

The Regents of the University of California

**COMMITTEE ON HEALTH SERVICES**

March 14, 2002

The Committee on Health Services met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Atkinson, Davies, Johnson, Kozberg, Lansing, Lee, Marcus, Moores, Preuss, and Seymour; Advisory members Sainick and Terrazas

In attendance: Regents Blum, T. Davis, Hopkinson, Montoya, Morrison, Parsky, Pattiz, and Saban, Regent-designate Ligot-Gordon, Faculty Representatives Binion and Viswanathan, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Drake, Gurtner, and Hershman, Chancellors Berdahl, Bishop, Cicerone, Dynes, Greenwood, and Vanderhoef, Acting Chancellor Warren, and Recording Secretary Bryan

The meeting convened at 9:22 a.m. with Committee Chair Lee presiding.

1. **APPROVAL OF MINUTES**

Upon motion duly made and seconded, the minutes of the meeting of November 14, 2001 were approved.

2. **UPDATE ON MEDICAL CENTER, SAN FRANCISCO CAMPUS**

Chancellor Bishop recalled that it had been two years since the dissolution of the merger between UCSF's and Stanford's medical centers, the legacy of which was the dismissal of all senior management, a deep operating deficit, depleted cash reserves, and a demoralized staff. Since then, the medical center has been working its way back to fiscal respectability under the direction of Hospital Director Laret.

Mr. Laret provided a brief overview of how the UCSF Medical Center is doing in the implementation of its recovery plan. When the UCSF Medical Center rejoined the University in April 2000, it lost almost \$15 million in its first three months and had an annualized loss of \$60 million. By the end of fiscal year 2001, the annual loss was down to \$17 million. As the budget was planned for the current year, the administration was mindful of Medicare cuts that are slated to go into effect, new costs associated with a shortage of nurses, pharmacists, and laboratory and radiology technicians, plus a 14 percent jump in the cost of drugs. A budget was developed to reduce the \$17 million loss to \$10 million, with a goal of breaking even in FY 2003. Mr. Laret reported that the medical center is far ahead of this budget, with a \$4 million

gain on the combined medical center and physician practice operations and an over \$9 million gain on the medical center alone. Even without the Medi-Cal medical education funds that are expected later this year, the UCSF Medical Center will almost certainly show a profit at fiscal year end. This progress is the result of work by the faculty and staff.

Mr. Laret described the operating strategy of the past year. He reported that the medical center's volume grew, but while patients were added, the number of staff was kept flat. Productivity increased. Nursing turnover and other labor expenses were reduced. Through new contracts and tight use controls, drug inflation was limited to 7.5 percent. On the revenue side, contracts that did not cover full costs were cancelled, including all commercial and Medicare HMO contracts. Many of the patients covered by these contracts, however, have continued their care at UCSF under different, better-paying health plans. Rate increases on commercial health plans were negotiated. Employees were given incentives of up to \$600 if the institutional goals for improvement were met in three areas: quality of care, patient service, and financial performance. Basic business practices were improved by submitting charges more promptly and becoming rigorous about collecting payments owed. In short, the medical center did and continues to do what any high-volume, low-margin business needs to do, which is to focus on the fundamentals of increasing revenue and controlling expenses.

Mr. Laret observed that the hospital's bottom line remains vulnerable to outside forces, one of which is the cost of new technology. He cited a recent example of a patient who required a new blood-clotting factor. The cost of the factor alone was \$1.6 million. The medical center's total reimbursement from Medi-Cal, intended to cover hospital costs and all pharmaceuticals, was less than \$40,000. An appeal to Medi-Cal has not resulted in further reimbursement. This circumstance was relatively uncommon in the past but seems to be occurring more frequently. Healthcare providers face the question of whether lifesaving care to a patient should be denied if insurance does not cover the cost of treatment.

Mr. Laret discussed the medical center's cash situation. He recalled that at the beginning of FY 2001, the medical center had \$55 million in cash on hand. During the next six months, the cash balance dropped precipitously. This occurred because of frequent financial surprises related to the dissolution of the merger with Stanford, some large expenditures on previously committed capital projects, and increasing volume coupled with weakness in the management of accounts receivable. The cash position reached its low point in December 2000 at \$15 million. Since then, it has increased to about \$47 million. That was possible while still making capital expenditures at or above depreciation of \$45 million per year. He believed that \$50 million in cash was a prudent operating minimum, but more will need to be accumulated in order to borrow the funds necessary to replace aging hospital facilities. One of the ways in which the cash position was improved was by reducing days in accounts receivable from 89 to 78. This was accomplished with the help of an outside

consultant who reviewed registration, billing, and collection efforts in order further to improve accounts receivable.

Mr. Laret noted that the Regents receive monthly reports on each medical center's days in accounts receivable, which is a rough calculation of the time it takes from the date services are provided to receiving payment for them. The shorter amount of time, the better the medical center's cash position. There are several variables that determine a medical center's days in accounts receivable. In general, the more HMO business or pre-paid capitation a hospital has, the lower its days in accounts receivable. The more government business and the less commercial business, the lower the days in accounts receivable, because the government generally pays in a more timely manner. The less complicated or complex the patients' cases, the lower the days in accounts receivable, because high-complexity, high-cost cases are audited routinely by commercial payors before they will pay the medical center, which slows payments. He noted that UCSF has almost no capitation, a high percentage of commercial business, and a very high complexity level of the patients cared for, all variables leading to higher days in accounts receivable. In addition, there are operational problems that contribute, such as unacceptably high error rates in coding patient insurance information and failure to get appropriate insurance authorizations before providing treatment. By addressing these problems, it is hoped that days in accounts receivable can be reduced by several more days. Every day that is cut puts more than \$1.5 million into the medical center's accounts.

Mr. Laret recalled that in his last update he had discussed an outstanding threat to the medical center's cash position, the \$73 million on the balance sheet as a third-party liability, the majority of which may have to be repaid to Medicare for services provided during the merger period. The issues are complex, but in large part they relate to aggressive, after-the-fact regulatory interpretations by a private agency representing Medicare. In the worst-case scenario, UCSF might be required to repay millions of dollars to the federal government as soon as next fall, with the effect of wiping out its current cash reserves.

Mr. Laret reported that the medical center is close to finalizing a new strategic plan that affirms the need to grow as the leading regional referral center and ultimately to build new hospital facilities worthy of the academic and clinical programs at UCSF. Additional inpatient bed and operating room capacity have been created at Mt. Zion Hospital. Another key accomplishment is that the finance staff eliminated the reportable condition note that accompanied the audited financial statements last year. Eliminating this problem was a major step toward creating the management and accounting controls necessary. He believed that all the key trends are positive, there is momentum, and the medical center is poised to achieve its goal of being the best possible healthcare provider, the best employer, and providing the best environment for teaching and research.

Regent Johnson thanked Mr. Laret for bringing a report that shows such positive trends.

Chancellor Bishop expressed his gratitude to the physicians and staff at the medical center for the remarkable recovery.

3. **UPDATE ON PERFORMANCE AND STRATEGIC PLAN, MEDICAL CENTER, IRVINE CAMPUS**

Chancellor Cicerone introduced Dr. Ralph Cygan, who was selected in September to be Chief Executive Officer of the UC Irvine Medical Center. Previously he served as clinical professor in the College of Medicine, during which time he founded UC Irvine's primary care group. He has also been president of the medical staff.

Dr. Cygan discussed the Irvine medical center's recent performance, its progress in meeting its health science strategic plan goals, and its new clinical enterprise business plan. He noted that the health sciences at UCI have undergone a dramatic transformation during the past few years. Recent successes are the result of closely aligned campus, medical, school, and hospital leadership in collaboration with faculty and staff. The clinical enterprise is well-managed and profitable, and the reputation and image of the hospital in the community continue to improve.

Dr. Cygan reported that the medical center administration is focused on three main goals: providing the highest quality healthcare, providing excellent service to patients, and improving the financial performance of the clinical enterprise. In the area of quality, the medical center's Joint Commission accreditation score in 2001 was among the top scores for academic medical centers nationwide. Its interdisciplinary risk management program has lowered the incidence of malpractice, such that it has the lowest claim rate in the UC system. The UCI medical center was recently cited as California's safest hospital in a survey conducted by the nation's foremost quality expert. Ninety-four percent of surveyed patients reported that they were satisfied or very satisfied with their care, and patients ranked the cancer center in the top ten percent of hospitals in the country. In addition, the faculty practice group has been selected consistently by independent consumer surveys as one of southern California's best in both quality and doctor-patient communication. These improvements in quality, patient safety, and patient satisfaction have led to increasing numbers of referrals, more admissions, busier operating rooms, and an improved bottom line for the hospital and medical group. The net gain for the medical center has improved substantially over the last several years, and there is now a healthy operating margin. Much of the recent success can be attributed to the effective execution of the health sciences strategic plan, which was developed jointly by the college and the medical center in 1998. The strategic plan set ambitious goals for each of the three main elements of the health sciences: the research programs, the educational programs, and the clinical enterprise.

Dr. Cygan provided a brief summary of the medical center's performance against its objectives. He reported that under the leadership of Dean Cesario, the academic programs are flourishing. The medical center is on the way to meeting its goals of increasing research funding and developing new research facilities. It is estimated that

research funding will have increased by 72 percent over the 1998 base year by the end of the 2002 academic year. Two new research buildings are nearly completed. The strategic plan also set educational goals including maintaining excellence in medical student education and strengthening residency program oversight and accountability. Both of these aims have been achieved. The UCI College of Medicine is enrolling the best and brightest medical students, ranked in the top tenth percentile nationally on their medical college admission test scores. In addition, all residency programs have received licensing committee accreditation, and the medical center's specialty training programs are among the most competitive in the country. Last year, the UCI Medical Center was one of only a select few academic health centers in the country and one of only two teaching hospitals in the state to fill all residency positions with graduates of American medical schools.

Dr. Cygan reported that the clinical enterprise is also thriving. The medical center continues to serve as Orange County's major safety-net hospital, and it is maintaining its commitment to the underserved. At the same time, UCI is attracting a broader cross-section of patients from throughout the region. The average daily census, ambulatory visits, surgical volume, and payor mix all continue to improve, resulting in increased practice plan revenue and a better financial performance for the hospital. The medical center will have met or exceeded all of its clinical enterprise performance goals for the first four years of a five-year plan. These successes are the most tangible evidence of a cultural shift that has taken place at the medical center over the last several years. Throughout the organization there is a commitment to excellence and performance improvement. The spirit of teamwork is pervasive, and the enthusiasm and optimism of the staff are evident. In a recently completed employee survey, the staff ranked the medical center well above national norms in all categories. Of particular note were its scores in organizational climate, job satisfaction, and communications.

Dr. Cygan emphasized the medical center's renewed strength. He believed it was in a better position to be an effective partner with the College of Medicine in support of its mission, and it has established a solid foundation for future growth and development. He noted, however, that the UCI Medical Center is located in one of the country's most dynamic and competitive healthcare markets, and it must continue to respond to new challenges and take advantage of new opportunities. To ensure continued success, a detailed six-month clinical enterprise business plan is being developed that targets high-impact programs and services which complement the college's research and educational activities and contribute most of the financial strength of the enterprise. In the next few years, the focus will be on investing in surgical specialties such as neurosurgery, orthopaedics, neurology and transplantation. Other investments will build on the gastrointestinal, senior, oncology, and women's health programs. At the same time, a more focused business implementation model is being developed that will integrate the medical center and College of Medicine functions and will focus resources on those operational and facility improvements that are critical to supporting the new initiatives. The Hunter Group is assisting with this part of the plan.

In closing, Dr. Cygan noted that one element is needed to complete the positive picture—a modern, first-class hospital specifically designed to support specialized patient care, education, and research. He reported that the campus is hoping to proceed with preliminary planning and design of a replacement hospital upon approval by The Regents later in the day.

Regent Johnson expressed her appreciation for hearing from medical center personnel first-hand. Vice President Gurtner stated that updates to the Regents by individual medical centers would continue to be scheduled.

Regent Preuss recalled that at one time it was thought that the only option at the UCI Medical Center was to sell the hospital. He was gratified that the situation has changed for the positive.

Regent Kozberg noted that the replacement hospital will require a large amount of private funds. Chancellor Cicerone responded that the campaign to solicit private funds for the new hospital would be the campus' top fundraising priority. The first step will be public education about what is happening at the hospital and what the possibilities are for improving it. Mr. Gurtner noted that the medical school and the faculty are committed to that process.

Regent Hopkinson asked when plans for new hospitals at the Irvine and San Francisco campuses would be brought to the Regents. Dr. Cygan reported that, assuming that approval is given for planning and design, financing approval for the new Irvine hospital would be sought in the fall, and the preliminary design would be presented later in the year. Chancellor Bishop reported that the process of determining the best location for a new hospital at UCSF is under way. He believed it could be eighteen months before anything substantive is brought to the Board.

Committee Chair Lee noted that, following cancellation of the meeting of Health Services at the January 2002 meeting, he and other Regents visited the UCLA Medical Center. He was confident that the medical center was on the road to financial recovery.

#### 4. **ACTIVITY AND FINANCIAL STATUS REPORT ON HOSPITALS AND CLINICS**

Vice President Gurtner reported that the long-term stability of federal funding for the University's hospitals continues to be a significant issue. He believed, however, that \$50 million in medical education funding from the State would be secured for the year.

Vice President Broome reviewed the financial results for the hospitals through January 31. She reported that all hospitals had a steady increase in patient activity. Outpatient visits increased at all medical centers and were particularly strong at Davis and Irvine. Excess of revenue over expenditures increased significantly, primarily at San Francisco and Irvine. The San Francisco medical center went from a loss of \$13 million for the comparable period last year to a gain of approximately \$9 million. Los Angeles is showing a loss for the period but is anticipating stronger revenues at year's end. Ms. Broome reported that all of the medical centers except San Diego were exceeding their budgeted targets.

Regent Marcus asked whether the hospitals contribute equal amounts of revenue to their medical schools. Ms. Broome responded that, although there is a long-term commitment, the amount of support differs yearly depending on need and the level of activity. It is not an expense item because it is not an appropriate cost to match against the revenues of the medical centers. Regent Hopkinson stated that the use of that method of reporting is the subject of debate. Some feel that the contribution is a reimbursement for support for the hospitals. Ms. Broome pointed out that there are many payments reported in the financial results as expenses that are actually payments to the medical schools. The differentiating factor is whether they are appropriate costs of the medical centers. Mr. Gurtner believed it was clear that a substantial amount of revenue generated by the hospitals is used to pay for costs that probably would not exist if there were no medical school involved. Whether those were legitimate day-to-day hospital costs or medical school costs could be debated at length, but he believed that the bottom line was that one of the primary missions of the hospitals was to generate revenue to help support the schools. From an accounting perspective, that money appears from above the line as expenses and below the line as transfers.

Ms. Broome noted that there are inconsistencies among medical centers in terms of the amounts they are reimbursed by Medicare and Medi-Cal. She emphasized the importance of these reimbursements. Some campuses do not receive enough from their patients to cover their costs. Regent Hopkinson believed that patient care was going to become a significant problem in the near future. President Atkinson noted that, because the University's hospitals tend to receive the sickest patients, managing their patient mix is an ongoing challenge.

In response to a question from Regent Parsky, Ms. Broome noted that the Los Angeles medical center, which is the only one showing a loss, expects to be profitable by year's end based on the fact that it has negotiated new contracts with Blue Cross effective October 1 and with HealthNet and Pacificare effective January 1.

Ms. Broome reported that all the medical centers have improved their rates of bill collecting this year. The preferred number of days of cash on hand is 60, a rate achieved only by the Davis medical center. Regent Hopkinson believed that, because there will be construction programs at two additional hospitals, the experience of the Los Angeles medical center pertaining to the level of cash on hand during construction of the replacement hospital should be examined closely. Provost Levey pointed out that if the medical center had been repaid the \$50 million in cash it spent on repairs necessitated by the Northridge earthquake, it would have been able to report a better cash position.

Regent-designate Terrazas believed that the presentation points out the competitiveness of the healthcare industry. He asked whether the hospitals share information among themselves on best practices. Ms. Broome responded that the hospital directors and finance directors constantly share information concerning financial models, reimbursement, and other issues. Senior Vice President Mullinix noted that the Los Angeles campus' experience with its replacement hospital costs is being analyzed with a view toward predicting costs for the new Irvine hospital. Mr. Gurtner assured the Regents that there are several levels of constant communication among the five medical centers and the Office of the President that facilitate the sharing of information.

Committee Chair Lee observed that the University's medical centers have become targets for recruitment by other healthcare entities. He believed that this was indicative of the high quality of the University's hospital managers.

The meeting adjourned at 10:40 a.m.

Attest:

Associate Secretary