

VALLEY MEDICAL CENTER FY 14 OPERATING AND CAPITAL BUDGETS

FF&A COMMITTEE

MAY 15, 2013

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FY13 RESULTS

- Net income from operations projected to be (\$17.9 million) at end of fiscal year.
 - \$10 million of the budget variance is attributed to the EPIC implementation
- Projection assumes break-even net income from operations for April-June, 2013.
- Operating margin loss projected at (4.1%).
- Volumes were stronger in first half of fiscal year 2013.
 - Third quarter, in particular, experienced less than budgeted volumes in nearly all inpatient and outpatient areas.

CHALLENGES IN ECONOMIC ENVIRONMENT MOVING INTO FY14

- Operating performance in FY2013 set the baseline for the FY14 Budget
- Federal Issues
 - Continued economic weakness
 - Sequestration, or its replacement as future budgets are proposed
- State Issues
 - Continued economic weakness
 - Budget shortfall for FY14-16 biennium
- Commercial Payor issues
 - Downward pressure on payment rates
 - Interest in risk sharing
- Health Care Exchanges – January 1, 2014

FY14 – INVESTING IN OUR FUTURE

Strategically, FY14 will be a year of positioning the medical center and the entire UW Medicine system for the future. Included in those plans are:

- ACO readiness planning including organizational focus on the IHI “triple aim”
- Leveraging Patients are First structure – patient experience, quality and fiscal responsibility
- IT Services investments including a common IT front-end, maximizing meaningful use incentive dollars and ICD-10
- Strategic clinical access investments such as Covington Clinic South, Maple Valley Clinic, the expansion of specialty physician practices in oncology, urology, women’s surgical specialties, and neurology; and other strategic investments in key service lines.
- Emphasis on Performance Improvement

FY 14 - INVESTING IN OUR FUTURE - ACO

Desirable Characteristics of an ACO:

- Sufficient size.
- Geographic distribution to meet the needs of the population served.
- Robust information technology platform
 - Supports the coordination of evidence-based healthcare
 - Provides sophisticated clinical, operational, and financial decision-making

*Source: Ramsey, Paul “The ABC’s of Accountable Care”
PSBJ, July 27, 2012*

FY14 – INVESTING IN OUR FUTURE

Desirable Characteristics of an ACO:

- Standardization of care protocols based on evidence-based research.
- Financial ability to enter into risk arrangements.
- Capability to manage financial risk proactively.
- Governance arrangements to align hospital and physician interests.
- Management systems to coordinate care across a continuum of healthcare settings.
- A “medical home” model that supports patients with chronic conditions on a routine and individualized basis to ensure high-quality, efficient and cost-effective care.

*Source: Ramsey, Paul “The ABC’s of Accountable Care”
PSBJ, July 27, 2012*

FY14 - INVESTMENTS IN OUR FUTURE - IT

The FY14 budget includes significant investments for IT Services that will better position UW Medicine for Meaningful Use requirements, including:

- Clinical Applications in preparation of ICD-10
- EPIC e-Connect, offering EPIC to external physician practices
- Upgrading EPIC
- Infrastructure

FY14 – INVESTING IN THE FUTURE - ACCESS

Significant work has been done to work across the system and at the medical center to ensure the right services are being developed and provided at the right site.

At VMC, strategic focus in FY14 will be around building volumes related to oncology, urology, neurology, surgery, and primary care.

Investments in facilities, infrastructure, information technology, and equipment are budgeted within the capital budget for \$18.9 million (including \$1.0 million for carryover for Covington South).

FY14 BUDGET ASSUMPTIONS

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FY14 BUDGET

The FY14 budget goal is a 0% operating margin or \$9k, with total margin (loss) of (.1%) or (\$241k.)

In support of the budget, the FY14 financial operating priorities are:

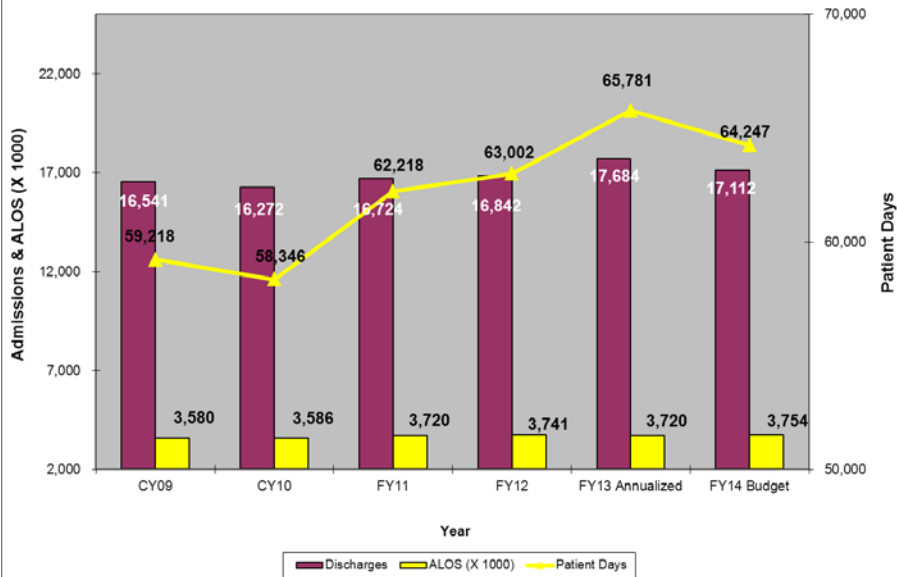
- Achieve operating initiatives focused on:
 - Volume & throughput focused on strategic growth initiatives
 - Net revenue enhancement
 - Productivity improvements
 - Salary, wage and benefit management
 - Overall expense reduction
 - Significant investments aimed at better positioning the organization for FY15 and beyond

FINANCIAL PLAN COMPARISON

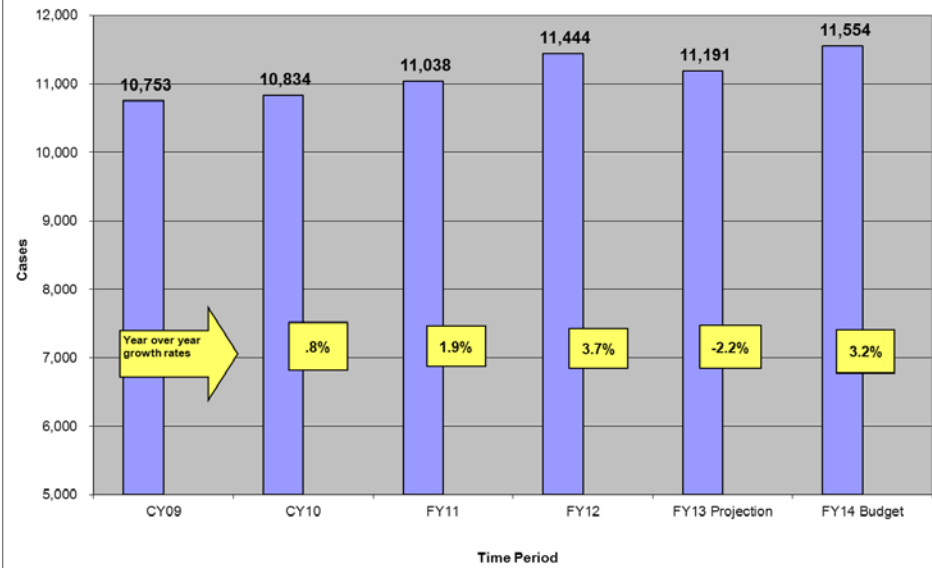
	<u>FY14 Budget</u>	<u>Financial Plan for FY14</u>
Net Patient Revenue Growth	8.4%	12.2%
FTEs per Adjusted Occupied Bed	6.95	6.64
FTEs	2,469	2,481
Salaries and Benefits as a % of Total Net Revenue	59.5%	60.8%
Supply Expense as a % of Total Net Revenue	13.2%	13.2%
Operating Margin	0.0%	2.3%
Total Margin	-0.1%	3.0%
Operating Expense per CMI Adjusted Admission*	9,810	10,183
<p>(1) Financial plan did not consider restructure of radiology joint venture. Impact of restructure on FTEs is 34 with a FTE/AOB impact of 6.86.</p> <p>* Casemix index (CMI) in financial plan - 1.32; CMI in FY14 budget - 1.37</p>		

PROJECTED VOLUME GROWTH

Volume Trends - Inpatient



Trended Surgical Cases



- Existing baseline inpatient admissions are projected to decrease 3% in FY14 and then increase 1% per year annually thereafter. Outpatient visits are projected to grow at 1% annually.
- Surgical case volumes are projected to grow at 2% based on work done to project volumes by surgeon.
- The slight volume decrease in inpatient admissions is assumed due to several external physician groups moving their births and related surgeries to another facility.
- Incremental outpatient volume is assumed to increase due primarily to expansion of the specialty clinics within the clinic network.

NET REVENUE ASSUMPTIONS

- Constraints on reimbursement by all payers are creating challenges in generating significant margins across the system.
- Overall price increase of 6%
- Reimbursement impacts by payer have been incorporated as follows:
 - Medicare – sequestration impacts offset by market basket increases. Net impact is close to zero.
 - Medicaid – 4% decrease
 - Commercial – nominal increases based on contracts that are currently in place
 - Unknown payment level for the healthcare exchanges commencing January 1, 2014

EXPENSE ASSUMPTIONS

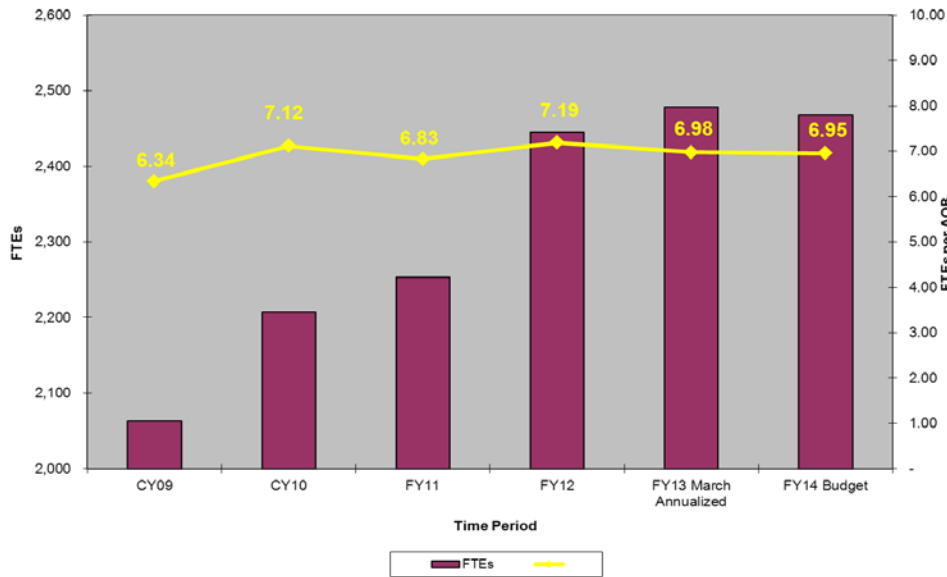
Inflation factors for all expenses are below.

	Budget 2014
Salary Increase %	
Classified Staff	3.0%
Professional Staff	2.5%
Management	2.0%
Hourly Staff/Premium Pay	4.0%
Supply Expense Increase %	
Medical Supplies	2% - 4%
Pharmaceuticals	5.0%
Other Supplies	2.0%

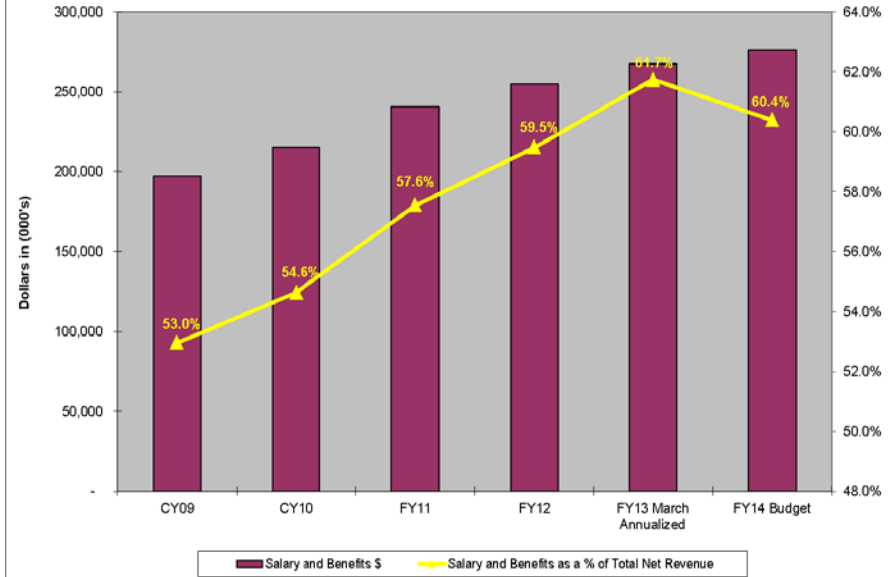
After inflation factors were applied, concentrated work on reducing costs was done. A number of areas came up with innovative ideas in cost reductions and improved efficiencies.

LABOR EXPENSE TRENDING

FTE Trending

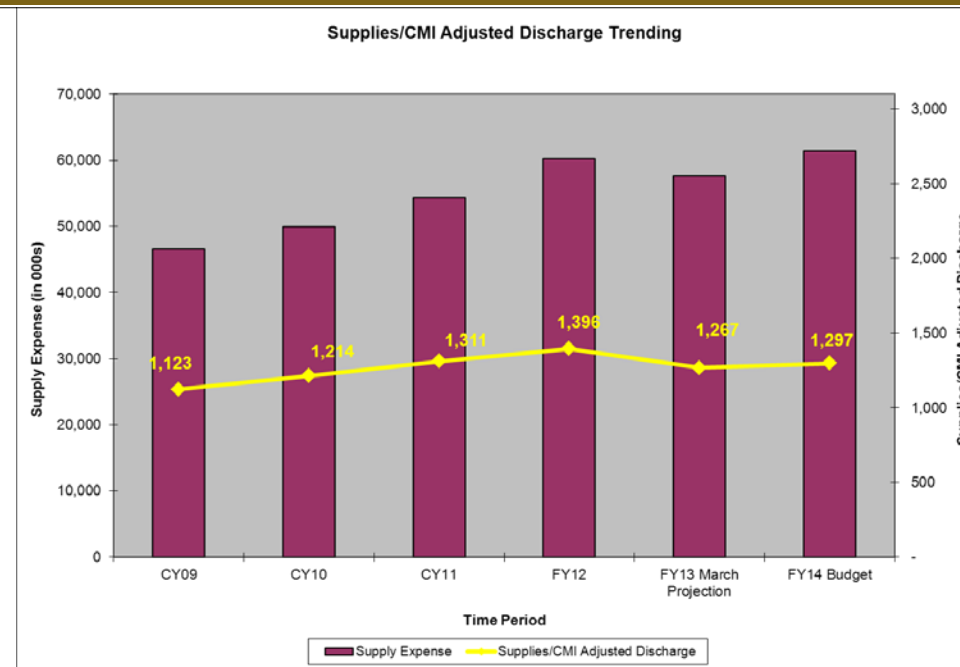
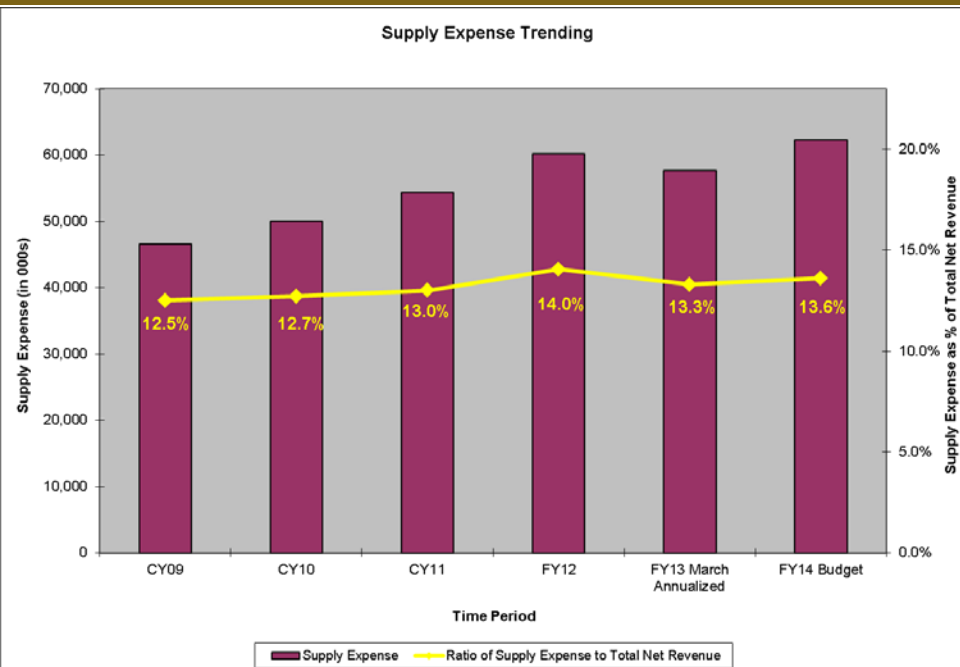


Salary & Benefits as % of Total Net Revenue



- The FY14 budget assumes FTE reductions in ongoing hospital operational areas, while providing for FTE increases in radiology and cardiology expansion and increases due to new physician programs and growth in specialty care (physicians not previously employed by VMC).
- Average salary inflation of 3% was included beginning July 1, 2013

SUPPLY EXPENSE



- While inpatient hospital services are predicted to remain fairly flat, new outpatient hospital services, along with expansion in the clinic network dictate increased supply needs for FY 2014;
- Scheduled lease buyouts are necessary to retain existing equipment; and
- With house-wide expense reduction initiatives in place over the last couple of years, minor equipment replacements have been put on hold. FY 2014 departmental budgets reflect true replacement needs in order to maintain basic levels of operation.

ALLOCATIONS AND OTHER EXPENSES

There are a number of allocations and system related expenses that have been included in the budget. Total allocations total \$2.2 million for FY14.

- UW Medicine Central Budgets
 - Compliance, Advancement, Patients Are First, Financial Services, ICD-10, Risk Management, Administration, Contracting, Internal Audit, Select Dues

PERFORMANCE IMPROVEMENT INITIATIVES

Included in the FY14 Operating Budget are the following performance improvement initiatives:

- Net Revenue initiatives of \$10.7 million for continued revenue enhancements due to improved charge capture, denials management, contract management and point of service cash collections.
- Other initiatives of \$9.2 million focusing on supply chain, transformation of care, and modification of benefits.
- These initiatives will be tracked, measured and reported out on a monthly basis throughout FY14.

NON-OPERATING REVENUE (EXPENSES)

- Non-operating revenue and expenses include the following:
 - Tax revenues of \$15.9 million
 - Investment income at 1.0% on average.
 - Interest and amortization on outstanding LTGO debt issues of \$19.0 million
 - Medical Office Building income and expense

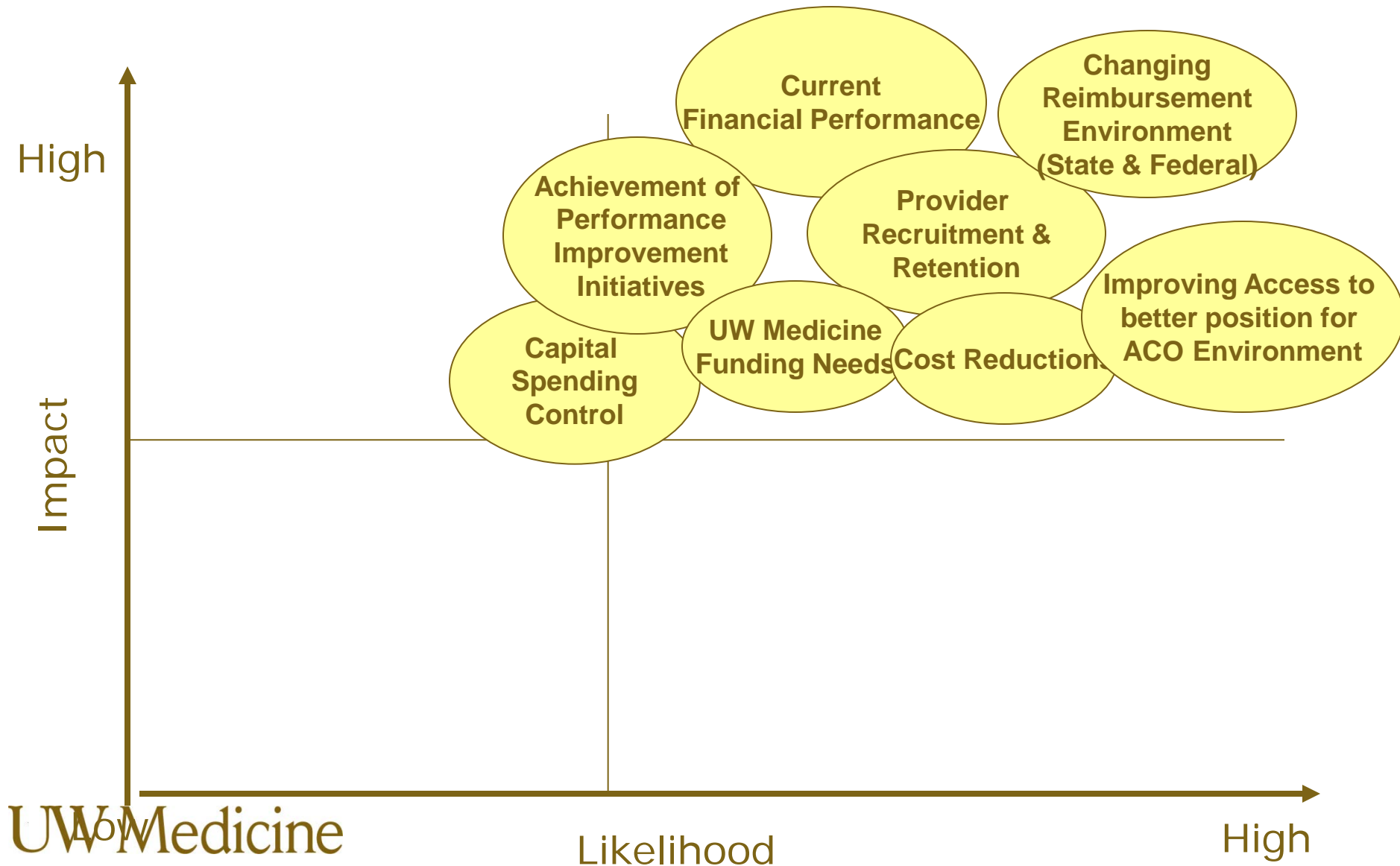
FY13 YTD MARCH VS. FY14 BUDGET

March 2013 Projected Operating Income (Dollars in 000s)	\$ (17,858)
Revenue	
Volume Increases (Net Revenue Impact)	12,086
Commercial Contract Changes & Price Increases (Net Revenue Impact)	5,893
Net Revenue Performance Improvements	12,184
Other Revenue Changes	(6,986)
Payor Mix Degradation	-
Total Revenue	23,177
Salary & Benefits	
Benefit and Salary Inflation	(8,028)
Increase and/or Changes in FTEs	1,575
Performance Improvements	5,400
Total Salary & Benefits	(6,453)
Non-Salary Expense	
Medical Supplies and Drug Expenses	(1,579)
Purchased Services and Other	1,357
Performance Improvements	2,298
Total Non-Salary Expense	2,076
Capital Expenses	
Depreciation	(933)
Total Capital Expenses	(933)
2014 Budgeted Operating Margin	\$ 9

FY14 OPERATING BUDGET SUMMARY

(in 000s)					% Change YTD
	CY11 Audited	FY12 Audited*	March FY13 Projected	FY14 Budget	Actual vs. Budget
Total Patient Revenue	\$ 1,137,989	\$ 1,192,078	\$ 1,241,793	\$ 1,359,838	9.5%
Total Deductions	(738,932)	(786,462)	(834,520)	(918,181)	10.0%
	64.9%	66.0%	67.2%	67.5%	0.5%
Net Patient Revenue	399,057	405,616	407,273	441,657	8.4%
Other Revenue	18,891	22,958	26,174	22,186	-15.2%
Total Net Revenue	417,948	428,574	433,447	463,843	7.0%
Expenses					
Salaries, Wages & Benefits	240,551	254,898	267,610	276,063	3.2%
Supplies and Other	140,128	149,825	150,581	153,724	2.1%
Depreciation	31,799	32,529	33,114	34,047	2.8%
Total Expenses	412,478	437,252	451,305	463,834	2.8%
Income from Operations	\$ 5,470	\$ (8,678)	\$ (17,858)	\$ 9	-100.1%
Operating Margin	1.3%	-2.0%	-4.1%	0.0%	-100.0%
Nonoperating Income (Expense)	7,067	3,471	1,386	(251)	-118.1%
NET INCOME	\$ 12,537	\$ (5,207)	\$ (16,472)	\$ (242)	-98.5%
Audited figures for CY09 and CY10 omitted as tax revenues and related debt were all classified as operating (they are now non-operating)					
* fiscal year ended changed to 6/30 as of 6/30/12; prior years are on 12/31 year-end					

FY14 BUDGET PLAN RISKS

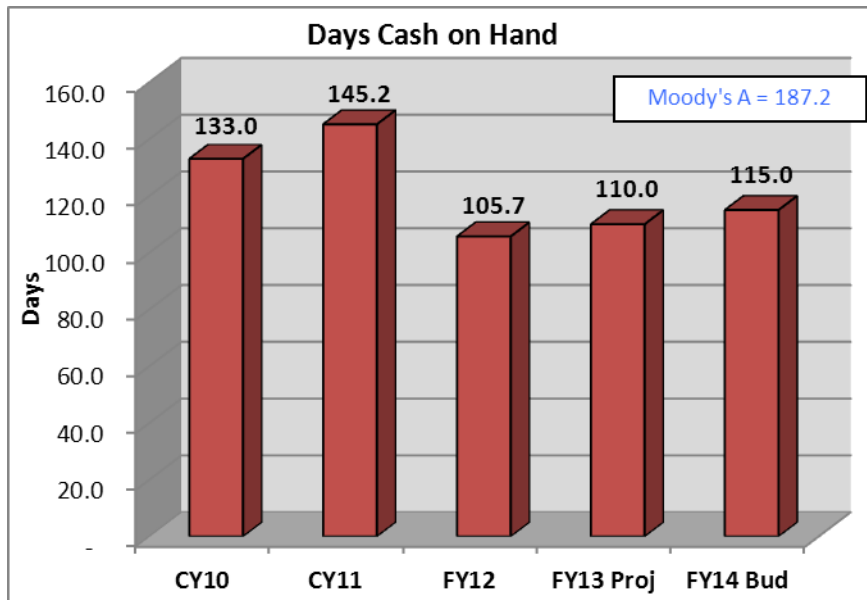


FY14 CAPITAL BUDGET

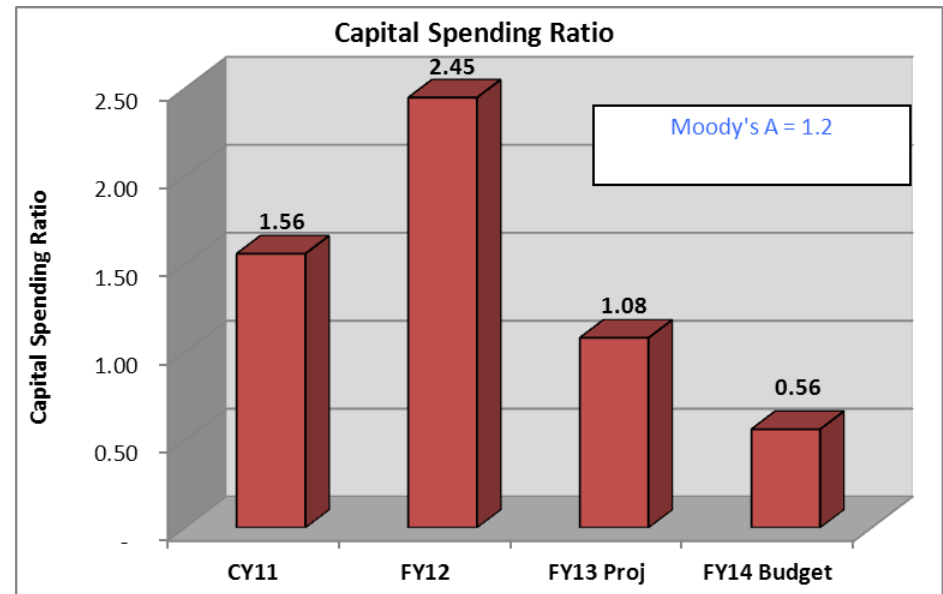
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KEY CAPITAL RATIOS

- Capital investment levels are evaluated based on comparison to key industry ratios and benchmarks, as well as margin targets
- Historical values for key ratios and benchmarks are as shown:



Days Cash = Cash / (Operating Expense – Depreciation) / 365



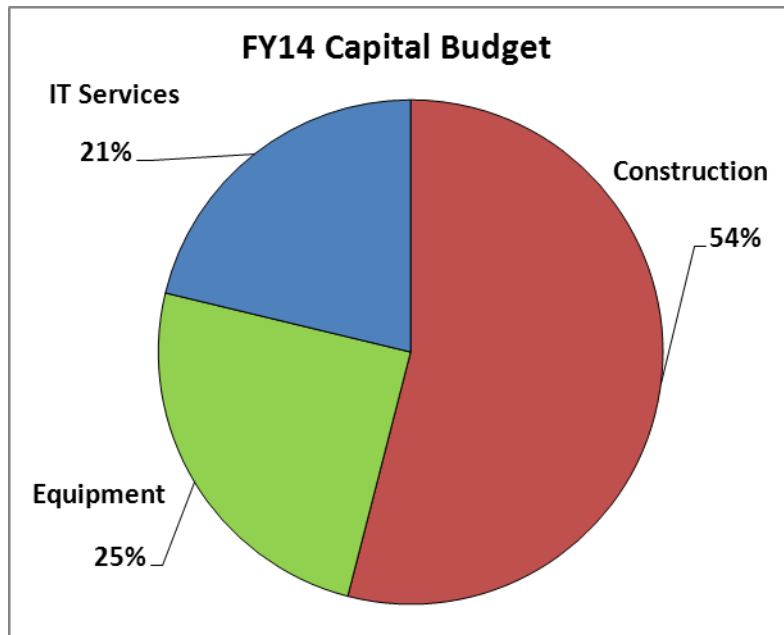
Ratio of Capital Expenditures to Depreciation Expense

CAPITAL BUDGET HISTORY

- VMC's capital history reflects block funding for 3 major areas:
 - Construction
 - Equipment
 - IT Services

Capital History and Projection (\$ in 000s)	CY10	CY11	CY12	FY13	FY14
Construction	34,851	26,811	32,825	14,900	8,105
Equipment	2,885	6,081	5,207	2,463	3,714
IT Services	8,444	39,515	29,084	18,376	3,187
Core Capital Budget	46,180	72,407	67,116	35,739	15,006

FY2014 CAPITAL BUDGET OVERVIEW



- VMC proposes a \$14.0 million core capital budget for FY14 with \$1.0 million carryover for Covington South (total \$15.0 million).
- Significant projects include
 - Maple Valley clinic
 - Infrastructure upgrades
 - IT ICD-10 initiatives and upgrades to ancillary systems
 - Equipment for new programs/growth
 - Equipment purchases on expiring leases

FY14 VMC CAPITAL BUDGET DETAIL

- Capital funding targets have been established within functional areas of the hospital as shown
- Capital project requests will be managed and approved within these target amounts

Categories	FY2014 Target Amount
<u>Original Allocation</u>	
Construction	8,104,608
Equipment	4,827,714
IT Services	5,967,678
Subtotal, VMC	18,900,000
<u>Transfer to FY2013 Capital *</u>	
Construction	-
Equipment	(1,113,296)
IT Services	(2,780,757)
Subtotal transferred to FY13	(3,894,053)
TOTAL, FY14 CAPITAL FUNDING	15,005,947

* Transfer of FY2014 funding to FY2013 due to timing of project completion

REQUEST FOR APPROVALS

- Management recommends approval of the FY14 operating budget of \$9 thousand, which represents a 0.0% operating margin and (\$241 thousand) or (0.1%) in total income.
- Management recommends approval of the FY14 capital budget of \$17.9 million, with \$1 million in carryover for the Covington South (total of \$18.9 million).