Office of the President

TO THE MEMBERS OF THE COMMITTEE ON HEALTH SERVICES:

DISCUSSION ITEM

For the Meeting of January 19, 2005

UPDATE ON MEDICAL CENTER, LOS ANGELES CAMPUS

EXECUTIVE SUMMARY

An update of UCLA Hospital System’s senior management changes, new hospital construction, and financial performance for fiscal year 2004 and for the current fiscal year will be presented to The Regents for discussion.

Previous Actions:  July 16, 2003:  Update on Medical Center, Los Angeles presented for discussion.

Relevant Policy:  Bylaw 12.7

Future Actions:  To be determined.
BACKGROUND

The following is an update of the change in senior management, hospital construction project, financial performance and action plan of the UCLA Hospital System.

New Senior Management

Calendar year 2004 for UCLA Healthcare was highlighted by the transition of senior enterprise leadership from the Navigant consulting group, previously known as the Hunter Group, to a newly recruited senior management team. In July 2004, UCLA Healthcare welcomed a new hospital CEO and a new president for the UCLA Medical Group. Dr. David Callender was appointed Associate Vice Chancellor, UCLA Hospital System, while Dr. Tom Sibert was named as Associate Vice Chancellor, UCLA Faculty Practice Group. In September 2004, Mr. Mitch Creem started his tenure as Associate Vice Chancellor and Medical Sciences Chief Financial Officer. In this position, Mr. Creem provides oversight for the financial systems of the UCLA hospital system and Medical Sciences entities, including the Faculty Practice Group and Medical School. In September 2004, Mr. Jay Kasey, a Navigant employee, was named interim Chief Operating Officer (COO) for the UCLA Medical Center in Westwood and the Santa Monica–UCLA Medical Center. Mr. Kasey will serve in the interim system COO role until a new COO for Westwood and a new chief administrative officer for Santa Monica are recruited. Both of the recruitments should be completed in the current fiscal year ending June 30, 2005.

Fiscal Year 2005 Financial Performance

In fiscal year 2004, the UCLA Hospital System posted $11.7 million of income before other changes in net assets, an $18.3 million shortfall from the $30.0 million that was originally budgeted. The difference between budget and actual was due to higher labor and purchased medical services costs.

With regard to fiscal year 2004 revenue variances, total operating revenue exceeded budget by $14.5 million despite a negative budget variance of $4.2 million for the category of “Other Operating Revenue.” However, the fiscal year 2004 total operating revenue was not sufficient to offset the costs related to patient acuity that was higher than budget forecasts and significantly unfavorable changes in payer mix, patient days, and admissions. During this period, patient days associated with higher-paying contracts and private payers fell short of budgeted targets. Additionally, patient days with low or no reimbursement, including those attributable to Medi-Cal and non-sponsored charity care patients, grew. Also, Medicare admissions were 655 admissions below the fiscal year 2004 budget forecast. Analysis reveals that the reasons for declines in favorable patient admissions are multiple and complex, including: 1) the declining volume of patients for profitable surgery subspecialties, most likely due to improved capabilities of local competitors; 2) a shift in referrals to competitors with lower rate structures for some profitable services; and, 3) the influx of Medi-Cal and non-sponsored charity care...
patients through the emergency department and transfer mechanisms, due mostly to hospital service level changes in Los Angeles and surrounding counties. Another factor that contributed to less than optimal revenue performance was the failure to achieve the budgeted conversion of capitation contracts to more profitable per diem arrangements. Finally, the category of “Other Operating Revenue” fell short of budget targets due to a reduction in State-supported Clinical Teaching Support (CTS) funds and reductions in various other revenue streams that are used to support patient care.

On the expense side of the net income equation, the UCLA Hospital System was substantially over budget, resulting in an unfavorable variance of $43.5 million during FY04. Expenses in the “Salaries and Benefits” and “Supplies” categories were responsible for unfavorable variances of $14.0 million and $18.7 million, respectively. These expense overruns were attributed to total patient days and patient acuity levels considerably in excess of budget forecasts. High patient days and acuity levels contributed to staffing costs in excess of budgeted levels. Patient volumes and acuity also contributed to the higher than expected demand for surgically implantable devices and pharmaceuticals. Costs for devices and drugs also rose dramatically related to inflation. Finally, expenses in the “Purchased Services” category exceeded budget by $11.2 million, due mainly to volume increases in purchased medical services (e.g., dialysis services and organ acquisition costs) and maintenance costs related to the operation of aging facilities.

Fiscal 2005 Year-to-Date Financial Performance through October 2004

Trends contributing to the UCLA Hospital System’s financial performance during the last half of fiscal year 2004 continued through the first four months of the current fiscal year. As of October 31, 2004, income before other changes in net assets for the hospital system was $2.7 million below budgeted projections. Net Patient Service Revenue was slightly below budget projections, with a negative $0.4 million variance. The problems with an adverse payer mix continued, with Medicare and favorable managed care contract business below budget targets, and Medi-Cal and non-sponsored charity care business exceeding budget targets. Likewise, total operating expenses were $5.7 million in excess of the budget target through October. Higher “Salaries and Benefits” costs accounted for $2.0 million of this operating expense variance. These higher personnel costs were associated with nurse orientation expenses, a retroactive union-negotiated salary expense, and temporary staffing. Purchased and Professional Services accounted for another $1.8 million in unfavorable expense variances, again related to medical services such as dialysis and transplant. Outside provider costs associated with capitated patients were $1.0 million over budget. Lower than budgeted transition costs, related to the delayed occupancy of new facilities, created a favorable categorical expense variance through October.
Fiscal Year 2005 Financial Outlook and Action Plan

With the weak financial performance during the first four months of fiscal year 2005 and continued unfavorable market trends, projected year-end financial performance will likely range between breakeven and a modest, positive net income. Cash projection will range between $32 million with a breakeven scenario, and $52 million if a small, positive net income is achieved. If the hospital system remains on its current financial trajectory, management believes that the health system can achieve break-even performance. If current and planned revenue-enhancement and cost-savings interventions are fully implemented, a net income of $10 million is achievable. Full implementation of the interventions will result in significant improvements in management of payer mix, length of stay, revenue cycle, and service volumes. Additionally, costs associated with supplies, personnel, outside providers and purchased services will also decrease. The interventions are included as part of a three-phase business improvement plan, with Phase I currently under way. Phase I includes adjustment of the hospital system’s operating cost structure to better match the revenue streams associated with a more adverse payer mix. Phase I includes introduction of new management tools and controls to better manage costs and new efforts to improve revenue cycle performance. Phase II begins at the mid-point of the current fiscal year with efforts to prepare the operating budget for fiscal year 2006, and will focus on improving business planning and development. Phase II includes the introduction of a service line approach to planning and management and a more thorough analysis of contracting performance and strategies. Phase III will begin in early fiscal year 2006 and includes a market assessment and development of a long-range strategic planning process.

New Hospital Construction Update

Construction work continues toward completion of UCLA’s new hospital facilities in Westwood and Santa Monica. In the summer of 2004, the Office of Statewide Health Planning and Development (OSHPD) issued a stop work order related to a number of outstanding inspection and documentation issues related to both sites. Relevant work resumed at both sites as the inspection and documentation issues were addressed, but the pace of activity at the Westwood site has not yet returned to previous levels. The UCLA Capital Programs hospital project team is working with the general contractor, subcontractors, and OSHPD to remediate outstanding inspection and documentation issues and to establish a revised Westwood construction schedule aimed at completion in December of 2005 and occupancy in mid-2006. Construction of the Santa Monica facility is in the shell and core stage, and completion is anticipated to be achieved in three phases, the first scheduled for late 2005 with occupancy in mid-2006. Completion of construction and occupancy of the remaining phases will occur over the following two years, with final demolition of the vacated facilities anticipated to occur in spring of 2008.

In summary, the UCLA Hospital System is faced with major financial and market challenges that force significant changes in operational practices and plans. Additionally,
a new strategic assessment and plan are necessary to best position the hospital system as an ongoing, contributing member of the UCLA Healthcare enterprise. Implementation of the business improvement plan will make it possible to address these challenges and plan for the future. It is expected that the hospital system’s financial performance will be restored so that it meets the needs of its UCLA Healthcare peers and the expectations of the University, its financial partners, and its bond insurers.

(Attachment)