Executive Board Committee Memorandum

Board of Regents, State of Iowa

Subject: FY 2005 Hospitals and Clinics Operating Budget Issues and Proposed Rate Increases

Prepared by: Deb A. Hendrickson

Date Submitted: May 10, 2004

Recommended Action:

Recommend that the Board approve a 9.5% rate increase, effective July 1, 2004, for the University of Iowa Hospitals and Clinics, Psychiatric Hospital, and the Center for Disabilities and Development.

Executive Summary:

Budget Issues
The University will provide a brief review of key operating indicators for FY 2004 and a review of the budget issues for FY 2005.

Proposed Rate Increase
The University is proposing a rate increase of 9.5% for patient services for UIHC, the Psychiatric Hospital, and the Center for Disabilities and Development. This increase is the same percentage increase that was approved by the Board for this fiscal year.

The University’s supporting data for the increase includes:

- A 9.5% rate increase translates to less than 1.5% actual increase in net patient revenue.
- UIHC continues to lag academic medical center peers and historical state-wide rate increases.
- University HealthSystem Consortium members (UHC) anticipate rate increases in the 7-20% range, averaging greater than 10%.

The University has provided further information regarding this rate increase beginning in section 3, page 25 of the attachment.

UIHC FY 2003 Audit
The UIHC FY 2003 audit is presented this month to the Audit Committee (AUD 4).

The audit indicated that the financial statements present fairly, in all material respects, the financial position of UIHC as of June 30, 2003 and 2002 and the changes in its net assets and its cash flows for the years then ended.

No significant audit adjustments or findings were reported.
Agenda

Brief review of key operating indicators for FY 2004

Review budget issues for FY 2005

Approval of gross charge increase for FY 2005
Summary of FY 2004 Operating Indicators

UIHC has experienced increased inpatient and outpatient volumes

Market share has continued to grow in both the State and primary service area

The acuity of the patients served remains relatively high

Length of stay has dropped by .31 days, which has a positive economic effect on UIHC

Increased nurse recruitment and retention has led to lower agency utilization

Patient billing system is stabilizing

Projected to finish FY 2004 with a 1.6% Operating Margin or $9.95 million
# Six Year Summary of Operations

<table>
<thead>
<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Acute Admissions</strong></td>
<td>23,399</td>
<td>23,179</td>
<td>23,286</td>
<td>23,386</td>
<td>24,104</td>
<td>19,062</td>
<td>25,574</td>
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<tr>
<td><strong>Length of Stay</strong></td>
<td>7.34</td>
<td>7.48</td>
<td>7.51</td>
<td>7.59</td>
<td>7.24</td>
<td>6.93</td>
<td>6.93</td>
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<tr>
<td>Surgical Cases</td>
<td>17,537</td>
<td>18,217</td>
<td>18,986</td>
<td>19,814</td>
<td>20,269</td>
<td>15,352</td>
<td>20,621</td>
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<tr>
<td>Clinic Visits</td>
<td>545,496</td>
<td>570,065</td>
<td>592,752</td>
<td>615,242</td>
<td>631,443</td>
<td>490,662</td>
<td>653,688</td>
</tr>
<tr>
<td>Market Share</td>
<td>6.3%</td>
<td>6.1%</td>
<td>6.1%</td>
<td>6.2%</td>
<td>6.7%</td>
<td>N/A</td>
<td>N/A</td>
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<tr>
<td>Net Patient Revenue</td>
<td>$432.7M</td>
<td>$457.1M</td>
<td>$506.9M</td>
<td>$525.2M</td>
<td>$547.2M</td>
<td>$418.3M</td>
<td>$590.4M</td>
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<tr>
<td>Operating Margin</td>
<td>5.8%</td>
<td>5.1%</td>
<td>3.6%</td>
<td>2.0%</td>
<td>1.4%</td>
<td>1.1%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Case Mix Index*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>All Acute Inpatients</td>
<td>1.5586</td>
<td>1.5569</td>
<td>1.5712</td>
<td>1.5866</td>
<td>1.6272</td>
<td>1.5983</td>
<td>1.5993</td>
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<tr>
<td>Medicare Inpatients</td>
<td>1.7243</td>
<td>1.7414</td>
<td>1.7778</td>
<td>1.7602</td>
<td>1.8182</td>
<td>1.7844</td>
<td>1.7814</td>
</tr>
</tbody>
</table>

*Case mix index is a national (Medicare) measure of inpatient severity, where the average case intensity is 1.0
** All years presented excludes newborn nursery utilization.
### Aa Bond Rating Key Financial Ratio Comparison

<table>
<thead>
<tr>
<th></th>
<th>Audited UIHC FY 1999</th>
<th>Audited UIHC FY 2000</th>
<th>Audited UIHC FY 2001</th>
<th>Audited UIHC FY 2002</th>
<th>Audited UIHC FY 2003</th>
<th>UIHC Mar 04 YTD</th>
<th>UIHC FY 04 Projected</th>
<th>Median Moody's Aa Rating*</th>
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</thead>
<tbody>
<tr>
<td>Days Cash on Hand</td>
<td>252.5</td>
<td>257.2</td>
<td>244.1</td>
<td>239.4</td>
<td>221.1</td>
<td>218.0</td>
<td>220.0</td>
<td>219.8</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>6.0%</td>
<td>5.3%</td>
<td>3.6%</td>
<td>2.0%</td>
<td>1.4%</td>
<td>1.1%</td>
<td>1.6%</td>
<td>2.5%</td>
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<tr>
<td>Debt to Capitalization Percent</td>
<td>2.3%</td>
<td>2.6%</td>
<td>2.1%</td>
<td>1.6%</td>
<td>4.3%</td>
<td>4.0%</td>
<td>4.5%</td>
<td>34.3%</td>
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<tr>
<td>Days in Accounts Receivable</td>
<td>76.7</td>
<td>79.1</td>
<td>69.1</td>
<td>67.3</td>
<td>101.3</td>
<td>77.9</td>
<td>75.0</td>
<td>62.2</td>
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<tr>
<td>Average Age of Plant</td>
<td>9.9</td>
<td>9.0</td>
<td>7.9</td>
<td>8.9</td>
<td>9.0</td>
<td>9.5</td>
<td>9.0</td>
<td>8.8</td>
</tr>
</tbody>
</table>

*Data is compiled from Moody's Investors Service publication "Not for Profit Healthcare: 2003 Outlook and Medians."
FY 2005 Operating Budget Assumptions

Revenues

Volume growth
  Inpatient admissions 3.5% increase
  Outpatient visits 5.0% increase
Revenue growth per unit of service 3.0%
Reduction in length of stay ½ day
Bad debts @ 3.0% of charges
Payer mix stable
State appropriation the same with no increase
Medicare prescription drug act
  Potential for drug cost inflation
FY 2005 Operating Budget Assumptions

Costs

- Salary & fringe benefit increases 4% - 6%
- Agency Expense No increase in agency utilization
- Length of Stay decreases by 0.5 day
- Supply Chain
- Unfunded regulatory mandates (patient safety & emergency preparedness)
- Recruitment and retention of quality patient care staff
- Inflationary increases in drug & medical supplies / implants 4% - 10%
- Utilities 6% - 10% increase
Patient Revenues per Unit of Service

Net Patient Revenue** per Adjusted Discharge

* Benchmark is the 50th percentile of the University Health System Consortium for the two quarter ending Dec 2003.
** Net paying patient revenue plus chapter 255 state indigent patient care program appropriation receipts.
Gross Patient Charges By Primary Payor

- Medicare, 29%
- Wellmark, 25%
- Commercial, 18%
- State, 6%
- Self Pay & Other, 8%

Year to Date March, 2004
STATE APPROPRIATIONS
Actual Dollars - Combined Hospital Units

<table>
<thead>
<tr>
<th>INDIGENT PATIENTS SERVED</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
</tr>
<tr>
<td>36,894</td>
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</table>

$50,000,000
$45,153,985
$46,771,838
$47,984,685
$46,939,640
$44,556,608
$43,000,911
$40,690,305

$40,000,000
$6,486,882
$6,991,199
$7,268,512
$7,487,966
$6,883,963
$6,724,505
$6,363,265

$30,000,000
$7,701,795
$7,968,076
$8,300,258
$8,411,522
$8,777,169
$7,442,897
$7,943,066

$20,000,000
$30,965,308
$31,813,509
$32,515,915
$33,040,152
$29,995,478
$28,833,519
$27,284,584

$10,000,000
$0

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<td>$0</td>
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<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>

☐ UH - State Appropriation for Indigent Patient Care
☐ PH - State Appropriation for Psychiatric Hospital
☐ CDD - State Appropriation for Center for Disabilities and Development
FY 2005 Revenue Plan

Focused Revenue Growth

- Capital prioritization process targets 20% return on investment
- Focused business plans for Cardiovascular, Neurosurgery, Orthopedic and Oncology service lines
- Addition of two new operating rooms, extended hours
- Opening of Radiation Oncology Center of Excellence
- Opening of new "world class" Labor and Delivery, Neonatal ICU, and Pediatric ICU
- Expansion of eight Surgical Intensive Care Unit beds; four Intermediate Pulmonary Care Unit beds
- Addition of eight telemetry beds
- Investment in Radiology will provide state-of-art technologies and increase throughput
FY 2005 Revenue Plan

Cash Acceleration and Revenue Cycle Redesign

Projects Underway with the assistance of First Consulting Group (FCG)

Outsource Vendor Strategy

Documentation Accuracy/ Coding with 3M

Insurance Verification/ Authorization

Addition of Health Benefit Advisors

Upfront Cash Collections

Review of Charge Master

Managed Care Underpayments

Development of Revenue Integrity Department

Focused efforts in Managed Care Contracting Strategy
Operating Cost per Unit of Service

Cost per Adjusted Discharge

- FY 2001: $14,385
- FY 2002: $14,741
- FY 2003: $14,727
- Proj FY 2004: $14,887
- UHC* 50th percentile: $12,837

* Benchmark is the 50th percentile of the University Health System Consortium for the quarter ended Dec. 2003.
Operating Costs per Unit of Service

Hours Paid per Adjusted Discharge

* Benchmark is the 50th percentile of the University Health System Consortium for the four quarters ending Dec 2003.
Reducing Agency Staff Use

Total Monthly Agency Staff FTE’s

FY 2002 - 2004

Full Time Equivalents (FTE’s)

July August September October November December January February March April May June

159 160 187 194 202 168 166 186 192 176 170 152
138 146 174 166 166 171 157 145 146 140 131
129 129 125 101 98 79 74 67 59

FY2002  FY2003  FY2004
Aggregate Fringe Benefit Costs as a Percent of Salary Dollar

Iowa Hospitals Data Bank, 2003
Median for University HealthSystem Consortium (UHC) hospitals reporting to ACTION OI for 2003.
Operating Costs per Unit of Service

Supply Cost per Adjusted Discharge

* Benchmark is the 50th percentile of the University Health System Consortium for the two quarters ending Dec 2003.
FY 2005 Expense Plan

Programmatic Reviews

Comprehensive review of programs that are not central to UIHC Mission

Development of accountability-based Medical Directorships

Review of Cost Sharing between UIHC and CCOM with focus on key performance indicators and accountability

Review of operations with opportunities for consolidation and shared staffing

Increasing throughput in all clinical areas with focused efforts on the Operating Rooms and Radiology

Utilization management in laboratory, pharmacy and respiratory services
FY 2005 Expense Plan

Expense Management

Productivity Based Labor Budgeting
- Staff-hour per Unit of Service
- Requiring performance at or above peer-group benchmarks
- Monthly/quarterly operations reviews

Agency utilization reduced from 132 FTE's at June 2003 to 59 at March 2004. Nursing leadership developing optimal flex staffing model

Intense Supply Chain management process underway
- Pricing initiative through University Health Consortium/Novation
- Vendor Consolidation
- Product standardization
- Right product/right patient
- Physician-driven utilization management
FY 2005 Expense Plan

Length of Stay Management

UIHC acute length of stay is at 6.93 days versus benchmark of 5.98 days

Continuum of Care Management and "Navigator Program" developed and has demonstrated improvement of .31 days YTD. Expansion of program underway

New Bed Placement Center opened to facilitate bed transfers and referrals

Peer comparison of physicians within clinical specialties

Development of clinical pathways
Combined Hospitals Sources and Uses of FY05 Proposed Budget

Net Patient Revenue
$600,707,313
88.4%

Other Operating Revenue
$38,056,440
5.6%

State Appropriation
$40,690,500
6.0%

Utilities and Repairs
$28,260,535
4.2%

Margin Reserve
$20,601,416
3.0%

Medical Supplies and Services
$277,156,252
40.8%

Staffing Costs
$353,434,050
52.0%

TOTAL = $679,454,253

TOTAL = $679,454,253
UIHC Cost Structure
FY 2005 Proposed Budget

Staffing 52.0%

Utilities, Maintenance & Purchased Services 15.4%
Deprec. Interest 7.5%
Pharmacy & Supplies 22.0%
Margins Reserve 3.0%
Residents 5.6%
Professional & Other 23.4%
AFSCME / Clerical & Maintenance 30.7%
SEIU / Nursing & Patient Care 40.3%

Staffing costs comprise over half of UIHC expenses; the majority of dollars spent are for staff covered by bargaining unit.
Operating Margin Comparisons

* Iowa Hospital Association Annual Report and DATABANK reports.
** Annual COTH Survey of Hospitals’ Financial and General Operating Data.
University of Iowa Hospitals and Clinics
FY 2005 Preliminary Capital Expenditure Budget

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
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<tbody>
<tr>
<td>EBDITA for capital</td>
<td>51,387,000</td>
<td>61,000,000</td>
<td>40,000,000</td>
</tr>
<tr>
<td>Proceeds of future bond issues</td>
<td>-</td>
<td>25,000,000</td>
<td>50,000,000</td>
</tr>
<tr>
<td>Use of Improvement funds</td>
<td>28,703,000</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Aggregate Rate Increase History

Source: Iowa Hospital Association Database based on average inpatient charges per patient day
Why 9.5% rate increase?

9.5% rate increase translates to less than 1.5% actual increase in net patient revenue

UIHC continues to lag academic medical center peers and historical state-wide rate increases

University HealthSystem Consortium members (UHC) anticipate rate increases in 7-20% range, averaging greater than 10%
Projected Percentage Net Price Increases at Alternate Gross Price Increases

* A 9.5% increase will generate $95.3M in gross charges and $14.8M in net revenue
Midwest Academic Medical Centers
Case Mix Adjusted Charges per Discharge CY 2003

Source: University Healthsystem Consortium, case mix adjusted average charges per inpatient stay
## UHC Peer Comparison
### Average Charges per Discharge

<table>
<thead>
<tr>
<th></th>
<th>All UHC Members</th>
<th>Midwest Members</th>
<th>Sole AHC in Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum 25th</td>
<td>$8,200</td>
<td>$14,263</td>
<td>$12,317</td>
</tr>
<tr>
<td>Percentile</td>
<td>$13,057</td>
<td>$15,271</td>
<td>$14,181</td>
</tr>
<tr>
<td>Median 75th</td>
<td>$15,927</td>
<td>$17,152</td>
<td>$14,947</td>
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<tr>
<td>Percentile</td>
<td>$21,495</td>
<td>$19,419</td>
<td>$17,046</td>
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<tr>
<td>Maximum</td>
<td>$51,184</td>
<td>$26,882</td>
<td>$20,567</td>
</tr>
</tbody>
</table>

**UIHC Average Charges per Discharge**

$14,947

**Iowa %tile**

44%  18%  50%

Source: University Healthsystem Consortium, case mix adjusted data
<table>
<thead>
<tr>
<th></th>
<th>All UHC Members</th>
<th>Midwest Members</th>
<th>Sole AHC in Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum 25th</td>
<td>$1,595</td>
<td>$2,039</td>
<td>$1,879</td>
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<tr>
<td>Percentile</td>
<td>$2,251</td>
<td>$2,544</td>
<td>$2,295</td>
</tr>
<tr>
<td>Median 75th</td>
<td>$2,759</td>
<td>$3,127</td>
<td>$2,629</td>
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<tr>
<td>Percentile</td>
<td>$3,629</td>
<td>$3,546</td>
<td>$2,954</td>
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<tr>
<td>Maximum</td>
<td>$9,651</td>
<td>$4,452</td>
<td>$3,337</td>
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</table>

UIHC %tile: 19% 9% 10%

UIHC Average Charges per Patient Day $2,157

Source: University Healthsystem Consortium, case mix adjusted data
Projected UHC FY2005 Comparison with 9.5% Increase

<table>
<thead>
<tr>
<th>Charge $ per case</th>
<th>Midwest</th>
<th>Sole AHC</th>
<th>All UHC</th>
<th>UIHC*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000</td>
<td>$18,867</td>
<td>$17,542</td>
<td>$17,520</td>
<td>$15,528</td>
</tr>
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<td>$18,000</td>
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<td>$16,000</td>
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<td>$14,000</td>
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<td>$12,000</td>
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<tr>
<td>$0</td>
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</tbody>
</table>

Source: University Health system Consortium, case mix adjusted average charges per inpatient stay, rolled forward with avg 10% CDM increase

*Assumes .5 day drop in length of stay during FY2005
What Is The Impact Of Chargemaster Increases On Employers?

If fully insured, no immediate impact. Risk is assumed by insurer.

If self-insured, impact of chargemaster increase limited to those services paid on discount from charges.

78% of UIHC total charges paid at fixed rate vs. discount

Those claims that are paid on discount pay at 85-90% of charges

Impact to any one employer would be minimal
What Is The Impact Of Chargemaster Increases On Patients?

Self Pay patients will be impacted (<5% of total charges).
Collections on this population is <30%.

Policy for discounts to the medically indigent being drafted based on the new OIG interpretation

University HealthSystem Consortium analyzed the impact of higher charges on insured patients:

No impact on deductibles

Actual copayment impact is minimal, out of pocket maximums limit patient liability
Impact of Higher Charges on Actual Copayment Surprisingly Small

Average Out-Of-Pocket Copayment Per Admission, All Patients

<table>
<thead>
<tr>
<th>Hospital Type</th>
<th>Average Copayment</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Cost Hospitals</td>
<td>$1,516</td>
<td>$46</td>
</tr>
<tr>
<td>Average Cost Hospitals</td>
<td>$1,470</td>
<td>$172</td>
</tr>
<tr>
<td>Low Cost Hospitals</td>
<td>$1,344</td>
<td></td>
</tr>
</tbody>
</table>

Patients will have only nominal out-of-pocket copayment impact with chargemaster increases.

1 The benefit plan design applied to develop average out-of-pocket cost per admission is comprised of a $300 deductible, $1,600 OOP maximum, and 90% coinsurance.
2 Hospitals ranked in quartiles by case mix-adjusted allowable charges developed from more than 300,000 PPO admissions and corresponding outpatient visits modeled through three standard benefit plan designs: High Cost = top 25%, Average Cost = middle 50%, and Low Cost = bottom 25%.

Source: Milliman USA, Consulting Actuaries
### Out-of-Pocket Maximums Limit Impact on Patients

**Comparison Of One Patient’s Out-Of-Pocket Copayments**

("High Cost" vs "Low Cost" Hospitals, In-Network PPO Benefits)

<table>
<thead>
<tr>
<th></th>
<th>&quot;Low Cost&quot; Hospital</th>
<th>&quot;High Cost&quot; Hospital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billed Charges</td>
<td>$25,943</td>
<td>$40,130</td>
</tr>
<tr>
<td>- PPO Discount</td>
<td>-$7,783</td>
<td>-$12,039</td>
</tr>
<tr>
<td>Allowable Charges</td>
<td>$18,160</td>
<td>$28,091</td>
</tr>
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</table>

10% Patient Copay
(Max. OOP=$2,000)*

- **$1,816**
- **$2,000***

**Cost Difference To Patient = $184**

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* Assumes patient met none of his/her out-of-pocket limit prior to admission.

1 "High Cost" hospital is defined as a hospital in the upper quartile of case mix-adjusted allowable charges developed from more than 300,000 PPO admissions and corresponding outpatient visits modeled through three standard benefit plan designs.

Source: Milliman USA, Consulting Actuaries
Conclusion

Patient Care Activity is projected to increase in FY 05.

Additional costs are expected to increase with the majority of these incremental costs in salary, benefits, supplies and implants.

UIHC is projected to finish FY 2004 with at least a 1.6% operating margin and anticipates making operational improvements in FY05 returning to 3.0% margin.

UIHC requests the Regent’s approval of 9.5% increase.
Discussion and Questions