly the Brotman Building).

Note 3: FY05 restricted revenue restated from 6/30/05 report, from \$7M to \$27M reflect \$20M transfer of funds from SOM to UW capital projects department in support of the construction of the Foegen Building. The transaction was recorded as a 'reverse revenue', this report reclassifies the transaction to an expense. This is consistent with FY06 treatment of Foegen Building construction costs.

Note 4: Research & Training revenue includes transfers from UWP and CUMG Clinical Medicine funds and hospital support to fund spending at the UW. Spending fluctuates from year to year by department, depending on availability of other fund sources.

Note 5: Grants and contracts revenue is recognized to the extent of expenditures, and spending fluctuates depending on awards received. Although NIH intends to slow the rate of increase in grants awarded in the future, the School of Medicine continues to show an increase in grant activity as a result of the addition of facilities (the Brotman Building, the Foegen Building), which provides additional research space.

	FY05	FY06
	<u>6/30/05</u>	<u>6/30/06</u>
Salary/benefits	436,230	462,115
Supplies and other exp (Note 2)	226,177	283,746
Equipment	19,652	13,242
Grants/stipends (Note 3)	9,962	12,395
Debt redemption (Note 4)	3,796	3,879
Indirect cost (Note 5)	96,305	97,470
Cost transfers (Note 6)	(17,802)	(22,177)
Total Expenditures (Note 1)	<u>774,320</u>	<u>850,670</u>

Notes:

Note 1: Some School of Medicine expenditures are recorded in hospital or practice plan income statements. Examples include hospital-based operations for the Department of Laboratory Medicine and resident salaries.

Note 2: Supplies expense includes \$20M in FY05 and \$51M in FY06 related to fund transfers to UW Capital Projects Department in support of the construction of the Foege Building. This report reclassifies the FY05 \$20M funds transfer from 'reverse revenue' to expenditure.

Note 3: FY06 grant/stipends expense increased as a result of the change in classification of Family Medicine resident capitation payments from supplies and other expense to grants/stipends.

Note 4: Increase in debt redemption from FY05 to FY06 is due to the Brotman Building debt service payments.

Note 5: Indirect cost: Grant revenues include a direct and indirect component. The indirect component is a percentage of direct costs (the rate varies among grantors). Individual grants are charged indirect cost, and the expense is offset by indirect cost revenue.

Note 6: Cost transfers. Nets out expenditures recorded in multiple entities within the School of Medicine.

	<u>FY05</u> <u>6/30/05</u>	<i>% of</i> <i>Total</i>	<u>FY06</u> <u>6/30/06</u>	<i>% of</i> <i>Total</i>
State funds (Note 1)	0		0	
Off Campus Facilities ICR/RCR (Note 2)	14,191	4%	15,593	4%
Endowment Income & Gifts:				
Restricted (Note 3)	116,285		71,684	
Unrestricted	12,180		14,390	
Total Endowment Income & Gifts	128,465	32%	86,074	22%
Self-Sustaining	17,047		18,737	
Clearing & Other	1,008		51	
Research & Training (Note 4)	21,439	5%	23,938	6%
Subtotal	182,150	46%	144,393	37%
Grants & Contracts (Note 5)	0		0	
Endowment Principal (at cost) (Note 6)	215,472	54%	249,730	63%
Ending Fund Balance (Note 7)	<u>397,622</u>	100%	<u>394,123</u>	100%

See notes on next page

Notes to ending fund balance as of 6/30/05 and 6/30/06:

Note 1: State appropriation revenue is assigned at the beginning of each biennium. Spending may vary from the 1st to the 2nd year of the biennium, but total spending does not exceed the biennial appropriation. In general, state appropriations are spent to zero by end of biennium. University policy allows some carryforward of unspent balances from biennium to biennium on a limited basis. Revenue is recognized to the extent of expenditures, therefore fund balance will be \$0 at the end of the reporting period. Note: Board Report issued last year included FY05 state funds ending balance of \$1.9M. Reporting methodology was modified in FY06. This report has been restated to decrease FY05 revenue and FY05 fund balance by \$1.9M. The funds were available to be spent in BI05 (FY06 and FY07), and will be recorded as expenditure during the reporting period they are actually spent.

Note 2: RCR revenue increased from FY05 to FY06; spending of RCR funds varies between time periods based on availability of other fund sources. RCR is used to fund facilities debt service and operations, as well as other operations expense.

Note 3: The ending balance of restricted gifts includes the Genome Sciences construction fund (\$54M at 6/30/05 and \$3M at 6/30/06). The \$45M decrease in restricted gifts ending fund balance from 6/30/05 to 6/30/06 includes a \$51M transfer to the UW capital projects department in support of the construction of the Foege Building.

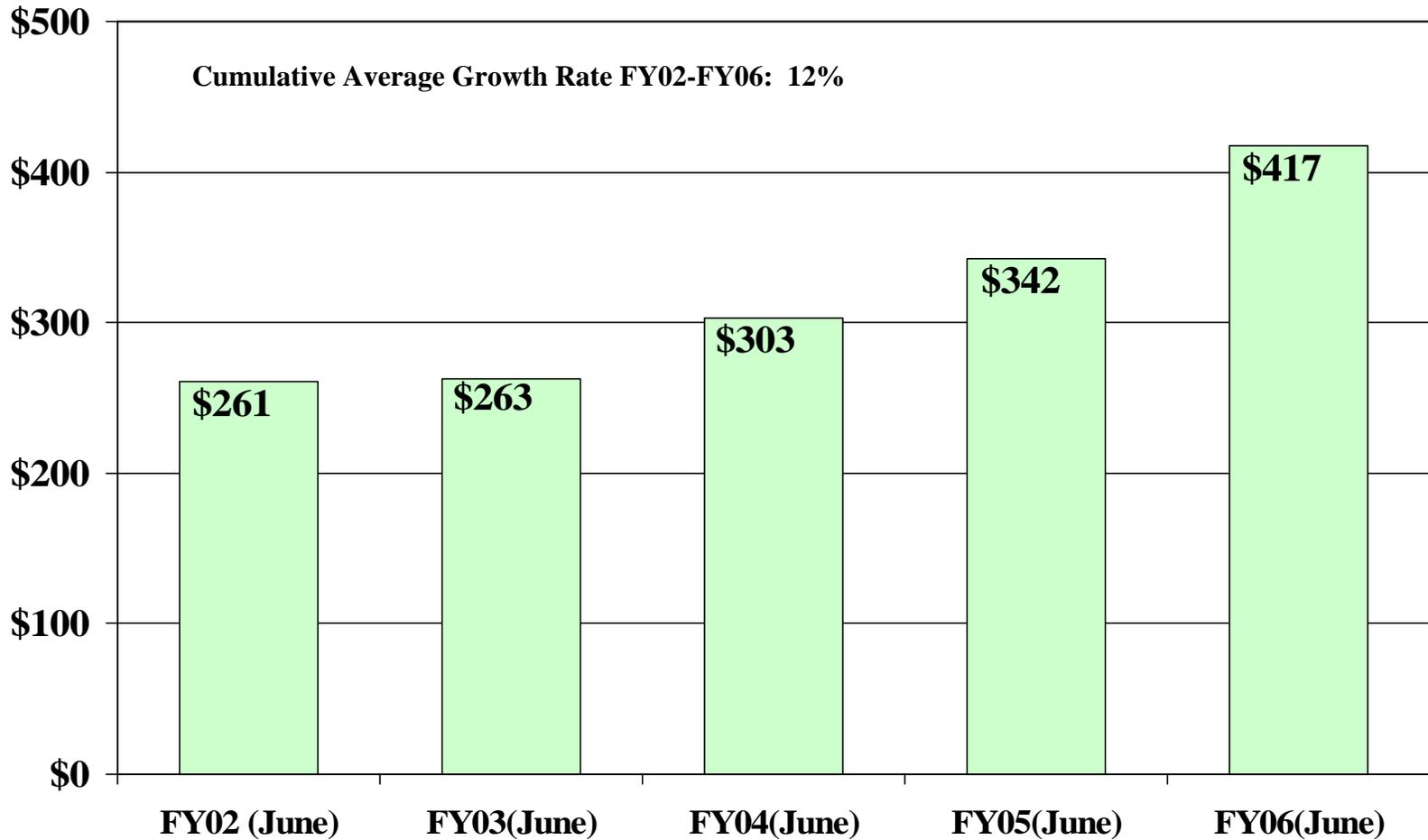
Note 4: Research and Training funds are funds held on account in the UW accounting system (Dean's Office as well as department accounts). The source of funds is practice plan or affiliated entity transfers to the School of Medicine. The transfers are made for expense reimbursement, or to fund School of Medicine operations. The majority of R&T funds are held at the practice plans (recorded as a liability by the practice plans) and are not included in this fund balance.

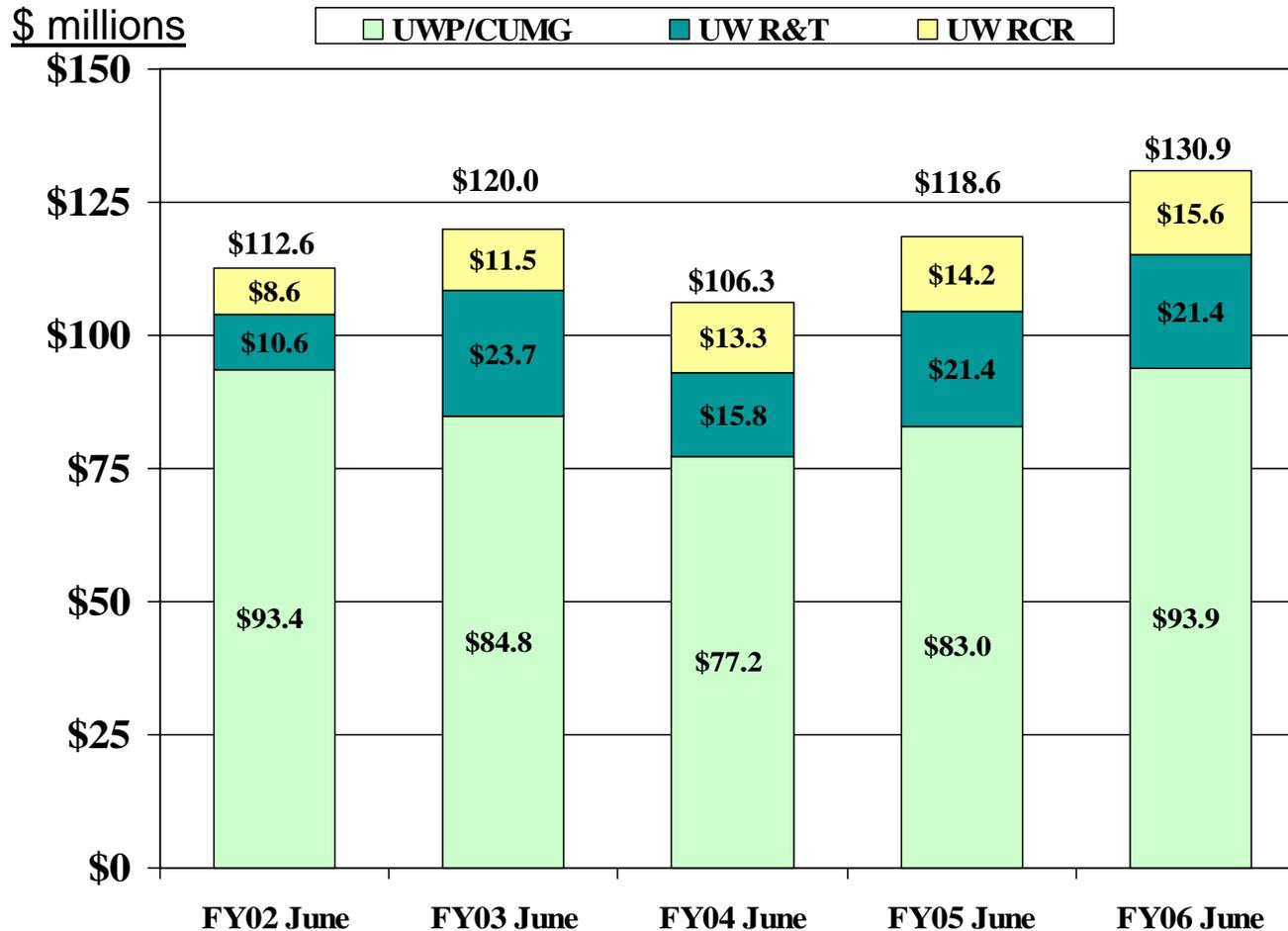
Note 5: Grant revenue is recognized to the extent of expenditures for each reporting period. As a result the ending fund balance is \$0. Unexpended grant and contract revenue is \$414M at 6/30/05 and \$378M at 6/30/06. The \$36M decline is due mainly to the spending down of large grants during the time period (\$20M in Department of Medicine due to HIV and ITEAC grants; \$10M in Biochemistry due to \$4M NCRR renovation grant and \$6M SPGG (Structural Genomes of Pathogenic Protozoa).

Note 6: Market value of endowments is \$342M at 6/30/05 and \$399M at 6/30/06. The increase includes additions to endowments as well as investment earnings.

Note 7: 6/30/05 ending fund balance decreased \$1.9M from \$399,547 on the June 2005 report to \$397,622 on the June 2006 report. The methodology for recognizing state appropriations in School of Medicine financial statements has been modified to recognize revenues as expenditures are made. The assignment of state funds from the UW Provost Office to the School of Medicine is permission to spend (a memo entry in the UW books), not recording of revenue. The \$1.9M from prior biennium was rolled forward as 'available to spend' in current biennium.

\$ millions





R&T funding is mainly clinical distributions, investment income and hospital support. Transfers from the practice plan reserves to the UW R&T accounts are made on a regular basis to fund research, training, and operational activities. UW R&T increased \$13M from FY02 to FY03 due mainly to \$6M hospital support and \$2M IME-DME reimbursement of expenditures. FY04 decrease due to federal billing investigation settlement costs. Balances can be carried forward from year to year, and spending can fluctuate depending on other available fund sources during the year. Source: UW-FIN data and UWP/CUMG reserve statements. Includes Dean's Office and all departments and UWP Lab Medicine and Hall Health payable.